

## Principal–Agent Relationship within a Cruise Supply Chain Model for China

### ABSTRACT

Changes in travelers' booking habits and the evolution of technology have come to threaten the existence of traditional travel agents (TAs). However, the cruise industry still relies heavily on TAs as its main distribution channel. A qualitative study was conducted to investigate the networks, relationships, and power distribution between cruise companies and TAs using a triangulation method via a tourism supply chain (TSC) model. Principal–agent (P–A) theory was taken as the framework to describe various parties' relationships and roles. Several TA business models were identified, including group blocks (i.e., guaranteed and nonguaranteed) and charter cruises (i.e., retail for resale and corporate; meetings, incentives, conferences, and exhibitions). Results show an imbalance of power between parties due to unique business practices and customer preferences in Mainland China. Principals (i.e., cruise companies) were found to rely excessively on agents (i.e., TAs) to create demand, with the growing number of cruise lines leading agents to overpower principals. The alliance among TAs further affected the P–A relationship. A refined TSC tailored to the cruise industry is thus proposed herein; this cruise supply chain model simplifies the complicated business network relationships between cruise companies and TAs in China.

**KEYWORDS:** cruise; tourism supply chain; principal–agent theory; travel agency; distribution; China

## INTRODUCTION

Thomas Cook's company, established in the 1840s, was the first to offer global tours, including rail and cruise travel in the 19<sup>th</sup> century and a "holiday package" in 1855; the company remains one of the world's oldest (178 years) and well-known travel agents (TAs) (Cripps, 2019; Martikke & Weisser, 2012). Thomas Cook declared bankruptcy on September 23, 2019, with Collinson (2019) noting that the company "[had] been destroyed largely by the internet and changing fashions, hastened along by trying to finance an impossible burden of debt." Shifts in travelers' booking habits along with technological advances have collectively endangered the existence of traditional TAs. Although TAs are facing threats to their survival, the cruise industry relies heavily on TAs as key members of its distribution network. At present, approximately 75% of cruise bookings come through traditional TAs (Sorrells, 2019). These channels offer a convenient, one-stop service for confirming reservations and making other travel arrangements. Other reasons for TAs' popularity pertain to travel party composition and customer segments: cruise holidays tend to attract families or groups, which require different travel arrangements; additionally, senior travelers constitute a traditional cruise market but may be uncomfortable booking travel online. The dynamics of cruise products and associated administrative burden (e.g., paid deposits, travel documents, and follow-up) have led cruise companies to partner or collaborate with TAs. In the context of the tourism supply chain (TSC), these travel distributors are key stakeholders who deliver cruise products to the market.

The cruise industry is relatively new to many countries in Asia. Between 2012 and 2017, the number of Asian cruise passengers ballooned from 775,000 to nearly 4.05 million with an estimated 39% compound annual growth rate. Roughly 60% of Asian passengers hailed from Mainland China (hereafter referred to as China; CLIA, 2018). China reported 2.4 million cruise

passengers (representing 10.5% of the global total) in 2018; the country ranked second among all cruise source markets after the United States, which accounted for 51.9% of the world's total (CLIA, 2019). Yet a report from the International Travel Monitor indicated that 90% of Mainland Chinese (hereinafter Chinese) do not have passports, especially in inner China and lower-tier cities (Chan, 2017). The Chinese market thus still has considerable tourism potential, including in the cruise industry. Historically, before China's "reform and opening-up" in the 1980s (Preen, 2019), outbound travel was heavily restricted (Tse & Hobson, 2008). Traditional TAs offer services such as visa applications and the provision of approval documents enabling the Chinese to travel abroad. The China National Tourism Administration established the "Approved Destination Status" label in 1995, allowing Chinese tourists to travel abroad for pleasure on group tours arranged by approved Chinese travel agencies using a special visa (Siriphon & Zhu, 2018). Citizens can travel exclusively via group tours when visiting countries that do not have a travel agreement with the Chinese government (Tse & Hobson, 2008). In light of such regulations, TAs have long been popular in China.

Many cruise companies have expressed interest in entering the emerging Chinese market given its growth potential. The company Norwegian Cruise Line even designed a cruise ship specifically for the Chinese market; however, the endeavor was unsuccessful and left the market after less than a year (Everington, 2018). Understanding the structure of China's cruise industry, which carries important practical implications for cruise companies, is therefore crucial. However, limited research has focused on China's cruise business model. An extensive literature search revealed a single Chinese-language article discussing the country's approach; the study indicated that travel operators sell most cruises to the Chinese market (Sun, Ye, & Xu, 2016).

Conceptually, the present study has three main objectives. First, it investigates the networks, relationships, and power distribution between cruise companies and TAs using a TSC model, specifically in the Chinese context (i.e., China and Hong Kong [HK]). Principal–agent (P–A) theory is taken as the framework to describe the various parties’ relationships and roles. Second, the hotel industry possesses similar distribution channels under the TSC model, and business models influence the relationships between these stakeholders; thus, this study compares how TAs operate when distributing cruise products (i.e., cabins) versus hotel products (i.e., guest rooms). Third, based on the results of data analysis, a modified TSC model grounded in P–A theory is developed for the cruise industry to illustrate P–A collaboration when delivering products and services. The proposed cruise supply chain model elucidates the current status of cruise companies and TAs in China. It should be noted that multiple tiers of agents are involved between suppliers (or principals) and customers (end users). For simplicity, this study refers to cruise companies as “principals,” wholesalers as “intermediaries,” and sub-agents as “the agency.” “TA” is a general term referring to wholesalers and sub-agents.

## LITERATURE REVIEW

Hauser and Truong (2012) viewed the cruise industry holistically, highlighting three unique and value-added characteristics. First, cruise products are heterogenous and consist of goods and services (e.g., transportation, accommodation, dining, and entertainment) that lead to customized experiences based on individuals’ chosen products. Second, these products are inelastic, such that they cannot be stored for future use. Lastly, a cruise is a bundled product; all services are complementary. From a supply chain perspective, a cruise is considered “one supplier” rather than bundling various suppliers’ offerings into one product. The service flow

requires intermediaries to distribute products to end users (customers), and this distribution channel embodies a supply chain that mostly involves distribution and marketing activities (Zhang, Song, & Huang, 2009).

Distributors are also known as intermediaries; they function as service providers between product suppliers and end users. These parties may be tour operators (wholesalers) and/or travel agencies (retail branches), which can represent the same or separate business entities (Zhang, Song, & Huang, 2009). With the development of internet technology, online travel agents (OTAs) have increased their shares in tourism distribution channels. Many travelers now prefer to purchase tourism products such as airline and hotel reservations either directly or through OTAs due to pricing transparency (e.g., a “best-price guarantee”) and the convenience of meta-search websites (e.g., Skyscanner and Trivago). OTAs have become major tourism distributors and are gradually replacing conventional distribution channels (i.e., tour operators and TAs). The implementation of a dynamic pricing structure also requires traditional distributors to maintain direct connectivity with hotels and/or airlines for live data (e.g., inventory and pricing). Unless traditional distributors possess the technology necessary for these connections, they should obtain products through other distributors (e.g., OTAs) that have the tools to do so. This phenomenon poses serious threats to traditional TAs’ existence, causing such companies to be labeled a “sunset industry.”

