

Ivanovic, Slobodan; Rot, Eddy; Pretula, Miroslav

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## SMALL ENTREPRENEURSHIP IN HOSPITALITY: CROATIAN EXPERIENCES

**Slobodan Ivanovic<sup>1</sup>**  
**Eddy Rot**  
**Miroslav Pretula**

### **Abstract:**

After introductory explanations regarding the selection problems of small enterprises in the Croatian hotel industry, the author provides a number of key indicators of their role in improving the competitiveness of the Croatian hotel industry in the global tourism market. In developed tourism countries, small enterprises have a dominant share in the structure of the hotel industry, and their importance is growing even in the former socialist countries of Europe. Small hotels in Italy accounted for more than 50%, and in Austria with more than 70% of lodging facilities and represent a generator of hotel business in a large number of European tourism countries, and great attention is given to the small entrepreneurs stimulating their growth with different measures of tourist and general economy politics. The author reflects on the Croatian experience of the small businesses in the hospitality through research of development of small family hotels and their importance for the improvement of the supply of the Croatian hotel industry which future is built on personal approach to guests and present trends in the tourism market. States that the role of the National Association of family and small hotels, which represents the specific interests of small hoteliers and enables the continuous improvement of the quality of their offerings, as well as measures to encourage small business development at the macro level. Based on the made analysis the measures of increasing the efficiency of small businesses in the Croatian hospitality are given.

*Key words:* small businesses, the Croatian hospitality, small and family-run hotels, development incentives.

*Jel Classification:* L83

### **INTRODUCTION**

Although entrepreneurship in the hospitality industry in the area of today's Republic of Croatia is present continuously since the mid-19th century when the first hotel facilities were built on the east coast of the Adriatic, modern entrepreneurship, especially small businesses reports its strong momentum in the mid 1990-ies by creating market

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<sup>1</sup> **Slobodan Ivanovic**, Ph.D., Associate Professor, **Eddy Rot**, PhD Candidate, University of Rijeka, Faculty of Tourism and Hospitality Management Opatija, **Miroslav Pretula**, Ph.D., Degra, Bjelovar, Croatia.

conditions for its development. In the subsequent period, there has been dynamic growth in the number of small businesses. In 2010 with 19,316 small businesses (up to 50 employees) the activity of 'hotels and restaurants' accounts for about 12% of the total number of small businesses in the Republic of Croatia. Hotel and similar services are provided by over 700 small businesses which, in the overall number of hotel companies are participating with around 85%.

One of the products of small entrepreneurship are small and family-run hotels. They represent a novelty in the Croatian tourist industry and account for about five percent of the total hotel capacity, ie 15% in total accommodation capacity, as opposed to Austria or Italy, where in excess of 50% or more, 70% in total accommodation. Given that Croatia did not utilize its potential in this segment of the hotel industry, that actualizes these issues, and suggests the need for a detailed analysis of the state of small entrepreneurship in the Croatian hotel industry, diagnosing problems that small businesses face and make proposals of measures to increase the efficiency of their operations.

#### **ANALYSIS OF SMALL ENTREPRENEURSHIP IN CROATIAN HOTEL INDUSTRY**

Entrepreneurial initiatives in the hotel industry in the territory of Croatia today, especially in the coastal region, in the modern concept has its continuity from the mid-19th century when the first hotel facilities were built. Yet in the transition from a planned to a market economy at the beginning of 1990-ies, enabled its strong momentum. The adoption of an adequate legislative framework (Crafts Act of 1994, The Companies Act of 1995, Law on Tourism of 1996, The Law on tourist activities in 1997) and implementation of international standards in the hotel premises (Regulation on classification, minimum requirements and categorization of restaurants from 1995) create the necessary conditions for achieving competitive Croatian hotel industry that will be able to fit into the global competition. Particular importance is given to small entrepreneurship with adoption of the Law on the Promotion of Small Business in 2002 (as amended in 2007 and 2012) which prescribes the basis for the application of economic policy incentives aimed at the development, restructuring and adjustment to the market of small entrepreneurship. The Act defines the classification criteria of small business entities (individuals and corporations) to micro, small and medium-small enterprises. Micro and small entities of small business that are studied in this paper: 1) with an annual average of employees less than 10 or 50 workers and 2) according the financial statements for the previous year with annual operating revenue in the amount equivalent to 2 million euro and up to 10 million euros, or have total assets if they are subject to profit tax, or fixed assets if they are subject to income tax in the amount equivalent to 2 million euros or 10 million euros (Zakon o poticanju razvoja malog gospodarstva).

