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Play or not to play—An analysis of the mechanism of the zero-commission Chinese outbound tours through a game theory approach

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Abstract

The purpose of this study is to demystify the mechanism of the so-called zero-commission tours that have become synonymous with the booming Chinese outbound tourism market in the past decade. Two models of game theory are applied to identify nine proposed key factors that constitute the “zero-tour” phenomenon. These involve interactions in both the temporal and spatial dimensions of all of the stakeholders concerned with such tours, from outbound tourists and outbound and inbound operators to local guides and governments both within and beyond the Chinese border. It is concluded that zero-commission tours, underpinned by the proposed factors and notwithstanding their current legal and practical viability, have a tremendous negative impact on all of the stakeholders. This study may serve as a reference for the drafting and implementation of both policy and business countermeasures to curb zero-commission tours, thus facilitating more positive contributions from Chinese outbound tourism to the development of world tourism.

1. Introduction

A parasitic phenomenon that has existed within the booming Chinese outbound tourism sector ever since its major period of development in 1997 has been the so-called zero-commission tour, in which a group of Chinese outbound tourists is first attracted by the unbelievably cheap rack fares offered by an outbound tour operator and then cheated or even forced into paying for items that range from motorboat rides to platinum necklaces by the local tour operators at the outbound destination. The symbiosis between the zero-commission mode and Chinese outbound tourism first began in tours to Thailand in the late 1990s and then spread to Hong Kong and Macau, where it is flourishing at present, and there is every possibility that it will spread to newer markets such as Europe and Australia.

With growing recognition of the importance of the Chinese outbound market to the entire world—this market is estimated to exceed 100 million in visitor volume by 2020 (The United Nations World Tourism Organization (UNWTO), 2003)—the problem of the zero mode should be tackled before it leads to further detrimental consequences at the regional, continental, and even international levels. Thus, a clear understanding of the key factors that underpin the mechanism of this mode is essential.

The purpose of this study, which begins with a brief overview of the history of zero-commission tours within the general development of Chinese outbound tourism, is to analyze the distinct mechanism of these tours and identify the key factors inherent in this mechanism through the application of two game theory models.

Game theory, which accounts for the decision-making process of stakeholders who are well aware of mutuality, has been proved to be useful in accommodating issues that concern business pricing. The relevance of game theory to the pricing of the tourism products discussed here is further underlined by the key theoretical assumptions in game theory that can be comfortably embedded in a service product context.

2. The zero-commission tour

The zero-commission tour is a pricing scheme that is widely adopted by local tour operators at outbound destinations that receive Chinese group package tourists. Local operators, instead of making a normal offer to outbound tour operators in China, including the costs of accommodation, transportation, and food and beverages, along with a necessary profit margin, charge their Chinese business partners nothing up-front and then try their very best, often through local tour guides, to get the tourists to spend on miscellaneous shopping or entertainment items during the tour. The commissions from these items are then collected to recoup the prepaid costs and at the same time to make a profit. This approach has proved to be so successful a strategy in targeting the Chinese
outbound market that in many cases the extreme “minus-commission” mode is quite prevalent. In this mode, the outbound operators charge the local operators a certain fee for every customer solicited. Thus, the key feature of zero-mode tours, in comparison with normal tours, lies in the direction of the cash flow among the parties concerned, as is illustrated in Fig. 1. The fares paid by the guests diverge both spatially and temporally, and there is no flow—or even a reverse flow—between the wholesaler (the local operator) and the retailer (the outbound operator). For tourists, the zero-commission tour is best identified by a dual impression of pull and push factors, namely the unbelievably cheap rack prices offered by outbound operators to pull potential guests into purchasing the tour on the one hand—in most cases, tourists are charged only the cost of the airfare and visa application fees—and, on the other hand, the endless persuasion from local guides during the tour that pushes guests into participating in additional paid activities, particularly shopping for a wide range of luxury items such as jewelry, watches, and cosmetic products.

