

GOVERNMENT SUBSIDIES EFFICIENCY ANALYSIS IN THE TOURISM SECTOR IN CROATIA

Scientific paper

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Abstract

Purpose – The purpose of the work undertaken was to assess to what extent the government subsidies influence the tourism volume in Croatia in order to be regarded a key influencing mechanism for meeting the objectives of the tourism development strategy.

Design –Tourism is seen by many as the most important sector in the Croatian economy. The key driver in generating this revenue is coastal Croatia focusing primarily on well-established landmarks. Given the key directions set forth by the Croatian tourism development strategy, further development is seen to be driven by promoting tourism in continental Croatia in addition to the traditional areas. This is expected to cut down seasonality and generate diverse new products and services. The corresponding investment and incentivising strategy relies largely on public subsidies to co-finance development projects at landmarks yet to attract substantial touristic demand.

Methodology – The paper analyses the efficiency of the subsidies from different public sources by investigating the subsidised amounts with the corresponding tourism volumes. First, baseline volumes were defined for the 2011 financial year using the overnights and employment data. The 2012 and 2013 volumes were then analysed against the baseline data. All the data assessed were geo-referenced to allow for the spatial analysis of the generated effects to be made.

Approach – A research hypothesis was set that, in continental Croatia, only marginal advances in the generated tourism volume may be expected as a direct consequence of the subsidised development projects primarily due to the lack of the tourist infrastructure needed. To assess the geographic distribution of both the subsidies and the corresponding volumes, advanced geographic information software (GIS) tools were applied on the NUTS III level statistical data.

Findings – Discrepancies in volumes not matching the subsidised amount have been identified and recommendations have been given to mitigate these adverse effects. The paper advocates changes in the subsidising policies to be made, focusing primarily on geographic areas which are capacitated to provide significant immediate positive effects on performance indicators such as employment, GDP and others. This is seen particularly important in times of major economic crisis.

Originality –The research utilises detailed NUTS III level data which were geo-referenced to allow for spatial analyses to be made. A state-of-the-art spatial model of the research territory was generated and advanced GIS software utilised in the analyses undertaken.

Keywords Croatian tourism, development projects, continental tourism, subsidies, GIS

1. INTRODUCTION

The business of travel & tourism accounts for one of the world's largest service industry. In 2012 alone, its total contribution comprised 9% of global GDP. Moreover, tourism outperformed many other more reputable industries such as manufacturing, financial industry and retail¹. This contribution includes both direct spending by

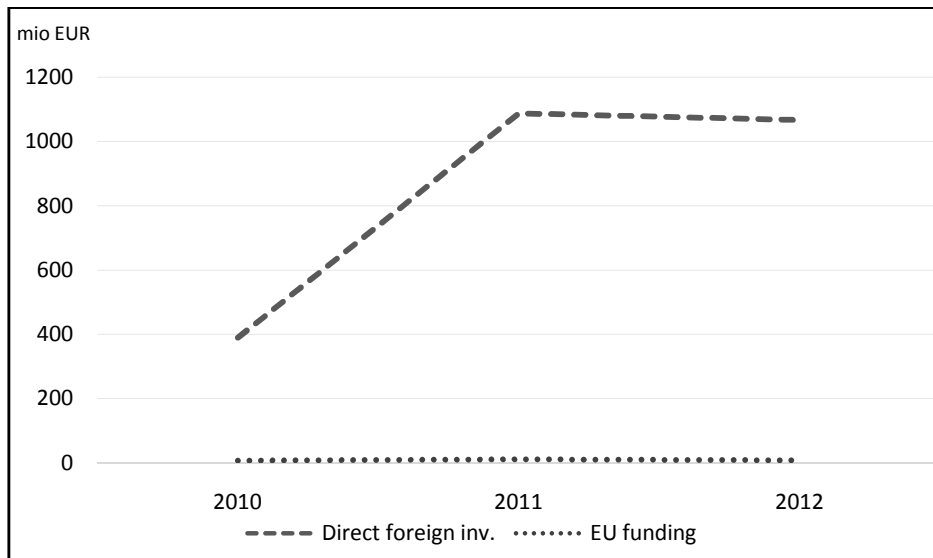
¹ World Travel & Tourism Council, The Economic Impact of Travel & Tourism 2013, London, UK, 2013.

residents and non-residents of a given country on leisure, cultural, recreational and other such services, as well as indirect purchases of goods and services dealing directly with tourists, which have wider impacts on the economy.

