THE DOMINICAN REPUBLIC TOURISM CLUSTER

This paper is submitted as the final assignment for the course Microeconomics of Competitiveness taught by Professors Michael Porter and Hiro Takeuchi at the Harvard Business School.

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EXECUTIVE SUMMARY

The Dominican Republic has achieved the fastest real GDP per capita growth in Latin America since 1965 on the back of consolidating democracy, economic liberalization, and foreign direct investments (FDI). However, social development has not been commensurate with the levels of growth. Real wages are at about the same level that they were in 1991 and the unemployment rate remains high at around 15%. Social indicators have stagnated because a lot of the returns have gone to capital. For example between 2000 and 2010 about half of the economic growth was generated by the capital intensive Telecom sector that only employs about 8% of the population. A major banking crisis in 2003 also exacerbated social conditions.

The country's competitive position is weak and eroding. An average trade deficit of 17% of GDP between 2007 and 2011 is reflective of this (EIU, 2012). Issues that undermine competitiveness include a dysfunctional electricity sector, poor human capital, and eroding rule-of-law. If the country does not improve competitiveness to bolster its tradable sector, a balance-of-payments crisis, coupled with a government debt crisis, would most likely ensue.

The only bright spot is tourism, which accounts for about half of net tradable exports. Taking advantage of its substantial natural endowments, the country's tourism cluster is the second largest in the Caribbean after Mexico's. However, recently important competitors in the region have outgrown the cluster. The underlying causes of this underperformance are intimately related to the competitiveness constraints mentioned above.

We have identified several policy measures that the government can take to close competitiveness gaps and strengthen the Dominican tourism cluster. Further, we see opportunities to scale-up the cluster away from the all-inclusive model whilst 'premiumizing' the product.

DOMINICAN REPUBLIC OVERVIEW

Background

The Dominican Republic is located at the heart of the Caribbean, between the Caribbean Sea and the North Atlantic Ocean, occupying the eastern half the island of Hispaniola, which it shares with Haiti. It occupies 48,670 sq km of land with 1,288 km of coastline. Its geographical location in the middle of the hurricane belt makes it subject to severe storms from June to October (CIA).

The island of Hispaniola, comprising the Dominican Republic and Haiti, was first colonized in 1492 by Spain and later occupied by Haiti in 1822. It finally reached independence from Haiti in 1844. However, democracy was not restored until 1966, after a brief civil war and over 30 years of brutal dictatorship under General Rafael Trujillo. Today, the Dominican Republic is run as a democratic republic with a presidential form of government. Three parties – PLD, PRD and PRSC – have dominated the political process since 1966 (EIU 1998).

The current total population of the Dominican Republic is estimated to be approximately 10 million, which makes it the second most populous country in the Caribbean after Cuba. 69% of the total population lives in urban areas, with an estimated 2.7 million inhabitants in the capital Santo Domingo, followed by approximately 900,000 people in the second largest city, Santiago. While more than one million Dominicans are estimated to reside outside the country, mainly in the U.S., 1.2 million foreigners live in the country (most of them are Haitians). The median age is 26 years. (CIA, EIU 2008)

National Economic Performance

The Dominican Republic is one of the largest economies in the Caribbean, with a total PPP-adjusted GDP of $ 83 billion as well as a PPP-adjusted GDP per capita of $ 9,300 in 2011. In the same year, Costa Rica and Barbados, two competing tourist destinations in the region, had a PPP-adjusted GDP of $ 50 billion and $ 6 billion, as well as a PPP-adjusted GDP per capita of $ 11,500 and $ 23,600 respectively[1] (CIA). Since the country embarked on its democratization process at the end of its Civil War in 1965, it has been the fastest growing country in Latin America up to 2008, with an annual average real GDP per capita growth rate of 3%, compared to Chile and Costa Rica with 2.5% and 2.2% respectively[2] (Maddison).

The underlying drivers of the Dominican Republic's economic performance can be broken down using the Cobb-Douglas production function. The Cobb-Douglas production function generates aggregate economic output through employing the total factor productivity (TFP), labor force, capital, and human capital variables. Between 1960 and 2007, the Dominican Republic grew its economy primarily by growing capital by a CAGR of 6% and secondarily by growing the labor force at a CAGR of 3%. Human capital and TFP both grew at a CAGR of less than 1% during the same period. Between 1990 and 2007, the growth rates of the factors of production is consistent with the growth rates experienced between 1960 and 2007 with the exception that TFP grew at a CAGR of 1% and capital at a slightly lower CAGR of 5%. We will see subsequently that the stagnation in human capital growth relative to the much faster growth in capital is consistent with stagnant real wage growth over the past two decades and the substantial expansion of capital-intensive sectors such as telecommunications. (Daude, Christian and Eduardo Fernández-Arias, 2010)

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[1] GDP and GDP per capita figures are PPP-adjusted, 2011 dollares

[2] GDP per capita figures are based on "1990 International Geary-Khamis dollars", also referred to as "international dollars"

Economic Liberalization Driving Growth Throughout the 1990s and 2000s

Since the mid 1990s, economic growth has been driven by increased economic openness in terms of trade as well as foreign investment. The Free Zone Incentives Law in 1990 marked the beginning of promotion of an export-oriented manufacturing sector. The new Foreign Investment Law in 1995 as well as the capitalization of state-owned enterprises (in the energy/electricity sector) in 1997 contributed significantly to a sharp increase in FDI inflows of 37% a year between 1994 and 1999. In 1998, following the admission to the WTO, a new telecommunication law (Law 153) also liberalized the telecommunication sector, which since then has been one of the main destinations of inward FDIs (UNCTAD, 2009). In order to enhance privileged access to certain key markets, the country has also signed a number of free trade agreements with Caribbean countries (CARICOM Free Trade Agreement in 1998), the US (DR-CAFTA in 2002), and the EU (EU Free Trade Agreement in 2004) (UNCTAD, 2009).

Structure of the Economy

Agriculture, industry, and services accounted for 9%, 30%, and 61% of total GDP in 2010, respectively. Among services, the two most important GDP components are telecommunication (20% of value added GDP) and tourism (18% of value added GDP - including indirect economic activities in addition to hotel, bars, and restaurants) (Dominican Central Bank and WTTO, 2011). Similarly, in terms of employment, 75% of the total work force is employed in the service sector, compared to 11% in the industry and 14% in the agricultural sector. Telecommunications only employs 8% of the total workforce, while tourism (indirect economic activities included) provides 16% of all jobs (Dominican Central Bank and WTTO, 2011).

In terms of contribution to GDP growth, the service sector plays an even more dominant role, accounting for 77% of the increase in GDP between '00 and '10, compared to industry and agriculture with 16% and 7% respectively. Particularly, the telecommunication industry's share of 47% of total GDP growth over the same time period highlights the important role it has played in fostering economic growth (Dominican Central Bank). At the same time, it indicates the predominant role that the non-tradable sector plays in the Dominican economy, which can also be observed in terms of target sectors of FDI inflows.

Foreign Direct Investment & exports

Strong economic growth was partly due to a steady increase in FDI inflows. Between 2000 and 2011, FDI inflows into the Dominican Republic increased by 150%, mainly driven by expansion in the real estate, telecom, trade, tourism, and mining sector. All five sectors account for approximately 14% each of accumulated FDI inflows over this time period, with US$ 2.4 billion going into the tourism sector. FDI into agriculture were negligible. The U.S. and Canada, (with 29% and 19% of accumulated FDI inflows between '00 and '11) have been the largest foreign investors in the Dominican Republic, followed by Spain (14%) and Mexico (11%) (Dominican Central Bank).

