

# THE ANALYSIS OF OPEN POLICY CHANGES IN MAINLAND CHINA'S FOREIGN TRAVEL AGENCIES AND THE EFFECT ON TAIWANESE TRAVEL FIRMS

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**Abstract:** The rapid development of the Mainland China tourism industry after deregulation has transformed the country into one of the top five destinations the world over. This has resulted in effectively attracting foreign currency, increasing employment, and promoting economic progress. Thus, the tourism industry has become the most important service industry right now. The WTO (World Tourism Organization) has estimated that by 2020, China will replace France as the most visited country in the world. Aside from playing a pivotal role, travel agencies have been enjoying government protection and so after the SARS outbreak in 2003, the communist party suddenly announced the opening up of foreign investment to solely invest in travel agencies. This was a turnabout from the previously held position of limiting foreign investment to jointly held travel agencies. This study will first analyze the legal process, for many years, of China's opening up of travel agencies to foreign investments, comparing the extent of liberalization at different stages, scopes, and influences. Special focus will be given to the long-term monopoly of state run travel agencies that has had to face this challenge. In addition, the study will propose measures that respond to legal changes directly affecting Taiwanese firms as travel ties between China and Taiwan become closer.

**Keywords:** China Tourism policy, Taiwanese travel agencies, Tourism exchanges

## 1. INTRODUCTION

Tourism industry of Mainland China experiences a rapid development after 1978, in which China adopted her reform and opening policy. Accompanied with this rapid development, travel agents play a vital role, because tourists no matter who enter the mainland China can not do business with others except through travel agents. Earning huge amounts of money, travel agents have been in the hands of Chinese government for a long time, monopolized. Anyone who wants to invest in the mainland travel agencies from overseas can only cooperate with these state-owned travel agencies to set up a "joint venture", and any attempt to set up a private agency is proven in vain. However, the situation has changed in 2003 for the deregulation of travel agency industry, worthy of research on the causes and effects. On the other hand, resent cross-strait tourism exchanges become increasingly intensive, and most travel agencies in Taiwan initiate business to people from mainland China, so this policy change will directly affect business strategy of Taiwanese tourism agency industry. As to investors from Taiwan willing to have their own enterprises rather than the "joint ventures", in the mainland travel agencies controlled or owned by the Taiwan tourism industry, I refer them to Taiwanese travel agencies because both sides of the strait define them as "Taiwanese entrepreneurs".

## 2. THEORETICAL BACKGROUND

The research adopts strategic management framework of SWOT analysis model. Donald A. Hay and Derek J. Morris posit that entrepreneurs will thoroughly consider the development of the industry that they decide to invest in, government policies and the other investment conditions such as supply and demand. As to industrial environment, the most concern is whether the host country possesses advantages, both subjective and objective, to develop this industry; in terms of demand analysis, the most important aspects are parameters in a specific product market, such as the price, quantity and trading opportunities; when it comes to supply conditions, labor, raw materials and cost of capital are of primary concern; while the analysis of government policy give more weight on privileges, institutions and facilitates. After finishing this preliminary analysis of four conditions, we will enter the decision-making framework. First, the entrepreneurs will make preliminary predictions under a rational analysis of the four conditions mentioned above, and these predictions include information of supply, demand and risk, which are three

major parameters of the important decision-making, and eventually entrepreneurs make the specific investment decisions. Figure 1 illustrates the process.

Philip Kotler, marketing professor at Northwestern University agree to that business investment profoundly influences the firm development strategy and product development strategy and market development strategy. So, entrepreneurs should think twice before deciding to invest in a specific industry. A rational choice should be based on the state industry policy, investment policy and trade policy, which is shown in figure 2.