In addition to impacting national GDP, being very labour-intensive with great involvement by the local population, the travel & tourism industry also has got significant impact on employment. In 2012 tourism supported more than one hundred million jobs worldwide. This is expected to have risen by 1.2% in 2013 and further by 2.0% per annum by 2023².

Finally, a third measure typically used to assess the impact of the tourism sector on the economy is the investment volume. It is regarded by many a highly important performance indicator given that it corresponds closely with the sector's growth potentials and provides grounds for business continuity and sustainable development.

Figure 1: Direct foreign investments vs. EU financing in Croatia



Source: Republic of Croatia, Ministry of Regional Development and EU Funds, 2013; Croatian National Bank, 2014

As much as 11% of worldwide capital investments target the tourism industry making it a lucrative business sector to work with³. In some of these investments public co-financing may reach up to 99% of the project value. It may therefore be argued that the government support is of the utmost importance for a given economy to develop and generate positive spin-off effects. However, the corresponding absolute values may suggest a different perspective making the public funding a deadweight rather than incentive. Thus, for instance, if direct foreign investments in Croatia are compared to

² World Travel & Tourism Council, *The Economic Impact of Travel & Tourism 2013*, London, UK, 2013.

³ Kopačević, N., *Government Subsidies in Tourism*, Master Thesis, University of Rijeka Faculty of Tourism and Hospitality Management, Rijeka, Croatia, 2010.

the EU investments subsidising various development projects in the pre-accession period (Figure 1), it can be seen that the influence of the latter on the national economy is marginal. At the same time, managing these projects required substantial effort, time and manpower to be invested to meet the requirements of the funding approval procedure.

2. TOURISM IN CROATIA

By becoming an EU member state, Croatia further affirmed its position as one of the most popular European tourist destinations. Its Mediterranean climate and long Adriatic coastline attract great many holidaymakers from EU member states which in 2012 made more than 7 million trips to Croatia, accounting for over 60 million tourism nights and nearly €7 billion of tourism expenditure⁴⁵.

Despite being ranked as close to top 10 EU countries by both the total number of arrivals (Figure 2) and the number of arrivals per total area of the country (Figure 3), Croatian tourism experience immense seasonal variations in the generated turnover and volume in general. The strong seasonality has been recognised as a critical factor impeding more sustainable development of the sector⁶. The peak season lasts for two months only accounting for nearly 60% of the nights spent. Compared with the EU-28, this is almost double the share⁷. As a result, the industry is repeatedly in a suboptimal operating regime being either over capacitated during the off-peak season, struggling to cover the costs of the idle resources, or under capacitated to meet the peak demands in summer.

Another compelling factor is the accommodation infrastructure which is mostly situated in coastal areas at well-established landmarks and resorts. The focus on coastal tourism may partially explain the seasonal character of Croatian tourism, hence it has been recognised as a key development area for generating new off-peak demand⁸. The corresponding new products and services are expected to follow the ongoing trends which may be summarised as follows⁹:

- occurrence of shorter and more frequent holidays,
- increasing number of visits by elderly population of tourists,
- expectations for new innovative products and services by more demanding and sophisticated visitors,
- expectations for tailor-made holiday offering and individual approach to customers,

⁴ Demunter, C., Dimitrakopoulou, K., *Tourism Statistics for Croatia*, Statistics in Focus, 2/2014, Eurostat, 2014.

⁵ Republic of Croatia, Ministry of Tourism, *Tourism in Numbers 2012*, 2013.

⁶ Republic of Croatia, Ministry of Tourism, *Croatian Tourism Development Strategy until 2020*, 2013.