As mentioned, an extensive literature search returned a single article related to cruise industry operations in China (Sun, Ye, & Xu, 2016). That study focused on the market’s pricing formulation. The authors identified charter ships and block group space as the industry’s main business models, which they termed “market types.” These market types are sold in packages; intermediaries represent distribution channels and create a monopolistic competition market,

resulting in a “low price dilemma.” The authors therefore suggested that cruise companies redesign their channel systems to reduce reliance on intermediaries to promote the Chinese cruise market’s development. The current study summarizes research related to the TSC model and P–A theory to address the identified research objectives through an appropriate theoretical lens.

### TSC Model

A supply chain represents a sequential system, starting from a product’s beginning as raw material (i.e., an initial supplier) to end users through multiple stages involving various stakeholders (i.e., intermediate suppliers). Mentzer et al. (2001) emphasized that a supply chain is a network structure constituting a “whole.” Hahn (2020) and Munksgaard, Stentoft, and Paulraj (2014) later added the two components of technology and business processes. Supply chain management encompasses the planning and management of all activities, including sourcing (e.g., raw materials), coordinating, and collaborating with channel partners (i.e., suppliers, intermediaries, and third-party providers) for customers (Chen et al., 2017; Mentzer et al., 2001; SCMP, 2013; Zhang et al., 2009). Munksgaard et al. (2014) pointed out that supply chain management includes strategic, tactical, and operational elements, thereby enabling firms to maintain their competitiveness among rivals. Firms seek competitive advantages by minimizing costs, risks, and conflict among stakeholders throughout the management process while aiming to ensure that customers benefit from the value created through this process (Munksgaard et al., 2014). Mentzer et al. (2001) proposed seven key supply chain management activities among stakeholders: (1) integrated behavior (i.e., stakeholder relationships); (2) mutually shared information; (3) mutually shared risks and rewards; (4) cooperation; (5) shared

goals and a focus on customer service; (6) process integration (from sourcing to manufacturing and distribution); and (7) partnerships to build and maintain long-term relationships.

Zhang et al. (2009) explained that formulating tourism products is coordination-intensive, and service is an inherent and perishable aspect of such products. Tourism products are naturally complex because they include multiple service/product components (e.g., accommodation, transportation, sightseeing, and dining) that involve uncertain demand and complicated dynamics. These features elicit information dependency among tourism product stakeholders. Essentially, Zhang et al. (2009) defined the TSC as

“a network of tourism organizations engaged in different activities ranging from the supply of different components of tourism products/services such as flights and accommodation to the distribution and marketing of the final tourism product at a specific tourism destination, and involves a wide range of participants in both the private and public sectors.” (p. 347)

The ultimate goals of TSC are tourist satisfaction, tourism sustainability, monetary value, alleviation of demand uncertainty, and inventory reduction (Zhang et al., 2009). Zhang et al. (2009) devised a corresponding framework to illustrate a destination’s TSC; see [Supplement Figure 1](#).

This framework conveys the importance of the network structure and relationships among suppliers and intermediaries (i.e., tour operators and TAs) within the tourism sector. The structure is relatively simple in that it contains only two supplier tiers: Tier-2 suppliers provide raw materials to Tier-1 suppliers for product assembly. Tour operators then coordinate to bundle tourism products from various Tier-1 suppliers and distribute the products to either TAs or tourists directly. Relevant information flows from tourists through intermediaries to suppliers;

the intermediaries can thus provide market intelligence that allows suppliers to improve their products. Service flows in the opposite direction, with these intermediaries acting as distributors and adding value to products/services. Lastly, the local government is a primary stakeholder that oversees tourism sustainability, destination marketing, and destination image.

### P–A Theory

Agency theory was initially developed to explain compensation contracting (Mitnick, 2006), particularly from a human resources standpoint (Heery & Noon, 2008). Economists have since adopted this theory to investigate problems related to risk sharing and incentives within the P–A relationship. Put simply, P–A theory aims to measure an agent’s willingness and interest consistency through contract design (Guo & Tang, 2015). According to Shavell (1979), four possible general outcomes exist: (1) the principal and agent possess equal risk and sharing; (2) the agent is risk-averse when facing high risk; (3) optimal outcomes are achieved when the principal and agent each benefit from their cooperation; and (4) as an extension of neutral sharing (from the first outcome), the agent faces less risk than the principal, leading to unequal incentive payment. Under this theory, effective cooperation and an equilibrium contractual form between the two parties are paramount (Jensen & Meckling, 1976).

Tourism involves multiple suppliers within the supply chain system, which complicates stakeholder relationships. As shown in [Supplement Figure 1](#), intermediaries bundle travel packages from various suppliers as a value-added process and then either sell the packages to travelers directly or to another layer of distributors (i.e., TAs). A review of the literature on TAs and P–A theory indicates that many studies have focused on incentive contracts within travel agencies. Huang, Huang, and Chen (2004) examined a performance-based salary system for

salespersons within travel agencies in Taiwan. Li and Zhang (2017) identified optimal incentives for tour guides (i.e., agents) using a multitask P–A model, with tips from customers and kickbacks from shops as main incentives. Corgnet, Gómez-Miñambres, and Hernán-González (2018) proposed a weak monetary incentive and replaced it with a nonmonetary incentive scheme to achieve balanced interests between the principal and agent.

Other hospitality studies have applied agency theory to parties either between the public and private sectors or within the private sector. Baum and Mudambi (1996) illustrated complex relationships among four parties (i.e., a government sponsor, local development agency, hotel enterprise, and financial intermediary) when performing risk sharing. In their research, the government (the principal) and a private hotel enterprise (the agent) aimed to maximize social (taxpayer) gains during the hotel development process. A second relational layer also existed in this scheme, namely that the local development authority acted as an agent on taxpayers' behalf. Liu and Xin (2013) conducted a similar study regarding a national tourism resource planning contract between the government and tourism developers in China and defined two layers of P–A relationships: local citizens versus local governance and local governance versus investors. Generally, the principal refers to the supplier that has the control and power to make decisions, whereas the agency implements the principal's choices (Harris & White, 2018). In other words, the principal's product will be bundled with an agent's service (value-added) and then sold to customers in the form of a final product. The P–A problem arises when both parties' interests are imbalanced.

Many scholars have considered P–A theory a top-down view of development. However, Steele and Scherrer (2018) examined relationships between host communities and volunteer tourism organizations from an opposite direction: they posited that the tourism organizations and

hosts were agents and the volunteer tourists were principals. In this case, the tourism organizations and hosts (agents) relied on volunteers' (principals') donations and payments for funding. Tourism suppliers can therefore be principals as well as agents, although their role largely depends on the direction of the supply chain flow. When a TA bundles various tourism products into a package and hotels supply one of the included products, the TA can act as the principal with the hotels as the supplying agents. However, when an individual hotel is the product source for distributors, the hotel serves as the principal. In a cruise industry context, the cruise company is the principal, and TAs act as agents; the cruise company's fundamental operational structure combines various tourism components (i.e., accommodation, transportation, entertainment, shopping, and dining) into one product. In other words, the cruise company (principal) rules over TAs (agents), and TAs sell products to travelers on cruise companies' behalf. Cruise companies are therefore the sources of products that distributors sell to tourists.