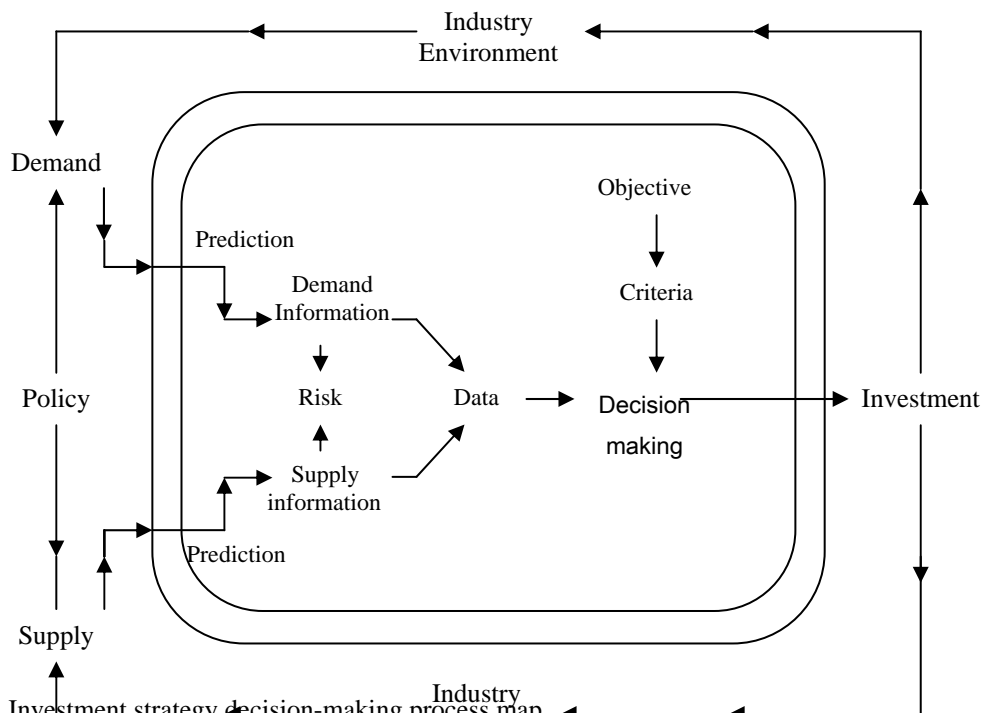


Figure 1 Investment strategy decision-making process map  
 Source : Donald A.Hay and Derek J.Morris, *Industrial Economics and Organization*(NY: Oxford University Press,1991),p.434.

The relation between government and enterprises in amassing stage

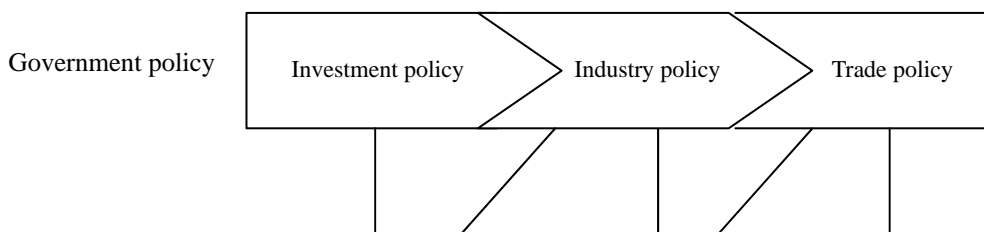


Figure 2 National wealth accumulation stage of the government and corporate relationships map  
 Source : Philip Kotler, *Marketing of Nations* ( N.Y:The Free Press, 1997 ),p.30.

The popular tool "SWOT Matrix" is to produce a matching strategy through evaluating the matrix of external-internal environment, enabling enterprises to make full use of their advantages and overcome their weaknesses, and avoid the threat of competitors through external opportunities.

Table 1 SWOT analysis matrix

	internal	Strong	Weak
external			
Opportunity		SO	WO
Threat		ST	WT

Source : Heinz Wehrich, "The SWOT Matrix –A Tool For Situational Analysis", *Long Range Planning*, No.2-5(1982),p.60.

The policy of Mainland China to set up foreign-controlled travel agency must have strong and profound influence on Taiwanese travel agency industry, this paper intended to produce matching strategies for Taiwanese travel agencies. With the tool of "SWOT Matrix", we examine the external environment first, which is, except for the threat of competitors from the other

countries, almost an opportunity to Taiwanese tourism agencies, and then we analyze the relative advantages and disadvantages of internal environment, and finally we propose our solutions.

