



Economics without tears

Why all destinations can learn from resorts

Daniel Anderson, LDR's Economics Commentator, considers the evidence and argues that resorts provide a perfect example of business planning and management to all destination developers.

In a recent workshop with the developer of a large-scale resort community, I was reminded of how useful resorts can be to illustrate and test important economic theories. Over the course of two days, we discussed the value generated by exclusivity in access to golf courses and marinas. At the same time, how could we capture the discretionary spend of visitors, without devaluing the membership? We talked about the allocation of infrastructure and service costs. Should these be rolled into house prices and if so which?

What costs should be covered by the standard service charge and which ones should be calculated on a pay-as-you-go basis? These are just textbook examples of price discrimination and the theory of public goods.

Indeed, resorts have always been fruitful territory for understanding the economy in general, let alone the economics of destinations. Just recently, in an article on neuroscience and economics, Camerer et al considered – amongst other things – the willingness of people to pay for all-in-one resort holidays and applied those lessons to all sorts of prepayment, such as fixed fee utilities contracts or prepaid telephone plans. They took this as evidence that given the right set of circumstances; people could be induced to act 'irrationally', for example by routinely paying over the odds for their vacations, their gas bills or their phones. It is a very powerful article. They used lab rats and CAT scans, which economists hardly ever get to play with.

One of my favourites is the textbook lesson on sunk costs offered by the all-you-can-eat buffet – which destination developers would do well to heed. Put simply, stuffing your face with mangoes and stealing all of the bacon bits from the salad bar does not – despite what

many claim – help you to 'get your money's worth'. Once you're full, you're full. Eating any more after that simply decreases your utility. Plus it leaves society worse off, because you've left us all with fewer mangoes and bacon bits. The money you paid at the outset is a 'sunk cost'. The only thing that should inform your purchasing decisions today is expected future outcomes, not the decisions you made yesterday. So continuing with projects long after it has become clear that they will not work simply because too much money has been invested to stop – and I can think of two coming out of the ground as I write this – is about as sensible as gorging yourself on mangoes and bacon bits for no good reason. Which is to say, not very sensible at all.

Integration

There is a particular feature of resorts, however, that has not been exhaustively studied and could, in my opinion, shed considerable light on the way to develop destinations of all kinds: the principle of integration.

'Integration' has been a buzzword of the destination business for years, but as far as I can tell, it is only the resorts that actually live up to it. The idea is that all parts of a given destination – the attraction, accommodation, restaurants, shops, offices, homes, etc. – contribute to the overall experience and should therefore be considered in harmony.

It is extremely frustrating for me and my colleagues when we come to a project late, because the destination has already been carved up into different little fiefdoms. Not only does this result in a lack of coordination within the destination and internal competition between different tenants, it also introduces a classic 'freerider' problem. Nobody wants to take responsibility for maintaining and programming the spaces in between – the public realm, the foyers – because they would incur additional cost, yet every organisation within the



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destination would benefit. The question each stakeholder invariably asks himself is, 'why should I do it?' From a visitor's perspective, the result is a destination that looks and feels clumsy, fragmented and uninviting.

Resorts don't have this problem, because they start from the principle that everything will be integrated. Whether it is a singularly managed resort in the Alps or the Med, the Las Vegas casino or the all-inclusive in Cancun, what they offer is a rounded, complete experience that includes leisure, retail, catering and accommodation. As a result, they have the ability to lever different parts of the business in a way that maximises profit.

Casinos and cruise ships

In Las Vegas, every part of the casino is subservient to the gaming. Gambling is the golden goose and everything else aims to feed it. The price of a hotel room in any of the major casinos is determined by a computerised system operating a virtual spot market that tries to fill as many rooms as possible. So the price can change from one hour to the next – if demand drops, the price goes down; as occupancy rises, so does the price.

