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EDITORIAL

On the Occasion of Publishing “Megatrend Review”, Vol. 7, No. 2, 2010

This issue of “Megatrend Review” is a result of long term strategy of its Editorial Board aiming to open pages of our scientific journal for applied economics to boarder states, region of South East Europe, Europe and the world. In that way, “Megatrend Review” becomes a place for intensive gathering and interaction of opinions and views on current events in national, regional and international economics with all challenges emerging in the field of global economy, economic policy and development, financial markets and business in present crisis period.

We would particularly like to stress that this issue of “Megatrend Review” is the fourth one in the series that will be devoted to certain states – in this case to the Slovak Republic and complex aspects of its present economic situation. The authors of contributions are distinguished scientists and professors mainly on *University of Economics in Bratislava*, Slovakia. Previous tree issues of “Megatrend Review” had been dedicated to the economy of Italy, Romania, and Hungary.

Our guest editor, Professor Dagmar Lesáková, Vice-Rector of University of Economics in Bratislava, has appointed the authors of contributions from Slovakia.

We are very grateful to Professor Lesáková for her professional effort she made as guest editor and an author of an excellent contribution for our journal. We also thank to all authors from Slovakia, Italy, Hungary, and Serbia for their excellent contributions.

PROFESSOR MIĆA JOVANANOVIĆ, PHD
President of Editorial Board
Rector of Megatrend University

GUEST EDITOR'S WORD

The aim of this paper selection is to give the reader an opportunity to reflect on the issues faced by Slovak companies and Slovak economy as a whole.

All Slovak organisations now operate in a competitive environment, which is dynamic and complex. This complexity has arisen from the need for companies to compete internationally as well as through the challenges of fast moving technological changes in their markets. Whatever the reason, Slovak managers are constantly facing new challenges requiring flexible decisions. In this context some of the papers stress the role of strategic thinking enabling to reinvent periodically the basis on which a company can compete in response to changes in the external environment.

Creativity and innovation are therefore needed in everyday business, if a company is to sustain its competitive advantage. Slovak companies must continuously reassess their business activities, to see whether it will be sustainable in the future. Businesses that are under-performing or in crisis must reinvent themselves.

Today markets are becoming ever more global in their nature and managers cannot ignore this fact. To achieve sustainable growth in markets that are becoming increasingly global, or merely to survive in domestic Slovakian market, that is attacked by international players, it is essential for Slovak companies to understand the complexity and diversity of foreign markets and for the managers to develop the skills and knowledge that are necessary in order to compete effectively. This is why in most of the included papers authors focus on business and management.

University of Economics in Bratislava is devoting a great deal of its research and development resources to actual business situations and problems and to developing teaching materials that address those situations in a manner suitable for classroom use. All Papers published in this issue represent the research projects outcomes of the professors from the University of Economics in Bratislava. University of Economics in Bratislava is the third biggest public university throughout Slovakia and the biggest one in social sciences. The profile of the university is unique in that sense, that it offers studies just in economics and business, while other universities in Slovakia have heterogeneous profile, offering studies in natural sciences, technical sciences, humanities, etc. Since 2008 the university was assigned to be the research university.

University offers actually study programmes in all three cycles of study: 18 accredited bachelor study programs, 31 accredited master study programmes, and 17 accredited doctoral study programmes. We offer master study programme "Sale and Purchase" in French language (with a possibility of obtaining double

diploma – with University in Grenoble), master programme “International management” in English and master programme “Financial management” in German language (again with a possibility of obtaining a double diploma – with University in Halle).

The University of Economics in Bratislava has an exceptional position in the system of university education within Slovak Republic in that: it is the first and one university institution in Slovak history, with focus on economics and management, possessing a high quality of lecturers and employees; it reaches long-term excellent results for students in the labour market, it possesses a reputation as the most prestigious institution sui generis in the Slovak Republic.

The rival position of UEBA is manifested also with the number of scientific publications and publications rate of professors and researchers, with the number of PhD students and PhD graduates. There are 9 scientific journals, published by the University.

The selection of papers in this issue is only a small part of all research projects in the University of Economics in Bratislava. We hope it will bring you an overview of the topics examined by the academic staff in Bratislava.

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PROCESSES OF BUSINESS INCUBATION AND CLUSTERIZATION TO SUPPORT THE CREATION OF A NETWORK ECONOMY IN SERBIA**

Abstract: *The network economy is a new entrepreneurial model which is developing thanks to information, innovation, communication and new technologies. It considerably changes the performances of international trade and competition in general. Under such conditions, network business linking is not a substitute for traditional hierarchical structures but a new management strategy and paradigm used by companies which base their growth and development on modern structuring of business processes. Practice has proven that, by networking organization structures, business processes and scientific research, we can gain key knowledge, skills and other advantages that are deemed as competitive on the market. Consequently, the analysis also deals with the networking of consulting organizations in Serbia, as well as their role in the processes of clustering and business incubation of domestic companies.*

Key words: *business incubators, clusters, network economy, competitive advantage*

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1. Introduction

Network business linking has become a contemporary strategic need, a new model of entrepreneurial behavior and a global megatrend, founded in the search for a company's core competency and efficiency of the organizational-processing

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network, representing the creation of an adjustable, synergetic and competitive organizational structure.¹

The key goal of network business linking is the achievement of its beneficial economic and organizational effects (direct and indirect). In literature, it is explained through its fundamental principles of formation and functional specifics of existence, reflected in a dynamic tendency of organizational growth, constant expansion and enhancement, towards the goal of the best possible positioning and success on the market.

In that sense, network business linking essentially represents a self-organized polycentric structure that is goal-oriented towards concrete tasks, on the basis of the following principles:

- Elitist linking of competent business partners;
- Business and partner anti-bureaucratism and informality;
- Decentralization of authority and responsibility (“democratic hierarchy”);
- Communicational-informational integration and synergism by way of highly sophisticated technologies;
- An affiliative and free character of linking on the basis of equality and independence, for a specific time period and on a consensual basis;
- Coordination of a joint strategy, based on clear rules, ambitious goals and a developed controlling system;
- Horizontal communication;
- Dynamic changeability, depending on newly formed problem situations;
- Dynamization of business and organizational strategy, through the introduction of the institute of “internal markets” (of a compensatory character), expert knowledge, innovational combinations of management models, motivation of entrepreneurial initiatives, etc.;
- Hybrid and non-traditional organizational structures; and
- “Boundless” expansion and growth, along with the erasure of organizational and business boundaries and differences between companies that are forming any sort of association.²

Network linking improves the ability to adjust to changes, innovativeness, modernization and training in relation to hierarchical-bureaucratic organizational structures. In addition, strategic management of network organizations allows lowering of costs, increased profits and better reactions to changes in market conjuncture. Networked partners in business processes are increasingly making joint use of their core competencies towards the goal of cheaper, more

¹ V. Drašković, “Mrežno poslovno povezivanje kao megatrend i nova menadžment strategija”, *Ekonomika preduzetništva*, No. 2, 2004, p. 126

² M. Drašković, “Klasterizacija kao komponenta globalne konkurencije”, *Montenegrin Journal of Economics*, No. 4, 2006, p. 168

flexible, more quality and better results, which gives them a competitive advantage on the global market.³

In that context, the analysis is oriented toward the networking of small consulting organizations in Serbia, and their role and place in the processes of the clusterization and business incubation of domestic firms. Consulting organizations in Serbia are mostly concentrated around university centers, such as Belgrade, Novi Sad, Kragujevac and Niš. The current state of the consulting services sector shows that consulting work should be decentralized networked.

Important support for this process should come from the decentralization of the advisory bodies of certain ministries and the Chamber of Commerce of Serbia, which would create conditions for more adequate responses to company needs, i.e., for a partnership-oriented approach to the solution of business problems. Also, towards the goal of efficient resource allocation, a regional exchange of experts is needed, for which the networking of consulting organizations in Serbia would be a prerequisite.⁴

2. Development of clusters in Serbia

Participating companies have to be the main actors in the development of clusters, as only their active role will ensure that clusters will grow in strength and develop. Educational institutions also have a role to play and, in certain instances, they have shown themselves to be important catalysts in cluster development. Universities can have an educational role, but can also be key actors in research and development, as well as in innovation within clusters. Another integral part of clusters is made up of business service providers with expertise that fits cluster needs, such as marketing, consulting and similar organizations (Figure 1).

All these bodies can contribute to stronger cluster development and play a legitimate role in them. A specific characteristic of clusters that stems from their very essence is – knowledge. Namely, in knowledge-rich businesses, the significance of concentrating researchers, consultants and laboratories in a single location grows, which increases the potential for the creation of innovations, values and quality of supply that more distant competitors cannot easily copy and surpass.⁵

Finally, local authorities, regional development agencies and other business bodies play an important role in stimulating cluster development by way of

³ M. Drašković, op. cit., p. 169

⁴ M. Milanović, “The research of the Serbian agrarian-development position in Europe”, *Megatrend Review*, Vol. 3, No. 2, 2006, Belgrade, pp. 23-40

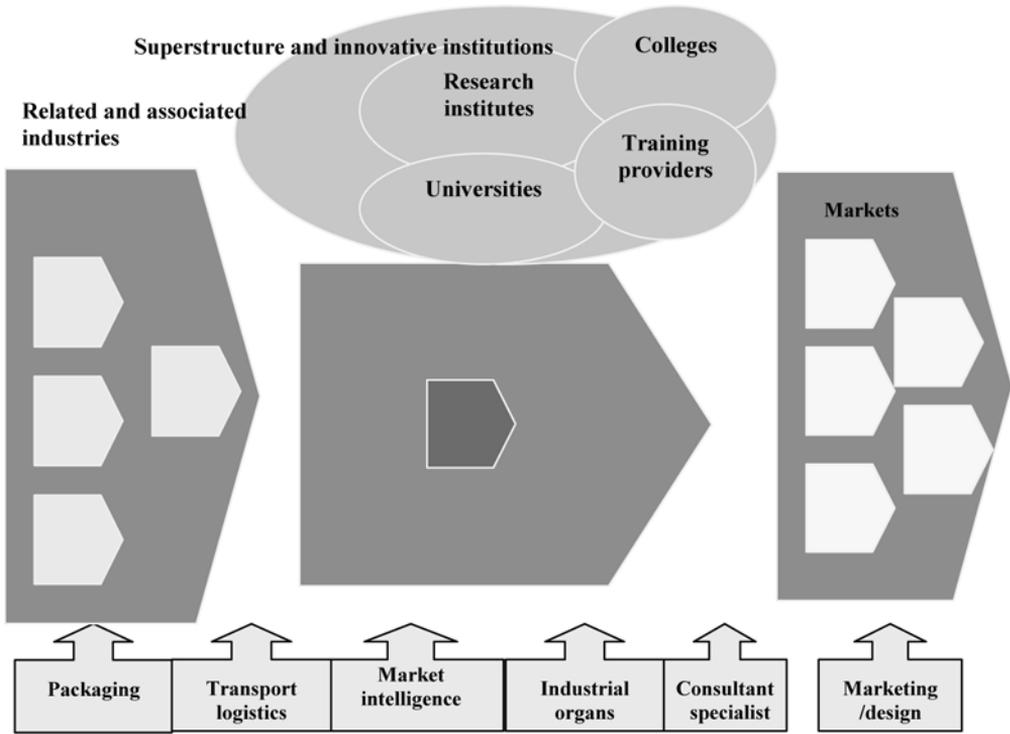
⁵ V. Paraušić, D. Cvijanović, J. Subić, *Afirmacija udruživanja i marketinga u funkciji kreiranja konkurentnosti agrarnog sektora Srbije*, Institute for Agricultural Economics, Belgrade, 2007, p. 61

interventions, strategic channeling and donations, creating favorable development conditions, organizing regional educational seminars, and lessening risk for business start-up or for taking on loans. There are several common elements in the functioning of clusters:

- 1) Base businesses – businesses that are the leading participants in the cluster and most often bring the biggest profits from users outside the cluster.
- 2) Support businesses – businesses that directly and indirectly support the base cluster businesses. These include suppliers of specialized machines, components and raw materials, as well as other service firms, including financial/brokerage firms and their capital, attorneys, designers, marketing and public relations firms. These firms are usually highly specialized and physically located close to the base business firms.
- 3) Intellectual support infrastructure – in clusters that operate on the top level, the base and support businesses do not work separately, in isolation. Many local community members participate in successful clusters: local schools, universities, political institutes, local commercial and professional associations, economic development centers and many others that support the cluster's activities and are in fact key cluster actors. The quality of this intellectual support structure and the level of teamwork within it represent a very important factor in the development of any cluster.
- 4) Physical support infrastructure – this is, before all, the physical infrastructure: roads, ports, ordered waste disposal facilities for classic or specific waste, communication links, etc. The quality of this infrastructure must be at least on the same level as that of the competition, although it is desirable that it be even better.

In most cases, the creation of clusters “from the bottom up” leads to so-called quasi-clusters, i.e., associations with prospects of becoming future clusters. It is worth highlighting the following “clusters,” more precisely associations formed on the initiative of their members, not for the sake of securing state stimuli, but so that the companies within the cluster can gain better market position:⁶ the *Fruitland* association, a cluster of agricultural producers in Kraljevo, *Rakovica agriculture cluster*, the Begeč vegetable producers association.