The zero-commission mode has seen a concomitant pace of development with that of Chinese outbound tourism in general, in both temporal and spatial terms (Jia, He, & Cui, 2006; Xu, 2004). What is interesting to note is that the crack down on such tours by Chinese tourism authorities around 2000, although it led to a steep decrease in their incidence, also precipitated an even steeper drop in the total number of visitors to the outbound destinations (Yang & Zhou, 2005). Such causality between the zero mode and total visitation was further seen in the period following the Severe Acute Respiratory Syndrome (SARS) epidemic from mid-2003 until the present. Although this mode is still primarily concentrated in traditional outbound destinations for mainland Chinese tourists, such as Thailand, Singapore, Malaysia, Hong Kong and Macau, it is now rapidly penetrating into new destinations, such as Australia, Japan and Europe. The term “ripple effect,” which was used by Zhang and Heung (2001) to describe the general development pattern of Chinese outbound tourism, seems to apply perfectly to the geographic rampancy of zero-commission tours.

3. Game theory

Game theory is a branch of economic theory that is related to the study of decision-making: several stakeholders must make choices that potentially affect one another’s interests, and the key issue is the equilibrium status at the point at which none of the stakeholders can make any unilateral decision to become better-off (Myerson, 1991). The key concept in game theory is the interactivity of the decision-making processes among all of the stakeholders. The strategies adopted by one stakeholder have not only been influenced by, but also influence, those made by the others. This interactivity goes one step further than traditional microeconomic thought in which the decision-making process of an individual who is seeking utility maximization is determined only by given and static factors such as price and personal income (Rasmussen, 2001). By emphasizing the interdependency of the decision-making processes among all of the parties concerned, game theory adds an extra factor, that of the choices made by others, to the list of determinants that influence the decision-making process of each individual. In this sense, game theory is primarily focused on decision-making under mutual external economic conditions (Nasar, 1998).

In general, the five key components of the various models derived from game theory include the Player, the Action, the Sequence, Information, and Utility (Gibbons, 1992). The player is the stakeholder who makes the decision in the game, and here a player may be interpreted as an individual or a group of individuals making a decision (Turocy & von Stengel, 2002). The action refers to the combination of the temporal and spatial arrangements of the strategies adopted by the player. The sequence indicates the order and repetition of the strategies initiated by the players when multiple players are involved in the game. Information relates to the messages available to each player that may influence the final equilibrium of the game. This factor is regarded as crucial, with the extent of the access to and the accuracy of the information obtained having a very big say in determining who the dominant players of the game are (Binmore, 1991). The final component, utility, has a similar meaning to its counterpart in traditional microeconomics: the payoff or profit that reflects the desirability of a particular outcome to a player. It is worth noting that in game theory the expected utility to a player is usually weighted with the respective probabilities of the strategies that may be adopted (Fudenberg & Tirole, 1991).

Three basic assumptions underlie the key components mentioned above, upon which some of the categorizations of the game can be made and its applications in the real world elicited. First, an important assumption is that all of the players in the game are rational, which means that each player pursues the well-defined exogenous objectives that are most preferable to him or her, based on his or her knowledge and/or expectations of the behavior of the other players (Dixit & Nalebuff, 1991). It is on this assumption that a game can be divided into two branches, namely, a cooperative game, in which the sets of possible actions of individual players are jointly made with others, and a non-cooperative game, in which individual players make decisions separately based on their own interests. It should be further noted that cooperation can and often does arise in non-cooperative models in situations in which the players find that being in a coalition is in their own best interests (Turocy & von Stengel, 2002). Second, in terms of the sequence, the game can be further classified into a static game, in which the players take simultaneous actions, or a dynamic or repetitive game, in which the actions are taken in sequenced orders. A strategic or normal form is introduced to study a static game, whereas an extensive form, or a game tree, is applied in dynamic game research. Finally, turning to the information component, a game can be categorized into a perfect information game, in which any player at the point of making a decision possesses complete knowledge of the moves of the other participants, and an imperfect game, in which the players are not well informed of one another’s actions.

