

# Ethnic Specialization of Travel Agencies

*Alexander Kons*

The travel agent market has undergone some severe shocks in the past few years. Continuously, the major airlines in the United States have cut down the commissions that travel agents receive for booking travelers on the airlines' flights, which are a percentage of the total cost of the ticket. This represents a major problem for travel agents, because airline commissions are by far their highest source of revenue. Despite the fact that travel agents account for eighty percent of the airline tickets sold in America, most U.S. Airlines feel that commission levels are one of the few areas left where airlines can lower costs. Additionally, most U.S. airlines believe that new technological advances, such as flight booking by the consumer via the Internet, will cause the airlines to become less reliant on travel agents for passengers. Since the travel agent market is a perfectly competitive market, each travel agent is bound to take the commission that the airline offers. As U.S. airlines have continued to cut commissions, many travel agencies have been forced to leave the market due to excessive costs. However just as some travel agencies have closed, there has been a steady growth of new, specialized travel agencies within the ethnic neighborhoods of America, who have enjoyed great success and profits. Many of the travel agents that were forced out of the domestic travel agency business by U.S. airlines have found that there are profits to be made by specializing in serving the travel needs of ethnic groups.

Over the past twenty years, there has been a large increase in the number of people immigrating to the United States from areas like Central America, Eastern Europe, and the Far East. Many of these immigrants want to frequently travel back to their native lands, but dislike the hassle of making travel arrangements with travel agencies that do not speak their language or understand their culture. Some of the travel agencies that have been driven out of business by the decreasing commissions from U.S. airlines have seen a new market in arranging the travel needs of the immigrants. Therefore, these travel agencies have trained their agents to speak the