⁶ B. Mihailović, V. Paraušić, Z. Simonović, *Analiza faktora poslovnog ambijenta Srbije u završnoj fazi ekonomske tranzicije*, Institute for Agricultural Economics, Belgrade, 2007, pp. 120-122

Figure 1: Cluster model

Source: www.arhiva.srbija.sr.gov.yu/g/documents/inovacioni_klasteri_srp.ppt

There are also initiatives for the formation of clusters in Serbia in the area of ecology. The participating companies of the Ecological Cluster of Serbia are authorized to receive and recycle certain kinds of dangerous and non-dangerous waste. It is important to underline that all the cluster member companies fulfill all technical requirements, such as the necessary documentation for recycling and receiving waste. The cluster member companies are authorized service providers in the areas shown in Table 1.

Table 1: *Areas of consulting services within the ecological cluster*

Consulting in the area of implementing ISO 9001, ISO 14001, EMAS, BSI OHASAS 18001, HACCP/Codex Alimentarius, EUREPGAP, ISO 17025 , ISO 22000
Producing reports on the strategic evaluation of environmental impacts of plans and programs
Producing integral local plans of waste management in municipalities
Writing projects for applying to domestic and foreign donors, for credit funds
Production and implementation of LEAP (local ecological action plans) and Agenda 21
Legal and political advisory services in the area of environmental protection
Lectures and training according to need in the areas of systems management and environmental protection
Producing environmental impact studies and all accompanying required documents through all phases of the process of environmental impact evaluation
Producing assessments of risk from chemical accidents
Eco-toxicological expertise production
Production and sales of equipment for the disposal and recycling of secondary raw materials

Experience has shown that the clusters (initiatives) with the greatest prospects for success are those that have a consensus on joint goals and activities, a clear framework for cooperation and were formed on their own initiative. In the course of the Clusterization Pilot Program, these also represent the biggest problems in the Serbian economy.

Namely, successful cluster work is hindered by a high degree of mutual mistrust among members, misunderstanding of the concept of clusters, desire for horizontal association without readiness for deeper cooperation, insistence on individual problems, fear of loss of autonomy in business decision-making. At the same time, the lack and underdevelopment of institutional and infrastructure support make these processes even more difficult in the Serbian economy. Cooperation between universities, scientific-research organizations and economic sectors is not sufficiently developed.⁷

3. Business incubators

Business incubators are instruments of local economic development for the support of newly formed small companies in the first years of their growth and development, when they are the most vulnerable.⁸ Namely, in order to mini-

⁷ *Program for the Development of Business Incubators and Clusters in the Republic of Serbia 2007-2010*, Republic of Serbia, Ministry of Economy, p. 34

⁸ G. Danilović Grković, B. Kovačević, A. Sedmak, M. Nedeljković, "Uspostavljanje biznis inkubatora tehničkih fakulteta u Beogradu", *XIII Telecommunications forum TELFOR*

mize lack of knowledge and inexperience in management, accounting, market acquaintance and business operations in the beginning phase of new small company creation, these functions are unified within a joint service and through occasional guest consultants that perform these tasks for all the companies in the new company incubator hall.

According to the same source, the most important services provided by the incubator capacities include organized access to expertise, experience, advisory services, counseling and mentoring in key business networks and groups.

The offered physical spaces and services increase these companies' chances of success relative to those companies that operate individually. EU-level research has shown that the rate of failure (during the first five years of existence) of companies that started their business life in business incubators is lower than 15%, as compared to other companies, whose rate of failure is as high as 50%. An incubator functions as a capacity that companies enter and exit. In other words, company stay in incubators is limited (most often to a period of 3 years).

Table 2: *Usefulness of business incubator services*

Expert services	Rank
Access to grants, initial and investment capital	1
Business planning and company start-up	2
Pre-incubation services	3
Business skills development training	4
Help in securing bank loans	5
Advice on developing new products and services	6
Other expert services	7
Advice on hiring and employee management	8

Source: G. Danilović Grković, B. Kovačević, A. Sedmak, M. Nedeljković, "Uspostavljanje biznis inkubatora tehničkih fakulteta u Beogradu", XIII Telecommunications forum TELFOR 2005, Beograd, Sava Centar, 22-24/11/2005.

The consulting services of a business incubator are created according to the expressed needs of not just its members but the local community at large, as well as according to global practices in the functioning of business incubators, and local specificities. They are to a large extent defined by the available personnel, funding and technical equipment. The consulting services offered by a business incubator have a vital significance for the development of its member companies, as well as of the business incubator itself. They can also be a source

for securing additional funds that would reduce the incubator's dependence on subsidies and donations, thus being a key to its self-sustainability.⁹

All consulting services offered by the business incubator are subject to changes; thus, new ones can always be added and others discontinued, depending on the needs of the local community and incubator members. At the same time, the prices of the consulting services can be changed depending on inflation, costs and supply/demand, but they should always be below-market for members and, at the same time, structured in such a way as to secure sufficient income to sustain the incubator. An adequate relation between offered consulting services and their price can turn a business incubator into a very efficient means of local economic development.

Most consulting services should be included in the membership fee for member companies. According to the European Commission report "Evaluating Business Indicators" (2002), "the base value of the functioning of business incubators lies in the type and quality of business support services for clients, in four key areas: entrepreneur training, business counseling, financial and technological support."

The most frequently mentioned incubator concepts here are the following:¹⁰

- *Business Innovation Centers*. The BIC concept is promoted by the European Commission as an instrument of regional development. BICs are managed capacities whose goal is to generate new innovative companies engaged in high added value activities, which are not, however, necessarily technological.
- *Innovation centers*. An innovation center provides advice and support to small companies in the development of new products and processes. This usually means support in the development of prototypes for new companies, or help to existing small companies in improving production processes. Differently from technological centers, they usually do not secure space for their clients. Also, innovation centers are not solely oriented towards high technologies. Their clients usually have joint access to equipment and machines, while some innovation centers offer services outside of their facilities as well. The goal is to stimulate the development of new companies, not necessarily high tech ones, and to dynamize an already active sector within the framework of a good, stimulating environment.

⁹ Support for the establishment of business incubators in southern Serbia, Project Feasibility Study "Business Incubator in Vranje", January 2006. Analysis produced by the expert team of TIM Timočki Club; team leader: Dragan Milutinović.

¹⁰ G. Danilović Grković, B. Kovačević, A. Sedmak, M. Nedeljković, "Uspostavljanje biznis inkubatora tehničkih fakulteta u Beogradu", XIII Telecommunications forum TELFOR 2005, Sava Centar, Beograd, 22-24/11/2005

- *Centers for companies – incubators without walls.* Centers for companies offer advice and help to entrepreneurs and small companies, but usually do not secure space.

In accordance with current trends in developed market companies, as well as the need to offer support to companies in Serbia during their first years of development, the first initiatives to form business incubators have appeared, which will be presented below.

Business Incubator – Bor Center is a non-profit organization that promotes the economic development of the local community. Its offices help entrepreneurs achieve growth and development. Under one roof and in a professional work setting, the business incubator supports new and developing businesses, offering a broad spectrum of business training, support programs and joint equipment.

The incubator's member companies form their own separate communities, building their own individual business success, and contributing to the regional economy. Business success offers new employment opportunities, diversifies the local economy and improves the quality of life for the entire populace.

Business Incubator in Niš was founded within the "ENTRANSE" Project, Private Sector Development – the Republic of Serbia, approved in September 2004 and financed by the foreign ministry of Norway. Its task is to found a business incubator and implement a training program for business start-up, with a clearly defined strategy of eventual transformation into an industrial park. The founders of the incubator are the city of Niš (51%) and the Regional Development Agency for MSE Niš, Ltd. (49%). The leading international partner for the realization of the SINTEF project is the Norwegian Foundation for Scientific and Industrial Financing, the national partner is the Ministry of Economy, while the national institution for implementation is the Republic Agency for the Development of Small and Medium Companies and Entrepreneurship.¹¹

Business Incubator in Prokuplje The Prokuplje Municipality has initiated the "Business Incubator Center" project, before all due to the need to find new possibilities for the use of old, abandoned factory halls, through initiatives of the local government, entrepreneurial associations and investors.¹²

The services that the Business Incubator Center would offer are, before all, the following: production and office space, information technology support,

¹¹ One of the founders and the local partner in the project is the Regional Agency for MSE Development Niš, Ltd. On a total area of 2700 m², of which 2100 m² is reserved for production, the business incubator hosts 13 entrepreneurs. Their basic businesses are: metal processing and decorative item production; aluminum frame production; production of foil enhancements; production of agricultural machine parts; bait production; production of expansionary and other vessels; nail production; production of non-ferrous metal castings; production of medical devices; and three programs of the MIN Holding Company.

¹² The Prokuplje municipality has set aside more than 20 million dinars for equipping the space to be used by 17 small and middle companies.

financing and accounting services, help in business basics, and organizing a network of exports that can offer support, help in business plan development and mentor services. The building of the BIC would influence the local community in two basic ways: directly – through employment, wages and sales, and indirectly – through increased employment and earnings in the broader community and not only in the member companies.

Business Incubator in Kruševac This is a broader project tied to reducing unemployment in the city and stimulating the work of small and medium companies at the start, which is their most difficult period. Kruševac is one of the first cities in Serbia that has initiated the realization of the business incubator project.¹³ Parallel with building, work is being done on establishing the criteria regarding the future residents of the business incubator, which should secure for new entrepreneurs office and production space, a joint administration, and expert and technical help, thus significantly reducing their business costs and allowing them to achieve profitability more rapidly.

Business Incubator in Bujanovac Eight small companies and entrepreneurial shops chosen by way of a public competition have signed contracts. The decision on which companies would be accepted was brought by a Council comprised of local government representatives, banks, private entrepreneur associations, the IMT factory and the Timočki Club. The companies will be able to spend their first three years of business in the incubator.

Business Incubator in Knjaževac The concept of this incubator was formed as part of the cooperation between the Timočki Club and CIDA and CESO from Canada. The Timočki Club made its first steps in the realization of this project at the end of 2002. In the preparatory phase, the Club organized a number of working meetings in the Vidin Business Incubator (Bulgaria), following which, with the help of its own experts, it organized an economic survey of the Knjaževac municipality.

As a partner on the project, the Timočki Club is responsible for adapting IMT's space into the incubator center,¹⁴ in which "young" companies will have everything they need to ensure stability and development: a joint hall for conferences and presentations with the necessary equipment, two halls for meetings and workshops, consultations with the Regional Center for MSE Development in Zaječar, mentor work with each company in the first 6 months, free Internet access,

¹³ The building of the business incubator, with more than 1400 sq. meters of space, is being financed with 36 million dinars from the National Investment Plan (NIP) and 32 million dinars from the municipal budget, while the Kruševac municipality provided the building grounds and the complete infrastructure.

¹⁴ A portion of the hall belonging to the 'IMT' Knjaževac factory, 1,200m² in area, and 600m² of parking space, have been reconstructed into the future incubator center. The building has all the necessary infrastructure: water, heating, climatization equipment. The space is divided into 11 smaller units in which 10-12 companies will work, and the units can be subsequently reordered and accommodated to the users.

cheaper accounting services (free for the first three months), consulting services for producing a business plan, seminars on business management skills (how to plan, organize, manage and control production), seminars on business operations (understanding accounting, marketing and finance), seminars on organizing and operating an office and Internet use, seminars on maintenance and modernization of IT equipment, and help in marketing and public relations tasks.¹⁵

Business Incubator in Zrenjanin On the basis of the Economic Development Program of AP Vojvodina and the Strategic Development Plan of the Zrenjanin Municipality, the Zrenjanin business incubator opened a contest for companies in the fields of information-communications technologies, design, and consulting and financial services, and organized the first pre-incubation training for potential incubator residents, where the basic idea of the incubator project was explained. As this is an idea that must not wait, great efforts are being made to expand the incubator's activities with new companies.

The Business-Technological Incubator of the Technical Faculties in Belgrade During the last 15 years, many outstanding researchers and scientists have left Serbia because they lacked adequate opportunities for work in the country. The idea of founding the Business-Technological Incubator is to secure a place in which good ideas will be able to see the light of day and to offer researchers the opportunity to compete with their colleagues in the global marketplace.¹⁶

Business Incubator in Beočin As a result of high unemployment and the desire of many to start their own business, the Business Incubator was established in Beočin as a way of organizing companies. The basic goal of the incubator is to help the founding and development of trade shops and small and middle companies, so that they enter market competition more rapidly and successfully.

The founders are the Beočin municipality, the "Lafarge BFC" company, the Beočin Business Association of Commercial Companies, "Elkond" company from Beočin and "Pro-ing" company from Novi Sad, Delta Bank, Agrobanka, the Novi Sad Open University and the Regional Chamber of Commerce. The goal is to take advantage of the municipality's potential for fast economic growth.

¹⁵ The project of starting the first business incubator is one of USAID's 830 CRDA programs carried out by CHF International "with the help of the American people" in 144 communities in eastern and southern Serbia. CRDA is a five-year civil society program being carried out on the territory of Serbia since 2001, which uses community development activities to move citizens to improve quality of life, promote economic development and build confidence between citizens and local authorities.

¹⁶ The incubator was established as a joint project of four technical colleges of Belgrade University (Civil Engineering, Mechanical Engineering, Electrotechnical and Technological-Metallurgical), the Palilula municipality and the Democratic Transition Initiative. The project was also supported by the Organization for Security and Cooperation in Europe (OSCE).

Having in mind previous experiences in offering consulting services to companies in business incubators, it would be useful to give a few recommendations on the structuring of the consulting services offered by business incubators:

- The number of consulting services offered to business incubator members should not be too great; it is necessary to optimize their quantity and quality.
- Depending on the needs of the business incubator, it is necessary to use the consulting services of other organizations (accounting agencies, chamber of commerce, agency for small and middle company development, NGOs, office equipment sellers, the media, universities, attorneys, banks, etc.), in order to be able to completely satisfy client needs and build partnership relationships with them.
- Create a quality control system that will monitor business incubator results on the basis of real facts, in order to constantly improve the quality of consultant services.
- It is necessary to use the Internet as much as possible; the advantage of information and communication technologies is that they represent the most efficient and fastest way of offering the information and knowledge necessary for the efficient functioning of the business incubator and its members.