### **3. THE DEVELOPMENT PHASE FOR THE OPEN POLICY OF CHINESE MAINLAND TRAVEL AGENCIES**

The open policies for Chinese mainland travel agencies can be divided into four stages, namely joint venture pilot stage, trade in services schedules stage, the regulations for travel agencies stage and temporary foreign-owned Interim Provisions stage. The first two stages occurred before China became a member of the World Trade Organization (hereinafter referred to the WTO), while the left two stages occurred after China entry into WTO.

#### **3.1、 The Joint Venture Pilot Stage**

In 1993, the National Tourism Bureau issued "temporary regulations on first sort of Sino-foreign joint venture travel agencies in tourist resort area " (hereinafter referred to a joint venture pilot approach), which declared to open 12 national tourism resort district, such as Dalian, Qingdao, Hangzhou, Shanghai, Hainan to foreign investors to initiate joint venture enterprises, which is the first legal statement of open policy of Chinese mainland government for foreign travel agencies. On December 2, 1998, the National Tourism Bureau, the Ministry of Foreign Trade and Economic Cooperation jointly issued the "Interim Provisions pilot Sino-foreign joint venture travel agencies" (hereinafter referred to a joint venture pilot scheme), is a turning point for Chinese government to open the Sino-foreign travel agencies.

#### **3.2、 The WTO Trade in Services Schedules Stage**

During early 1990s, the mainland government proposed the draft on the trade in services. In July 1991, the "initial commitment list" including tourism industry is proposed by government. From 1992 on, the National Tourism Bureau participated in the series of negotiations for initial commitment to the service trade, and submitted the revised "list of commitments."

In 1994, "the General Agreement on Trade in Services" involved a total of 12 service categories, in which "tourism and travel-related services" is divided into four sub-categories, A: hotels, restaurants and meals on wheels; B: travel agents; C: guided tours; D: other. As to foreign-funded travel agencies, which perform their business in Chinese mainland, the crucial binding regulation is the provision B "travel agents and tour operators" (ID: CPC7471) of ninth item on "Trade in services schedules, which stressed two concepts "restrictions on market access" and "national treatment restrictions". The rules are based on commitments, so the role it played was mainly for show, and failed to implement in the short term.

According to the "Uruguay Round of multilateral trade negotiations text of the law" and "China's accession to the WTO legal document", the official commitment for Chinese tourism industry is listed in the "Annex 9" of the "People's Republic of China to accede to the Protocol," whose name is "Chinese People State trade in services and schedules of specific commitments "(hereinafter referred to trade in services schedules), these documents were recognized in the ministers peak in November 2001, in Doha.

#### **3.3、 The Regulations for Travel Agencies Stage**

In response to rapid changes in the travel industry after entry into WTO, the National Tourism announced on New Year's Day 2002, a revised "regulations for travel agencies". Chapter 4, "foreign-invested travel agencies in particular," is solely for foreign funds, which was basically a revised "joint venture pilot approach" which content are as follows:

From a perspective of control rights, "regulations for travel agencies" puts that a cap of foreign parties in the investment proportion of Sino-foreign joint venture travel agencies will be given by National Tourism Administration as well as Department of commerce. This claim is a vague statement, and meanwhile it paves ways to future changes. Basically, if we recall the statement that "investors from China must at least control 51% of the shares in the joint ventures, meanwhile the CEOs of the joint ventures must be appointed by Chinese investors and the cooperation will terminate in 20 years" in "the pilot joint-venture approach", the ambiguity of "regulations for travel agencies" shows a increasingly bright direction of policy changes.

As to opening areas, "a joint venture of community approach" allows only 12 national tourism resort area to initiate joint venture travel agencies, while in "trade in services schedules," there were only totally 4 open areas: Beijing, Shanghai, Guangzhou and Xi'an. However, in "regulations for travel agencies", no such restrictive claims exist more, which shows more flexibility of setting opening areas. However, "regulations for travel agencies" insisted that no joint venture travel agencies can operate outbound travel, the "service trade concessions Table" and "joint-venture pilot approach" also insisted on this point,

which witness a strong determination of communist party in restriction to outbound travel for Chinese.

