THE EFFECTS OF SELECTED MACROECONOMIC VARIABLES ON THE PRESENCE OF FOREIGN HOTELS IN CROATIA

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Abstract
While an increasing number of hotel firms expand their operations abroad, it is not always clear how hoteliers select one country over another. Thus, the purpose of this research is to investigate the influence of inward *foreign direct investment, market interconnectedness, and tourist flows* on the entrance of foreign hotels in Croatia. Research was carried out via time-series analyses of the secondary data to a sample of foreign hotels from 35 countries with operations in Croatia during the 1997-2007 period. Statistical analyses were performed by way of correlation and regression. Study findings suggest that inward *foreign direct investment, market interconnectedness* and *tourist flows* are highly positively correlated with the presence of foreign hotel companies in Croatia. Additional examination is performed separately on hotels in foreign ownership and hotels operating under foreign brand, producing different results. Namely, from the host country perspective, it is difficult to analyze in the same way hotels with foreign ownership share and hotels operating under a foreign brand. Therefore, a foreign hotel is defined as either a foreign-owned hotel (i.e., a hotel present in Croatia by share of ownership above 10%) or a foreign hotel brand (i.e., by franchise or management contract, lease agreement or consortium). This is one of the few studies to explore some important macroeconomic variables that have not been considered in previous research in the international lodging sector.
Keywords Foreign Direct Investment, Market Interconnectedness, Tourist Flows, Hotel Industry, Croatia

INTRODUCTION

In the recent years continuous economic growth has created extraordinary market opportunities that stimulate global expansion of companies. This trend is additionally reinforced by privatization and opening of formerly closed markets in the ex-socialist countries. While national markets are becoming increasingly open, globalization of operations occurs in an increasing number of industries and international companies. In this very tough market competition, survival is possible only for those companies that are able to adapt their operations to international standards. In other words, due to the fast changes in the global environment, internationalization of operations becomes the only possibility for survival of national companies.

Firms primarily expand into their immediate environment. Geographical distance, cultural similarity, and the level of economic development are the factors that explain the routes of firms' international expansion (Johansson, 1997). Gradually, however, companies also expand into more distant countries. The framework showing in which directions companies expand their operations internationally is called the internationalization paradigm (Johanson & Vahlne, 1990). In spite of the dramatic growth of the service sector and its significant contribution to the growth of GDP in developed countries (Contractor & Kundu, 1999), research on multinational operations mostly deals with the manufacturing sector. In Croatia, such research is generally rare in both manufacturing and service sectors, and especially in hotel and tourism industries.

Despite the challenges related to internationalization, a plethora of research has shown that internationalization improves on firm's financial performance and reduces the total risk (Reeb et al. 1998). Service companies expand internationally with the idea of (1) following their patrons who travel abroad, (2) following manufacturing companies expanding internationally in an effort to offer them their services, or (3) in response to similar actions of their competitors (Björkman & Kock, 1997). Internationalization of tourism activities is one of the consequences of globalization of international investments, which stimulate hotel companies to seek new destinations for offering their services. The factors which drive foreign direct investment (FDI) in tourism are identical to the factors in other sectors, and refer to cultural similarity, historic and geographical distance, political and economic risk, level of economic development, social and economic environment, privatization, FDI policy, tax and investment incentives, infrastructure, labor cost, local suppliers, as well as corporate strategies and company specific factors (Rodríguez, 2002).

It is characteristic for FDI in tourism that company ownership is separated from company management, so that a local investor without any experience in hotel industry can lease his land or facilities to a foreign firm. The foreign company can operate the venture in compliance with its business practices or through local managers, depending on its competitive advantage, adaptability to the local market, and availability of local resources (Brown et al. 2003). FDI in tourism may occur in five ways: a stake in the ownership ensuring control of the firm (e.g. 100% or majority ownership), a smaller share of ownership (from 10 to 49%), lease contract, management contract, franchise agreement or some type of marketing agreement (Endo, 2006). It must be noted that non-ownership FDI in tourism (and in other sectors) is difficult to follow since it tends not to be included in the national FDI statistics. When evaluating conditions for a new hotel, location is of crucial importance (Bull, 1994), and it is influenced by the degree of political stability (Purcell & Nicholas, 2000), taxes, expropriation, attitude of political parties to foreign investments, labor relations, administrative procedures, and company image (Kobrin et al. 1980).

Although many studies deal with international expansion of hotel brands, very little scholarly research examines certain specific factors affecting the choice of location. Such an exception is Dunning, with his eclectic paradigm that has become the starting point for research on internationalization, and has been applied in the international hotel sector (Dunning & McQueen, 1982; 1981; Kundu, 1994). Similarly, the expansion strategies of multinational hotel companies in five countries of Central and Eastern Europe have been examined by Johnson and Vanetti (2005). However, no research has been done on the possible links between the presence of a foreign hotel brand in country A and (1) the total FDI in country A from country B, (2) trade connections between country A and country B, and (3) the number of visitors from country B.

Consequently, the goal of this research is to investigate the macroeconomic factors affecting the entrance of foreign hotels in Croatia. The results of this research will highlight the current situation in the entire macro-environment in Croatia and its effect on inward FDI in the hotel industry. Analysis of the specific variables that mostly affect the size of inward FDI will also provide some recommendations to the official tourism policy in Croatia.