## METHODOLOGY

Most tourism research involving P–A relationships has been generic. The current study focuses on these relationships in the cruise industry. A qualitative approach involving interviews is the most appropriate means of obtaining an in-depth understanding of cruise companies' operations in China. The interviews were intended to explore cruise companies' business models as well as these companies' roles, relationships, and interests within the TSC network, guided by P–A theory.

## Triangulation Method

Triangulation originates from surveying; it aims to balance triangular views on a phenomenon, “where multiple measures from different vantage points are used to locate an object in space by creating a triangle of three points when only two points can be measured directly” (Heath, 2015, p. 639). Denzin (1978) outlined four types of triangulation, covering the method, investigator, theory, and data source. Method triangulation entails the use of multiple methods of data collection to address one phenomenon (Decrop, 1999; Denzin, 1978; Heath, 2015; Oppermann, 2000). Investigator triangulation involves two or more researchers, including confirmation of data analysis and findings (Archibald, 2016; Carter, Bryant-Lukosius, Dicenso, Blythe, & Neville, 2014; Decrop, 1999), who possess different backgrounds (Oppermann, 2000). Scholars have recommended adopting multiple theoretical perspectives during data analysis and interpretation (Decrop, 1999; Denzin, 1978; Guba & Lincoln, 1994; Oppermann, 2000). Data source triangulation involves multiple sources of data collection (Archibald, 2016; Decrop, 1999; Denzin, 1978), which can occur across time (Heath, 2015) or include various parties, such as individuals, groups, or communities (Carter et al., 2014). In-depth interviews are one of the most popular methods of data collection to achieve data source triangulation (Carter et al., 2014). Perspective and epistemological dialogues are additional triangulation dimensions (Archibald, 2016; Hammersley, 2008). Flick (1992) revisited Denzin’s (1978) definition of triangulation and proposed “systematic triangulation of perspective” as an alternative triangulation approach to combine multiple perspectives in a study; the key is “to explore the structural aspects of the problem... which can capture the essential elements of its meaning to those involved...” (Flick, 1992, p. 183). In other words, Flick (1992) suggested a systematic approach to triangulate a study with theory through comparative or conversation analyses to underpin a phenomenon.

Flick, Garms-Homolová, Herrmann, Kuck, and Röhnsch (2012) adopted this method and illustrated how diverse perspectives (of nurses, doctors, and patients in their case) could be linked through an embedded design. The present study follows this systematic triangulation of perspectives by incorporating several viewpoints from cruise management companies, Chinese TAs, and HK TAs through epistemological dialogue to build upon knowledge from the literature.

### Research Design and Researcher as an Instrument

The research design is critical to achieving triangulation. In this study, in-depth interviews were used as the primary means of data collection. Interviewees represented cruise companies (principals) and TAs (agents) in HK and China. Some cruise companies' corporate offices were in HK while their sales or related departments were in China. The same circumstance applied to TAs: some had sub-agents (or partners) in China. HK-based interviewees were recruited to provide a clearer understanding of cruise business models in general. In this way, the researchers were able to pinpoint nuances in business models and practices among the markets in China, HK, and elsewhere.

Interview questions covered three main topics: (1) participants' backgrounds, (2) the current cruise market situation and distribution methods, and (3) participants' perspectives on the other party (i.e., principal or agent, depending on each participant's role). Additional questions were posed during interviews as needed to gather richer information about the phenomenon of interest. Questions involved companies' distribution and commission models, the evolution of the business environment and resultant interference in companies' business strategies, and the relationships among individual parties (i.e., principals, intermediaries, or sub-agents).

The investigators carefully attended to the research design, process, and transformation of data into knowledge. The primary investigator has over 15 years of revenue management experience in the hospitality industry, mainly in the Asia Pacific region (including HK and China), and possesses fundamental knowledge about TAs' roles in terms of their business models and practices. These characteristics added value to the study's hotel industry comparisons. The second investigator has research expertise in cruise industry development in the greater China region and has advised regional governments on their travel agency operations. Both investigators provided in-depth insight based on the study findings.

#### Participants and Data Analysis

Interviews were conducted in November and December 2019. Data saturation occurred after 20 interviews, although additional interviews were performed to increase the validity and reliability of results. During interviews, interviewees' words and meaning were constantly recapped and rephrased to avoid any misunderstanding. Twenty-three participants were recruited through the investigators' professional networks and snowball sampling. The sample included 10 employees from TAs and 13 from cruise companies (including specialized cruise consultancy firms and cruise shipbuilders). [Supplement Table 1](#) outlines the participants' profiles. Most participants held managerial positions (e.g., managers, directors, or chief executives). Two revenue analysts from cruise companies were interviewed to obtain different perspectives; these analysts provided useful information related to the distribution channel mix. Three participants had less than 3 years of cruise product experience. Interviewee 1 worked in a small TA in China; the participant had previously sold all travel products and was recently put in charge of cruise products. As the owner of a TA, Interviewee 2 recognized the cruise market's potential and had

decided to expand her business to include the cruise sector. Interviewee 3 was a revenue analyst who had recently joined a cruise company. Overall, participants' average experience in the cruise industry spanned 9.2 years.

Telephone interviews were conducted in interviewees' preferred language (either English, Mandarin, or Cantonese) and recorded with participants' consent. Each discussion topic was summarized and transcribed in English. Content analysis was performed, and all data were organized in NVivo 12.0 software. Codes were sorted, and themes were manually categorized after rereading interview transcripts and listening to the audio recordings several times. Four major thematic categories corresponded to the study's main findings: (1) the business environment and its evolution, (2) travelers' preferences and behavior, (3) cruise business models and commission, and (4) the roles and responsibilities of principals and agents. A large amount of information overlapped and recurred; thus, interviewees summarized their stories individually during data classification. Themes were further divided based on market differences (i.e., among HK, China, and international markets). A cross-story analysis, separated by principals and agents, was also conducted to classify the data by headings/topics.