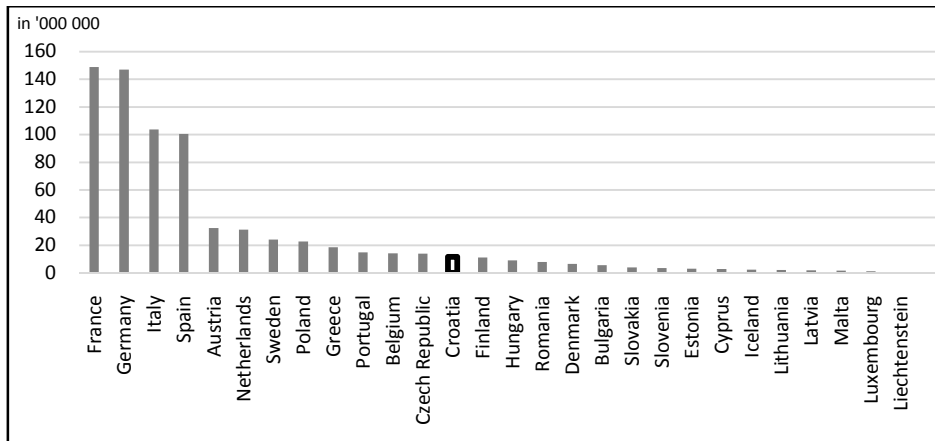
⁷ World Travel & Tourism Council, *The Economic Impact of Travel & Tourism 2013*, London, UK, 2013.

⁸ Republic of Croatia, Ministry of Tourism, *Croatian Tourism Development Strategy until 2020*, 2013.

⁹ Baldigara, T., Mamula, M., "Tourism Statistics in Croatia: Present Status and Future Challenges", in XI International Conference Service Sector in Terms of Changing Environment, *Procedia - Social and Behavioral Sciences* 44 (2012), 53-61.

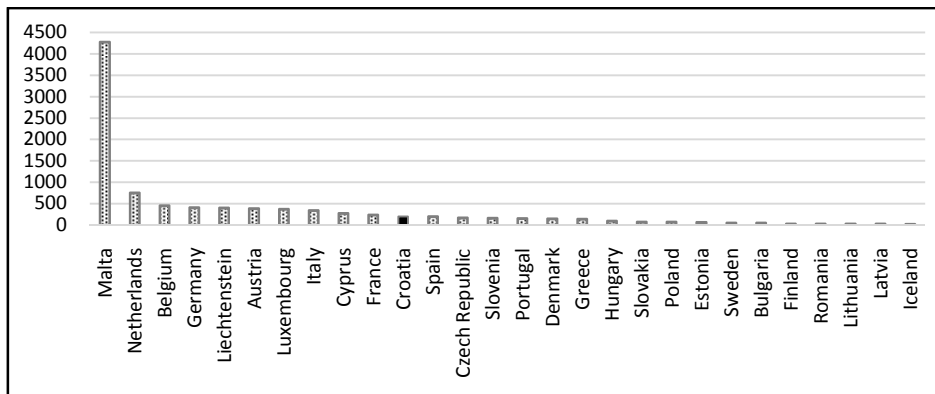
- safety issues and terrorism threats becoming a compelling factors in choosing holiday destinations,
- climate changes shifting focus from popular destinations to those yet to be discovered,
- emerging new technologies generating a new generation of holidaymakers.

Figure 2: **Number of arrivals in 2012**



Source: Eurostat, 2014

Figure 3: **Number of arrivals in 2012 per km²**



Source: Eurostat, 2014

Given the above, further development of the sector is seen to be driven by promoting tourism in continental Croatia in addition to the traditional areas. Apart from cutting down seasonality by attracting new types of tourists, this is also expected to mitigate adverse effects of operating in suboptimal regimes explained earlier. In order to build infrastructure needed to facilitate tourism in the new areas, government subsidies are seen as the primary source of funding needed to kick-off the corresponding development projects.

3. SUBSIDIES IN THE CROATIAN TOURISM SECTOR

Generating good decision making about public funding requires processes for decision-making that facilitate good analysis and temper the influence of self-interest. The corresponding decisions are seldom driven by the dictates of cost-benefit analyses, but rather focus on improving living standards by redistributing infrastructural resources making them accessible to a larger population of users. This however means that projects may fail to generate positive outcomes despite being substantially subsidised¹⁰. Therefore, a combination of good government policies and appropriate fiscal support for optimal structuring of private projects is most likely to be sufficient to ensure that socially valuable projects are successfully completed¹¹.

