TOURISM IN THE DOMINICAN REPUBLIC

MOC Project Paper

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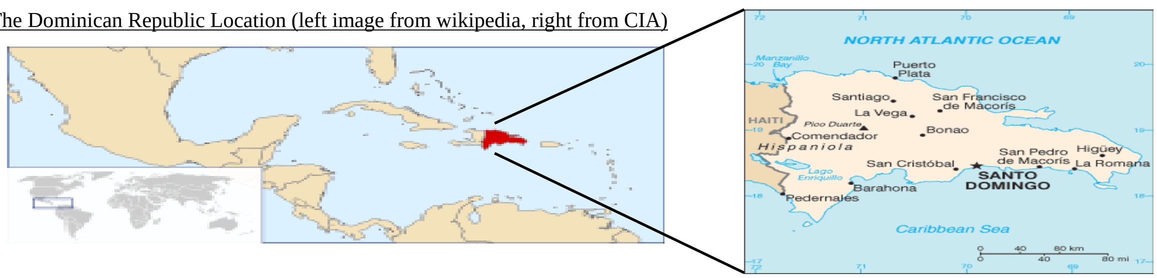
The Tourism Cluster in the Dominican Republic

Located about 800 miles from Miami between the Caribbean Sea and the Atlantic Ocean, the Dominican Republic´s proximity to the large North American market makes it ideal for a number of industries, most notably tourism. Occupying the eastern two-thirds of the Caribbean island of Hispaniola and much larger than any of its regional competitors (except for Cuba), it is about twice the size of the U.S. state of New Hampshire with more than 800 miles of coastline (CIA), white sand beaches, and warm climate that makes it very attractive for tourists worldwide. In 2005, over 3.6 million people visited the country (WB CEM 73), and the tourist sector accounted for 7% of national GDP (Christie Table 2) and 35% of exports (Christie Table 4).

Figure 1. The Dominican Republic Location (left image from wikipedia, right from CIA)



Discovered in 1492 by Christopher Columbus on his first voyage to the New World, the country has a very rich history. As the first point of colonization in the Western Hemisphere, Santo Domingo, the nation's capital, became the site of the first cathedral, hospital, customs house and university of the Americas. Due to its outstanding universal value, the colonial part of the city was designated a Cultural World Heritage Site by UNESCO in 1990 (UNESCO). Early on, the plantation-based economy gave way and the Dominican Republic became a haven for pirates. Between 1821 and 1865, the country struggled for and finally achieved its independence, but was plagued by successive military coups as the economy moved from sugar to tobacco as its primary crop. A 1916 occupation by the U.S. brought institutional reforms and infrastructure development, but decades of successive dictatorships starting in 1930 left a legacy of corruption that is still a major problem for doing business in the country. Luckily, the country has moved towards a presidential representative democracy and held its first truly democratic elections in 1996. Currently, the political system is divided into an executive, judiciary and legislative branch, the last composed by two bodies: the Chamber of Deputies and the Senate. With a population of 9.3 million people, 95% of whom are Catholic, and its official language of Spanish, the Dominican Republic is one of the largest markets in the Caribbean (CIA).

Overall Economic Performance

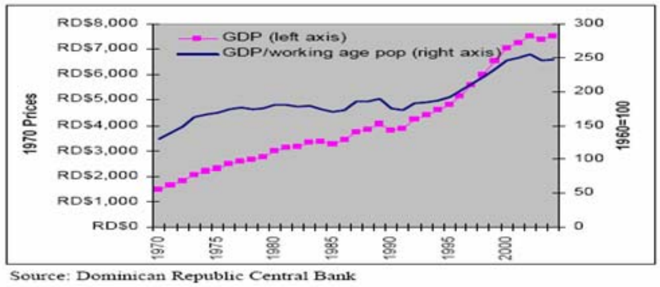
The Dominican Republic is a low-income developing country primarily dependent on natural resources and services. In 2005, the country had a PPP-adjusted GDP per capita of $6,761 and inflation of 3.5%. GDP growth was 4.5% for the same year while the population grew only 1.4%, making per capita economic growth 3.1%. Unemployment was high at 16% and the 51.7 GINI index indicated high inequality in the country (WB WDI). Compared to both its local competitors in the region and other nations of similar size with a similar tourism concentration to their economies (Table 1), it is clear that the Dominican Republic has some catching up to do.

Table 1. (WB WDI)

		Local Caribbean Competitors			World Tourism Competitors		
2005	Dominican Republic	Costa Rica	Trinidad & Tobago	Jamaica	Croatia	Tunisia	Mauritius
GDP (Current Billion US$)	28.3	19.4	14.8	9.7	37.4	28.7	6.6
GDP per Capita (Current US$)	6,761	9,887	12,794	4,327	11,568	7,732	12,215
GDP Growth (Annual %)	4.5	4.1	6.7	1.8	4.2	4.2	4.5
Inflation (Annual %)	3.5	10.1	12.3	9.6	3.3	1.9	5.6
Exports (% GDP)	34.7	51.5	61.3	40.6	-	47.9	53.4
Unemployment	16	6.6	7	11.3	17.2	13.9	9.4
GINI Index	51.7	49.9	40.3	37.9	29	39.8	N/A
Literacy Rate (% >15)	87	94.9	N/A	79.9	N/A	74.3	84.4
FDI (Current Billion US$)	0.64	0.61	1	0.6	N/A	0.59	0.14

Which is not to say that the country has not been prospering. GDP in 2005 was $28.3 billion, up from $6.6 billion in 1980. This implies annual GDP growth averaging 4.2%, well above the Latin America-Caribbean regional average of 3.2% (WB CEM 1), though major challenges remain: poverty, inequality, the need to strengthen public institutions, and the improvement of basic services.

Figure 2. GDP Growth(1970-2005)(WB CEM 2)



The Dominican economy is highly volatile: three major economic crises (mid-1980s, 1990, and most recently the banking crisis of 2003-2004) have triggered inflation, devaluation, unemployment, and deterioration of income levels and rising poverty levels. In fact, the Dominican Republic was on a strong trajectory until its 2003 bailout of the country's second-largest private bank. From 1992 to 2002, the country's GDP grew 74% and inflation was in the single digits for eight of the ten years in that period. Because of the bailout, however, the economy actually shrank in 2003 by 0.4 percent and inflation skyrocketed at 42.7 percent (Hanke 2-3). Now on a path to recovery, the inflation rate has stabilized and GDP growth has returned, but investor wariness is still high and in the first half of 2004, 42 / 100 Dominicans were poor of which 16 / 100 were living in extreme poverty (WB CEM ix). Table 2. Exchange Rate Volatility (WB CEM 0).

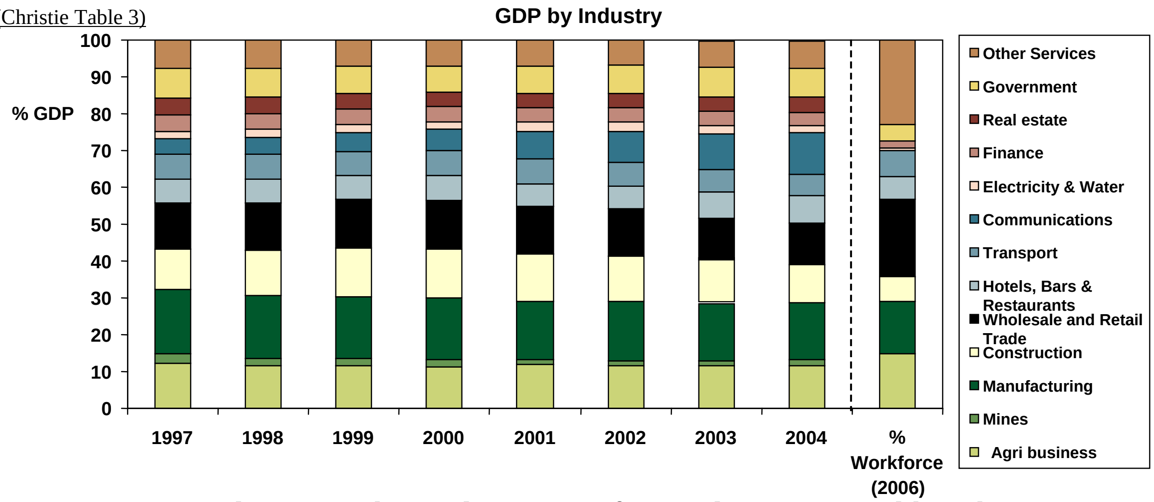
RD$ per US$

1998	1999	2000	2001	2002	2003	2004	2005
15.27	16.03	16.42	16.95	18.61	30.83	42.12	30.00

During the last three and a half decades, the structure of production has shifted away from agriculture to manufacturing, primarily free trade zones (FTZ) and construction. Services have long held a majority share of GDP, where the tourism sector has emerged as a substantial force (WB CEM i). In the last decade, however, there has been little change in this mix (Figure 3), implying that sectors may not be innovating in order to garner a larger share of the market.