OVERVIEW OF THE CROATIAN HOTEL SECTOR

In Croatia, the vast majority of hotel capacity (95%) is located on the Adriatic coast, and most of it was built during the 1960s and 1970s. At that time, market trends were directed to tourists with low purchasing power seeking sun and sea, i.e. to mass tourism concentrated on the summer months (July and August). Croatia did not make use of its comparative advantage for development of winter tourism or any other form of tourism, which resulted in uniform facilities. Nowadays, only 12.5% of accommodation facilities are offered by hotels, of which most are three star hotels (56.9%), with some two star (20%) and four star (19.8%) properties (Croatian Ministry of Tourism, 2010; 2008). Croatia has not developed infrastructure for tourists with high purchasing power, as evidenced by a mere 16 five star hotels (2.8%). This inadequate offer of hotel capacity results in lower occupancy in comparison to competitors, lower productivity, high seasonality of operation, inadequate structure of guests, and consequently poor performance of the entire sector (Crnjak-Karanović & Petrić, 2000). Development problems of the Croatian hotel industry can be solved only by considerable investments aimed at repositioning the entire hotel industry, along with the changes in the development strategy and the completion of market infrastructure in the country. A higher inflow from FDI is not possible without creation of a more attractive environment, i.e. creation of locational advantages. Locational advantages involve access to resources, security of investment and host government incentives (Crnjak-Karanović & Petrić, 2000).

In order to operate successfully, seasonal hotels have to achieve adequate standards and have to be repositioned in the market. To be competitive in the international market, Croatian hotel industry has to constantly adapt its development and operational strategy in response to the increasing demands in terms of size, technical and organizational competence, staff training, etc. These, in turn, require continuous improvement on all managerial levels, technological upgrades, and market repositioning. They can be achieved by implementation of higher standards and promotion of quality. It is also necessary to stimulate horizontal and vertical grouping of hotel firms to make them desirable partners for banks and foreign investors. In this research, the notion of foreign hotel refers to a hotel present in Croatia via ownership share above 10%, franchise agreement, management contract (Contractor & Kundu, 1998), lease agreement, and/or consortium[1]. During the recent years, several renowned hotel companies have entered Croatia, thus improving the overall quality of lodging facilities (Table 1).

Table 1. International hotel companies in Croatia in 2010

Company	Hotel	# of hotels	Form of entry	Country of origin
Sol Melía	Sol Stella Maris, Sol Umag Sol Polynesia, Sol Coral Sol Garden, Sol Aurora Sol Šipar, Moj mir bungalows Kangera, Savudrija, Istrian Villas	11	mngm[1]	Spain
Azalea	Mina, Fontana, TN Jadran Zora, Labineca, Faraon	6	mngm	Austria
Utell	Excelsior, Dubrovnik Palace Grand Villa Argentina Bellevue, Kompas, Bonavia	6	consortium	USA
Vienna International	Astoria, Bristol, Opatija Miramare, Apoksiomen	5	mngm	Austria
Falkensteiner	Funimation Club Dalmacija, Zadar Donat, Diadora, Iadera	4	FDI, mngm	Austria
Starwood	Le Meridien Lav, Sheraton Zagreb Four Points Zagreb, Westin Zagreb	4	franchise, mngm	USA
Iberostar	Iberostar Epidaurus Iberostar Albatros Iberostar Cavtat	3	mngm	Spain
Radisson SAS	Radisson Hotel Split Radisson Dubrovnik	2	franchise, mngm	Denmark
Regent	Regent Esplanade Regent Dubrovnik	2	franchise, mngm	USA
Arcotel	Arcotel Alegra	1	franchise, mngm	Austria
Best Western	Astoria	1	consortium	USA
Golden Tulip	Hotel Holiday	1	consortium	Netherlands
Hilton	Hilton Imperial Dubrovnik	1	franchise, mngm	USA
Kempinski	Hotel Adriatic Savudrija	1	franchise, mngm	Switzerland
Leading Hotels of the World	Adriana	1	consortium	USA
Lifeclass Hotels	Grand Hotel Adriatic	1	franchise, mngm	Slovenia
Small Luxury Hotels	Riva	1	consortium	UK
SRS	Millennium	1	consortium	Germany
Turkish Rixos	Rixos Libertas	1	FDI, mngm	Turkey

[1]Management contract
Source: Authors' research

In 2008, there were 53 hotels in Croatia operating under foreign brands, most of which originate from Austria (16), USA (15), and Spain (14), while two of them originate from Denmark, and the rest of them are from Germany, Slovenia, Switzerland, Turkey, and United Kingdom. Most branded hotels are located in Dubrovnik and Istria regions (coastal Croatia), and Zagreb (continental Croatia). In addition to the foreign hotel

[1] Although hotel consortia are not chains, but rather marketing associations, they are a form of non-equity expansion of foreign hotel chains (e.g., Best Western) into Croatia.

brands, some domestic hotel management companies have also developed, such as Adriatic Luxury Hotels, Valamar, and Sunce Concern with its brand Bluesun. As the investment conditions have been improving with the imminent Croatian accession to the EU, the number of foreign investors in Croatian hotels in 2010 has reached 107 (Table 2). Among the 107 foreign-owned hotels, 65 of them (about 60%) are owned by companies from the neighboring countries (Austria, Italy, Hungary, and Bosnia and Herzegovina), which may be explained by geographical proximity, the size of potential market, and cultural similarity, which is in line with the conclusions made by Jiatao and Guisinger (1992). Besides, another notable fact is that Croatia's largest banks are owned by Austrian and Italian banks.

Most of the foreign owned hotels are located in Istria County (36), then in the Split-Dalmatia County (25), Primorje-Gorski Kotar County (22), Zadar County (10), Dubrovnik-Neretva County (8), Šibenik-Knin County (3), the City of Zagreb (2), and Krapina-Zagorje County (1). With the exception of the latter two, all other regions and/or counties are coastal. Such uneven distribution of hotels results from the fact that most arrivals and room-nights are realized along the Adriatic coast where most foreign-owned hotels are located. The greatest investors in the Croatian hotel industry in terms of the number of hotel units owned originate from Austria, Italy, the Netherlands, Hungary, and Luxembourg (Table 2). Although Table 1 indicates the presence of 14 Spanish hotels in Croatia, Spain is excluded from Table 2. Spanish FDI via ownership stake is non-existent in Croatia, and it is only through non-equity forms that Spanish hotels are present in Croatia. It is to be expected that the presence of international hotel companies will increase in the future, especially due to the forthcoming accession of Croatia to the EU. From the company perspective, a certain period has to pass before the company can benefit from the advantages of internationalization of its operation (Lee, 2008).