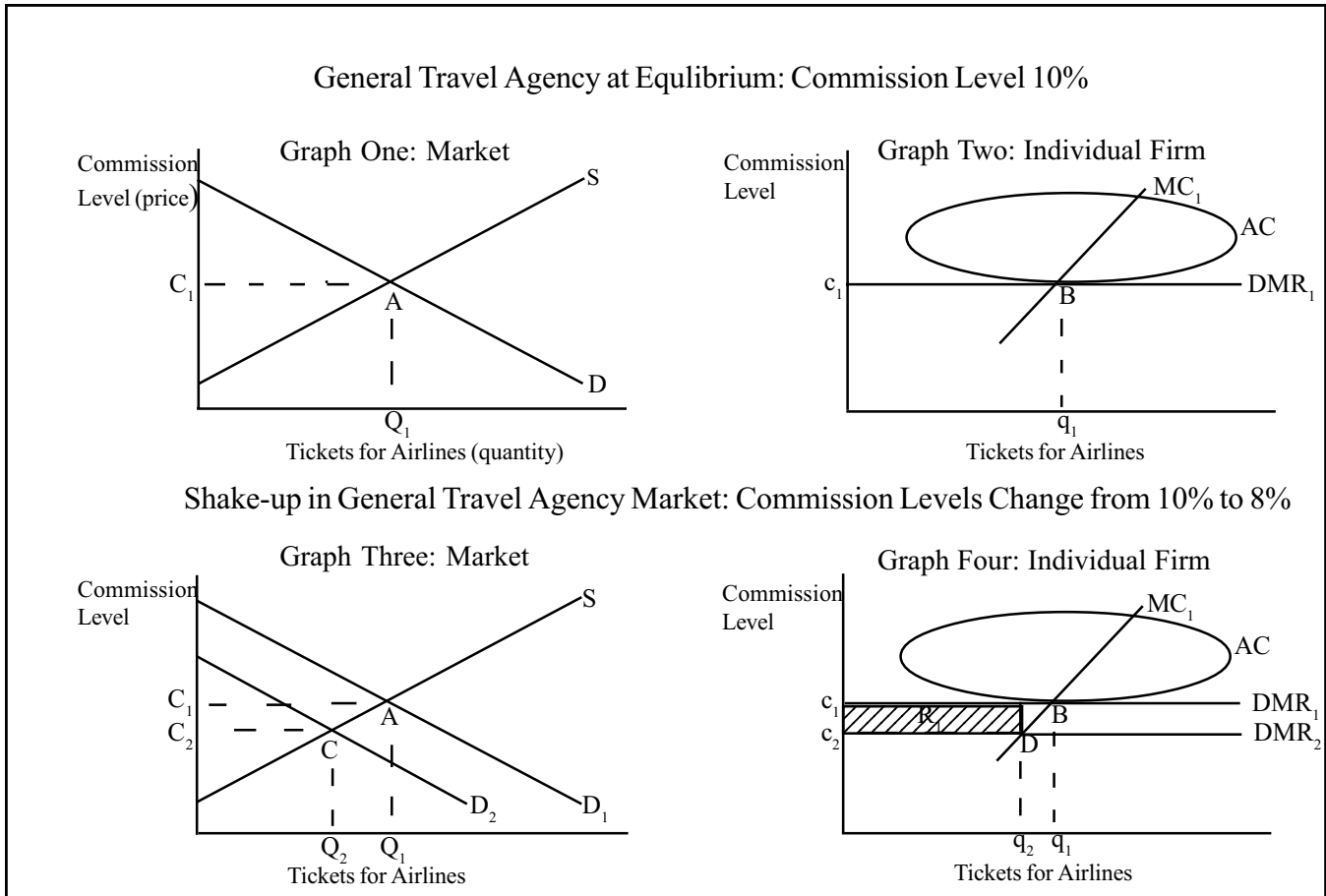
language of a particular ethnic group and opened offices in the ethnic neighborhoods in major cities, since most immigrants appreciate a travel agency that speaks their native language and is located near their residence. The reason these specialized travel agents are making profits is because almost all of the immigrants they handle fly their native country's airline when flying to their homeland. These ethnic specialized travel agents almost always book the immigrants on flights from their native country's airline. This is usually what the immigrants want, because they feel a certain amount of comfort and familiarity in flying with their "native airline." Not only does this make the immigrants happy, it's also beneficial for the travel agencies. The commissions that the travel agents receive from foreign airlines are usually double what the commissions are for the United States' major airlines. For, most foreign carriers are more reliant on travel agents to do business for them in the United States. For example, the commission for a travel agency that books Mexican immigrants on Mexico's major airline Mexicana is nearly sixteen percent. This is compared to only an eight percent commission rate that travel agencies would receive for the same flights on a U.S. airline. General travel agencies cannot take advantage of higher commission rates of foreign airlines, because they receive very few customers whose travel needs call for foreign airlines. By catering to the needs of a particular ethnic group, these travel agents are able to make profits that they could not have made in general travel. To clarify, a general travel agency is one that does not specialize in the needs of any one nationality.

In order to fully appreciate the entrepreneurship shown by the ethnic specializing travel agencies, it is necessary to show the relationship between the decline in the general travel agency market and the growth of new specialized travel agencies. Throughout this model, the demand curve represents the amount of airline tickets that the airlines require from the travel agencies, while the supply curve represents the amount of airline tickets that the travel

agencies supply to the airlines. Therefore, price is actually the commission level that the airlines are willing to offer to the travel agencies. Also, consider the average costs of a specialized and non-specialized agency to be equivalent. Graph One shows the demand and supply curve for the entire general travel agency market at a commission level of ten percent, while

so it is making a normal profit. At a commission level of ten percent, the general travel agency market is at equilibrium for a perfectly competitive market.

Now it is announced that the U.S. airlines have decided to cut the travel agents' commissions down to eight percent. The airlines feel that they are less reliant on travel agencies to get passengers, so they reduce