4. Networking scientific - research and consulting activities

The following is known in economic theory and contemporary practice: if total capital, as a production potential, is conditionally divided into *natural* (K_p) and *man-made* – physical and intellectual (K_h), it is necessary that the total capital inventory ($K_p + K_h$) does not fall in the foreseeable future.¹⁷

An obvious prerequisite for this is to secure a certain degree of substitution between various forms of capital, i.e., that the inevitable decrease in natural capital be compensated with an increase in available human, before all intellectual capital. This can be achieved only by increased application of already acquired and new knowledge and the best contemporary production practice, i.e., by using the resources of the total scientific-technical and cultural potential. The essential contribution and the main role in satisfying this important prerequisite belongs to science and the profession, i.e., to an appropriate network of institutes that would offer necessary support to companies in managing their processes of transformation. With time, institutes in Serbia have adjusted

¹⁷ Milanović, M., Stevanović, S., Đorović, M. (2008): "Razvojne prednosti i elementi beogradske agrarno-ruralne multifunkcionalnosti", International Scientific Meeting: *Multifunctional Agriculture and Rural Development III – rural development and (un)limited resources*, 4-5th December 2008, Faculty of Agriculture in Zemun – Belgrade, book 2, pp. 83-89

their activities to suit the needs of the economy. Many institutes¹⁸ have gradually transformed themselves from classical scientific-research institutes to professional organizations for offering consulting services in the area of industry, infrastructural branches and agriculture. However, according to the results of empirical research, 54.29% of the consulting organizations in Serbia are engaged in some form of networking.¹⁹ On the other hand, business incubators and clusters are still in an “embryo phase” of development and sporadic in character, so it is understandable that their influence on company performance has so far been negligible. In such conditions, it is necessary to stimulate a more significant partnership of the public and private sectors, before all in the form of:

- intrasectoral mobility of researchers and consultants;
- intersectoral mobility of researchers and consultants.

Namely, an interdisciplinary approach is necessary in the resolution of business problems, since non-structural business problems to which routine solutions cannot be applied often appear. At the same time, since consulting organizations in Serbia are mostly concentrated around university centers (mostly in Belgrade), in order to move this sector nearer to the model of total competition it is necessary to decentralize and network consulting work. Significant support in this process should be provided in the form of decentralizing the advisory bodies of certain ministries and the Chamber of Commerce of Serbia, which would create conditions for more adequate responses to company needs, i.e., the possibility of a partnership approach to the solution of business problems. Also, towards the goal of a more efficient allocation of resources, a regional exchange of experts is necessary, which means the networking of consulting organizations in Serbia. Support for this process should come in the form of consultant certification, due to the appearance of unfair competition. Namely, several firms have created an environment favorable only to themselves, and surveyed companies are pointing to the existence of an oligopolistic consulting market.²⁰

It is, therefore, necessary to institutionally support the development of a consultants association in Serbia that would minimize unfair competition by setting down a code of professional behavior, i.e., defining ethical, professional and other performances of consulting work, and requiring consultant certification as

¹⁸ Institute for Agricultural Economics, Mihajlo Pupin, Nikola Tesla Institute, Institute for Chemistry, Chemical Engineering and Metallurgy, Institute for Corn, Jaroslav Černi Institute.

¹⁹ B. Mihailović, *Razvoj konsultantskih usluga u Srbiji i njihov uticaj na performanse preduzeća u agrokompleksu*, PhD dissertation, Faculty for Management, Valjevo, Megatrend University, Belgrade, 2010

²⁰ B. Mihailović, *Razvoj konsultantskih usluga u Srbiji i njihov uticaj na performanse preduzeća u agrokompleksu*, PhD dissertation, Faculty for Management, Valjevo, Megatrend University, Belgrade, 2010

well as the control and evaluation of consulting services. This would clarify the boundaries of consulting and reduce the possibility of abuse and manipulation.

5. Conclusion

The processes of business incubation and clusterization in Serbia are in their “embryonic” phase of development, and represent an initial step in the affirmation and stimulation of networking between economic actors. The goal of business incubators has to be the establishment of the most suitable structure and forms for the specific needs of the local and regional economy. Still, they cannot achieve economic development by themselves. Whether they are located within scientific-technical parks or outside them, business incubators must form a part of a broader strategy or economic development program that covers all the dimensions of economic changes, especially transition economies, in which incubators have shown themselves to be the most efficient within the scope of broader programs for the development of the small business sector.

The clusterization of Serbia’s economy is in its earliest stages. Clusters can make their contribution in the development of competitiveness, through productivity growth and the creation of innovative strategies, which should not be lost from sight in the coming period, when more intense processes of cluster creation and functioning should be expected. This way of strategic linking of companies for the sake of further growth should gain momentum, so that it can play a key role in strengthening competitiveness and ensuring a more effective performance of Serbian companies on the international market.

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ECONOMIC ASPECTS OF DOING E-BUSINESS IN COMPANIES^{**}

Abstract: *The economic aspects of e-business can be seen by analyzing the contribution of information-communication technologies to the economic growth and higher productivity of companies. On one side, micro-level analyses indicate the strategic importance of e-business for companies while, on the other side, macro-economic analyses indicate that e-business has only moderate effects on industry productivity and growth levels. In this paper, the value-chain is used as conceptual framework that allows the economic assesment of the whole e-business process evolution: from system acceptance, use and diffusion of ICT, impact of ICT and e-business on the innovation process, to changes in doing business and related effects on improved business results.*

Key words: *e-business, value chain, productivity, competitiveness, information-communication technologies*

JEL classification: M15, L23

1. Introduction

Under contemporary global business conditions, the use of information-communication technologies (ICT) and e-business has become a horizontal issue involving all industrial branches and companies since, as general purpose technologies, they play an important role in overall operations as a factor that stimu-

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lates innovations and productivity, and raises competitiveness levels.¹ Thus, the matter of an appropriate introduction and broad use of ICT and e-business has become an important part of a country's overall industrial and innovation policy, being no longer a topic limited only to specific programs or plans of action. As a result, all broader frameworks for creating development policies must include elements of ICT and e-business at a very high level.

A second change is also evident in present-day conditions, the change in global ICT policy. Initially, it was created solely as support to ICT investments. With time, ICT policy began to support quite sophisticated e-business solutions. Today, its goal is to support the development of e-business value networks within and between branches of industry. The policy is following development in accordance with phase 3.0 of e-business, i.e., the trend toward digitally integrated value systems, in which a basic information infrastructure has become necessary for doing business. Also, it is important to note the need for the existence of a close relationship between ICT policy and a country's industrial and innovation policy.²

2. The development of the concept of e-business

According to the OECD definition, e-business is a “process of business automatization (both within and outside the company) over computer-supported networks.”³ This definition sheds light on the fact that e-business is much more than e-commerce (which focuses on commercial transactions between companies and their customers, whether these are individuals or other companies), and that e-business also includes company internal processes, as well as processes between the company and its external partners. This points to the fact that an examination of e-business requires that the monitoring and measurement of data on realized e-commerce (quantity of goods and services sold online) be augmented with studies that analyze the degree to which company processes, including intrafirm processes, are electronically interconnected and digitally integrated.

In order to understand the changes in the contemporary concept of e-business, it is necessary to remind that traditional definitions of e-business refer to the process of business process automatization (both inside the firm and in relation to external partners) by way of digital networks. Here automatization means that formally manual and paper-based processes or transactions are partially or totally replaced with digital processes and the digital exchange of the same data.

¹ European Commission, *E-Business Watch: E-Business in Europe - 2008, Industry Perspectives on E-business Development and ICT Impact*, Brussels, 2008, p. 9

² M. Vidas-Bubanja, “**Advantages and Limitations of the Introduction of E-business in Serbia**,” *Megatrend Review*, Vol. 4, No. 1, 2007, pp. 143-174

³ OECD: *Shaping Policies for the Future of Internet Economy*, Paris, 2008, p. 5

However, today's e-business does not solely refer to systems and technology, but encompasses:⁴

- Optimal management of relations with customers, suppliers and business partners in a complex and frequently global competitive environment;
- More than the realization of electronic transactions in purchasing and sales, including access to, securing and sharing of information in the business network;
- Doing business in an advanced digital economy.

The trend toward digitally integrated, ICT-connected value systems requires a distinction between three phases of e-business development. The first phase, the so-called e-business phase 1.0, encompassed the period between 1995 and 2000, when firms purchased by way of the Internet various kinds of still-undeveloped technological solutions with which they tried to support their business. Phase 2.0 of e-business, which followed the crash of the 2000s and the identification of several unsuccessful business models, focused on the problem of lowering business costs through the application of ICT. In the period leading up to the present, phase 3.0 of e-business, the basic information infrastructure developed and matured, removing any dilemmas about the importance of e-business for modern business realization. Firms change their ICT solution focii. Although the application of ICT is still primarily connected with improving business process efficiency (mostly through cost cutting), ICT is increasingly viewed as a significant tool for innovation and profit growth through the realization of new products and services and the implementation of new work conditions within value networks.

Globalization and the development of value networks are forcing companies to cooperate and compete in new ways. New challenges include the appearance of special intermediaries and a growing influence of knowledge-intensive activities, both in the production and the service sectors. Companies are increasingly focusing on their core competences, while outsourcing their non-core activities to external partners within a framework of new forms of network cooperation. These advances are becoming possible thanks to the abundance, accessibility and transparency of information, which is made possible by the application of ICT in all business segments. In this way, ICTs are becoming important not only for the innovation of internal business processes but for the innovation of external ones as well.

The entrance of the concept of e-business into phase 3.0 is also being confirmed by trends that have characterized the application of e-business in practice:⁵

⁴ European Commission: *E-Business Watch, E-Business in Europe-2008, Industry Perspectives on E-business Development and ICT Impact*, Brussels, 2008, p. 9

⁵ European Commission, 2008, *ibidem*, p. 10

- 1) Greater e-maturity, related to the higher level of the ICT infrastructure of contemporary companies, which are thus becoming more able and better prepared to realize new forms of e-business.
- 2) The application of e-business is outgrowing the mere realization of business transactions, entering the phase of directing e-business towards the goal of better customer service. The goal is to establish permanent/sustainable customer relations.
- 3) The application of ICT supports information management, and the transparency of business processes is raised to a higher level. ICTs increase the efficiency of internal processes, allowing information management to ensure better planning and more precise/exact business decision-making.
- 4) ICT and e-business open up new possibilities for the outsourcing of specific business processes. The outsourcing process increases company productivity. Specialized e-intermediaries support data exchange between companies, for example, ensuring the compatibility of document formats. Electronic invoices are a good example of a B2B service that can be outsourced.
- 5) The connection between ICT application and sustainable development is now also tied to the energy sector, and the ability of IC technologies to reduce energy use, or at least improve energy efficiency, is being examined. This issue is also becoming quite current for the business and research sectors, as well as for the creators of energy and industrial policies.
- 6) In the course of the 3.0 phase of e-business, many companies are expected to change their business models in accordance with their e-strategies. This would imply decisions such as: which part of the value chain should be covered and which outsourced, the issue of creating product portfolios, choice of distribution channels and strategies of cooperation. The new business models must also be harmonized with market development and competitive demands.

3. The economic impacts of ICT and e-business

The economic aspects of e-business have always been tied to the dilemma regarding how much ICTs contribute to economic growth and greater business productivity. It has never been easy to shape research results into clear conclusions. While micro-level analyses in companies showed the strategic importance of e-business for individual companies, macro-economic analyses revealed only moderate effects of ICT capital and investments on productivity and industrial branch growth (see table 1).

Table 1: Effects of e-ICT and e-business on micro and sector levels

MICRO-LEVEL	SECTOR LEVEL
<ul style="list-style-type: none"> ICTs are general purpose technologies and, as such, are broadly applied in numerous business functions. For many companies, e-business has become an important instrument for realizing business strategies. Specific e-business goals and applications differ depending on company business model, size and market in which it is operating About 55-70% of companies in all sectors expect that e-business will have a large or at least medium effect on their business. This approach is valid in all functions, including primary business functions and supporting business functions ICT is closely correlated to sales growth in all sectors. Also, there is evidence of the positive effect of ICT on market share. Both items give further evidence of improved company business. 	<ul style="list-style-type: none"> A direct contribution of ICT to productivity and industrial branch growth is less evident. ICT has the greatest significance in the banking sector. A moderate influence of ICT on work productivity growth. The key stimulant of work productivity growth was the intensity of raw material and intermediate product input. The intensity of energy usage is reduced by the use of communication devices, but energy usage for IT increases (computers and software)

Source: European Commision, E-Business Watch: *E-Business in Europe-2008, Industry Perspectives on E-business Development and ICT impact*, Brussels, 2008, p. 12.

The famous productivity paradox (or the Solow computer paradox) is tied to the discrepancy between IT investments and the results measured by achieved outputs. The paradox was especially present in research conducted during the 1980s and 1990s, while later studies found a number of effects that confirmed the correlation between ICT investments and productivity growth.

The problem of this correlation can also apply to the following facts:⁶

- 1) E-business is usually connected with the optimal organization of information flows and work and production processes by way of electronic exchange and data processing. This requires ICT, but investments in technology are sometimes negligible relative to needed investments in the transformation of the company's organization.
- 2) When ICT capital is calculated, it includes investments in computer hardware, software and telecommunication services, while the technical components built into the equipment are often excluded.