Table 2. Foreign-owned hotels in Croatia by country of origin in 2010

Country of origin	# of hotels
Austria	40
Italy	14
Netherlands	11
Hungary	10
Luxembourg	9
USA	5
Russia	4
Slovakia	4
Germany	3
Belgium	1
Bosnia and Herzegovina	1
France	1
Canada	1
Poland	1
Slovenia	1
Ukraine	1
Total	**107**

Source: Authors' research

LITERATURE REVIEW

Why do countries accept FDI? A research carried out by Klein, Aaron, and Hadjimichael (OECD, 2001) reveals that FDI stimulates economic growth of developing countries due to transfer of new technologies and knowledge. A good example is China, where in the 1978-1993 period FDI had a positive impact on economic growth (Chen, Chang & Zhang, 1995). However, to make this possible, developing countries have to cross the minimal development threshold (Blostrom et al. 1992). Most research shows that foreign subsidiaries have higher labor productivity due to larger capital and company size (Lipsey, 2002). On the other hand, the research published by Mencinger (2003) – on the correlation of FDI and economic growth in eight transition countries candidates for EU accession in the 1994-2001 period – reveals that this correlation is negative. The author explains that the reason for this result lies in the type of investment. Namely, at that time, the dominant form of investment was privatization by takeover, and the profits from sale were mainly spent on consumption and imports rather than on productivity improvement. Thus, the FDI contributed to imports rather than to exports, even though the foreign trade increased.

In the Central European transition countries, FDI played an important role in restructuring home industries, increasing productivity, and making the key economic sectors more competitive for export (Barell & Holand, 2000). Similarly, in the USA, a substantial inflow of FDI in 1974 resulted in higher exports in the subsequent period (Lutz, 1987). Direct positive effect of foreign investment was also evident in China where the FDI level correlated to higher exports in individual provinces (Zhang & Song, 2000), whereas in the 1979-1996 period, it had a significant impact on China's economic growth, increase in exports and employment (Sun, 1998). Malaysia and Ireland had similar experiences with increased FDI (Athukorala & Menon, 1995; Barry & Bradley, 1997). Equally important is the finding whereby FDI in the services sector may bring about investments in the manufacturing sector of the host country, so that by allowing FDI in the services sector many developing countries create a stake for future foreign investment in other industries (Li, 1994).

FDI and OLI

According to Dunning's eclectic paradigm (OLI - model), which serves as the theoretical basis for this research, FDI will occur if ownership (O), location (L), and internalization (I) advantages exist (Dunning & Dilyard, 1999). *Ownership advantages* are mostly intangible and within a multinational company are transferred in the form of lower costs (e.g. technology, brand, economies of scale). These advantages allow higher yields or lower operation costs. The U.S.-based global companies have absolute ownership advantages in almost all foreign locations due to their size, experience, technological, and marketing superiority (Erramilli et al. 1997). A firm operating in a foreign country is challenged by additional costs in comparison to the local competitors: lack of knowledge of the local market, legal, institutional, cultural and language differences, and higher operation and communication costs. *Location advantages* are crucial in selection of investment location. Attractiveness of a particular location can vary from time to time and locational advantages of some country can be economic, political, social, and cultural. Economic advantages consist of a number of production factors, transport and telecommunication costs, size of the market, etc. Political advantages include government policies affecting the flow of FDI, intercompany trade, and international production. Social and cultural advantages involve physical distance between home and host country, language and cultural difference, general attitude to foreigners, and the general position of free enterprise. Moreover, it should also be more profitable for a firm to use its ownership advantages by itself in the form of FDI, i.e. to establish its own internal channels (markets) rather than using international market as its distribution channel (Crnjak-Karanović & Petrić, 2000). This is the issue of *internalization advantages***.** Internalization theory explains the internal functioning of large companies that place many different activities such as production, distribution, use of materials, components, products, and services within the firm’s hierarchy. Internalization theory is focused on economy of horizontal and vertical integration benefiting from making decisions within the company (Behrman & Grosse, 1992).

While ownership and internalization advantages are company-specific factors, location advantages are crucial for the FDI inflow to the host country (United Nations Conference on Trade and Development [UNCTAD], 1998). While ownership advantages determine which companies will supply a given foreign market, locational characteristics determine whether a firm will supply this particular market by export or by local production (Dunning, 1980). Motives that stimulate investors are primarily economic. Investor companies look for locational factors which, in interaction with their specific ownership and internalization advantages, help them reduce risk, implement oligopolistic competition, and find sources of competitive advantage in the market. The size of the market, labor costs, and government's trade and tax policies affect the choice of the country to which a firm will transfer its FDI, while population density, labor costs and unemployment rate affect the choice of region (Billington, 1999). Wheeler and Mody (1991) argue that market size is a more important factor than labor cost and tax rate. On the other hand, Deveraux and Griffith (1998) hold that market size and tax rates are more important factors for the inflow of FDI than the labor cost, which, in their opinion, is not important at all.