On the other hand, "pilot venture approach" was set jointly by the national tourism bureau, and the ministry of foreign trade. So, it still belongs to the level of departmental rules and regulations although it was censored by the State Council ahead of the official launch. On the contrary, "Regulations for travel agencies" is personally signed by premier minister, and legislated as the administrative rules and regulations, so it was in a higher level than the previous two regulations. More important, it was more accepted in format as "national treatment principle" of WTO.

### **3.4、 The Foreign-owned Interim Provisions Stage**

On June 12, 2003, "the establishment of foreign holding, foreign-owned travel agency" Interim Regulations (hereinafter referred "Solely Temporary Provisions") promulgated.

The first clause of "Solely Temporary Provisions" clearly states that "this provision is legislated and enacted according to relevant laws and regulations for foreigner-operated travel agencies, in order to adapt to the new situation of China's accession to the World Trade Organization, intensify the achievement of open policy in tourism industry, facilitate the development of tourism agencies in china". So the background of this open policy is WTO context.

It was originally expected to allow absolute control rights of foreign funds at the end of 2003, and allow 100% control right at the end of 2005, but thanks to the unexpected visit of SARS, which has forced the mainland government totally deregulate tourism industry and open the market entirely by the end of June 2003. Travel agencies purely controlled by foreign investors, intended to maximize their earnings, will no doubt intensify the marketing effort to attract travelers from their country to China, which fuel the development of china's inbound travel industry. Native travel agencies, under the umbrella of Chinese government, make limited progress. Once the foreign owned travel agencies land onto Mainland China, they will no wonder bring the latest management culture and knowledge into this promising industry, "turning the threat into opportunity" in the competition.

In addition, as to foreign investment, mainland China shows a more pragmatic attitude. As mentioned above, the number 6 clause in "solely Interim Provisions" posited that the registered capital of foreign-owned or controlled travel agencies should be no less than four million Yuan. However, this requirement decreased to 2.5 million Yuan by the end of year 2005. In addition, the clause 7 stressed that foreign-owned or controlled travel agencies cannot do business except in the tourist resort approved by the State Council (Beijing, Shanghai, Guangzhou, Shenzhen and Xi'an), but this was finally eliminated in 2005.

## **4. ANALYSIS OF EXTERNAL ENVIRONMENT**

Under the "Solely Temporary Provisions", Taiwan-funded travel agencies share the same treatment as foreign-owned travel agencies in general, and take the format of both wholly-owned or controlled. So it will exert a direct impact on Taiwan travel agencies that have interests in Chinese travel markets. We first analyze the opportunities and treats of external environment for Taiwanese travel agents.

### **4.1、 The Opportunity**

The opportunities of Taiwanese travel agencies are outlined below:

#### **4.1.1、 The rapidly growing tourism industry in mainland China**

Kotler emphases that investment strategy usually has relation with two conditions: one is the attractiveness of the industry, and the other is the country's competitiveness. To extent of the strength of these two conditions will produce 4 distinctive types of investment, as shown in Figure 3.

##### **1) Investing to penetrate**

this is the portfolio of high attractiveness of the industry with strong competitiveness of the country, which usually occurs in the early stage of an industrial development or of growth stage.

##### **2) Investing to rebuild**

a combination of high attractiveness of the industry with weak competitiveness of the country, which demonstrates that this industry has a splendid past.

##### **3) Selective investment**

Both the attractive to industry and the nation's competitiveness, so it is wise to invest in projects with net earnings but less competitive, and reduce or even abolish the ones lack of attractiveness.

##### **4) Reduced investment**

The worst combination, low attractiveness of industry and weak competitiveness of the countries, please reduce your investment in industries without development potentials or use selective investment strategy to invest in industries with high profits.