The average annual inflow of FDIs into the Dominican Republic between 2000 and 2009 was US$ 1.3 billion – higher than FDI inflows into regional neighbors such as Barbados (US$ 139 million) and Costa Rica (US$ 1.1 billion). However, taking into consideration the relative size of the economy, the Dominican Republic lagged behind most countries in the region.

Average annual stock of inward FDIs between 2000 and 2009 only accounted for 18% of GDP, compared to Barbados with 24% and Costa Rica with 28%. (UNCTAD Database)

Excluding remittance transfers, tourism is by far the biggest earner of foreign exchange, accounting for about 50% of total export revenues in 2010, while Free Zones continue to play an important role in terms export manufacturing, contributing 20% of total export revenues. Traditional commodities, such as sugar, coffee, cocoa, and tobacco have played a decreasingly important role. In 2010, they only accounted for 5% of total export revenues. (Dominican Central Bank) The U.S. continues to be by far the most important trading partner, receiving more than 50% of all exports from the Dominican Republic (CIA).

Limited Social Benefits Resulting From Economic Growth

While economic growth has been particularly strong over the last two decades, not everybody has been able to benefit from it, partly due to the negative socio-economic impact of the banking crisis of 2003/04. Most importantly, this is likely due to the fact that much of the returns have gone to capital (i.e. low labor-intensive telecommunications sector accounting for about half of GDP growth over past decade). In 2011, unemployment continues to be very high at 15%, while real wages still have not yet recovered from the banking crisis and remain at the 1991 real wage level. (World Bank and Dominican Central Bank)

Similarly, poverty and income inequality remain to be addressed effectively. The portion of people living below the poverty line has hardly changed since 2000 and remains high at approximately 10%, after moving temporarily above the 20% during the midst of the banking crisis in 2004[3]. Despite some marginal changes since the early 1990s, the Dominican Republic

[3] Poverty is measured by the poverty headcount ratio at $2 a day (PPP) (% of population), calculated by the World Bank

continues to be characterized by a high degree of inequality in terms of income distribution, as measured by the GINI coefficient (47 in 2010). (World Bank)

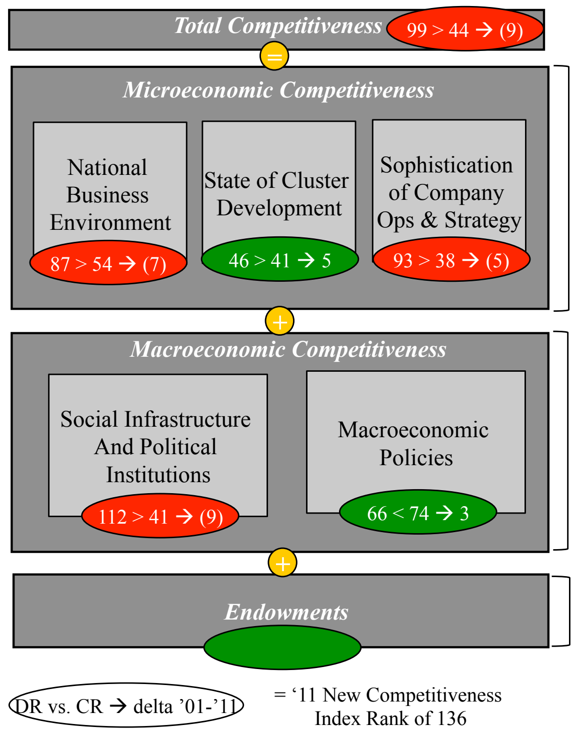
Finally, with regards to the broader well being of the population as measured by the Human Development Index (UNDP), the Dominican Republic ranks 98 out of 187 countries. A score of 0.689 in 2011 places the Dominican Republic below the regional average as well as below various Latin American countries with lower levels of GDP per capita, such as Ecuador and Peru. (UNDP)

COUNTRY LEVEL COMPETITIVENESS

Determinants of Competitiveness

We will be using the New Competitiveness Index (NCI) produced by the Institute for Strategy and Competitiveness (ISC) at the Harvard Business School (HBS) to assess country level competitiveness. NCI evaluates both macro and micro factors. An overview of the Dominican Republic's competitiveness position relative to Costa Rica is illustrated in **Figure 1** below. Costa Rica in particular is an important benchmark because it shares many of the same natural endowments and level of economic development as the Dominican Republic but is also a leading tourism brand in the region and a role model in terms of environmental, social and economic sustainability.

Figure 1: Dominican Republic Competitiveness Position



Source: (NCI, 2011); Authors' analysis

As shown in **Figure 1**, between 2001 and 2011, the overall competitiveness ranking of the Dominican Republic deteriorated by 9 ranks to 99 out of 136 countries (NCI, 2011). This is mainly due to significant deterioration of its social infrastructure and political institutions, as well as national business environment and sophistication of company operations and strategy. By contrast, both the macroeconomic situation and the state of cluster development have both improved, while endowments continue to be the most important asset, particularly with regard to the tourism cluster. Compared to Costa Rica, the Dominican Republic only performs better in terms of macroeconomic management. In all other categories, Costa Rica is clearly ahead.

Key drivers of competitiveness gaps as it relates to the tourism cluster are a dysfunctional electricity sector, eroding rule-of-law, and poor human capital. These will be discussed in more detail in the following sections.

Endowments

The Dominican Republic enjoys rich endowments in terms of tourism assets. On the historical and cultural side, Dominican Republic features many worldwide-acknowledged attractions such as the Colonial City of Santo Domingo (UNESCO World Heritage Site), which was the first permanent settlement for Europeans in the Americas. Another landmark is the still well preserved house of Diego Colon, Christopher Columbus' son, which was the first vice regal residence in America. The Dominican Republic also has the largest and most reputed museums in the Caribbean, as well as the greatest number of caves with Taino cave paintings in the Antilles. Finally, a longstanding tradition of carnivals mixes Taino, African and European influences. (Lieb, 2001)

Although historical and cultural attractions are important, Dominican Republic is better known for its natural endowments. The country holds the largest biodiversity in the Antilles, with 24% of the national territory protected (14 national parks and 7 natural reserves). It has the highest number of visiting whales in the Caribbean as well as other exotic animals and plants (crocodiles, iguanas, 250 different species of birds and over 5,600 plants documented including 300 species of orchids). Its privileged geographical location allows the Dominican Republic to enjoy vast expanses of pristine beaches along its coastline, three mountain ranges and desert, rainforest, alpine, and Andean vegetation, the highest and lowest points in the Antilles, and waterfalls up to 80 meters high. This unique combination of assets makes the Dominican Republic a perfect place for both land and water sport activities (golf, polo, mountaineering, trekking, as well as wind and kite surfing, deep sea fishing, rafting, scuba diving, and sailing). (Lieb, 2001)

Lastly, the Dominican Republic has produced a number of globally accomplished and influential personalities such as top major league baseball players and Oscar de la Renta, recognized as one of the top global fashion designers. In addition, the Dominican Republic has produced the musical genres of Merengue and Bachata that are present in airwaves across the world. Finally, branded goods including rum, cigars, and beer are strong in the U.S. and Europe. These personalities, culture and brand names can help the country build its country brand to generate tourism demand among foreigners.