OLI and Hotels

The eclectic paradigm is particularly applicable in the hotel sector, with the emphasis being placed on location as one of the three pillars of this theory. The first pillar involves ownership advantages originating from the specific activities of the company. International hotels provide quality service to guests who cannot evaluate the service before using it. In such circumstances, the hotel logo, i.e. its brand which guarantees the quality of service, can be a strong competitive advantage, especially if the guest is looking for the service in an unknown environment (Dunning & McQueen, 1982). Therefore, in developed countries where domestically branded hotels firms exist, the share of foreign hotels will be small. On the other hand, in most developing countries, where domestic branded hotels are rare, foreign hotels will play a more important role. Ownership advantages can be structural or behavioral (Johnson & Vanetti, 2005). Structural advantages result from the company size and its ability to achieve economies of scale. Another important factor is company's international experience, as the knowledge of foreign markets and cultures provides a competitive advantage over companies that operate in only one market. Behavioral advantages result from changes in the dynamic hotel market, which necessitate brand development and technologically improved operations.

Furthermore, in the market in which it operates, a multinational hotel firm establishes a set of intangible assets and logistical skills which are transferred to the newly associated hotel at far less cost (Dunning & McQueen, 1982). Depending on the degree of internationalization, product / service quality and the marginal costs of personnel and supplies can be significantly lower, as compared to a newly established firm. The most important ownership advantages for a foreign hotel company are: superior managerial know-how, experience in hotel facilities' planning and design, technological innovation and operational skills in routine activities, human resources, control and maintenance, centralized booking system, knowledge of guests' tastes and requirements, and recognizable brand (Dunning & Kundu, 1995). Through investigating the ownership advantages in expansion strategies of international hotels in five Central and Eastern European countries (i.e., Czech Republic, Hungary, Poland, Slovakia, and Slovenia), Johnson and Vanetti (2005) identified the main competitive advantages as being knowledge of customer needs, strategic planning, and technological progress.

Still, there are differences in terms of company size and home country. In terms of size, *the largest hotel chains* see their competitive advantages in the booking system, human resources, brand, and international experience. While *large hotel chains* see their advantages in company size and in a network of strategic alliances and technological progress, *medium and small enterprises* see their crucial advantages in their knowledge of customers' needs, strategic planning, and financial power. In terms of the home country, the three most important factors for all hotels are knowledge of customers' needs, strategic planning and booking system. Unlike European and American companies, Asian companies do not consider strategic alliances and international experience as very important advantages.

In terms of locational advantages, hotel location is country specific, as it depends on the tourists flows. A foreign hotel firm must first decide on whether it will enter a certain country, followed by a decision on where to locate its hotel, what type and size of hotel, and through which mode of market entry (Dunning & McQueen, 1981). Several factors determine the attractiveness of a country, i.e. the size, growth, and development level of the tourism market, general infrastructure relevant to the tourism industry, availability and quality of hotel inputs, host government policy on FDI, the importance given to tourism industry, general political, economic, and social stability, and the attitude of local population towards foreign tourists.

Another important factor is cultural similarity and physical distance between the two countries, as well as the number and the type of attractions in the host country (Johnson & Vanetti, 2005). According to Porter (1990), the four main factors behind the international success of any country in a given industry are: demand conditions, factor conditions, company strategy, structure and competition, and connected and supporting industries. If these factors are applied to Croatia in the context of its locational advantages for the entry of foreign hotels, the following is evident. First, hotel chains have recently been moving from large city centers to the locations of moderate demand (Johnson & Vanetti, 2005), which is Croatia's advantage since it does not have large cities by global standards, except its capital, Zagreb. Furthermore, very important are the statistical data pointing to the increased demand for hotel services. Data on overnights in the 2001-2005 period show that the ratio of foreign to domestic guests was 87% to 12% (Horwath Consulting Zagreb, 2005). In 2007, the preceding trend carried on, with 89% foreign vs. 11% domestic guests. Having in mind that in Western Europe the ratio of foreign to domestic guests is roughly 50:50 (Johnson & Vanetti, 2005), it is plausible that with the obvious domination of foreign guests, Croatia is in terms of demand conditions a viable location for the entry of foreign hotel chains. This conclusion is also consistent with the results published by Johnson and Vanetti (2005), who found a similarly strong growth potential in Poland.

Second, in terms of factor conditions, due to historic reasons (socialist system) and the consequent lack of established hotel chains, it is possible to produce new standardized products that can be branded. In Croatia, all larger hotel companies were – and some still are – state owned, while the emergence of small hotels has been only a recent phenomenon – a move that corresponds with the European hotel industry and tourist policy. Owing to skilled labor force, natural resources and rich cultural heritage, and lack of branded hotels, Croatia can be seen as an appropriate location for entry of foreign hotels. If the government policy of incentives for foreign investors is also taken into account, then investment in Croatian tourism appears very encouraging. The only limitation in terms of factor conditions seems to be the cost of labor, as Croatia is perceived as a country with pricey labor. Third, in terms of competition, there are several foreign hotel chains in Croatia, as well as domestic groups, i.e., Adriatic Luxury Hotels and Bluesun. Fourth, for the development of tourism as a whole, supporting industries play an important role, especially the passenger air transport, which also makes Croatia an attractive location for the entry of foreign hotels.

In terms of internalization advantages, the stimuli for a hotel firm's internationalization arise due to specific and heterogeneous character of tourism and tourist market itself (Go & Pine, 1995). Two main trends are evident in the choice of entry: an increase of mergers and acquisitions, and an increase of non-equity entry (Johnson & Vanetti, 2005). Mergers and acquisitions are widely spread in the international hotel sector. Still, a large number of international hotel chains use the non-equity ways of entry. Some hotel companies, e.g. Choice Hotel International and Marriott Corp., have split into two companies, one running hotels and the real estate, while the other operates in the form of franchise or management contract (Contractor & Kundu, 1998). The rise of such non-equity forms of entry results from the need to reduce the risk of operation in an unstable environment (Davé, 1984), and it provides hotel chains with some competitive advantages that make their entry into a foreign market easier (Litteljohn, 1985). On the other hand, direct investment allows economies of scale, better knowledge of needs and wants of international customers, better trained personnel, better management and booking systems, as well as the strong brand, service quality, coordinated activities with the parent company, transfer of know-how, and control (Dunning & Kundu, 1995). Internalization arises when the company believes that internal transaction costs are more efficient than the external market. In such case, the company can benefit from such advantages, even if the communication cost is higher (Johnson & Vanetti, 2005).