A sectoral decomposition of growth shows that long-run GDP growth has been largely associated with significant output expansion in four main industries: FTZ, tourism,

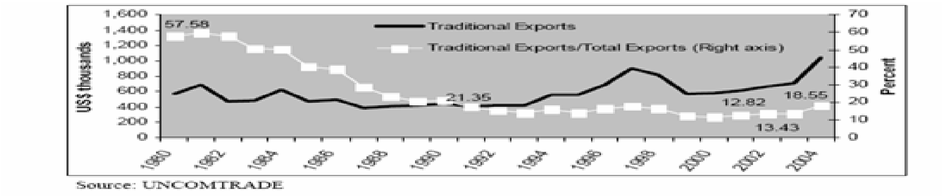
Figure 3. (Christie Table 3)



telecommunications, and, up to the early 1990s, financial services. Although inter-sectoral linkages are important in some cases, for example tourism-related demand for construction, transport, and commerce, they have been somewhat limited. Another explanation of the unequal distribution of growth is the fact that these leading sectors are dominated by large firms, while 2/3 of all workers in the economy are employed in firms with fewer than 20 employees (WB CEM iv).

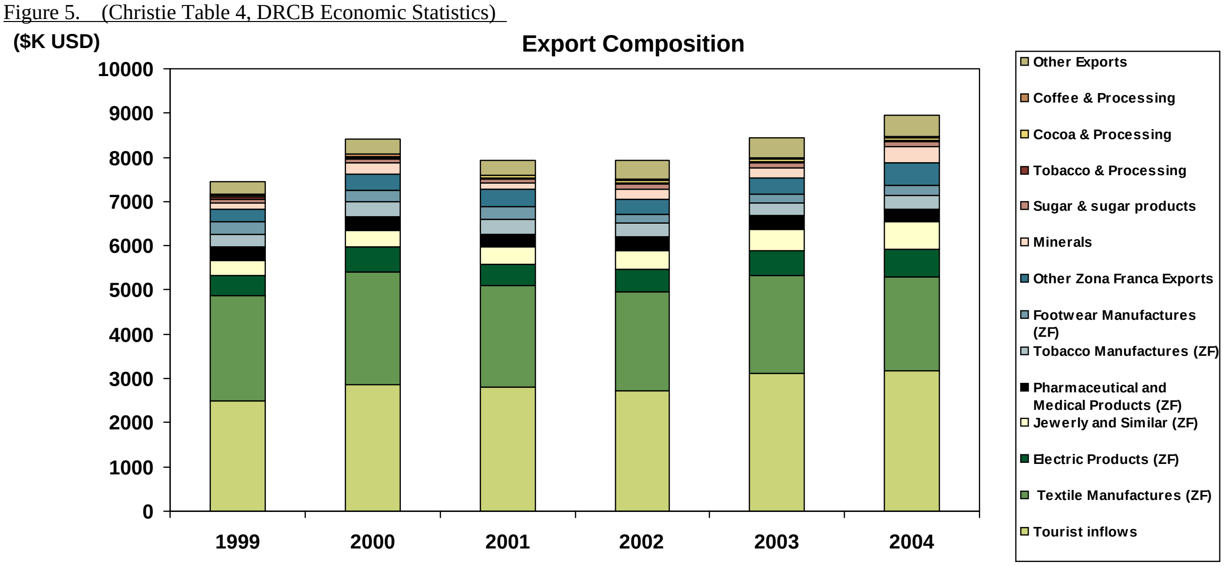
The Dominican Republic has pursued an economic strategy of export promotion, especially through the FTZ. Dominican trade increased in volume terms during the 1990s: exports of goods and services nearly doubled from US$4.1 billion in 1993 to US$8.2 billion in 2004 and imports rose from US$5.5 billion to US$9.0 billion in the same period (WB CEM 47). Dominican trade is carried out primarily with the US, with 82% of exports (including tourism) going to the U.S. in 2004 (WB CEM 47). This is despite the fact that the Dominican Republic is a signatory to a range of preferential bilateral trade agreements with countries such as Spain (State Department) and multilateral agreements such as the Cotonou Accord with the EEC and DR-CAFTA and CARICOM with other Caribbean nations and the United States (WB CEM 54-55). The Dominican Republic remains a net exporter of traditional commodity exports (tobacco, sugar, coffee, cocoa, fruits, and vegetables) even though these have declined significantly from 58 percent of total exports in the early 1980s to almost 19 percent in 2004 (WB CEM 48).

Figure 4. Export Growth (1980-2005) (World Bank CEM 49)



One of the reasons for this decline has been the booming export-oriented manufacturing sectors in the FTZ, which have diversified exports and triggered the shift from tropical agriculture to labor-intensive products, mainly apparel and textiles. FTZ exports grew by an average 10 percent per year between 1993 and 2000 (WB CEM 51).

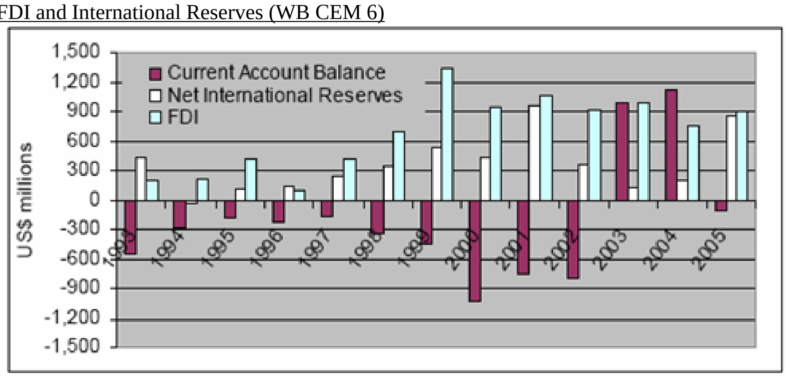
Figure 5. (Christie Table 4, DRCB Economic Statistics)



With respect to trade in services, the Dominican Republic is a major exporter of tourism services, which accounts for about 7 percent of exports, as represented by hotels, bars and restaurants, but tourism activities extend to other sectors as well. Total tourism receipts reached nearly US $3.2B in 2004, even outstripping remittance income of over $2 billion annually (WB CEM 73-74, 8).

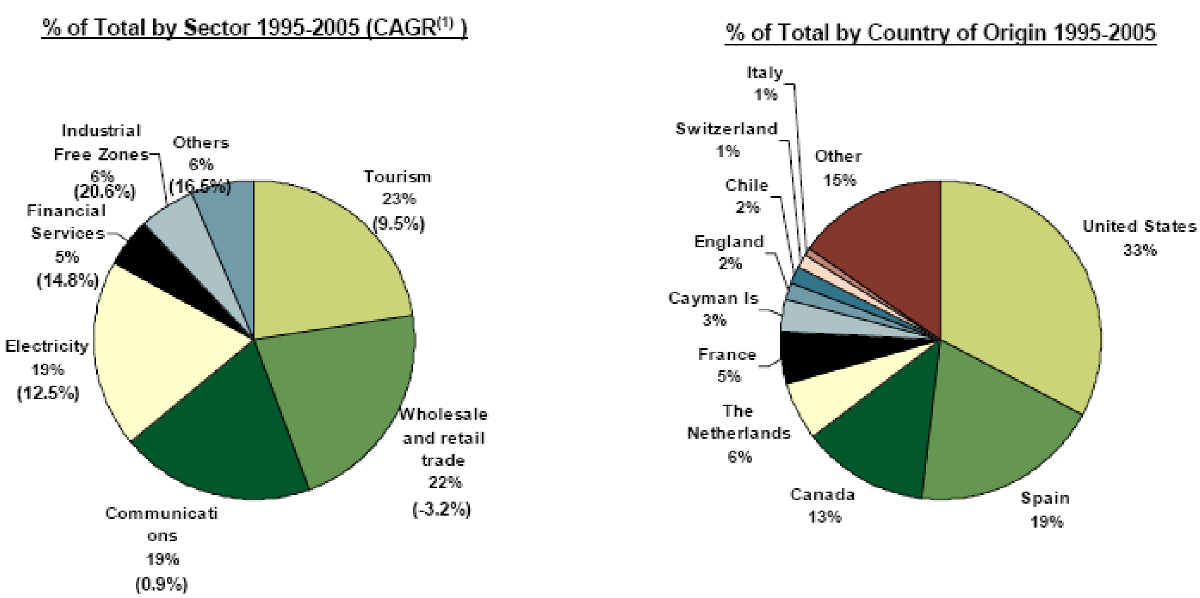
With respect to FDI, however, the tourism concentration of the economy makes some investors nervous. Alex Bolen, CEO of Oscar de la Renta, cited this as a key factor when asked why de la Renta doesn't invest in more clothing production in his home country, commenting, "When tourism gets a cold, the Dominican Republic get pneumonia." Still, this is more a problem of the government failing to create linkages, as it is clear the economy would be in poor shape without the sector. Indeed, the sector has been the major recipient of FDI, attracting investments by large foreign hotel chains, highly concentrated in large Spanish-owned hotels (WB CEM 74). Other significant recipients are retail and wholesale, and the government's liberal investment and ownership policies (discussed below) have also generated a concentration in infrastructure segments such as communications and electricity (Figure 7). Indeed, a diverse base of investors seems to be a bellweather of strong FDI policy all around (Figure 7). On the other hand, the predominance of the US as a destination market for exports suggests that FDI from this country has focused on FTZ and is aimed at exporting production back to the source country. This implies that FDI may be primarily vertical in nature, enabling firms to exploit cost advantages, especially the lower cost of Dominican labor compared to the US and the geographical proximity to the US.