Table 1: Financial Review of the Pre-Accession Assistance Programmes 2007-2013

Operative Programme	Allocated Amount	Contracted Amount	Amount Paid	Contracting Rate	Payment Rate
1	2	3	4	5 (3/2)	6 (4/2)
IPA I (2007-2013)	249.047.325 €	168.020.117 €	139.142.070 €	67,47%	55,87%
IPA II (Cross-border Cooperation + Transnational Programme 2007-2013)	17.519.302 €	12.263.321 €	9.131.395 €	70,00%	52,12%
IPA V (2007-2013)	144.283.680 €	77.969.325 €	92.697.409 €	54,04%	64,25%
TOTAL:	410.850.307 €	258.252.763 €	240.970.874 €		

Source: Republic of Croatia, Ministry of Regional Development and EU Funds, The Total Financial Review of the Pre-Accession Assistance Programmes and SKF 2007-2013 [online], Available at *<http://www.strukturnifondovi.hr>, [Accessed 01 March 2014]

Fiscal support from the EU may be either in the form of grants, public tenders, loans or guaranties¹². An EU programme which was utilised most to subsidise investments in Croatian tourism in the late pre-accession period was the Instruments for Pre-Accession Assistance (IPA) programme exceeding €400 million in total^{13,14}. As can be seen from Table 1, despite its size, roughly only a half of the allocated funds have been used. It is reasonable to expect that some of the subsidised projects will fail to demonstrate long-term sustainability which, coupled with the relatively low payment rate, lowers down the overall success rate of the assistance programmes even further. This may hence suggest that perhaps a different approach should have been exercised focusing on projects with quick impacts on the economy and GDP growth in particular.

¹⁰ Kopačević, N., *Government Subsidies in Tourism*, Master Thesis, University of Rijeka Faculty of Tourism and Hospitality Management, Rijeka, Croatia, 2010.

¹¹ Irwin, T., "Public Money for Private Infrastructure: Deciding When to Offer Guarantees, Output-based Subsidies, and Other Fiscal Support", The World Bank, Paper No 10, Washington, D.C., USA, 2003.

¹² Belić, M., *Subsidies and EU Public Tenders*, Nova knjigaRast, Zagreb, 2011.

¹³ Belić, M., Štilinović, J., *EU Funds and Programmes for Tourism*, Nova knjigaRast, Zagreb, 2013.

¹⁴ Republic of Croatia, Ministry of Regional Development and EU Funds, The Total Financial Review of the Pre-Accession Assistance Programmes and SKF 2007-2013 [online], Available at *<http://www.strukturnifondovi.hr>, [Accessed 01 March 2014].

4. RESEARCH UNDERTAKEN

To study the effects of the government subsidies on the tourist volume, a research hypothesis was set that, in continental Croatia, only marginal advances in the generated volume should be expected as a direct consequence of the subsidised development projects, primarily due to the lack of the corresponding tourist infrastructure needed. Furthermore, immense seasonal variations in the generated tourism volume suggest that more noticeable short-term growth may be expected at already established locations if the two-month peak season, accounting for almost 60% of the total tourism volume, would be extended as has been the case with the top 10 EU countries¹⁵.

In carrying out the research, the following grant schemes were analysed:

- schemes supporting events for tourism promotion,
- grants targeting undeveloped tourist areas,
- grants from the “Innovative Tourism” and “Step Further” programmes of the Croatian Ministry of Tourism and
- EU grants for development projects in tourism.

The efficiency of the above subsidies was assessed by investigating the effects on the tourist volume. The indicators used to measure the changes in the volume were the number of overnights and the employment rate. Although the GDP growth was also indicated earlier in Section 1 as an important performance measure, it was not used in the study. Such an approach was influenced by the fact that the national GDP in the assessment period was in its record decline hence it would be hard to expect any positive impact on the local GDP values anyhow¹⁶.

