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PRICE ELASTICITY OF DEMAND FOR HOTEL SERVICES ON THE BUSINESS EXAMPLE OF TWO HOTELS IN THE REPUBLIC OF CROATIA

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ABSTRACT

The paper analyses the elasticity of demand for hotel services in two different destinations in the Republic of Croatia, Zagreb and Dubrovnik, using the Sheraton Zagreb Hotel and the Sheraton Dubrovnik Riviera Hotel as examples in 2019 before the pandemic. Through the analysis of statistical data from the relevant tourist offices and based on the analysis of case studies of two hotels, it is found that the price elasticity of demand for hotel services depends on a number of different factors, such as the availability and type of hotel service for which there is a demand, the type of market, pricing policy, the specificity and diversity of destinations, seasonality and others. From the analysis it appears that it is necessary to consider the elasticity of demand in all its sub-segments, taking into account the peculiarities of all types of demand, which differ significantly (leisure, "city breaks", MICE tourists, etc.) in the destinations mentioned, despite some basic similarities of the hotels observed (identical brand business standards of the global hotel company, identical franchise agreements, etc.).

In summary, there is a relationship between low hotel occupancy (low season) and relatively high price elasticity of demand and high hotel occupancy (high season) and relatively high price inelasticity of tourism demand.

Keywords: *hotel industry, price elasticity of demand, pricing policy, destination specificity, seasonality*

1. INTRODUCTION

The subject of this paper is the analysis of price elasticity of demand for hotel services in two different destinations in the Republic of Croatia, i.e. in Zagreb and Dubrovnik. Elasticity, as one of the basic concepts and phenomena in economics, describes how (direction and intensity) one economic variable responds to the change in another economic variable. Elasticity is a very broad concept in economics, and this paper primarily analyses the price elasticity of demand[1], which is the percentage change in the quantity demanded of a particular good in relation to the percentage change in the price of that good (Samuelson, Nordhaus, 2011). It is emphasized that the price elasticity of demand in tourism is a very sensitive category, which, in addition to (and above all) the price of the tourist or accommodation service, is also influenced by other relevant factors such as the season, i.e. the time period of high or low occupancy of accommodation facilities takes place, the tourist destination itself and the attractiveness of the accommodation facility.

A comprehensive review of research on tourism demand modelling and forecasting was provided by Song and Li (2008). Since then, numerous researches have been conducted based on tourism demand models. Among them, the following researches are worth highlighting: studies on the price elasticity of demand for foreign tourism using the competitiveness index (Seetaram, Forsyth, Dwyer, 2016), the multidimensional price elasticity of demand for leisure and business destinations in the low-cost air travel market (Morlotti et al., 2017), online models of hotel demand, i.e. the price elasticity of demand for two resort hotels in Mallorca by evaluating different seasonal elasticities for the online booking segment (Vives, Jacob, Aguiló, 2017), analysis of consumption and price elasticity of demand for domestic tourism in Iran (Sadeghi, Jamshidi, Tayyebi, 2005), analyses of tourism and hospitality demand, determinants and price elasticity of demand (Konovalova, Vidishcheva, 2013), then the resilience of domestic tourism demand in the Spanish hotel industry during the reopening of the economy due to the pandemic COVID-19 (Boto-García, Mayor, 2022) and others. In addition to understanding the price elastic-

[1] The concept of price elasticity of demand was developed in 1890 by Alfred Marshall in his seminal work Principles of Economics (Marshall, 1890).

ity of demand for hotel services, the literature also recognises the importance of establishing a strategic pricing policy for hotels (Tutek, Cerović, 2020).

Considering the topic of the paper, the research hypothesis is established: based on the knowledge of the peculiarities and differences of the two destinations in the Republic of Croatia, the relationship between low hotel occupancy (low season) and high price elasticity of demand for hotel services and high hotel occupancy (high season) and high price inelasticity of tourist demand for hotel services is investigated.

