# FINANCIAL RISK MANAGEMENT CHALLENGES IN CROATIA'S HOSPITALITY INDUSTRY

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## ABSTRACT

*The main aim of this paper is to investigate the implementation of risk management in Croatia's hospitality industry. By using a structured questionnaire, quantitative methodology was implemented for collection of primary data. The authors analyze data collected from hospitality industry professionals. The paper examines the implementation of financial and business risk management in companies and the application of methods for managing business and financial risks. Additionally, it provides an experience of practitioners on usage of financial billing instruments. The paper's findings confirm that more developed and financially powerful companies such as hotels and tourist resorts systematically manage risks, as opposed to smaller businesses where no function is assigned to cover risk management, or it is performed by the person in charge, usually the owner/director.*

*This study provides valuable information on previous research findings on business and financial risk management in hospitality industry as well as an interpretation of the present research. The paper provides an original perspective on business and financial risk management in the hospitality industry of Croatia. The limitation of this paper emerges from the fact that this is a first-of-its-kind analysis in the Croatian hospitality industry and it necessitates the collection of additional data. The paper provides academics and business practitioners with new outlook of the financial and business risk management in the Croatian hospitality industry.*

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## INTRODUCTION

During the lLast decade the issue of risk management in tourism and hospitality journals has become a hot topic. According to research from Jang and Park (2011), of the total number of published finance papers in the top four tourism and hospitality journals, 17.7% are investigating risk management. The importance of risk management and papers that investigate that risk domain has been dramatically increasing for the last decade. This could be explained by the increased number of financial crises that have emerged at the beginning of new millennium. Also, it requires mentioning that risk management is part of financial management, which itself one of the main pillars of any business domains in all industries. The risk and uncertainty in the hospitality industry is linked to the main characteristic of this industry – capital-intensive (Choi, Woods, & Murrmann, 2000; Krajnovic, Cicin-Sain, & Prevolsek, 2011; Lee, 2008). Explanation for capital-intensive industry emerges from the fact that the majority of assets essential for doing business is of long-term nature and proportional to that, the debts and owners' equity is high. Based on abovementioned, it may be concluded that the probability of risks is high for hospitality industry. High risk in hotel industry is connected to the capital structure and the level of fixed costs that does not change over the time regardless to the level of the sales volume (Pacheco & Tavares, 2017; Devsa & Esteban, 2011; Lee & Qu, 2011; Karadeniz, Kandir, Balcilar, & Onal, 2009). In addition, risk in tourism and hospitality industry can emerge from the financial framework, uncertain demand, high seasonality, interest rate change, change of exchange rate and risk of suppliers.

The main characteristic of Croatian tourism is its high seasonality given how thealthough hotel industry is the backbone of tourism. Main problems of seasonality manifest themselves as sudden growth of visitors in destination and enormous pressures to the hotel industry that must provide same quality services. Hotel industry usually combines lodging services and food services and it is very dependable on the quality of the inputs i.e. it is dependable on the suppliers. This dependency is particularly highlighted in the high season. Mutual dependency between the hotel industry and its suppliers is indisputable, especially if we observe them through the supply chain. Companies that recognize the need to understand suppliers and their demands and find good supplier business models i.e. manage supplier chain risk may fully succeed in cooperation and achieving better competitiveness and performance in an industry that does not forgive risk neglect. Therefore, in this kind of relation there is always a chance of relational risk. Yan describes relational risk as the risk of opportunistic behavior of one particular partner having negative impacts on the others (2011). Consequently, supplier risk in hotel industry is very important and could have a significant impact on the effectiveness and profitability. The aim of this article is to investigate the implementation of financial and business risk management in hospitality companies and application of methods for managing business and financial risks. The paper is structured as follows: Section 2 provides an overview of the existing literature on the topic. Section 3 treats the issue of research data and use of methodology. Section 4 reports the empirical findings, while Section 5 concludes.

## LITERATURE REVIEW

There is extensive literature – studies and empirical research on risk management in hospitality industry. Based on literature analysis we may conclude that present several different approaches towards risks and towards risk management. The basic approach of scholars and researchers and their literature studies on risk can be divided into the microeconomic method leaning towards risk and its management (Jansone & Voronova, 2014; Bodnar, Consolandi, Gabbi, & Jaiswal-Dale, 2012; Fong-Woon & Samad, 2011; Brown, Crabb, & Haushalter, 2006) and the systemic risk approach (Kim, Kim, & Gu, 2012; Tasca & Battiston, 2016; Namvar, Phillips, Pukthuanthong, & Rau, 2016; Uhde & Michalak, 2010). Since risk management emerged from the insurance industry, it has been incorporated in finance during the past thirty years ba the majority of the researches who hail from, or have strong connections to the finance and insurance sector. Nevertheless, risk management and risks have not been studied solely from those two points of view. Some authors have analyzed the perception of risk by managers and risk management (Cross, 1998; March i Shapira, 1987; Virglerova, Kozubikova i Vojtovic, 2016). In addition to these, there exist studies on the managerial perception of risk and the influence of personal risk attitudes pointing to the connection between personal attitudes and risk behavior (Legohérel et al., 2004).