As an example of operation of American banks in foreign countries, Miller and Parkhe (1998) explain how banks follow the clients in order to satisfy their needs. Namely, banks which do not open their branches in foreign countries may lose their competitive advantage both in domestic and international markets. Many studies recognize this follow-the-client policy as a motive for the service sector investment in a foreign country (Nigh et al., 1986). Similarly, hotels might also strive to meet the needs of their guests visiting foreign countries by expanding their operations abroad. Highly mobile consumers look everywhere for familiar brands and services. This primarily refers to the car rental activities, telecommunication services and hotel services (Douglas & Craig, 1996). Situation in a foreign market will offer both opportunities and threats for the investing company. A hotel chain does not have to consider the specific characteristics of the foreign market, but they still represent the main factor when making the decision on entry. Parallel with the graduate increase of international trade and investments, companies implement the strategy of following their clients to international destinations. International trade and foreign investment are closely connected, not only in manufacturing, but also in many service industries (Porter, 1990). In countries with higher concentration of FDI, hotels will attempt to choose the likewise model of market entry (Rodriguez Ramón, 2002).

Research Hypotheses

Based on the previous theoretical and empirical research – and in context of Croatia – we set the following hypotheses:

H1: *There is a positive relationship between the presence of a foreign hotel from a particular country and the total FDI from that country in Croatia.*

Foreign hotel is defined as a hotel present in Croatia either by share of ownership above 10%, by franchise or management contract, lease agreement or consortium. From the host country perspective, it is difficult to analyze in the same way hotels with foreign ownership share and hotels operating under a foreign brand. Namely, some hotels have foreign owners from one country, while they operate under the brand from a different country. In order to avoid a non-trivial issue of what counts as hotel's home country, H1, as well as the two subsequent hypotheses, will be examined by two sub-hypotheses analyzing separately hotels in foreign ownership and hotels under foreign brand. Thus:

H1a): *There is a positive relationship between the presence of a hotel in foreign ownership above 10% and total FDI from its home country in Croatia.*

H1b): *There is a positive relationship between the presence of a foreign hotel chain in Croatia and the total FDI from its home country in Croatia.*

Many countries trade in products and services with other countries. The volume of trade with other countries is an aspect of economic interrelatedness. Trade interrelatedness of two countries can be observed in their sharing of the same consumers or competitors, the volume of mutual trade, the same or similar tastes of their consumers, and the similar market environment (Douglas & Craig, 1996). Geographical interrelatedness has three dimensions – macroeconomic, product-market, and company-specific. Macroeconomic dimension, referring to the company's business environment, assessed through the volume of mutual exchange and the number of tourists from each country. Product-market dimension involves the flow of products and services. In the services sector, this refers to the mobile consumers mentioned earlier, who look for familiar brands and services wherever they are. Company-specific dimension denotes different markets using the same facilities for research and development, sharing the same management, etc.

Bilateral trade indicators are useful when interrelatedness is determined at the country level. However, as the relative sizes of any two markets are almost never the same, the market interrelatedness between the countries will be asymmetrical, and thus not fit for comparison. Although it might be concluded that companies will invest in countries that are geographically contiguous, culturally similar, or where they already have some investing experience, (Davidson, 1980), strong trade linkages also exists between very distant countries (e.g. USA and Japan and China). Nevertheless, the greater the market interrelatedness, the greater the probability of growing demand for well-known brands and services. In other words, if decision makers perceive that some foreign market is highly interrelated with the domestic market, they will be able to plan similar demand in that market.

While previous research studied the environmental factors affecting the decision on the mode of entry into a particular market, there is a paucity of research investigating the effects of trade interrelatedness and market similarity on the presence of foreign hotels in a particular country. Therefore, this study investigates the effect of trade interrelatedness on the presence of foreign hotels in Croatia. This leads us to the second hypothesis and two sub-hypotheses:

H2: *There is a positive relationship between the presence of a foreign hotel from a particular country and the index of trade interrelatedness of Croatia with that country.*

H2a): *There is a positive relationship between the presence of a hotel in foreign ownership above 10% and the index of trade interrelatedness of Croatia with its home country.*

H2b): *There is a positive relationship between the presence of a foreign hotel chain and the index of trade interrelatedness of Croatia and its home country.*

As has already been stated, service companies follow their clients into foreign countries, so it is to be assumed that clients/consumers will look for familiar service providers when they visit foreign destinations. Being faced with an unfamiliar environment and not having enough time to evaluate alternative choices, consumers are more apt to choose a product or service with a familiar brand in favor of a local product or brand, as the former offers a guarantee of a certain quality (Mathewson & Winter, 1985). A similar finding was made by Kabir (1998) when analyzing growth strategies of American franchised restaurant chains. It intuitively makes sense that guests are more likely to choose a restaurant carrying a familiar brand in an unknown destination. In much the same way, hotel companies with an established brand in the domestic market will follow their clients that look for familiar and standardized services in a foreign country. In that way, hotel companies have competitive advantage in the form of a well-known brand and access to the needed resources, such as capital and technology, which enables them to offer higher levels of service quality to their clients. Consequently, it could be expected that tourists from country A visiting country B will look for service providers from country A. In such event, it may be assumed that the number of visitors to Croatia coming from a particular country will be a significant factor in evaluation of benefits from entry into the Croatian market.