Figure 6. Current Account, FDI and International Reserves (WB CEM 6)



Source: Dominican Republic Central Bank, IMF

Figure 7. FDI Destination and Source (DRCB Economic Statistics)

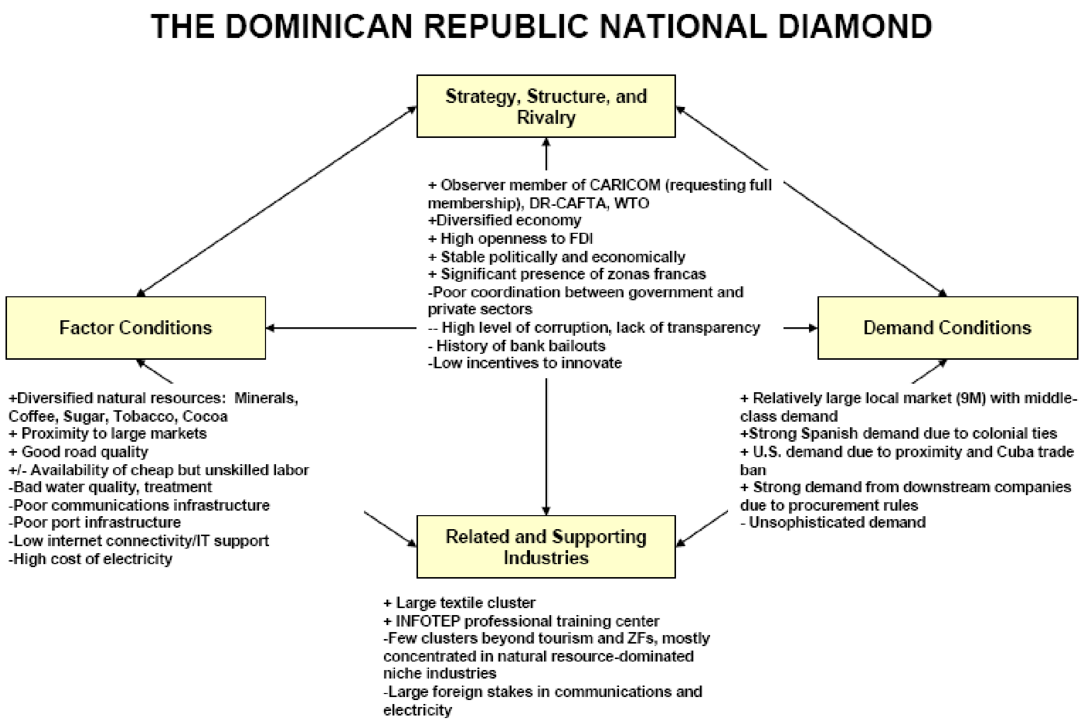


(1) From 1995 – 2005 for Tourism, Wholesale and Retail Trade, Communications, Financial Services.; 1996 for electricity, 1998 for others; 199 for Industrial Free Zones – based on first recorded

Overall Business Environment and Policy

Recent economic growth has been accompanied by a series of economic reforms initiated by the government in the 1990s to achieve macroeconomic stability, namely reducing the budget deficit, curtailing money supply and eliminating inflation, abolishing price controls, and reverting the anti-export bias of the economy (WB CEM). Policies geared towards increasing FDI have been especially effective, and these combined with current growth and economic stabilization policies have boosted investor confidence in the country. Domestic investment has consistently been high, and accounting for about one quarter of total GDP from 1998-2002 (IMF CR 4).

Figure 8.



Strategy, Structure, and Rivalry. Arguably, the strategy of openness and privatization of state-owned enterprises, accompanied by broad array of pro-active policies for the promotion and protection of investments has been one of the most favorable developments in the business climate of the Dominican Republic. Some notable recent policies and developments:

- Significant tariff reform (Law 146-00, December 2000), slashing the number of tariffs by half and cutting off peaks, dropping tariff dispersion from 10.2 to 7.9% (WB CEM 56-57).

- Foreign Investment Law 16-95 opening all sectors of the economy to foreign investment, including a private airport, with very few exceptions limited to sectors deleterious to the public welfare (e.g., hazardous waste). (State Department)
- There are no restrictions on foreign exchange, ownership share, or technology transfer (State Department).
- In 2003, a Center for Export and Promotion of Investment was established as a one-stop-shop for investors, joining the Office for Investment Promotion, est. in 1997 (CEI website).
- Enhanced access to strategic markets through DR-CAFTA Free Trade Agreement with the US and Central America, the CARICOM FTA with 15 Caribbean countries, the Caribbean Nasin Trade Partnership Act and the Cotonou Accord with the EEC Community, and the Generalized System of Preferences with several WTO members (WB CEM 54-55).
- Law 69 mandates local sourcing for companies when products are of roughly the same cost and quality as imports, but this has helped local business without deterring investors (State Department).
- Capital markets are strong: the Dominican stock exchange, Bolsa de Valores de Santo (est. 1991), traded $86 M (USD) in 2006 (BVS).

The largest drawback in the investment climate is perceived corruption in government as well as the private sector, increasing costs and level of uncertainty in doing business. The Dominican Republic has a 2.8 CPI corruption score from Transparency International (ranked 99th/163) (TI 2). Another weakness is the low level of innovation in the economy, which is partly the result of weak protection of intellectual property rights, which placed the Dominican Republic on the 2007 U.S. IPR Watch List, although it did pass some laws in 2006 that improved its standing (USTR). Also, the dispute resolution system at regional level, with no government-private dispute resolution system present, and a system difficult for foreigners to access. In addition, 80 percent of non-administrative staff of a foreign company, including free trade zone companies, must be composed of Dominican nationals. Finally, there have been numerous disputes with investors, especially in the U.S. on excessive expropriation (State Department).

Factor Conditions: Relative to its neighboring countries in the Caribbean (with the exception of Cuba), the Dominican Republic enjoys favorable factor conditions in terms of its relative large land size and population, diversified natural resources, and geographic proximity to North American markets (CIA). On the downside, there is a shortage of skilled labor and communications/IT is relatively weak, in particular internet connectivity. Moreover, the costs of electricity are high, although since the Enactment of the Electricity Law in 2001 there have been significant strides towards operating a more competitive electricity sector and the number of *blackouts* has dropped considerably. Poor infrastructure in ports and customs causes very inefficient cross-border procedures and hurts the export sector (WB CEM).

Demand Conditions: Given the relative large size of the population, there has been an emerging middle class of Dominicans that has fostered local demand conditions. In addition, the surge of foreign commercial presence from OECD countries has contributed to the creation of a more sophisticated demand. Current trends towards diversifying and upscaling the profile of international visitors, and increasing their longevity by developing real estate for foreigners, serves to promote a more diversified and sophisticated level of demand in the country (WB CEM).

Related and Supporting Industries: Notably, INFOTEP (Instituto Nacional de Formación Técnico Profesional) offers subsidized training on a broad array of skills, from computer science to languages. At present, there are over 175 training centers spread thoughout the country. INFOTEP has developed a New Plan (INFOTEP Acción 2005) with the cooperation of the International Labor Organization and has recently successfully implemented a methodology for the measurement and improvement of productivity (INFOTEP).

Competitiveness Indicators: The Dominican Republic ranks 84, from 121 countries, in the BCI of the Global Competitiveness Report 2005-2006 (GCR ES 13). It has an unfavorable position in most of its competitiveness indicators, both compared to its Caribbean neighbors and compared to similar-sized countries that are also leaders in their regional tourism markets. For example, it ranks very low in its capacity to innovate and in its intensity of local competition. Moreover, it has the worst macro environment on almost all dimensions in the comparison group shown in the charts below. However, it does have strengths that are key for the tourism industry. Even though its overall infrastructure (3.1) is below the world mean (3.9), the country has a competitive airport infrastructure that is ranked 30 in the GCR. FDI is strong, as is seen by its score on "Impact of Rules on FDI" which is 5.4, above world the average of 5. The GCR defines its stage of development as efficiency-driven, which indicates that the country indicates that the country still lacks innovation and business sophistication (GCI 13).

