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## POSSIBILITIES OF FINANCIAL SUPPORT TO SMALL AND MEDIUM HOTEL COMPANIES IN SERBIA

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### **Abstract:**

Small and medium hotel companies in the majority of developed tourist countries have dominant role in hotel industry. The same situation is with Serbia. An important precondition for successful business of a hotel is accepting and applying basic pillars of marketing concept i.e. satisfying needs and expectations of guests in order to achieve profit. Small hotel companies have specific problems in their daily business. Top priority in management and surviving of hotels is cash, because fixed costs are very dominant so hotels earmark more resources for them than for marketing. This means higher engagement and involvement of the state in further development of small and medium hotel companies in Serbia. The state should provide favourable subsidized credit lines for small and medium hotel companies in Serbia, through appropriate support programmes.

*Key words:* small and medium hotel companies, financial support, support programme.

### **INTRODUCTION**

The size of the hotel is determined by its business (planning, organization, management and control) and requires broadness and skills of the persons managing it. The size of a hotel can be expressed through the hotel's capacity (number of rooms and beds), number of employees and number of square meters, sum of invested money or some other parameters. In terms of work organization, satisfying of tourists' needs and creating an appropriate atmosphere in the hotel, it should be a distinctive border line depending on the type of hotel.

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There are no officially adopted standards for hotel size, in theory and practice there is a dominant opinion that hotels should have minimum 15 rooms. Basically, it is important to define the bottom line i.e. minimum number of rooms. Up line is defined by the investor of the hotel. There are different approaches to hotel size segmentation. Having in mind the mentioned assumptions of hotel size, hotels can be divided as follows: **small hotels** (up to 30 rooms / up to 60 beds), **medium hotels** (from 30 up to 120 rooms/ up to 250 beds) and **large hotels** (above 120 rooms / above 250 beds).

There are other approaches connected to the size of the hotel. For example, in Great Britain bottom line for hotels is 10 rooms, while in USA hotels are divided into two groups: up to 25 rooms and above 25 rooms. According to our regulations, bottom line is 10 rooms for the facilities which can perform business as hotel.

Small hotels, irrespectively of the size criteria (sum of invested money in it, number of rooms i.e. beds, turnover expressed by number of nights or number of employees and other parameters) in the most of developed tourists countries have dominant place in hotel industry.

The same situation is with our country. If we analyze official statistics reports, counting and estimated number of entrepreneurs performing business in Serbia as free professions, small and medium companies represent more than 99% of all companies within the sector "tourism and servicing". Majority of them are small companies – above 99%. Number of large companies is more dominant only within the accommodation capacities – between 5% and 6%. If we consider similarly the participation of small and medium companies in terms of employment in tourism and servicing, we can conclude that they represent above 90%, while the participation of pure small companies is above  $\frac{3}{4}$  of total number of employed in the sector. It is important to stress that the employment in services of accommodation is the lowest in small companies (cca 30%), while the majority of employees work in medium-sized companies. In terms of revenues, those companies achieve above 60% of all revenues of all companies in tourism and servicing which are obliged to prepare official financial reports (according to the data from the National bank of Serbia). If we include in those figures free professions in the field of servicing, participation of small and medium companies will be higher.<sup>2</sup>

### THE MAIN CHARACTERISTICS OF BUSINESS OF SMALL HOTELS

Hotel size is determined by market size and competition straightness. Many of hotel services markets are small and many small markets are served by more than one hotel.

The majority of small hotels are offering more than one product – rooms, food and beverages, and very often other services through different combinations. Rooms can be, and cannot be, the main individual source of income. Many of small hotels have

<sup>2</sup> Zecevic, Bojan; *Small and medium enterprises in Serbian tourism: Potentials, challenges and chances*, Turisticki pregled 2(1), Beograd, 2005., page 14-18

big restaurants and bars (comparing to accommodation capacity) whose guests are not only hotel guests, but also local citizens who increase total revenue of the hotel, which is very often higher than the accommodation revenue. Having in mind the mentioned fact, it is not useful for the purpose of this analysis to consider a small hotel through its accommodation capacity. The second important criterion for defining the hotel size is connected to the volume of invested money or sales, which is a changeable category, depending on different factors (level of market development, competition, etc.). If we apply it to hotels with other standards or price level, it means something else, because their value is changing over time.