Macroeconomic Competitiveness

Macro Policies

The Dominican Republic's macro-economic performance is considered to be relatively strong as compared to other drivers of competitiveness (NCI, 2011). Since its severe banking crisis in 2003/04, the country has responded with prudent monetary and fiscal policies. While consumer prices skyrocketed during the crisis by 52% in 2004, the central bank has managed to keep inflation under control, despite the relatively strong growth between 2004 and 2008. (EIU Database, 2011 and EIU, 2012).

Similarly, fiscal policy became more prudent in the aftermath of the crisis, including a major tax reform in 2004 that boosted government revenues, as well as a government payroll cut by 10%. As a result, public debt has been stable at an average of approximately 35% of GDP. However, debt interest payments have been slowly increasing over the last years from 1.4% in 2006 to 2,2% in 2011. (EIU, 2012)

However, concerns regarding the macroeconomic future of the country remain. Consumption (private and public) continuously increased after the banking crisis and accounted for more than 90% of GDP in 2009 and 2010, making it the highest consumption rate in the region (Dominican Central Bank). At the same time, domestic savings as a percentage of GDP have been falling since 2004, placing the Dominican Republic among the countries with the lowest gross saving rate in the region. In 2010, the country's gross domestic saving rate (as % of GDP) was 4.7%, compared to 27% in Peru and 20.5% in Ecuador – both countries with similar GDP per capita level (World Bank).

Further concerns relate to the persistent imbalance in the Dominican Republic's external sector. Strong domestic demand has contributed to a chronic trade account deficit, reaching above 10% of GDP in 2010, as well as to a negative current account, ranging from -4% to -10% of GDP in the second half of the 2000s (Dominican Central Bank).

Foreign direct investments – driven by privatization in the power sector and opportunities in telecommunication, tourism and free zones – as well as remittances and tourist receipts have long served to offset a significant portion of the current account deficit. However, most recently foreign exchange inflows from these three sources have started to show signs of decline, which causes concerns in light of the current economic situation with regard to the sustainability of the current growth model (EIU, 2010).

Social Infrastructure and Political Institutions

In terms of social infrastructure and political institutions the country deteriorated between 2000 and 2011, ranking 112 among 136 countries in 2011 (NCI, 2011). Corruption, a weak legal framework, deteriorating public safety, and low human capital are among the main concerns.

The "Economic Freedom Index" ranks the Dominican Republic 18th out of 29 countries in the South And Central America region, with an average regional score. Though with regard to rule of law it is far below world standards. The court system is inefficient, red type is common, and corruption remains endemic in both the private and public sector (IEF, 2012). Corruption is also identified by the private sector as the most problematic factor for doing business, followed by tax rates and an inefficient government bureaucracy (NCI, 2011).

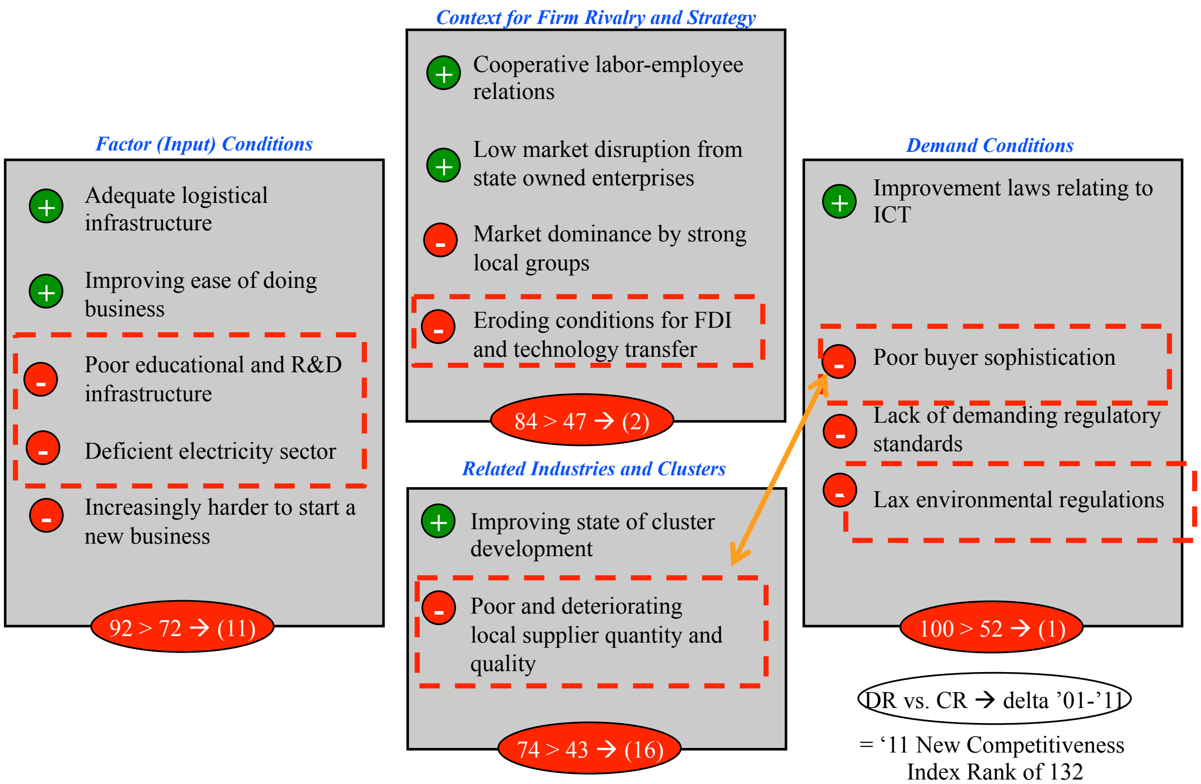
Similarly, the Economist Intelligence Unit's 2011 democracy index refers to the Dominican Republic as one of 14 "flawed democracies" in the region. It is ranked 15th in the region overall, behind countries as El Salvador, Trinidad and Tobago, and Costa Rica. Little political participation and trust in a functioning government, due to corruption fuelled by increased drug trafficking, are the main reasons for the poor performance of the country in this index (EIU, 2012).

Microeconomic Competitiveness

National Business Environment

It is striking that over the last decade, the Dominican Republic deteriorated in its performance in all four sub-categories of its national business environment vis-à-vis the rest of the world (NCI, 2011). While the overall list of constraints is long, **Figure 2** highlights those shortcomings that are most relevant from a tourism cluster perspective. The most important concerns are related to poor factor conditions that negatively impact the development of business, such as the deficient electricity sector, poor educational outcomes and a lack of sophistication of suppliers and buyers (NCI, 2011).