First, baseline volumes were defined for the 2011 financial year using the overnights data (Table 2). Given that a more balanced geographic distribution of the tourism volume has been identified as a strategic development goal¹⁷, to analyse the geography of the volume measures chosen, advanced geographic information software (GIS) tools were utilised on the detailed NUTS III (Nomenclature of territorial units for statistics) statistical data.

Figure 4 hence depicts the 2011 overnight data by every 100.000 nights spent represented as a separate dot. As can be seen from the figure, the contribution of the continental Croatia is marginal and accounts for less than 5% of the total volume (Table 2). Upon setting up the baseline, the 2012 and 2013 volumes were analysed against the baseline data. The results show that both continental and coastal counties do not seem to follow any growth pattern and only a few of them have demonstrated sustainable growth. As can be seen from Figure 5, only three out of seven coastal counties and five out of fourteen continental counties demonstrated positive growth in the two consecutive years of the study period. Interestingly, the county with the highest

¹⁵ World Travel & Tourism Council, *The Economic Impact of Travel & Tourism 2013*, London, UK, 2013.

¹⁶ Croatian Bureau of Statistics, *Gross Domestic Product – Flash Estimate* [online], Available at: [*http://www.dzs.hr](http://www.dzs.hr), [Accessed 10 March 2014].

¹⁷ Republic of Croatia, Ministry of Tourism, *Croatian Tourism Development Strategy until 2020*, 2013.

contribution to Croatian tourism (Istarska County) failed to generate consecutive positive growth.

Table 2: **Overnights Data by Counties**

	OVERNIGHTS			GROWTH RATE	
	2011	2012	2013	2012	2013
	1	2	3	4 (2/1)	5 (3/2)
Croatia Total	60.354.275	62.742.417	64.827.814	3,96%	3,32%
Costal Counties	58.015.765	60.303.914	62.090.899	3,94%	2,96%
Primorsko-goranska	11.741.692	11.973.931	12.348.195	1,98%	3,13%
Ličko-senjska	1.697.107	1.824.036	1.949.651	7,48%	6,89%
Zadarska	6.481.067	6.783.072	6.747.858	4,66%	-0,52%
Šibensko-kninska	3.975.122	4.139.536	4.513.814	4,14%	9,04%
Splitsko-dalmatinska	10.250.215	10.517.880	11.467.965	2,61%	9,03%
Istarska	19.095.401	19.877.368	19.445.130	4,10%	-2,17%
Dubrovačko-neretvanska	4.775.161	5.188.091	5.618.286	8,65%	8,29%
Continental Counties	2.338.510	2.438.503	2.736.915	4,28%	12,24%
City of Zagreb	1.183.125	1.245.669	1.451.891	5,29%	16,56%
Zagrebačka	66.502	67.703	83.382	1,81%	23,16%
Krapinsko-zagorska	153.046	161.811	177.587	5,73%	9,75%
Sisačko-moslavačka	87.317	82.303	84.498	-5,74%	2,67%
Karlovačka	269.291	303.522	324.039	12,71%	6,76%
Varaždinska	118.597	115.008	111.549	-3,03%	-3,01%
Koprivničko-križevačka	25.351	29.037	28.337	14,54%	-2,41%
Bjelovarsko-bilogorska	30.468	31.294	32.565	2,71%	4,06%
Virovitičko-podravska	32.917	29.252	32.406	-11,13%	10,78%
Požeško-slavonska	23.627	19.299	22.376	-18,32%	15,94%
Brodsko-posavska	33.127	35.585	43.545	7,42%	22,37%
Osječko-baranjska	173.892	168.122	169.952	-3,32%	1,09%
Vukovarsko-srijemska	62.394	60.538	75.606	-2,97%	24,89%
Međimurska	78.856	89.360	99.182	13,32%	10,99%

Source: Croatian Bureau of Statistics, Gross Domestic Product – Flash Estimate [online], Available at: [*http://www.dzs.hr](http://www.dzs.hr), [Accessed 10 March 2014]

If the volumes are normalised as a percent of the total volume, it can be seen that the highest growth rates are measured in mainland Croatia (Figure 6). Such a contribution is somewhat expected from undeveloped areas, however, despite the high growth rates, almost all continental counties demonstrate growth inconsistencies and significant oscillations between the 2012 and 2013 data. This may suggest a lack of a sound policy aimed at bringing balanced nation-wide growth of the sector.

