SMALL AND FAMILY HOTEL INVESTMENTS IN CROATIA

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ABSTRACT

This paper reports the results of a mail survey of the small and family hotel investments in Croatia. It is based on a questionnaire sent to 162 small and family hotels. The response rate was 22.22% (36 out of 162). The goal of the empirical survey was to determine business specifics in this part of small and medium enterprises (SME) in the particular conditions of the Croatian financial market. The focus was on the know-how and information necessary for planning, financing and implementation of investments into small and family hotels based on quality, exclusivity and business profitability.

Introduction

Croatia has a long history in hotel tourism. The first big hotel was opened in Zagreb in 1840 - Hotel Pruckner, later Hotel Royal. Mr. Von Scarpa built Villa Angiolina in Opatija in 1844. The first touristic hotel was built in on the Adriatic coast – Hotel Kvarner [4]. Since then, intensive development of hotel tourism can be found in the whole Adriatic coast.

The last twenty-two years have been a period of constant change with wide swings in performance caused primarily by war, two recessions and economic conditions. However, in the last ten years small and family hotels became very interesting and perspective form of entrepreneurship in national tourism. Croatia became a good touristic destination because of its natural and cultural heritage and better traffic connections. Small and family hotels have a big share in total number of hotels in Croatia (30.7%) and during the period from 2000 to 2010 the number of small and family hotels grew from 40 to 184 [5]. “Incentive for success” [1], a credit program of Ministry of Tourism contributed a lot to the growth and development of small and family hotels. Small and family hotels are one of the important directions for development and competitiveness of Croatian tourism, for which availability of the long-term financing is important.

Empirical survey has been implemented to define investment project financing model of small and family hotels in Croatia. The goal of the empirical survey was to determine business specifics in this part of SME in the particular conditions of the Croatian financial market (emerging market). The focus was on the know-how and information necessary for planning, financing and implementation of investments into family and small hotels based on quality, exclusivity and business profitability.

The survey was based on a questionnaire sent to all members of National Association of Family and Small Hotels (142 hotels) and additionally to 20 hotels, clients of Erste&Steiermärkische Bank that are

not members of the Association, but are users of the credit program “Incentive for success”. The response rate was 22.22% (36 out of 162).

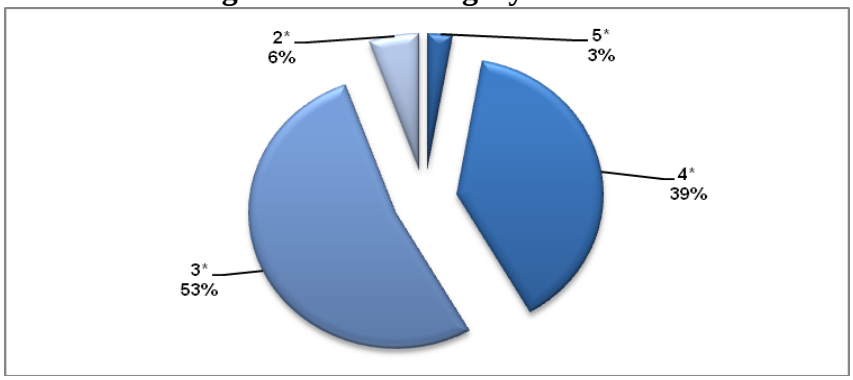
Small and family hotels are the one with up to the 50 lodging units (rooms and apartments) with family ownership. Besides ownership, family participates in daily business and hotel management.

Basic characteristics of the sample hotels

The results of the survey show that 42% of the sample hotels are located on the Adriatic coast, 25% on the Adriatic islands and 22% of them on the continental part of Croatia. Taking into consideration the regional structure of all small and family hotels in Croatia, the sample is representative. Furthermore, business philosophy and touristic offer on the Adriatic coast differ from those on the mainland; for this reason regional specifics should be taken into consideration.

The majority of sample hotels (75%) are organized as limited liability company (Ltd.), while the remaining hotels are organized as crafts. Hotel buildings have, on average, 19 years and 24 lodging units, while the last renovation was made approximately 10 years ago. The results of the survey show that 67% of the sample hotels are open the whole year, and 33% of them just during the season (from Easter until the end of October). It is interesting to notice that all hotels located on the continental part of Croatia are open the whole year. 50% of those located on the coast and islands are open the whole year, whereas the rest of them are open just during the season. The results of the survey show that 86% of the sample hotels provide full service and 14% of them provide just bed and breakfast. The majority of the sample hotels (92%) have three and four stars (see Figure 1 below).

