

AN ANALYSIS OF THE HOTEL INDUSTRY IN CROATIA

Applying Porter's Diamond Model

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<p>Abstract</p> <p>Croatia is a country, located in the very center of Europe, possessing diverse and pure Mediterranean nature across the long coast and thousands of islands. The climate is mild and from the first glance the country looks like an attractive spot for travel. Yet, the tourism in the country is on a premature, underdeveloped level. Hotels are scarce and in many cases sub-standard. The entertainment, catering and other tourism-related industries are all in their infant stage of development.</p> <p>The objective of the research was to study the reasons behind the slow development of the hotel industry in Croatia. Because very little research had been done addressing this issue, the author was left to follow an exploratory method. Thus, the goal was to collect different pieces of relevant information from the available sources, including the author's own experience as an employee of one hotel in Croatia, and analyze and present them in a way, which would allow for further research. The Porter's Diamond model was chosen as a framework for the analysis and the presentation of the results. During the course of the research, the author attempted to study and report on as many different factors, suggested by the Diamond Model, as possible.</p> <p>As a result, the author uncovered a set of different negative factors affecting the industry, which mixed together to form a closed circle with no apparent way out. The author came to a conclusion that the Croatian government was the major contributor to that situation and the future of the hotel industry would heavily depend on the governmental policies and their implementation.</p>		
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1 CROATIA AS A TOURIST DESTINATION

Since the end of the War of Independence from Serbia (1991-1995) and the end of membership in Yugoslavia, the last 15 years have shown a robust economic growth and political stability for Croatia. Nowadays, Croatia is the leading country of the region (after Slovenia) in terms of economic development and standard of living. This has not been overseen by foreign investors. Since the beginning of EU accession talks in 2005 the annual FDI inflows rose from 950 million to 4.2 billion into the country.

Croatia is conveniently located in the heart of Europe. It takes less than two hours by plane to reach Croatia from most of the EU countries. The pure and diverse Mediterranean nature across the 1,770 km long coast with 1,185 islands makes the country a tremendous spot for different types of tourism. The country has several UNESCO protected natural and cultural sites. There are numerous nationally protected parks of nature, including unique mountain ranges, mountain lakes, waterfalls and islands.

According to Croatian Ministry of Tourism, the tourism sector of the country's economy contributes to some 20% of its GDP (Mičić 2007). This makes tourism one of the most significant industries in Croatia.

However, hotels in Croatia are lagging behind. Though Croatia has already reached pre-war level of tourist traffic, these days hotels account for merely 12.5 % of the total supply of tourist accommodation in the country. There are 55 beds in hotels per 1 km of the Croatian coast, which is a very low rate if compared to well-developed tourism destinations, for example, Spain (235 beds/km). Surprisingly, hotels are scarce and unpopular in this tourism-driven country. Due to this, not much research has been done in the field of the hotel business.

In general, the slow development of Croatian hotels can be explained by the fact that the process of redesigning the nation from socialist to democratic structure shall apparently take some time. This generic explanation makes no practical sense though. This is why the author undertook to make a study of the hotel industry of Croatia and tried to discover the reasons behind the slow development. The research question of the work became:

What is the current level of development of the hotel industry in Croatia?

This was accompanied by a sub-question:

What are the reasons behind the slow development?

The goal of this research was to collect relevant material, analyze it and provide an answer to the research question. As the author did not have any previous research material to build on, it was decided that the framework for data collection as well as the analysis had to be well-known among other researchers. It was important to make sure that other researchers could use the collected and analyzed data as their starting point for further research. This way, this exploratory research was expected to contribute to the understanding of Croatia as an environment for hotel business.

Porter's Diamond model was used as a framework for analysis of the collected data, because it was specifically developed for analyzing industries in the modern, globalized world. The secondary data consisted of the collection and revision of the official governmental statistics (CROSTAT, Ministry of Tourism of Croatia). The primary data was collected during a set of short interviews, which were conducted with professionals of the hotel industry and other related industries. Also a reflection of the author's working experience in one of Croatian hotels was included in the primary data.

The author of this research was motivated by the fact that she wanted to share her own working experience in this field. She strived to organize the knowledge gained and other available data into one report. The written report could be useful for further research and help to understand Croatia and its hotel industry in particular.

2 METHODOLOGY

2.1 Exploratory research method

The current work was chosen to be carried out in a form an exploratory research. This methodology seemed to the author as the only possible choice. As Kotler et al. (2004, 345) explained that exploratory research in marketing is a type of research, aimed to “gather preliminary information that will help to better define problems and suggest hypothesis”. The fact that the country with such a beautiful nature and mild climate had such a poor and underdeveloped tourism industry seemed to be a paradox. To get things even more complicated and shady, almost no literature could be found that described the hotel industry in Croatia. Different fragments of information were dispersed across different sources, but no single significant effort to address the problem could be found. That is why in order to get an idea of what was going on with the hotel industry, one sensible way was to start gathering all available and relevant information in one place. Then the information could be analyzed and presented in a systematic manner, prepared for further exploration and enhanced understanding of the issue.

The same approach is supported by Routio (2007). He explains that it is usual that you start an exploratory research by gathering as much information about the objects as possible, and postpone the task of cutting away unnecessary data until you get a better picture about what *is* necessary. He continues by admitting that any object can be looked at from different viewpoints, for example, from the viewpoint of an established science. Each viewpoint can change the direction of the research. He explains this as a method of alternating point of view, depicted in Figure 1.

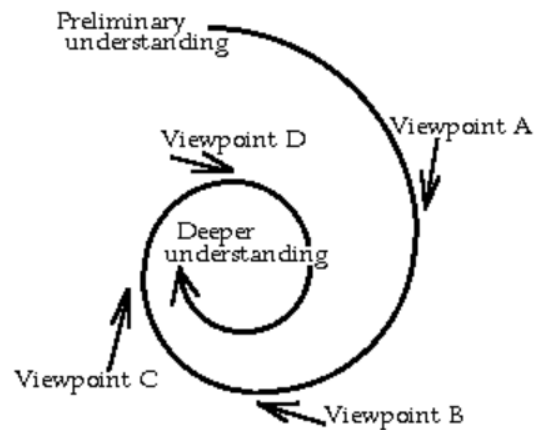


FIGURE 1. Alternating point of view method by Routio (2007)

In case of analyzing the hotel industry, it made sense to try to find some well-established economic model for analyzing industries. If the model could be found, that would provide a clear framework or standpoint from which the author would take a look at the hotel industry of Croatia. Using such model as a viewpoint would also make the result of the work more uniform, understandable and make it easy for other researchers to build on its results.

2.2 Porter's Diamond Model as analytical framework

It was decided to use Porter's Diamond Model as a standpoint from which the author of this research would take a look at the hotel industry in Croatia. Porter's model is considered by many economists to be one of the most up-to-date and relevant models. The model strives to explain why particular industries are successful in particular countries. It is well-known that this question has been around quite a long period of time and many famous scientists tried to investigate it. Starting from Adam Smith's Absolute Advantage and Comparative Advantage by David Ricardo in the 18th century, many bright economists have made their contribution to the development of the modern economic theory. However, since then the rapid pace of the development of the world economy has been the major obstacle to designing an accurate and comprehensive model enough. At this point of time, the Porter's theory seems to be the most up-to-date and taking into account the most of the recent

changes including the phenomenon of globalization of trade and emergence of multinational enterprises (MNEs). Porter's Diamond Model provides a comprehensive framework for analysis of different forces and factors, which predetermine nation's success in different industries.

It is worth mentioning that the Porter's model is very detailed. Porter builds his theory on analysis of numerous different factors, which affect how companies behave within a given industry and country. He puts a major emphasis on the level of competition between companies, and how the government and other external factors shape it. These external factors are numerous. According to Porter (1990, xxv), in his theory he tried to capture the full complexity and richness of actual competition, rather than to abstract from it. This seems to be the reason why the 1990 edition of the book "The Competitive Advantage of Nations", in which Porter first introduced the Diamond model and theory behind it, was around 900 pages long. This means that the author of this research could not attempt to embrace the model in its full depth and with all of its numerous details. However, the author could make her own contribution by filling the parts of the model with the information she could collect from different sources, including her own personal experience and experience of relevant practitioners of the hotel industry.

The result of such methodology was expected to be a collection of industry-related information, assembled, analyzed and presented in a well-established format (Porter's Diamond Model) and ready for further improvement and analysis by other researchers (see Figure 2).

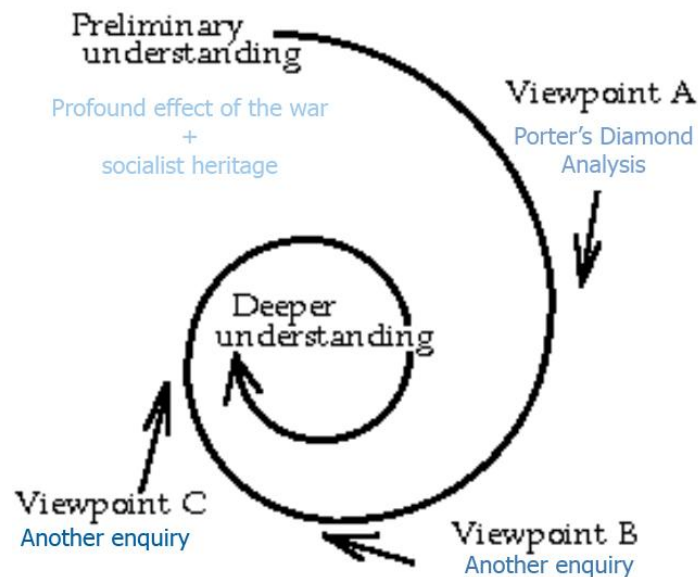


FIGURE 2. Alternating point of view method adapted to the research

2.3 Primary data collection and reporting

During the summer and the autumn of 2010, the author was working as a receptionist in Hotel Kolovare, Zadar. This experience exposed the author to a reality of the daily operations of a medium sized hotel, which is located on the coastal part of Croatia (see pp.41-43). The experience gained allowed the author to assess the overall quality of the services and discover what the situation in the hotel “behind the curtains” was. The author could see from the inside how the hotel was operated, what the corporate culture was and, finally, what the reasons behind that were.

It is fair to say that the study of the situation in only one hotel could not be generalized to apply to other hotels. That is why the author undertook a set of short interviews with a group of different practitioners, related to the hotel industry. These were hotel managers of different level, as well as other professionals, like real-estate developers and members of local chambers of economy. There were nine people interviewed: seven hotel managers, one real-estate expert and one governmental officer from a chamber of commerce.

These interviews were supposed to underpin the major concerns of the chosen practitioners about the state of the hotel industry and give them a chance to express their opinions about what was the most significant factor for the development of the hotel industry in Croatia. The summary of the interviews is provided in Appendix 1. When the ideas of the respondents are used in the text, there are corresponding references to the summary. The ideas of the interviewees were used as a stepping stone for analysis of each component of Diamond Model (e.g. factor conditions, demand conditions etc.).

3 THEORETICAL BACKGROUND

3.1 Tourism industry fundamentals

The hotel industry as a part of the tourism system

In order to be able to analyze the hotel industry of Croatia, it is important, first, to define who the industry participants are, what their products are and what the major relevant issues in the industry are. Thus, it is necessary to introduce the concept of tourism in a broader sense. Many authors tried to come up with a definition of tourism; however, all of the attempts seem to have come to a different conclusion. Sharpley (2009, 7) claims it to be an unrealistic task to devise a single, all-embracing definition for tourism. However, there is one attribute of tourism that has always been associated with it. It is the fact that tourism, by definition, involves travel (op.cit.). And the reasons, why people leave their habitual day-to-day environments, are astonishingly numerous. People make business trips, go on sun-sea-sand holidays, involve in educational tourism, just to name a few. Moreover, Sharpley introduces another group of travelers, usually not associated with tourism. This group includes different kinds of people from nomads, refugees and temporary immigrants to diplomats, border officials or members of military forces.