By entering Croatia, foreign hotels improve their image and recognition, and strengthen their market position for the tourists visiting from their home country. For instance, some American companies operating in the national market are for the same reason compelled to increasingly spread their operations to foreign markets as Americans increasingly travel abroad (Bell, 1989). This leads us to our third hypothesis and two sub-hypotheses:

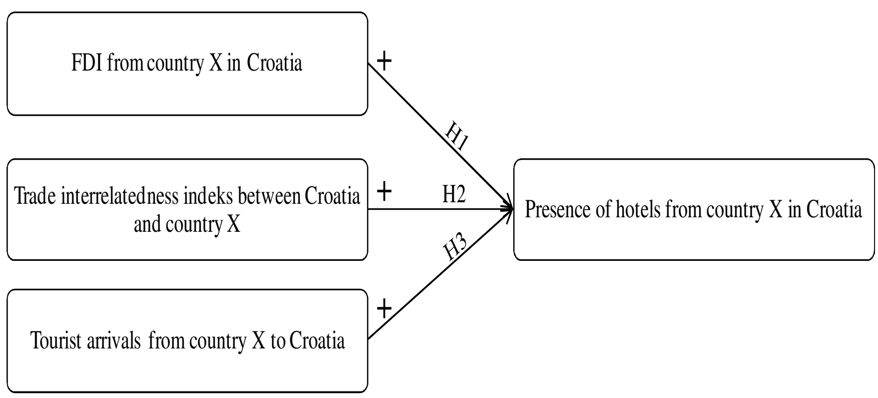
H3: *There is a positive relationship between the presence of a foreign hotel from a particular country and the number of tourists in Croatia visiting from that country.*

H3a): *There is a positive relationship between the presence of a hotel in foreign ownership above 10% and the number of tourist visiting Croatia from that country.*

H3b): *There is a positive relationship between the presence of a hotel chain and the number of tourists visiting Croatia from that country.*

All of the hypotheses that are tested in this study are illustrated in Figure 1.

Figure 1: Hypothesized effects of selected variables on the presence of foreign hotels in Croatia



METHODOLOGY

This study set out to find which variables are important for the entry of foreign hotels in Croatia. Data on the countries relevant for the research are based on the presence of foreign hotels in Croatia in terms of their home country, although not all of the observed countries have hotels in Croatia. As we investigate the effect of the total inward FDI in Croatia, trade interrelatedness with other countries (mutual exports and imports), and tourist turnover in terms of visitors' country of origin, our sample involves those countries with which Croatia has FDI, exports, imports, and tourist turnover. The time-series analyses employed herein spans the 1997-2007 period. The sample comprises only the following 35 countries for which data on the variables of interest are available: Austria, Belgium, Bosnia and Herzegovina, Bulgaria, Canada, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxemburg, Malta, Norway, Poland, Portugal, Romania, Russia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, UK, Ukraine, USA, and the Netherlands.

Presence of foreign owned hotels in Croatia (*Hotel FDI*) – is a dependent variable in this research. It represents a single observation of the total number of foreign-owned hotels from a particular country in Croatia on April 22, 2008. The reason behind selecting a single observation (as opposed to multiple observations over time) is the unavailability of time-series data. Namely, the data were obtained from the several official sources, such as Internet pages of the Zagreb Stock Exchange (2007) for quoted companies, from the official Internet pages of particular hotels, and from the official Internet pages of the Croatian National Company Registry (affiliated with Croatia's Ministry of Justice). For this reason, we consider this as this study's limitation that ought to be resolved in future research attempts. For the purpose of this study, a foreign-owned hotel is a hotel company in which foreign investor has a share of at least 10% (UNCTAD, 2007). The home country of the hotel is the country in which the hotel company owner is registered. The list of hotels is based on the list of the Croatian Ministry of Tourism (2008), the web pages of the Croatian National Tourist Board (2010), and of each particular hotel. From the entire list of hotels in Croatia, we selected those in which foreign investors have an ownership share.

Presence of international hotel brands in Croatia (*Hotel brand*) – is a dependent variable involving a single observation (on April 22, 2008) of any hotel operating under franchise or management agreement, or within a consortium. The brand home country is the country in which the brand owner company is based. Foreign direct investment in Croatia (*FDI*) – this independent variable measures the amount of total inward FDI in Croatia in millions of Euros from a given country during 1997-2007 (time-variant variable). The data source is the official web page of the Croatian National Bank (2010). Index of trade interrelatedness (*TradeInt*) – is an independent variable representing the degree of interrelatedness at the country level (Douglas & Craig, 2000), also a time-variant variable. The index of trade interrelatedness between any two countries can be expressed through mutual exports and imports as the percentage of their total exports and imports (Douglas & Craig, 1996), as represented by the following formula:

$$\text{Interrelatedness index of Croatia and country X} = \frac{\text{Exports to X + Imports from X}}{\text{Total exports Croatia + Total imports Croatia}}$$

The time-series data on Croatian exports and imports during 1997-2007 were obtained from the Statistical Yearbooks of the Croatian Central Bureau of Statistics (CBS) in millions of USD in current or nominal prices. Although the data that were available for this research were mostly in nominal (i.e., non-inflation adjusted) values, none of the observed years in the time-series (i.e., 1997-2007, that is, after the crisis generated by Croatia's Homeland War and before the global financial crisis) deviated significantly enough to justify the selection of the base year. However, this can be changed in future research. The interrelatedness index is expressed as an average value for the 10-year period, except for Luxembourg, Latvia, Lithuania, Estonia, Cyprus, Ireland, and Portugal, for which the individual data were not available, but were calculated on the basis of total imports and exports between these seven countries and EU25, from which the amounts referring to the remaining 18 countries were deducted, and then taking the four-year average (2003-2006). Since Latvia, Lithuania, and Estonia accessed the EU in 2004, the data from previous years were not available, hence the four-year average.