As already mentioned in the past years, there has been a significant increase in the number of risk management studies in the area of the hotel industry. Williams and Baláz (2014) show that there is a need for a better theoretical framework of the concept of risk management and measurement of uncertainty in tourism. These authors have analyzed the exposure of the hotel industry to foreign exchange risk and arrived at the conclusion that multinationals could diversify these risks while domestic companies are more exposed to these risks. Their conclusion was based on the exposure to interest rate risk in hotel business, as well as determinants such as company size, indebtedness, asymmetry of information, cash flow volatility and its effect on the interest rate risk. Serrasqueiro and Nunes' (2014) investigation on relationship between risk and capital structure, particularly in small and medium-sized tourism companies in Portugal, clearly shows a high risk of hotel business and the need for managing them. Risk and risk management is a worldwide phenomenon which is analyzed and researched in all economies. Every now and then it comes back again into focus, especially in times of crisis. Jason and Vorono (2012) in their research clearly indicate an increase of business risks during the global financial crisis. Waikar, Desai, and Bordeaux (2015, 2016) have explored the existence of risks in the Indian hotel industry and how it is managed as well as the influence of business entities and managers on managing them.

## DATA AND METHODOLOGY

The survey on knowledge and use of risk management methods, billing instruments and supplier risk management was carried out on Croatian companies in the period from December 2016 to February 2017. Only catering companies were investigated. There were 24 questions in the survey that were designed to address the four study objectives. The survey consists of eight sociodemographic questions, four questions were focused on examining the existence of systematic management of business and financial risks, three questions for examining the knowledge, use and importance of risk management methods. The following three questions examined the knowledge, use and importance of instruments for bill insurance, whereas the last six questions investigated the supplier risk management and its impact on business. The survey was sent by e-mail to 900 catering companies. The overall response that was collected included 68 responses, amounting to a 7.55% response rate.

Two questions used a five-point Likert scale to set and identify the importance of methods for risk management and importance of listed billing instruments as follows: 1 denoted “Not important”; 2 denoted “Slightly important”; 3 denoted “Moderately important”; 4 denoted “Important”; and, 5 denoted “Very important”. A sixth option of “Don’t know” was provided. One question used a seven-point Likert scale to set and identify importance of the criterion for choosing supplier as follows: 1 denoted “Not important”; 2 denoted “Almost not important”; 3 denoted “Moderately not important”; 4 denoted “Neither important nor unimportant”; and, 5 denoted “Moderately important”; 6 denoted “Highly important”; 7 denoted “Significantly important”. There were five questions that included listings – 1 methods used for risk management; 2 reasons for using methods; 3 contracts used with business with suppliers; 4 billing instruments used; and 5 most common suppliers’ omissions – that respondents could mark as answer. Two were used to discover if the respondent was familiar with risk management methods and if there was a person in the company or department in charge of managing the risks.

## SURVEY RESULTS

Out of the 68 respondents, 45 were limited liabilities companies or 66,2% of the total sample. Joint stock companies came in second place with 15 responses, i.e. 22,1% followed by crafts with 5 responses or 7,4% and simple limited liabilities companies with 3 responses or only 4,4% of overall sample.

*Table 1: Type of companies by type of service and work process*

| Name | N | % |
|---|---|---|
| All-suite hotels | 1 | 1,5% |
| Inns | 1 | 1,5% |
| Hotels | 22 | 32,4% |
| Integral hotels | 2 | 2,9% |
| Spa hotels | 1 | 1,5% |
| Fast foods | 4 | 5,9% |
| Boarding houses | 3 | 4,4% |