Figure 4: Geographic distribution of the baseline data

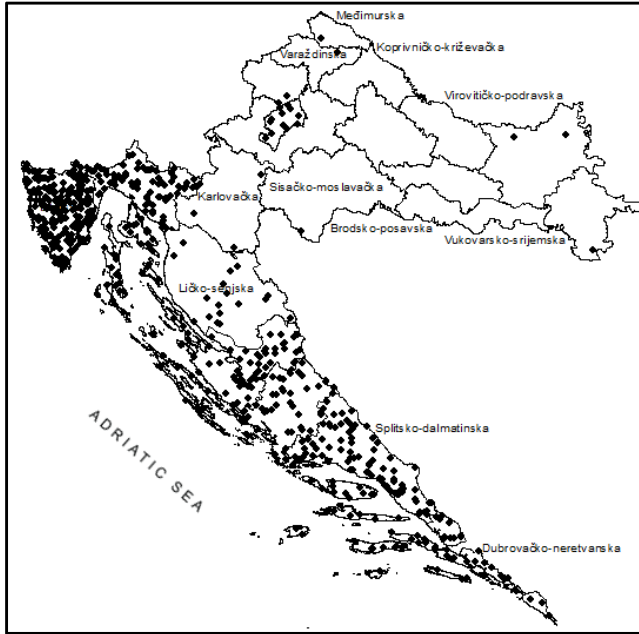


Figure 5: Croatian counties with the sustainable tourism growth

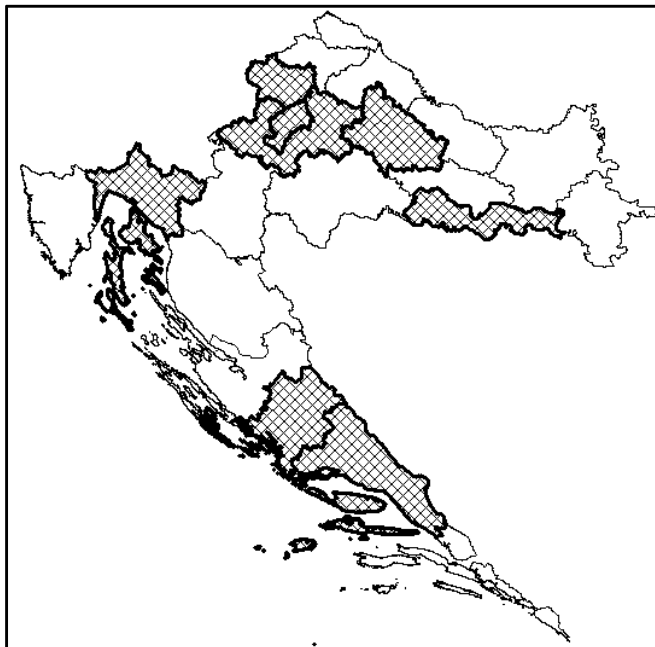
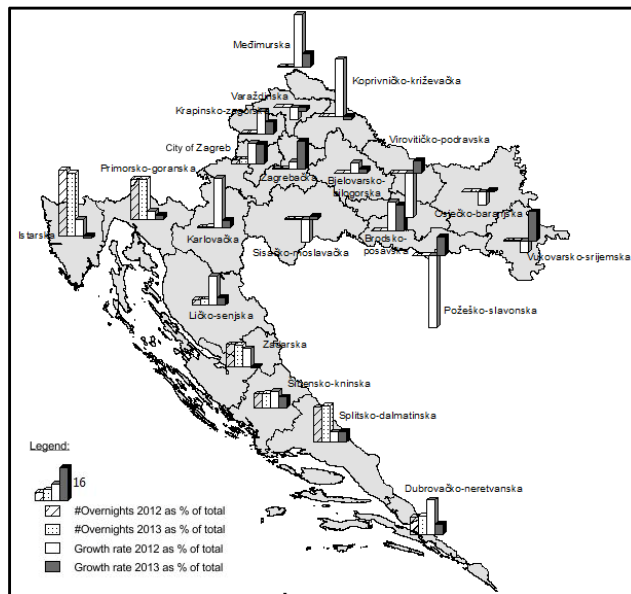