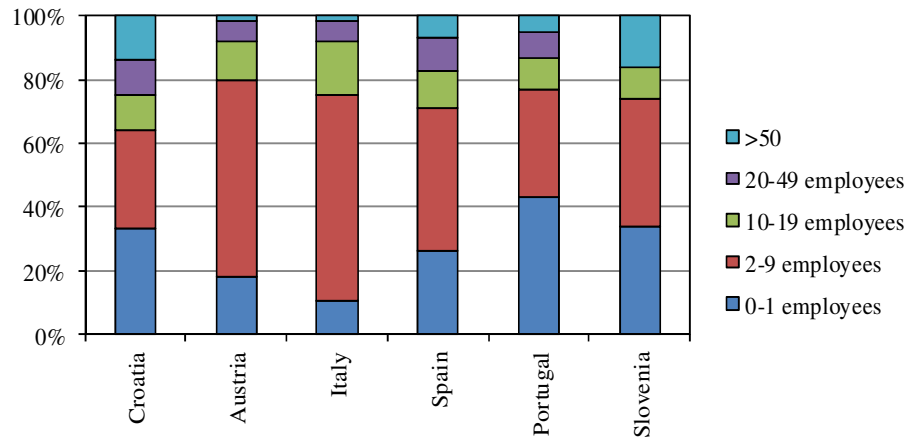
According to Eurostat data, the number of small businesses up to 50 employees in the sector of hotels and similar establishments in the Republic of Croatia in the period from 2008 to 2010 is growing faster than the total number of hotel companies. This resulted in an increase of their share in the total number of hotels to 83.5% in 2008 to 86.4% in 2010 (Figure 1). Unlike Austria, Italy, Spain and Portugal, which show decreasing number of small hotel companies, Croatia shows increasing. The reason for

this can be found in the greater involvement of the state and local communities in promoting the development of small enterprises in the Republic of Croatia and the achievement of better tourism results in the analyzed period of these countries.

**Table 1.** Micro and small enterprises in sector of hotels and similar establishments, 2008-2010.<sup>2</sup>

	2008	2009	2010	Index 2010/2009	Index 2010/2008
0-1 employee	276	297	272	91,6	98,6
2-9 employees	186	202	252	124,8	135,5
10-19 employees	87	89	91	102,2	104,6
20-49 employees	63	77	92	119,5	146,0
Total	612	665	707	106,3	115,5

The structure of small businesses in the sector of hotels and similar establishments is dominated by companies with one employee involved with a share of 33% in the total number of hotels in 2010, followed by companies with two to nine employees with a share of 31%. For comparison, in Austria the dominant position is occupied by businesses with two to nine employees with a share of 62%. Similar structures have also some other developed tourism countries in Europe (Figure 1).



**Figure 1.** Structure of hotel companies in Croatia and chosen European countries according the number of employees, in 2010.<sup>3</sup>

Small businesses in the hotel industry has its own specifics that apply to a small number of employees and other dimensions, but also the specificity arising from the activities of hotel industry. This requires special legislation concerning the organization and operation of the national economy, streamline regulations to make their operations more efficient, special treatment of the hotel industry in the fiscal system, etc. The state, therefore, should create conditions for the effective functioning of a large number

<sup>2</sup> Eurostat, <http://epp.eurostat.ec.europa.eu> (accessed January 7, 2013.)

<sup>3</sup> Made by author according the data from Eurostat.

of small businesses with the aim to develop all options of economic subjects, and simultaneously to reduce and eliminate weaknesses.

Although in the last decade was made remarkable progress in structuring the overall economic and institutional and legal environment for profitable operations and business development, at the sectoral level of hotel industry there is the lack of progress. This was due to structural problems of a relatively small share of hotels in total tourist economy, the problem of insufficiently differentiated products, operating on a 'sun and sea' and the associated seasonality, and fiscal and parafiscal pressures that inhibit business sector under competitive conditions in the global market. Development of the hotel industry is difficult due to a number of obstacles in the institutional environment, and the lack of incentives aimed at developing the sector.