From the perspective of industry, the best way to invest is of course penetrating investment. A strong national

competitiveness and high attractiveness of the tourism industry will guide the investors to invest in the strategy of penetrating, intensify the competition within the industry, so that these in whole enhance the competitiveness of this industry.

As to competitiveness of mainland China, economic research team of Goldman Sachs, in 2003, predicted that China will surpass Japan in 2014, and replace the United States to be in the world's largest economy in 2041.

#### 4.1.2、 Foreign investment will enable the transformation and sustainable growth of tourism industry in mainland China

Porter and Kotler, Strategic management professors at Harvard University stressed the important influence of foreign funds on domestic industrial development, particularly for developing countries. This coincides with China's let-in policy for foreign travel agency.

Porter posits that the analysis based solely on production factors has difficulty to explain diversified trend of industrial development, a better specification is the analysis on the basis of national competitiveness. Under the premises of "dynamic and continuous development of competition", Porter develops "Diamond map" theory for national industries, as shown in figure 4.

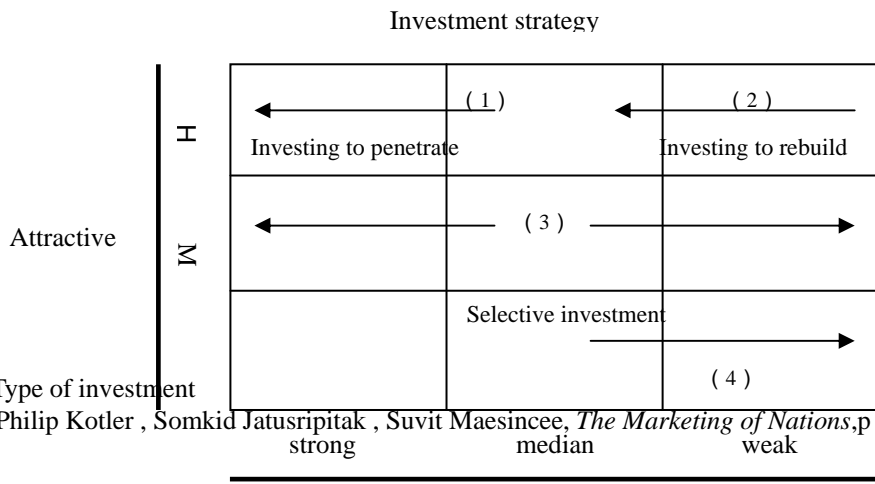


Figure 3 Type of investment  
Source : Philip Kotler , Somkid Jatusripitak , Suvit Maesincee, *The Marketing of Nations*,p.222.