Having in mind the above-mentioned, in this paper a small hotel is considered as a hotel company with the capacity between 50 and 60 beds and in private ownership i.e. managed by the owner on daily basis, employing certain number of employees and owners feel it as business. This is not the case with all small hotels, but analyzed conception is important first of all from the aspect of ownership and management of the hotel in general and specially from financial, organizational, recruitment and control aspect.<sup>3</sup> In this context, small hotel is different comparing to other accommodation facilities, which are in private ownership and whose offer usually includes sleep or sleep and breakfast.

Small hotels are usually in family ownership. It means that very often, members of one family work in hotels, with other employees. In small companies comparing to large companies, the function of the owner and manager is combined in one person, also in many small hotels a lot of operative management functions are connected with ownership and management function (finance, human resources, sales, supply). Also, business of other hotel departments is in the hands of a small number of employees. The owner – manager of hotel, in terms of finance, legal regulations, architecture and design, promotion or monitoring of the equipment can cooperate with business' associations in order to get help or advice, but in most cases he is an expert for marketing, human resources, sales, supply and coordinator of all hotel's activities.

As a rule, small hotels are not members of hotel chains. It allows them to be recognizable and different comparing to uniform and standardized accommodation offer of many international and national hotel chains.

The basic difference between small and large hotels is not only in the number of the rooms, but the complete offer of the hotel too. Besides the accommodation, food and beverages, small hotels offer as additional services phone call services, news, wash laundering, possibilities of organizing small events and eventually some other jobs.

Small hotels are dominant in large towns, tourist and other regional and local centres, in which there is no need for large hotels. They increase accommodation offer of large towns, make it different and contribute to the competitive advantage of the town in which they are located.

<sup>3</sup> Medlik, S., Ingram, H., *Hotelsko poslovanje*, Golden marketing, Zagreb, 2000, str. 53.

The atmosphere in those hotels is warm, cosy and friendly. Attitude of employed staff towards guests is more personal. Many guests prefer small hotels, because they feel alienated, without feelings of warmth which they expect from a hotel.

Location, view and equipment are very important for small hotels, which mean that they should be positioned in accordance with the requirements of their target market (customers). As a rule, tourists who need special treatment, professionalism, privacy and events, are oriented towards small hotels. Concept of differences (every room or floor is created in different design by different designers) is also very important for one number of small hotels.

An important basic precondition for successful business of small hotel is accepting and applying basic pillars of marketing concept i.e. satisfying guests' needs and expectations in order to achieve profit. This implies answering to the following questions: Who will be the guests (structure of guests) of the hotel? To whom (which segment(s) of tourist demand) should the complete hotel's offer be adjusted? Which are the characteristics of target segments? Which contents do guests expect from a small hotel? How to recognize and react properly to the changes connected with the tourist demand, especially new requirements? Are results of market research regarding attitudes of targeted segments taken into account appropriately?

This is especially important for analyzing small hotels, having in mind that they do not have financial support of hotel chains. Due to the lack of their own funds, they are frequently bound to apply for bank loans. It means that they should make additional efforts to survive on the market.

Small town hotels apply the strategy of differentiating marketing and strategy of market segmentation. Applying famous criteria for defining segment, there are two important target segments of those hotels: 1. Business people (middle-aged and elderly people, experienced, sophisticated, educated, demanding high quality, mid to high level of income, environmentally-conscious) and 2. organised groups.

Hotels offering everything without recognizable spirit, are not interesting in terms of marketing and therefore it becomes necessary to create "specialized signs" as a kind of standard. The system of „specialized signs“ is accepted in hotel business, and it represents an established standard. Specialized signs mean orientation to the defined market segment, destination and further.<sup>4</sup>

Specialized signs allow guests (users) additional knowledge about characteristics of particular hotel, eco-signs, additional characteristics of the offer and its surrounding. Raising the accommodation quality, modelling of the offer etc., influence the tourist demand so that there are fewer hotels with general offer comparing to the hotels specialized for the specific target segments. The most important small and medium hotels are:

<sup>4</sup> Take over from the source: Zivkovic, Radmila, Gajic, Jelena; *Impact of tourists' behaviour changes on modelling of hotels*, „Hotelska kuca 2008“, Hores, Zlatibor, 2008., page 167-169.