## FINDINGS AND DISCUSSION

TAs represent the main booking channel for cruise products because they offer the convenience of one-stop, personalized services. TAs are responsible for a sizeable proportion of travel bookings in China, largely due to citizens preferring group-based travel and for policy-related reasons. Most interviewees stated that at least 95% of their bookings came through intermediaries. A few interviewees thought this figure exceeded 98% in China, excluding gaming ships ("cruise-to-nowhere"), which are mainly for members. Only one international

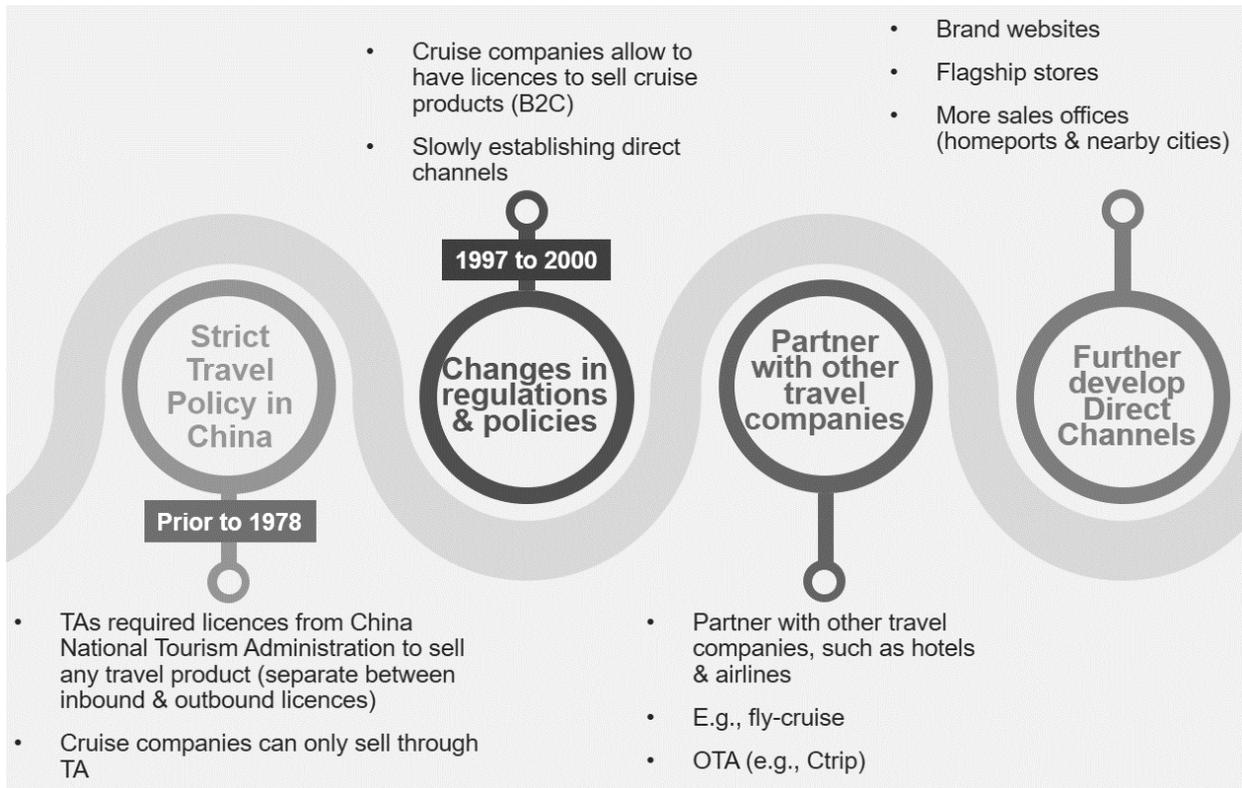
cruise company representative believed that roughly 75% of bookings were from intermediaries; the interviewee's company could potentially leverage its direct channels given its strong brand image and well-established online booking channels. Interviewee 12 explained that cruise companies struggle to receive direct bookings due to a lack of sales channels and investments (i.e., manpower) to cater to all available ships and itineraries. Training also appeared scarce despite being essential. Direct channels (i.e., call centers and websites) are inherently reactive. Yet product sales should be proactive, thus enabling intermediaries to leverage distribution channels more effectively. Within intermediaries' multiple distribution networks, including shops, hotlines, and websites, they have also invested in technology (i.e., mobile apps) and have allocated resources to cooperate with other sub-agents. Study findings are discussed in greater depth in the following section on the bases of content analysis, the investigators' prior knowledge, and the literature.

#### Tourism Evolution in China: Sales Channels and Travel Modes

Interviewee 14, who had 18 years' experience selling cruises in China, had witnessed changes in the country's cruise industry over time. In the early years, tourism business in China was somewhat strictly regulated. TAs were required to obtain permission or a license from the China National Tourism Administration to sell travel products, whether domestic/inbound or outbound (e.g., cruises). Cruise companies were purely cruise operators at that time, and only TAs could sell cruise products. This phenomenon explains TAs' strong influence throughout the Chinese market. The Chinese government only recently relaxed its licensing regulations and policies: cruise companies can now sell cruises directly to consumers. They have since begun to establish direct sales channels in China, including in partnership with other organizations (e.g.,

with airlines to bundle cruise and flight tickets). The next phase will involve expanding these direct channels, such as by creating brand websites in Chinese and opening flagship stores. Sales office locations will depend on companies' target markets and homeports. For example, with Shanghai as the homeport, cruise companies may consider opening an office near the city to attract residents from neighboring areas.

According to Travel China Guide (2019), the “real” development of China’s tourism industry began in 1978 when inbound travel was run by state-owned travel enterprises. Before 1997, TAs were entrenched in the business-to-business model. In 1997, as the internet developed, several leading TAs created websites (e.g., WarriorTour.com and TravelChinaGuide.com) to draw foreign travelers to China. By 2010, online sales in China represented 5.1% of the country’s annual tourism revenue (China Travel Guide, 2019). Although many Chinese travel websites were launched between 1997 and 2000, cruise-booking channels lagged somewhat behind. Cruising has a long international history but emerged relatively recently in China. **Figure 1** summarizes the evolution of China’s cruise sector, combining Chinese TAs’ and OTAs’ development timelines with interviewees’ responses.



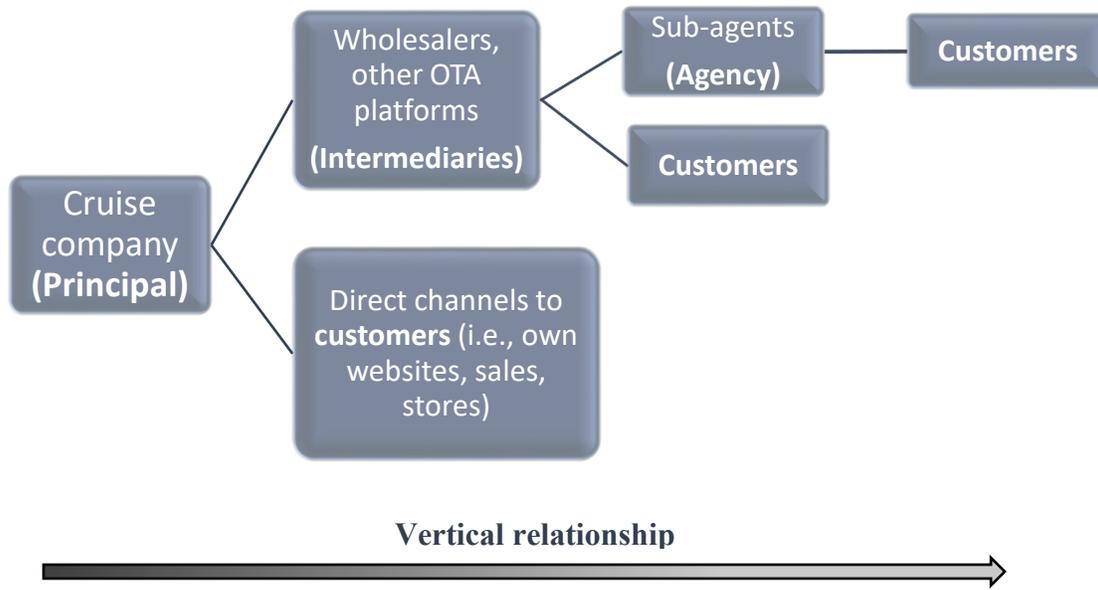
**Figure 1:** Cruise Industry Evolution in China