Figure 1. Hotel category structure



Business specifics of small and family hotels in Croatia

The main characteristic of small and family hotels is the fact that they are owned and run by a family. According to the results of the survey just 8% of sample hotels have professional managers, while for 92% of the hotels the owner acts as general manager. In general, there are two main reasons for hotel investments: 1. Profit making and 2. Image and prestige. In Croatia, dominant motive for family and small hotel investments is the desire or need for expansion of existing business in order to increase quality and business volume (44%). For others, these are better working place and achievement of higher living standard (31%), as well as creation of distribution channel for their own products (3%). Profit maximization and higher income of the owner are the reasons for just 22% of entrepreneurs. From the aspect of long term sustainability and business competitiveness’ these results show that there is a need for systematic and continuous education for entrepreneurs in this segment of SME.

The results of the survey show that guests usually stay in small and family hotels from 3 to max 10 days. Regarding number of employees, results show that the sample hotels have, on average, 10 employees during the whole year and 5 seasonal workers (for hotels on the Adriatic coast).

Financing small and family hotel investments

Entrepreneurs participate with significant share of their own funds when financing operating business and real investment opportunities. Results show that before credit program “Incentive for success”, entrepreneurs used 44% of their own funds for real investments and 56% of external financing. High interest rates on entrepreneurial loans forced entrepreneurs to rely on their own sources of funds (savings, borrowing from family or friends). On the other hand, lenders (banks) required higher down payment as a risk premium. Results show that 94.44% of sample hotels used external financing, and all of them used bank loans (100%). Along with bank loans they used other sources - financial leasing (14%), operating leasing (3%), borrowing from business partners (6%), venture capital funds (3%) and factoring (3%).

Financing conditions are key decision-making factors for hotels' financial management. Results show that education through seminars increase understanding of financing process and appropriate decision making regarding financial needs. On the scale from 1 to 5 they had to mark relevant factors for successful and intensive use of financial products and services (Table 1).

Table 1. Relevant factors for successful use of financial products and services

Education and consultancy about risks and business planning	3.78
Simple approval procedure	4.17
Better financing conditions	4.67
Available information about financial products and services	3,83

Existing forms of financing are not appropriate for 64% of sample hotels. This is an expected result because the credit program “Incentive for success” is not available any more. When it was available, 83% of sample hotels used that credit program. For them, some of the advantages were: interest rate, grace period, maturity, protection of cultural heritage, assistance of Ministry of Tourism. On the other hand, disadvantages were: long time of credit realization, complicated administration, limited capacity, education in the area of capital budgeting.

Today, the key factors to accept credit conditions are: 1. More information about the forms of financing (17%), 2. Lower down payment (39%), 3. Flexible credit repayment (83%), 4. Longer grace period (52%), 5. Longer maturity (39%), 6. Fixed interest rate (43%) and 6. Lower interest rate (83%).

Essential factors for long term competitiveness and profitability are quality of service, individual approach and satisfied guests and costs management according to the results.

Characteristics of small and family hotel investments

One of the goals of the empirical survey was to find out the basic information regarding investments taken, such as the purpose of investment, amount needed, sources of financing and costs structure. Furthermore, we wanted to get information about the revenues and costs (amount, structure and growth rate), and number of nights in the last business year. According to the results 67% of the sample hotels

invested in reconstruction of the existing building, while the rest of them (33%) invested in new capacity.

Until the credit program “Incentive for success”, family entrepreneurships were realized through simpler forms of accommodation according to the possibilities of the entrepreneur. The basic guideline of credit program “Incentive for success” was to raise the quality of existing accommodations and to renew cultural heritage. The program was successful. Table 2 shows the amount, dynamics and financing structure of the sample hotels, and table 3 shows the costs structure for the sample hotels.

Table 2. The amount, dynamics and financing structure of small and family hotel investments

Type of investment	Total amount	Investment per room	Investment duration	Period of business stabilization	Down payment	Portion of debt
All	€ 1.874.138	€ 82.490	12-18 m	2.7 y	44%	56%
Reconstruction of existing building	€ 1.561.765	€ 72.455	12-18 m	2.4 y	43%	57%
Construction of new building	€ 2.316.667	€ 100.702	12-18 m	2.8 y	42%	58%

Table3. Costs structure of small and family hotel investments

Costs structure	Reconstruction	Per room	Construction of new building	Per room
Building or land purchase	15%	€ 14.249	8%	€ 8.074
Reconstruction / Construction	43%	€ 32.869	57%	€ 60.505
Equipment	25%	€ 15.614	25%	€ 21.088
Various compensations (license, architect)	6%	€ 4.183	6%	€ 5.445
Pre-opening costs	7%	€ 3.589	3%	€ 3.284
Others	1%	-	1%	-

Subsequent deviation in costs is a significant investment risk for small hotels. 69% of the sample hotels had subsequent deviation in costs (with additional funds needed amounting to 20% of predicted investment costs). This should be taken into consideration for future investments and included in the financing model. Some of the reasons are: higher prices of land, higher prices of construction materials and additional expenditures for equipment or other facilities.