2. COMPARATIVE ANALYSIS OF THE TOURISM SECTOR OF THE CITY OF ZAGREB AND DUBROVNIK RIVIERA

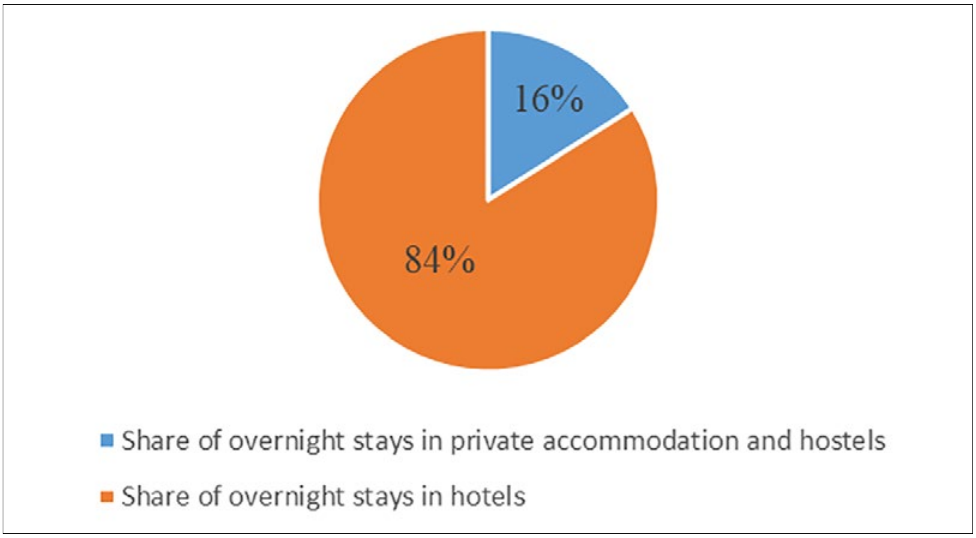
In this part of the article, the overall tourism market of the two observed destinations is considered in the context of accommodation capacity in general, arrivals and overnight stays at the destination, capacity occupancy and tourist preferences for a particular type of accommodation (hotels, hostels, private accommodation), in the period before the pandemic COVID-19, which is the relevant period of analysis.

2.1. TOURISM SECTOR OF THE CITY OF ZAGREB

As the capital of the Republic of Croatia, Zagreb has undergone a tourism transformation in recent years: from a city where mainly business tourists come for various congresses, with an extremely low percentage of "leisure" tourists, to a city with a large, even dominant, share of leisure tourists, both in the winter period (Zagreb was awarded "The Best Christmas Market" by the Internet portal European Best Destinations) and in the summer months, which until recently recorded a low number of arrivals.

Data show that in 2012, Zagreb recorded 1.2 million overnight stays, while 5 years later, i.e. in 2017, it recorded 2.2 million overnight stays (Tourist Board of the City of Zagreb, Horwath HTL, 2016; City of Zagreb, 2018). In the record year 2019, Zagreb reached 2.6 million overnight stays (Croatian Bureau of Statistics, 2019). Looking at the structure of accommodation over the observed years, several phenomena are noticeable. At the beginning of Zagreb's popularity as a tourist destination, i.e. in 2012, hotels were the predominant form of tourist accommodation, as shown in graph 1.

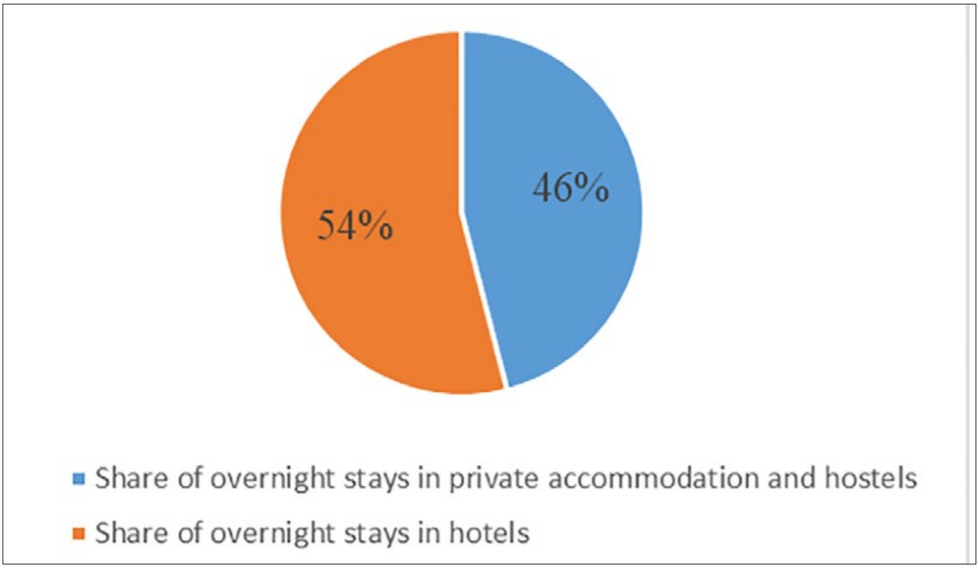
Graph 1. Share of overnight stays by accommodation structure in the City of Zagreb in 2012