Figure 9. Competitiveness Indicators (from Competitiveness Institute)

	vs. worldwide tourism leaders	Dominican Republic	Carribean avg.	Mauritius	Croatia	Malaysia	Tunisia
Macro Indicators	GDP per capita (U$ PPP 2004)	6761	8687	12215	11568	10423	7732
	GDP per capita (U$K PPP 2004)	6.8	8.7	12.2	11.6	10.4	7.7
	Macro Environment Index	2.78	3.628	4.01	3.76	5.12	4.59
	Impact of Rules on FDI	5.4	5.34	5.1	4.2	5.7	5.8
	Access to Loans	2.5	2.72	3.4	3.3	4.4	3.2
Micro Indicators	Nature of Comp Adv	2.5	3.38	3.4	3.6	3.3	3.5
	Intensity of Local Competition	3.8	4.6	4.8	4.7	5.6	4.8
	Local Supplier Quality	3.8	4.3	4.7	4.2	5.3	4.6
	Local Supplier Quantity	4.8	4.66	5.3	4.5	5.6	5.1
	Local availability of specialized research and training	3.4	3.72	3.9	4.1	4.7	4.3
	Capacity for innovation	2.5	3.1	2.9	3	4.2	3.3
Infrastructure	Overall Infrastructure	3.1	3.22	4	3.6	6	4.6
	Airport Infrastructure	4.8	4.7	5	4	6	5.3
	Port infrastructure quality	3.4	3.42	5	3	5.9	4.4
Social Indicators	Crime and Violence	3	2.56	3.9	4.4	5.5	5.5
	Informal Sector	5.1	4.96	3.8	4.7	3.8	4
	Women Employment	4.4	4.52	3.9	4.4	6	6
	Time to start a business (Days)	78	61	n/a	49	30	14
	Stage of Development	1.5	2.1	2	2	2	1.5

	Vs. local competitors	Dominican Republic	Trinidad & Tobago	Costa Rica	Mexico	Jamaica
Macro Indicators	GDP per capita (U$ PPP 2004)	6761	12794	9887	9666	4327
	GDP per capita (U$K PPP 2004)	6.8	12.8	9.9	9.7	4.3
	Macro Environment Index	2.78	4.44	3.44	4.35	3.13
	Impact of Rules on FDI	5.4	5.5	5.2	5.1	5.5
	Access to Loans	2.5	3.3	2.6	2.6	2.6
Micro Indicators	Nature of Comp Adv	2.5	2.8	4	3.3	4.3
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	Local availability of specialized research and training	3.4	3.3	4.2	4	3.7
	Capacity for innovation	2.5	2.6	3.9	3.2	3.3
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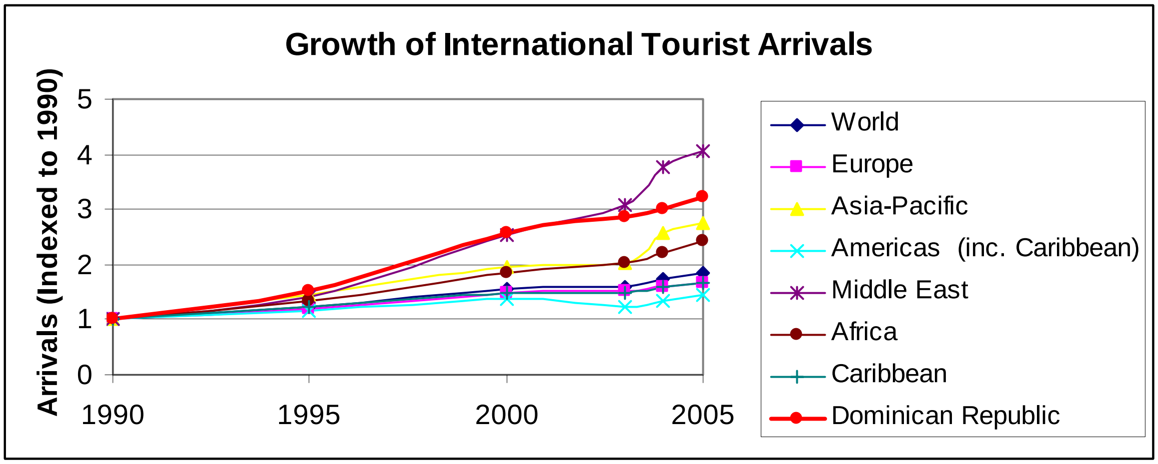
	Airport Infrastructure	4.8	4	4.5	4.9	5.3
	Port infrastructure quality	3.4	3.1	2.3	3.3	5
Social Indicators	Crime and Violence	3	2.3	3.2	2.2	2.1
	Informal Sector	5.1	4.4	4.5	5.4	5.4
	Women Employment	4.4	4.5	4.5	3.8	5.4
	Time to start a business (Days)	78	n/a	77	58	31
	Stage of Development	1.5	2.5	2	2	2.5

The Tourism Cluster

The World Tourism Industry: Tourism has been facing many issues lately: terrorism, natural disasters, oil price rises, exchange rate fluctuations and economic and political uncertainties. Yet in 2005, international tourist arrivals worldwide hit record highs, with over 800 million visitors (WTO 2). This growth in the world tourism market displays an impressive 5.5% against 2004, well above the 3.3% average growth rate in the 15-year period from 1990-2005 (WTO 3). Europe has market dominance with 54.8% share. Asia-Pacific follows with 19.3%, the Americas (ex-Caribbean) at 14.3%, Africa at 4.6% and the Middle East with 4.8%, and the Caribbean with 2.3%. From 1990-2005, the world tourism market grew 83.6%, while the Americas as a whole only grew 43.9%. Yet, the Caribbean market grew 65.8% within this period (WTO 3) and the Dominican Republic grew an astounding 222.4% (CB, foreign air arrivals only).

Worldwide, international tourism receipts are estimated at US$680 billion in 2005, up US$ 47 billion over the previous year, with receipts per arrival at US$840. The Americas and Caribbean do better than the world market, each at US$1080 per arrival (WTO 4). In 2004, the Dominican Republic was somewhere in between, receiving $924 per arrival (CTO 12).

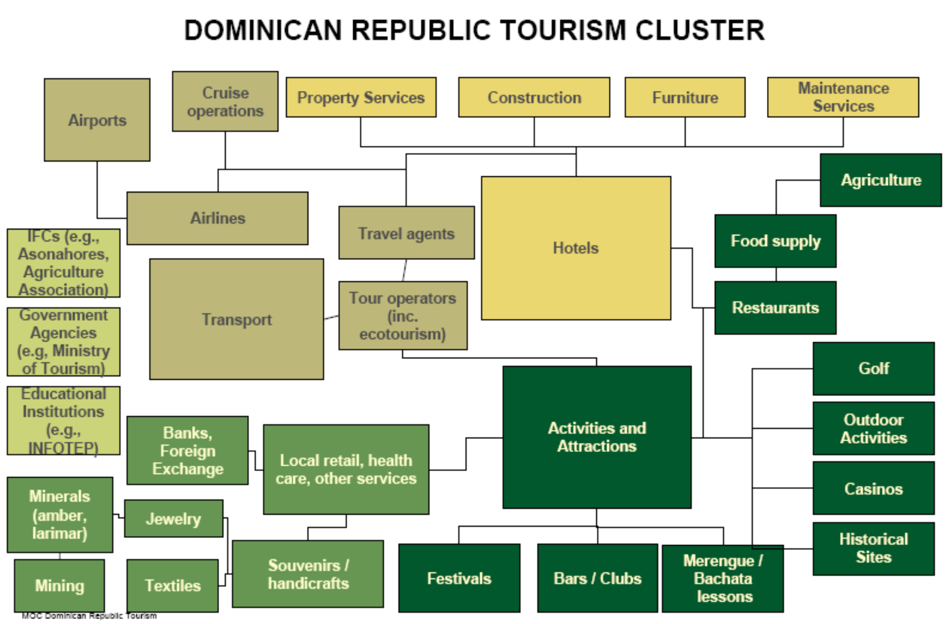
Figure 10. (Compiled from CB, WTO 3)



Note: Dominican Republic data is foreigners arriving by air only

Tourism in the Dominican Republic The tourism cluster in the Dominican Republic is rich with many extensions into other areas of the economy, from transportation and communications to agricultural production, construction, and water and energy consumption. Other contributions to the economy stem from foreign exchange inflows, job creation, and FDI. Total employment – including direct and indirect activities – surpassed 180,000 workers in 2004, or 6 percent of total employment (similar in magnitude to FTZ employment, and also with a high proportion of women – 50 percent in tourism) (Christie Table 13, WB CEM 54).

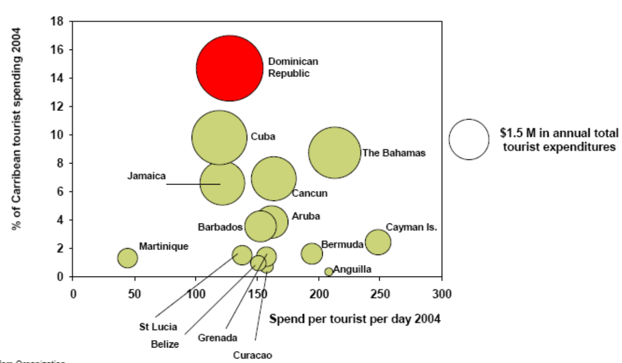
Figure 11.