Entrepreneurs did not finance additional costs, mentioned above with their own funds, so there is an additional risk. The results show that, on average, 53% of additional funds needed were raised by new, more expensive loans. Consequently, owners earn lower return. Furthermore, there is a risk of possible delay in the end of work. This could jeopardize the whole business. If a new hotel loses the season, successful market positioning, debt repayment, and the existence of the business are in question.

Hotel industry financial metrics

There are numerous standardized ratios widely used in hotel industry. The most commonly used hotel industry financial metrics are: Room Occupancy or occupancy rate, Average Daily Rate (ADR), Revenue Per Available Room (RevPAR), Total Revenue Per Available Room (TRevPAR), Revenue Per Occupied Room (RevPOR) [2] [3].

Room occupancy (occupancy rate) is calculated by dividing the number of rooms occupied by the number of available rooms. Occupancy rate is the percentage of rooms that are occupied at a given time. *Average daily rate* (ADR) is calculated by dividing daily revenue by the number of available rooms. ADR excludes rooms used for "house" purposes (those occupied by hotel employees). Average daily rate is one of the core indicators - along with other metrics such as occupancy rate and revenue per available room - used to measure the operating performance of a hotel. *Revenue Per Available Room* (RevPAR) is calculated by dividing the total room revenue in a given period (excluding discounts, sales tax and meals) by the number of available rooms in the same period. Revenue Per Available Room can also be calculated by multiplying the Average Daily Rate by the percentage of occupancy. Revenue Per Available Room (RevPAR) may also be expresses as *Total Revenue Per Available Room* (TRevPAR) which includes not only the room rate itself, but also any extra services such as room service, laundry services or other services.
Key financial metrics for small and family hotels in Croatia, according to the results of survey are shown in table 4.

Table 4: Financial metrics

Category	Occupancy rate	TRevPAR	Employees per room	Revenue per night	ADR	EBITDA/ revenue	Costs - Am / sold room
2*	45%	€ 13.192	0.44	€ 44	€ 55	34%	€ 55
3*	38%	€ 18.758	0.46	€ 81	€ 70	25%	€ 118
4*	40%	€ 20.411	0.57	€ 79	€ 86	26%	€ 110
5*	67%	€ 41.108	0.76	€ 93	€ 115	24%	€ 127
Total	40%	€ 20.204	0.51	€ 78	€ 77	26%	€ 110

Regarding revenues, luxury hotels have a higher portion of accommodation revenue. They offer additional contents (gift shop, fitness studio, nail studio, spa and massage), so they are supposed to have higher portion of other revenues. The revenues structure for the sample hotels are shown in table 5.

Table 5. Revenues structure

Category	Accommodation revenue	Food and beverage revenue	Other revenues
Total	62%	32%	6%
5*	69%	28%	3%
4*	67%	26%	7%
3*	59%	36%	5%
2*	66%	33%	1%

As far as operating costs for small and family hotels in Croatia are concerned, results show that the sample hotels, on average have: payroll costs of 28.24%, F&B costs of 27.03%, energy costs of 15.23%, maintenance costs of 18.68% and other of 10.82%.

The sample hotels have expected growth rate of revenues and costs of 6.5% for the next three years, and expect the same profitability. These confirm the fact that education is necessary to help the owner to raise efficiency and to start to create added value for the owner and for the destination where small hotel operates.

Conclusion

The role of tourism in the national economy depends on the possibilities for its sustainable development and the ability of major tourism actors to generate income and profits. Investments are one of the key factors to increase the competitive ability of the Croatian tourism sector. The results of the survey show that despite intensive use of its own funds, 94.44% of entrepreneurs used external financing. Average small and family hotel covers 56% of investment costs externally. However, existing forms of financing are not appropriate for 64% of sample hotels.

Small and family hotels are one of the important directions for the development and competitiveness of Croatian tourism, for which availability of long-term financing is important. Furthermore, it establishes that in order to provide better support to investment in the development of family and small hotels it is necessary to improve existing loan models and introduce a financing model which would be in line with the specific features of their business, by means of additional measures and activities of all participants in the financing process. “Incentive for success” a credit program of Ministry of Tourism was a very successful program and it would be good to restart the same program or to create a new one based on similar conditions.

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