⁶ R. M. Solow, "Technical Change and the Aggregate Production Function," *Review of Economics and Statistics*, 39, 1957, pp. 312-320

- 3) The effects of ICT outsourcing must be taken into consideration in the case of many companies. Outsourcing is perhaps the key factor for work productivity growth. ICTs have a twofold role in this context. A good ICT structure facilitates the outsourcing of business processes while, on the other hand, portions of the ICT infrastructure and maintenance can also be outsourced.
- 4) The story according to which ICT solves the question of productivity gaps cannot be accepted. A good e-business strategy can be of key importance for the company's presence on the global market, without necessarily increasing its productivity. ICT implementation may be able to identify problems in business, allowing for greater transparency and thus contributing to better product and service quality – which is significant, regardless of the effects in the area of productivity.

All these facts serve as confirmation that a company's growth is not necessarily an indicator of the influence of ICT and e-business exclusively on its productivity. The consideration of several different analytical approaches gives a much more balanced basis for conclusions regarding the ways in which e-business can bring better business results for a company.

Most theoretical studies mainly conclude that ICTs have a positive effect on company business, but only when ICT implementation is accompanied by other changes and investments, primarily in organizational transformation and employee training. Numerous empirical studies now confirm that ICTs primarily bring effects to companies that have transformed organizationally and which have an adequate working capital structure. The next important factor are innovations, as potential investors in new technologies such as ICT are usually more likely to achieve such changes through their own experiments and innovations. Without this process of "co-inventions,"⁷ which usually have a slower tempo of realization than do technological innovations, the economic effect of ICTs may be limited.

In analyzing the effects of ICT on company business, Pilat begins with an interpretation of the following factors:⁸

- 1) an effective use of ICT requires a trained work force;
- 2) organizational change is the key for the functioning of ICT in a company;
- 3) ICT effects are tied to the level of competition and readiness to experiment and innovate;
- 4) company size influences the scope of ICT effects on its business;
- 5) ICT effects appear with a certain time lag.

⁷ T. F. Bresnahan, S. Greenstein, "Technical Progress and Co-Invention in Computing and the Use of Computers," *Brookings Papers on Economic Activity: Microeconomics*, 1996, pp. 1-77

⁸ D. Pilat, *The economic impacts of ICT - lessons learned and new challenges*, OECD, 2005

3.1. Effective use of ICT requires a trained work force

Company-level studies have most often confirmed the complementarity between technology, knowledge and the level of employee training. In companies that have managerial teams focused on continual product and service quality improvement and an aggressive strategy of human capital management in the form of permanent training and education, better results were attained in terms of achieved levels of multifactor productivity (MFP). Also, the positive effects of ICT use on MFP growth were usually tied with the company work force's level of training and knowledge, with the company's experiences in the domain of innovation, the application of advanced business practices and intensive organizational changes. Analyses confirm that large firms with a high percentage of educated managers and workers are the biggest ICT users.

3.2. Organizational change is the key for the functioning of ICT in a company

Empirical studies show that companies gain the biggest benefits from ICTs when the ICT investment is combined with other organizational changes such as new strategies, new business processes and practices and new organizational structures. A common element of these policies is that they include a higher level of individual worker responsibility regarding the content of their work and, to a certain degree, bring management and labor closer together. Since such changes are specific for each company, on the average empirical studies show a positive return on ICT investments, but with large variations from company to company. There is also a significant interaction between ICT use and complementary organizational variables in all sectors.

The introduction of ICT and employee training are important stimuli for organizational changes, such as the introduction of total quality management, lean administration, elimination of hierarchical levels and transfer of authority. Companies that have raised the level of intra-company communication through organizational change were more successful in accepting new technologies. Also, such organizational changes increased company capacities to adjust to varying market conditions, precisely through technological innovations and the lowering of inventory costs. In addition, work productivity is positively correlated with human capital intensity and organizational factors such as teamwork, work task rotation and decision process decentralization.

Some studies connect ease of implementing organizational changes with company age, observing that young and new companies realize such changes more quickly and easily.

3.3. The effects of ICT are linked with the level of competition and the readiness to experiment and innovate

Intense international competition serves as a frequent motive for companies to start using electronic business, especially in the B2B segment. Also, studies show that, under conditions of a competitive economy, effective ICT use can help efficient companies to capture larger market share at the expense of less productive firms.

Some studies link the positive effects of ICT on productivity growth with a company's readiness to experiment and take greater risks for the sake of greater benefits. The business environment can be an important factor that will stimulate companies to innovate and experiment, since business entry and exit barriers are relatively low. Having space for experimenting under conditions of technological uncertainty can be a big advantage for a company that is learning what does or does not succeed on the market.

The link between ICT use and a company's ability to innovate is important. Firms that introduce new products and new processes and adjust their organizational structure can gain greater advantage from ICT use than companies that don't. Spillover effects are especially linked to the use of ICT capital, and are much less present when it comes to non-ICT investments. A company's innovation strategy stimulates its readiness to adapt new ICT technological solutions. A strategic orientation toward high technology is usually a base for successful business strategy. When a firm combines ICT with other technologies, it achieves better results than those that opt for the use of only one technology.

3.4. Company size influences the effects of ICT on business

The level of advanced technology acceptance and use grows along with company size. Big firms, with more than 250 employees are more prone to using network technologies such as the Internet or EDI than SMEs. Also, big firms often use a combination of network technologies. Big firms use ICT in order to redesign their internal information and communication flows, as well as to integrate these flows throughout the production process. Most MSEs use the Internet for marketing purposes.

3.5. ICT effects appear with a certain time lag

Having in mind the period needed for the full adoption of ICT and its introduction into company business practice, its first advantages become evident only after a certain period of time. In the initial period, the firm may suffer losses or even falls in production until the ICT business solution starts functioning in practice.

Pilat's analysis showed that turning an ICT investment into a successful business solution is not a simple process. It demands complementary investments and applications in the company's human capital, organization and innovations. Moreover, ICT-induced changes form a part of the process of company research and experimenting, in which some succeed and achieve further growth, while others do not and fail. Countries that create such a business environment, which supports the process of so-called creative destruction, will more easily realize the advantages of ICT implementation than countries in which such changes are carried out more slowly and with greater difficulty.

The challenges are also closely linked to the existing level of consciousness regarding the advantages that ICT implementation brings to companies in business and work. In that sense, business policies must be carried out in an appropriate way.

4. E-business and company innovativeness

The combination of Pilat's theoretical interpretations and value chain concepts⁹ were tested in practice by the European Commission's *E-Business Watch* study of 2008, which examined the application of ICT and its effect on company innovation and business. The study started from the premise that ICTs support innovation and productivity growth, which in turn has an effect on the economic success of company business. In that context, the study started from the following questions:¹⁰

- why do companies adopt ICTs;
- how do they use them; and
- how do they affect company business?

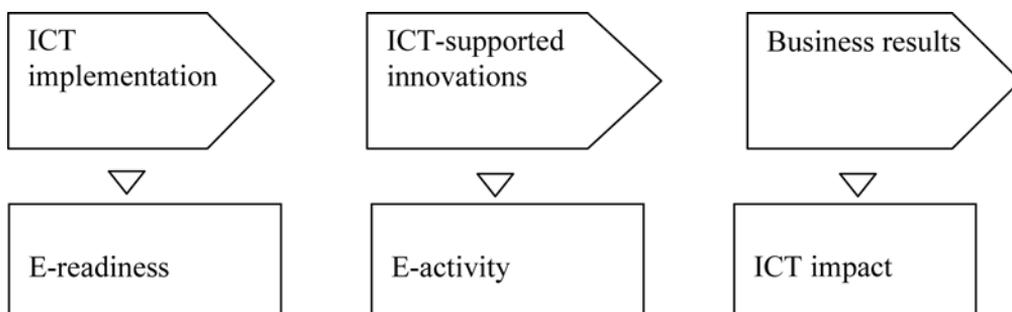
The ICT value chain was used as a conceptual framework for the study precisely because it allows an economic evaluation of ICT influence through the entire process of ICT evolution: from system adoption, i.e., from the acceptance, use and diffusion of ICT, its influence on the creation of innovations, to changes in business and related effects on business economic results. The study is based on an ICT value chain structure that consists of three segments (see Figure 1): 1) application and effects of ICT (e-readiness), 2) innovations supported and

⁹ Michael Porter recommends the value chain as a means of identifying ways of creating more value for the consumer. Within a company, the value chain represents a set of activities that the firm must undertake (from raw material purchasing to final product delivery to the buyer). Each step in the value chain adds a certain value in the creation of the final product.

¹⁰ European Commission, *E-Business Watch: E-Business in Europe-2008, Industry Perspectives on E-business Development and ICT Impact*, Brussels, 2008

made possible by ICT (e-activity), 3) implications for the company and industrial branch (ICT influence).

Figure 1: *ICT value chain structure*



Source: European Commision, *E-Business Watch: E-Business in Europe-2008, Industry Perspectives on E-business Development and ICT Impact, Brussels, 2008, p. 40*

The study offers an economic evaluation of the conditions that affect the adoption, use and diffusion of ICT, its effect on the creation of innovations and linked effect on economic business results. The fundamental premise is that ICTs have an impact on company business, setting in motion the innovation process, which, on the other hand, depends on the company's internal and external characteristics. These characteristics include available knowledge and abilities, distribution channels and corporate culture, which vary and differ from company to company and from sector to sector. Innovations are affected by demand price elasticity, type of innovation that ICT allows and the timing of innovations in relation to other innovations on the market. Another premise is that ICT adoption and application in themselves do not automatically stimulate innovation. However, ICTs can indirectly impact company business by enabling work productivity growth, redesign and a new conception of business processes and the development of new products. Within the framework of the said three segments of e-business analysis, the following hypotheses, presented in Table 2, have been defined:

Table 2: Hypotheses that interpret the impact of e-business on company operations in individual segments of the value chain

Segments of the value chain	Subject of study	Hypotheses
Factors that affect the adoption of ICT – <i>E-readiness</i>	Impact of ICT on company business and the relationship between structural development and the use and diffusion of ICT in companies and on the market.	<p><i>Hypothesis A1:</i> Growing competition on the market determines ICT adoption</p> <p><i>Hypothesis A2:</i> Companies that maintain long-term relationships with their suppliers and buyers are more likely to use technologies that support inter-company cooperation than other companies from their group.</p>
Innovations made possible through the application of information-communication technologies – <i>E-activity</i>	<p>A) The role of internal company potentials such as knowledge and capabilities.</p> <p>B) Cooperation within and between companies.</p> <p>C) Does ICT use influence the company's decision to outsource secondary activities.</p> <p>D) How is ICT diffusion correlated with organizational changes.</p>	<p><i>Hypothesis I1:</i> Companies that have a higher percentage of employees with a university diploma are more likely to realize ICT-supported innovations.</p> <p><i>Hypothesis I2:</i> Companies that use ICT applications in order to exchange information or cooperate with their business partners are more likely to realize ICT-supported innovations.</p> <p><i>Hypothesis I3:</i> ICT use is positively correlated with organizational change.</p> <p><i>Hypothesis I4:</i> ICT potentials are positively correlated with the process of outsourcing company business operations. The more advanced the company in the use of ICT, the more likely it is to outsource some secondary activities in the value chain.</p>

<p>Implications for the company and the industrial branch – <i>ICT impact</i>.</p>	<p>Degree to which ICT-supported innovations are linked to improved company business, and do such improvements include total productivity growth.</p>	<p><i>Hypothesis P1:</i> ICT-supported innovations are correlated with the level of company turnover. <i>Hypothesis P2:</i> ICT potential is positively correlated with market share change. <i>Hypothesis P3:</i> ICT capital has become a key element in work productivity growth and value creation, while the importance of non-ICT capital investments is falling. <i>Hypothesis P4:</i> MFP growth is accelerating along with growth of investments in ICT capital, especially in service branches that use ICT, such as retail, wholesale and banking. <i>Hypothesis P5:</i> ICT and employees with higher or middle education have a direct positive impact on work productivity growth.</p>
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Source: European Commission, E-Business Watch: *E-Business in Europe-2008, Industry Perspectives on E-business Development and ICT Impact*, Brussels, 2008, pp. 39-53

The study was based on the experiences of three industrial branches: the chemical, the lead and the furniture industry, and three service branches: retail, transportation-logistics and banking. The results obtained through testing the set hypotheses in the said branches are shown in Table 3, and interpreted in the subsections of the work that follow.

Table 3: Results of hypotheses testing

	C	L	F	R	T&L	B
ICT adoption, use and diffusion						
A.1. Rivals/competitors ↔ ICT adoption	No	No	No	(Yes)	Yes	n.a.
A.2. Connection ↔ ICT use	No	No	No	No	No	n.a.
Innovations						
I.1. Employee capabilities ↔ ICT-supported innovations	Yes	Yes	Yes	Yes	Yes	n.a.
I.2. E-cooperation ↔ ICT-supported innovations	Da	Da	Da	Da	Yes	n.a.
I.3. ICT availability ↔ outsourcing	Yes	Yes	Yes	Yes	Yes	n.a.
I.4a. ICT use (infr.) ↔ organizational change	No	(Yes)	Yes	Yes	No	n.a.
I.4 b. ICT use (soft.) ↔ organizational change	Yes	Yes	Yes	Yes	Yes	n.a.
Company business results						
P.1. ICT-innovations ↔ turnover	Yes	Yes	Yes	Yes	Yes	n.a.
P.2. ICT availability ↔ market share	Yes	No	No	Yes	Yes	n.a.
P.3. ICT capital investments ↔ growth of added value	No	No	n.a.	No	No	Yes
P.3. ICT capital investments ↔ work productivity growth	(Yes)	(Yes)	n.a.	(Yes)	No	No
Reduced significance of non-ICT capital	Yes	No	n.a.	(No)	(No)	(No)
P.4. MFP growth accelerated with the aid of ICT capital	No	(Yes)	n.a.	No	No	(Yes)
P.5. ICT & middle-educated work ↔ force work productivity	Yes	No	n.a.	(Yes)	No	No

Source: European Commision, E-Business Watch: *E-Business in Europe-2008, Industry Rerspectives on E-business Development and ICT Impact*, Brussels, 2008, p. 51.