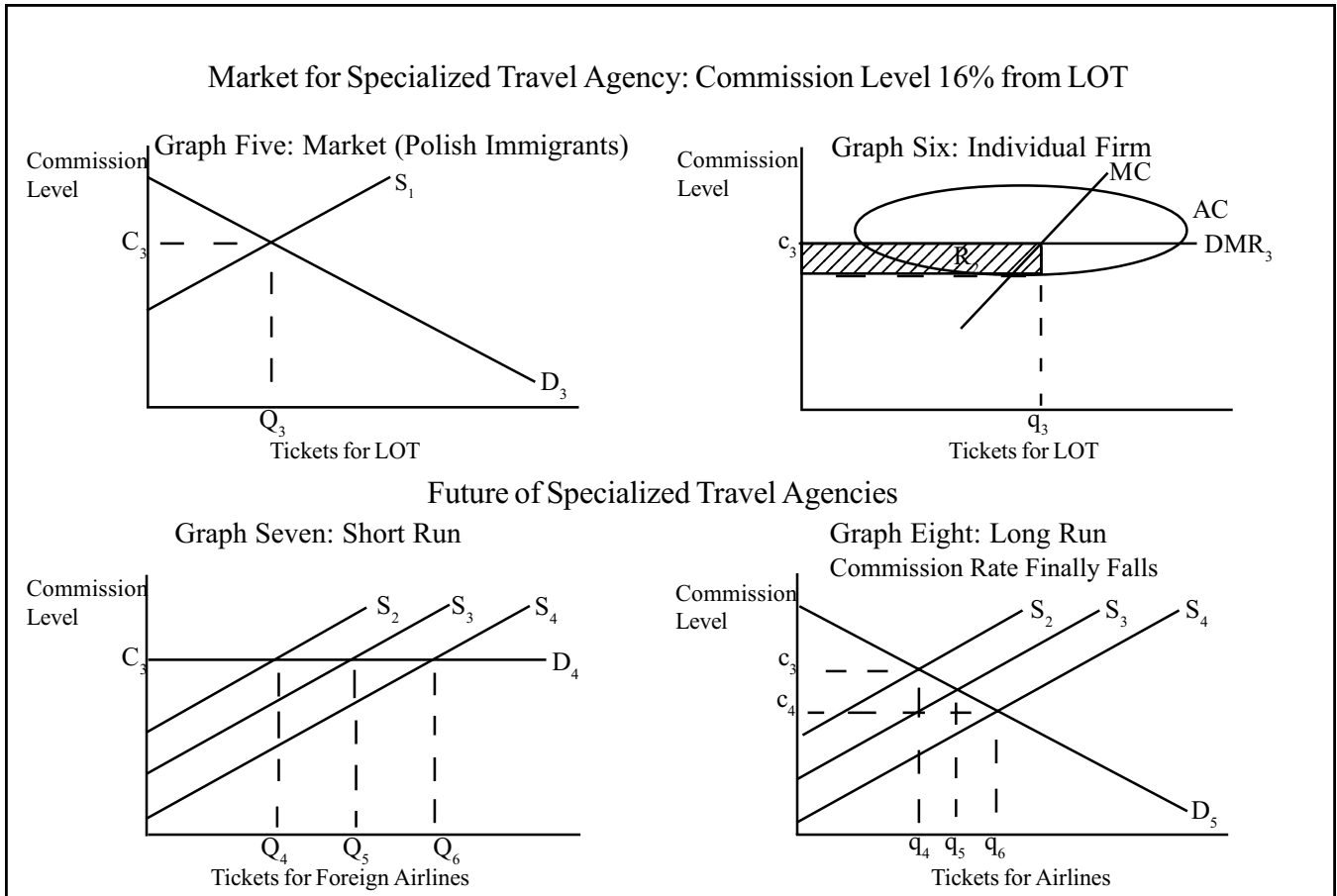


Graph Two shows the individual costs and revenue curves of a particular general travel agency. The equilibrium market commission level ( $C_1$ ) and number of tickets supplied to the airlines ( $Q_1$ ) is shown on Graph 1 at point A. Since this market is perfectly competitive, each travel agency is a price taker and must take the commission level at  $C_1$ , which again is ten percent. Therefore, the individual firms demand curve is  $DMR_1$  and commission level is  $c_1$ . Since an individual firm produces at the point where the marginal revenue curve ( $DMR_1$ ) intersects the marginal cost curve ( $MC_1$ ), the travel agency supplies the number tickets at  $q_1$ . At the commission and output level of B, the travel agency can cover its average costs,

their commission or demand for travel agencies' services. Graph's Three and Four demonstrate the effect that the decrease in commissions has on the general travel agency market. First the demand curve shifts from  $D_1$  to  $D_2$ , which shows the immediate effect of the change of commission level. As a result, the market's new equilibrium point is now C. Therefore, the individual firm's marginal revenue and demand curve shifts down from  $DMR_1$  to  $DMR_2$  on Graph Four as commission levels move from  $c_1$  to  $c_2$ . This new equilibrium point at point D does not allow the individual firm to cover its average costs, so the firm is no longer making a normal profit. The loss of profit is shown by Area  $R_1$  on Graph Four. Essentially, the