- **Business hotels** - oriented towards accommodation of business guests. Hotels of this type have very good quality of rooms, equipped with state-of-the-art equipment that allows guests to organize smaller meetings or events (internet connection, computers, projectors, audio-video equipment, equipment for simultaneous translation etc.) and other elements of entertainment offer, aimed at satisfying customer needs (fitness – wellness, participation in cultural, entertainment or sport events, sightseeing tours – cultural and historical sights of the town or near surroundings). Business hotels are usually located on attractive locations such as the urban core, business centre or centre of tourist destination. Target segments are: middle-aged and elderly persons, experienced, sophisticated, educated, demanding high quality, mid to high income level.
- **Sport hotels** - specialized for spending free time and sport activities. They have a wide offer of sport products: sport coaches, free time programmes, animators, swimming pools, fitness centres, massage, spa, gardens and restaurants. Hotels must meet needs of their target segment – sportsmen (football, basketball, volleyball, skiing of the water, etc.). Target segments are: young to middle-aged persons, who require high quality and have mid to high income level.
- **Family hotels** - oriented to the accommodation of families with children. They are built to have connected rooms, with possibilities of adding a spare bed in the room. These hotels offer good entertainment for families, possibilities of using different services within the destination, depending on the offer of local events and sport activities which are precondition for new experience. Target segments are: families with children, group of families, mid income level.
- **Hotels for elderly people** – specialized for accommodation of senior guests. Health and entertainment services are obligatory part of the hotel offer. Having in mind high demand for this type of hotels, it is obvious that there is more and more newly-built or refurbished hotels, as well as construction of whole tourist complex aimed to satisfy needs of old persons. Target segments are: old age persons, mid to high income level, with defined experience for vacation and taking care about the nature.
- **Hotels specialised for health and physical condition** - adjusted to offer services connected with health and physical condition of the guests. They are constructed as hotels of general type for vacation, but their offer can be adjusted to the needs of individual guests. Target segments are: young and middle-aged persons with mid to high income level.
- **Boutique hotels** - with limited number of rooms and specific details of ambiance. With large hotels, representing a recognizable offer of hotel chains, there is an increasing demand for small boutique hotels, which may be located in villas or have other characteristics of **boutique** hotels. The reason for it is the fact that they offer specific experience i.e. “exotic offer”

in “a small package”. Key factor of success of a small hotel is its specific image that should be based on recognizable features and competitive advantages. Target market segments are: middle-aged persons, people wishing to run away from everyday life, looking for special and new things, authentic location and destination, those who travel very often with short stay, high income level.

Respecting particular requests of tourists (consumers), it is necessary to invest a lot of effort to offer to the market product which will be in the line with their expectation, wishes and needs.

### PROBLEMS IN BUSINESS OF SMALL HOTEL COMPANIES

Small and medium hotel companies have specific difficulties as compared to the large ones. These difficulties are connected with the ownership, power of the hotel owners in daily business or decision making process. Top priority in management and survival of hotels is cash, because fixed costs are very dominant so hotels earmark more resources for them than for marketing. Due to the lack of financial support or management expertise many small companies end up in bankruptcy (for example in Great Britain in the period of 4 years up to 64% of small companies go bankrupt, in Germany 32% / according to Kozak, Rimington).<sup>5</sup>