Legend: C – chemical industry, L – lead industry, F – furniture industry, R – retail, T&L – transportation and logistics, B – banking.

4.1. ICT implementation

Within the first segment of analysis, the EBW study tested the factors that influence ICT adoption in a company. The goal was to observe the impact of ICT on company business and the relationship between structural development and the use and diffusion of ICT in companies and on the market.

Growing competition on the market can be an important factor that stimulates the adoption of new technologies and innovations, since companies tend to seek new chances to lower costs, in the process improving the efficiency of the business process or new product development (Hypothesis A.1 – is the most evident in retail, transportation and logistics; see Table 3).

According to the results of the analysis in all tested industrial and service branches, the nature of the relationship between buyers and sellers does not play a significant role in the process of diffusion of ICT implications (Hypothesis A.2). Usually it is the competitive relationships in the branch that motivate companies to adopt ICT, with the goal of achieving a better market position through more innovative ways of doing business.

4.2. Innovations made possible by the implementation of information-communication technologies

In order to be able to understand all the factors that influence the creation of innovations supported by IC technology, the EBW study studied the following factors in its second segment: a) role of internal company potentials such as knowledge and capabilities; b) cooperation within and between companies; c) does ICT use influence a company's decision to outsource secondary activities; and d) how is ICT diffusion correlated with organizational change.

In all the analyzed branches, the success of the ICT innovation depends on work force availability and quality (see Table 3 – Hypothesis I.1). ICTs are the most productive when combined with complementary investments in work practice, human capital and company restructuring.¹¹ The stock of knowledge and work capabilities influences the the company's absorption capacity to adopt new technologies.¹² This, on the other hand, has a positive influence on the company's innovational activities. Thus, in order for a company to be able to develop marketable products and implement adequate ICT-based business processes, it must first build complementary assets in the form of knowledge and expertise

¹¹ T. F. Bresnahan, S. Greenstein, "Technical Progress and Co-Invention in Computing and the Use of Computers," *Brookings Papers on Economic Activity: Microeconomics*, 1996, pp. 1-77

¹² W. Cohen, D. Levinthal, "Innovation and Learning: the two faces of R&D," *Economic Journal*, Vol. 99, No. 397, 1989, pp. 569-596

stock. Also, it must invest in employee training and the organizational transformation of the company that will accompany investments in ICT.

ICTs have a direct effect on the innovation process, as they support interorganizational ties (Hypothesis I.2).¹³ Interorganizational integration and cooperation enabled by ICT improves company innovation capacities by enabling the division of learning, technological knowledge transfer and raw materials exchange. The most obvious advantage of informational integration with the aid of ICT is value chain optimization. A less obvious effect for company innovativeness is the creation of a communications infrastructure that supports the production network, or allows partners to unite their initiatives (multiple players) by creating joint business units or teams working on the same task. The use of electronic networks leads to a greater probability that companies will cooperate in innovational activities and increase the scope of their cooperation.¹⁴ Thus, there is a close link between ICT-enabled innovations on the level at which companies electronically exchange information. Companies use various means (SCM systems, applications that allow cooperation between partners in product design, electronic exchange of information on inventory levels or production plans with business partners), and this depends on the branch or sector. For each sector, some means are more important than others. In all analyzed industrial and service branches, interorganizational integration and cooperation make a positive contribution to the innovativeness of the companies in question (see Table 3).

The intensity of ICT use increases the probability of realizing the company's organizational transformation. Quality of human capital is less significant for organizational changes than for ICT-supported innovations. The most frequent organizational change is the outsourcing of certain business activities (Hypotheses I.3 and I.4).

4.3. ICT implications for the company and industrial branch – company business and productivity growth

In the last segment of the ICT value chain, the subject of analysis is the degree to which ICT-supported innovations are linked to improved company business, and whether such improvements include overall productivity growth.

As shown by the findings in three industrial and three service branches (Table 3) in the EBW study, ICT and e-business eliminate location limitations and allow a company to expand independently of geographic borders. The company easily crosses country and industrial branch boundaries, thus increasing its potential market share. In other words, ICT-supported business models allow

¹³ H. L. Lee, "Creating Value through Supply Chain Integration," *Supply Chain Management Review*, September/October, 2000, pp. 30-36

¹⁴ European Commission: *E-Commerce and firm performance. An assessment using multiple survey sources and linked data*, 2004

companies to enter markets and overcome (leap over) existing market innovators. In that way, greater ICT potentials are positively correlated with market share growth in all analyzed branches. Also, companies that realize ICT-supported innovations are more likely to experience growth in company business turnover (Hypotheses P.1 and P.2).

More recent research suggests that changes in company business are not directly caused by changes in ICT capital, but by ICT-supported innovations. The EBW study also confirmed that ICT capital does not have a direct influence on various processes of adding value within the framework of the company value chain, but that ICT capital allows company management to introduce various innovations that are, in return, supposed to improve company business (Hypothesis P.3).

In addition to the various effects of ICT on productivity growth, it is generally accepted that ICT has a positive influence on overall factor productivity, as well as on work productivity.¹⁵ It has been especially confirmed that ICT has a great effect on productivity growth in ICT production sectors and in some service branches such as retail, wholesale, finance and telecommunication services (Hypothesis P.4).

A second factor that can influence the level to which ICTs enable productivity growth is the complementarity between ICT capital and the work force (work capabilities) (Hypothesis P.5). ICT increases demand for an educated work force and the creation of jobs for such employees while, on the other hand, reducing the number of jobs for uneducated workers. Also, the difference in wage level increases in favor of educated workers.

4.4. Conclusion and the political implications of the analysis of ICT implementation along the company value chain

The central conclusions of the EBW study can be formulated in the following way:¹⁶

- ICT use does not by itself impact company business; rather, these technologies allow companies to improve work productivity, to rethink and improve processes and to develop new products. In this way, ICTs are seen as a factor that enables innovations and productivity growth.
- Growing competition compels companies to use ICT in order to lower costs and find more innovative ways of doing business.
- Companies with long-term contractual relationships with business partners are more likely to use ICT, which in turn allows them to use a new

¹⁵ D. Pilat, *The economic impacts of ICT-lessons learned and new challenges*, OECD, 2005, p. 10

¹⁶ European Commission, *E-Business Watch: E-Business in Europe-2008, Industry Perspectives on E-business Development and ICT Impact*, Brussels, 2008, pp. 39-53

organizational structure and realize ICT-supported innovations, which brings additional business benefits.

- Once a company begins using ICT, its educated work force and intense use of electronic systems of information exchange such as SCM systems increase the likelihood of creating ICT-supported innovations. Intensive ICT users will also change their organizational structure and outsource their non-core activities.
- At company level, there is evidence that ICTs bring growth in turnover and market share. At sector level, these relations are less pronounced and evident.
- Larger companies more easily implement ICT and realize ICT-supported innovations. In that sense, there is a gap between large companies and MSEs.

The EBW study has shown the necessity of focused and targeted measures directed towards greater ICT implementation and use in companies, with the goal of sustaining necessary competitiveness levels. In that sense, measures of improving the business environment in which companies make their decisions on EB implementation play a very important role.

5. Impact of e-business on the innovativeness and economic results of domestic companies

In order to analyze the impact of e-business on the innovativeness and economic results of domestic companies, it is useful to examine available statistical data (Table 4), which show that a significant percentage of domestic companies (98%) use computers in their business and have Internet access (95%). However, the use of ICT and e-business towards the goal of redesigning information and communication flows inside domestic companies, or integrating flows throughout the production process, stands at a very low level. This is shown by data according to which only 11% of companies in Serbia use ERP systems and only about 10% use CRM systems, which allow analysis of client information for the needs of marketing and the creation of long-term relationships with loyal customers. Most domestic companies still use the Internet only for marketing purposes, as only about 20% of them receive orders over the web or engage in online purchasing. In order for the real effects of expected savings brought by the adoption of information-technological tools to be realized in domestic companies' practice, a complete reengineering of their business and work organization is necessary, and information-communication services need to be integrated into the overall business system and business environment. Only then can we expect the benefits indicated both by Pilat's analysis and the *E-Business Watch* study, in

the sense of greater innovativeness, competitiveness and market positioning of companies that use ICT tools and have well defined and implemented e-business strategies. If new technologies are not linked with real changes in business structure, both in internal relations and processes and in external relations with buyers and external partners, there will be no positive effects for the domestic economy, while relations between actors within the value chain may be disrupted.

Table 4: *ICT use in domestic companies in 2009*

- As of 2009, 97.8% of companies on the territory of the Republic of Serbia used computers in their business.
- Use of computers is greatest among large companies (those with more than 250 employees) and middle companies (those with 50-249 employees), equalling 100%, while use of computers in small companies (10-49 employees) equals 97%.
- 94.5% have an Internet connection.
- 67% of the companies with an Internet connection have their own web site.
- 65.5% of the companies with an Internet connection use a DSL (xDSL, ADSL) connection.
- 68.9% of companies have Wire based LAN, 43.7% Intranet, 37.4% Wireless LAN, while 12.2% have Extranet.
- 11.3% of companies in Serbia used the ERP system in January 2009.
- 49.2% of large companies possess the ERP system, along with 21.6% of middle and 7% of small companies.
- 10.1% of companies in Serbia have used the CRM system, which allows analysis of client information for marketing needs, while 12.9% have used CRM for entering information on company clients and storage and availability for other company sectors in January 2009.
- 17% of companies have used the Linux "open source" OS.
- 22.4% of companies that have an Internet connection in the Republic of Serbia have ordered products/services over the Internet.
- only 19.9% of companies with an Internet connection have taken orders (other than e-mail orders) over the Internet

Source: Republic Bureau of Statistics: *Upotreba IKT u Republici Srbiji 2009*, Beograd, 2009, pp. 68-136

If we were to rely on the model laid out in *e-Business Watch* in domestic conditions, an analysis of the segments of e-readiness, e-activity and ICT impact would have to encompass the following necessary activities on domestic company level and on the national level:

- a) The *e-readiness* of domestic companies must start from the need of raising consciousness regarding the development and existence of the information society and the advantages that ICT and e-business can bring. It

is necessary to engage in consciousness raising regarding the existence of the information society on all levels, from the level of decision makers – politicians (which will push forward the process of reform), to the local community and company levels (in order to give them support in recognizing new opportunities).¹⁷

Access and infrastructure are the second important segment of e-business implementation in domestic conditions. A developed telecommunications infrastructure, and especially the Internet, is the prerequisite for e-business development. E-business cannot develop to a sufficient extent until a critical mass of users can come into a position where it can change the way in which it does business and the way in which public administration functions. An efficient reform of the domestic telecommunications sector has to include three key elements: private sector participation, opening the market for competition and active participation on the part of an independent regulatory body.

b) *E-activity*. In order for domestic companies to achieve a greater orientation towards the innovation of business processes, products and services through the implementation of ICT, an educated work force is necessary. In other words, training and education are necessary in order for consumers and companies to possess the necessary knowledge and abilities to efficiently use the new technologies.

Under such conditions, the question of improving and adjusting the system of ICT-related education and training, and the question of ensuring the possibility of Long Life Learning (LLL) are becoming a priority. Namely, in a knowledge society moved by technological changes, educating and training the work force to use contemporary techniques and tools in business is of key importance. These specific company employee capabilities are a prerequisite for the creation of ICT-supported innovations.

On the other hand, research results indicate the importance of educating ICT users, as this factor is even more important for the success of the ICT investment than the technology itself. Thus, companies must regularly invest in employee training and education, while the state must stimulate all citizens to learn to use IT tools and technologies. It is also important to establish cooperation between industry, government and educational institutions regarding improvements in ICT education. This includes the following activities: a) improving the quality and importance of business education through special developmental-educational programs for teachers; b) stimulating closer, preferably international cooperation between universities and industry, in order to promote research and development; c) designing training certificates and education diplomas in accordance with industry needs; d) promoting the development of quality criteria that will be accepted for e-education and e-certificates.

¹⁷ M. Vidas-Bubanja, *E-poslovanje: menadžment, tehnologije, aplikacije*, BPŠ, Beograd, 2010, pp. 367-394

The realization of e-activities in domestic conditions also requires the building of a domestic e-business environment, which still does not have a complete legal infrastructure. Starting from the premise that legal security and trust are the key to each commercial transaction, the credibility of e-business greatly depends on the potential of national legal organs to define and create a healthy and comprehensible legal base for e-business, one that will raise trust and confidence. It would be ideal to adopt national laws that would give digital signatures and electronic documents the same legal status possessed by written signatures and paper documents. The use of ICT in the realization of commercial transactions opens up numerous legal dilemmas and challenges, such as: validity of documents produced and exchanged electronically, security of commercial transactions and trust, questions tied to copyright and intellectual property in web-based commerce.