Source: Author's preparation based on statistical data from the Tourist Board of the City of Zagreb, 2012

In 2014, there was a clear trend of opening and promoting a large number of hostels (Institute for Tourism, 2014). From 2016, after the period when investments in hostels were popular, there was a large number of investments in private accommodation, i.e. apartments. The reason for the conversion of numerous apartments and investments in the adaptation of various rooms into apartments was the growing demand and popularity of Zagreb as a tourist destination, especially among leisure tourists. It is noted that there were as many overnight stays in private accommodation in 2019 as in hotel and private accommodation (combined) in 2012. Nevertheless, hotel accommodation capacities are still the predominant form of organized accommodation in Zagreb, as graph 2 shows the above data.

Graph 2. Share of overnight stays by accommodation structure in the City of Zagreb in 2019



Source: Author's preparation based on statistical data from the Tourist Board of the City of Zagreb, 2019

Finally, given the increasing demand, it is important that tourism recognizes its role in sustainable development through economic, social, and especially environmental aspects, for example, through the use of renewable energy and energy-efficient technologies (Trinajstić, Cerović, Krstinić Nižić, 2022; Cerović, Drpić, Milojica, 2014).

2.2. TOURISM SECTOR OF THE DUBROVNIK RIVIERA

Since the middle of the 20th century, Dubrovnik has been considered the capital of tourism, both in Croatia and around the world. The city has always been visited for its cultural and historical sights, from the city walls of Dubrovnik to the arboretum of Trsteno and the islands of Lokrum and Elafite. The tourism industry of Dubrovnik and its surroundings is primarily characterized by a large number of tourist arrivals and overnight stays, the arrival of cruise ships, luxurious hotel complexes, the visit of celebrities and, finally, the local population that participates in tourism in the form of renting apartments and villas. With 81 hotels, the Dubrovnik Riviera, i.e. Dubrovnik-Neretva County, is the destination with the largest number of five-star hotels in Croatia, which suggests that it is a destination of elite tourism. It is stated that Dubrovnik-

Neretva County has 17 five-star hotels and 23 four-star hotels, while in the City of Zagreb there are only 3 five-star hotels and 22 four-star hotels (Ministry of Tourism and Sports, 2018). Similarly, Dubrovnik is considered an "expensive" destination for wealthy guests who stay either on luxury cruise ships or in five-star hotels. Moreover, the development of the private accommodation offer takes as long as the development of the hotel industry. Private accommodation is not a new type of service, as it has been in Zagreb in recent years, but it is the basic source of income for a large part of the local population. In contrast to the Zagreb market, the share of hostels in Dubrovnik and its surroundings is minimal. Therefore, the tourism sector on the Dubrovnik Riviera includes almost exclusively hotels and private accommodation (Tourist Board of Dubrovnik-Neretva County, 2019; County Development Strategy of Dubrovnik-Neretva County 2016-2020, 2016).

The average number of overnight stays in Dubrovnik Riviera is 4.3 days. If we compare these figures with those of the City of Zagreb, it becomes clear that these are completely different markets. In fact, the average length of stay in Zagreb hotels is 1.7 days (average of the period from 2013 to 2017). So, Zagreb is a real city break destination and business destination, while Dubrovnik Riviera is mainly a holiday destination for tourists, especially in summer. This is supported by the fact that hotels in Dubrovnik-Neretva County were open on 255 days in 2016 (7 days more than in 2015) and were fully occupied on 155 days (100% occupancy). On the other hand, hotels in Zagreb were open all 365 days a year, regardless of hotel category, location, ownership structure, management, etc. (Tourist Association of the Municipality of Župa Dubrovačka, 2019; Ministry of Tourism of the Republic of Croatia, 2019).