Most of the tourism is driven by the hotels, with the large all-inclusives accounting for the majority of spending. So, although in 2004 there were only 30 hotels with over 500 rooms (vs. 649 total establishments), these hotels accounted for over 1/3 of the rooms available on the island. The majority of establishments are smaller, at 516 total, but make up only 20% of the rooms available (Christie Table 11). Law 69, discussed above, improves linkages to food and beverage procurement, as well as other items such as furniture, linens, construction, and support services. In addition, the six major airports located in the tourist destinations process over 3 million tourists annually (Christie Table 8). Activities and attractions beyond the all-inclusives are numerous, though as we show later not necessarily utilized. Most prominent are the casinos, with 31 major casinos in all, concentrated in the Santo Domingo area. Hispaniola Hotel & Casino is the largest, with 37 table games and 300 casino slot machines / video poker games. In addition, there is a theme park, a marine park, and an ecological park, as well as numerous historical sites and small operators of restaurants, bars, merengue and bachata clubs, and adventure sports (Fodor's, Frommer's). The local support clusters found in almost every economy have strong links to the tourism sector, including banks, local retail, and health care companies. Jewelry, especially amber and larimar are especially important retail products, and unique souvenirs many tourists bring back (Fodor's). In addition, local IFCs such as Asonahores hotel association, the government Ministry of Tourism, and educational institutions such as INFOTEP support the sector through coordination, marketing, and improvement of factor conditions (WB CEM), though as discussed below these are not always adequate.

Figure 12.

DOMINICAN REPUBLIC HAS POSITIONED ITSELF AS LOW-COST, HIGH-VOLUME DESTINATION

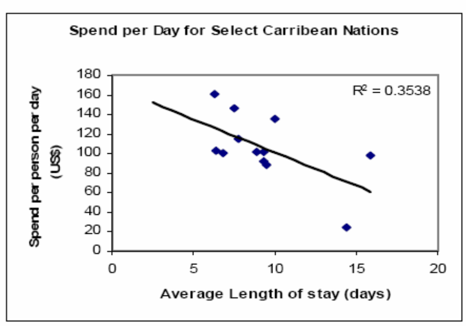


Source: Caribbean Tourism Organization
MOC Dominican Republic Tourism

With a 30 bps increase in Caribbean market share between 2000 and 2004, the Dominican Republic has kept its position with the largest marketshare within the Caribbean (14.7% of tourist expenditures). The only competitor that comes close is Puerto Rico with a 14% share, with Cuba trailing for third place at 9.8% (CTO 66). These tourist arrivals are split evenly between North America (45.1% in 2003) and Europe (45.5%), but since 1999 the number of North American tourists has increased at a 14.6% CAGR, while tourism from Europe has been relatively flat at a CAGR less than 1%. The North American tourism focus in dominated largely by the United States (including Puerto Rico), which accounts for over 1/3 of all international tourist arrivals. Canadians are another 15%, with the other major tourist entries coming from France (11%), Germany (9%), Spain (7%), the U.K. (6%), and Italy (5%) (Christie Table 9). Surprisingly, this leaves the Dominican Republic as one of the most diversified destinations in the Caribbean (CTO 18-28). In terms of positioning, the Dominican Republic is very much a leisure destination, with 96.3% coming for vacation and only 2% of arrivals coming for business travel (the lowest in the Caribbean besides the British Virgin Islands and Cuba), with 1.2% for other purposes. Even Jamaica gets 5.5% of tourist arrivals for business purposes, plus 8.3% for “other” (CTO 51). In addition, only 60.7% of tourists are from the key market aged 21-49, with 16.1% below this age and 23.2% above (CTO 55). The proximity to its main market of the United States, lack of business travelers, and reverse-bell curve age distribution are all consistent with the Dominican Republic’s positioning as a high-cost, low-volume destination within the Caribbean. So, although it captures almost 15% of the Caribbean market, the average Dominican Republic tourist spends only $127.92 per day, with only tourists in Jamaica, Cuba, and Martinique spending less (out of our sample). Destinations such as Aruba, Cancun, and Bermuda generate over 25% more spend per day (CTO, data compiled and analyzed from various pages).

Part of the reason for the success of this positioning may be the longer stays exhibited by the Dominican Republic's guests. Analysis of data from the Caribbean Tourism Organization shows the surprising result that among islands, longer stays seem to drive less spending per day (Figure 13). Although this result may seem surprising, data from both the US and UK.tourist boards by region of arrival seem to confirm it (UK ONS, US OTTI). The intuition is simple: To some extent, there is a fixed number of tourism dollars that get spread out over the length of the stay. So, a couple visiting the Dominican Republic for the weekend might take a tour of Santo Domingo, get a massage, and eat out both nights. But, a couple staying for a week might still only take that one tour, get only one massage, and probably won't eat out every night, so the spend gets spread out more. If resources were unlimited, the extra hotel nights would be marginal revenue and it would be worthwhile to have the longer stays. But, if resources are saturated, they might be better used towards these shorter-stay customers in order to increase productivity. Of course, high-spend customers such as business travelers should be encouraged to stay longer. But, the data flags the importance of looking at tourists by segment and spending habits (for instance, business vs. leisure or package tour vs. a la carte) instead of purely length of stay.

Figure 13. Spend per Day (CTO)

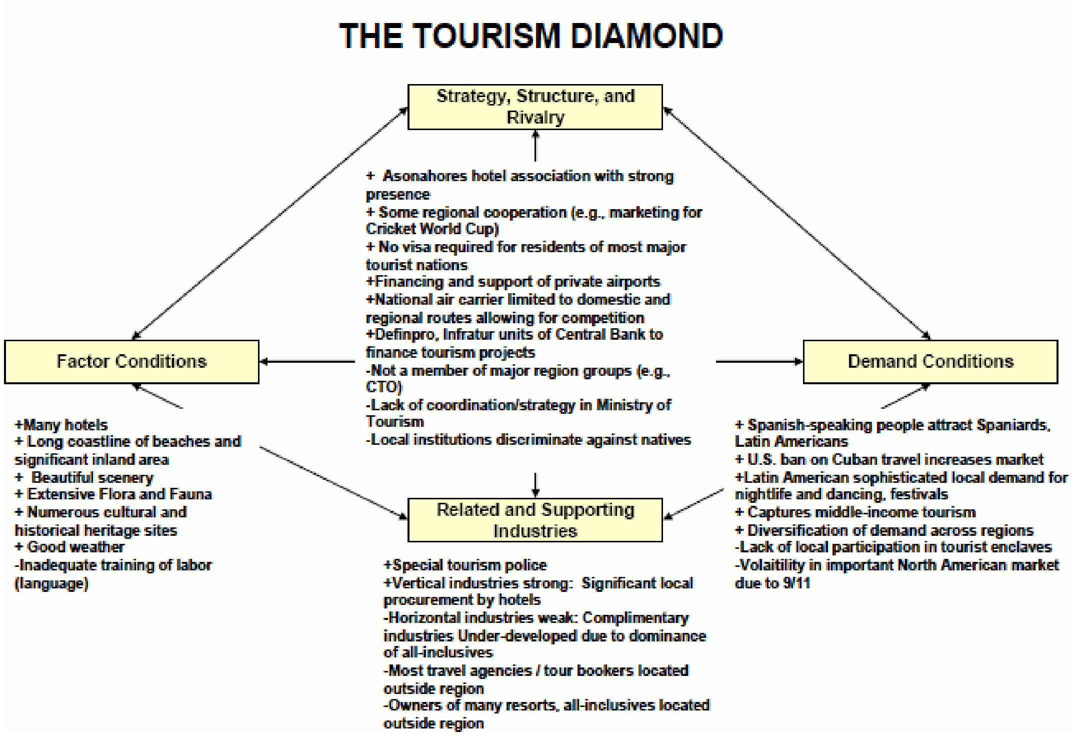


Note: Not all team members endorse data based on .35 R-squared
Source: Caribbean Tourism Organization
MOC Dominican Republic Tourism

	Avg Stay (2004 or most recent available)	Spend per person per day
Bahamas	6.3	160.18
Grenada	7.5	146.48
Barbados	10	135.48
Aruba	7.8	114.29
Bermuda	6.4	102.3
Dominican Republic	8.9	101.88
St Lucia	9.3	101.02
Belize	6.8	100
Montserrat	15.9	98
Jamaica	9.3	91.74
Dominica	9.5	87.84
Martinique	14.4	24.19

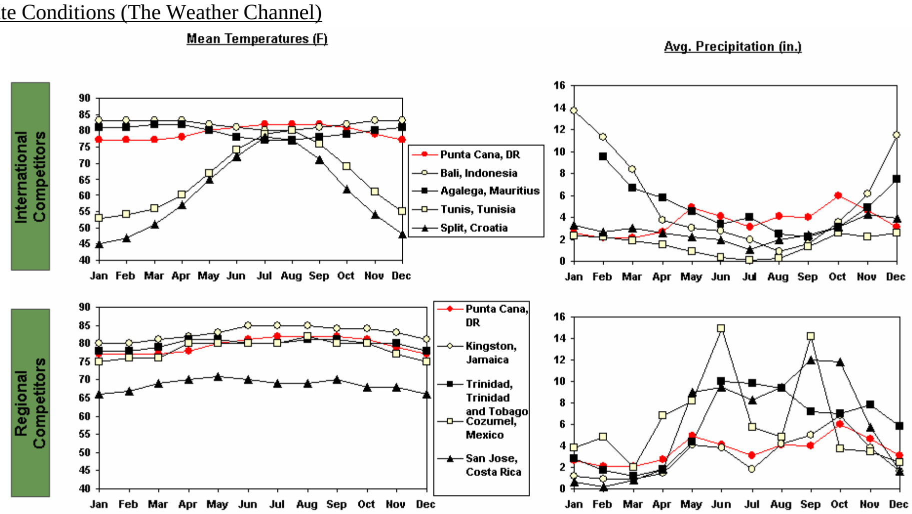
In general, the tourism diamond below shows strong factor conditions, with mixed reviews on both Strategy, Structure, and Rivalry and Related and Supporting Industries and poor Demand Conditions.