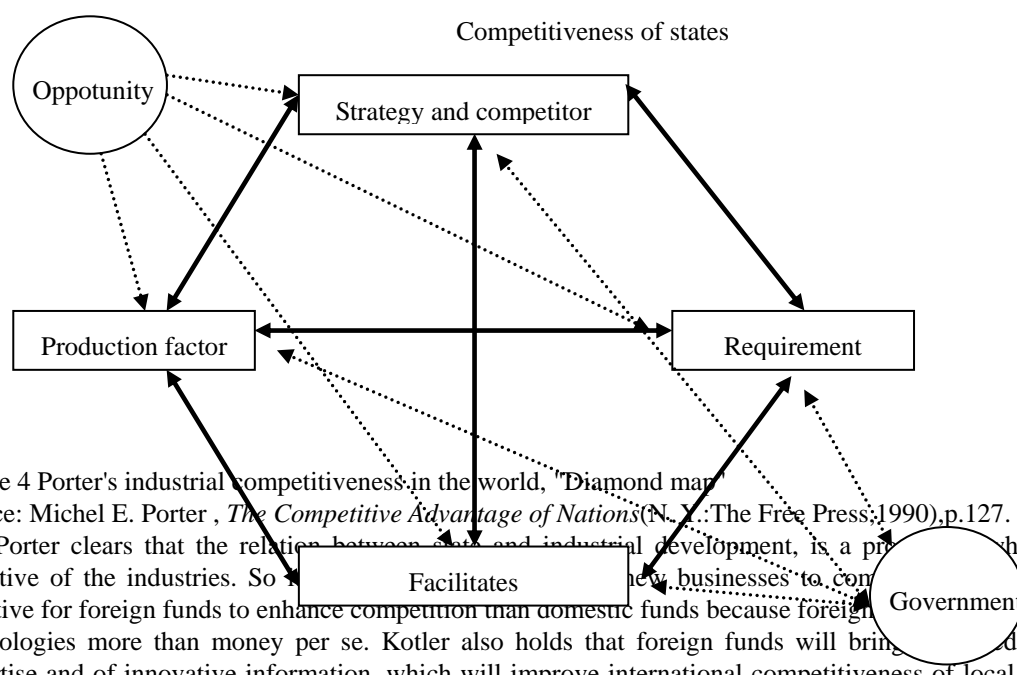


Figure 4 Porter's industrial competitiveness in the world, "Diamond map"  
Source: Michel E. Porter , *The Competitive Advantage of Nations*(N. Y.:The Free Press,1990),p.127.

Porter clears that the relation between state and industrial development, is a process in which the state stimulates the incentive of the industries. So it facilitates new businesses to compete in a market, in which it is more effective for foreign funds to enhance competition than domestic funds because foreign funds bring in brand-new concepts and technologies more than money per se. Kotler also holds that foreign funds will bring in advanced technologies, management expertise and of innovative information, which will improve international competitiveness of local enterprises. These are right purposes of mainland China to open travel agencies for foreign funds after SARS, and will accelerate restructuring and internationalization of local travel agencies. So, in the long run travel agencies in China will witness a global competitiveness.

#### 4.1.3、 The Cross-strait Close Relation in Sightseeing

On October 15, 1987, under the humanitarian considerations of Taiwan to improve cross-strait relations, Executive Yuan issued files titled "Taiwan people leave for the mainland to visit relatives," which is a stone mile in Taiwan history of sightseeing, because since then the mainland has become Taiwan's most important outbound tourism area.

In addition, the number of mainland residents visiting Taiwan in recent years is increasing rapidly. "Documents on people from the mainland to Taiwan for sightseeing activities" is enacted in December 2001. In 2002, a total of 160 delegations of

2,324 visitors left China to Taiwan, while in 2003, the number increased to 909 delegations of 12,808 people. Basically, this only did a very limited favor to Taiwan's tourism industry, so everyone in this industry hopes to fully open the market to the mainland, Hong Kong and Macao people. According to the Taipei Association of Travelers' estimation, under the assumption of an average of eight days per trip and one million visitors per year, if each mainland tourists consume 150 U.S. dollars daily in Taiwan, it can create about 40 billion new Taiwan Yuan per year, and its multiplier effect can also bring about a significant growth of other industries.

## **4.2、 The Threats**

The external environmental threats for Taiwan travel agencies come mainly from the fierce competition from the rivalries.

### **4.2.1、 The market suffering monopoly of state-owned enterprises**

Since the travel agents in China have long been monopolized by state-owned enterprises, especially by three agents: the China Travel Service Co., China International Travel Service Co., China Youth travel service Co.. They three have branches all round China, not less than their cooperative companies, such as the hotels, the car firms, guided tours, attractions, etc., and they are completely familiar with the local tourism industry, therefore on the short term foreign-owned and controlled travel agencies are with extremely difficulty to compete with them. On the other hand, the state-run travel agencies are established by the government, for example, the China International Travel Service Co. is an utility of the National Tourism Administration, China Youth Travel Agency is one facilitates of the Communist Youth League, Travel Agencies across the Strait is affiliated to Taiwan Affairs Office of the State Council, China's travel agencies are belonged to the All-China Women's Federation, so Taiwanese travel agencies face great difficulty in such political atmosphere, it is rarely anticipated that there will be fair competition to a considerable extent.