*continued Table 1*

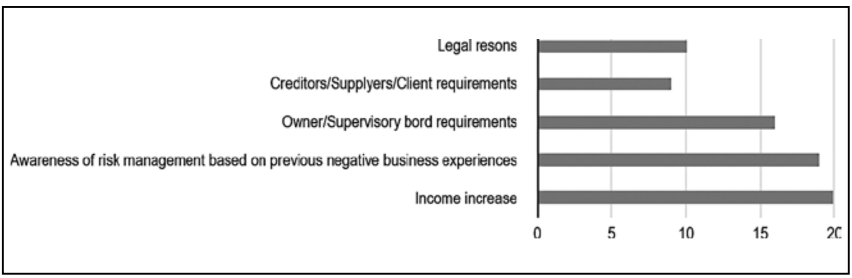
| **Name** | **N** | **%** |
|---|---|---|
| Rotisseries, | 1 | 1,5% |
| Pizzerias | 3 | 4,4% |
| Restaurants | 18 | 26,5% |
| Pastry shops | 3 | 4,4% |
| Tourist apartments | 3 | 4,4% |
| Tourist resorts | 5 | 7,4% |
| Snack bars | 1 | 1,5% |
| **Overall** | **68** | **100,00** |

Hotels and restaurants are the most represented with 22 responses, or 32,4% share and 18 or 26,5%. They are followed by tourist resorts with 7,4%, fast food facilities with 5,9%, boarding houses, pizzerias and pastry shops with 13,2% and other business entities represented by 14,6% in the total sample. In the sample, companies from the group of hotels, all-suite hotels, apartments, integral hotels and spa hotels with tourist resorts and restaurants make up 51,6%. In addition, 17 out of 68 respondents have seasonal character, meaning that they are closed during winter. In addition, the number of employees in companies were also investigated; the most represented are business entities from 10 to 49 employees which make up 32,35 of the total sample. Then follow companies from 50 to 249 employees with 22,06%, while just behind them are companies with 5 to 9 employees amounting to 20,59%, then companies with 0 to 4 employees with 14,71%, and companies with 250 and more employees with 10,29%. It is evident that companies employing 10-49 employees are the most representable, which was not surprising since this range of employees responds the most to the needs of majority of surveyed catering companies. The surveyed companies have headquarters in Primorje-Gorski Kotar County with 35,9% sample and Istria County with 23,53%. Following are the city of Zagreb with 10,29%, then Vukovar-Srijem County, Osijek-Baranja County 5,88%, and 18,52%, respectively. The proximity of Primorsko-goranska and Istarska County and the possibility of personal surveying of companies is the main reason for the high response rates.

Furthermore, we have investigated the existence of persons and/or department for risk management in companies. The results are as followed; 42.65%, or 29 of companies don't have a person and/or department for risk management; while 57,35% or 39 of companies stated that there is someone in their companies in charge of managing business and financial risks. In companies that have someone for risk management; one person is represented by 35,29% or 24 of the surveyed companies, while the risk management department is represented by 22,6% or 15 companies out of the total sample. These results are not surprising since engagement of a person or department for risk management demands frrm companies' additional allocation of money. It can be concluded that large companies will have a risk management department or a person. The bigger and more developed companies could afford that kind of expenses, while smaller and financially fragile companies can do business without a person and/or departments managing business and financial risks.

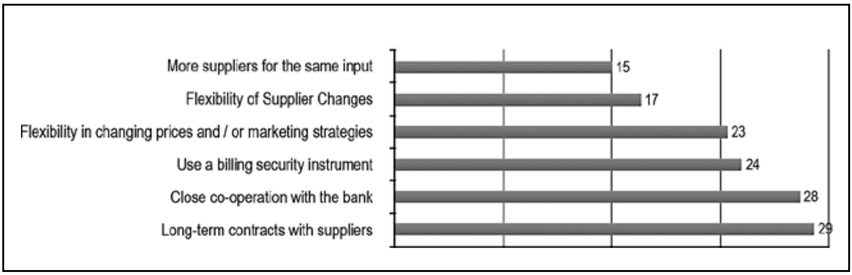
Additionally we have analyzed the number of companies that have implemented risk management process. The results were as follows: 33 companies have implemented risk management process and 35 companies have not. Graph a shows the stated reasons for risk management implementation.

*Graph 1: Reasons for implementation of risk management process*




The previous graph shows the answers to the question where it was possible to provide multiple responses, or business entities had the opportunity to choose several reasons why they implemented the risk management process. The analysis was on a sample of 33 business entities previously stated to have implemented the process of risk management. It follows from the above that from the 33 respondents who implemented the risk management process, 20 stated that the increase in revenue was one of the reasons for the implementation of the process itself. Then follow 19 respondents with answer – reason awareness of risk management based on previous negative business experiences, followed by 16 respondents saying the reason for implementation is the owners/supervisory board requests. Also, we have investigated knowledge and usage of risk management methods in companies. Results are presented in next graph.