Growth of the domestic IT sector may represent a critical factor in the growth of the use of information-communication technologies in a large number of sectors of the national economy, since this is the sector that provides inputs to domestic companies that desire to adopt e-business techniques in their practice.

Of great importance are policies directed towards attracting foreign investment in the development of IT-related industries. Offering financial incentives and preferences in order to attract foreign capital in this area can have a cost impact on the domestic budget. It is important to make sure that foreign companies create as many links as possible with the domestic economy, through ties with domestic suppliers, domestic software companies and other service providers. An accent should also be placed on programs and policies that support the private sector, especially small and middle companies.

- c) *E-impact on the business of domestic companies.* The basic motives that should move domestic companies to adopt online communication are the following:
- 1) possibility of establishing direct communications with customers/users;
 - 2) global accessibility; and
 - 3) expanding business profit margins.

The process of globalization intensifies competition. Thus, web-presence has become a prerequisite for acquiring competitive advantages for domestic companies. However, Internet acceptance does not solely mean being connected to the web. In order to achieve the expected effects of savings, innovativeness and more successful business in practice, it is necessary to lay down the correct e-change strategies and secure a smooth transfer from traditional business to the new network economy. Greater market transparency, low entry barriers and direct communication between buyers and suppliers are causing dramatic changes in the global economy, which is something that domestic companies must realize on time, in order to begin the proper implementation of e-business in practice.

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BRANCHE SPECIFIC ELEMENTS IN SLOVAKIA'S RETAILING**

Abstract: *The objective of this paper is to explain main drivers of retailing industry in the last decade in Slovakia and to analyse three main groups of retailers in the country. The progress in retail evolution in the Slovakia's cities is evaluated by new shopping and retail formats. We also analyse logistics market, which started to develop only a few years ago; however, its results are impressive. As the relationships between retailers and consumers are changing remarkably during last years, the most important indicators of this process are highlighted in the paper. We conclude that retailers became more consumer-oriented, offering wider product assortments, additional services and better shopping conditions. In final part of the paper scenario for the next few years is developed.*

Key words: *retailing, shopping habits, buying behaviour, logistics, Slovakia*

JEL classification: L81, D12

1. Introduction

Slovakia became an autonomous state in January 1993, following a peaceful "Velvet Divorce", from Czechoslovakia. In May 2004, Slovakia acceded to the European Union, along with nine more countries including the Czech Republic, Hungary, Poland and Slovenia. The republic is therefore subject to all EU laws and directives. Slovakia has adopted euro currency on January 1st 2009. The corporate and personal rate of tax is relatively low – both fixed at 19 %.

Slovakia has a population of over 5 million people, 11 % of which live in the capital city, Bratislava. Bratislava is located at the western edge of Slovakia, on the border with Austria and Hungary. As such it is the only capital in the world which borders two other countries. Bratislava is only 50 km from Vienna and a hour's drive from the border with the Czech Republic.

Slovakia has traditionally had a strong focus on heavy industry. Under Communism it was an important centre for heavy machinery, metals and steel pro-

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duction. Building upon these manufacturing traditions, Slovakia's key industries today are automobiles and electronics, both of which have attracted a large number of foreign investors eager to take advantage of a cheap and skilled workforce, favourable tax rates and geographic location. Car manufacturers PSA Peugeot Citroen and Kia Motors Corp. Both opened new factories in 2006, and electronics giants Sony Corp. and Samsung Corp. also have operations here.

The aim of this paper is to present last development trends in Slovakia's retailing and in shopping habits of Slovakia's population. We also comment on rapid development in logistic parks, which supported the branche infrastructure.

2. Slovakia's Retail Structure

The retailing in Slovakia was privatised during the 1990s and has consolidated considerably since 2000. The main drivers of retailing industry have been: economic growth, which led to growth in consumer's purchasing power, rapid expansion of bigger formats such as hypermarkets or shopping malls and the entrance and strong expansion of international retailers. The growth has been achieved with a stagnating number of outlets, what meant that the bigger and stronger formats squeezed smaller and independent retailers out of the scene.

There are three main groups of retailers in Slovakia: the co-operative societies (*jednota*), domestic multiples and independents (mainly small shops, kiosks and a number of department stores), and international players.

Since Slovakia's accession to the EU strong international players established for some time to dominate the market. The infrastructure of suppliers is rapidly changing – the market has been penetrated especially with goods imported from neighbouring EU countries (Czech Republik, Poland, and Germany). Numerous Slovak companies on the other hand are concentrating more on export. Retailers are facing the new market situation by strengthening their competitiveness and escalating price wars.

The market has evolved due to increased foreign investment. The food market has traditionally been dominated by local retailers. In the face of increased international competition, the co-operatives have merged large proportions of their operations under the *Jednota Slovensko* banner, which is for the moment country's largest retail group.

Having entered the market by buying the ex-PRIOR department stores from the US Kmart in 1996 and subsequently expanding, Tesco is now the second largest retailer in Slovakia. This position is consolidated through an organic expansion rate of six new stores per year (including smaller outlets for less extensive catchment areas).

Other western grocery retailers actively expanding in Slovakia include (Billa (part of the German Rewe group), Kaufland (Schwarz Group Germany) and Rema 1000 (Reitan Norway)).

The non-food market also has a relatively large number of foreign retailers, including IKEA, bauMax, dm-drogerie-markt, Quelle and Neckermann, as well as Datart, an electrical retailer from the Czech Republic, in which Kesa Electricals from UK has a 60 % stake. Nay is the largest domestic non-food retailer, operating a chain of electrical stores.

The retailing market value share of grocery retailers increased steadily since 2005, mainly at the expense of non-grocery retailers. Larger grocery retailers chains started to build their own logistic centres in Slovakia, not only to supply their domestic outlets, but also outlets in surrounding countries. This trend was particularly beneficial to the further expansion of hypermarkets chains.

Non-grocery retailers witnessed increasing specialisation during last two years, as chains began to target specific groups of consumers. Among the most successful specialised non-grocery retailers outlets were those selling consumer electronics and DIY and hardware products.

Until economic reform in the late 1990s, there were no shopping centres in Slovakia. The influx of western food retailers (Tesco, Carrefour, and Ahold) has supported the development of galleria shopping centres – purpose-built retail warehousing shopping centres, anchored by a major hypermarket, typically located in edge- or out-of-town locations. The hypermarket is supported by smaller ancillary retail units, often with a clothing bias.

Table 1: Selected key retailers in Slovakia

Retailer	Country of origin	Operation (s)	No. of outlets	Sales (SKKbn)
Jednota Slovensko	Slovakia	Co-operative	2.318	30,0
Tesco	UK	Hypermarkets	41	22,1
Metro	Germany	Cash and carries	5	13,5
Schwarz Group Slovakia	Germany	Hypermarkets and discount stores	96	13,3
Ahold	Netherlands	Supermarkets and hypermarkets	25	11,2
Billa (Rewe)	Germany	Supermarkets	81	10,0
M-Market	Slovakia	Hypermarkets and superettes	195	4,8
bauMax	Austria	DIY	11	3,2
IKEA	Sweden	Furniture	1	1,5
Datart Megastore (Kesa)	UK	Electricals	7	1,5

Source: Mintel, 2008

The progress in the capital – Bratislava’s retail evolution is manifested in its four main shopping malls (by definition, free-standing multi-level sites, either in town-centre or destination edge-of-centre locations, with clothing-oriented retail propositions). The four key shopping malls cover around 150.000 m² of floorspace. The largest of these is the Avion Shopping Park by the airport, which now covers 96.000 m².

Discount stores now reach almost every type of consumer. Particularly strongly represented are multi-member households, i.e. families with children who have a high demand for every possible type of fast moving consumer goods. This is a group which is increasingly seeking out the discount stores. The same also applies to a growing degree to younger consumers, some of whom are still in education and some of whom are young, working singles. In addition, the phenomenon known as the “smart shopper” is on the March, looking for a combination of bargains for daily consumer goods on the one hand and quality, brands and prestige products for those special occasions on the other. This group now also belongs to the core shopper group of the discount stores.

Internet sales grew significantly in Slovakia, especially since 2007 and are anticipated to grow further. Most of the larger retailers have websites, but generally these are only a source of information and do not offer genuine internet shopping facilities. However, there are still factors hindering its development: these include low internet penetration, the relatively low penetration of home computers, payment problems and the high cost of telephone calls. Some genuine internet shopping facilities are available, mainly offering CDs, books, computer equipment and other consumer durables and groceries.

2.1. Trends in Retail Industry

The research in retail industry and buying behaviour shows that high-priced purchases, purchases worth the money and low-priced purchases appear simultaneously in shopping. The induced trend for polarization in retailing will therefore be prevailing for the future. Two distinct channels for product distribution have evolved, which both exist successfully: specialized dealers on the one hand and hypermarkets on the other hand. In between are the less outstanding distribution channels, such as the department stores, with only limited prospective for the future.

Generally, hypermarkets serve purchases that are felt riskless and therefore are carried out under saving orientation. As saving orientation does not necessarily mean buying “the cheapest possible” but also “luxuries at a bargain”, hypermarkets increasingly offer high quality branded products that are seen as incurring no problems and therefore bought as reasonably priced as possible.

On the contrary, specialized dealers serve the high-priced purchases that are considered as being important and risky. The wish to confirm the decision

is dominating. This requirement is met by a comprehensive product range and professional advice as well as a complete and competent service offering.

While hypermarkets are booming, the position of the specialized dealers will probably be less secure. Hypermarkets treat even at present into the classical assortments of specialized dealers, but without providing the service, advice and comfort.

Some guidelines for the specialized retailers can be extracted for their future:

- As narrow-margin offerings need much selling space with high rates of inventory turnover and low labour costs relative to sales, specialized dealers are handicapped as far as purchases worth the moeny and low-priced purchases are concerned. Therefore, a price war with hypermarkets is hopeless.
- Purchasers that feel a perceptible technical or social risk offer a chance for specialized dealers. They are ready to spend more if a comprehensive product range, advice, and service is offered. Thus, competent advice is the fundamental instrument for differentiation. Investing in training and development of the staff is a basic requirement for specialized dealers.
- Additionally, emphasis should be put on the depth of the assortment because depth signalizes competence and, combined with competent advice, can lead to a strategic competitive advantage. A deep assortment of high-quality and well-known brands corresponds with the brand preference of the high-priced purchases.
- For indicating competence to consumers in need of securing their purchase, a repair service can be of use. It should be organized as a profit center and by means of a cooperation of small and medium sized businesses it can be extended to a joint 24-hours-service.
- A lot of consumers in need of securing their purchase, have double income or are singles with demanding jobs.

They do not have the time for advance information: The lack of time forces these well earning consumers into hypermarkets (one-stop-shopping), although they would prefer the advice of specialized dealers in the city. But restrictive shop-opening hours (in some countries) make a concentrated shopping necessary, which is not possible in the city because of huge setup times (approach, looking for a parking place, walking around). First experiences with liberalized shop hours show that not the hypermarkets, but specialized dealers were able to improve their competitive position. In the light of this consumer potential, the very restrictive usage of the liberalization by specialized dealers seems to be quite astonishing: with representing only one third of the regular customers, this group is not large but generous.

Considering the above mentioned ideas, the common notion that consumers are looking for events while shopping and the act of purchasing is a developing

part of spare time occupation, is to be responded. An alteration of specialized shops to a “theatre of events”, should only be propagated, as far as these events can be characterized as “competent advice”, “deep assortment”, and “profound service”. Specialized dealers should not choose “glitter and glamour” for their store layout, but prefer a clear concept which supports fast orientation inside the shop. The customer is not searching for extravagance or iridescent events, but for competence and clear product information. Being close to the customer in order to ease the buying decision and process, is an important aspect in choosing a shop for consumers with higher income but short of time. Only by appearing as decision supporting specialized dealers (helping to solve problems) can, perhaps combined with a high price strategy, secure long-term success.

Hypermarkets have a strategic competitive advantage if they concentrate on purchases experienced as not problematical. There is also a considerable potential for success in offering branded products at reasonable prices. In this connection, however, the – very successful – specialized markets gave already the slip to the “classical” hypermarkets: their reasonably priced and deep assortment is a “paradise” for saving-oriented buyers of branded products.

At present, department stores are positioned in between the sketched “tracks of success”. The orientation towards “marble and luxury” without a clear distinction fails to meet the requirements of the diversified buyers. A clear strategic orientation is absolutely necessary: either the consumers of high-priced products in need of securing their purchase have to be attracted or one has to concentrate on riskless low-priced or reasonably priced purchases.

The total stock of modern warehousing in Slovakia is estimated at 420.905 m², the majority of which has been built in last five years. The logistics market started to develop only a few years ago; however, its importance within Europe is increasing. There is also a significant increase in the development of light-industrial properties.

As the Bratislava region becomes more expensive, manufacturers look towards the other regions of Slovakia, in the search of more affordable land and inexpensive labour.

In some cases, international developers have struggled to acquire suitable sites for development. Land ownership in Slovakia is very fragmented and land is usually owned by local farmers.