Sharpley (2009) also continues:

Although tourism and travel is a social activity, that activity is to a great extent dependent upon the provision of goods and services that facilitate people's travel and their activities at the destination. In fact, as long as people have been able to travel they have required a variety of services, such as lodging, food and refreshments... (p.9)

This way the hotel industry can be viewed as a part of the complex tourism system, which comprises 4 key elements:

- *The tourism generating region: the region that is the source of the tourists and where significant sectors of the tourism production system (for example, airlines, tour operators, travel retailers, international accommodation providers) may be located or based.*
- *The tourism destination region: the region that attracts tourists, which experiences the consequences of tourism development and where the primary elements of production system (**hotels**, attractions, facilities) are located.*
- *The transit region: the region or route a tourist travels through to reach the destination.*

- *The environment within which the tourism generating, transit and destination regions are located and with which tourists interact. (Op. cit. p.12)*

Such a complex look at the tourism system is necessary to understand the nature of the hotel industry and its specific problems. The hotel industry cannot be viewed separately from other industries constituting the whole tourist experience.

Tourism and its impact on the environment

One of the most recognized problems of tourism is its impact on the cultural and natural environments of the target country. As long as tourism in many countries is heavily relying on natural and cultural resources, these are also the ones which suffer the most. According to Saxena (2008), at many destinations, nature is ruined after just a few decades of exploitation. Tourists are deserting impoverished destinations to seek new unspoiled places to travel to. (p.261)

For example, Spain paid a high price for its loose policy in controlling tourism development. Especially, this concerns a liberal policy in the construction of hotels and other types of buildings on the coast. As a consequence the once pure and green coastal towns were turned into Manhattan - like crowded streets, which ruined the native Mediterranean landscape and severely damaged the nature. Figure 3 and Figure 4 illustrates this phenomenon. Back in the 1950s, Benidorm was a small agricultural village, and these days it is a skyscraper city with more than 60 million tourist overnights per year (more than in the whole Croatia). There are over 150 hotels with 40,000 beds, more than 2,000 shops, 86 banks. (Huete, 2009.)



FIGURE 3. View of Benidorm in 1960s



FIGURE 4. View of modern Benidorm

Unfortunately, Spain is not the only example of uncontrolled development of tourism. Sharpley (2009, 172-173), also reports that the coasts of Cyprus suffered from a similar development.

“Leakage” of generated foreign exchange

Another important problem, which comes with the development of tourism, is that in many cases the returns, which are generated by tourism, are going outside of the destination country. According to Saxena (2008, 12), the World Bank estimates that

55% of tourist spending in developing countries leaks back to developed countries, while other studies indicate the figure may be as high as 90%. Apparently, a significant part of spending, like agency fees or air transportation fees, insurances, happens in a tourist generating region. But given the globalized economy and freedom to operate in almost any country, a range of multinational hotel chains emerged (Starwood, Melia etc.). Competing against strong multinational brand names should be rather hard for local hotels, which leaves the citizens of destination region outside of a lucrative hotel business.

Natural resources as a “free” startup resource

According to Sharpley (2009, 15)

Tourism is frequently based on existing natural or man-made attraction, such as beaches, wilderness areas or heritage sites. Thus, tourism may be considered to have low “start-up” costs when compared with other industries.

Conclusion

To sum up, tourism, as well as the hotel industry, is a double-edged sword. On one hand, with development of tourism come new sources of employment and income for residents of destination countries, which normally lead to rise of the overall standard of living. On the other hand, uncontrolled development of tourism can lead to negative, sometimes catastrophic consequences, deteriorating natural resources without improving a standard of living for citizens of a destination country. This means that nowadays, governments, having seen mistakes of the past, tend to be more careful with development of tourism. This should have a direct affect on the hotel industry, because construction of new hotels and other types of accommodation is a strong catalyst of tourism.

Another peculiarity about the hotel industry is its strong reliance on other industries, like entertainment or food, sports; just to name a few, which together affect the “whole” tourist experience. The total experience by definition has to be compelling and make people want to leave their homes and travel. If these additional services are poorly developed, the hotel industry will most likely be also lagging behind. However, as Sharpley (2009, 15) noticed tourism utilizes natural, “free” infrastructure. This makes the tourism system balance between these “free” and man-made types of infrastructure. For instance, the beauty of the nature can offset

the poor development of hotel or entertainment industry and vice versa. This way, the special feature of the hotel industry is that its main product (temporary accommodation) is just a part of what forms the overall tourist experience. Therefore, during an analysis of a hotel industry it is important to pay attention to what M. Porter calls “supporting and related industries”.

3.2 Porter’s Diamond model

About Michael Porter

Michael E. Porter is a leading authority on competitive strategy, the competitiveness and economic development of nations, states, and regions, and the application of competitive principles to social problems such as health care, the environment, and corporate responsibility.

Professor Porter is generally recognized as the father of the modern strategy field, as has been identified in a variety of rankings and surveys as the world’s most influential thinker on management and competitiveness.

He is the author of 18 books and over 125 articles. (Harvard Business School 2011.)

See the background information about the model in Appendix 2.

The Diamond

The model itself is depicted in a form a diamond with four facets. Each facet represents a major factor, directly affecting the level of productivity and, therefore, overall competitiveness of an industry. There are two addition entities, which can affect each facet, namely: Government and Chance. (See Figure 5.)

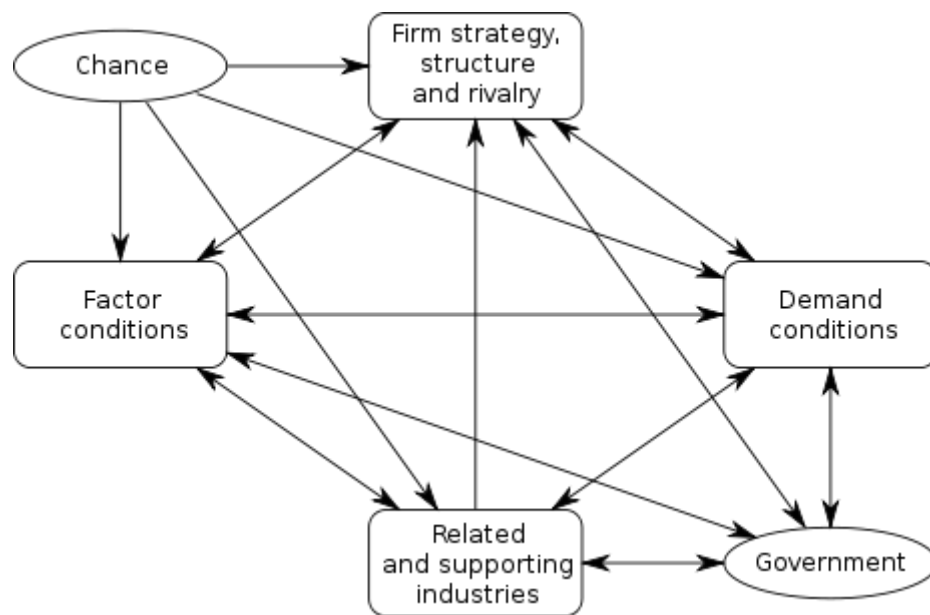


FIGURE 5. Porter's Diamond Model by Porter 1990

1. Factor conditions. The nation's position in factors of production, such as skilled labour or infrastructure, necessary to compete in a given industry.
2. Demand Conditions. The nature of home demand for the industry's product or service.
3. Related and supporting industries. The presence or absence in the nation of supplier industries and related industries, which are internationally competitive.
4. Firm Strategy, Structure and Rivalry. The conditions in the nation governing how companies are created, organized and managed, and the nature of domestic rivalry.

Porter 1990, 71

Each facet of the Diamond represents a comprehensive set of particular attributes of a nation. Both individually and as a system they are responsible for shaping the environment, in which local firms from a particular industry operate and compete. As you could have already noticed, some of the facets of the Diamond resemble major ideas of the economic theories of the past two and a half centuries. Factor conditions facet is a direct descendant of Ricardian ideas of the Comparative Advantage as well as A. Smith's Absolute advantage. Demand Conditions facet resembles the thoughts of R. Vernon and his "product cycle" model and important role of demand conditions. The rest of the facets as well as the other two crucial entities (Government and Chance) were introduced by Porter in attempt to capture the big

picture and make the model comply with the latest major developments in the world.

The author assumes that for the purpose of this research the Diamond Model can be described from the standpoint of a hotel industry. While in his book Porter goes into numerous details and cases applicable to various industries, the author thinks that it will be more productive to focus only on the hotel industry.

Factor Conditions

These are commonly called by economists as factors of production and represent merely the inputs necessary for everyday operations. In case of hotel industry, these are:

- Human resources – availability of trained, skilled personnel and management and its cost
- Physical resources – the nature (coast and sea), geographical location, climate, availability of natural resources (electricity, natural gas, petrol), length and condition of the coast
- Knowledge resources – general stock of scientific, technical and market knowledge relevant to the hotel industry. Availability and quality of relevant statistical databases, measuring tourist arrivals/nights etc. Availability of industrial non-profit organizations, carrying out market research of current tourist demand conditions etc.
- Capital resources – availability of capital both local and international. Attitude and interest of investor towards the hotel industry
- Infrastructure – first of all, air transportation. Road and maritime transportation. Electricity, water, sewage, natural gas supply. Health care system is rather important factor for tourism. Overall development of real-estate, national parks and other cultural institutions.

Demand conditions

This facet represents an analysis of foreign and domestic demand conditions.

According to Porter (1990, 86), home demand conditions have influence in almost every industry. However, what concerns the hotel industry, it is the foreign demand

conditions, which have the major influence. On the other hand, home demand conditions pay certain role in other related industries, such as sports and recreational facilities, like golf, football stadiums etc.

In the Diamond Model Porter pays significant attention to product industries. He describes various important characteristics in demand for products, which could be exported and distributed around the world. In case of a hotel industry, which is a service industry attached to particular geographical location, most of the demand characteristics described by Porter are of minor importance. In this sense, what really matters for a hotel industry is how many foreigners choose Croatia and Croatian hotels in particular as their travel destination.

Related and supporting industries

This facet represents another determinant of national advantage in an industry and stands for the availability in the nation of supplier and related industries, which are internationally competitive. As has already been mentioned major product of a hotel industry is a part of the whole tourist experience (see pp. 10-11). Moreover, seldom are hotels the reason, why tourists choose to come to a particular destination. Therefore, a hotel industry is more of a supplementary type and it relies heavily on the development of other parts of tourism system.

According to Cooper (2003, 22), the supply side of the tourism industry includes accommodation, transport, agency services, food and souvenirs. In addition, Williams, Bruswell (2003, 5) argue that there is a close relationship between leisure and tourism industries. He explains that tourism has three broad categories of purpose:

1. Leisure and recreation, including holidays and social events
2. Other tourism, including educational and health reasons
3. Business, including conferences, meetings and exhibitions

Williams et. al (2003) continue that context of leisure activities can range from purpose-built facilities such as leisure centers and theatres to resources such as national parks and urban open spaces. Other two categories include facilities like spas, health centers, conference halls, business centers and concert halls. (p. 5)

Firm strategy structure and rivalry

The last, but not least, determinant of national competitive advantage in an industry is the nature of the ways firms are organized. This includes typical structure, goals and methods of running local companies and rivalry between them. This determinant is relying on cultural and historical background of a nation.

Regarding a hotel industry, this facet of the Diamond would include analysis of managerial abilities and style, their relationship with employees and owners as well. Another important factor for analysis would be the level of competition between the hotels.

Government and its role

Porter (1990, xiii) stressed the importance of government and its ability to influence all facets of the Diamond. Indeed, it is the government that creates policies and governs how the natural resources are exploited, how firms interact within industries and how businesses are run in general.

One of the key relationships between government and the facets of the Diamond is the governmental policy for preservation of natural resources. Government is free to decide how the most suitable for tourism parts of a country will be developed. History of 60s and 70s in Spain shows the importance of governmental control of the real-estate industry and construction of hotels, in particular.

4 RESEARCH: Results & Facts

4.1 Key facts

**Population**

4.5 million

Land Area

56 542 km²

Sea Area

33 200 km²

Total amount of islands

1,185

Of which populated

67

Coastline

1,770 km

Capital

Zagreb (800,000 inhabitants)

Independence Day

October 8th, 1991

International telephone code

+385

Domain

.hr

Time zone

CET(GMT+1)

Government

Parliamentary Republic

Location in Europe



FIGURE 6. Location of Croatia in Europe by APIU (2009a)

Croatia has a very favorable location in the very heart of Europe. In two hours by plane it can be reached from almost any European country.