Figure 2: Country Diamond



Source: (NCI, 2011); Authors' analysis

Factor Conditions

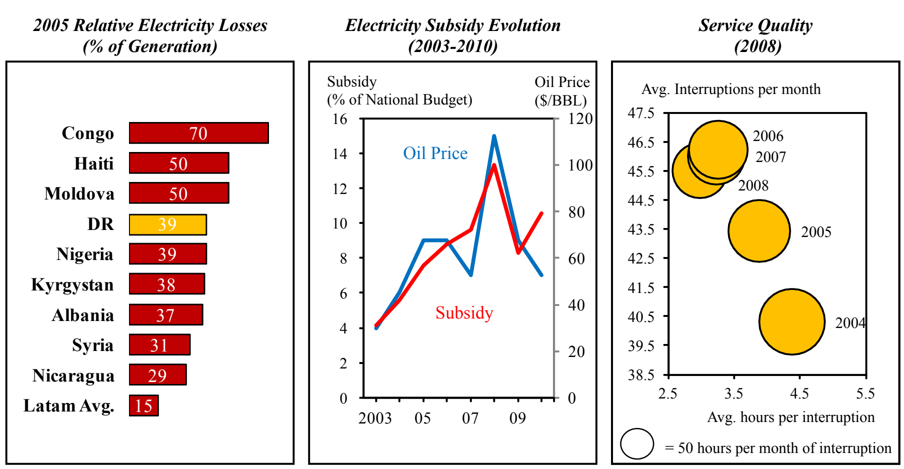
One the positive side, the Dominican Republic performs well in terms of its physical infrastructure, with the exception of its electricity supply, compared to its overall competitiveness performance. The quality of air transport as well as port infrastructure is relatively high, which is slightly less true for roads and railroad infrastructure (NCI, 2011).

Though the country's two main bottlenecks with regard to factor conditions relate to its inefficient primary and higher education system, as well as to the poor quality of its energy supply infrastructure. The primary net enrollment rate is significantly lower (83%) than in other countries in the region as is the quality of educational outcomes. Students in the Dominican Republic score a significantly lower mean test scores than their peers in the region, despite the fact that education expenditure per child is higher than in many other countries with higher mean test scores. (Dominican Central Bank)

Similarly, the higher education system, particularly in terms of mathematics and science, is of relatively poor quality. This in turn seems to contribute to a general lack of scientists and engineers, low quality of scientific research institutions, as well as an overall low capacity for innovation in the Dominican economy (NCI, 2011).

The poor electricity supply system represents another major barrier to the improvement of the national business environment. Inefficiencies and shortcomings in the generation of electricity do not only lead to significant losses of electricity (39% of generated electricity), but also result in poor service quality with an average of 45 interruptions per months, each last about an average of 3 hours (Adam Smith Institute, 2007 and Superintendencia de Electricidad, 2008). Substantial subsidies are required to cover electricity loses. In 2010, electricity subsidies accounted for 10% of the national budget (Ministerio de Hacienda, 2010). This money could be utilized to finance spending in competitiveness gaps. These issues are captured in **Figure 3** below.

Figure 3: Profile of Electricity Supply Service in Dominican Republic



Sources: Adam Smith Institute; Ministerio de Hacienda; Superintendencia de Electricidad

Context for Firm Rivalry and Strategy

Per the NCI, intensity of local competition is relatively high (rank 43 of 136) in part due to the relatively high prevalence of foreign ownership (rank of 35 of 136) (NCI, 2011). Numerous multinationals such as Ambev, Barrick Gold, Soctia Bank, AES and Barcelo Hotels are present in most of the dominant industries of the country, such as telecommunication, mining, hospitality, consumer goods, and energy.

However, the high extent of market dominance by business groups (rank of 134 of 136) creates oligarchic conditions that could undermine the competitiveness of certain sectors of the economy (NCI, 2011). The tourism sector is largely directly unimpaired by this situation given that high degree of competition in the sector provided that in 2006 11 of the 22 largest hotel chains in the world present in the country (UNCTAD, 2007)

Demand Conditions

Demand conditions in Dominican Republic are generally weak, ranking 100 out of 136 (NCI, 2011) consistent with the low levels of education, stagnant real incomes and relatively poor population we have already mentioned. Although, on a slightly more positive note, a new National Quality System has been established that provides businesses and associations with official certifications, e.g. for above-average quality and environmental sustainability, such as "Blue Flag" and "Green Globe" (Van der Horst, 2011).

Related Industries and Clusters

Per the NCI, the Dominican Republic's state of cluster development has consistently improved over the last years, ranking at 46 out of 136 in 2011 (NCI, 2011). A significant part of the success can be contributed to leadership that the National Competitiveness Council (NCC) has provided over the last years. Since its establishment in 2001, the NCC has played an essential role in establishing and promoting the country's 23 operative clusters in the areas of tourism, manufacturing, and agriculture. The council integrates the public and private sector and coordinates cluster competitiveness initiatives across the country as well as national business climate reform (CNC). Its main initiative is to implement the National Plan of Systemic Competitiveness, which was launched by President Leonel Fernández in 2007.

One of the main improvements to date has been the promotion of new and more cluster specific business associations. Similarly, the launch of the Dominican Network of Business Incubators ("Dominicana Incuba") and the strengthening of programs such as PROINCUBE and EMPRENDE mark at least a good intention in strengthen related industries and clusters (Van der Horst, 2011).

ABOUT THE LOCAL TOURISM CLUSTER

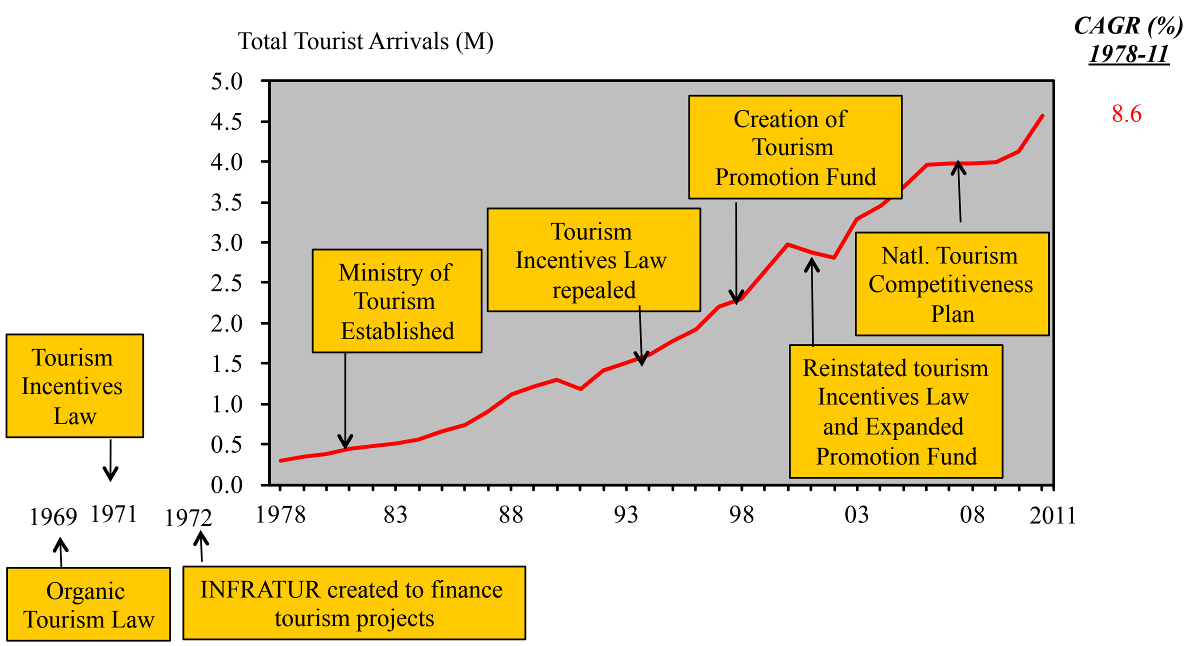
Cluster Evolution

Institutional History

The Dominican Tourism Cluster has grown at a CAGR of about 9% since 1978 on the back of favorable legislation that has attracted substantial FDI into the sector (Dominican Central Bank). Perhaps no other sector of the Dominican Economy has benefited from such effective coordination between public policy and private sector initiative.