### **4.2.2、 Other foreign investors**

Foreign travel agencies will make combination of hotels, restaurants, and shopping malls funded by the same countries, and form a huge and comprehensive travel system, which will exert strong influences on the interests of the mainland travel agencies; On the other hand, foreign travel agents will also gradually acquire various local travel agencies so as to grasp the market shares. At present, tourism groups including those from Japan and Germany have entered the mainland. Japan's largest state-owned aviation company "Japan Airlines" (JAL) established the "JAL International Travel Service (China) Ltd." on July 18, 2003, which was the first travel agency belonging to foreign operators; the first foreign controlled travel agency (Germany) —"easy journey Company" was set up in Beijing on December 1 in the same year. German Chancellor Gerhard Schroeder attended the initiation ceremony, indicating that foreign travel agents are actively enter the mainland, obviously the agencies with the support of some hidden powerful multinational companies, even the government. However, due to the deadlock of cross-strait political relations, these government-backed advantages were out of the wild imagination of Taiwanese travel agencies.

### **4.2.3、 The relevant provisions remain temporary**

Present open policy of Mainland China are based on the provision "the temporary regulation of establishment of foreign holding, foreign-owned travel agency". Temporary, of course, means not for ever, and worse of worse, the authority and prestige of political leaders were always over the holy law, so relevant provisions may sudden change without anticipation; it is also a risk of external environment to Taiwanese investors.

## **5、 ANALYSIS OF INTERNAL ENVIRONMENT**

Taiwanese travel agencies that intend to set up business in mainland have to consider its internal environmental advantages and disadvantages :

### **5.1、 Strengths of Taiwanese Travel Agency**

Compare with others , Taiwanese agencies have a number of advantages, for the following reasons :

#### **1) Communication advantage**

Both countries share the same language and culture, that is why the people of Taiwan have a better understanding of the mainland people's ways of thinking and behavior; Also Taiwanese have better international contacts with foreigners without

thinking and ideology conflicts. As the travel agency is part of the service industry with particular emphasis on people-to-people contacts, so Taiwanese travel agencies have such communication advantages that competitors from other countries obviously do not have.

## 2) Similarity in operation mode

Practical mode of operation of these two countries are similar and closer than others, which can reduce unnecessary transaction costs to a minimum, because the mainland travel agencies copied and learned many experiences of Taiwan businesses after the reform and open policy, coupled with a large number of Taiwan tourists to visit the mainland, both sides made frequent contacts, or even had gone through many incidents, such as the Qiandao Lake incident, and the crash of Guilin. On the other hand, travel-related sectors such as aviation, hotels as well as restaurants in Taiwan and the mainland can mutually and directly contact and communicate.

## 3) Advantages in marketing and management

Travel agencies in Taiwan have two advantages over their counterparts in mainland and even other countries. The first one is very close net relations; the other one is diverse alliances between travel agencies and other industries. Taiwan travel agents net can be divided into two aspects: First, the so-called "Internet travel agency," that is, their own virtual sites for consumers and businesses directly through the Internet to conduct business transactions and therefore there is no need for service personnel to complete transactions, such as e-travel and other travel agencies, this has been called the "virtual travel agent"; the other is the so-called "travel agency network," or the travel agents have their own entity's office, although the site were erected to introduce products and to provide information retrieval, in fact most of the business is done by face-to-face service, such as the Lions travel services.

In addition, a large number of travel agencies in Taiwan in recent years through different business alliance with the information technology industry, the financial industry, logistics industries, combined with each other to form new patterns in the travel industry business model.

## 5.2、 The Weaknesses of Taiwan Travel Agents

### 1) Large proportion of SMEs travels agents in Taiwan.

Taiwan companies are mostly SMEs, according to the "regulations for travel agencies," the establishment of the scope and scale of the largest "Comprehensive travel agents" only need NT 25 million, as to grade A and grade B of travel agents, the total capital needed is NT 6 million and 3 million. Taiwan has 2042 travel agents Corporation, of which integrated travel agencies amount 84, grade A takes 1833, grade B amounts 125, indicating that SMEs travel agents account for a larger scale, so its is very weak in risk-bearing, when there are natural disasters or cash flow problems, bankruptcies or mergers frequently occur.