The most important problems that act as limiting factors on business operations of those hotels are: 1) *Space for expanding* is limited because the owners of hotels can invest only their own sources or loans granted by commercial banks, which are frequently not favourable in terms of participation, interest rate and tenor. Some owners are not interested in further development of the hotel company and are satisfied with the current position. 2) *Planning in small hotels* is not organized adequately. It is more informal than formal and is usually connected with short term, which prevents, in the circumstances of keen market competition, long term sustainability of company operations. 3) *Market research* is oriented towards using secondary and other official external reports due to the lack of financial, human resource and organizational possibilities. Specific problem is connected with the minimal research of surrounding. Very few hotels carry out this type of research, though information about the business environment is considered to be particularly important in the circumstances of extremely strong competition. 4) Insufficient level of implementation of *modern information technologies and involvement in reservation systems*. Incorporating new technologies into the way of doing business can be for small hotels the basis for acquiring competitive advantage. Speed, information availability, possibilities of internet booking is especially important for small hotels, especially for those which do not have good location. Internet possibilities are not used in appropriate level in small hotels. Some of the limitations are (Ancar, Valden)<sup>6</sup>: lack of financial resources, lack of IT knowledge, change resistance – depending on the characteristics of the owner and

<sup>5</sup> Took over from the source: Zecevic, Bojan; Aleksic, Ana; *Problems of marketing of small hotels' companies*, „Hotelska kuca 2008“, Hores, Zlatibor, 2008., page 110.

<sup>6</sup> Took over from the source: Zecevic, Bojan; *Problemi marketinga malih hotelskih preduzeća*, Zbornik radova, Hotelska kuca 2008, HORES, Beograd, str.112.

periphery location – hotels in urban surrounding are more easily adjusted than ones in the undeveloped areas. 5) considerably *limited funds for promotion* activities. 6) *Creating of trade mark is not an achievable task* in many cases. This is an important disadvantage for the hotel, as a trade mark is very efficient means for hotel identification. 7) *Lack of business knowledge and high fluctuation of employees* is evident due to inadequate salary, motivation, poor human resources management (the entering ticket in the hotel is family or friendly relationship), misunderstanding perspective etc.

### POSSIBILITIES OF FINANCIAL SUPPORT TO SMALL AND MEDIUM HOTEL COMPANIES

In accordance with Basel Rules, specialized financing of legal entities means that a loan is granted to the company established only for the purpose of a specific project. The company established for the purpose of the specific project has small material assets i.e. activity, which means small repayment capacity. The source of credit repayment is revenue from the future project that is subject of financing. It means that the focus is on the project analysis, not on legal entity credit beneficiary. Specialized financing of legal entities in area of hotel and services belongs to the group project financing – IPRE (Income Producing Real Estate), purpose of the loan is constructing or buying **hotel**.

**The basic principles** of specialized financing of legal entities, connected to the construction and purchase of a hotel are: 1) The loans are approved to the companies which are registered as legal entities. It is recommended that they are newly established local companies, established for the purpose of special project (SPV – Special Purpose Vehicle). In case of crediting hotel construction, the SPV – credit beneficiary of the loan will be the owner of the location on which the hotel is to be constructed or the hotel which is already constructed in accordance with appropriate hotel standards. 2) The basic source of credit repayment is minimum 50% of cash flow from operations (future) project i.e. hotel occupation. 3) The volume of revenues and exposure of borrower are not the basis for the client segmentation in the bank's balance.

Having in mind clients' requests and experience in the group, in the offer of local banks are the following **models of specialized financing of hotels and tourist facilities**: a) Financing of construction or purchase of the hotel, which will be rented to famous operator or experienced management in hotel management. The source of credit repayment is a concluded rent agreement between SPV and operator. b) Financing of tourist facility construction (in famous tourists centres).

The **loan amount** is up to 80% of the total project value. The recommendation is that the participation of credit beneficiary (SPV) in the total investment is minimum 20% of total investment value as a proof that SPV is ready to take part in investment risk. The **purpose** of the loan in the case of specialized financing of hotels can be: 1) **loans for constructing of the hotel** which will be the subject of renting. 2) for **buying the land** (pre-development loan) – acquisition of the land on which will be the **hotel** constructed in the future. The **availability period** of loan using is in accordance with

the construction dynamic i.e. performing basic business of the hotel. The **dynamics of loan repayment** is in accordance with the dynamic of sales, renting or performing basic business of the hotel. It should be mentioned that the terms for loan repayment are up to 20 years. **Collaterals** for the loans are in accordance with collateral catalogue of the bank. The specific of project financing is that there is no additional collateral of SPV i.e. basic collateral for the loan is: pledge on the shares of SPV (borrower), mortgage on the hotel subject of financing and assignment of receivables (result of renting or performing basic activity of the hotel).