FIGURE 7. Major Croatian cities by APIU (2009b)

Croatia can be broken into several parts for convenience. The coastal area includes Istria (violet) and Dalmatia (green, red, yellow). The other two parts Central (blue, Zagreb) and Slavonia (white, Osijek).

4.2 Factor conditions

Physical resources

Croatia is famous for the beauty and diversity of its nature. The coastal part of Croatia is about 1,700 km long and has a great number of bays and caves.

Croatia has a large archipelago of 1,185 islands; of which only 67 are inhabited.

Croatia is an ideal place for sailing. The high density of islands and bays is unique and makes a sailing experience especially safe and pleasant. One is not going to find anything similar across the whole Mediterranean. Maritime tourism attracts a significant amount of visitors every year (see pp. 45-46).

Croatia is also rich in UNESCO protected locations like Plitvice Lakes and a range of ancient cities, as well as numerous protected national parks of nature, such as Kornati islands, Paklenica Mountain Park, Krka waterfalls and many others.

The climate is mild with 100 sunny days per year on the average. The summers on the coast are quite hot with the average temperatures of 24-26 degrees Celsius.

There is a mountain range Velebit, stretching across the whole coast. The mountain range preserves the coastal part of Croatia from cold winds and precipitation coming from the north.

These robust natural resources make Croatia a very attractive destination for tourists. Given the fact that the tourism industry is still underdeveloped in Croatia, and the country is not yet as popular as Spain or France, many celebrities choose it as their holiday destination. Among them is Bill Gates, who has been seen almost every year in a small coastal town Skradin, where he comes on a rented yacht (Forbes 2010).

Most of the respondents considered the nature and the sea as the major attractions for tourists (see Appendix 1, Q1). In their opinion, the nature of Croatia is still very pure and intact.

Some of the hotel managers also thought that the climate causes a major problem of profitability at their hotels (see Appendix 1, Q4-2,4,8 ; Q5-4,5). The fact is that the bathing season in Croatia is comparatively short – from June to August. This is the high tourist season. If compared to Greek or Cypriot hotels, Croatian resort hotels

experience a more adverse seasonality effect due to the climate. This issue is further discussed in chapter 4.3 Demand Conditions.

Human resources

The total workforce in 2009 was estimated to be 1.7 million people (Business monitor 2010, 39).

According to IMF (2011), unemployment in Croatia has risen from 8.3% in 2008 to 12.3% in 2010. However, according to the Croatian Central Bank (2011), unemployment in 2010 was as high as 17.4%. On the other hand, such unemployment rate does not seem to be unreasonably high, though. For example, during the period 2000 – 2005 the average unemployment rate was 20.1% with the average real GDP growth of 4.3%. (op.cit.)

In general, Croatian labour force is well-educated. Despite the high unemployment rate, the proportion of young educated workforce is quite high. According to APIU (2005, 11), 92.5% of Croatians between the ages of 20 and 24 had a completed their secondary education, which was higher than in many EU countries.

Unfortunately, it was discovered during the research that most workers employed in the hotel industry lack the appropriate education. In spite of the fact that the country pays significant attention to education, the interviewed practitioners of the hotel industry testified that the level of education of employees was still poor. One reason for this may be the fact that the country had been isolated from the modern society for quite a long period of time (Yugoslavia, 1991-1995 war). The Croatian hotel industry is in its initial stage of development. Apparently, not much industry specific experience and knowledge has been accumulated. One illustrative example of this is included in the interviews with a manager from Le Meridien Lav (Starwood's 5 stars hotel near Split):

When we opened the hotel in 2006 we barely knew what our customers were expecting from us. Because we are a part of a multinational chain Starwood Hotels we were expected to deliver a certain level of service and stand up to the name of the brand. But back in 2006, our guests knew more about Starwood's brand and quality standards than our entire management team and we had to learn from them.

Hence, it seems that Croatia has the necessary human resources for the expansion of the hotel industry, but the industry specific knowledge (that can be obtained only with expertise) has not yet accumulated.

Infrastructure (public utilities)

There is a modern toll highway road crossing the whole country. Speed limits up to 130 km/h and excellent quality of the road surface allow to get from coastal Zadar to the capital Zagreb in about two and a half hours by car.

The only two regions, which have not yet been reached by the highway, are short part connecting Dubrovnik and Makarska and some roads on the Istrian peninsula.

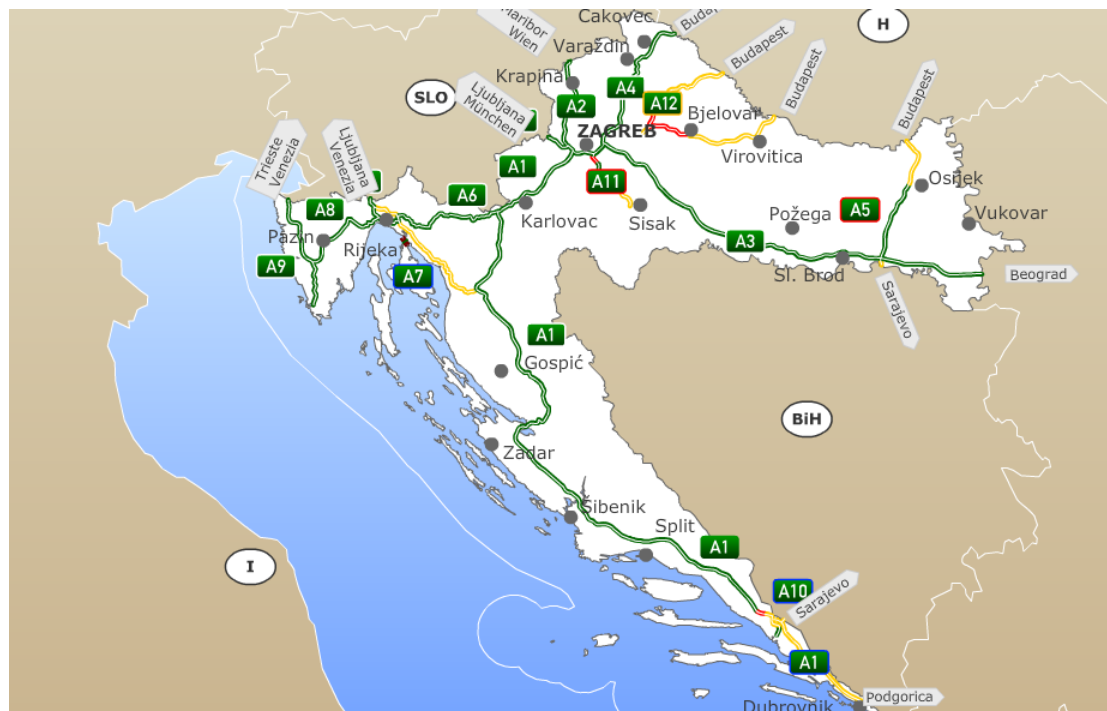


FIGURE 8. Motorways in Croatia by neretva.info (2011)

During the last decade, the government of Croatia has been investing in development of transportation system.

Gas grid covers most of the territory of Croatia. However, the largest part of Croatian coast does not have a gas pipeline network.

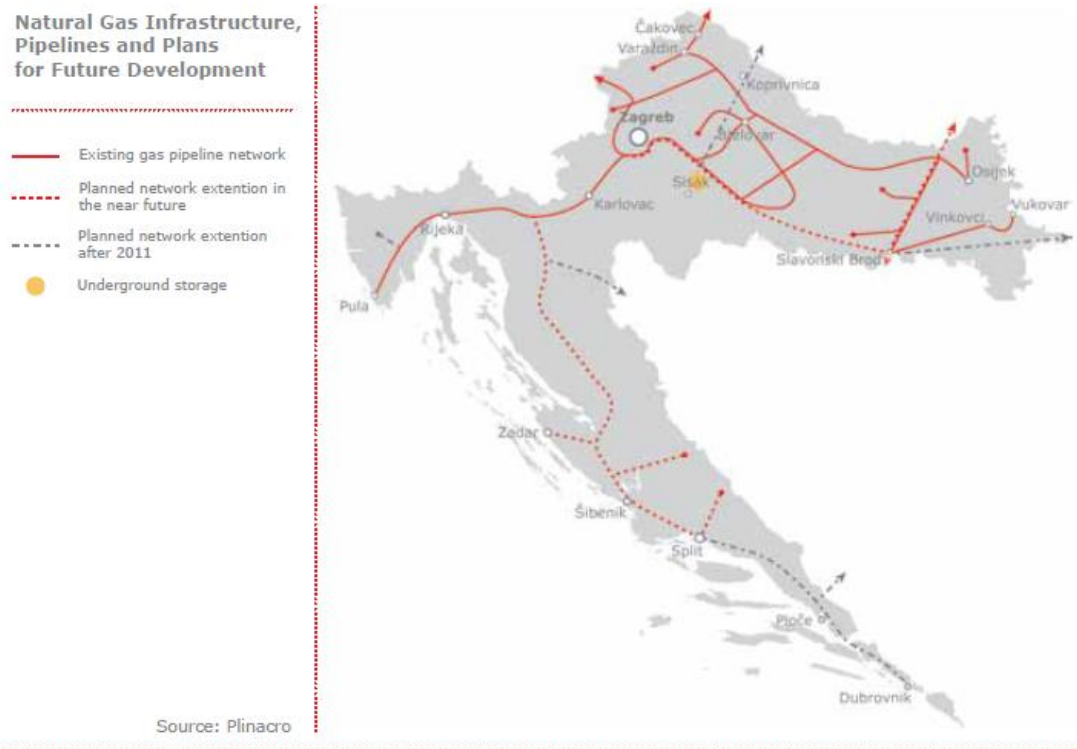


FIGURE 9. Croatian Natural gas grid by APIU (2009c)

Capital

The history of development of capitalism and market economy in Croatia is quite short. Given the long period of Yugoslavia and devastating war with Serbia, it is quite natural that Croatia does not have much of its own capital. However, starting in 2005 foreign direct investments started to inflow into the country. 2005 was the year, when the country officially entered into EU accession negotiations.

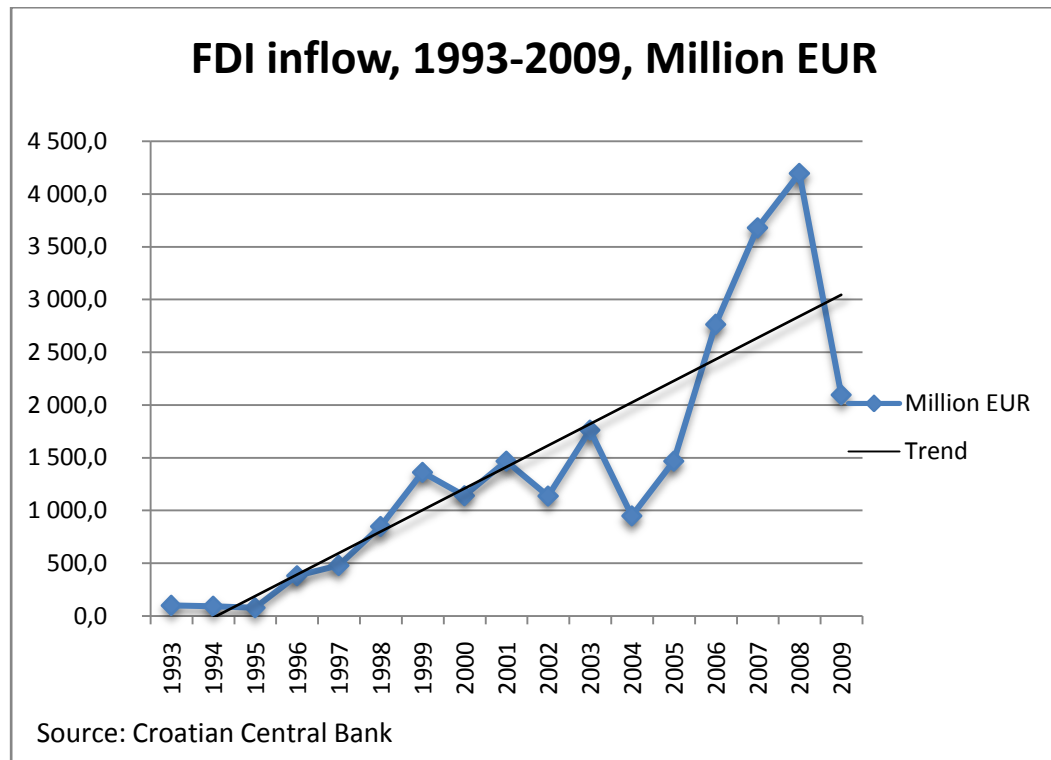


FIGURE 10. FDI inflow in Croatia 1993-2009. Croatian National Bank (2011b)

As can be seen in Figure 10, the distinctive period of rapid growth was from 2004 to 2008. During this period annual FDI inflow had grown 4.4 times from 950 million euro in 2004 to 4.2 billion euro in 2008. In the author's opinion, this astonishing growth was due to significant change in process of EU accession negotiations. The author believes that the turning point happened in 2005, when Chief Prosecutor of International Criminal Tribunal for the former Yugoslavia (ICTY) assessed that "Croatia is now fully cooperating with ICTY". When the announcement was published official accession negotiations were launched.