Moreover, the Dubrovnik Riviera is highly dependent on the season, i.e. the sunny and warm summer months, and therefore the share of leisure tourists, who come primarily for the sun and the sea, in all overnight stays on the Dubrovnik Riviera is significant. Another reason for visiting is MICE (Meetings, Incentives, Conferences and Exhibitions) tourism. According to the International Congress and Convention Association report, the MICE industry now accounts for almost a quarter of all international tourism worldwide in terms of arrivals and foreign exchange inflow. Fifty percent of all MICE events in Croatia take place in the City of Zagreb, while Dubrovnik is the second most represented city in MICE tourism. However, the average price of accommodation during the congress never reaches the price of accommodation during the summer months, but generates additional revenues (rental of congress rooms, food and beverage services, etc.).

3. PRICE ELASTICITY OF DEMAND FOR THE EXAMPLE OF HOTELS IN THE CITY OF ZAGREB AND ON DUBROVNIK RIVIERA

The differences in prices and price elasticity of demand are significant for both observed destinations and thus for Sheraton Zagreb Hotel and Sheraton Dubrovnik Riviera Hotel. The tourist destinations, the City of Zagreb and the Dubrovnik Riviera, differ greatly in terms of the structure of the accommodation offer, seasonality and the type and segment of tourists arriving in the mentioned destinations, as well as the prices in the observed hotels. In this chapter, an analysis of the publicly announced average daily prices, the so-called ADR (Average Daily Rate) for the Sheraton Zagreb Hotel and the Sheraton Dubrovnik Riviera Hotel for the year 2019 before the pandemic is conducted, with the aim of determining the price elasticity of demand, i.e. the reaction and sensitivity of guests to the price level, i.e. to changes in hotel accommodation prices.

3.1. THE INFLUENCE OF PRICING POLICIES AND SEASONALITY ON THE DEMAND OF SHERATON ZAGREB HOTEL

Sheraton Zagreb Hotel, just like the City of Zagreb, recorded 2019 as one of the most successful years in terms of tourist arrivals and overnight stays. According to the report of the Tourist Association of the City of Zagreb, Sheraton Zagreb Hotel recorded 119,817 overnight stays that year, which corresponds to an average annual hotel occupancy rate of 72%. The hotel's business flow is characterized by a high percentage of business travelers and MICE guests. Looking at the hotel's brand and brand awareness, it can be stated that Sheraton Zagreb Hotel is one of the leading convention hotels in the City of Zagreb. The average length of stay of guests (both MICE and "leisure") in Zagreb is 1.7 nights, and it is assumed that this is also true for Sheraton Zagreb Hotel.

Sheraton Zagreb Hotel was put into operation in 1995. The hotel is operated under a franchise agreement with Marriott International Inc. and holds a licence for the Sheraton brand. The hotel has 306 rooms, 13 multipurpose conference and congress halls, a large wellness and SPA centre, two restaurants and two bars. The hotel hosts numerous conferences, congresses and meetings, various banquets, weddings and other celebrations. In autumn and spring the hotel is an extremely popular place for holding numerous congresses, conferences and meetings, in spring it is a particularly popular destination for various "incentive" trips, while in summer Sheraton Zagreb Hotel is a destination for leisure tourists and leisure groups.