Stringent policies often complicate outbound travel. In many cases, Chinese citizens need to have a visa when visiting international destinations. They also tend to rely on TAs when making travel arrangements. Most of the time, tourists can acquire a visa more easily through group tours than individual trips. Although the Chinese government has eased these policies since the 1980s, tours or groups remain the preferred travel mode in much of China. Younger generations are an exception in that they may feel more comfortable traveling independently (Yao, 2016). According to McKinsey and Company's 2018 report on Chinese tourists, language is a key barrier when organizing a trip; however, this obstacle can be removed by booking through a TA (Dichter, Chen, Saxon, Yu, & Suo, 2018). Nearly all cruise passengers in China

reserve their trips through TAs in groups. Understanding Chinese citizens' preferences for group travel and the history of tourism in China can explain how TA business models have formed in the cruise industry.

#### P–A Relationship and Business Models

Prior to discussing TA business models specifically, it is necessary to understand the relationships among cruise companies, wholesalers, and sub-agents; these connections are best illustrated by the P–A relationship. [Figure 2](#) depicts the cruise product distribution flow between a principal and agency. A cruise company plays the role of a principal that sells its inventory either through direct channels (i.e., business-to-consumer) or intermediaries (i.e., business-to-business). Because these TAs also distribute their products to other sub-agents, they are known as “intermediate” agents or “wholesalers.” These intermediaries or wholesalers distribute their inventory to other distribution channel members, such as smaller-sized TAs (also called “sub-agents”) who are unable to bargain or interact directly with the principal. In a way, wholesalers leverage their risk to these sub-agents.



**Figure 2:** Business Flowchart for Cruise Products

The TA business model can be divided into two types, namely “block allotments” and “charter cruises” (Figure 3), as discussed in Sun et al. (2016).

#### *Group/Block Allotment*

The concept of group allotment is similar to hotel industry practices. TAs are bounded by two types of contracts. The first type involves pre-paid allotments, wherein TAs guarantee payment in full for agreed-upon blockage either per sailing (for a specific itinerary date), per ship (for a specific ship regardless of itinerary), or per season (e.g., winter); blockage terms are outlined in the contract. In these cases, TAs assume the risk of selling itineraries at their own cost (i.e., nonrefundable payment). The second type of allotment is pre-blocked with a deposit or nonguaranteed; under this type, TAs can release their inventory according to agreed-upon terms and conditions (i.e., a percentage of cabins within a certain number of days prior to departure).

Pre-blocking generally proceeds in phases. For instance, TAs can release 5% of their cabins 60

days before arrival for free or will otherwise incur a penalty. The next phase might open 30 days before departure, at which point TAs can release an additional 5% of their cabins for 30% of payment and so forth. Because TAs have more flexibility under the nonguaranteed option, the cabin rate is higher than the guaranteed rate. The hotel industry also has these guaranteed and nonguaranteed allotments.

Notably, cruises' wholesale rates are based on a commission (i.e., a percentage of the selling price) rather than a fixed wholesale price, which differs from hotel practices. Historically, hotels have applied two wholesale contract structures: a commission-based and fixed price. The fixed-rate structure varies either by season or is a year-round flat rate; applies to guaranteed and nonguaranteed allotments. For nonguaranteed allotments, hotels also have the right to reduce or close out an allotment within an agreed-upon timeframe with written notice. However, a rising number of hotels (especially international chains) are shifting away from this fixed-rate model. One of the main reasons for this move is that TAs often undercut hotel pricing or sell at a price lower than the hotel's best available rate. Problems can then arise for hotels regarding their best-price guarantee because their best available rate is dynamic. Instead, hotels ask TAs to provide direct connectivity for updated inventory and prices, which requires wholesalers' or TAs' systems to be connected to hotels' central reservation systems. TAs that do not have systems to support this technology may obtain their room inventory from OTAs. For example, Marriott International has partnered with Expedia as a redistributor for these TAs to obtain rates and availability (Marriott News Centre, 2019). In other words, hotels are moving away from a traditional fixed wholesale rate to a commission-based model.

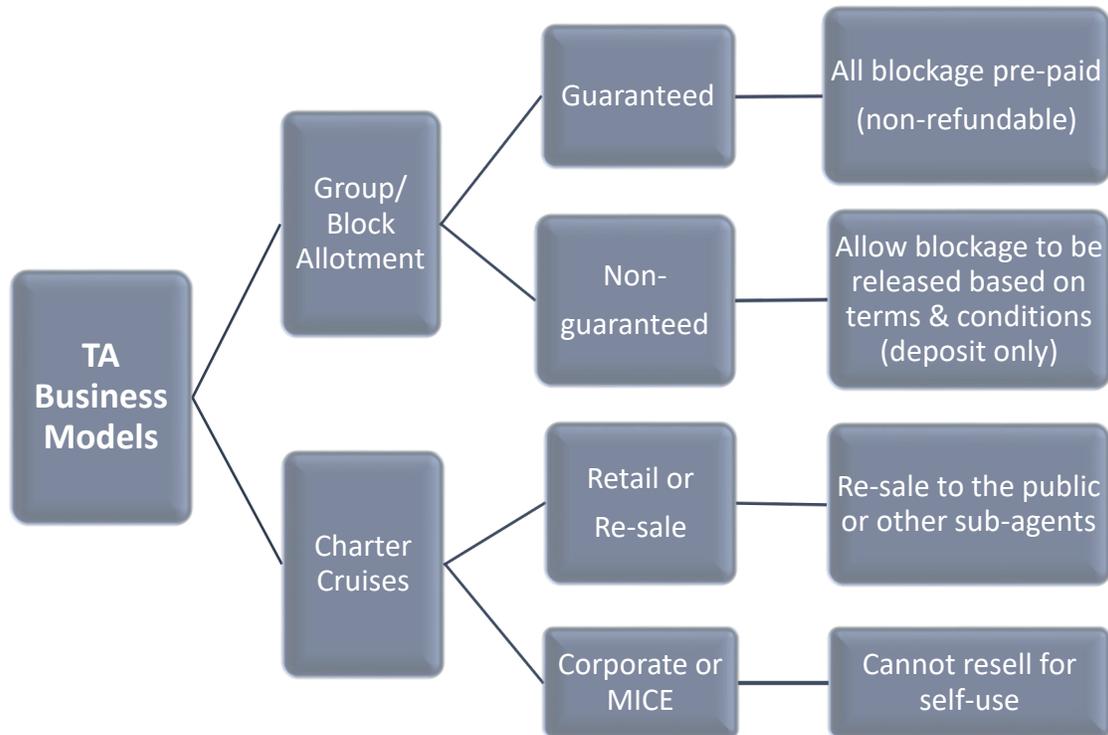
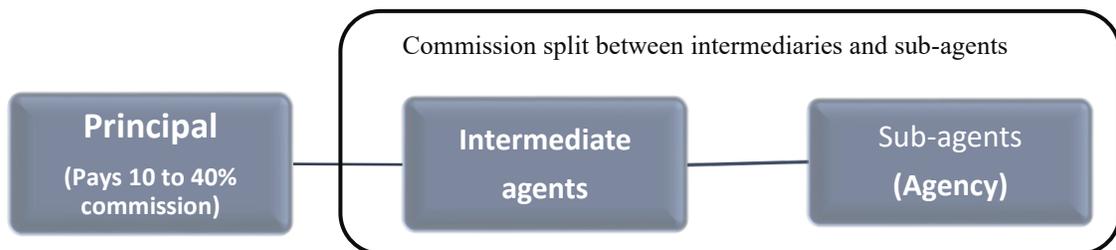