On 10-th of June 2011 the EU Commission proposed to close last four chapters in negotiations and 1-st of July 2013 was introduced as an estimate, when the country will become a 28-th member of EU (Barosso 2011).

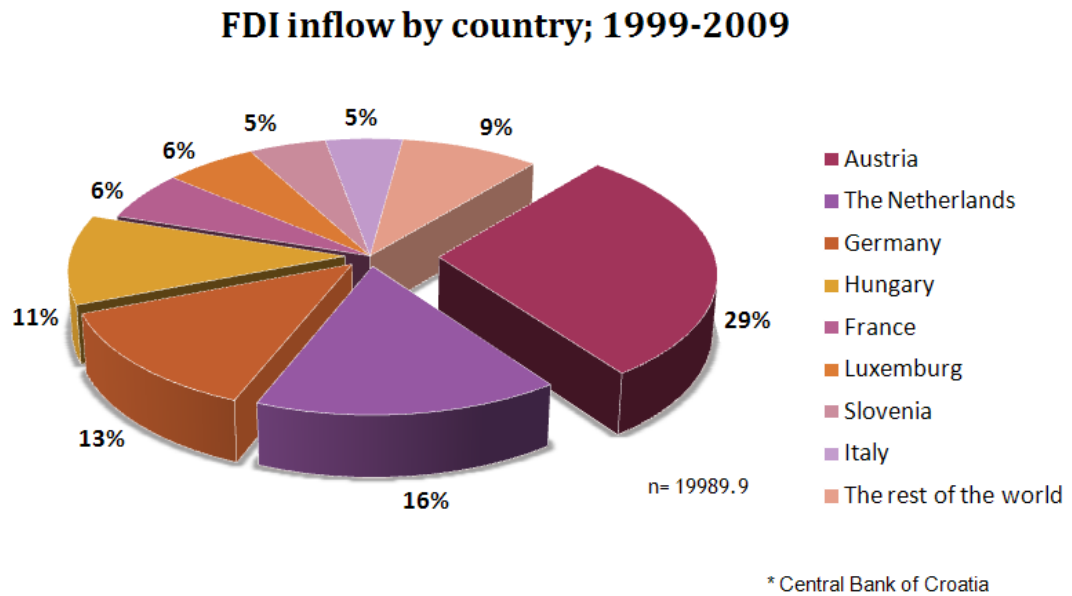


FIGURE 11 FDI inflow in Croatia by country 1999-2009 (Croatian National Bank 2011c)

In spite of this large gain in FDI, only 350 million EUR were invested by foreigners into the hotel and restaurant sector from 2004 to 2008 (Croatian National Bank. 2011d). According to Croatian Central Bank, this accounts to less than 3% of total amount of FDI for the period from 2004 to 2008. It means that foreign investors are not targeting hotel industry as a field of investment.

During the interviews, some of the respondents shared that they view the lack of capital as one of the major obstacles to development of the hotel industry in Croatia (see Appendix 1, Q4-1; Q5-2,7).

Role of the government

According to one of the respondents, the Croatian government has a very strict policy towards development of the coastal part of the country (see Appendix 1, Q4-1). The country has a centralized (inefficient) system for planning of land utilization. According to the respondent, it is the long procedure of getting all the necessary construction permits, which hinders the development of real-estate in Croatia, including hotels. The government is trying to protect the coast from uncontrolled development by any affordable means. This is why there are numerous strict laws regarding the construction in the coastal areas. As it turns out, the inefficient

governmental system, inherited from Yugoslavia, seems to be working rather well in restricting construction on the coast. However, while protecting the nature, the system also makes it virtually impossible for investors to start new development projects on the coast.

As a result, Croatia possesses lucrative natural resources, but almost entirely restricts the use of these resources. Given the abundance of sad stories of mass tourism development in countries like Spain, Bulgaria and Cyprus, this seems to be the only appropriate strategy for a developing nation. With time Croatian governmental system will improve and reach the point, when it will be ready to use its natural resources in a sustainable way. Until then, all foreign investors will have to cope with enormous amount of bureaucracy, strict laws and rules.

On the other hand, the government has been successfully investing in the country's transport infrastructure. The government seems to have a clear goal of making Croatia one of the most easy-to-access locations in Europe. Given the country's favorable location and persistence of the government, this goal seems to be realistically achievable. Moreover, Croatia is currently on its final step in the process of accession into EU, which will further ease transportation.

4.3 Demand conditions

Croatia is known among Europeans as a destination for summer stays and vacations. This can be easily explained by the country's convenient geographical location as well as beauty and purity of the Mediterranean nature and mild climate.

During the three years from 2007 to 2010, annual amount of foreign visitors in Croatia has been fluctuating from 9 to 9.5 million people. The prevailing group of visitors comes during the "high season" from June to August.

2010 was rather successful year for Croatia from the point of view of tourist arrivals. According to Minister of Tourism Damir Bajs (2010), July 2010 might have been the best July ever for Croatian tourism, with its impressive total of 2.7 million visitors.

Croatia has very tight, long-standing relationship with its Western European neighbours. For more than a millennium (7th to 18th century) some coastal parts of Croatia belonged to the Republic of Venice. The coastal part of Croatia has also used to be under the influence of Austro-Hungarian Empire for a long period of time.

During the period of Yugoslavia, Croatia was considered to be one of the most economically developed and western oriented member state along with Slovenia.

Therefore, it seems that it is the mix of cultural similarities together with the long-standing common history and beautiful nature that, nowadays, attract Europeans to Croatia.

Composition of demand

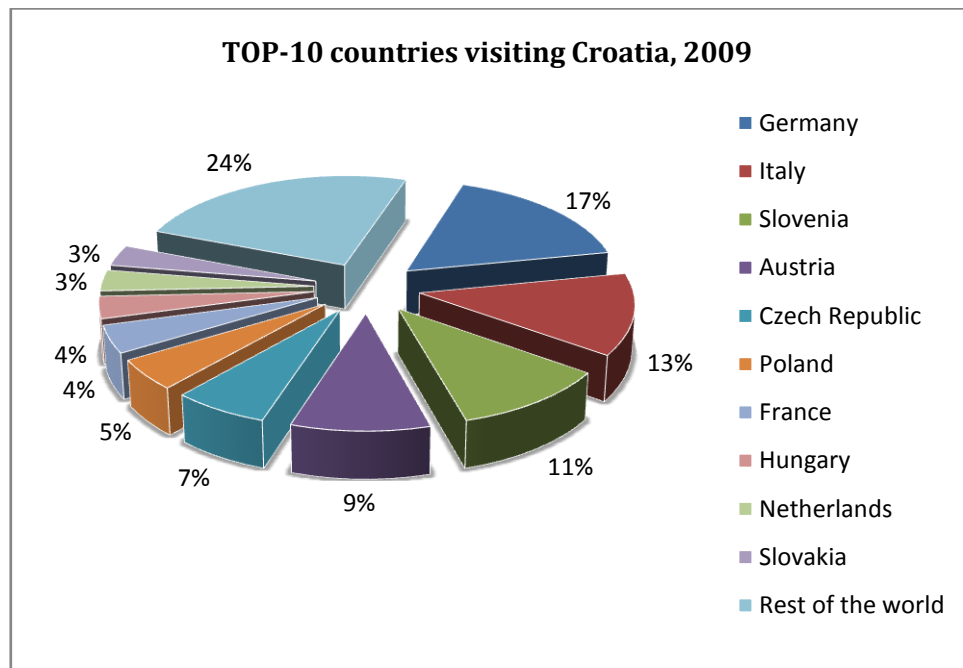
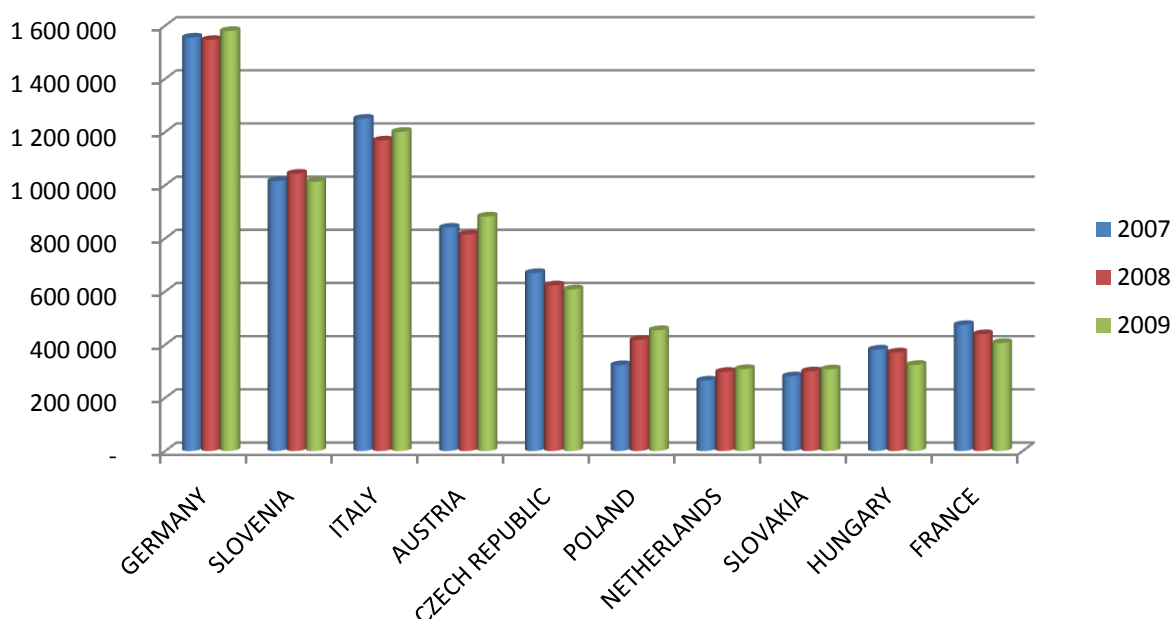


FIGURE 12. Top-10 countries visiting Croatia in 2009. Data by MINT 2011a

As shown by Figure 12, more than 76% of visitors came from EU member states. 50% of all visitors in 2009 came from four key destinations (Germany, Italy, Slovenia and Austria).