Since the 1960s tourism has been an increasingly important priority for the Dominican Republic. The first pieces of legislation specifically incenting the development of the tourism cluster were enacted between 1969 and 1971, with the first government-backed fund to finance tourism infrastructure launched in 1972. During the early 1980s, the Ministry of Tourism was established. In the early 2000s, the tourism incentives legislation was re-enacted to reflect modern challenges and opportunities. More recently, in 2008, the National Tourism Competitiveness plan was crafted and set in force. The overlay of institutional evolution on top of arrivals growth is included in **Figure 4** below.

Figure 4: Tourism Cluster Evolution



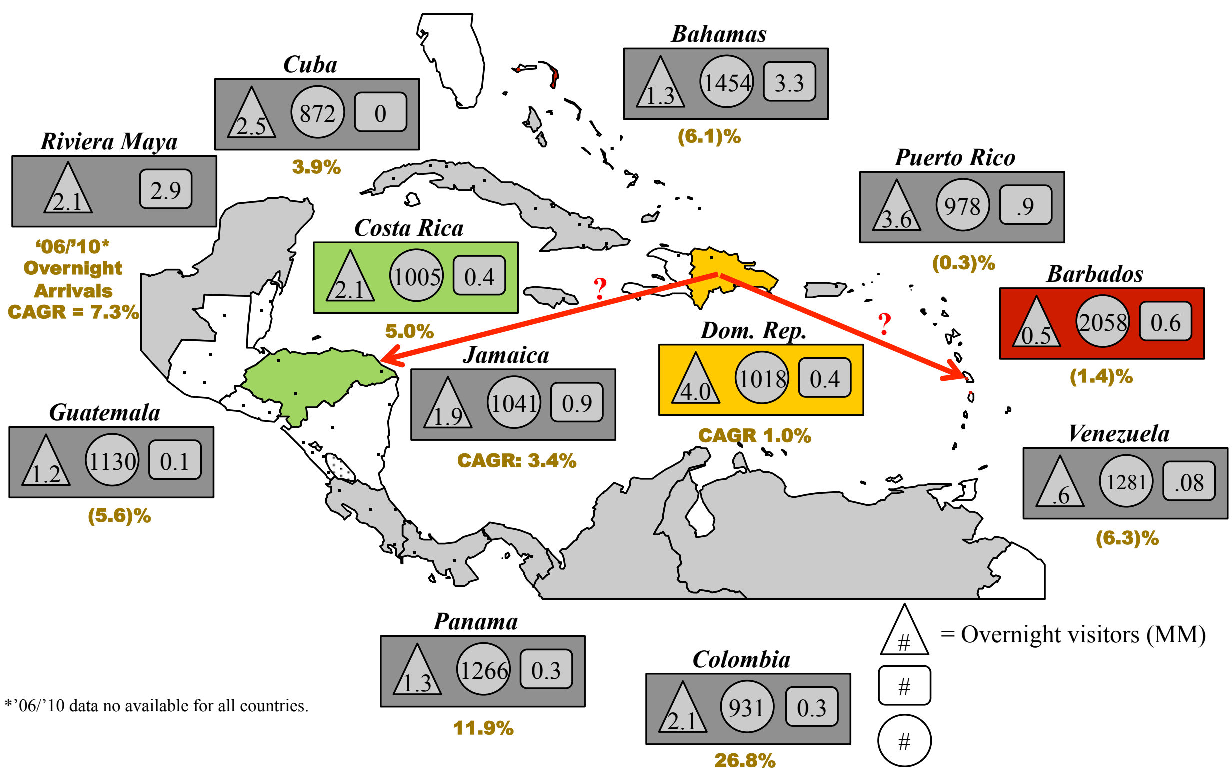
Sources: Dominican Central Bank; Pellerano & Herrera; Authors' Analysis

Performance

After Mexico, the country receives the greatest amount of tourist arrivals in the Caribbean Basin with about 4 million in 2010 (UNWTO, 2010 and Dominican Central Bank). An installed base of over 60,000 hotel rooms with an average utilization in 2011 of 67% serves as the cluster's backbone (UNWTO, 2010).

Despite the impressive run that the Dominican Republic's tourism sector has had over the past few decades there are indications that growth is slowing down relative to core competitors. During the second half of the past decade arrivals have grown at a CAGR of about 1%, whereas during the same period arrivals have grown at a rate of 3%, 5% and 4% in Jamaica, Costa Rica and Cuba respectively as shown on **Figure 5** below (UNWTO, 2010).

Figure 5: Caribbean Tourism Sector



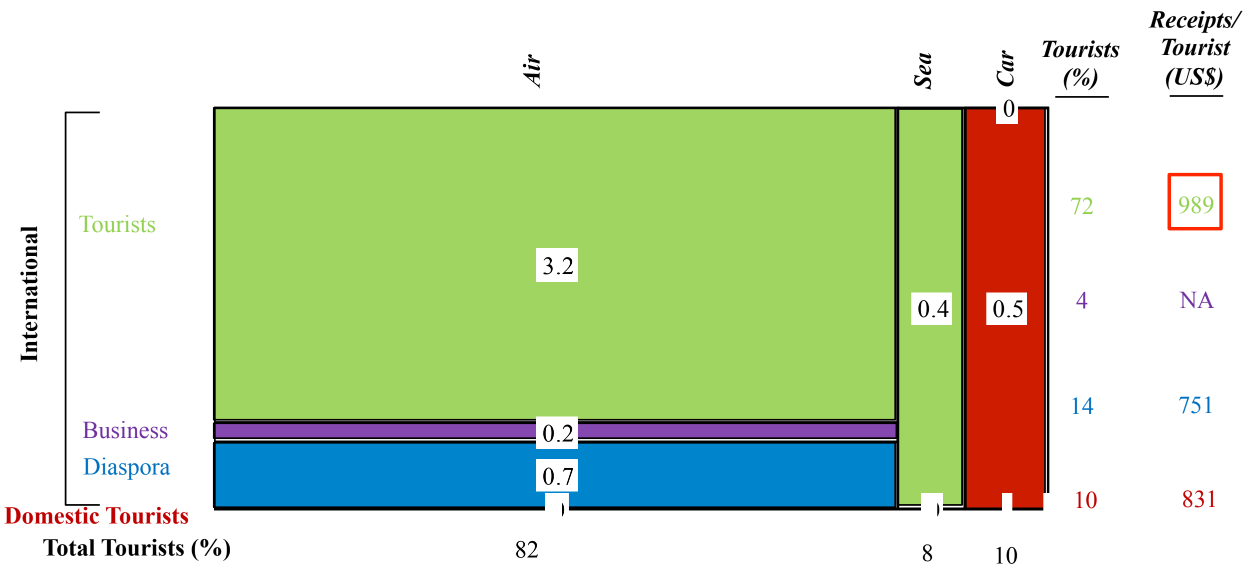
Source: (UNWTO, 2010); Authors' analysis

In addition, Dominican Republic is substantially underutilizing its capacity for cruise ship arrivals. In 2010, only about 400 thousand tourists arrived in cruise ships to the Dominican Republic. This compares unfavorably to Caribbean cruise ship arrival leaders Bahamas and Mexico (Riviera Maya) with 3.3 million and 2.9 million arrivals respectively during 2010. (UNWTO, 2010)

Cluster Positioning

Most of the tourism in the country is all-inclusive, sun & beach with receipts per arrival of US$989 in 2010 as shown in **Figure 6** below (Dominican Central Bank).