Figure 3: TA Business Models

Interviewees 8 and 22 shared that in the past, cruise companies provided TAs with a recommended retail price; however, given concerns about the competition law, stating a minimum selling rate can be illegal or unethical. The commission model, which is tied to dynamic pricing, was originally designed for smaller or mid-sized agents who did not have the negotiation power for a wholesale rate. International Association of Travel Agents members reportedly earned commissions ranging between about 10% and 15% for hotels and cruises. However, interviewees reported a wider range of commissions (i.e., from 3% to 40%) with discrepancies based on TAs' roles in the P-A relationship—whether they were intermediaries or sub-agents—and on the group block size (i.e., guaranteed or nonguaranteed). Interviewees 21 and 22 commented that the minimum cruise commission was normally 10%. Interviewees who

reported commissions in a lower range (i.e., below 10%) were mostly sub-agents; thus, they split their commissions with intermediaries.

**Figure 4** incorporates commissions into the P–A relationship model. The higher the commission percentage, the greater the allotment/risks TAs will assume. For cases with commissions as high as 40%, TAs include additional incentives in their calculations. Supplementary incentives from cruise companies are meant to motivate loyal or top producers to sell more, particularly during slow periods. Occasionally, incentives are structured based on incremental sales. For instance, TAs may earn a 10% commission on the first 100 cabins sold and an additional 10% commission on the next 100 cabins. This incentive strategy also exists in the hotel industry, but only for selected TAs during extremely slow periods. The benefit of this dynamic commission method is that TAs are encouraged to sell more, resulting in a win-win arrangement. By contrast, with a higher fixed commission, the agency earns more, but the benefit does not necessarily apply to the principal.



**Figure 4:** Commission in the P–A Relationship

### *Charter Cruises*

The second model is charter cruises. This format is somewhat similar to a guaranteed blockage but on a larger scale, specifically an entire ship. A wholesaler “buys out” the entire cruise ship from the principal in this model. The cruise company is only responsible for

operating the ship, including onboard services. In other words, ticket revenue is secured, and ship operators can still earn revenue through onboard facilities and activities. Cruise companies usually sell charter cruises on a per-diem basis (i.e., average rate per passenger per night) regardless of cabin type (Interviewee 22). The total charge is based on this fixed per-diem rate according to the expected number of passengers and number of sailing nights. Agents can propose an itinerary, and the cruise company will assist in planning. In addition, TAs need to pay port charges (depending on the itinerary/destination) and gratuities (depending on the number of nights). Take, for example, a cruise company that charges US \$180 per diem for 2,000 passengers for a 5-day/4-night itinerary: TAs must pay US \$1.44 million in total ( $2,000 \text{ passengers} \times \text{US } \$180 \times 4 \text{ nights}$ ). In an extreme case, if the TAs cannot sell any cabins, then they must pay US \$1.44 million in addition to the onboard revenue, port charges, and gratuities for the expected 2,000 passengers. Consider an arrangement involving a port charge of US \$25 per port per person with two ports of call (i.e., US \$50 per person), gratuities per sailing per person of roughly US \$20 per night (i.e., US \$80 per person for a 4-night trip), and onboard revenue per sailing per person of about US \$50 (i.e., US \$200 per person for a 4-night trip). For this cruise, TAs will be charged a total of US \$2.1 million (per-diem cabin fee + onboard revenue + port charges/gratuities). Hence, the risk for TAs is extremely high under this model.

Corporate or meetings, incentives, conferences, and exhibitions (MICE) cruises differ slightly from retail charter cruises because the latter follow a business-to-consumer model. With corporate/MICE cruises, business buyers are the end users because they do not resell cabins. Examples of business cruise end users include insurance companies, pharmaceutical companies, and government officials (Interviewee 12). Interviewee 12 favored cruises over other traditional meeting venues, such as hotels or resorts, due to convenience. From a corporate company and

event organizer perspective, a cruise package includes the cost of transportation (to multiple destinations), food and beverage, accommodation, and activities. Interviewee 12 also stated that a ship offers more facilities and activities than a hotel. Furthermore, the organizer has greater control over the budget and event attendance because all attendees are on board a private, enclosed ship. Depending on group size, MICE cruises can be performed through partial blocks or a full charter cruise. With a group of approximately 1,000 attendees, organizers can choose the partial block mode, which is similar to a group allotment. Attendees share facilities with other (non-MICE) guests on the ship. This arrangement requires advanced and detailed planning and coordination with onboard operators to schedule meeting facilities and activities, such as reserving a theatre for opening and closing ceremonies without disturbing other guests. The event holder will be charged according to cabin type, with additional fees for meeting facilities and exclusive events, similar to hotel MICE arrangements. For a group of about 3,000 guests, a charter ship can be booked exclusively for a MICE cruise. This business model is identical to that for a retail charter cruise. MICE offers a potential market for cruises, which can boost cabin occupancy to generate revenue while increasing onboard revenue through chargeable events (i.e., activities) and items (i.e., meeting facilities).

Any additional benefits offered by a principal to the market also apply to TAs. If a cruise company decides to offer additional onboard credits and/or free cabin upgrades on ticket prices, then TAs can take advantage of the same promotions, which is unique from hotel practices.

### Business Practices in China

Apart from the business models displayed in [Figure 3](#), China has an additional model: ship rentals. Under block allotments, China's allotment size is often larger than that of HK and

international markets. Chinese travelers favor group tours, and TAs arrange shore excursions. Cruise companies also allow TAs to arrange tours and excursions in exchange for additional blocked cabins. Moreover, these cruise companies are rarely based in China and generally rely on local agents for information (e.g., supply chain information flow) due to their lack of understanding and research about the Chinese market. Most cruise lines have either adopted a low-price strategy or have been forced to do so due to market competition; the consequence is attracting customers who may not generate as much profit. Approximately 80% of itineraries departing from China are nearly identical, with Japan as the most popular destination. Shore excursions in Japan mainly involve shopping due to compensation arrangements between local shops and TAs. As such, only 10% of Chinese cruisers are repeat customers because the tours involve uninteresting itineraries and activities. These China-specific phenomena are explored further in the following sections.