Table 2: Logistics parks in Slovakia

Scheme	Location	Total existing area (in m ²)	Total potential area (in m ²)	Developer / Investor
Autologistic Park	Bratislava - Lozorno	110.000	90.000	AIG/ Lincoln
PDC Bratislava	Bratislava - Svätý Jur	84.800	-	Parkridge
Devínska Nová Ves Logistic park	Bratislava - Lozorno	38.000	82.000	J&T / IIG
Senec Cargo	Bratislava - Senec	15.000	50.000	IPEC / UBM
Logistic Centre	Bratislava - Rača	66.605	-	HB Reavis
Bratislava Logistics Park	Bratislava	34.500	122.500	Karimpol
Westpoint D2 Distribution Park	Bratislava - Lozorno	30.000	55.000	Merill Lynch / Pinnacle
Logistic Park Svätý Jur	Bratislava - Svätý Jur	-	36.000	HB Reavis
PDC Sereď	Bratislava - Sereď	-	145.000	Parkridge
Bratislava Business Park (BBP)	Bratislava - Petržalka	12.000	-	Across
Eurovalley - phase I	Bratislava - Malacky	-	66.000	HB Reavis
Sever Industrial Park	Nitra	15.000	-	J&T / IIG
Trnava Logistics Park (PSA)	Trnava	138.500	25.000	J&T / IIG
Tesco Distribution Centre	Beckov	15.000	-	Parkridge
Punch Campus	Námestovo	53.000	25.000	Punch International
KIA	Žilina	163.000	-	Glovis / ALS

Source: King Sturge, 2007

2.2. Slovak shopping habits

Relationships between retailers and consumers also changed during last years. Retailers became more consumer-oriented, offering wider product assortments, additional services and better shopping conditions. Within retailing, current value sales of private label products increased steadily in the last decade.

Since 2005 consumers are investing more and more in household goods, furniture, DIY products, consumer electronics and electrical appliances. Slovak shoppers are more willing to take on debt. As a result purchases on instalment and credit purchases face a great boom.

Slovak consumers are price sensitive and demand value for money. Consumers outside of the large towns have lower purchasing power and look for cheaper products. Those on lower income still buy cheap clothes and footwear from market stalls, often run by Chinese or local traders.

Consumer attitudes are shaped by advertising, changing demographics and global influences. Slovak families have become used to one-stop and once-a-week shopping, thanks to the growth of modern shopping centres offering longer opening hours, home deliveries and, in case of household goods, also favourable credit facilities.

Slovak customers shop impulsively and react very sensitively to leaflet campaigns. Households with higher number of members, with average and higher income, have tendency to buy also goods which were not included on their shopping list. It is evident that clearly signed price discounts, conveniently placed products, product presentation, or possibility to try the product on the spot will have success by many Slovak customers.

Half of Slovaks who are responsible for shopping for household have tendency to impulsive shopping which is not planned in advance. The other half usually buys only the products they had intended to buy.

Table 3: Slovak shopping habits

Which of the statements best identifies your attitude to shopping:	
In the shop I only buy the goods which I had planned to buy	51 %
In the shop I often also buy other goods than those, which I had planned to buy	49 %

Source: GfK Slovakia, 2007

Another feature of Slovaks is their sensitivity to leaflets, through which chain stores introduce themselves to the customers, and bring attention to their current product offer. As much as 85 % of Slovaks who are responsible for shopping for their households receives and reads leaflets. Almost half of them actually follow the information stated in the leaflets when shopping.

Leaflet campaign is effective mainly among the people with secondary education – roughly 40 % of them not only read the leaflets but also use them as guides in the shopping.

Table 4: Attitude towards leaflets

Do you get leaflets to your mailbox? If yes, do they influence you when you are shopping:	
Yes, I get them, read them and follow them when I am shopping	39 %
Yes, I get them and look them through	46 %
Yes, I get them, but I do not read them	8 %
No, I do not get them	7 %

Source: GfK Slovakia, 2007

3. Conclusion

The aim of the paper was to offer a picture of the retail industry and wholesale in Slovakia. Because of the small size and small market of Slovak Republic, the competition between players is very tough. New, international companies which have entered the country in the years 2007-2009 have strengthened the competition tremendously.

As for the scenario for the next few years, the industry growth will be influenced by gradual saturation, number of active players, lower purchasing power on the customer site, but also by the conditions or support offered to the industry players.

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THE STRUCTURAL CHANGES AND RESULTS OF AGRICULTURAL COMPANIES IN THE SLOVAK REPUBLIC**

Abstract: *The aim of this paper is to find out and analyze structure of entrepreneurial entities in Slovak agriculture by use of standard statistical methods. Based upon the results of the analysis, I shall evaluate development trends and possibilities for further development of predominant forms of farming operations in the Slovak Republic.*

Key words: *agricultural farms, legal persons, natural persons, crop output, animal output, economic revenues*

JEL classification: Q15, O13

1. Introduction

Agriculture in Slovakia contributed to national GDP in year 1999 ca 4 %, but in year 2007 it dropped to 2.55 %. In 2004, over 79 % of the agricultural cooperatives were profitable and it was expected what influence would be coming from Common Agricultural Policy and from joining the European Union. In year 2007, 89.1 % of individual farmers without employees were profitable, with average profit of 2,291 Slovak Korunas (76 EUR) per hectare of agricultural land. Extraordinary successful economic results were, on the other hand, reached on account of liquidation of numerous economically ineffective farms.

2. Data and methods

As a base, the paper uses data from CD list of the Ministry of Agriculture of the Slovak Republic. The ministry collects data from 2,509 entities, out of

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which more than 50 % are agricultural farms. The reasons for processing these data are:

- 1) Magnitude of the data and their representativeness, which is suitable for using comparative analysis. It is currently the broadest undertaking concerning use of the data from agriculture in Slovakia.
- 2) The data are collected annually, which means that for having the analysis more precise, there is a possibility to use time series and process the data continually (up to the length of the time period under evaluation).

Comparison of economic results of individual farms was completed for years 2004 and 2007 (year 2007 was the last one for which the data were available at the time of analysis). The methods employed were the general ones – analysis and synthesis, induction and deduction; as well as standard statistical methods – index method, calculation of mean values, medians, etc.

3. Ownership structure in Slovak farming

Agricultural farms in Slovakia are currently relatively stabilized, despite economic crisis. To support entrepreneurship in agriculture, Slovak government adopted in 2002 the “European charter of small enterprises”, based upon which conditions for agriculture entrepreneurship have partially improved. The most important adopted measures are as follows:

- Education and training for agro-entrepreneurs,
- Enhancement of on-line access to information,
- E-commerce and websites,
- More advantages implying from single European market,
- Representatives of small businesses in various committees on national level.

Slovak agricultural companies – farms, undergone substantial changes which resulted in changes of structure of their ownership and in changes related to acreage of agricultural land.

Acreage of cultivated land in Slovak Republic does not correlate with economic results of entrepreneurial entities active in agriculture. If calculated per 1 hectare of agriculture land, the situation is very interesting: production is the most profitable in the largest companies, while the medium-sized ones have problems. Small family operations are profitable only if they are subsidized.

Because of the situation in recent years we decided to research structure of entrepreneurial forms in Slovak agriculture and to compare years 2004 and 2007.¹

Based upon number of individually farming farmers (“IFF”) as of December 31, 2004 there is prevailing number in category of natural persons – 6,669. Average acreage of cultivated land for IFF was only 42 hectares. As of December 31, 2007, there were 6,893 IFF which means only a moderate increase by 3%.

There is interesting switch in acreage of cultivated land – in year 2004 the largest acreage of agricultural land in primary production (crop products and animal products) in Slovakia belonged to cooperative sector.

Table 1: Basic characteristics of legal persons in agriculture in the Slovak Republic, 2004 and 2007

Indicator	Year 2004		Year 2007	
	Number of companies	%	Number of companies	%
Legal persons total:	1,917	100.0	2,041	100.0
out of that:				
- agricultural cooperatives	668	34.8	603	29.5
- private inland companies	1,171	61.1	1,285	63.0
- state agricultural firms	6	1.0	5	0.3
- other legal persons	72	3.1	148	7.2

Source: Green report, Ministry of Agriculture SR, Bratislava 2005, 2008, p. 6, 80

Author’s calculations

Out of the total acreage (hereon only “t.a.”) 2,083,513 hectares, the transformed cooperatives owned almost 49 %, with average acreage of 1,596 hectares, and more than 37.1 % - with average acreage 931 hectares - was owned by private inland (commercial) companies. The predominant form of ownership continually passes to capital companies, mostly limited liability companies. While tracking structure of ownership one can see gradual “decrease” of cooperatives. Crucial form of ownership in legal persons became limited liability companies.

¹ This topic was subject of works by P. Bielik, M. Račániová, “Competitiveness Analysis of Agricultural Enterprises in Slovakia”, *Agricultural Economics*, Česká zemědělská univerzita, 50 (12), 2004, pp. 556-460; E. Šúbertová, “Formy podnikania v poľnohospodárstve”, Kapitola 3, in: Grznár, M. et al.: “Podnikanie v agropotravinárstve”, *EKONÓM*, Bratislava, 2006, pp. 46-57; E. Horská et al.: *Internacionalizácia poľnohospodárskych podnikov SR*, SPU Nitra, 2008; M. Kubanková, *Ročenka VÚEPP*, Bratislava, 2006; L. Lesáková, “Small and medium enterprises in the Slovak Republic after Slovakia’s accession to European Union”, in: *Small and medium enterprises in are of globalization and integration*, Banská Bystrica, EF UMB, 2006; E. Šúbertová, “Current situation in co-operative entrepreneurship in Slovakia”, in: *VADYBA Management*, No. 1, 2007, pp. 68-74, et cetera.

Out of 1,171 private inland companies in Slovakia in year 2004 there were 1,044 (89 %) limited liability companies, while in year 2007 it was already 1,159 Ltd's out of 1,295 private inland farms - commercial companies, which is 90.19 %. On the other hand number of cooperatives decreased in year 2007 compared to 2004 by 5.3 % from 668 to 603.

Starting new commercial companies, namely limited liability companies, or in some cases joint stock companies, became a failback for those entrepreneurial which were burdened by "past debts" and so the problems with settlements of ownership relations solved by transferring the functional property to a new commercial company and the bad debt left behind with the old company. Therefore during the years 1999 to 2007 the number of private commercial companies arose to the level of 296 % at the expense of agricultural cooperatives.

Cooperatives, contrary to private inland farms – commercial companies, are slowly creating joint so-called food verticals together with processing industry and trade. Agricultural cooperatives can secure over 30 % of the food production in Slovakia, but they have substantially lower effectiveness of work measured by added value per one person. While this index is 207 thousand SKK for cooperatives, it is already 227 thousand SKK for private commercial companies.

4. Discussion: Economic results of farmers in the Slovak Republic

Slovak farms have currently substantially higher outputs (revenues) from crop production, than from animal production, calculated per hectare of agricultural land (hereon "a.l."). According to soil-climate conditions, the Slovak Republic (SR) is divided into five production regions (by prevalent crop): corn, sugar beet, potato, potato-oat and mountain production region (PR). Traditionally, higher revenues from crop production are in corn PR, which is a logical outcome of favorable soil-climate conditions.

Table 2: *Economic results for agriculture: crop and animal output shown by production region in the Slovak Republic in years 2004 and 2007, calculated in SKK per 1 hectare of a.l.*

Indicator	Corn PR	Sugar beet PR	Potato PR	Potato-oat PR	Mountain PR	Average SR 2004	Average SR 2007
Crop output	16,259	11,772	5,910	3,409	1,519	10,396	31,255
Animal output	15,688	22,205	10,946	15,854	11,387	16,187	28,071
Total	31,947	33,977	16,856	19,263	12,906	26,583	59,326

Source: M. Kubanková, V. Burianová: *Vlastné náklady a výsledky hospodárenia poľnohospodárskych podnikov v SR za rok 2004 v triedení podľa výrobných oblastí*, VÚEPP Bratislava, 2005, p. 57

Author: Own calculations

In crop output, cereals production are grown on 59.5 % of agricultural land, canola 11.7% and sunflower 4.9%, while other crops are planted on less than 2 % (potato, sugar beet, horticulture). On the other hand, these crops have the highest yields per hectare: sugar beet 44.89 t/ha, 20.92 t/ha, potatoes 16.19 t/ha. Absolutely highest crop production in Slovakia is permanently the production of cereals – almost 3 millions of tons, with ca 50% of it is accounted for wheat. Slovak cereals production is higher than their consumption, which means full self-sufficiency in this commodity.

In animal output, there is a decrease in numbers, especially in grazing live-stock. By the end of year 2007 there were ca 952 thousand hogs in Slovakia, which was 13.8% less than the year before. The reason is in increasing prices of feed on input, while there are decreasing prices of production on output. There were also 502 thousand of cattle in Slovakia by the end of year 2007 and gross production was higher by 5.4 % compared to year 2006. There was also increase in results of animal output by 5 %, especially milkiness which reached 5,951 kg/year. Production of poultry decreased by 11.4 %, from 95,136 tons to 84,309 tons of poultry weight. Breeding of sheep is a stabile part of animal production, with ca 350 thousand sheep.

Average economic results – profit (loss) by individual production regions (PR) in Slovakia calculated per 1 hectare of agricultural land is shown in Table 3. The difference between corn PR and mountain PR was over 48-fold in the set of researched companies.

Table 3: *Average profit (loss) by individual production regions (PR) in the Slovak Republic; calculated per 1 hectare of a.l. in SKK*

Indicator	Corn PR	Sugar beet PR	Potato PR	Potato-oat PR	Mountain PR	Average SR 2004	Average SR 2007
Profit (+)	+4,227	+2,046	+999	+2,273	+88	+2,408	+2,846
Loss (-)							

Source: M. Kubanková, V. Burianová: *Vlastné náklady a výsledky hospodárenia poľnohospodárskych podnikov v SR za rok 2004 v triedení podľa výrobných oblastí*, VÚEPP, Bratislava, 2005, p. 59; M. Kubanková: *Ročenka*, VÚEPP, Bratislava, 2006

It is interesting to note, that companies, which are working in worse soil-climate conditions, as is for example potato-oat PR, have better economic results than companies in sugar beet PR. It is clear, that optimizing a production structure in worse conditions can secure better results than inadequate use of production resources at hand as for example in potato PR.