With its strategic perspective, realistic analytical system, and powerful mathematical supporting models and tools, game theory has been widely applied in many microeconomic fields, particularly in pricing issues between competitors and in customer-manufacturer interactions covering a wide range of products—from disposable bottles to home appliances and communication gadgets. The mainstream recognition of game theory in modern microeconomics is best testified by the conferment of the Nobel Prize in Economic Sciences to scholars in this area in 1994, 1996, and 2005. With its unique strength in formulating, structuring, analyzing, and, finally, understanding scenarios at the strategic level, game
theory has also been successfully applied in many other subjects, such as politics, biology, psychology, and sociology. It has been estimated that the transformational role played by game theory in economics will also be witnessed in sociology (Pindyck & Rubinfeld, 2000; Turocy & von Stengel, 2002).

The success of game theory in explaining the various phenomena that take place across different economic sectors also endorses its applicability to tourism studies. It is said that game theory can be embedded into certain areas of tourism research, particularly the pricing of tourism products, taking cognizance of the features demonstrated by the activities that correspond to its key theoretical assumptions, as outlined above (Lu & Peng, 2006). First, the principle of rationality stressed in game theory fits well with tourism pricing scenarios, that is, all of the players, whether they be wholesalers, operators, or guests, act in a way that achieves the best payoff. Game theory is particularly well-suited to providing a global perspective, and it offers the means to incorporate the institutional and behavioral aspects of player relationships that are subject to deeply rooted historical, cultural, and organizational rules. Also, the sequences emphasized by game theory take into account the possible influence of the order of the decision-making processes on the final outcome. This corresponds well to tourism products, which are service-intensive, experiential, and intangible and characterized by a high level of price elasticity, thus highlighting the significance of the order of the offers and responses made by the players involved in the trade. The norm-rather-than-exception scenarios of inequality with regard to players’ access to information about tourism products, for which the simultaneity of the production and consumption of those products is partly to blame, are particularly compatible with the game theory framework, thanks to the due rigor assigned to imperfect information situations. Game theory has been successfully applied to a range of tourism issues that concern the inter-relationships between respective members of the tourism industry, such as travel services, attractions, hotels, and tourist bus services (Lu & Peng, 2006). The interactions between the industry and tourists and government authorities have also been discussed from a game theory perspective (Tian, 2004).

Two models derived from game theory have been regarded as particularly useful in pricing issues, namely, the Nash Equilibrium Model and the Perfect Bayesian Equilibrium Model, which are illustrated in Figs. 2 and 3. The first model, which is also called the Prisoner’s Dilemma, is applied under a scenario of a static game with perfect information. Two players, I and II, acting in a rational way with full knowledge of the possible payoffs to each other, choose a compromise dominant strategy that results in the best payoff for neither individual. The second model applies to the case of a dynamic game with imperfect information. In this scenario, the players take their later actions based on the imperfect information at hand, assign probabilities to the actions already taken by others, analyze the respective payoffs that result from their responses to such possibilities, and make continuous observations and due adjustments through several trial games to achieve the equilibrium status. They figure out the exact or most approximate actions taken by others and thus the most suitable counteractions to be adopted.

4. Zero-commission tours from a game theory perspective: Proposed factor generation

The zero-commission mode has been the predominant travel pattern for Chinese outbound tourists. As has been pointed out, with its vast potential to reach a head count of 100 million by 2020, the Chinese outbound tourism market will have fundamental consequences for the pattern of tourism development throughout the world (Lew, 2000; Zhang & Heung, 2001). Thus, efforts to probe into the mechanism of the predominant operational pattern in this market, the zero-commission mode, are essential. This mechanism is analyzed here using a game theory approach. The zero mode is disaggregated into two games, namely, the game between the inbound tour operators when they choose this mode as the ideal product for the market, and that between the outbound tour operator and the potential tourists with regard to the actual acceptance and purchase of the mode. Correspondingly, the Nash Equilibrium Model is applied to explain the former game, whereas the latter is accounted for by the Perfect Bayesian Equilibrium Model. The two models are illustrated in Figs. 4 and 5, respectively.