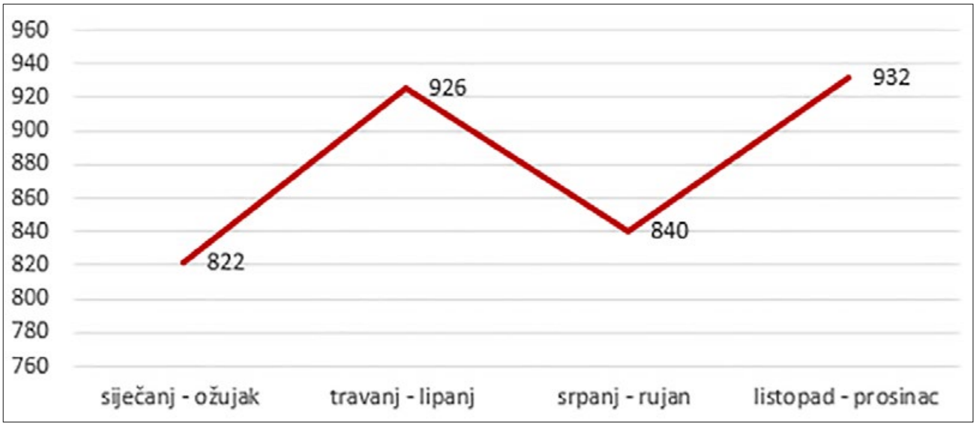
Accordingly, the accommodation prices reach their maximum in autumn and spring (HRK 932 in autumn and HRK 926 in spring), while in summer and winter the offered price for accommodation reaches its minimum. Therefore, autumn and late spring are characterized by high occupancy of the hotel due to numerous congresses and conferences, and this is the period when the hotel generates the most revenue. The mentioned period, together with June, represents the hotel's peak season. In the summer months, on the other hand, the price of accommodation capacity decreases to HRK 840 in order to meet the needs of vacation guests. The price also decreases in January and February, when the Sheraton Zagreb Hotel records the lowest minimum prices (822 kn) and the lowest hotel occupancy. This is explained by the fact that the Advent season in Zagreb is over, leisure guests hardly come to Zagreb at this time, and the number of business meetings and bookings for the needs of the MICE industry is also lower. The increase in guest requests and hotel occupancy, and thus the increase in accommodation prices, starts with the beginning of spring, i.e. in April, while the peak of spring prices is recorded in May and early June, when the hotel is visited by various "incentive" groups (part of the MICE segment), other MICE guests and part of leisure guests. In July and August, occupancy is the result of bookings by tourist/leisure groups and individual guests visiting Zagreb for vacation and sightseeing as part of tourist packages offered for trips of several days or weeks in this part of Europe. Prices are then the lowest of the year, while in the autumn prices rise again to record levels, as demand then exceeds supply (MICE tourism and accommodation services for business travelers). It can be concluded that in spring and autumn, when hotels are heavily occupied (high season), the relative price inelasticity of tourism demand is expressed, i.e. regardless of the percentage increase in the price of accommodation at the Sheraton Zagreb Hotel, demand will eventually decrease by less than a percentage change in price. Also, despite the price increase, the demand may remain at the same level or even increase, which contradicts the law of demand and is an exception to the rule characteristic of the Veblen effect (snob effect) and the effect of quality goods. On the other hand, the price elasticity of demand is highest in summer and winter when hotel occupancy is low (low season), so guests in summer and winter in Zagreb look for lower prices and react more strongly to their changes.

According to research (Konovalova, Vidishcheva, 2013), "business tourists travelling to a destination are less sensitive to price changes because they have less flexibility to cancel their business commitments." On the other hand, the same authors claim that "holiday motives and visits to families and friends, motives that make tourist demand more sensitive to price" when it is more elastic. The authors also address the phenomenon that business tourism has a lower positive price elasticity of demand when "a more expensive destination or a more exclusive destination attracts more tourists" and tourists demand more despite a price increase. In addition, mass tourism reflects another effect related to the elasticity of demand, namely the "effect of joining the majority" (the so-called "Bandwagon effect"), i.e., when the purchase or booking of a particular destination or hotel increases, the additional demand also increases, in other words, they become "popular" (Leibenstein, 1950). This can be well observed in the example of the Sheraton Zagreb Hotel.

The fluctuation of average daily rate (ADR) in Sheraton Zagreb Hotel in 2019 is shown in the following graph 3.

Graph 3. Average daily rate fluctuation in Sheraton Zagreb Hotel by quarters in 2019

(bed and breakfast in a double room in HRK)



Source: Author's creation according to publicly published prices on the official website of the Sheraton Zagreb Hotel, www.marriott.com/ZAGSI

From the graph, it is possible to notice that the price range in the Sheraton Zagreb Hotel during the year is not dramatic, i.e. from the lowest price at the beginning of the year to the highest price at the end of the year, the price varies by HRK 110 (13.4%).

