

CASE

Carnival Cruise Lines

*I must go down to the seas again, for the call of the running tide
Is a wild call and a clear call that may not be denied*

—John Masefield, *Sea Fever*

The call of the sea spurs the cruise business.⁵¹ Sea voyages have had an aura of mystique for centuries, but only in recent decades have they been available to a mass market. Historically, recreational sea voyages were an essentially elitist endeavor. Certainly, members of the lower classes occasionally found themselves on the open sea, but usually as displaced job seekers or ships' crew members. In recent years, however, the cruise industry has targeted the working middle class as well as the idle rich.

What's a Cruise, and What Happened to the Cruise Industry?

A "cruise" is a sea voyage taken for pleasure (as opposed to, say, working aboard a ship or conveying oneself from point A to point B). Typically, passengers enjoy cabin accommodations for the duration of a fixed itinerary that brings them back to their original point of embarkation.

There was a time when ships (called *liners*) transported people across waters for business or pleasure, but the advent of transoceanic air service after World War II offered a speedier and less expensive alternative, and airlines captured liners' passengers. The competitive balance tipped decisively in the 1960s, when advances in jet technology made air travel a viable option for a growing mass market of budget-minded travelers. One by one, shipping companies retired the great luxury liners that had plied the seas for decades.

The Contemporary Cruise Industry

Today, the cruise industry is dominated by two companies: Carnival and Royal Caribbean, which command a combined 71 percent of the market. By far, the largest is Carnival, which offers cruises to every continent on the globe and operates 10 lines that it calls *brands*. Map 1.2 shows the headquarters of these brands.

Carnival was born when its founder saw an opportunity to expand mass-market sea travel by promoting the idea of the "Fun Ship" vacation—an excursion designed to be a little less formal and luxurious than the traditional ocean liner. The timing was right. Sea travel still projected a certain aura, and more people could afford an ocean-borne vacation. Further, a lot of vacationers preferred to spend their holidays in ways that were compatible with the Fun Ship concept, such as on group tours, theme-park visits, and sojourns to Las Vegas. Carnival bought a retired liner at a good price, refurbished it

in bright colors, rigged it with bright lights, and installed discos and casinos. On its maiden voyage in 1972, the ship ran aground with 300 journalists on board; fortunately, neither the ship nor the business concept was severely damaged.

Over time, Carnival added not only ships but also whole cruise lines to its fleet. Today, each brand operates primarily in a designated region and is differentiated from other Carnival brands in terms of geographically pertinent themes (in Italy, for instance, Costa boasts a Mediterranean flavor) and in terms of cost (cruises on Cunard and Seabourne cost much more per night than on Carnival). In 2016 Carnival commenced a brand, Fathom, which takes passengers to developing countries for a week where they participate in a variety of volunteer services.

Doing Business in International Waters

Almost the whole cruise-line industry is international in scope. Take the nationality of competitors. Companies can obtain *flags of convenience* from about 30 different countries. By registering as, say, a Liberian legal entity, a company can take advantage of lower taxes and less stringent employment rules. Legally, Carnival is a Panamanian company, even though it's listed on the New York Stock Exchange, has operating headquarters in Miami and London, and caters mainly to passengers who set sail from the United States. Although cruise-line revenue is subject to neither Panamanian nor U.S. income taxes, Carnival does have to pay substantial "port fees." In fact, ports compete for cruise stopovers because of fees and tourist expenditures.

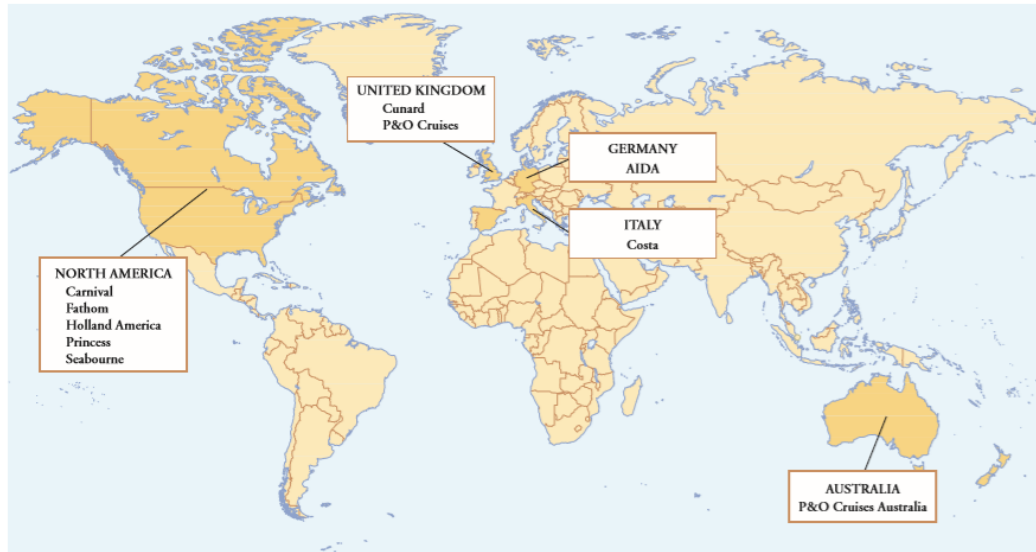
Only a few cruise-line offerings—such as excursions along the Mississippi River—can be characterized as purely domestic. Even trips from the U.S. West Coast to Alaska are "international" because they stop in Canada. By far the most popular destination for cruise passengers is the Caribbean/Bahamas, largely because the area boasts balmy weather year round. During summer months, Carnival shifts some of its ships from Caribbean/Bahamas to Alaskan and Mediterranean routes.