The level of the tax burden creates uncompetitive framework for hotel operations in Croatia in comparison with countries that are the major tourist competitors for Croatia (especially as regards reduced rates of value added tax). In order to eliminate this limiting factor the changes in VAT rates in the hotel industry were made. Applying the Law on Value Added Tax of 1 January 2013 the threshold of entry into the system of VAT was raised, from 85.000,00 kn to 230.000,00 kn. Persons who are not registered for VAT gain the possibility of joining the lump taxpayers (lump sum taxation) in order to reduce the tax burden and increase competitiveness in the market. In applying the new VAT rate on accommodation, food and beverages (coffee, tea, water) the rate of 10% is applied; the rate for soft drinks, wine and beer 10% plus tax on consumption; sales of cigarettes and other goods and other hotel services are taxed at 25% and spirits at 25% plus tax on consumption. Rates of VAT on services in hotels are higher than in most European Union countries. Austria has the same rate of VAT, a higher rate of VAT has Cyprus, Czech Republic, Hungary, Slovakia and the United Kingdom. It is estimated that the application of a reduced rate to restaurant services from 1 January 2013 should result in a reduction of price of those services to 12%.

In economy of Republic of Croatia, it is not formed a complete system of incentives for investment in the hospitality and tourism. Institutions such as the Croatian Agency for Small Enterprises (CASB) seem to encourage development of small businesses and to increase its stake in Croatian economy creating an enabling environment through the effective development of supporting infrastructure at the national, regional and local level, by enabling the use of grants based on the needs expressed in the financing, development and application of technology, improving quality, increasing competitiveness, securing new markets and employment, and through networking, collaboration and networking among entrepreneurs, institutions and support (HAMAG). Their activities are only partially focused on sector development of small businesses. In 2009 the credit line of CBRD Incentive for success, which was the trigger for the development of the sector was abolished. During six years that existed, it helped in the construction and reconstruction of 300 properties. Its elimination sparked a stagnation of investment, and called into question the competitiveness of the entire hotel industry. In 2012 with the aim of attracting investment into the Republic of Croatia and the improvement of the economy, the Act on the Promotion of investments and improvement of the investment environment, which, among other things, regulates the incentives for activities in the field of tourism services more value-added projects such as hotel accommodation, apart-hotels and resorts category four or more stars, heritage hotels, etc. That same year, CBRD has launched a new line of credit for small hoteliers in an easy loan terms (interest rate reduction to 1.3 and 5% depending on the

purpose of the loan) and increased mass of resources (one billion kuna or about 210 million more than in 2011) which wants to invest in tourism. That is to launch a new wave of investments in small and family-run hotels. Commercial banks offer costly loans that small hoteliers do not allow operations under the same market conditions with competitive tourist countries.

In the European hotel industry, under the pressure of globalization, for a while has the trend of mergers, acquisitions and consolidation of small hotels to meet the challenges of constant change in the tourism market and the pressures of international hotel chains with a strong brand and reliable reservation system. Networking of small family hotels in Croatia started with the foundation of the National Association of Family and small hotels in 2004 as the needs of a growing number of small and family-run hotels, representing their specific interests, actions for continuous improvement of the quality of their offerings and improving business conditions. The association brings together 146 hotels and 66 guest houses and agricultural farms and households from all over Croatia (National Association OMH). Association activities are focused on the areas of marketing, categorization, certification and inspection, lobbying, training, advisory services, and dissemination of information. It is also provided the foundation of an internationally recognizable market brand of Croatian family and small hotels. Initiating and implementation of several major projects (project 'Incentives for Success' that provides an affordable source of funding for small hoteliers, catalog 'Family-run and small hotel', held in cooperation with the CNTB distributed in 120,000 copies in 11 languages worldwide, contracts with 20 suppliers which ensure the better rebates and annual bonuses to Association members, on-line reservation system). The association has been active in increasing business efficiency and small hotel companies improve their competitiveness on the market.

Despite still present limitations and shortcomings in the organization and establishment of a favorable environment for business of small hoteliers, there is a significant progress and implementation of measures and activities to improve their market position. It is initiated by a role that was given to small businesses to improve the competitiveness of the Croatian hotels.

## **IMPORTANCE OF SMALL ENTERPRISE COMPETITIVENESS OF CROATIAN HOTEL INDUSTRY**

Legal and institutional framework creates only the basic conditions for the development of small businesses in the hotel industry. The inclusion of small businesses in strategic priorities of Croatian tourism leads to a significant shift in thinking about the welfare of their strength in the local and regional community with the potential to create employment.