3.2. THE INFLUENCE OF PRICE POLICIES AND SEASONALITY ON THE DEMAND OF SHERATON DUBROVNIK RIVIERA HOTEL

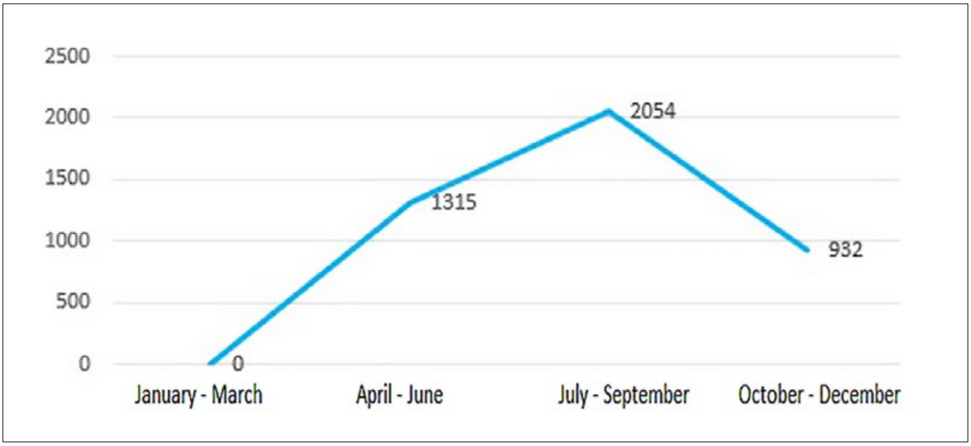
Sheraton Dubrovnik Riviera Hotel is a sister hotel of Sheraton Zagreb Hotel; the investor, i.e. the owner of the property, is currently the hotel company Maistra Inc. (since 2018), previously for many years it was HUP Zagreb Inc. Sheraton Dubrovnik Riviera Hotel was built and opened in 2015 in the town of Srebreno in Župa Dubrovnik, popularly known as "Dubrovnik Riviera". The hotel has 251 rooms and suites, a spacious wellness centre, outdoor and indoor swimming pools, tennis courts and large congress facilities. Of particular note is the Orlando conference venue, which is one of the largest hotel congress venues in Croatia and can accommodate up to 1,000 delegates.

Sheraton Dubrovnik Riviera Hotel is operated under a licence/franchise agreement by Marriott International Inc., which owns the Sheraton brand. The two observed hotels that are analysed in this paper have identical brand standards and business postulates according to Marriott Group rules. However, the mentioned hotels do not have the same business dynamics and, consequently, the same pricing policy. Namely, Sheraton Dubrovnik Riviera Hotel is largely a typical summer "beach" hotel, which usually opens during the Easter vacations, i.e. late March or early April. Prices then range from HRK 887 for the first few days of the hotel's opening to about HRK 920 for May, which still corresponds to spring. In early spring, i.e. in March, April and May, various packages are offered, thematically related to spring and spring vacations in the surrounding feeder markets (Slovenia, Austria, Germany, Italy, Bosnia and Herzegovina), as well as the so-called "early booking" prices for the Scandinavian market and the British market, both characterised by early booking of spring and summer vacations (about 6 months in advance). Another important segment of the hotel business outside the peak season, i.e. in spring and autumn, is the already mentioned MICE tourism, i.e. international, regional and local conferences and congresses of the corporate sector, political and governmental offices. MICE tourism is an important part of this hotel's business, contributing to early and late season bookings, unlike in the summer when there are no "big" congresses because there is no market for this type of events.

Since the hotel began operating in the spring, the price of overnight stays has been rising steadily, almost as the number of hours of sunshine increases. For example, in June the price is already HRK 1,315, while in July and August it is a maximum of HRK 2,054 for the same double room. The summer months of July and August are the "shoulder season" and therefore the highest hotel occupancy, when the so-called "overbooking" occurs, i.e. an excessive number of reservations compared to the offer (as in the Sheraton Zagreb Hotel in September, October or December). In September, the occupancy of the Sheraton Dubrovnik Riviera Hotel is lower, and the price of accommodation is about 10% lower than in July and August, with a tendency to further decrease in October. November is mainly reserved for congresses, conferences and meetings, while December also has a low occupancy rate, with the exception of New Year's Eve at the hotel, which always attracts a large number of domestic and foreign guests. The hotel usually closes at the beginning of January until the Easter holidays due to insufficient or non-existent demand for accommodation. It should be noted that, unlike the Sheraton Zagreb Hotel, which has the highest overnight rates for congress/business guests, the Sheraton Dubrovnik Riviera Hotel sets the maximum rates specifically for leisure guests during the summer, as can be seen in the following graph 4.