### *Low-price Strategy*

Cruise companies cannot control TAs' resale prices; thus, rock-bottom ticket prices are common in the market during slow periods to book ship space (Interviewees 14, 17, and 23). Interviewee 2 noticed an extremely low cruise fare of RMB \$50 per diem (US \$7 per person per day), which attracted “*da-ma*” (highly price-sensitive middle-aged women from lower-tier Chinese cities). Such instances can immediately alter a cruise company's brand image, reputation, and profit margin. Given this low-price strategy and the fact that Chinese travelers prefer to drink hot tea over alcoholic beverages, onboard revenue is also lower than for other international cruise sailings. Cruise lines must therefore cut costs to earn a profit, leading to low-quality food and service. Cost-cutting measures ultimately compromise tourists' perceptions of

cruising; travelers view it as a disappointing experience rather than a luxury. Interviewee 9 complained that some international cruise companies purposely adopt low-price strategies to gain market share in China given that their main sources of revenue are outside Asia. Yet this strategy has been unsuccessful as evidenced by Norwegian Cruise Line's exit from China in 2018.

Many cruise companies operating in China rely excessively on TAs, which inspires low-price strategies (Interviewee 15). They therefore no longer use the resale charter business model that was popular between 2011 and 2016 (Interviewee 21). Surging supply growth caused one leading cruise company to abandon this model to protect its brand image. Interestingly, other TA representatives (Interviewees 14, 16, and 18) provided contradictory observations that cruise companies have continued to offer low-price strategies to the market during low seasons. The interviewees further added that if demand is low, companies will do anything to earn revenue, aiming to cover costs as much as possible.

#### *Shore Excursions Arranged by TAs*

TAs in China greatly influence cruise product distribution and possess considerable bargaining power when negotiating wholesale prices. They provide all travel arrangements during a trip to facilitate all-inclusive service. Travelers' experiences encompass pick-up, embarkation, group shore excursions, and disembarkation, including drop-off (Interviewees 1, 14, 15, and 17). TAs do not charge for shopping-dominant shore excursions because they receive commissions from shop owners, sometimes with additional incentives (Interviewees 14 and 15). TAs' operations are somewhat similar to "zero-fare" tours, where tour operators rely on commissions and kickbacks based on tourists' destination expenditure (Chen, Mak, & Guo,

2011). Interviewee 14 explained that TAs can earn an average of US \$20 per passenger per day; over a 5-day itinerary, TAs can make more than US \$100 per passenger from on-shore shopping alone. Cruise companies cannot earn revenue from shore excursion sales. As a compromise, companies allow TAs to organize shore excursions and encourage agents to sell balcony or higher cabin categories. Cruise companies would prefer to host more passengers (higher occupancy) than to run an empty ship during slow seasons.

### *Ship Rental*

Interviewee 7, who was responsible for setting resale cabin prices and sourcing itineraries for the HK market, observed another unique way for cruise companies to earn revenue: by leasing their ships to other companies to operate in China. This idea is similar to one- to two-year ship rentals in that all onboard services and crew do not belong to (and are not managed by) the owning company. The leasees are effectively running their own cruise company, unlike charter cruises whose itineraries are arranged by the cruise company. Interviewee 7 recalled, “A few years back, Beijing Caesar had a chartered MSC ship [that was] run by a Chinese firm for a year.” Interviewee 4 was in the process of designing and building the company’s own ship to operate in China. This rental approach represents a strategic decision to gain operational experience and test the market (via a low-risk investment) before officially launching a cruise company.

### *Agency’s Power over the Principal*

The cruise market has expanded considerably over the past decade, especially in China. Nearly half of interviewees expected China to enjoy another 10 golden years as more ships and

competitors enter the market. The remaining interviewees were concerned about oversupply; they believed it would elicit firm rivalry and additional reliance on TAs for demand.

#### *Principals' Over-reliance on Agents to Create Demand*

Almost all TA interviewees remarked that cruise companies' marketing efforts in China were lacking. Principals have apparently devoted insufficient time and investment to marketing. Relevant tasks are generally assigned to TAs; local TAs create most advertisements, including translating brochures into local languages. Cruising is also a new travel experience in China. Between potential customers lacking product-related knowledge and Chinese tourists' preference, cruise lines must rely heavily on TAs. TAs can therefore evoke demand indirectly and decide where such demand is directed. The choice to shift demand toward a particular cruise liner depends on the appeal of TAs' associated incentives and relationships, which exacerbates the P–A power imbalance.

#### *Increase in Rivals Creating Greater Power Imbalance Between Parties*

China's market circumstances have changed drastically since 2017 due to surplus supply as a growing number of international cruise companies enter China. The growth of supply has exceeded that of demand. As such, TAs demand an extremely low per-diem rate. Interviewee 21 contended that no firm wishes to sell products at low prices; however, many cruise companies are desperate to gain market share without truly understanding local consumer behavior, resulting in low-price strategies. Interviewees 1, 2, and 22 echoed this sentiment regarding the negative effects of low prices. As an example, Norwegian Cruise Line adopted this strategy and failed to find success in the Chinese market.

Price wars among cruise companies have granted TAs opportunities to cooperate in negotiating better prices. Interviewee 21 added that the market situation has become increasingly challenging since 2017, with many TAs either downsizing their departments or ceasing to sell cruise products altogether. Some companies have even disappeared. Yet China is a large market: new TAs enter as others leave. Many TAs also remain interested in the cruise business despite market difficulties. Although the market is not as promising as it was before 2017, there remains room for improvement. Royal Caribbean Cruises, a pioneer in the Chinese market that has established a well-reputed brand over the past 10 years, eliminated its resale charter business model to prevent TAs from setting extremely low prices. The company also invested substantial time and effort into market research and advertising in China.

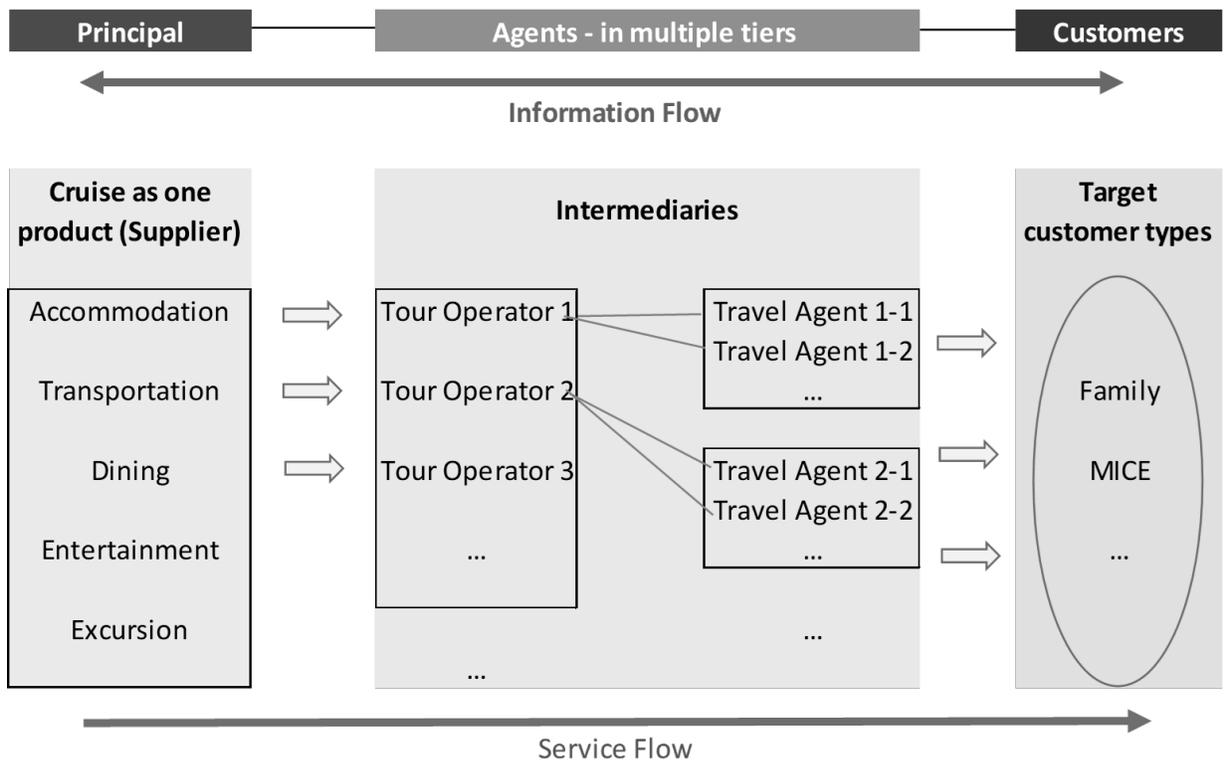
#### *Agent Relationships and Alliances*