Tourist arrivals in Croatia, 2007-2009



SOURCE: Central Bureau of statistics

Tourist traffic by region (foreign and local)

Region	Traffic by year		
	2007	2008	2009
ZAGREBAČKA	32.376	35.131	36.942
KRAPINSKO-ZAGORSKA	61.197	65.145	56.497
SISAČKO-MOSLAVAČKA	33.164	31.618	29.273
KARLOVAČKA ŽUPANIJA	160.958	164.883	161.277
VARAŽDINSKA ŽUPANIJA	48.987	46.698	38.612
KOPRIVNIČKO-KRIŽEVAČKA	18.357	18.042	15.592
BJELOVARSKO-BILOGORSKA	14.669	14.776	12.719
PRIMORSKO-GORANSKA	2.247.788	2.214.061	2.205.627
LIČKO-SENJSKA	359.635	365.709	386.720
VIROVITIČKO-PODRAVSKA	14.415	14.368	14.395
POŽEŠKO-SLAVONSKA	8.356	8.365	9.630
BRODSKO-POSAVSKA	22.757	24.847	23.118
ZADARSKA	1.072.659	1.102.170	1.049.019
OSJEČKO-BARANJSKA	84.724	89.386	78.382
ŠIBENSKO-KNINSKA	820.312	822.879	746.532
VUKOVARSKO-SRIJEMSKA	38.355	39.765	33.828
SPLITSKO-DALMATINSKA	1.731.039	1.746.311	1.657.945
ISTARSKA ŽUPANIJA	2.719.949	2.729.618	2.755.269
DUBROVAČKO-NERETVANSKA	978.402	986.851	957.229
MEĐIMURSKA ŽUPANIJA	28.909	35.019	32.351
GRAD ZAGREB	665.398	705.165	633.517
UKUPNO ŽUPNIJE	11.162.406	11.260.807	10.934.474
Source: Central Bureau of statistics			

It is well known that Croatia is a representative of so-called Balkans or countries, located on the Balkan Peninsula. For good or bad, it is common that people, who have never visited Croatia, usually suppose that Croatia has many cultural similarities with its Balkan neighbours (Albania, Bulgaria, Montenegro, and Bosnia and Herzegovina). Even though some cultural or linguistic similarities exist, Croatia is one of the most western oriented countries in the whole region. And this is reflected by the nature of the tourist traffics the countries receive. For example, while the prevailing part of the Croatian tourist traffic consists of visitors from four major EU countries, the Bulgarian tourist traffic consists of an absolutely different cluster of countries, many of which are non-EU as shown by Figure 13.

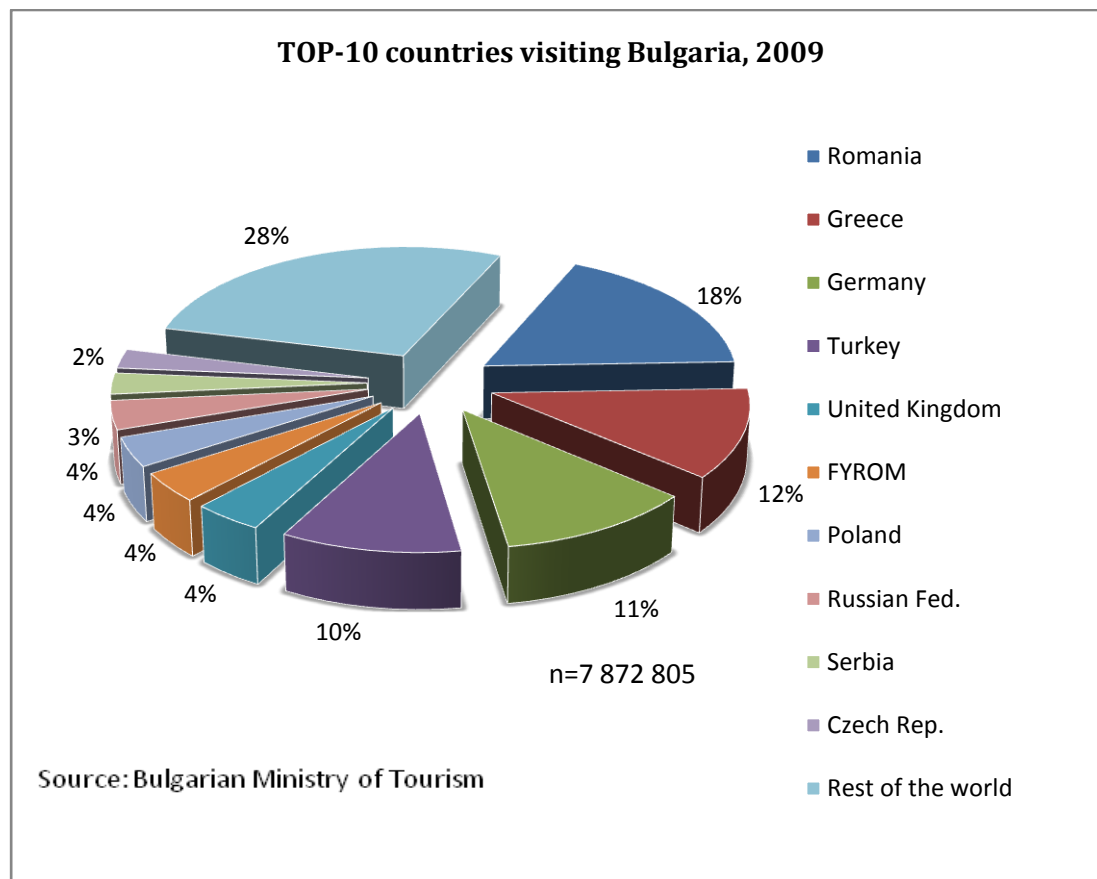


FIGURE 13. TOP-10 countries visiting Bulgaria in 2009. (MEET 2011)

Life cycle of demand

As shown in Table 1 in 1985, Croatia hosted as many as 10,125,000 visitors. However, it took the country approximately 15 years since the end of the war to merely recover this level of annual tourist traffic. It is worth mentioning that in 1985 Croatia was part of Yugoslavia, and neither highway roads, nor low-cost air transportation existed. This fact points out that demand for Croatia as a tourist destination has revived and is in its initial stage of development. This reveals a hidden growth potential of Croatia as a tourist destination.

TABLE 1. Major tourism indicators in Croatia by MINT 2005, 2010

	1980	1985	1990	1995	2000	2005	2010**
Tourist arrivals (in thousands)	7,929	10,125	8,498	2,438	7,136	9,995	10,604
Overnights (in thousands)	53,600	67,665	52,523	12,885	39,183	51,421	56,416
Average number of nights per arrival	6.8	6.7	6.2	5.3	5.5	5.1	5.3

Seasonality of demand

According to the prevailing part of the respondents, short season was considered to be a determining factor for hotel industry in Croatia (see Appendix 1, Q4-2,4,8 ; Q5-4,5). According to Croatian Central Bureau of Statistics (CBS 2007, 21) four months of the high season in Croatia (June-September) on the average account for 75% of yearly tourist arrivals. This means that the demand is highly seasonal, which makes it difficult for entities like hotels to operate profitably. Indeed, according to one of the respondents only 25-30% of all Croatian hotels are profitable.

Role of the government

According to prevailing part of the respondents, Croatian government is not spending enough on establishing awareness about Croatia as a tourist destination. Most of the hotel managers, who were interviewed during the research, testified that many of their guests come for the first time and have very limited knowledge about the country. (See Appendix 1, Q3)

Despite this negative trend, tourism in Croatia continues to progress and the annual amount tourist traffic is constantly increasing. The government and local authorities are constantly improving their efforts to increase general awareness about Croatia worldwide. These efforts range from funding special promotion agencies (e.g. APIU) to rather unconventional ideas like renaming one of the inhabited islands “Facebook” (Croatian Times 2011).

4.4 Firm strategy, structure and rivalry

Rivalry

Hotels vs. other types of accommodation

As many other Croatian industries, the tourism industry has not yet fully recovered from the consequences of the War of Independence from Serbia (1991-1995). The industry is characterized by poor supply of accommodation. There are few new developments and majority of units located in outdated, soviet facilities.

TABLE 2. Breakdown of accommodation in Croatia 2009 by CBS 2010

Breakdown of accommodation in Croatia, 2009		
Accommodation type	Amount of Beds	Share of total, %
Hotels, hotel resorts and apartment hotels	121 086	12,5
<i>One star (0,1%)</i>	<i>89</i>	
<i>Two stars (15%)</i>	<i>17 593</i>	
<i>Three stars (46,9%)</i>	<i>56 853</i>	
<i>Four stars (30%)</i>	<i>36 851</i>	
<i>Five stars (8%)</i>	<i>9 700</i>	
Camping sites	217 177	22,4
Private accommodation	446 354	46,0
Other	185 109	19,1
Total	969 726	100,0

As can be seen from Table 2 hotels represent only a minor part of total amount of beds. Private accommodation, such as rooms, flats, apartments and summer houses, has been and continues to be the most popular accommodation type in Croatia. According to CBS (2010), private accommodation accounted for almost half of all the beds available in Croatia in 2009. Moreover, one also should take into account that these are only official statistics, and it is quite hard to estimate the real amount of supply from private accommodation segment. While statistics can be quite precise about the amount of registered hotels and campsites, private accommodation figures are somewhat vague and are likely to be underestimated to some extent.

TABLE 3. Number of beds by type of accommodation, 1985-2009 by CBS 2010

Number of beds by type of accommodation, 1985-2009, in thousands			
Year	Total	Collective	Private
1985	820	561	259
1992	576	521	55
1995	649	523	126
2000	759	479	280
2005	909	499	410
2009	969	523	446

According to CBS (2010), during the period of 14 years from 1995 to 2009 total amount of beds in hotels had been staying at approximately the same level of 523,000 beds. During the same period, amount of available beds in private accommodation had grown from 126,000 in 1995 to approximately 450,000 in 2009. (See Table 3.)

This unprecedented growth in the supply of private accommodation means that hotels are unable to attract tourists, which passes a large part of tourist traffic into hands of private accommodation suppliers. Given the scale of private accommodation sector and its rapid development during last 15 years, it nowadays seems to be an important constraint for the development of the hotel industry. It is true that staying in a hotel and renting a private villa will provide a different kind of experience. However, if we are talking about a summer vacation by the sea, these types of accommodation appear to be quite interchangeable and, consequently, are competing against each other. Indeed, a private and well-equipped villa with a swimming pool in front of a beach can offer a great vacation experience. If the villa is located in amenities of a village or small coastal town (which is usually the case) then a range of different dining options is guaranteed to the tenants. Renting a villa also gives a flexibility of having an own kitchen or an outdoor grill, which may seem attractive for particular segment of tourists.

Case: staying in a hotel vs. renting a private villa

It has already been mentioned, that staying in a hotel and renting a private apartment or villa provide different type of experience. Choosing a coastal apartment or villa will leave the tourists without important services and facilities, like 24 hour reception, dining & entertainment facilities right in front of your door and other merits of “all-inclusive” vacation. In addition to that, when dealing with private accommodation no brand names and established quality standards exist and the would-be tenants must be picky with their choice. In spite of these facts, it is a matter of hard fact that most of the tourists in Croatia do go for private accommodation. It may be illustrative to take a look at typical hotel and private accommodation offers and compare them as shown by Table 4.

TABLE 4. Comparison of a Private Accommodation vs. a Family Hotel

Type	Private villa	Family hotel Diadora
Location	Petrčane	Petrčane
Price/person/night	53 EUR, bed & breakfast	155 EUR, full board
Description	Fully equipped villa with a swimming pool, 20 m from the sea coast, 600 m from the town center, nearest restaurant is 200 m away, nearest grocery shop 600 m away, sea view, 200 m ² garden with grill. TV+SAT, air conditioning, fan, Internet connection, telephone	New four stars hotel for family vacations. Several outdoor pools, water slides, entertainment for kids. Spa & wellness center, fitness center, 3 restaurants, 2 bars.
Residence unit	Second floor of the villa 2 bedrooms, 1 bathroom 47 m ²	“Standard family room, sea view” 2 bedrooms, 1 bathroom 35 m ²
Link (Accessed on 26.06.11):	http://www.search-villas.com/r/rent?id~HR3016481~site~2~c~y~sess~978154519.htm	http://www.falkensteiner.com/en/hotel/diadora/room-prices-croatia2011.htm

As can be seen from Table 4, private accommodation is significantly cheaper. Thanks to the fact that the villa is located in close amenities of the city center, there should be absolutely no problem with dining and shopping. Moreover, the hotel (Diadora) is nearby, so in case the tenants of the villa will feel like going for a spa or using any other hotel facility, they can do it for additional charge (just like people who stay in the hotel). All these facts make the price of the hotel appear too high.

One of the respondents noticed (see Appendix 1, Q4-5):

Private rooms are cheaper, they are not run by professionals, they are only a supplementary activity. Ever since the time of socialism people could construct apartments with relatively low cost investments, so the private accommodation remained from those times. And hotels were questionable because the problem was in the fact that the season was too short, so their profitability was uncertain.