Having in mind current market situation and banks' offer, it can be concluded that foreign hotel operators or local entities established by foreign equity can get favourable financing easily. Reasons are: good long term relationship between operator and main bank (owner of the local bank), positive experience in specialized financing business between the bank and operator in different foreign countries, positive reference in business of operator on foreign markets and satisfactory financial results of operator which is able to provide adequate corporate guarantee to the bank borrower i.e. participation in the risk.

Having in mind that the segment of small and medium hotel companies in Serbia is pillar of tourism development in Serbia, involvement of the state is important in further development of tourism in Serbia in order to provide the situation in which local banks will finance more development of small and medium hotel companies. It means that the state should participate in the risk of particular credit business and with own rating will have impact on less mandatory reserve providing with the National bank of Serbia (which will have impact on lower interest rates for credit beneficiary).

The state should provide favourable subsidized credit lines for small and medium hotel companies in Serbia through appropriate support programmes. It means a coordinated action of the Ministry of Economy and Regional Development of the Republic Serbia, the Development Fund of the Republic of Serbia, municipalities, tourist and hotel associations, Chamber of Commerce and commercial banks (which will be partners of the programme) within permanent education of entrepreneurs, i.e. small and medium hotel companies in Serbia. Education seminars will be in the function of development (creating) of qualitative and competitive advantage of the local product.

The Ministry of Economy and Regional Development of the Republic of Serbia should provide a support programme for small and medium (privately-owned) hotel companies in Serbia, which will be connected to: 1) Buying, construction, refurbishment and equipment of hotel facilities (minimum 3-star hotels), 2) Construction of additional facilities to expand the hotel offer (swimming pool, tennis courts, children playgrounds, wellness centres, fitness centres, etc.), 3) Refinancing of existing loans with unfavourable terms and conditions, which were exclusively used for investment into the hotel or expanding its capacities.

The principal amount of the investment loan will be provided by commercial bank which is the partner of support programme (min amount EUR 50,000- max



amount EUR 500,000), and borrower should provide participation in the amount of 20% of the project value (participation can be in cash, land or object).

The Ministry of Economy and Regional Development of the Republic of Serbia would subsidize interest rate (4%-6% p.a.; the borrower would pay fixed interest rate of 2%-3% p.a.). Tenor of the loan would be up to 20 years with possibility of using grace period up to 2 years. Criteria for subsidised loans would be as follows: harmonisation of the project with the Programme, quality of the project (economic feasibility and assessment of contribution of a particular project to the development of tourism and expanding of Serbian tourist offer), contribution to preservation of ambient architecture, credit worthiness of the borrower and collateral (for the loan repayment).

Necessary documentation for loan application would be: court registration, business plan, certified statement of the borrower on acceptance of terms and conditions of the support programme, certificate issued by tax authorities that the borrower does not have any tax commitment toward the state, collateral-related documentation, i.e. appropriate construction or refurbishment licences.

Loan approval workflow would include the following steps: commercial bank would prepare a preliminary analysis and propose loan amount (participation of the borrower, collateral and limitations connected to the financial operations of the borrower). After receiving a preliminary positive opinion of the bank, The Development Fund of the Republic of Serbia and the Ministry of Economy and Regional Development of the Republic of Serbia would make a final decision about the loan. In case of a positive decision, the borrower (small and medium hotel company) would be obliged to use the loan in accordance with the earmarked purpose (monitoring of loan utilisation would be done by commercial bank). Also, collateral (it is usually the facility which is the subject of the loan) for the loan could not be sold to the third party during the tenor. In case the borrower has any intentions to do so, the commercial bank and the Development Fund would have to be duly informed in order to prepare the calculation for prepayment of the loan.

The success of the Support Programme would be dependent on educational seminars that would be held throughout Serbia. The aims of seminars would be: knowledge and information necessary for planning; work and management of small and medium hotels in accordance with general regional strategy of Serbian Tourism; products based on quality and exclusivity; construction of small boutique hotels and hotels with high category; replacement of apartment accommodation and increase of accommodation quality and privacy.