Although the basic business principles in China and HK are fundamentally similar, these markets prefer different models due to P–A relationships and local travelers’ behavior and preferences. For instance, the P–A relationship in China is distinct from that in HK and other international markets: principals over-rely on agents for market feedback (information flow), which affords agents excessive power along with opportunities to develop alliances and bargains with principals for better deals. In terms of size, any TA in North America who can block 50 cabins per sailing is considered a large agency. In China, however, TAs’ average blockage involves at least 100 cabins per cruise (Interviewee 21). Interviewee 22 shared her experience dealing with TAs in Asia and noted that those from Taiwan and China tend to be united. Her office in Taiwan formed alliances with competitors (i.e., other TAs) to charter a ship together and split their revenue based on the ratio or percentage of business. Her China division team

worked indirectly with competitors (TAs) to align market information against the principal. This scenario would not arise in HK or other international markets due to competition law/regulations and the fact that TAs compete directly. Another common practice among Chinese TAs, which they first adopted with hotels but have since applied to the cruise industry, involves withholding the room list (i.e., customers' names) until principals drop their prices to obtain a higher profit margin.

### Redefined TSC Specifically for Cruise Products

Cruise products are composed of accommodation, transportation, excursion, dining, and entertainment aspects, which represent the Tier-1 suppliers in [Supplement Figure 1](#). This study aims to review the supply chain network among cruise companies, their distribution agents or intermediaries (i.e., TAs), and travelers (end users); hence, a modified TSC tailored to cruise products is presented in [Figure 5](#). This network structure incorporates P–A theory to contextualize the depicted relationships. The service flow moves from a principal (cruise company) to intermediaries (tour operators and/or travel agents) and finally to end users (customers). These intermediaries' roles as product distributors can span multiple tiers before products are delivered to consumers. TAs also understand the cruise market better than principals and maintain direct contact with end users; therefore, a mutual agreement will ideally exist for sharing information, risks, and rewards to foster healthy and enduring relationships (i.e., throughout supply chain activities). The arrow denoting information flow should therefore be bidirectional rather than unidirectional under the cruise TSC model ([Figure 5](#)).



**Figure 5:** Cruise Supply Chain Model

However, an imbalanced relationship exists between the cruise companies and intermediaries associated with market supply and demand in China. **Supplement Figure 2** elaborates upon the top portion of **Figure 5**, illustrating the Chinese cruise industry's current status. Information breakage is apparent between agents and principals: the cruise supply in China has increased dramatically over the past two years, outpacing demand growth. Agents thus play critical roles in the cruise supply chain due to a lack of knowledge among other industry stakeholders: (a) consumers, regarding cruise products; and (b) principals, regarding the cruise market. Agent-based alliances in China further reinforce agents' imbalance of power over their principals.

## CONCLUSION

China is at the forefront of the world's growing cruise market. As Interviewee 21 stated, "Population is the key weapon for China." However, exactly how to stimulate market demand remains unclear. An insufficient understanding of Chinese culture and travel behavior spurred Norwegian Cruise Line's failure in China. Imbalanced interests are evident between principals and agents in China: the relationships are generally short-term and transactional instead of long-term and relational. Ideally, the parties should share a common goal with a focus on customer satisfaction. However, low-price strategies often drive principals to cover costs by reducing food and service quality, resulting in poor cruising experiences. Chinese agents tend to cooperate with one another for better deals rather than sharing accurate risk information and industry insights with principals. This practice could have worrisome industry consequences if it continues, particularly given anticipated increases in supply.

In view of P-A theory, collaboration among TAs has led agents to wield power over principals, who rely considerably on agents to create market demand. To enhance principals' level of power, cruise companies should conduct in-depth research into the Chinese market and emphasize direct marketing and promotion. Travelers' expectations and experiences will likely be misaligned if firms do not have comprehensive communication with, or a clear understanding of, their customers. Interviewee 2 pointed out that the principal must source quality agencies from thousands of agencies in China. Rather than hiring agencies who offer volume, the principal should focus on appropriate customer types. In one strategic move, a cruise line could affiliate with a reputable local firm (e.g., a TA) to quickly gain market insight and leverage the TA's resources and networks to increase the cruise line's competitive advantages. For example,

Royal Caribbean Cruises and Ctrip established the SkySea Cruise Line Joint Venture in 2015, a strategic P–A alliance focused on China’s emerging cruise market.

This study used a triangulation approach with multiple data sources and perspectives (i.e., principal, agent, and emic perspectives) to explore the rationale behind the focal phenomenon and present relevant findings. This study enriches the knowledge base around the history of cruise development in China, namely by explaining why TAs constitute the primary booking channel. It further explains TAs’ unique operational characteristics. Group/block allotment and charter cruises are TAs’ two main business models, with ship rentals serving as an additional business form in the Chinese market. These models are derived from the market’s common travel mode and preferences. Chinese TAs arrange cruises from beginning to end, including shore excursions. The hotel industry has undergone the same TSC with TAs as the major distributor. However, as China’s cruise market matures and prices become transparent, consumers may prefer to book through either OTAs or suppliers directly. Subsequent studies could investigate how the cruise industry can communicate effectively with end users, shift booking channels from traditional TAs to OTAs and/or direct bookings, and regain power in the P–A relationship.

A cruise supply chain model was developed based on the results of this study. Future research could test the applicability of this model within other Asian or emerging markets. Taiwan is Asia’s second largest source market, followed by Singapore and Japan (CLIA, 2018). Cruise business models and P–A relationships in other markets warrant consideration. Instead of focusing on the supplier side (i.e., cruise companies and agents), further exploration into Chinese cruisers’ experiences when booking trips and taking cruises could facilitate strategy development to promote a win-win-win situation for principals, agents, and consumers.

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