As can be seen in Fig. 4, a Nash equilibrium is achieved by the two local operators when both choose the zero mode and settle for a payoff of 25 each, rather than the normal mode from which both would achieve a payoff of 50. To explain this choice, there must be certain economic and social factors that, on the one hand, “pull” the local operators, who are acting rationally with full knowledge of the possible payoffs that would result from different strategies, away from the larger payoff of the normal mode, and, on the other hand,
“push” them to settle for the lower payoff of the zero mode. Of the pull factors, the most pronounced seems to be related to the limitation imposed by the China National Tourism Administration (CNTA) on local operators. This limitation, which is postulated in the Approved Destination Status (ADS) scheme or in bilateral agreements between the Chinese authorities and those of the destination countries (UNWTO, 2003), stipulates that local operators can only receive Chinese outbound tourists traveling in organized groups. The second pull factor concerns the current Chinese outbound tourism policy framework, which, also encompassed by the aforementioned ADS scheme, does not permit overseas tour operators to promote and organize outbound tours locally. The Chinese outbound market can be served only by domestic travel services with certain qualifications. Thus, with no access to direct sales to potential outbound tourists, local operators have no say in who these tourists are or how they will travel. The result is fierce competition among operators to enter into partnership arrangements with outbound operators. It seems that the pre-determined pattern of group travel, together with the monopoly of “tourist resources” remaining in the hands of domestic outbound operators, provides a solid foundation on which the commission concept can be established. Consequently, local operators are pushed into submitting to the zero mode in the game they play among themselves.

Turning to the push factors, the first is the similarity of the tourism products offered by local operators. In marketing theory, it is generally believed that pricing strategies are the most effective approach for products with identical features (Doeringer & Terkla, 1995; Gordon & McCann, 2000; Jacobs & de Man, 1996; Tao & Lu, 2005; Zhao, 2003), and the outbound products discussed here are no exception. These products are usually in the form of sightseeing itineraries that involve the most representative attractions of a given destination. With nothing else available to distinguish themselves from their competitors, local operators tend to resort to price-reducing strategies to attract Chinese partners, and, naturally, the zero and even minus modes are the extreme ends sought. In addition, the local operators find it even easier and more comfortable to choose the zero mode because it allows them to transfer the possible financial risks of such prepaid practices to the local tour guides, who then arrange commission-negotiated shopping or entertainment business during the tour. It has been reported that most of these tour guides have to pay local operators a certain amount in advance to “buy out” such tours. This amount is nonrefundable, regardless of whether the guide manages to get the guests to spend at the places visited (Long, 2004; Ou, 2004). These pull/push factors, which can be grouped into extrinsic and intrinsic dimensions from the perspective of local operators, have been sporadically mentioned in some of the literature (Huang, 2006; Jia, 2006; Jia, He, & Cui, 2006).

The second game, which is illustrated in Fig. 5, integrates the interactions between a tourist and the outbound operator, which takes place in three temporal stages, namely, before departure, during the tour at the destination, and after the tour. Path I highlighted in Fig. 5 indicates the actual strategies adopted by the tourist and the operator during a zero-mode trial period promoted by the operator. Several propositions are made here to account for this mode being preferred by the tourist, and these are facilitated by push/pull factors from the tourist perspective. In the pre-departure stage, the information construct of game theory can be factored in. It is suspected that the incomplete knowledge held by the tourists about a destination with regard to shopping and entertainment services is compounded by the misleading information provided by the operator during the sale. Both factors have helped to push the tourist into believing that he or she is being offered an attractive price and that the product will be of high quality. In the at-destination stage, the pull factor of the coercive and persuasive language and behavior on the part of the local guide forces the tourist to spend more of his or her own money on a number of items. This is regarded as the more important trigger for exposing the full negative picture of the zero mode to the tourist for the first time (Jia, 2006). The bitter feelings of tourists toward such tours are then greatly exacerbated when, regrettably much later, they find that the items they bought at places recommended by their guide were astronomically expensive. It should be pointed out here that, although the local guides are in fact employed by the local operators, the victimized tourists often link them directly to the outbound operator (Fu, 2004; Li, 2005). The proposed pull factor in the final stage that makes the survival of zero-mode tours possible concerns the ineffective complaint-handling mechanism of the Chinese tourism authorities, who fail to deal with the complaints lodged after these tours. In addition, the advantageous position held by outbound operators is further buttressed by the contract that the tourist co-signs before departure. This contract is either ambiguous about or dodges the subject of additional paid activities at the destination and any ensuing liabilities.