Figure 14.



Factor Conditions: As with any tourist destination, one of the key drivers of both tourism and hotel developer spend (Atkins, Cefalu) is the climate. As Figure 15 shows, the Dominican Republic has many natural advantages versus its international competitors in terms of consistently high temperatures throughout the year as well as low average precipitation, which means fewer days of rain keeping tourists inside. Yet, within the Caribbean region the Dominican Republic is fairly non-distinctive, meaning that it must find other sources of competitive advantage.

Figure 15. Climate Conditions (The Weather Channel)

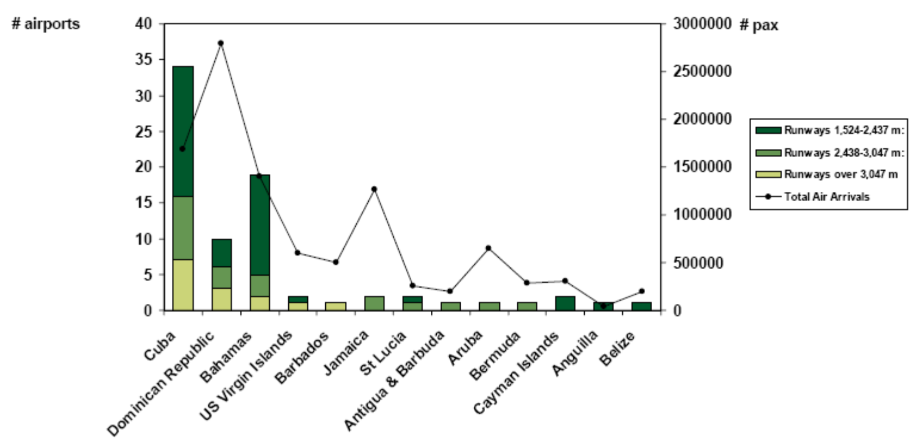


Even its long coastline, at 1,288 km has only a .03 ratio to its total landmass (CIA), implying that the Dominican Republic cannot achieve its full productivity relying solely on its beaches, and must utilize its inland assets as well.

Luckily, there are many of these assets available. The Dominican Republic has a rich history, including many structures left over from Columbus's time, and the Colonial City of Santo Domingo, one of the 13 UNESCO World Heritage Sites in the Caribbean and one of the 5 not in Cuba (UNESCO). In addition, it has received accolades in travel publications such as Frommer's for two of the nine "Best Golf Courses" in the Caribbean, as well as being one of the eight islands named for having the "Best Nightlife" (Frommer's). Its parkland is a major asset, and with almost one-third of its total surface area protected (U.N. Common database), rich with over 5,600 plant species, 20 species of land mammals, and 303 bird species (Nature Conservancy). Tours and excursions to view these assets could be a differentiating factor for the Dominican Republic and drive a significant number of tourists out of the hotels and beaches to other parts of the island, generating incremental revenues and boosting productivity.

Yet, despite all of these natural assets, the Dominican Republic's strong FDI climate and liberal government policies have allowed the airports and hotels to flourish. As Figure 16 shows, although the Dominican Republic has fewer airports than either Cuba or the Bahamas, the airports are highly productive, moving more tourists through its ten airports than any other country in the Caribbean. This gives the Dominican Republic a huge convenience advantage versus other destinations, with a recent web search showing 17 total flights (2735 seats) from the US every day and 10 from Europe (2962 seats).

Figure 16. Efficient Airport System (CIA)



With over 60,000 hotel rooms, the most in the Caribbean, one would think that the Dominican Republic would have trouble filling the space. Yet, since it recovered from 9/11 and the 2003-2004 financial crisis, it has consistently maintained year-round occupancy levels around 75% (WB). This is much higher than international competitors such as Mauritius (63%), Tunisia (49%), Bali (48%), and Croatia (42%) (WB), and quite stunning for the hotel industry in general. In addition, this number puts it higher than almost every other Caribbean nation for which data is available, including all nations with over ten thousand hotel rooms such as Cuba at 64%, Jamaica at 61% and the Bahamas at 65% (CTO).

The Dominican Republic's final strength is in its labor productivity, where the number of employees per tourist has decreased from .074 in 1999 to .060 in 2003. This increased productivity has not hurt employment, however, and rather had been accompanied by modest .8% CAGRs in both direct and indirect employment from tourism (Christie Table 13).

<u>Related and Supporting Industries:</u> Of course, with increasing labor productivity and saturation of airports and hotels, simply getting tourists in the door won't be enough to improve the productivity of the tourism sector. Instead, it will be necessary to move tourists out of the hotels and get them to spend money in the economy. Yet, as Table 3 shows, the Dominican Republic is only in the middle of the pack in this compared to some of its Caribbean peers).

<u>Table 3. All Inclusives Hurting Supporting Industries (CTO 68).</u>

	Bermuda	Barbados	Jamaica	Belize	Dominican Republic	Bahamas	Aruba	Martinique	Suriname
■ Other	5.3%	4.7%	7.8%	4.5%	7.8%	16.2%	3.2%	8.8%	34.9%
□ Shopping	8.3%	10.2%	10.9%	7.7%	8.6%	7.7%	25.5%	23.9%	30.2%
■ Entertainment	(inc. in "Other")	4.7%	9.5%	11.6%	13.6%	19.7%	20.9%	8.8%	(inc. in "Other")
■ Transport	5.4%	6.4%	6.3%	12.4%	8.8%	12.0%	6.9%	17.9%	16.3%
□ Accomodations + meals	81.0%	74.1%	65.5%	63.8%	61.2%	44.4%	43.5%	40.6%	18.7%

This is attributable to the large number of all-inclusive resorts in the country, which tend to keep tourists in their hotels and keep them from going out (WB CEM). The restaurant situation is especially dire. Although the Dominican Republic gets more tourists than any other country in the

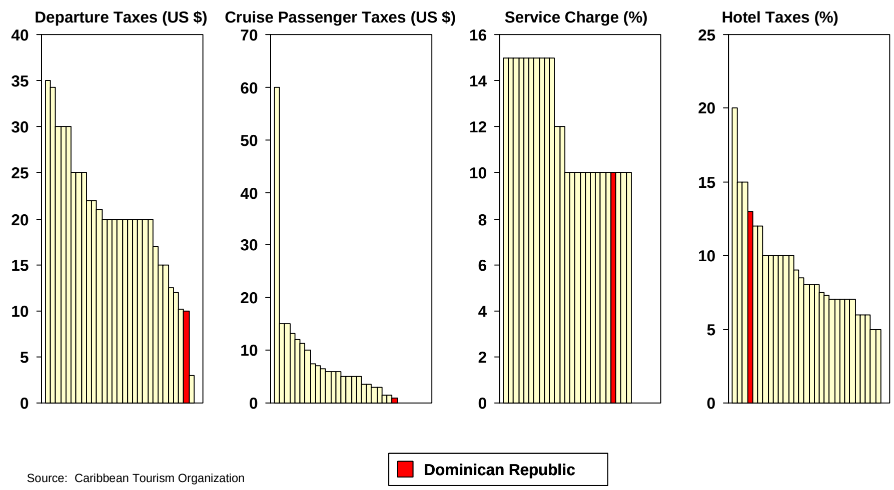
Caribbean, it only has 21 restaurants worthy of note in Frommer's, giving it .075 notable restaurants per 10,000 tourists, less than any other Caribbean nation for which data is available, with it's closest competitor, Barbados, with four times as many notable restaurants per tourist.

Strategy, Structure, and Rivalry: The Dominican Republic's strengths and weaknesses can largely be tied back to the government policies both aiding and inhibiting tourism. For instance, the liberal FDI policies mentioned earlier have been instrumental to attracting hotel and other companies to invest in the country. The Definpro and Infratur units of the Central Bank finance numerous tourism projects (Ceara-Hatton). Furthermore, the Dominican Republic has been very aggressive about leaving assets in the private sector. Even its national carrier, Air Santo Domingo, is limited to mostly national and some regional routes (Frommer's), allowing for increased competitiveness and willingness to establish routes among the major international carriers as they don't have to worry about government measures to protect its own carrier. The government has even allowed for the first private international airport in Punta Cana, which as will be discussed later has become the most productive airport on the island (PCRC). Also in the private sector, the Asonahores hotel association has strong presence, allowing for data collection and some marketing coordination (Ceara-Hatton 79). Additionally, although Spanish is the official language of the country, English is taught in all schools, which is necessary given the number of English-speaking tourists entering the country. Also, hotels are able to receive U.S. television channels, considered a large benefit by many English-speaking tourists. And visas are required from very few countries, improving ease of travel. And, although it does not participate in many regional groups, the Dominican Republic does join its neighbors for selected events, such as improving ease of access for tourists during the Cricket World Cup. Finally, the Politur tourist police, a cooperative effort between the National Police, Secretary of the Armed Forces, and the

Secretary of Tourism, has kept incidences of crime against tourists low (State Department CIS, Frommer's, Fodor's, Interviews).