On the other hand, Taiwan travel agents are in extremely fierce competition, so the industry pick up low-cost strategy, resulting in rather limited profits. The vicious cycle of travel agents under the current adverse competition is hard to improve.

### 2) Taiwan is difficult to cross the threshold

As mentioned above, the establishment of wholly foreign-owned travel agencies of foreign investors, requires a total income of 500 million US dollars per year, while registration capital of travel agents should not be less than 4 million RMP, these standards seems too high for Taiwan's SMEs travel agents.

### 3) China's demand of open Taiwanese market to Chinese investor

Taiwan exerted a total ban on the China funded travel agencies through Law of exception and even foreign travel agents can only set up a "branch" in Taiwan and can only undertake promotional activities and cannot do business under the "regulations for travel agencies". However, when the mainland China allows Taiwanese operators to set up foreign-owned travel services, Taiwan may have to open tourism market under the WTO counter-claims. This would enable Taiwan's travel agencies to encounter considerable threats. Because once the state-own travel agencies enter Taiwan market, with a strong financial background with the same culture, together with access to closer cross-strait exchange market, Taiwan companies will be dwarfed by their Chinese counterparts.

## 6、 CONCLUSION

Based on the analysis above, this paper asserts that as a whole, it is an opportunity more than a threat for Taiwanese travel agencies in terms of the external environment in mainland China, because the mainland tourist market in the future is still very optimistic and full of potential for growth, particularly in outbound tourism. Although at this stage, the Chinese Communist Party insists in that foreign-owned or controlled travel agencies cannot operate outbound travel businesses, but this is the right

attraction in the mainland market of travel industry. According to statistics delivered by the World Tourism Organization, in 2002 the Chinese mainland in the global outbound tourism spending ranked No. 7 and it forecasted that by the end of 2020, there would be 100 million outbound tourists from china to all round world, accounting for 6.2% of the global market shares, the fourth largest tourist source country only dwarfed by Germany, Japan, and the United States.

But the most concern at present is the internal environment of Taiwanese travel agencies. Short-term advantages may still exist for a while, but in the long run, unless the Taiwanese travel agencies create new advantages, the present advantages will gradually vanish to null. In contrast, the disadvantage of Taiwan travel agents is obvious, and difficult to resolve in the short term. We therefore believe that Taiwanese travel agencies posit in the matrix of maximum external opportunities and also maximum internal threats in face of mainland's open policy for foreign-owned or controlled travel agency, so a "WO policy" should be taken.

According to Figure 4, "the strategic planning process map", we posit that the most important and fundamental solution for Taiwanese travel agencies is to make the large larger and make the small smaller, namely, through the horizontal mergers model, which is on one hand, to build travel business empire in large, enhancing market power by large groups and integrated conglomerates, reducing cost through economies of scale and increasing profits and market shares, on the other hand, is to downsize the small travel agencies that have cost advantages to attract specific sources of customs to survive. At present, merger and acquisition is the similar trend in different industries, such as Taiwanese financial industry, the IT industry, the civil aviation industry, and only if accompanied with these well-capitalized, well organized and supported by conglomerates, large travel agents can win their positions in the mainland travel industry

As Porter said, the role of the state is to actively guide the new enterprises to participate in the competition, so the government must establish a favorable investment environment for new entries. Basically, only if the tourism industry within a country has potentials and attractiveness, foreign counterparts will make investments in it, thereby increasing competition among tourism industry within the country, enhancing the advantages as a whole of tourism industry and attracting more investments, which creates a "virtuous circle". The demand of mainland tourism industry for foreign funds continues to be strong in the future, and without doubt, relevant laws will inevitably move towards more open direction. On the other hand, the mainland is already the world's focus and most rapidly growing tourism market, Taiwanese travel agencies should fully grasp such an opportunity to expand themselves in the global background, turning around unpleasant situations into pleasant ones in addition to performing their own advantages, only by these means can Taiwanese travel agencies win first mover advantages and sustainable superior competitiveness in this emerging markets with strong rivalries from other countries.

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