Number of tourists visiting Croatia by country of residence *(TourTurn)* – this independent variable measures the total number of arrivals in terms of tourists' countries of origin (in thousands) during 1997-2007. The data are also time-variant and were obtained from the CBS.

Statistical analyses were performed by way of correlation and regression. Correlation determines the strength of the relationship between the dependent and independent variables. It also shows whether there is a problem of multi-colinearity between the independent variables. The ordinary least squares (OLS) regression further shows if there is a relationship between the dependent and independent variables, and if there is one, how significant is it.

FINDINGS

The data were processed by SPSS. Initially, we examined the relationship between the dependent and independent variables using Pearson's and Spearman's correlation coefficients (Table 3). The results show a significant correlation between *Hotel FDI* and all three independent variables examined in this study: *FDI*, *TradeInt*, and *TourTurn*. Spearman's correlation coefficient shows a strongly significant positive correlation of *Hotel FDI* with all three independent variables ($p<0.01$): 0.597 with *TradeInt,* 0.531 with *FDI,* and 0.595 with *TourTurn*. Pearson's correlation coefficient shows a strongly significant positive correlation of *Hotel FDI* with *FDI* in the amount of 0.858, while with the remaining two independent variables it shows a moderately significant positive correlation ($p<0.05$): 0.386 with *TradeInt* and 0.395 with *TourTurn*. Thus, correlation provides support for all three hypotheses: H1a, H2a, and H3a. Correlation analysis is also used to test the existence of multi-colinearity between the independent variables. Spearman's correlation coefficients show significant positive correlation between independent variables, ranging from 0.65 to 0.81, which points to the existence of multi-colinearity between the independent variables.

Table 3. Pearson's and Spearman's correlation coefficients (N=29)

Variables	Hotel FDI		Hotel Brand		TradeInt		TourTurn	
	P[1]	S[2]	P[1]	S[2]	P[1]	S[2]	P[1]	S[2]
FDI	.858**	.531**	.390*	.195	.440*	.713**	.513**	.654**
TradeInt	.386*	.597**	.050	.316			.868**	.810**
TourTurn	.395*	.595**	.077	.217				

[1] Pearson's correlation
[2] Spearman's correlation
* $p < .05$
** $p < .01$

The next step in the analysis is to test whether there is a relationship between the dependent and independent variables, and if there is, whether it is significant. Due to multi-colinearity, it is not appropriate to carry out the regression analysis with all the variables included. Therefore, the effect of each independent variable on the dependent variable is analyzed separately (Table 4). It is apparent that the dependent variable *Hotel FDI* is very significantly and positively affected by *FDI* with R^2 amounting to 0.73, F test 75.18, t value 8.6, and significance 0.000. *TourTurn* has a moderate positive effect on the dependent variable with R^2 value of 0.156, F test 4.99, t value 2.23, and significance 0.034. *TradeInt* also has a moderate positive effect on the dependent variable with R^2 value of 0.150, F test 4.73, t value 2.17, and significance 0.039. The joint results of the correlation and regression analyses suggest that in terms of the dependent variable *Hotel FDI,* all three starting hypotheses H1a, H2a, and H3a appear supported.

Table 4. Regression of individual independent variables on Hotel FDI and Hotel Brand

Variables	Hotel FDI			Hotel Brand		
	R^2	F	*p*	R^2	F	*p*
FDI	.730	75.180	.000**	.152	4.848	.036*
TradeInt	.150	4.730	.039*	.003	0.068	.796
TourTurn	.156	4.990	.034*	.006	0.159	.693

* $p < .05$
** $p < .01$

In the third step, correlation and regression analyses are carried out regarding the effect of the same independent variables (*FDI, TourTurn,* and *TradeInt)* on the dependent variable *presence of international hotel brands in Croatia* (*Hotel Brand*). From the above tables of Spearman's and Pearson's correlation coefficients, it is apparent that there is positive but insignificant correlation of the dependent variable *Hotel brand* with independent variables. Spearman's correlation coefficient shows positive but insignificant correlation with all three independent variables: 0.316 with *TradeInt*, 0.195 with *FDI* and 0.217 with *TourTurn*. Pearson's correlation coefficient shows positive and significant correlation of the dependent variable *Hotel brand* with *FDI* 0.390, while with the other two variables correlation is positive but insignificant, with *TradeInt* 0.050, and with *TourTurn* 0.077. Again, owing to multi-colinearity among independent variables, *HotelBrand* was regressed separately on each independent variable. Table 4 output suggests that dependent variable *HotelBrand* is positively and marginally affected by *FDI,* while *TourTurn* and *TradeInt* do not siginificantly affect *HotelBrand.* The joint results of the correlation and regression analyses show that in terms of the dependent variable *HotelBrand,* hypothesis H1b seems supported, while hypotheses H2b and H3b are rejected.

CONCLUSION

This study explored important variables that have not been considered in previous research. Neither tourist arrivals from the hotel brand home country nor trade interrelatedness between the two countries affect the entry of international hotel brands in Croatia. It may well be that international hotel brands perceive tourists as a global phenomenon, regardless of tourists' country of residence. A hotel chain's international operations enhance its image and recognition, thus strengthening its market position for global guests. In that way, hotel brands are less dependent on the follow-the-domestic-client model and try to meet the needs of global clients. Consequently, trade interrelatedness is not significant to these hotel operators. The significant effect of total inward FDI in Croatia from the hotel brand's home country can be explained by tendency to avoid political and environment risks and insecurity. Marginally significant effect of total inward FDI and the insignificant effect of trade interrelatedness are related to the lower levels of risk and uncertainty of operations in Croatia, especially after Croatia has obtained the candidate status for the EU accession. Moreover, hotel brands are concentrated mainly in Zagreb, Dubrovnik, and the Istria region. For the purposes of this research, a hotel brand refers to a hotel operating under franchise agreement, management contract or consortium. If we were to analyze hotel chains at the level of different business strategies (i.e., franchise agreements, management contracts, etc.), the results may have been different, thus this may be something that future research could look into.