Figure 6: Number of overnights and growth rate as a percent of total volume



If the growth rates are analysed against the total amount of the government subsidies at a given geography, certain discrepancies may be found in terms that the generated growth in tourism volume in the year that followed the subsidised investment does not seem to match the subsidised amount (Figure 7). Thus for instance, in 2012 tourism in the City of Zagreb was subsidised with absolute amounts matching those of the areas which generate highest tourism volumes such as the Istarska County. However, at the same time the county generated the total of nearly 20 million overnights in 2013 as opposed to roughly 1.5 million overnights generated in Zagreb. Furthermore, as can be seen from Figure 7, the Osječko-baranjska County received in 2012 subsidies amounting over 1 million HRK (the equivalent of roughly €130.000) which represented the third largest subsidy in continental Croatia. This however did not prove to be fruitful given that the growth rate the following year was a mere 1.09%. At the same time the neighbouring Vukovarsko-srijemska County generated an increase of nearly 25% in recorded overnights upon receiving approximately the same amount of subsidies.

Further to the above, the cost of every new overnight generated was the highest in the Osječko-baranjska County and amounted almost €80/ON. At the same time the coastal counties showed much better effects of the subsidies given. Thus for instance every 1€ invested in the Dubrovačko-neretvanska County generated almost 10 times higher volume than a euro invested in the City of Zagreb and 100 times the volume of the Sisačko-moslavačka or Bjelovarsko-bilogorska counties. In this regard, it may be argued that far more tangible and/or immediate positive effects would have been experienced if the subsidies were allocated according to economic rather than political reasoning. Given that the total funds allocated were spread across continental and coastal counties roughly in a 50:50 share, the latter is indeed more than obvious.

Figure 7: Growth 2012-2013 vs. subsidies in 2012

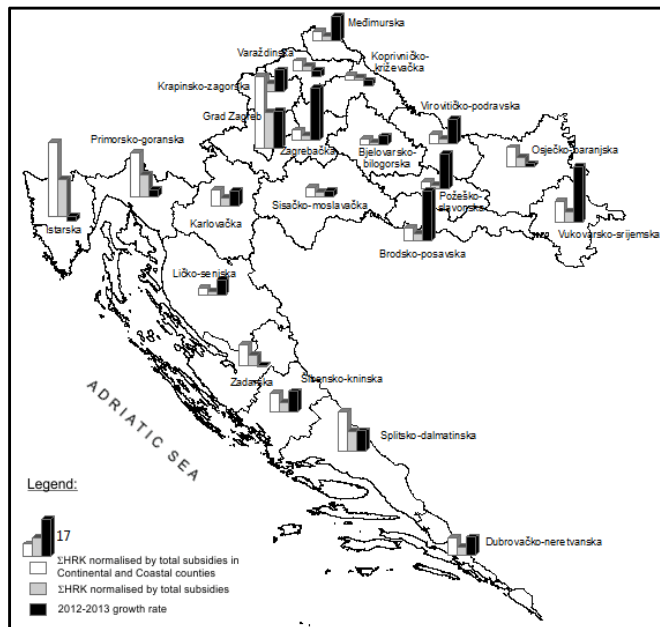


Table 3: Cost of new overnights

	€ per new ON
Costal Counties	
Primorsko-goranska	0,90 €
Ličko-senjska	0,46 €
Zadarska	4,40 €
Šibensko-kninska	0,37 €
Splitsko-dalmatinska	0,32 €
Istarska	1,30 €
Dubrovačko-neretvanska	0,31 €
Continetal Counties	
City of Zagreb	2,65 €
Zagrebačka	4,57 €
Krapinsko-zagorska	7,66 €
Sisačko-moslavačka	32,12 €
Karlovačka	6,14 €
Varaždinska	20,67 €
Koprivničko-križevačka	61,35 €
Bjelovarsko-bilogorska	35,05 €
Virovitičko-podravska	21,29 €
Požeško-slavonska	17,96 €
Brodsko-posavska	12,40 €
Osječko-baranjska	77,35 €
Vukovarsko-srijemska	10,25 €
Međimurska	7,34 €