Thus, through the three aforementioned stages, a perfect Bayesian equilibrium is reached and retained: the tourist makes the decision to buy an itinerary tagged with a zero-commission label, and the operator perseveres in maintaining the operability of this mode. It has also been discussed that, in the long run or at the end of the trial period, the equilibrium at path I may shift to path II. This is because when the zero mode dominates the market, even though its negative aspects are well known, it is still preferred by the outbound market, because the few, if any, “normal” products on the market are regarded with even greater suspicion and mistrust. In this extreme case, the entire outbound market could collapse, which is exactly what happened with the outbound market for Thailand in many provinces in China in 2002 (Yang & Zhou, 2005).

To sum up, two game models have been utilized to account for the mechanism of the zero-commission tour. From the above discussions, nine proposed factors can be extracted as the key components that are positively associated with this mechanism, as follows.

F1 Group travel as the only permitted travel mode
F2 Restrictions on local operators with regard to direct business in the source market
F3 Homogeneity in outbound tourism products
F4 Transfer of financial burden to the local guide by the local operator
F5 Incomplete knowledge of the destination held by tourists before departure
F6 Misleading information from the outbound operator and ambiguous clauses in the tour contract
F7 Deceptive and bullying language and behavior from the guide that encourages tourists to spend additional money during the tour
F8 Poor quality and exorbitant prices of items purchased
F9 Ineffective post-tour complaint-handling mechanism at origin locale

5. Discussion

As can be seen from these nine proposed factors, the zero-commission tour is a carefully fabricated tactic, the success of which is framed by a range of factors that encompass nearly all of the interested parties at all levels and span the entire process of the outbound trip, from the tourists and domestic and foreign agencies to the employees of the travel agencies and the authorities both within and across the border. The first game contextualized the formation of zero-commission tours by examining the external and internal factors that shape the “zero-oriented” relationship between the domestic outbound travel agencies in China and their foreign counterparts on the receiving end. The second game elaborated on the interactions between the tourists and the travel agencies that resulted in the zero-tour mode. Hence, the Chinese outbound travel agency can be preliminarily identified as the core component of the zero-tour scheme because of its pivotal role in both games.

In fact, price-reduction approaches that are of a nature similar to those of the zero-commission Chinese outbound tours have also been recorded in other fields. For instance, the telecommunications industry, especially its wireless branch, is also fraught with zero-based activities that are attributed to the government contracts with harsh terms that favor the industry. Although such zero-based activities have also been attributed to the government deregulation of the industry in the past few decades (Kim & Gerber, 2005), the two game theory models employed here have merit in holistically accounting for the unique mechanism that underlies the zero-based phenomena in the outbound tourism arena by comparing outbound travel with other industries. For instance, outbound tourism products are characterized by greater inequality in information possession between customers and the industry due to their intangible and complex features, as evidenced by F5. Travel business owners also boast greater bargaining power in industrial relationships because of the low-skilled nature of tourism employment, as can be explained by F4 and F7. Finally, historically, there has been weak government involvement in tourism administration, as is illustrated by F9. Therefore, the stability of the two models applied here seems to be especially underpinned by the peculiarities of outbound tourism products.