The casinos will also spend fortunes on bringing in blockbuster events and entertainment. Celine Dion earns the GDP of a small country for warbling that annoying song from Titanic three times a week. MGM spent so much on the set for Cirque du Soleil's *Ka* show at the Grand that it will need to run at 95% of capacity for ten years just to recover its costs. And then there is the catering – if you are there to gamble, you'd be a real schmuck actually to pay for a meal. They will comp you as many waffles as you can eat if you're a player. The endgame is always the same: keep them gambling. Mr Burns described it best when he opened a casino in Springfield. 'I've discovered the perfect business,' he said. 'They come in, they empty their pockets and then they go home.'

If the cost of accommodation means very little to a Las Vegas casino, it means everything to a cruise ship in the Caribbean. For them, the cost of all you consume is rolled into the room rate. As a consumer, you are left with the illusion of paying over the odds for a luxurious room in a floating palace, but have everything else for 'free'.

If you stop and think about it, you know that it isn't really free, but generally speaking you tend to behave as if it is.

The point of integration is that when a single organisation runs the whole destination, it can determine what parts generate the most value and manage its portfolio accordingly. A theme park may break even on the rides, but make a huge profit on its concessions. The main concern of a shopping centre is dwell time. The longer you stay, the more you shop, the more you eat. So they will develop anchor attractions like ski slopes and ice rinks that only ever need to break even. For what's a dad to do while the kids are schussing down a slope? Oooooo...Apple Store!

Even ski resorts are getting to grips with this. They used to be all about rented chalets and lift tickets. Then they realised that the summer season was attracting fewer people, but they were staying longer and were more interested in buying a house than renting a room. Now the ski season has become a comfortable little earner before the property boom in the summer.



Ownership and management

For truly integrated destinations like resorts this is all a basic part of the business model. Integration works. Why then, can't we adapt these same principles to the other destinations we develop?

The obvious answer is because we rarely develop destinations in single ownership. Nowadays it seems that every new attraction is part of a mixed-use development. We carve up the plans with our red markers and every part of the destination is expected to be self-sufficient. The value-generating bits of the destination are there to create profit for their owners, not to cross-subsidise loss leaders. As a result, you get arts organisations running shops and restaurants, while commercial tenants run competing shops and restaurants that are in no way sympathetic to an artsy destination. The residents can't hear themselves think about their rising house prices for all the noise made by the pesky tourists. And nobody cares to do anything with the windswept, litter-filled piazza outside because that should be someone else's responsibility.

I am loath to be too critical, however. It is a tough nut to crack. Just recently, I was asked to look at a visitor attraction within

a mixed-use development. I have been involved with this project for more than a year and the whole time I've been preaching the Gospel of Integration with the fervour of a bible-bashing zealot. Then I was asked to write the business plan for the attraction. The minute I put my business planning hat on, I reverted to type – in came the admission charge, I found some space for a café, I put in a shop and I considered all of the lucrative conferencing that could happen.

It is hardwired into my feeble consultant's brain that a visitor attraction has to generate enough income to cover all of its costs. In other words, I was drawing a big red line around my territory in the plans. It took a final re-read after a boozy lunch and an alcohol-induced moment of clarity for me to realise that I had completely ignored my own advice. It is such a slippery slope.

At the very last minute, I re-opened the document and simply struck out all of the income lines. The plan is now to meet the developer with an idea of what the attraction itself will cost to operate. I won't take any catering income; he can take all of the retail; he is free to use the attraction for a conferencing business that he can operate himself.

The attraction is designed to do one thing and one thing only: to attract footfall and create brand value. That has a cost. It is up to him to determine how much that footfall is worth and what level of cost can be borne within the business plan for the development as a whole.

The root of the problem is that you've got individual managers trying to look after individual components. The best resorts, on the other hand, all have robust management plans in place. By taking a singular view of the business, resort managers are able to deliver the right mix of facilities, which in turn allows the resort to develop a true sense of place. A good management plan also helps keep these facilities healthy in the long term, keeping present and future investors happy.

When you consider all the benefits, it really is time for more destination developers to start thinking and acting like resorts.

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