*Graph 2: Knowledge and usage of risk management methods in companies*




The most commonly used risk management method includes long-term contracts with suppliers, which are used because they ensure achieving better prices, more favorable payment conditions, certain rebates and manage specific risks through their use. Subsequent are close cooperation with banks and use of a billing instruments as two firm methods for risk management. With 5-point Likert scale were: 1 denoted “Not important”; 2 denoted “Slightly important”; 3 denoted “Moderately important”; 4 denoted “Important”; 5 denoted “Very important”; and 6 denoted “Not sure/do not know” we have measured importance of methods of risk management and results are presented in table 2.

*Table 2: Importance of methods of risk management*

| **Methods of risk management** | **Mean** | **N** |
|---|---|---|
| Close co-operation with the bank | 4,09 | 55 |
| Use a billing security instrument | 4,49 | 60 |
| Flexibility in changing prices and/or marketing strategies | 4,39 | 58 |
| Long-term contracts with suppliers | 4,31 | 62 |
| Flexibility of Supplier Changes | 4,02 | 62 |
| More suppliers for the same input | 4,09 | 59 |

All methods were marked as important, but usage of a billing security instrument; long-term contracts and flexibility in changing prices and/or marketing strategies are marked in with highest average grade. The difference in N is result of usage of number 6 - unknowing method.

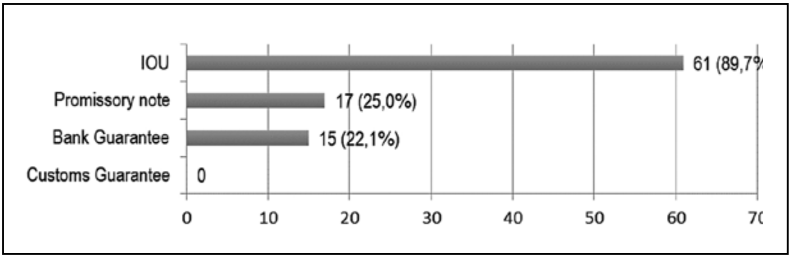
Additionally, we have investigated the knowledge and usage collateral security tools – billing security instrument in hospitality companies. The following table shows results on knowledge of billing security instrument.

*Table 3: Knowledge of billing security instrument*

| **Billing Security Instrument** | **YES** | **NO** | **Do not know/ Not sure** | **YES (%)** | **NO (%)** | **Do not know/ Not sure (%)** | **N** |
|---|---|---|---|---|---|---|---|
| Promissory note | 54 | 12 | 2 | 79,4% | 17,6% | 2,9% | 68 |
| IOU | 64 | 3 | 1 | 94,1% | 4,4% | 1,5% | 68 |
| Bank Guarantee | 47 | 15 | 6 | 69,1% | 22,1% | 8,8% | 68 |
| Customs Guarantee | 21 | 33 | 14 | 30,9% | 48,5% | 20,6% | 68 |

From the analysis of results presented in table 3 we may conclude that IOU and promissory note as billing security instruments are well known than follows bank guarantee. Inly 31% of interviewed managers are familiar with the customs guarantee while 20,6% is not sure of or do not know that billing instrument. The usage of billing security instruments can be see in Graph.

*Graph 2 The usage of billing security instruments*




We may conclude that the majority of companies is using IOU as billing security instrument, 25% of companies is using promissory note and 21% is using bank guarantee. None of the surveyed companies use customs guarantee.

## CONCLUSION

From the gathered and researched data it can be concluded that risk management is a practice that only larger and more developed companies that have a risk management department exercise. Companies that are aware of risk and risk management benefits and are in financial position and that can afford it will hire at least a person that will manage risks. Smaller and financially weaker companies will do business without a person and/or a department dealing with managing business and financial risks. Considering the reasons for implementation of the risk management process 60% of companies who have implemented the risk management process answered that they implemented the same because of the increase in revenue. A second reason (58%) for implementation of risk management process is based on previous negative business experiences. In addition, one of the main reasons for risk management process implementation is demand of owners/supervisory board.

Other results connected to the importance of methods for risk management were expected, given that all methods were marked as important. Also, managers of surveyed companies showed high knowledge of billing security instruments except the customs guarantee. Mutual dependency of hospitality companies and suppliers is indisputable in the common chain of business success. Therefore, it may be concluded that risk management in small hospitality companies is undeveloped, giving them plenty of room for further development and improvement.

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