The total number of employees in the accommodation providers and food service in 2010 (State Institute of Statistics 2012, 220), workers in micro and small enterprises accounted of 71% (66 401). This industry accounts with 12.5% of the total number of employees in micro and small enterprises in the Republic of Croatia. Taking into account the data on the number of micro and small hotels by the criteria of employment, it can be estimated that an average of about 5,500 employees in micro and small hotel companies or 8% total employment in micro and small hotel enterprises in the Republic of Croatia.

One of the products of small enterprises are small and family-run hotels. They are the objects that present local environment featured in the architecture which reflects the influence of climate, distinctive interior design, customs, gastronomy, enology, sightseeing tours, etc. Filled in 180 days in a year and generate a third more nights compared to conventional hotels. Therefore, in recent years, increasing attention in the hospitality is given to this segment. Tourism market research shows that modern tourists on tourist travel are looking for something different, specific, authentic and individualized. Anonymity in large hotel complexes are replacing small family hotels where they feel accepted, respected and satisfied. In the small hotels there are no strict standardized procedures as in big hotels, and owners can more easily be made available to guests. Guests are offered the comforts of home, the flexibility of service and a personal approach to each guest; everything is subordinate to guest's wishes.

Following the example of developed tourism countries in the region, especially in Austria and Italy, even in Croatia there is a trend of opening small hotels, and not just on the coast, but also in the mainland. They substantially differentiate and deal with the Croatian tourist offer, but they also represent a very interesting space for private initiative for small local businesses. Number of small hotels in 2012 grew for 27.5% compared to 2005, but compared to 2009 it decreased by 6.1%. After increasing the share of small hotels in the total number of hotels in Croatia in 2009 in comparison to 2005, in 2012 this share was diminished (Table 2).

**Table 2.** Structure of hospitality in Croatia according the size of hotels

	2005	Share in %	2009	Share in %	2012	Share in %	Index 2012/ 2009
Small hotels (to 100 beds)	240	47,4	326	56,7	306	52,7	93,9
Medium hotels (101-500 beds)	230	45,5	207	36,3	229	39,4	110,6
Big hotels (more than 500 beds)	36	7,1	40	7,0	46	7,9	115,0
Total	506	100	572	100	581	100,0	101,6

Growth or decline in the share of small hotels in the total number of hotels in the Republic of Croatia is a result of a decrease or increase in the number of medium-sized hotels. Transformation of small hotels in medium-sized hotels in 2012 has led to a reduction in the number of small and almost the same increase in the number of medium-sized hotels. It is estimated that the number of small hotels have an upward trend in the near future and thus attain the level that is present in nearby European tourist countries. Small family-run hotels in Italy accounted for more than 50%, and in Austria with more than 70% lodging facilities and represent a generator of hotel business in a number of European tourist countries.

Most small hotels are classified in the category of so-called 'intermediate small', ie those of 21-50 beds, categorized with three stars (Table 3). There is the lack of small hotels of high category.

**Table 3.** Profile of small hotels in Republic of Croatia in 2012

	2009	Share in %	2012	Share in %
<b>Size</b>				
To 20 beds	43	13,5	34	11,1
21-50 beds	163	50,0	165	53,9
51-100 beds	119	36,5	107	35,0
<b>Category</b>				
2*	59	18,1	52	17,0
3*	193	59,2	161	52,6
4*	70	21,5	84	27,5
5*	3	1,0	9	2,9
<b>Total</b>	<b>325</b>	<b>100,0</b>	<b>306</b>	<b>100,0</b>

Overwhelming number of small hotels located in coastal tourist areas, which is understandable considering that the main Croatian tourist product is 'sun and sea'. It is disconcerting the fact of increasing the number of small hotels in the coastal tourist areas while reducing in the continental parts (Table 4).

**Table 4.** Small hotels in different tourist regions in Republic of Croatia

	2009	Share in %	2012	Share in %
Coastal region	228	70,3	252	82,4
City of Zagreb	25	7,7	32	10,5
Continental Croatia	72	22,1	22	7,2
<b>Total</b>	<b>325</b>	<b>100,0</b>	<b>306</b>	<b>100,0</b>

According to the National Association of Family and small hotels, hotels-member of Association achieved, in 2010, 23,414 arrivals and 45,874 tourist nights and were used only 73 days (Table 5). Dependence of small hotels on the resort greatly affects their usability, especially if one keeps in mind that the majority of small hotels are located in coastal destinations with a highly seasonal business.