Source: Croatian Bureau of Statistics, Gross Domestic Product – Flash Estimate [online], Available at: *<http://www.dzs.hr>, [Accessed 10 March 2014]; Republic of Croatia, Ministry of Tourism [online], Available at: *<http://www.min.hr>, [Accessed 11 November 2013]

Relatively poor outputs in the generated volumes may also be seen if the effects are analysed using the employment rate as the performance indicator. In this regards, despite the substantial subsidies received in 2012 by the Osječko-baranjska County as explained earlier, the unemployment rate rose by more than 5% in 2013¹⁸. It needs to be said however that such an outcome was somewhat expected given that the nation-wide employment in the tourism sector recorded a 7% decline in the number of persons employed in 2013.

5. CONCLUSIONS AND RECOMMENDATIONS FOR FUTURE WORK

Tourism in Croatia is undisputedly a sector with substantial contribution to the national economy. With its 20% share in the national GDP and roughly €7 billion in revenue, tourism is seen by many as the most promising sector to secure future economic growth¹⁹. Extreme seasonality however impedes significant development of the sector and measures are sought to balance the volumes in peak and off-peak seasons. One such measure recognised by the Croatian tourism development strategy is aimed at exploiting touristic potentials of undiscovered continental Croatia, and as such it has been substantially funded by different public sources.

The study has shown that, despite the financial support, certain continental areas still failed to generate significant growth in the tourism volume. Indeed, it may be argued that any major economic development needs to be preceded by substantial investments and the effects may need time to materialise. Nevertheless, given the large disproportion in the cost of generating new volume in continental Croatia compared to the corresponding cost at coastal areas, it may be concluded that changes in the subsidising policies should be introduced. As the ongoing economic crisis puts emphasis on achieving quick wins and immediate effects on indicators such as employment, GDP and generated revenue, focusing on core business – or in this particular case off-peak offer in coastal Croatia – is seen far more appropriate.

As discussed earlier, the influence of public subsidies on the national economy may sometimes be marginal despite the absolute amount that has been invested. At the same time, managing these projects very often requires substantial effort, time and manpower to be invested by the project partners in order to meet the requirements of the funding approval and project delivery procedures. As such, it is reasonable to expect that higher efficiencies will be accomplished at projects delivered by experienced partners and/or projects larger in size and hence easier to enforce the progress monitoring mechanisms upon.

The study also suggested that a balanced politically correct approach was exercised in distributing the allocated funds geographically. As it may be expected that less established resorts were under capacitated to utilise the funding in a timely and efficient manner, the partial utilisation of the allocated funds shown in Table 1 may be attributed directly to inappropriate selection of projects to be sponsored. In this regard,

¹⁸ Croatian Chamber of Economy [online], Available at: *<http://www.hgk.hr>, [Accessed 13 March 2014].

¹⁹ Republic of Croatia, Ministry of Tourism, Tourism in Numbers 2012, 2013.

focusing on projects aimed at coupling the existing physical infrastructure with state-of-the-art technological advances which would bring the touristic offer closer to potential visitors may seem far more beneficial²⁰.

Even though the results of the study undertaken may be found conclusive enough to generate interest for changes in the subsidising policies, certain aspects have been identified as interesting for future work. In this regard, providing detailed breakdown of the funding by project and/or resort is seen beneficial. In addition, assessing the long-term effects of the subsidies analysed in this study is also seen appropriate.

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²⁰ Lathiras, P., Zopidou, A., Mylonakis, J., Tahinakis, P., Protogeros, N., Valachis, I., "An Evaluation of Websites Quality Factors in Agro Travel and Ecotourism", *Tourism and Hospitality Management*, Vol. 16, No.1, 2010, 11-30.

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