Figure 6: Dominican Tourism Cluster Profile (2010)—Arrivals in Millions



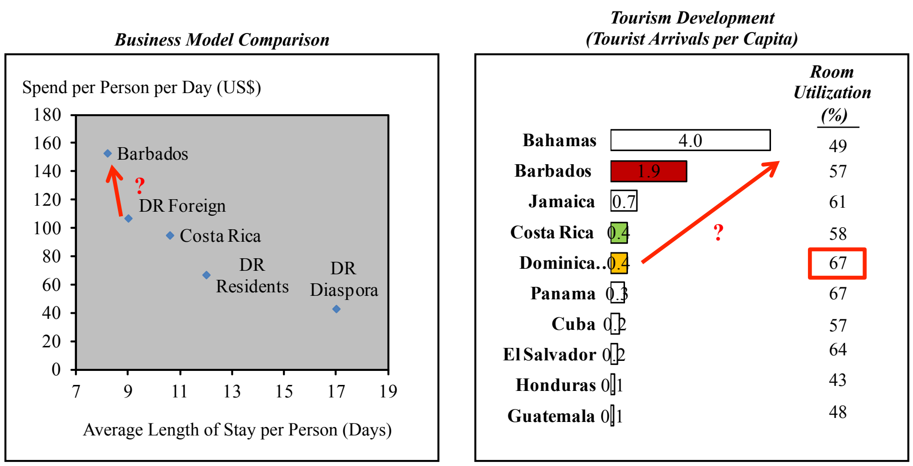
Source: Dominican Central Bank

This level of receipts per arrival is inline with Puerto Rico and Jamaica, which are countries that have also have primarily a sun & beach model. Costa Rica also has a similar level of receipts per arrival but achieves this result employing a model that is substantially diversified into ecotourism. The more premium locations of Barbados and Bahamas drive receipts per arrival of about 2.0x and 1.5x greater respectively through a high-end, luxury sun & beach strategy. (UNWTO, 2010)

Cluster Potential

The Dominican tourism cluster has the potential to continue expanding receipts through both increasing arrivals and boosting receipts per arrival. As seen in **Figure 7** below, the average foreign tourist in the Dominican Republic spends just about US$100 per night while the average tourist in Barbados spends over US$150 per night. Further, as seen in **Figure 7** below, Bahamas drives about 4 arrivals per capita whereas Dominican Republic only drives about 0.4 arrivals per capita—clearly there is runway to expand the cluster in terms of arrivals.

Figure 7: Dominican Tourism Model and Potential



Sources: Dominican Central Bank, Caribbean Tourism Organization, World Tourism Organization

Avenues for Growth

There are several avenues for future growth that the Dominican Republic can follow. These are:

1. Expansion of the sun & beach model to take advantage of substantial undeveloped beach front
    a. Develop non all-inclusive segment to drive linkages with broader economy
    b. Add luxury capacity to increase receipts per arrival
2. Development of cruise traffic, especially to Santo Domingo where tourists have the opportunity to see the experience the historical richness of the Colonial Zone

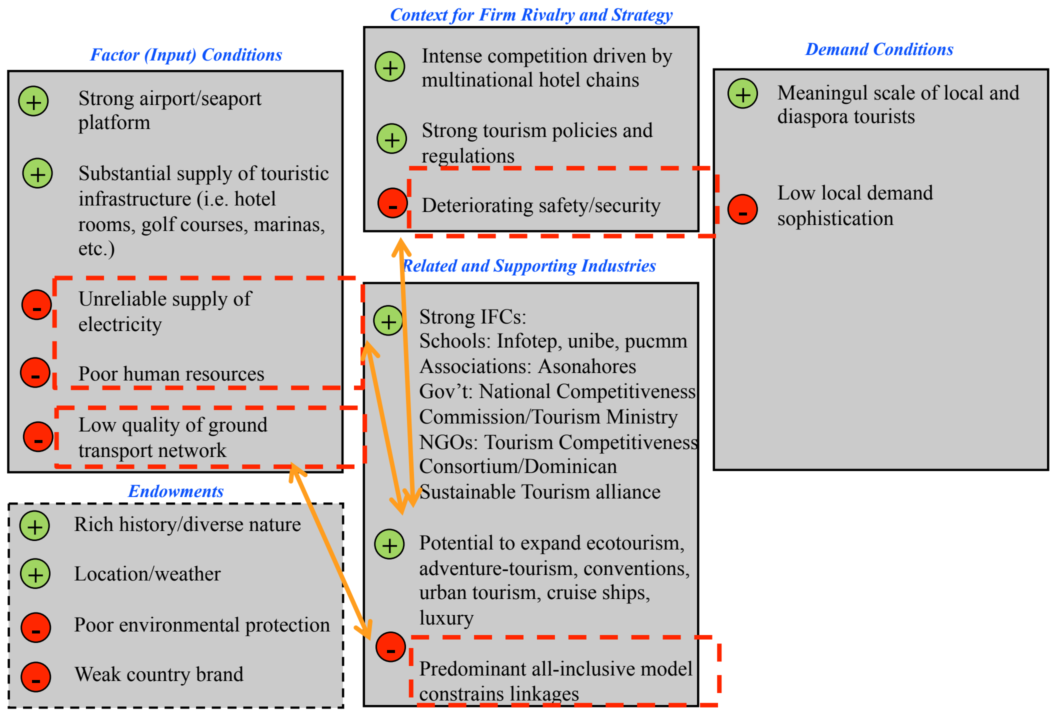
3. Adjacent diversification into ecotourism segment leveraging on the country's substantial bio-diversity and driving greater economic linkages
4. Push business conventions and retreats segment leveraging on central location in the heart of the Caribbean

TOURISM CLUSTER COMPETITIVENESS

The Dominican Republic's most formidable competitors in the Caribbean are Costa Rica and Barbados. Costa Rica has managed to drive arrivals growth through employing an ecotourism strategy that leverages its biodiversity and achieves greater linkages with the broader economy. On the other hand, Barbados achieves the highest receipts per arrival pursuing a high-end premium strategy. Having said that based on the World Economic Forum's 2011 Tourism Competitiveness Report (TCR) the Dominican Republic ranks meaningfully inferior in terms of competitiveness (77 of 139) relative to Barbados (28 of 139) and Costa Rica (44 of 139) (TCR, 2011). This poor ranking is important because there is evidence that better tourism competitiveness ranks correlate with higher rank and receipts per arrival (TCR, 2011).

We will use the MOC Diamond Framework to isolate some of the key constraints that are undermining the competitiveness of the cluster. This framework is shown in **Figure 8** below.