Indeed, private accommodation has a way different cost structure. Virtually all Croatian people, who live in the coastal part, have some kind of real-estate in ownership. After the war, the government used to provide abundant finance for reconstruction of housing sector (see Appendix 1, Q4-6), and citizens were able to get attractive loans for construction of houses. In addition to that, the government still does not collect any real-estate tax, meaning that there are no additional costs except for renovation. This puts private accommodation providers in a very competitive position against hotels, which have a lot heavier cost structures.

Croatian hotel supply vs. other countries

As compared to countries with well-developed tourism, the hotel capacity in Croatia seems to be lagging behind. For example, the length of coast on a continental part of Croatia is 1,770 km, and length of south-eastern coast of Spain (from Cadiz to Gerona) is about 2,300 km. According to MINT (2009), in 2009 there were approximately 98,900 beds in hotels in all seven coastal counties or on the average 55 beds per one km of the coast. In contrast, according to INE (2011), in 2010 there were approximately 545,000 beds in hotels in 11 coastal provinces on the eastern part of Spanish coast (from Cadiz and up to Gerona). Hence, there are approximately 235 beds in hotels per one km of the south-eastern coast of Spain. This comparison is quite illustrative.

Competition within the country

Indeed, the level of competition among the hotels in Croatia is significantly lower than in other countries with developed tourism. While in more developed regions like Dubrovnik or Istria concentration of hotels is higher, in the rest of the counties the concentrations is pretty low. For instance, the amount of beds in hotels in Istria approximately equals the amount of beds in hotels in three central Dalmatian counties: Lika-Senj, Zadar and Šibenik-Knin. As can be seen on Figure 14 these three

Dalmatian counties occupy roughly a half of the whole coast, but represent only 12.2% of total hotel capacity.

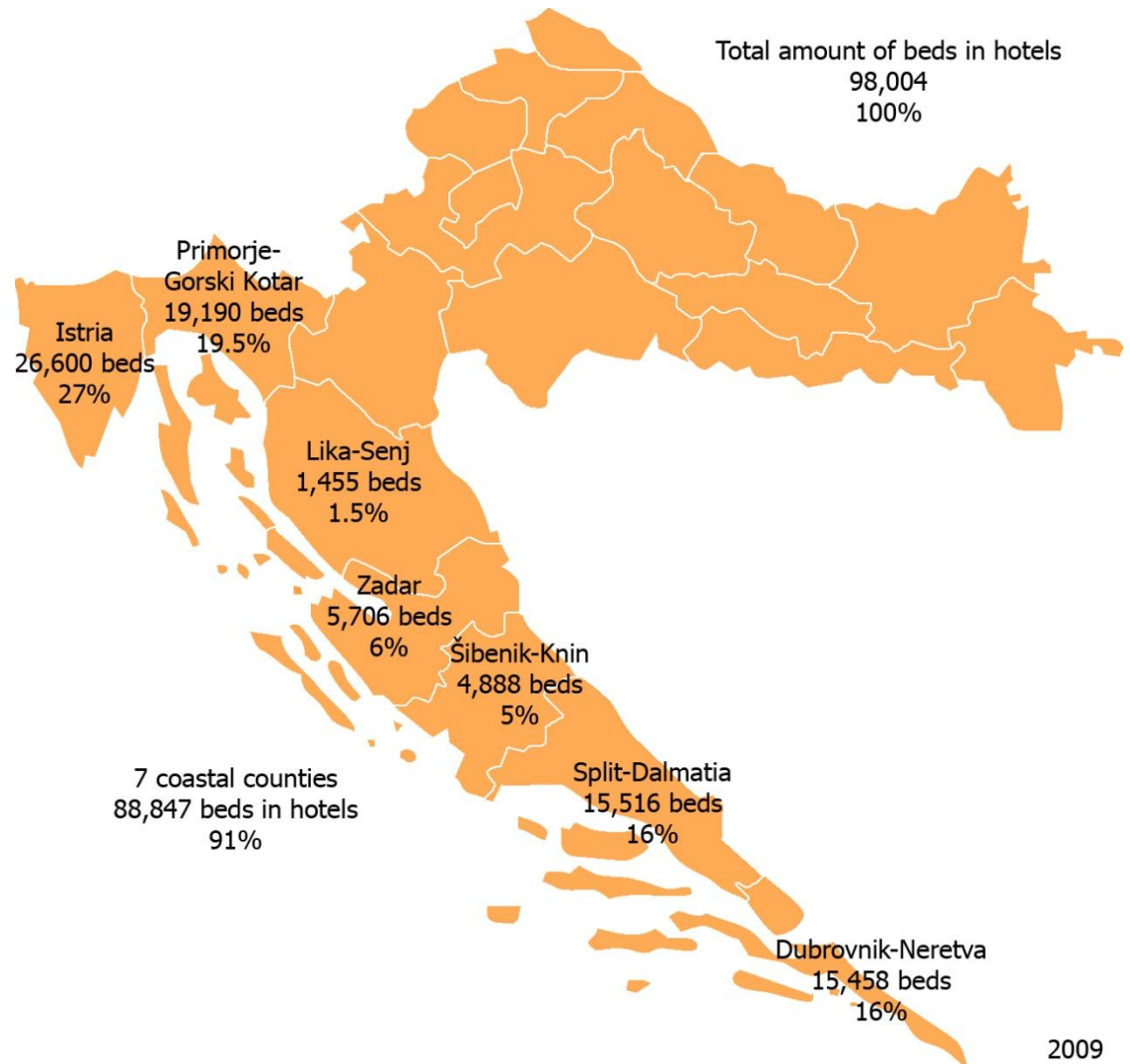


FIGURE 14. Breakdown of hotels across the coastal counties in 2009. Data by MINT 2009

Firm Strategy and Structure

Croatian hotel industry is still far from its maturity. This can be seen in statistics as well as in the way how some of the hotels are operated. Unfortunately, it is not uncommon that hotels are operated with indifference, unprofessionalism, and in some cases, pure greed. For example, the author had experience of working five months in one of the typical Croatian hotels. The hotel is located in a coastal town Zadar.

Case: Kolovare

The name of the hotel is Kolovare and it is a 4-star hotel located by the sea close to the city center. The hotel was built in 1974 and renovated in 2004. There are 191 rooms including suites and 12 apartments. The hotel offers the following facilities and services (Kolovare web-page 2011):

- car parking
- room service
- outdoor swimming pool
- cocktail bar
- restaurant
- terrace
- beauty salon
- massage parlour
- congress hall
- rent-a-car service
- tourist agency
- sports-recreation centre.

Most of the services are paid separately. Nevertheless, prices in the hotel start from 180 EUR per standard double room per night during the high season (July-August).

The main segment of guests is business corporate guests and business individual guests, mostly foreigners. During the summer time, the hotel is also popular with travel groups and individual travelers. Leisure group travelers usually come from Spain, Italy, Germany, the USA and Japan.

During her working experience at the reception desk of the hotel, the author could see in practice how ineffectively a hotel can be operated; the management and staff seem to be sure that the customers will keep coming anyway. Thanks to the fact that Kolovare is the only medium sized hotel in the whole city and surroundings, it enjoys a de-facto monopoly for accommodation services. The market is shared by a couple of boarding houses, one micro-hotel and Kolovare.

While most of the business visitors did not seem to care about the price their employers paid for their stay, most of the holidaymakers seemed astonished by the hotel's prices. The author noticed that many of the random visitors (those who did not plan to come to Kolovare) were especially surprised at the prices. In some of such cases these visitors had no other place to go so they paid, but some just went away.

The condition of the hotel and its equipment was quite poor. Some guests complained several times about the outdated air-conditioning system, which sometimes let the temperature in the rooms go down to as low as 14 Celsius. The floor in the corridors is rickety and the carpets are worn out.

Another problem is the relationship towards employees. According to the Croatian Labour Law, the employer is obliged to provide an employee with a permanent working placement in the firm, after the employee successfully works the first three years. This is the reason, why most of the employees in Kolovare never get an employment contract for more than one year and after two and a half years are getting laid off. It is the management team which remains untouched, and other staff members are constantly shifting. This makes it hard to build a solid team.

To sum up the experience of the author in the hotel, it seemed that the owner of the hotel was trying to get the most of the outdated asset by raising the prices to the maximum and reducing the costs to the minimum. This inevitably led to a poor performance of the hotel and unhappy customers and staff. No doubt that the situation in the hotel will change dramatically as soon as at least one competing

hotels of similar size will open in Zadar. But until then, most visitors of Zadar will end up visiting Kolovare.

Role of the government

According to one of the respondents, the government and local authorities still holds ownership of quite many hotels (see Appendix 1, Q4-2,4,6). Not surprisingly, this leads to inefficient management practices and lack of flexibility. Unfortunately, in some less developed areas of Croatian coast the prevailing part of hotels is still in hands of local authorities. For example, Makarska, which is a local center, located in a picturesque mountainous environment, is almost entirely dominated by governmentally owned hotels. There are three governmentally owned hotels with total amount of 730 beds.

Another important issue that was described by one of the respondents was that Croatian government maintains rather high taxation rates (see Appendix 1, Q3-4 ; Q4-3). For example, VAT is 10% only for accommodation services in hotels and 22% for the rest of the services, while, for example, in Cyprus VAT is 5% for all services. This gives a certain disadvantage to the cost structure of Croatian hotels and makes them less competitive against other destinations. In addition to that, as noted by one of the respondents, the government has been quite active in providing cheap and affordable finance to citizens, willing to build a second house. This could be one of the reasons, why private accommodation supply has been developing so rapidly since 1995.

Another major concern is that the governmental system is still pretty bureaucratic and inefficient. This especially concerns development of new hotels and other tourism related objects. On one hand, the government is trying to preserve the nature and control the development of tourism on the coast. But on the other hand, the governmental system has not yet reached the point when it will be able to develop tourism sustainable, instead of drowning its development in bureaucracy.

4.5 Related and supporting industries

As has already been mentioned in the theoretical part, related and supporting industries are of special importance for the hotel industry. Normally, it is not the hotels that attract tourists to particular destination country. It is other attractions, such as nature, culture, climate, entertainment infrastructure that attract tourists. While nature, climate and culture are virtually free to exploit, other important attraction such as appropriate transport infrastructure, entertainment and sports industries are man-made and require time and investment for development. As expressed by Williams et al. (2003, 5) tourism in many cases is leisure-related activity. Therefore, all the industries catering for leisure-related needs of tourists can be grouped together under one term “leisure infrastructure”. Other significant part of worldwide tourism is generated by business-related activities. In the same way, all industries catering for needs of business tourists, can be grouped in “business infrastructure”.

Leisure infrastructure

Croatian coast can be characterized as underdeveloped in terms of leisure infrastructure. In spite of the fact that 15 years has already passed since the end of the war, the development of leisure infrastructure has been quite slow and in most cases funded by the central and local government. These include national parks of nature, sports centers, museums and reconstruction and maintenance of ancient monuments. Nevertheless the development is quite slow and not many private companies are involved in it. For better or worse, such urban leisure objects like night clubs, shopping mall, cinemas, and casinos are developing quite slowly.

To get a general outlook of the situation, one can take a look at an up-to-date satellite image of Croatian coast. Many forests, deserted beaches and tiny villages can be spotted across virtually the whole coast.

The most developed regions from the point of view of leisure infrastructure are Istria and Dubrovnik. These two regions look quite different from the rest of the coastal part and tourism is developing faster there. Istrian Peninsula (or simply Istria) has always been popular among its closest neighbours – Slovenians, Italians and Austrians. Istria is especially attractive for Slovenians, who can travel to Istria by car

every weekend, thanks to lax border control and good road connection. Another important fact is that, due to its distant location from Bosnia and Herzegovina and Serbia, Istria was spared from devastation of the 1991-1995 war. While Dubrovnik and parts of Dalmatia were occupied by Serbians, Istria remained intact.

Business infrastructure

As well as the leisure infrastructure, facilities for business events are quite underdeveloped in Croatia. The country has few facilities for large business events, like conferences or trade shows. While most of the newly constructed hotels on the coast have conference facilities, they all are suitable only for medium-size corporate events (usually with some 200-500 seats). During the research, the author could locate only few conference facilities (Hotel Kvarner, Hotel Rixos Dubrovnik), which were able to cater for more than 1,000 guests.

Nautical tourism

Nautical tourism is a special segment of tourism in Croatia, which indirectly contributes to development of the hotel industry.