While the composition of tourist demand has remained stable over the past 30 years (i.e., 90% of foreign tourists come from 15 countries), the number of tourists from countries that are sources of FDI in Croatia has increased significantly in recent years. Namely, one has to consider that it takes some time before the positive effects of inward FDI (e.g., transfer of know-how, understanding guest needs, leveraging central reservation systems, etc.) can be realized. Similarly, the number of hotel accommodation units and beds has remained relatively unchanged over the past 20 years because the vast majority of inward foreign investment took the form of brown field FDI. That is, investors' efforts were directed at buying and upgrading the existing lodging establishments with the goal of their market repositioning. The amount of inward green field FDI in Croatia's hotel sector was virtually insignificant during the observed time frame, and thus further analysis would not have been appropriate due to small sample size.

This research also shows that the decision of the foreign owned hotel to enter Croatia is more affected by trade interrelatedness between the hotel's home country and Croatia, as well as by the number of tourists from a respective country to Croatia, whereas the effect of total inward FDI from a given country to Croatia is very significant. These findings suggest that foreign hotel firms pay attention to cultural similarity, confirming that cultural similarity is the main determinant of entrance into a particular country (Erramilli et al., 1997). Since hotel's focus is on the tourist, it seems plausible that hotel companies entering Croatia will be from the same country as the investors in other industries. Namely, the level of total inward FDI in Croatia points to the presence of foreign companies in other industries as well. This confirms the thesis that following other international companies into a particular country (Croatia) is a locational advantage that ensures growth and allows foreign owned hotels and foreign hotel brands to keep their clients and to attract new ones. The results show that a higher degree of exchange between Croatia and some country also causes a higher presence of hotels from that country in Croatia.

Higher significance of total inward FDI, trade interrelatedness, and tourist arrivals in the analysis of foreign owned hotels can be explained by greater financial investments by these investors, as compared to those of foreign hotel brands. Considering financial investment, it makes sense that foreign investors look for an environment with less political and economic risk because government policy affects the business environment (Anttonen et al. 2005). Stated differently, higher total inward FDI translates to lower political and economic insecurity. In regards to financial investments, foreign hotel companies are more likely to invest in countries with whom their home country has certain economic relations, and which are visited by the tourists from their own country looking for familiar hotel brands, or hotels whose owners come from their own country.

In the context of findings as they relate to individual countries, Spain and Luxembourg warrant additional explanation. While Spanish hotels' presence in Croatia is through non-equity forms, Spanish FDI via ownership stake is non-existent, which correlates with the overall low FDI from Spain. Since the entrance of Spanish hotels into Croatia ten years ago, the number of Spanish tourists has increased tenfold. On the other hand, despite the presence of Luxembourg-based Orco Property Group (with nine hotels under the subsidiary company Sunčani Hvar d.d.) in Croatia, tourists from Luxembourg comprise a meager 0.05% of all foreign visitors to Croatia. Owing to its reputation for being a corporate tax haven, Luxembourg is home to numerous international companies. In fact, Luxembourg derives its prosperity partly from its status as Europe's number one investment fund center and as the world's leading hub for global fund distribution. Hence the large amount of FDI and few visitors from Luxembourg.

The results of this research can be useful in planning and development of tourism policy in Croatia. Namely, if it is expected that companies from other sectors will invest in Croatia, some hotel company from the same country may wish to enter the Croatian tourist market in order to realize its comparative advantages. In this sense, it is necessary to focus on countries with which Croatia already has developed trade relations, which already invest in Croatia, and whose tourists visit Croatia. Bearing in mind the research methodology used herein, it must be noted that the variables analyzed may be used as a framework for future research regarding the entry of foreign hotel brands into Croatia. While analyzing international hotel chains, one may wonder whether the tourist's home country is the same country where the hotel brand is based, or is the tourist perhaps seen as a global guest, regardless of the country of origin. The results herein can also be used not only in defining strategy to attract foreign hotel companies to Croatia, but also in designing strategies to attract foreign companies from other service industries. Numerous service industries (restaurants, travel agencies, banks, advertising agencies, etc.) also have renowned brands, which has to be taken into account when devising strategies to attract foreign investors to Croatia.

This work also offers some directions for future research. Namely, the dilemma is whether hotels from a particular country enter Croatia before or after more comprehensive FDI from that country. According to Sanford and Dong (1980), growth of tourism demand in a particular country may enhance its attractiveness to foreign investors. These authors stress the importance of tourism as a catalyst for new inward FDI. Furthermore, it is possible to investigate whether greater trade interrelatedness causes potential tourists from a given country to perceive Croatia more positively. .

This study also has some limitations. The hotel firm's home country is the country in which the holding company is based. For the purpose of this study, we did not look for more detailed data on the ownership of the holding company, simply because they are not available. Similarly, some company ownership data may also be unavailable if a given firm is under custodial account of some bank. The companies for which there were no data available were considered to be Croatian companies. Another limitation is that the presence of a foreign hotel company in Croatia represents a single observation in time. As stated earlier, the reason behind selecting a single observation (as opposed to multiple observations over time) is the unavailability of time-series data. This being said, we hope that the conditions surrounding the availability of data in appropriate form will help resolve this limitation in the forthcoming research attempts. Finally, only few variables were included in this study's correlation and regression analyses. Thus, future studies may consider including some other theoretically supported variables.

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