Figure 8: Tourism Cluster Diamond



Source: Authors' analysis

Factor Input Conditions

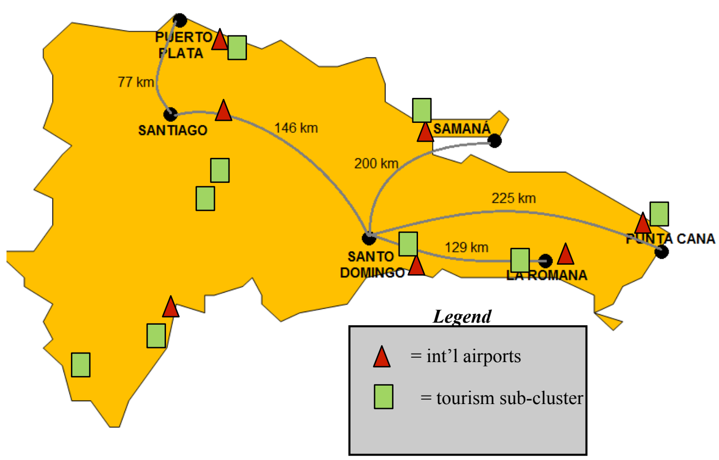
A dysfunctional energy sector, poor human resources, and the low quality of the ground transport network are all bottlenecks to greater competitiveness of the tourism cluster specifically.

First, an unreliable electricity service affects both the operating costs and service quality of hotels and other tourism outlets. Customarily tourists are not happy if their vacations are interrupted by power blackouts. And, hotel cost competitiveness is also eroded with rising energy bills.

Second, as Barbados shows us, in order to service the more sophisticated needs of high-premium customers a commensurately well-educated labor force is required. The Dominican Republic has one of the lowest tourism output per worker in the Caribbean at around $15,000 per worker. The Barbados cluster achieves one of the highest in the region at more than $45,000 per worker (WTTC, 2011). We believe these gaps exist because of the relatively poor quality of the education system in the Dominican Republic (ranked 133 of 139) relative to Barbados (ranked 15 of 139) (TCR, 2011). In addition, the tourism cluster in the Dominican Republic also attracts one of the least educated members of the labor force having only an average schooling of 9 years, right behind construction at 8 years (Dominican Central Bank).

Third, although Dominican Republic has a solid International Air Transport network (ranked 29 of 139), the poor quality of the ground transport network (ranked 82 of 139) is an issue (TCR, 2011). Without adequate means of travelling internally between different existing and potential tourism clusters it will be difficult logistically for tourists to leave the sun & beach enclaves and spend money elsewhere outside of the all-inclusive hotels. Improving the local transport network is thus imperative to support a transition away from the all-inclusive sun & beach model. The map in **Figure 9** below shows the various tourism sub-clusters in the Dominican Republic and how they are connected amongst each other and externally.

Figure 9: Cluster Footprint



Sources: National Competitiveness Commission

Demand Conditions

Domestic demand conditions in the tourism sector are relatively poor. As a small, poor country the Dominican Republic lacks both a sizable and sophisticated tourism demand. The local demand could be identified as both the incoming members of the diaspora and local residents. As shown in **Figure 6** In 2010 there were about 500 thousand internal tourists and about 700 thousand diaspora visitors as compared to about 3.6 million foreign tourists (excluding business travelers). Receipts per arrival are about 16% and 24% less than foreign tourists for the local residents and diaspora visitors respectively. Diaspora visitors and internal tourists spend an average of about 17 and 12 days per arrival respectively. Considering that foreign tourists only spend an average of 9 days per arrival, the expenditure per day of diaspora visitors and internal tourists is about 40% and 60% the level expended by foreign tourists respectively. (Dominican Central Bank)

Context for Firm Rivalry and Strategy

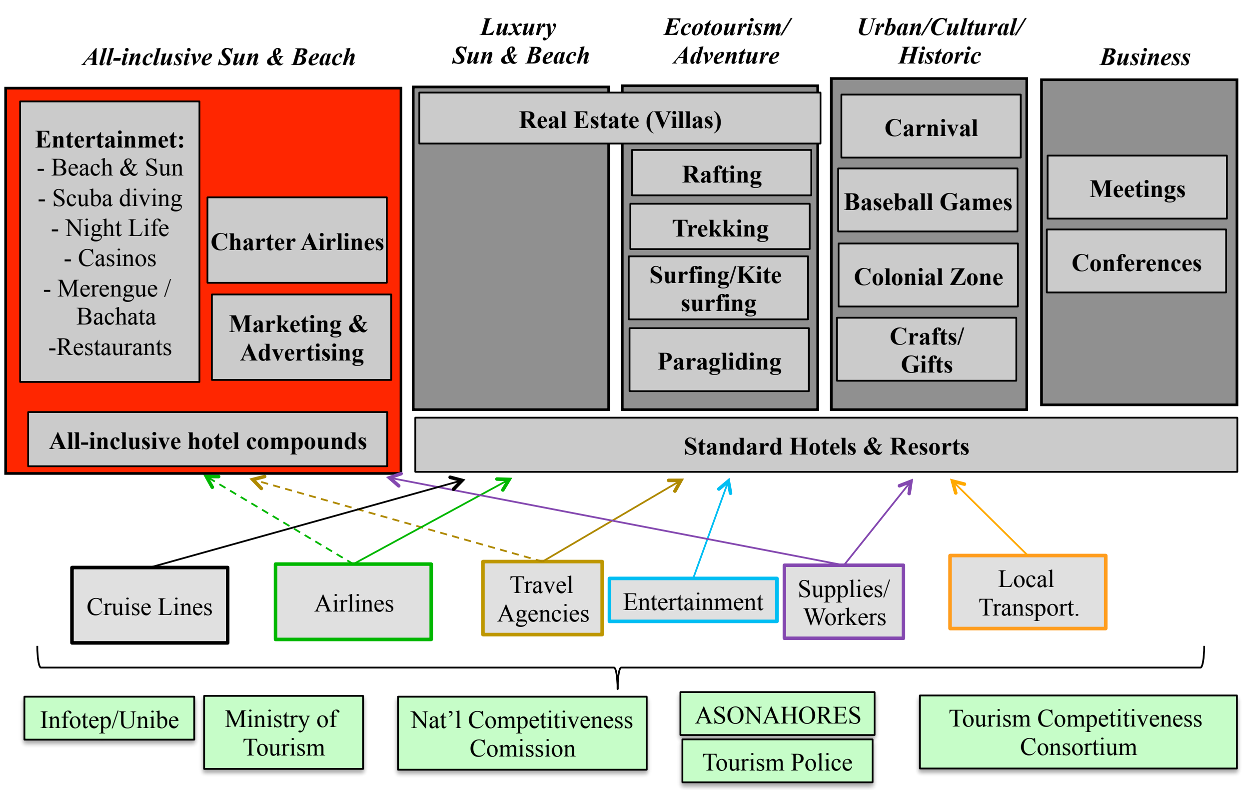
As shown previously, the Dominican Republic has attracted many international hotel chains and therefore there is intense competition although concentrated in the low-end. There are notable players in the high-end luxury space such as Casa de Campo and Cap Cana that prove that luxury a la Barbados can be successfully in the country. The country also ranks favorably (32 of 139) relative to Barbados (75 of 139) and Costa Rica (66 of 75) in terms of tourism policy rules and regulations (TCR, 2011).

However, the poor reliability of police services (ranked 134 of 139) and high business costs of crime and violence (ranked 125 of 139) barriers to shifting away from the all-inclusive model (TCR, 2011). It is easy for all-inclusive hotels to control safety and security within their own premises. However, tourists are not likely wander outside of said venues if perceived levels of crime and violence are high outside. This is particularly concerning because today Dominican Republic has a homicide rate more than twice as high as the one in Barbados and Costa Rica, after having almost doubled since 2002 (United Nations).