Graph 4. Average daily rate fluctuation in Sheraton Dubrovnik Riviera Hotel by quarters in 2019

(bed and breakfast in a double room in HRK)



Source: Author's creation according to publicly published prices on the official website of the Sheraton Dubrovnik Riviera Hotel, www.marriott.com/DBVSI

The graph gives an insight into the range of hotel rates during the year (from HRK 932 to HRK 2,054), which is significantly higher than that of the Sheraton Zagreb Hotel, which is HRK 1,122 (56.2%). Taking into account the above prices and the business dynamics of the hotel, it is concluded that the summer months, i.e. favourable weather conditions (sunny weather, warm sea, water sports and recreation opportunities) strongly correlate with the price of accommodation. In other words, in summer the hotel is fully booked and has the highest accommodation prices, while in autumn and spring the hotel is less booked with lower accommodation rates. In this sense, the relative price inelasticity of demand is also expressed in summer, when hotel occupancy is high (peak season). Namely, during the summer, guests are willing to pay a higher price for an identical hotel room that was offered at a significantly lower price just a few months earlier. In the early and late season, on the other hand, when the average price for a room is many times lower, a relative elasticity of demand occurs. Namely, then the hotel offers weekend packages, as well as weekly vacations at favourable prices, and it is the price that is the main factor competing in the market and increasing demand. In the "high season" the price does not play a major role, i.e. the decision criterion, because the market, i.e. the customers agree with several times higher prices. It can be concluded that the high price inelasticity of demand (in summer) requires additional non-price marketing and sales efforts by the hotel, while autumn and spring are reserved for price elastic demand and the basic communication and sales message is then the (reduced) price.

4. CONCLUSION

Based on publicly published data, i.e. accommodation prices and facilities published on the websites of Sheraton Zagreb Hotel and Sheraton Dubrovnik Riviera Hotel, as well as statistical data from local tourist offices on the occupancy of accommodation capacity, it is found that both hotels have high price elasticity of demand in the low season, when supply exceeds demand, and relatively high price inelasticity of demand in the high season, i.e. high hotel occupancy. This confirms the assumption of the research, i.e. the hypothesis of the paper. And while in low season, price, i.e. accommodation rate is the key competitive factor; in high season price "gives way" to modern non-price forms of competition - quality, design, geographical location, sales advantages (discounts, instalment payments) and others.

Although the hotels have common brand standards under which they operate, given the fact that they are located in two different destinations, they have completely different business dynamics, different time periods of high and low season, and therefore different demand and related pricing policies, i.e. different price elasticity of demand.

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CJENOVNA ELASTIČNOST POTRAŽNJE ZA HOTELSKIM USLUGAMA NA POSLOVNOM PRIMJERU DVAJU HOTELA U REPUBLICI HRVATSKOJ

SAŽETAK

U radu se analizira elastičnost potražnje za hotelskim uslugama u dvije različite destinacije u Republici Hrvatskoj, u Zagrebu i Dubrovniku, na primjerima Sheraton Zagreb Hotela i Sheraton Dubrovnik Riviera Hotela u predpandemijskoj 2019. godini. Analizom statističkih podataka nadležnih turističkih zajednica te temeljem analiza studija slučaja dva hotela, u radu se utvrđuje da cjenovna elastičnost potražnje za hotelskim uslugama ovisi o nizu različitih čimbenika kao što su dostupnost i vrsta hotelske usluge za kojom postoji potražnja, vrsta tržišta, cjenovna politika, specifičnost i različitost destinacija, sezonalnost i drugo. Iz analiza postaje razvidno da se elastičnost potražnje mora promatrati kroz sve svoje pod-segmente, uvažavajući specifičnosti svih oblika potražnje koji se u navedenim destinacijama bitno razlikuju jedni od drugih (odmorišni, „city break“, MICE turisti i dr.) unatoč nekim temeljnim sličnostima promatranih hotela (ujednačeni brand standardi poslovanja koje nalaže globalna hotelska korporacija, istovjetan franšizni ugovor i dr.). Zaključno, utvrđuje se korelacija između niske popunjenosti hotela (niske sezone) i relativno visoke cjenovne elastičnosti potražnje te visoke popunjenosti hotela (visoke sezone) i relativno visoke cjenovne neelastičnosti turističke potražnje.

Ključne riječi: *hotelijerstvo, cjenovna elastičnost potražnje, cjenovna politika, specifičnost destinacije, sezonalnost*