Annually nautical tourism contributes some 700 mil. EUR in revenues and attracts thousands of well-off Europeans to Croatia. Only yacht charter companies realize annually around 25,000 ship-weeks with over 150,000 tourists and more than 1,000,000 overnight stays. (Assetreal 2007.)

Moreover, according to the author's short enquiry about availability of free berths on couple of marinas in Zadar and Šibenik region (Marina Dalmacija, Marina Mandalina, Olive Island Marina) it was discovered that these marinas did not experience virtually any change decrease in demand since 2008. Prevailing part of the berths on these marinas are covered with long-term contracts, which is a sign of a high demand.

Archipelago of 1,185 islands of different sizes and shapes makes Croatia ideal place for sailing. Such a high density of islands and bays is truly unique and makes sailing experience especially safe and pleasant. One is not going to find anything similar across the whole Mediterranean.

At the same time, there are only 20,500 berths in 50 marinas in Croatia, which makes a ratio of approximately 11.5 berths per km of the coast (1,770 km of coast, islands

not included). For example, according to Assetreal (2007) there are 64 berths per km in France and 20 berths per km in Spain.

Marina business seems to be very attractive in Croatia. Moreover, it can be successfully combined with hotel business.

Air transportation

Despite the fact that the prevailing part of tourists come to Croatia by means of road transport, air transportation is an important industry for development of hotels (MINT 2007, 63). One of the respondents emphasized that for 5 star resorts availability of this mode of transport is crucial (see Appendix 1, Q4-7).

Moreover, due to the shape of the landscape and borders with neighboring countries, Croatia has some distant areas (e.g. Dubrovnik) which are not easily accessible by road. For these locations air transportation is crucial.

The role of the government

According to one of the respondents, the government has been quite inactive in helping hotels to establish relations with international air charter companies. It is a common practice that central governments or local authorities financially help hotels in their attempts to negotiate charters to the destination country. However, at this point Croatian government does not seem to be cooperating much in order to open new charter lines and, therefore, increase the amount of incoming tourists.

5 DISCUSSION: Conclusion & Further Research

5.1 Conclusion

This exploratory survey focused on the hotel industry of Croatia. As it was discussed in the theoretic background, the hotel industry is a supplementary industry, rather than an independent one. This is generally due to the fact that people's urge to travel is not generated by the hotel industry. Thus, it is a range of tourist attractions, which in great scale predetermines the success of a hotel industry in a particular country. From this point of view, Croatia has the extraordinary resources and attractions: the diverse and pure Mediterranean nature spread across 6,000 km of the coast and over 1,000 islands. Besides, the country has a rich cultural heritage and longstanding relationship with its Western-European neighbours. However, as the current condition of the industry reveals, these factors alone do not make a successful tourist destination and lucrative spot for the development of hotels. As the results of the research shows, Croatia has several important drawbacks as an environment for the development of the hotel industry (see Figure 15).

As discovered during the research the Croatian government has chosen a sustainable and well-balanced approach to the development of tourism and hotel industry in particular. All the necessary environment-protection legislation is in place, as well as a well-functioning system for controlling its implementation. However, the government has not yet been able to adopt the crucial policies, which would foster the development of hotels in Croatia. The research uncovered the existence of inefficient, bureaucratic procedures in obtaining construction permits for the development of new hotels. Also there is a lack of cooperation from the government in promotion of the country, as well as heavy taxation and excessive presence of the government in ownership of hotels and other tourist objects (e.g. marinas). Absence of new developments puts the existing hotels in a dominating position, which fosters inefficient management practices and resistance to any change (tourists keep coming anyway). On the other hand, another major challenge for hotels derives from a short season and the inability of current industry participants to extend it. The hotel

business is further hit by a fierce competition from public accommodation providers, who operate at low cost and provide a decent level of service.

These drawbacks are the reason why the Croatian hotel industry is still in its initial stage of development, with the total amounts of beds in the hotels being less than in a single tourist city in Spain (e.g. Benidorm).

Figure 15 shows the summary of all the researched factors, affecting the hotel industry in Croatia.

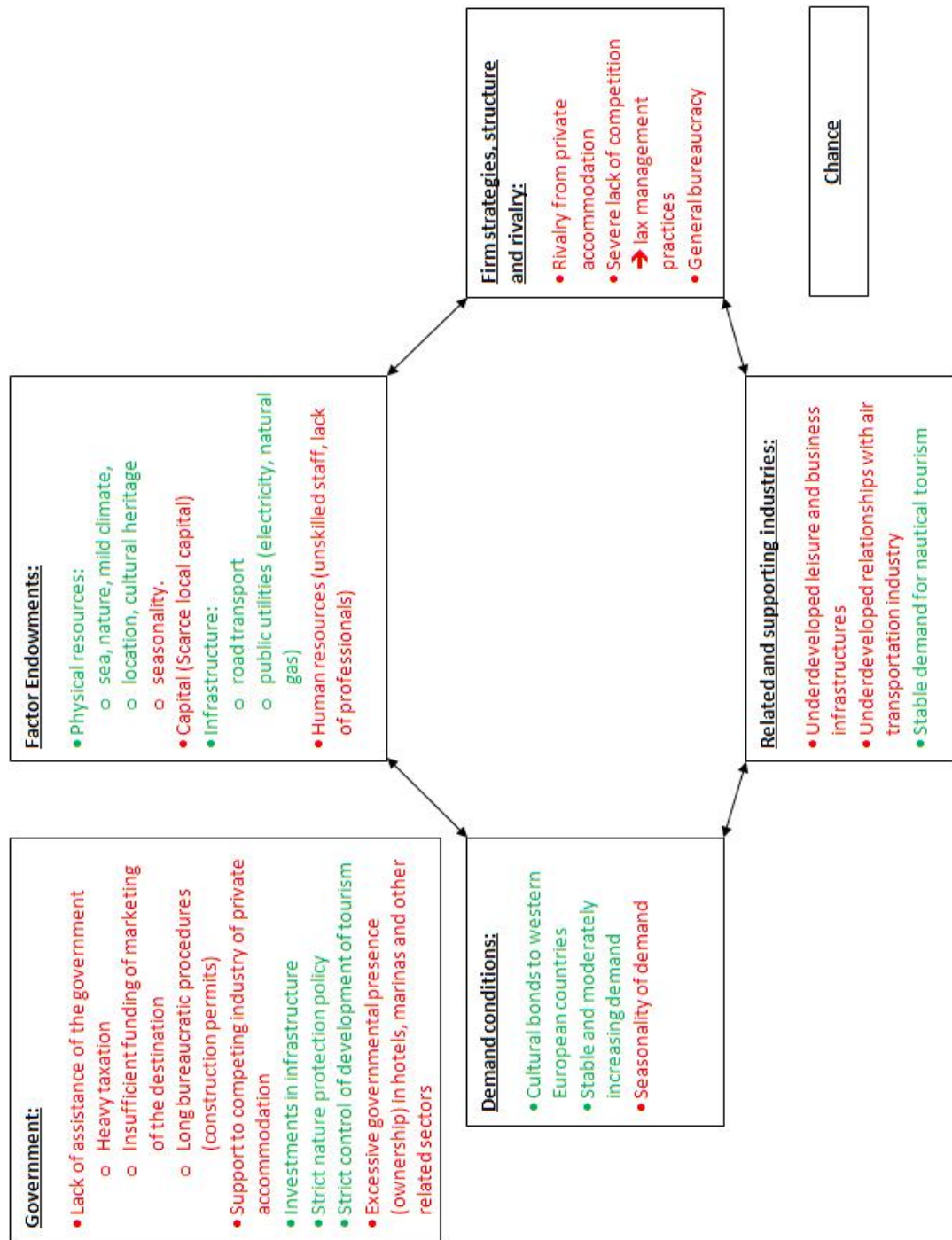


FIGURE 15. Hotel industry of Croatia through Porter's Diamond Model

Implementing sustainable development

As Figure 15 shows, the country while having splendid natural resources and a government which understands the importance of its preservation, has a large set of problematic areas. However, all these problems can be solved with time. During the past 15 years the country has been consistently stirring into the right direction, reviving its political, economic, social and legislative environments. At this point, it seems that the government will play a major role in future development of tourism in Croatia. As soon as it is capable of implementing the chosen (sustainable) development model of tourism, the hotel industry will improve dramatically. But for the time being, the situation within the industry seems to be a vicious circle. Due to the fact that bureaucracy and complicated nature protection system hinders construction of new hotels, the existing ones enjoy monopoly position. This in turns deteriorates the quality of service and keeps the room prices high. Furthermore, current inefficient labour legislation treats employees of hotels in a subdue way, which further deteriorates the quality of service. At the same time the government is putting pressure on cost structures of the existing hotels by raising high taxes. Unfortunately, the government does give much to hotels in return. Spending on promotion of Croatia as a tourist destination is insufficient, as well as efforts to negotiate more air charters to the country. As a result, heavy cost structure and short tourist season make profitability of the current hotels questionable. Given the availability of alternative, competitively priced private accommodation, the hotel industry at the moment does not appear to have attractive economics.

Future prospects

30 June 2011 the EU-Croatia entrance negotiations were successfully closed. The country has been scheduled to become a lawful member of the EU by July 2013. The fact that the country has finally resolved all major political and administrative issues and is more than halfway through the process of becoming an EU member state, proves that the governmental system will significantly improve its efficiency in near future. Moreover, the news about the EU accession is expected to fuel the interest of foreign investors and increase the amount of available capital (just like in 2005, when negotiations started). The interest of foreign investors and decrease of bureaucracy will inevitably lead to the development of tourism and the hotel industry in

particular. As the respondents unanimously expressed, the country is not expected to show any rapid growth in the next five years though (see Appendix 1, Q7). The author's opinion is that it is hard, if not impossible, to predict when the hotel industry will finally start to develop. The result of the research shows that the country has been moving forward despite numerous headwinds. At this point, EU accession can become a major tailwind for the development of tourism in Croatia and, therefore, fuel the development of the hotel industry.

5.2 Discussion of the methodology

The current research question was a challenging one. More importantly, it was the question, which has not been addressed much by other researchers. This is why the author did not assume to provide a comprehensive answer to the question. Instead, the goal of the research was to start researching the issue and provide an easy-to-follow basis for further inquiries.

The current methodology suited the goal of the research well. Exploratory research based on a well-known Porter's theoretical framework allowed the author to organize and analyze various pieces of primary and secondary data under one easy-to-understand framework. The diamond model itself seems to be easy to work with. What is more important is that the model can be easily updated with new or revised data.

The qualitative nature of the primary data collection also suited well the goal of the research. Instead of providing quantitative data that could be generalized, the research provided insights and experience of industry practitioners, which can be then used as a basis of further quantitative inquiry by other researchers.

5.3 Limitations of the research

The primary data collection was limited to only nine interviews and five months of working experience in one Croatian hotel. This means that the results of the research shall not be treated as an outcome of a quantitative inquiry. It also shall be noticed that the prevailing part of respondents were from marketing and sales departments of hotels. This shaped the results of the research according to perception of this particular management layer.

Another limitation of the research was scarcity of information in English about the industry. The author came across various sources (press, official statistics) which were available only in Croatian language. Even if the author managed to translate several of these, it is likely that some valuable information (in Croatian language) is missing from the report due to the language.

5.4 Implications for further research

The results of the current research can be treated by further researchers as a starting point in their study of the topic. The hypothesis stated by the respondents of the research can be further studied with use of quantitative methods or statistics. As long as all of the collected data during the interviews is the opinions of practitioners, most of the expressed ideas will prove to be relevant and worth a further detailed study.

It is recommended that the same theoretical framework (the Diamond Model) is used for further research. This will allow researchers to build on the collected material, revising it and enhancing the Diamond with every new inquiry. This way the knowledge can accumulate and always be ready for analysis in a well-known, established format.