At the same time, such factors as F1, F2, F6, and F7, which are specific to the contemporary Chinese context, also lend strong support to the vibrancy of zero-based tours for Chinese outbound travelers as a unique category of consumers. F1 and F2 reveal the Chinese outbound market to have incomplete competition and to be heavily regulated by the Chinese government, which has traditionally treated outbound travel as a symbol of the outflow of cash and considered that the development of inbound and domestic tourism should take precedence (Gao, 2006). Such tight control, with the accompanying consequence of limited choice for Chinese outbound travelers in both travel mode and travel agency selection, is anticipated to remain in place for the near future because of the arrangements made by the Chinese government with regard to its outbound tourism market in its World Trade Organization (WTO) commitments (CNTA, 2002). F6 and F7 are concerned with the consumer behavior of individual Chinese outbound travelers, which helps to locate them as victims of zero-based activities. As residents of a country that has just embarked on outbound tourism development, these travelers are still inexperienced in making consumption decisions that are in their best interests. Therefore, they are more susceptible to the tricks played and traps laid by travel agencies. The spectacular volume of the Chinese outbound tourism market in its early stages may also have helped to “blur the real picture of the market” (Kuang, 2001). In fact, zero-based pricing tactics have also prevailed in a number of other countries and regions in their early years of outbound travel, including Japan, South Korea, and Taiwan (Gao, 2004). What is more, the peculiarities of the Chinese culture of consumption, which has traditionally emphasized the priority of low prices, may also account for the considerable appeal of the low prices offered by zero-commission tours. This appeal is so great that even when the negative aspects of zero tours have been widely discussed, many potential Chinese outbound tourists are still seduced by the low rack prices and head into the traps laid again and again (Jia, He, & Cui, 2006). Thus, it seems to be no coincidence that zero-commission tours are most rampant in countries significantly influenced by Chinese culture, such as Taiwan and certain Southeast Asian countries (Zhang, 2005).

It is a natural and logical next step to call for future research efforts that examine empirically through appropriate research methods the validity of the nine factors generated here. Of particular interest would be an evaluation of the respective weights of the verified factors, which would help to identify the most important dimension(s) of the mechanism of zero-commission tours. This could be done on a comparative basis using case studies. For instance, although zero-commission tours have also been spotted in domestic travel within China, whether the factors that are specific to the Chinese context play a greater role in the zero-tour mechanism needs to be assessed through further empirical studies.

6. Implications and conclusion

To sum up, it can be seen from the analyses presented above that the zero-commission phenomenon is, in essence, a price-reduction strategy that is adopted by foreign operators to attract Chinese outbound tourists. Its legitimate operation would be out of the question in a market economy, and it is further protected by its unique features as a service product. However, the irony is that these zero tours, even though they have apparently gained legitimacy, must be regulated, if not eradicated, because of their numerous negative consequences. First and foremost, there is the direct harm to tourists, who experience trauma rather than refreshment when they go abroad, thanks to ill treatment from local guides when they do not buy what they are expected to buy. Moreover, the negative media exposure of such tours could deal a great blow to the image of the destinations. Taking cognizance of the fierce competition between destinations in vying for visitors, not necessarily limited to travelers from China, this could be disastrous. As Chow (2006) reported, an incident that arose from a zero tour in Hong Kong and subsequently gained media exposure offset the effects of promotional campaigns by the Hong Kong Tourism Board by HK$1 million. Zero tours ultimately harm the industry. When they indulge in zero-sum games in which the gains of one player result in the losses of another, operators have no willingness to initiate more sophisticated strategies such as product renovation or diversification, let alone engage in coordination and collaboration. Thus, the general competitiveness of the industry remains mired in the mud of internal frictions due to the simple yet savage price wars. In the extreme scenario that we saw
in the perfect Bayesian equilibrium model, the entire outbound market could collapse thanks to the vicious circles of the zero tour game, which would benefit no one. The travel service industry itself would definitely be the biggest victim.

This study, through its identification of the mechanism of the zero-commission tour that is underpinned by the nine proposed key factors, can serve as a foundation upon which future empirical studies of zero-commission tours can be conducted. It can also serve as a reference point for relevant authorities to better tackle this parasitic problem, which, regrettably, has become nearly synonymous with Chinese outbound tourism over the past decade. Related measures that target specific factors can be initiated, and coordinated efforts that command a holistic perspective promoted, thus taking cognizance of the interests of all parties both within and outside of the industry, and, more crucially, both within and outside of the country. It is widely anticipated that in the coming century many aspects of China’s tourism development will boost its international significance. Its outbound tourism development is no exception here; however, the “something for nothing” tactic that underpins this development at present is rarely achievable or even a sound sales strategy. Zero-commission tours are flagrant breaches of consumer rights and business ethics, and they should be eliminated to ensure the healthy development of both the Chinese outbound tourism and other similar travel markets.

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