Especially noteworthy is the Dominican Republic's tourism tax policy. As shown in Figure 17, the country has some of the lowest taxes in the Caribbean, instrumental in driving demand, except for hotels, where as discussed previously the market is close to saturated and the Dominican Republic can harvest extra revenues from the tourists.

Figure 17. Tourist taxes (CTO 14)



On the negative side, the Ministry of Tourism provides poor guidance for the industry, and there is little centralized coordination or strategy (WB CEM). In addition, the Dominican Republic is not a member of most major regional groups (such as the Caribbean Tourism Organization) (CTO). Also, many national standards make it hard for tourists entering the country, especially from the key North American market. Neither cell phones nor electrical devices are compatible with local networks (interviews).

Demand Conditions: Although the Dominican Republic has almost 16% share of tourists coming to the Caribbean, it has not effectively leveraged the local Caribbean demand. In fact, it only captured 5.9% of intra-Caribbean travel in 2004. Luckily, the trend has been in its favor. Since 2001, the growth rate of tourists from within the Caribbean has been at an almost 42% CAGR, almost quadrupling in that time period. In that same time period, the intra-regional tourism for the region as a whole has been less than 6%, implying that the Dominican Republic is doing an admirable job of catching up (CTO 38). The Dominican Republic needs to take better advantage of this local demand as its connections to a more demanding local market can provide better opportunities for learning and innovation.

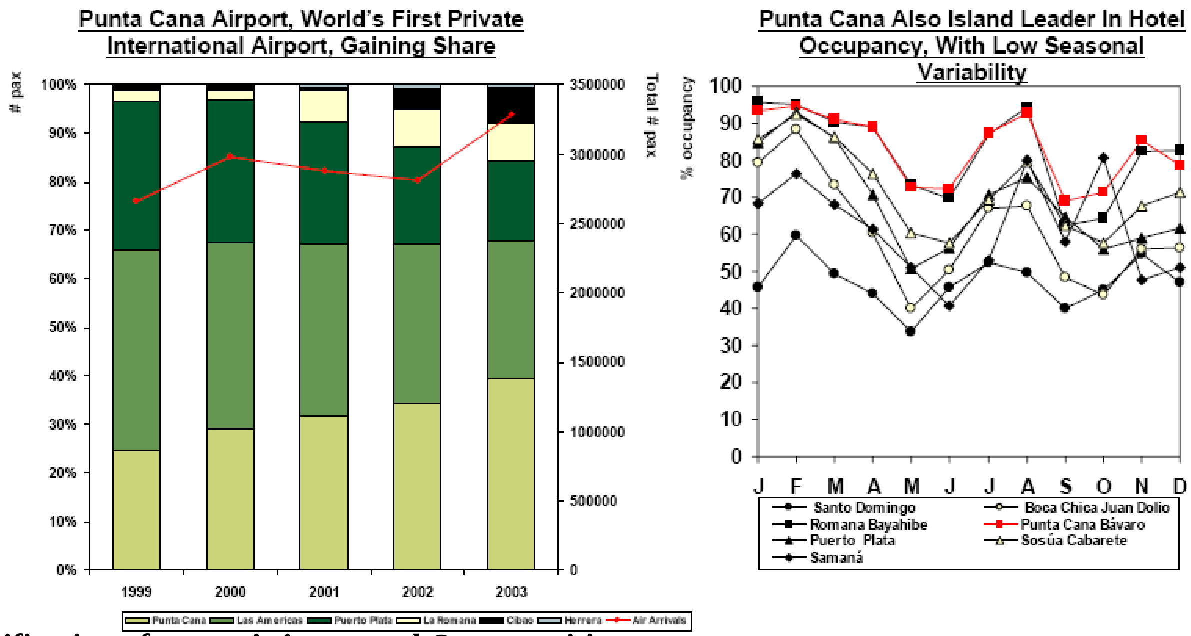
On the flip side, in a slightly broader view, the Dominican Republic has been able to capture significant demand from its other local markets, North and South America. In particular, the Spanish-language history of the country has given it a whopping 52% share of Spanish tourists (CTO 34). The closure of Cuba to American tourists has also given the Dominican Republic a lift, allowing it to capture 8.1% of that market, on par with Jamaica and behind only the Bahamas and Cancun of non-U.S. territories. Its next closest competitor, Aruba, captures only 4.6% of U.S. tourists (CTO 13). In contrast, Canadian tourists (with no restrictions on travel to Cuba) prefer Cuba to the Dominican Republic, with about 25% more visiting there in 2004 (CTO 21).

Finally, the Dominican Republic has managed to maintain a broad base of tourists from a much more diverse set of regions than many of its Caribbean competitors. So, although it gets many U.S. tourists, they only account for 27% of total arrivals, versus 70% of Jamaica's and 87% of the Bahamas's. In fact, there are 14 Caribbean destinations (including Cancun but not including U.S. territories) for whom United States tourists are more than 50% of total arrivals (CTO 18). In this context, both the Dominican Republic's ability to court this population and its lack of dependence on it is rather astounding.

Given the near-saturation of the hotels and airports of the Dominican Republic, plus the high level of labor productivity in the tourism sector, increasing productivity further is a daunting task. There are, however, two main paths that can be followed. One is to increase the number of linkages to other industries, so that the existing assets of the tourism sector produce more income per tourist via new assets and channels. As discussed above, this strategy has so far been underutilized. The other strategy is to increase the amount that tourists are willing to pay for the same assets, to migrate from the current low-cost high-volume position to a luxury positioning. The luxury positioning has numerous advantages besides pure incremental revenue. Luxury tourism tends to be countercyclical and less subject to normal macroeconomic fluctuations. In addition, luxury hotels employ more people with increased training and skills development. Finally, luxury hotels increase opportunities to drive linkages to other sectors – by not being all-inclusives and forcing tourists off-property, by attracting tourists with more money who are more likely to spend elsewhere, and by investing more in capital improvement, refreshing artwork, furniture, linens, etc. more frequently and therefore providing more frequent stimulus to these sectors of the economy.

But can it be done? Can luxury tourists be convinced to visit a low-cost, high-volume destination? The example of Punta Cana provides a ray of hope and a roadmap showing that this might be an option. The Punta Cana Resort and Club was started by a group of American investors who bought the land in 1969. Later joined by famous Dominican Oscar de la Renta and Julio Iglesias, the resort quickly became known among the jetset elite, attracting famous guests such as the Clinton's, who were there this past Easter. The strategy has been simple: own all of the infrastructure. The holding company on its website takes credit for "access roads, security, waterworks, electricity, garbage disposal, waste disposal and schools . . . all operable through projects and subsidiary corporations," in addition to having gotten permission from the Dominican Republic government to open the world's first international private airport. This strategy has led to a smashing success. As shown below, the airport is one of the most productive in the Dominican Republic and rapidly growing. Punta Cana hotels have some of the highest occupancies on the island, with some of the lowest variability. This success has attracted a number of additional developers, with Starwood Hotels, the first big American chain to open a hotel outside of Santo Domingo, set to open a Westin golf resort in Spring 2008 (Starwood Hotels and Resorts). So, although Punta Cana has shown it can be done, its success must be carefully studied in order to be replicated elsewhere in the Dominican Republic.

Figure 18. (Christie)



Identification of strategic issues and Opportunities

Issues

Saturation of current resources: Generally, the Dominican Republic tourism industry has been positioned as low-cost and may be nearing saturation because of the high hotel occupancy, air arrivals, and labor productivity. The sector faces the turning point of needing to add value to drive productivity. Yet, products and services are still low-grade and it will be difficult to change the consumer image.

Longer stays hurting productivity: From the previously described analysis, because of issues related to tourist profile and spread of spend, long stays are associated with lower spend per day. The current business model of the Dominican Republic to increase absolute revenues through maximizing occupancy seems to have peaked. To increase productivity via higher spending per day, driving high-value visits, either through attracting a different segment or getting the same segment to spend more money in fewer days through high-value weekend stays is a priority.

<u>All-inclusives minimize potential revenues:</u> All-inclusives present a package plan which normally includes flights, transfers, accommodation, meals, and drinks. All-inclusive plans account for most of the stays in the Dominican Republic except for Punta Cana. This enclave model keeps tourists on property and minimized linkages to other potential industries such as retail and restaurants, minimizing spend and productivity.

<u>Supporting industries weak and underutilized:</u> Industries such as restaurants and sightseeing are not as linked to tourism as in comparable destinations. Supporting and related industries should be better utilized and marketed so that they provide the overall tourism industry with synergy effects.

<u>Corruption discouraging investors:</u> Although current investment is high, the perceived cost of doing business is deterring many potential suitors who might want to invest in different sectors.

<u>Infrastructure deficiencies:</u> Despite the high productivity of the airports and hotels, other infrastructure such as seaports, roads, electricity, and sewage have major room for improvement. Modernization of these social foundations is required to contribute to basic conditions for growth.