Topics of the seminar would include the following: key questions and problems in the segment of small and medium hotels (GDP growth, employment, increase of local self-government standards); establishment process of limited company (considering that, according to Basel II, borrowers of project financing loans should preferably be SPV); town planning documentation; analysis of location, hotel, market and industry; optimal hotel product and preparation of marketing plan; investment and financing (preparation of business plan, and/or investment plan for small and medium hotels); guidelines for loan application preparation; presentation of the terms and

conditions of the Support Programme; short information about Call centre of the Ministry for Economy and Regional Development of the Republic of Serbia, the Development Fund of the Republic of Serbia and hotel and tourist associations in Serbia; presentation of a successful small hotel in Serbia; hotel (quality criteria, innovation and authentic features) – the experience of tourist and hotel associations in Serbia prove that hotels with higher category achieve higher price and better occupancy rate (most respected). Family hotels with local identity in architecture, gastronomy and traditional family hospitality are important for successful business of small hotels. Also, important component of success of small hotel is the human bean, which means that systematic recruitment of the employees and permanent education are precondition (for success).

The important element of the support program would be a business plan and/or cost-benefit analysis. The case should provide answers to two crucial questions: which hotel product is adequate to the market and what is the profitability of the investment in the particular hotel project. The document should represent the entrepreneur's project idea, argumentation of the viability and financial profitability of the entrepreneur's idea. The case study would include: location analysis, market analysis, description of hotel products, projections of business revenues and costs (usually taken period is 10 years), SWOT analysis (including quality of the mortgage i.e. possibility to sell it on the market, human resources and worthiness of the entrepreneur – borrower of the loan), marketing of defined hotel product, full explanation of planned investment and expected profitability. It is very important to make realistic estimation and argumentation of the projected revenues and costs. It is recommendable to prepare it in the form of international standardized financial report for hotels (Uniform system of accounts for lodging industry).

The exact amount of investment costs would be based on clear definition of the type and category of tourist facility with full and objective cost table formed on suppliers' offers and confirmation by independent supervisory body. It would be important that the projections would be realistic (on both sides – revenues and costs, respecting seasonality in performing business as well as type of both categories) in order to provide repayment of the loan from available future revenue.

## CONCLUSION

All above mentioned facts show us that the future of small and medium hotels lies in the quality of offer and creating of common recognizable trade mark. How to achieve quality and create a recognizable trade mark? Solutions should be found in following directions:<sup>7</sup> 1) Setting up or joining a consortium or association of small independent hotels through two basic types: a) The first type is group of independent local hotels of the same town or region, which are competitors to each other. When trust and reliability are established between the hotels, it directly leads to joint market approach, joint supply and other types of cooperation, which provides important cost cutting. b) The second type of consortium of independent hotels, located on broad

<sup>7</sup> Medlik, S., Ingram, H., *Hotels' business*, Golden marketing, Zagreb, 2000., page 62.

geographic location, that are not competitors. Their focus is on joint engagement on bus and car tours and providing jobs and other business strategies. In order to be successful, consortia establish central office with permanently employed people. Those consortia are financed by membership fees paid by members of consortium. Consortium can make small hotels recognizable on the market and offer their products to huge number of consumers.

**Resolution** is the leading world consortium, with over 1,500,000 beds and 7,700 hotels all over the world. 2) Establishing advisory offices for small hotels. Such offices should be set up by national hotel associations or tourist offices. The office should be organized as a small team of advisers (consultants from different areas such as: tourism, hotel industry, finance, architecture, town planning, legal regulations, etc) to provide hotel owners/managers with practical advice. 3) Applying research carried out by other small hotels or research results of more important areas done by specialized institutions. 4) Higher involvement of the state in the segment of law regulation of hotel - tourist industry, providing of sources for tourist infrastructure and promotion, but also in providing financial support to small and medium hotel companies in Serbia.

Having in mind the experience of the neighbouring countries that are more developed than Serbia, we can expect that the Support Programme of development of small and medium hotel companies in Serbia could result, in the period of three years with EUR 145mio of loans, in the construction, adaptation and refurbishment of 200 hotels and employment of 2,500 people.<sup>8</sup>

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<sup>8</sup> Source: web site of Erste bank Croatia

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