Obviously, cruise ships go only where there are seaports, but Carnival cooperates with (and owns some) tour operators who provide almost 2,000 different onshore excursions (for additional fees). Carnival estimates that half its passengers to the Caribbean take shore excursions to such sightseeing attractions as the Mayan ruins in Belize. Nevertheless, critics contend that passengers see and spend too little in the countries they visit, going only to cruise-line-sanctioned locations and stores.

MAP 1.2 Where Carnival's Cruise Lines (Brands) Are Headquartered

Countries designated on the map denote headquarters locations of each company/brand (e.g., five lines operate out of North America and two out of the United Kingdom). Carnival has the most recognized brands in North America, the United Kingdom, Germany, Italy, and Australia—areas that account for 85 percent of the world's cruise-line passengers.

Source: Data from "Carnival: Our Brands" at <http://phx.corporate-ir.net/phoenix.zhtml?c=200767&p=irol-products&some+changes> (accessed March 17, 2016).



What It Takes to Operate a Cruise Line

Ship Shopping

Ships constitute the biggest investment for cruise lines. Carnival introduces two to three new ships per year. Governments in several countries subsidize shipbuilding because it employs many people and uses locally produced steel—a practice that gives the cruise-line industry less expensive ships.

Where to Find Crew Members

Shipping companies scour the world for crew members who can perform specialized tasks, are properly certified (by international agreement, a registered crew member can enter virtually any port in the world), and who can interact with passengers, especially in English. On a typical Carnival ship, crew members hail from over 100 countries, but about a third of the world's ship crews are Filipino because of their English fluency and willingness to work for low wages.

Casinos and Other Amenities

Each of its Carnival's cruises offers one or two formal nights per week; theme-based dinners centering on national cuisines; a variety of musical entertainment, games, and contests; spas and athletic facilities; and onboard shopping. Casinos are onboard fixtures because cruises,

by operating outside the jurisdiction of any national authority, are not subject to any national laws restricting gambling.

The Overseas Environment

Because Carnival operates around the world, it has the advantage of treating the whole world as a source of both customers and supplies. In addition, because its chief assets are ocean-borne, Carnival can move them where they can best serve the company's needs. However, it's also vulnerable to a wide range of environmental disturbances. Let's take a look at a few of these.

Safety Issues

After terrorists seized a cruise ship in the Mediterranean in 1985, the major cruise lines instituted strict security checks for boarding passengers; thus, they had in place a security protocol before 9/11 and before the airline industry had one.

In the wake of 9/11, when cancellations started to exceed bookings, Carnival increased the number of U.S. ports from which its ships embarked so that passengers with a heightened fear of flying could reach points of departure by land. Carnival also redeploys cruises to avoid areas of political upheaval or crime. During the mosquito-borne Zika virus outbreak, Carnival offered cancellations with credit for future cruises to pregnant women and their families.

Fortunately, shipboard emergencies are infrequent, but when they do occur they are problematic. For instance, the Costa Concordia hit a rock and sank off Italy, causing 32 people to die. A generator fire on the Carnival Triumph stranded 4000 passengers for four days. Sporadically, viruses causing diarrhea and vomiting strike cruise ships, causing Carnival to take an infected ship out of service to eradicate all traces of the virus by sanitizing virtually every object on board. Although these incidents are costly, the cruise industry has a fatality rate three times better than airlines.

Economic Issues

Spending for a cruise is generally considered discretionary. During recessions, people are more apt to take shorter cruises and to embark from nearby ports rather than flying to faraway points of departure. Interestingly, however, in comparison with other segments of the tourist industry, cruise lines have fared well during economic downturns, partly because of offering discounts and partly because fixed cruise-line prices spare passengers the added risk of encountering unforeseen unfavorable exchange rates.

The Weather

Whenever there is extreme weather, Carnival may have to cancel trips, switch embarkation points, or change destinations. Typically, passengers on canceled trips receive full refunds and those on shortened cruises partial refunds.

The Future

Overall, the outlook for Carnival and the cruise-line industry is mixed. On the one hand, with prospects for growing incomes in many countries, such as China, more people will have discretionary income to spend on tourism. There are

still relatively untapped cruise destinations that Carnival has either not exploited or has only recently begun to serve, such as the addition of ports in Vietnam, Indonesia, and Papua New Guinea. Further, changes in U.S.–Cuban relations is expected to create a boon in U.S. cruise travel.

Since only 20 percent of the U.S. population has taken a cruise, there is growth potential. On the other hand, people who have taken a cruise continue to be repeat customers, but the percentage of first-time customers is declining. On the downside, then, industry observers worry that experienced cruisers will tire of visiting one port that's pretty much like another and that noncruisers will still prefer to fly to resorts where they can spend more time in a single place than they can on cruises. There is also concern about the uncertainty of gasoline prices, taxes, and mortgage interest rates.

QUESTIONS

- 1-3. What specific steps has Carnival Cruise Lines taken to benefit from global social changes?
- 1-4. What economic factors influence success of the international cruise industry? Explain how each affects such success.
- 1-5. Although most cruise-line passengers are from the United States, the average number of annual vacation days taken by U.S. residents is lower than that of workers in most other high-income countries (13 days, compared to 5 weeks in France and Germany). How might cruise lines increase sales to people outside the United States?
- 1-6. What threats exist to the future performance of the cruise-line industry and specifically of Carnival Cruise Lines? If you were in charge of Carnival, how would you (a) try to prevent these threats from becoming reality and (b) deal with them if they were realized?

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- 1-7 What global forces have contributed to the growth of the cruise-line industry? How have they contributed?
- 1-8 Discuss the ethics of cruise lines regarding the avoidance of income taxes while buying ships built with governmental subsidies.