<u>Environmental sustainability:</u> Although the Dominican Republic still enjoys pristine nature, environmental pollution from solid waste, littering, and sewage will result in the island losing its allure. The waste problems in the capital Santo Domingo have had bad impact on tourists particularly from seaports. New recommendations must make sure to take this into account.

<u>Exploitation of local workforce:</u> Recommendations must continue to avoid exploitation of the local workforce so that business structure can transcend low-quality services.

<u>Cuba liberalization:</u> We cannot predict the moment when Cuba liberalizes its political regime and stops its hostile view against the US. Yet, such a condition might hurt the Dominican Republic tourism market share. Cuba has tripled its market share of Caribbean tourism in the last decade,

and with large investment in infrastructure this growth rate is predicted to continue. Currently, 32.4% of Canadian tourists to the Caribbean visit Cuba. If the same percentage of U.S. tourists were to visit a liberalized Cuba, and assuming these came equally from the Dominican Republic as from other Caribbean nations, this would take about 9% of the Dominican Republic's tourists, or about 300K people.

Opportunities:

Proximity to North America and strength of airports: The Dominican Republic has an advantage in geographical proximity to North America and in its efficient use of the airports compared to other Caribbean countries, providing an opportunity to market shorter getaways for tourists.

Strong relationship with European market: Consumption habits of Europeans, which are different from North Americans, can diversify revenue sources regarding tourism industry and galvanize related industries.

High-productivity trajectory in Punta Cana: Current success in Punta Cana, not dependant on the all-inclusive model, suggests the future path for increasing productivity. High value-added services, not only in hotels but also in related industries and improved infrastructure, can be a possibility to attract upper segments of tourists.

Historical, natural assets underutilized: Since Christopher Columbus visited the Dominican Republic, a lot of historical heritage has been accumulated but underutilized for tourism. Eco-tourism to enjoy the country's biodiversity has just started and should be encouraged.

Golf gaining in popularity: Tourists, especially, those who are drawn to the island's consistently comfortable climate, may begin to visit the golf courses in the Dominican Republic. This is an option to attract tourists not just for sun and sea but also for inland activities.

Lack of coordination and strategy minimizes marketing efficacy: Weak presence of IFCs and the Ministry of Tourism shows room for improving marketing activities for segmenting and attracting tourists. In addition, a comprehensive strategy for upgrading the tourism industry in cooperation with the private sector can provide effective development plans. The lack of current policy means there is a quick win available.

Expand hotel procurement regionally to increase international exports: The current procurement law requires companies to source locally instead of importing when similar products of similar quality and price are available. If this policy is appropriately linked to tourism-related industries, there are a lot of chances to increase exports based on souvenirs and reputation.

Recommendations.

National recommendations:

- The Government of the Dominican Republic should formulate a National Strategic Vision for its key industries (5-years and 10-year plans) in order to provide consistency for investors; to enable coordination, allow synergies, and achieve economies of scale among industry participants, and to foster additional linkages among all sector participants and between sectors. Difficulties could be encountered in this process due to insufficient capacities of current government agencies and also some industry segments could feel disenfranchised if the strategy does not include them.
- Improve corruption climate by prosecuting key offenders. Bring in outside consultants such as Transparency International to improve climate. While it may be difficult to make these changes stick since they are so ingrained, any sign of progress will be positive to investors.
- Accelerate process of Intellectual Property Protection, going beyond requirements of DR-CAFTA. Use U.S. policies as a model.
- Encourage innovation in key industries through investment in universities and study abroad programs. Utilize strong tourism sector to host conferences that generate the exchange of ideas with local residents and companies. This has the advantage of boosting both existing

sectors (tourism) while encouraging new sectors, and exposing international investors to the Dominican Republic and its companies.

- Privatize additional infrastructure projects (e.g., sewage), enabled by the strong FDI climate and precedents in industries such as communication and electricity. This could help increase competitiveness of these industries and allow possible eventual international growth. The downside to this could be problems due to the existing corruption in the country, the need to enforce the existing laws, and the difficulties to ensure environmental sustainability.
- Enforce existing laws in infrastructure maintenance, creating compliance through high-profile cases where offenders are punished. Moreover regular compliance reviews should be used when granting additional licenses and permits for investment in infrastructure projects. This could improve transparency, trust, competitiveness and incentives for investors. The challenge is again in the corruption climate in the country and in the lack of transparency.
- Improve national standards to meet international demands (e.g., labeling and packaging for agriculture). This could leverage the existing consumer base of international hotel chains, as the chains come to appreciate the high quality of Dominican Republic products and perhaps use them in other properties in the region and beyond, increasing the potential to expand the domestic markets to exports, while also increasing consumer satisfaction with local products and providing local hotel chains a good guidance with regard to quality. On the other side, this could be difficult to implement if local producers are not able to meet demands and existing problems in communications and coordination may make implementation difficult.
- Use tourism as a springboard to build other industries. Create a strategic vision and plan to get either hotels or tourists to begin purchasing local products. For instance, as shown recently on the Food Network, Tortuga Rum Cake is now the #1 export of the Cayman Islands after tourists coming to the country began ordering them at home. Also, Kona coffee has become a

popular product throughout the U.S. after tourists to Hawaii fell in love with it. A strategic vision and marketing around a product such as sheets or furniture could cause it to take off.

Cluster recommendations:

- Actively recruit development of high-end, non-all inclusive properties since big hotel developers usually follow each other. This kind of property increases productivity of land and labor with higher revenues per asset as well as supporting industries because of better-quality supplies procured. To this end, much improved marketing is needed. Also, resources such as coastline, airport traffic, and similar may be saturated, which could pose problems.
- Sponsor scholarships for hospitality study abroad in order to improve the quality of labor, increase the level of education, and to acquire international standards. This process has to be monitored to avoid misallocation due to corruption and also to make sure it does not hurt development of local educational institutions.
- Increase marketing to the rest of Latin America, leveraging proximity to these countries and a Spanish-speaking population, as well as LA income growth. To have continuing success in this process, there is need for more and better marketing expertise. Moreover, the purchasing power of these countries may be low, So the target should be high-income tourists from LA.
- Leverage Dominicans living abroad (especially higher-income and in the USA) with "come back home" campaigns, giving fiscal incentives to open restaurants, hotels, and merengue clubs abroad to familiarize foreigners with Dominican culture. The latter will drive value-added tourism interested in more than sand and sun, while the former will drive remittances which will help the economy of the country. Both have ancillary benefits for non-tourism exports, as familiarity with the culture drives demand for its products.

- Provide coordination to facilitate shopping tours to FTZ's which will increase their revenue. Moreover, the tourist who bring local products home could increase international demand. But, these activities are difficult to coordinate and could hurt village-level retail for local merchants.
- Promote golf vacations through land partnerships. This is environmentally sustainable and develops high-growth, high-revenue attractions for the wealthy tourist segment. This operation could be facilitated by the availability of inland property and ease of investment. However, it is important to carry out environmental impact studies and supervise that the golf vacations do not run into conflicts with protected areas in accordance with environmental laws.
- Improve restaurant presence by attracting celebrity chiefs, and promoting of local cuisine. The difficulty here is to initially attract an anchor tenant. However, as in the case of hotel chains, the herd effect will trigger growth once the first of this restaurant is established. Plus, this will improve linkages with the agriculture sector.
- Improve ease of travel and find ways around restrictive international travel laws (by providing, for example, travel-size liquids on arrival). Moreover, the Dominican Republic should try to integrate into the North American cell phone system to facilitate the communication.
- Improve marketing of historic sites in the Dominican Republic (e.g., request that additional sites on the UNESCO World Heritage list; create marketing materials for distribution at airports and hotels; create incentives for all-inclusives to take guests off property). This could improve productivity for the existing assets, could increase the overall volume of tourists, and could drive FDI to create new outlets. However, achieving this requires coordination, strategy and investment which are not currently present. Additionally, DR must make sure to preserve environmental sustainability and the historic value of its attractions.
- The Dominican Republic should protect itself from the threat of Cuban liberalization. If Cuba opens to US tourism it could be difficult to compete against this new market. So, the

Dominican Republic should move up towards higher market segments Cuba may have difficulty capturing. Also, it should reinforce marketing to attract non-all-inclusive tourists and/or higher spending visitors.

Conclusion

The Dominican Republic has had a very dynamic economy in the last decades, with growth driven by attractive FDI policies although innovation has been low. The economy has been very dependant on Tourism, with successful positioning as a low-income tourism destination, but the sector has reached a saturation of its assets and has not maximized linkages throughout the rest of the economy. This has been largely because of an all-inclusive enclave model and a focus on volume over productivity. Punta Cana provides evidence that it is possible to move beyond this, and that productivity can be improved both by increasing spend on the same assets (such as hotels) and making going off-property attractive to tourists. The country needs to improve its policies to attract high-end, non-all-inclusive resorts that will bring higher spending tourists to the country. This should trigger spillovers throughout the economy, driving diversification and linkages.

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Recent visitors to the Dominican Republic interviewed (HBS students):

- Jens Audenaert
- Matthew Dunn
- Peri Edelstein
- Evan Horowitz
- Christopher Pierce
- Jonathan Pollock