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APPENDICIES

Appendix 1: Interviews

Your name (if You wish - leave this line empty)

- 1) Denis Giergia
- 2) Leo Pavic
- 3) Vedrana Andrijasevic Melada
- 4) Irena Gasparovic
- 5) Marija Mišulić
- 6) Sandra Komljenovic
- 7) Mario Baras
- 8) Ana Peracic
- 9) Nikola Barisic

Occupancy

- 1) Director of land-developing company
- 2) Technical Manager (Hotel Kolovare, Zadar)
- 3) Front office manager (Hotel Kolovare, Zadar)
- 4) Marketing manager(Hotel Kolovare, Zadar)
- 5) Zadar county chamber of economy (associate)
- 6) Sales and Marketing Director (Health resort& hotel Biokovka, Makarska, owned by local authorities)
- 7) Financy Department (Hotel Le meridian Lav, near Split, privately owned 5 star hotel)
- 8) Sales referant (Hotel Dalmina, Split)
- 9) Marketing Manager (Makarska Hotel group: Meteor ´´´´, Dalmacija´´´´, Riviera´´´´)

Nationality

- 1) Croatia
- 2) Croatia
- 3) Croatia
- 4) Croatia
- 5) Croatia
- 6) Croatia
- 7) Croatia
- 8) Croatia
- 9) Croatia

Can I present Your answers in my thesis?

- 1) Yes
- 2) Yes
- 3) Yes
- 4) Yes
- 5) Yes
- 6) Yes
- 7) Yes
- 8) Yes
- 9) Yes

Question 1

What is the main attraction for tourists in Croatia? What makes them come here?

- 1) –
- 2) Nature (Air, sea, national parks); but nowadays the nature is not smth outstanding any longer, people want to have smth else in addition to it.
- 3) Sea
- 4) Sea
- 5) Adriatic Sea and the preserved nature.
- 6) Health resort(spas, medical treatment)

7) –

8) Culture (Architecture, history, churches, Film Festivals, summer congresses)

9) Sea

Question 2

Can you name some 4 more important attractions for tourists in Croatia? Please, put them in descending order from the most important to less important.

1) –

2) –

3)

- a. Nature(national parks)
- b. Heritage (historical)
- c. Popular destination (Fashionable, not explored, new)
- d. Climate (hot weather)

4)

- a. Islands
- b. National parks
- c. Food

5)

- a. national parks in general
- b. old Mediterranean towns starting from Dubrovnik
- c. islands
- d. rural tourism

6) Sea

7) –

8)

- a. Food (Dalmatian, Istrian)
- b. Sea
- c. Islands
- d. Sightseeing trips

9)

- a. Culture (food etc.)
- b. Natural beauties in Makarska

Question 3

What do you think Croatia lacks to become a truly popular tourist destination for Europeans? Explain why?

- 1) –
- 2)
 - a. “Bad marketing” (lack of awareness of Croatia as a tourist destination and in general as a country)
 - b. Tourist always wonder why they have not been here before
 - c. Infrastructure(aqua parks, good restaurants, entertainment)
- 3) Awareness. Advertising
- 4) Support from government (taxation)
- 5) Better organization of tourist offers and commitment and engagement of the professionals in the sector and local authorities.
- 6)
 - a. Still Croatia is positioned in people’s minds as a post-war country
 - b. Promotion of Croatia as a tourist destination, which is done mostly by governmental organisations (under ministries of tourism etc.), is slow, ineffective and inflexible. It seems to the respondent that this is caused not only by hierarchical(slow, inflexible) structure of those organisation, but also by the attitude. Government is not putting so much stress on development of tourism(according to the respondent).
 - c. Hotels are not doing proper promotion by themselves.
- 7) There is a need for determining and developing some specific tourist attractions. Some kind of paradox takes place in the industry: there is huge potential for different types of tourist attractions(pure nature, rich culture), but all of them(except pure sea) are unknown by tourists and undeveloped. “Bad marketing”, inability to develop and sell. “Take an example of Spain- they have famous Tomatina; we also have tomatoes and narrow streets in Croatia, but nobody is coming here for Tomatina ”
- 8)
 - a. Lack of awareness
 - b. Help from government (Author: example of Roaring tigers of Asia)
- 9)
 - a. Price competitiveness
 - b. Better marketing

Question 4

According to Croatian Ministry of Tourism, in 2007 hotels and apartment hotels together accounted for only 12% of total amount of beds available in Croatia. Private rooms accounted for 44%. The rest of the beds are in camps (22%) and other minor modes of accommodation.

Why, in Your opinion, hotels in Croatia account for such a small part of total figure and private rooms are so popular?

1)

- a. Overpriced land (huge amount of land is owned by individual persons, who set prices for their land according to their feelings and wishes, but not according to real value)
- b. Attitude of investors (investors are willing to buy only ready objects, instead of developing new ones. Therefore they are waiting for somebody else to develop land for them. The problem is that nobody wants to take the risk to develop the land)
- c. Long procedure of getting necessary permits for construction and land utilization. Central planning system of managing land to some extent is one of the main reasons for such slowdown.

2)

- a. "Hotels are not profitable" (Hotels are a way (approximately twice) more expensive, than, for example, private apartments, which are competing with hotels).
- b. Hotels are not working efficiently (a lot of staff)
- c. Government (taxation is heavy)
- d. Seasonality (2-3 hot months per year)

3)

- a. Only 25% - 30% of hotels in Croatia are profitable, according to Zagreb conference in 2009.
- b. Low price/value ratio in hotel, compared to Turkey, Greece.
- c. Taxation (VAT is 10% only for accommodation service in hotel, 22% for the rest of the services; in Cyprus 5% for all services)
- d. Margins are higher, than in competing countries (100% in Cyprus, 200% in Croatia)

4)

- a. Hotels are not profitable
- b. Seasonality(2-3 months per year)
- c. Privatisation (1995-) Bad management by owners of hotels

5) Private rooms are so popular because ever since the time of socialism people could construct apartments with relatively low cost investments, so the private

accommodation remained from those times. And hotels were questionable because the problem was in the fact that the season was too short, so their profitability was uncertain. And the private rooms are cheaper, they are not run by professionals, they are only a supplementary activity. That is why they are so popular.

6)

- a. A lot of hotels still are owned by local authorities, which causes an enormous slowdown in decision-taking (a lot of bureaucracy and decision-takers). Also decisions taken by those managers are often motivated by politics, rather than by rational approach. Those management boards are not responsive to demand.
- b. Local authorities are not supporting hotels. The general agenda of government is supporting hotel development, but this agenda is not implemented very well by local authorities. Respondent claimed that she has encountered even some protectionist attitudes towards foreign hotel chains, that start their operations in Croatia.
- c. Special favorable loans at low interest are given to private persons, who are willing to build/renovate their houses for establishing accommodation offers for tourists. Those loans are not given for purpose of developing a hotel.

7)

- a. Big hotels are not developing fast, because the demand is too low.
- b. Lack of cooperation with government (high taxation, customs = high costs; No help for opening new charter airlines = low occupancy in hotels = low profitability)
- c. Currently 5 stars hotels in Split are cooperating and forming alliances to join their efforts in lobbying local authorities (about 1000 rooms in next two years) and establishing new charters.

8)

- a. Ability of population to accommodate tourists
- b. Private rooms outprice hotels (2x or 3x)
- c. Seasonality
- d. Low quality of services and few of them

9)

- e. Prices are too high in hotels
- f. 2 stars hotel is full
- g. 4 stars hotel is empty
- h. According to the respondent and his measures: value/price ratio is ok

Question 5

What is the biggest challenge for hotel development in Croatia?

1) –

2)

- a. Make hotel operations profitable
- b. Make people invest in hotels

3)

- a. To get image/ recognition as a country for pleasant/safe vacation. Safety is important
- b. To get more entertainment objects (casinos, restaurants, shops)
- c. To reestablish traditional villages with traditional Croatian food, sights.
- d. To get a good balance of c. and b.

4) Make a season longer

5) The biggest challenge is how to prolong a season.

6)

- a. Survive recent crisis (This year there are approximately 10% tourists less, than last year). Germans and Brits (other western Europeans) were champions in sales decrease.
- b. Learn how to work in high competition (about competition from other destinations)
- c. Establish communication with local authorities

7)

- a. To get more hotel = gain more power and weight in relationship with local authorities
- b. Get more professional workers (This hotel is quite young, and in the beginning (3 years ago) hotel's staff knew less about Starwood quality of service than their visitors)

8) Overcome attitudes of people (long-term) "to give less and to gain more" – do not use

9)

- a. More partners, tour operators (specifically for those hotels)
- b. Survive the crisis

Question 6

Can you think of 4 more challenges and put them in descending order from most important to less important?

1) –

2) –

3) –

4) –

5)

- a. creation of offer out of the season
- b. making small land larger-condition indispensable for the construction of large tourist complexes
- c. ensuring of sustainable development, protection of natural environment
- d. ensuring of all profiles of professionals and labour force

6) –

7) –

8)

- a. To build infrastructure (Roads, airports, entertainment facilities, wellness facilities)
- b. More help from the government& local authorities (reduce taxation)
- c. To learn **not to use tourism, but make it!**
- d. The only way to survive is to increase quality

Question 7

How do you think Croatia will look like as a tourist destination in next 5 years?
What kind of tourist attractions it will offer?

- 1) –
- 2) No rapid growth
- 3) No rapid growth
- 4) Destination for middle class families, no rapid growth.
- 5) Great changes are not expected. The existing attractions (natural beauties, entertainment manifestations, mild climate, historical monuments etc) will still be offered.
- 6) No rapid growth. Middle class destination. 5 stars hotels will decrease??? More specialized hotels, like Biokovka
- 7) A lot more 5 stars hotels. Next year in Split – Hilton Hotel (by Kerum- major of Split), Radisson
- 8) –
- 9) More 5 stars hotel

Appendix 2: The Diamond Model background

Porter's Diamond Model

The scope of the model

The Diamond model emerged as an attempt to depict the national and regional environment for competition in a particular industry. This environment predetermines the ability of the country in question to be productive and, therefore, competitive in a particular industry.

In his book “Competitive advantage of nations”, Porter (1990) emphasized that productivity in a particular industry cannot be achieved without rigorous competition within that industry. Porter built his theory from individual industries and competitors up to the economy as a whole. He emphasized the importance of thousands of competitive struggles within each individual industry, the outcome of which determined the overall state of nation's economy and the way it progressed. (p. xxv)

He also put a great emphasis on the role of the government in creation of an environment, which would foster productivity. He claimed that it is the policies, laws and institutions that ought to create an environment, which would ensure the productive use of national resources. (op. cit. p. xii)

That is why his choice of the title of the book was to contrast with the long-prevailing concept of Comparative Advantage, which heavily relied on economic inputs such as labor, natural resources, and financial capital. He argued that these inputs had become less and less valuable in the globalized economy, where they all became more easily available and less attached to a particular nation. (op. cit. p. xi)

This way even if the scope of the Diamond model was to explain the overall competitiveness of a whole nation, its concepts could be well applied on a local level (e.g. region or city). In practice, this means that the Diamond model is well applicable

for analysis of industry of any scale, which is located in a country with a market economy.

Evolution of economic theory

It is also worth mentioning the position of the Diamond Model in the process of historic evolution of the economic theory. The Diamond, being one of the most recent significant contributions to the economic theory, is a product of an evolution, rather than a revolution of the economic thought. The model embraces, rather than objects, the economic theories of the past. It includes original thoughts of all major economists, starting from A. Smith and D. Ricardo and to Heckscher, Ohlin and Vernon. This way the model represents a synthesis of economic thoughts of the last two and a half centuries.

It is obvious that the model cannot be considered as the ultimate model for assessing which industries are going to prosper and which nations are going to increase their wealth. The last two centuries of the evolution of the economic theory has shown that we are living in a complex and rapidly changing world, full of swings in political, economical and technological environments. In other words, the world now does not look like the world, in which Adam Smith lived and worked. A. Smith and D. Ricardo lived in the world, where most of the foreign trade consisted mostly of goods like tobacco, spices, cocoa, rice etc. And during these times, labor, natural resources and capital seemed to be the determining factors of nation's success and prosperity. Later Heckscher and Ohlin recognized emergence of different technologies, which could compensate for nation's lack of natural resources or labor. Then came the understanding of the "product cycle" theory and importance of demand conditions, introduced by R. Vernon in the first part of 20-th century.

The second part of the 20-th century was full of important political and economic events. One of the most important was the swing from the economic and political isolation of countries and emergence of what we call a global economy. Porter's theory and the Diamond Model, strives to study of all these recent changes and combine the results with historically cumulated knowledge.