Related and Supporting Industries

The Dominican tourism cluster is optimized for the low-end, all-inclusive sun & beach model. There are a plethora of institutions for collaboration (IFCs) that are indicated in **Figure 5** below including, associations, educational organizations, government dependencies and NGOs. Further, there are at least 9 organized sub-clusters throughout the country (CNC). Clearly, there is not a shortage of supporting institutions. The issue lies in the drawbacks with the all-inclusive model that limits linkages with the broader economy as shown on **Figure 5** below.

Figure 5: Tourism Cluster Map



Source: Authors' analysis

In fact, in the Tourism Competitiveness Plan of 2008, developed by various of the cluster actors, already recognizes that the highly concentrated nature of the 'all- inclusive' model has led to insufficient public infrastructure and ecological degradation. All of these factors are considered to have a dire effect in the repetition rate of visitors (Consejo Nacional de Competitividad, 2007). It is therefore imperative shift away form the all-inclusive model in the interest of sustainability and the pursuit of further growth.

Barbados and Costa Rica both have tourism models that are not as concentrated and these countries are thus reaping the rewards that come from broader economic linkages within their respective tourism clusters.

Ecotourism in Costa Rica gave nature an economic value, incentivizing governmental and private efforts to maintain it. This model of tourism also seems to bring further economic development to some of its regions such as Monteverde where local ownership of tourism services is high and the economy has diversified to fulfill an increasingly demanding tourist. Of course, this is not always the case, and economic benefits are less prevalent in regions where packaged tours from the outside are more common (Koens, Dieperink, & Miranda, 2009).

According to Alvin Jemmott, former President of the Barbados Hotel and Tourism Association, his country's touristic success is due to a high repeat visitor component. Jemmott argues that Barbados past success in the time-share market could have provided the right precedents for the now booming luxury condominium market in the island (Barbados Success, 2011).

Endowments

We have already discussed Dominican Republic's natural advantages for tourism. However, the country is not doing enough to preserve those assets. Although the country ranks highly (13 of 139) in the proportion of its land area that is protected, enforcement (111 of 139) and stringency (97 of 139) of environmental regulation are poor (TCR, 2011).

Additionally, the country's brand is not inline with the quality of the endowments or key competitors. Based on the 2012 Future Brand Report, the Dominican Republic's country brand ranks 55 inferior to Barbados (36) and Costa Rica (24) (Future Brand, 2012). Most concerning is the fact that the country has recently dropped 17 places in its ranking even while the Dominican Republic outspends Costa Rica in tourism expenditures as a % of GDP by more than 3x (World Bank).

RECOMMENDATIONS

Tables 1 and **2** below highlight our overall recommendations to help improvethe competitiveness of the tourism cluster in the Dominican Republic. We believe that the four most important constraints that need to be dealt with as it relates to the tourism cluster are: **1) deteriorating public safety, 2) dysfunctional electricity supply system, 3) poor environmental enforcement, and 4) low levels of human capital**. Failing to address the first three will place the sector in danger of decline whereas the fourth constraint restrains growth opportunities in the more lucrative luxury tourism segment.

Second order constraints that we have identified and addressed have more to do with barriers to increasing economic linkages through moving away from the low-end, all-inclusive sun & beach model. These areas that should be addressed include the need for an improved local transport network, incentives to small and large investors looking to deploy capital in non-traditional (i.e. non all-inclusive) luxury and adventure/ecological tourism, and greater number of IFCs supporting non-traditional tourism formats.

In addition, we believe the country can do more to drive tourism demand in particular to the Colonial Zone in Santo Domingo where the requisite cruise ship infrastructure already exists. The country can also promote itself as a location for business retreats and conventions given its central location, high degree of international connectivity, and existing infrastructure.

Below is a legend for the 'actor' name abbreviations used in **Tables 1** and **2**:

> **MT** = Ministry of Tourism; **ME** = Ministry of Environment; **MH** = Ministry of Hacienda; **CS** = Civil Society; **CNE** = National Energy Commission; **MIC** = Ministry of Industry and Commerce; **IFCs** = Institutions for Collaboration; **CNC** = National Competitiveness Council; **MIP** = Ministry of Interior and Police.

Table 1: Macro Recommendations

	Challenge	High Level Recommendation	Priority; Actor
Endowments	• Poor enforcement and stringency of environmental regulation	• Raise and enforce penalties for environmental non-compliance	• 1; MT/ME
		• Organize cluster level coalition to create action plan for mitigating environmental risks resulting from all-inclusive model	• 2; MT/ME
	• Relatively weak country brand out of line with quality of endowments	• Government collects substantially more revenues from tourism then the resources it deploys into the sector. Tourism revenues should be earmarked for use entirely against sector brand building	• 2;MT/MH
Macroeconomic	• Domestic savings rate very low and large current account deficits making net international investment position unsustainable	• Continue developing domestic capital markets to generate domestic savings	• 3; MH
		• Raise taxes on luxury consumption items to curb consumption of imported goods	• 3; MH
Social Infrastructure and Political Institutions	• Rampant corruption undermining conditions for FDI	• In the absence of political accountability, pressure to keep corruption at bay should be applied by Civil Society (media/NGOs/private sector initiative)	• 2; CS
	• Low levels of human capital not aligned with migration to luxury tourism model	• Disburse mandated 4% of GDP in education (up from current 2%)	• 1; ME

Table 2: Micro Recommendations (Business Environment)

	Challenge	*High Level Recommendation*	*Priority; Actor*
Factor Conditions	• Broken electricity supply system a drag on competitiveness and government finances	• Focus on reducing non-politicized technical loses in the short term and on enforcing payment of highest consuming customers to avoid popular backlash. Resources releases can be used to spend against other constraints	• 1; CNE
	• Poor local transportation network restraining cross-cluster linkages	• Give tax breaks to incent more players to enter bus line sector. Initially subsidize routes that would otherwise be uneconomic for private sector to run	• 2; MIC/MT/IFCs
	• Hospitality sector attracting some of the laborers with the least amount of schooling hampering productivity	• Mandate hotel sponsored training programs to raise vocational training levels	• 2; MT/IFCs
Context for Firm Strategy and Rivalry	• Deteriorating public safety a deterrent of tourism demand	• Reinforce the tourism police to make of tourism clusters pockets of security. Purge ranks of corrupt policemen and raise salaries for servicemen	• 1; MT/MIP
	• Negative externalities concentrating tourism sector on all-inclusive 'enclave' model	• Provide targeted fiscal incentives promoting non all-inclusive luxury developments and adventure and ecological tourism operators	• 2; MH
Related ad Supporting Industries	• IFCs and supporting industries focused on low-end, all-inclusive tourism model	• Need to support creation of new IFCs to meet the needs of the luxury segment (association, educational, NGOs)	• 2; CNC/MT/IFCs
Demand Conditions	• Lack of sophisticated local demand has depressed industry standards	• Bolster National Quality System. Mandate (and enforce) improved standards for all vendors selling into the tourism cluster. Using international certifications to differentiate quality levels.	• 3; MIC/MT/CNC

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DISCLOSURES

Fernando Gonzalez is a citizen of the Dominican Republic. In addition, Rodrigo Terc and Gabriela Jaramillo both visited the Dominican Republic briefly on tourism during the elaboration of this project.