new commission level will force many travel agencies to leave the general travel agent market. Normally the exit of firms would cause the market supply curve to shift to the upper left, which should bring commission levels back to ten percent. This case is different, because unlike conventional economics the consumers (airlines) have direct control over what

travel agency market. Since the agents of this firm have invested many years of education and experience in the travel business, they would prefer to find a new market where their current education and skills as travel agents can be maximized. If the firm is able to discover the opportunity that exists in serving the travel needs of ethnic groups and utilizing the higher



prices (commission level) they want charged. Since the airlines believe they will be less reliant on travel agencies, it is unlikely that the airlines will raise commission levels because the number of general travel agencies is shrinking. It is quite possible that the market demand curve may become a straight line and the number of travel agents left in the market will not influence commission levels. Therefore, the only way for general travel agencies to make a normal profit is by finding ways to reduce their average costs. This is exactly what the airlines hope will happen. As long as travel agents rely on U.S. airlines for commissions, they will struggle to make profits.

Consider a firm who has just left the general

commission rates of foreign airlines, then these people have found a way to maximize their skills. Graph's Five and Six reveal the opportunity that lies in the specialized travel agency market. Graph Five shows the market demand and supply curves for specialized travel agencies dealing with the travel needs. The commissions rate that travel agencies receives from the Polish national airline, LOT, is approximately sixteen percent ( $C_3$ ) and the quantity supplied by travel agencies at this commission level is  $Q_3$ . Since this market is also perfectly competitive, the individual specialized travel agency must take the commission level of sixteen percent. Therefore, the marginal revenue and demand curve for an individual firm is

DMR<sub>3</sub> on Graph Six. The commission level for the individual firm is  $c_3$  and the number of tickets supplied to LOT is  $q_3$ . Immediately it can be seen in Area R<sub>2</sub> that the individual firm will make an excess profit in this market. The firm that attracts the business of individual ethnic groups is able to acquire excess profits, if it utilizes the higher commission levels of foreign carriers. As long as foreign carriers continue to offer significantly higher commission levels than U.S. airlines, specialized travel agencies will make much higher profits than general travel agencies. These high profits are made as a result of very little investment required by the firms to enter the specialized travel agency market. These specialized travel agencies were able to see an opportunity in a new market and have enjoyed great success.

Many travel agents wonder what the future holds for the specialized travel agency market. Since the specialized travel agency market is perfectly competitive, it is likely that more former general travel agencies will enter the market in order to receive the excess profits that current firms are enjoying. In perfectly competitive industries, when the firms are enjoying excess profit, new firms enter the market and drive prices down to the point where each firm makes a normal profit. However, this may not be the imme-

diately case in the specialized travel agency market. How long specialized travel agencies make excess profits all depends on how fast foreign airlines adjust the commission level to the number of suppliers in the market. Changing commission levels is a long-term decision, thus in the short run commission levels remain high. In the short run, the demand curve would be essentially a straight line as shown in Graph Seven by line D<sub>4</sub>. No matter how many travel agencies enter the market in the short run, the foreign airlines are unable to adjust their commission levels. Therefore, the entry of new firms into the market merely increases the number of tickets supplied to foreign airlines in the short run (i.e. Q<sub>4</sub>-Q<sub>5</sub>-Q<sub>6</sub>). However, in the long run the foreign airlines will find that they are unable to lower commission levels to a percentage that is more equivalent to the number of firms in the market. This causes the equilibrium price to change from C<sub>3</sub> to C<sub>4</sub> on Graph Eight. Thus in the long run, specialized travel agencies will tend to come closer to making a normal profit. If the commission levels start to approach the commission levels of U.S. airlines, then firms will start to leave the travel agency industry all together. The changes that the travel market is undergoing are quite remarkable. Cost cutting maneuvers and technology is pressuring to replace the travel agent, which has forced many travel agents to find more creative ways of providing their service to travelers and operating a profitable business.