**Table 5.** Tourist arrivals and nights in hotels-members of National Association of family-run and small hotels in 2010.<sup>4</sup>

Category of hotels	Number of hotels	Share (%) in OMH	Share (%) in total number of hotels	Number of beds	Number of arrivals	Number of nights
Total	184	100	30,7	6.037	218.694	467.587
5*	2	1,1	8,0	75	3.180	9.067
4*	31	16,8	19,4	988	39.930	86.127
3*	123	66,8	39,2	4.101	152.170	326.529
2*	28	15,2	27,7	873	23.414	45.874

<sup>4</sup> Bartoluci, Mato, Poduzetnistvo u turizmu.



The strategic guidelines for Croatian tourism, to small hotels is given an important role in improving the Croatian accommodation (Croatian Ministry of Tourism). In doing so, it also aims to open 200-odd of theme small family hotels and guest houses of traditional architectural expression along the Adriatic coast and its hinterland, but also on the continent. Building a new and improving existing offerings of small family hotels and guest houses relies mainly on objects 3 and 4-star hotels, and construction emphasizes the need for supporting autochthony destination product and ensuring visual harmony with the environment.

### **PROPOSED MEASURES FOR IMPROVING BUSINESS EFFICIENCY OF SMALL ENTERPRENEURSHIP IN CROATIAN HOTEL INDUSTRY**

The analysis shows that small businesses in the Croatian hotel industry has several important limitations to achieve market-business potential and increase business efficiency. In doing so, we identify the limiting impact of the macroeconomic environment that does not comply with the conditions that exist in the country - Croatian tourism competitors, and the impact of general legal and institutional framework that makes difficult current operations of small businesses in the hospitality and restricts their development. In order to establish a competitive and sustainable development of the hotel industry in the direction of action of small businesses in the hospitality, it is necessary to structure the measures to minimize the limitations for the development of small businesses in the Croatian hotel industry:

- 1) Measures to strengthen the competitiveness of small hotel companies, aimed at harmonizing terms and conditions in relation to the competitive tourist country and the creation of conditions for development of the sector.
- 2) Stimulating development measures aimed at creating conditions for development in order to increase the competitiveness of small hotels and a Croatian hotel industry in general with an emphasis on the establishment of a system of incentives for investments in new small hotel facilities.
- 3) Measures to create conditions favorable to greater availability of funds for investment in expensive hotels and rescheduling of loans through CBRD.
- 4) The creation of business clusters. As part of the strategic thinking of development of Croatian tourism was established need of structuring entrepreneurial cluster as a supplement to individual activities of professional associations (eg small hoteliers). Entrepreneurial clusters would be created on a regional basis (total available regional offer for the market of tourism experiences) and /or the production-thematic basis (cluster of small boutique hotels, a cluster of small hotels wellness tourism). The project would define and establish a number of business clusters in each of the typical tourist macroregions and ensure the organizational, financial and human resources of their functioning.
- 5) Measures to strengthen professional management system of small hospitality sector with a focus on strengthening links such as the training of personnel, organizational improvements, development of tourist infrastructure, establishing a network of information systems, statistical monitoring and similar.

## CONCLUSION

In the Croatian hotel industry there are still limitations and shortcomings in the organization and establishing a favorable environment for small business entrepreneurs in the hospitality industry. Shortcomings are particularly evident in the lack of adaptation of legal and institutional frameworks of specific hotel industry. Positively, however, is that the adoption and implementation of various measures and activities improves the position of small businesses and create conditions for improving their competitiveness. It is also contributing to the involvement of small businesses in the strategic priorities of Croatian tourism, which leads to a significant shift in thinking about the welfare of their strength in the local and regional community with the potential to create employment. Special emphasis is given to increasing the number and quality of services of small hotels, as a new product in the Croatian hotel industry. Although in the European hotel industry for some time there is a trend of association, acquisitions and consolidation, trends in the market of tourism demand indicate that guests are increasingly choosing hotels that offer differentiation and reflect the peculiarity of the local environment, the hotels where everything is subject to a particular customer. Therefore, it opens up space for small hotels that variance of their offerings can attract a target market segment.

Opening of small family hotels which build their future on a personal approach to guests and present trends in the tourism market, small businesses directly affect on the improvement of the supply of the Croatian hotels.

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