However, due to increasing costs of inputs, the price scissors in agriculture in general continue to open up more and more. Productivity of work does not

reach required levels, which is true in particular for agricultural cooperatives, because if the cooperatives want to keep their employees and to behave socially, they have to create for their employees also adequate working conditions.

Results under average are shown by northern and eastern regions, with differences compared to others are more than double: for example in Bratislava region, which is in corn PR, in year 2003 the intensity of production was 2.6 times higher than in Presov region, which is in potato-oat region. However, Presov region participated on the profit more than 2.8 times more than Bratislava region. This is caused by various reasons:

- a) different production structure in the two regions (in Bratislava region prevails intensive products like grape vine, which requires high input costs; while in Presov region there is a high percentage of permanent grass);
- b) low cost in case of extensive farming, which results in higher profits (in Presov region even had the highest number of profitable farms in Slovakia – 122. Presov region, in its worse soil-climate conditions, created profit over SKK110 million, which is SKK 901,640 per 1 farm. The second was Trnava region, in which 119 agricultural farms created profit SKK236 million, which gives on average SKK1,983,200 per 1 farm).

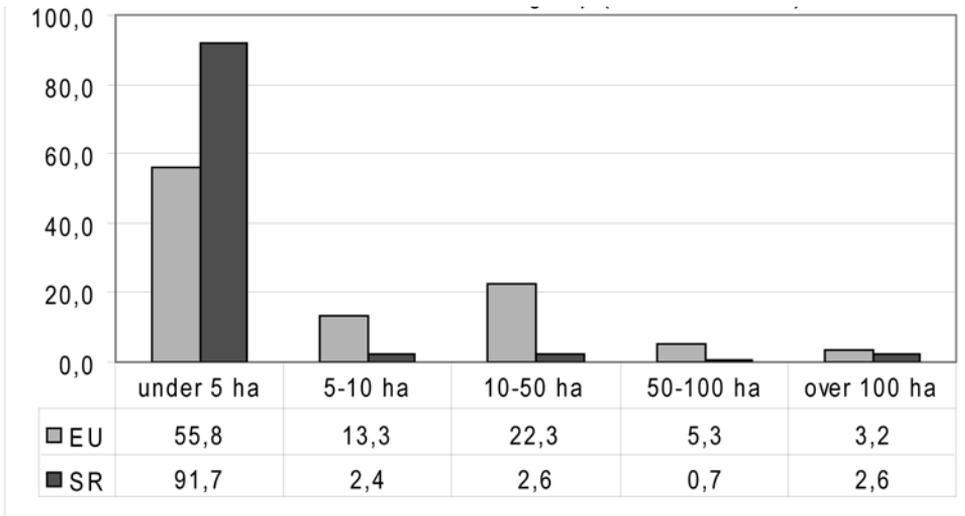
Slovak agro-entrepreneurs can now apply for financial support of their activities from structural funds of the European Union, namely:

- From the European Regional Development Fund (ERDF) which is intended for financing infrastructure, creation of job opportunities, support of small and medium enterprises, local economic development, measures for improvement of environment, cross-border cooperation;
- From European Agriculture Guidance and Guarantee Fund (EAGGF) which is targeted to support countryside and assist farmers.

Slovak Republic has an opportunity to obtain up to EUR 1.969 billion from the EU during years 2007 to 2013, which is on average more than EUR 281 million a year. It is very desirable that all financial resources, whether being from abroad or domestic, should be used in optimum ways.

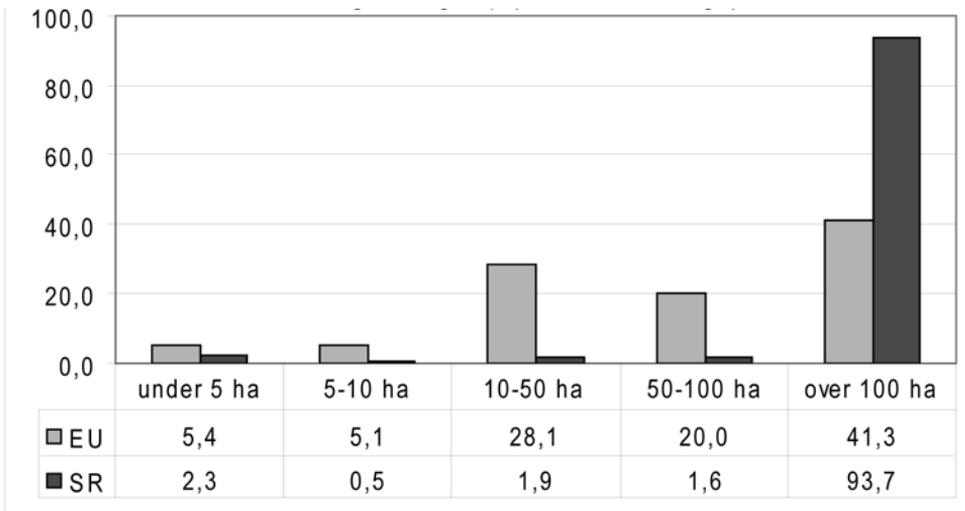
Slovakia has a problem with disintegration of agricultural land, having much higher proportion of farms with acreage below 5 hectares than is usual in other EU countries.

Figure 1: Number of farms in a group (% of total farms)



Slovak farms count for ca 1.7 % of the agricultural land of the EU, but only 1.02 % as to the number of farms. We can assume that that future development will head towards further integration of farms and, in relation to creation of food verticals, also to their internationalization.

Figure 2: A creage of a group (% of total acreage)



It is interesting to compare relations between size of the companies and their profits by 1 ha a.l. In general, there are two groups of profitable farms. The first group consists of small companies, with acreage below 50 ha a.l. and growing products supported by various funds. The second group is on the opposite side of the line as to the size: large companies with acreage over 500 ha a.l. which are capable to combine various produce and maximize their profits.

Table 4: *Economic results of self-employed framers in Slovakia*
Slovak Korunas (EUR) per hectare a.l.

Interval	Economic results with support on level of average wages	Economic results without support	Difference
0,1 – 50 ha a.l.	2,989	- 3,155	- 6,144 (203.94)
51- 100 ha a.l.	2,389	- 308	+ 2,697 (89.52)
101-500 ha a.l.	1,888	935	+ 2,823 (93.71)
over 501 ha a.l.	2,913	2,668	+ 245 (8.13)
Total (average)	2,291	800	+ 1,491 (49.49)

Source: Green Report, MP SR 2009

Author: own calculations

Clearly, support of small farms is a condition for their survival. These small firms are owned by people, with diverse qualifications for management. However, being an owner is the most decisive position. On the other hand, large enterprises usually employ professional management, which are able to work in difficult economic conditions.

5. Conclusion

At present, newly created private commercial companies which, contrary to cooperatives do not have any long-term liabilities, are more effective on markets.

Those were mostly agricultural cooperatives, being medium-size as to the number of their members as well as to their average land size, which were the major employers in countryside.

Newly created private farms – limited liability companies – are more efficient as agricultural cooperatives, but with fewer employees and without burdens of liabilities from transformation process. It is interesting, that most of profitable enterprises are from less-productive regions. The reason is their faster optimization of production structure (they are not involved too much in losing branches of business, are mostly oriented towards crop production, thus they have lower expenses in feeding livestock, etc.). Newly created private farms are more efficient as old agricultural cooperatives, because they have flexible top-management.

The most important tasks which enterprises in agriculture are the following:

- To secure adequate outputs, which are conditioned by economic stability and adequate inputs from industries (chemical industry, engineering, etc.);
- Restructuring the production in relation to market,
- Optimal use of production capacities in accordance to specific conditions in individual regions;
- To improve working conditions of employees with the goal to increase their labor productivity
- To employ professional managements which are able to made optimal decisions in agricultural enterprises
- To create vertical co-operation agricultural farms with processing food industry and trade.

They are possibilities for further development of existing forms of farming operations in the Slovak Republic.

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DEVELOPMENT OF ENTREPRENEURIAL BEHAVIOUR OF YOUNG PEOPLE IN THE REPUBLIC OF SERBIA

Abstract: *In this paper, the authors analyze the necessity of applying the contemporary concept of entrepreneurship in the Serbian market, with a special emphasis on the role of young people, and the possibilities of engaging them in entrepreneurial activities. According to the experience of developed countries, young people who are starting their own business for the first time represent an important category for developing an entrepreneurial climate on the national economy level. Serbia still does not have a favorable enough environment in which young people can be inspired to start their own business. As a possible solution emerges the encouragement and education of the young to start and run their own business. Encouraging entrepreneurial behavior among the young is especially important in countries in transition, which are facing transitory recession.*

Key words: *entrepreneurship, young entrepreneurs, small and medium-sized enterprises, competitiveness, knowledge.*

JEL classification: L26, M21

1. Introduction

The basis of successful business, especially on a global scale, is the creation of a favorable climate in an organization that stimulates entrepreneurial behavior, innovation and flexibility. In order to achieve unencumbered economic development, it is necessary to accept the model of entrepreneurial behavior on all levels. More and more companies, regardless of size, financial strength and ownership structure, are beginning to behave entrepreneurially, accepting the basic tenets of entrepreneurial business and using entrepreneurial management. According to experiences

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of developed countries, young people who are starting businesses for the first time represent a very important category for the development of an entrepreneurial climate on the national economy level. Young entrepreneurs in the European Union are offered significant stimulation through support programs, which increases their self-confidence in the process of starting their own business.

2. Contemporary tendencies in the development of entrepreneurship

Entrepreneurship presumes a continual creative process, whose basic goal is to implement innovations in the organization, in the function of successful business operations and of resolving the problems of consumers and society. Successful business in the 21st century will depend on a company's stance toward the increasing need for knowledge and the application of the latest technological achievements in managing the company, as well as on its capacity to transfer information to the consumer target group and buyers in the fastest, most understandable and most efficient way.

The contemporary organization must base its business on the entrepreneurial concept of behavior, which champions a strategic approach based on acceptance of risk, creativity, innovation and the responsibility of each individual for the organization's business operations. Special emphasis is placed here on innovativeness, due to the fact that our society is based on knowledge. Companies must **apply the entrepreneurial concept consciously and in an organized way and behave entrepreneurially**, as well as constantly engage in processes of innovation. In order for a company to be able to systemically engage in innovation, it has to create an appropriate organizational structure, which allows employees to act in an entrepreneurial manner. The company must establish a system of connections and relations that will allow focusing on entrepreneurial behavior.

Entrepreneurial behavior in the contemporary organization is not tied exclusively to one person and their abilities and experience; rather, it relies more on teamwork. In that sense, a model of **corporate entrepreneurship** has been developed that promotes teamwork, with members motivated to work on achieving success and accepting risk. **Big companies must stimulate entrepreneurship** in order to overcome the difficulties they face while learning to work with partners or allies. In their organizational structure, big companies create a unit that behaves completely differently from the rest of the organization.

P. Drucker¹ thinks that every big company must be able to do three different things at once – **improve, expand and innovate**. Drucker underlines that he has yet to encounter such a company, but that a large number of companies are working on it.

¹ P. Drucker, *Upravljanje u novom društvu (Managing in the Next Society)*, Adžives, Novi Sad, 2005, p. 82

Most developed countries are characterized by the following principles by which the labor market functions, especially when it comes to young people and their employment:

- 1) Youth unemployment is higher than adult unemployment, usually at least by a factor of two;
- 2) Increasing the level of young people's formal education is growing in significance, and this trend will continue in the future;
- 3) Young people fear marriage due to questions of social security, and opt for it in later years of life;
- 4) The participation of women in employment is increasing;
- 5) The labor market's programs for young people generally have a low rate of return.²

Government administrations of developed countries are trying to find new solutions regarding young people's employment, with special emphasis being placed on the creation of **entrepreneurial abilities among the young**. Self-employment represents a possibility for an individual to define their own model of business and development. Developed countries view self-employment as a measure that helps resolve the issues of youth poverty and employment, and, thus, aids the development of small business. Such actions find affirmation in the numerous potential benefits they offer, among which especially the following:

- entrepreneurship stimulates innovation and new job creation;
- entrepreneurship and new business startups directly increase employment by creating new jobs at the very start or in the near future;
- new small firms increase competitiveness on the national economy level, which benefits consumers;
- small entrepreneurs can meet market demands in a flexible way, especially when it comes to the use of new technologies and following market trends;
- higher level of youth self-employment gives young people more self-confidence, as well as social beneficence.³

3. Analysis of the competitive ability of domestic companies

The domestic economy has been experiencing labor productivity problems for a number of years. Insufficient business productivity, which was a result of an inadequate way of doing business – which was not based on market principles – was transformed into unrealistically high prices of certain products, which

² *Youth Unemployment: The Policy Agenda*, Promotional Activities, ILO, <http://www.ilo.org/public/english/employment/skills/targets/youth/sympo/id8nhtm>, p. 1

³ *Youth Unemployment: The Policy Agenda*, Promotional Activities, ILO, <http://www.ilo.org/public/english/employment/skills/targets/youth/sympo/id8nhtm>., p. 5

could not be placed on the global market. As a result, in order to successfully compete on the global business scene, domestic companies lowered their export prices, while the difference in non-productivity was paid by the domestic consumer through high prices. The market was protected with unrealistically high tariffs and other import limitations, and the domestic consumer could not buy products at realistic prices. A free market economy represents a great problem for countries that are undergoing transition from a planned economy to a sharp market battle. A period of adjustment is necessary for the participants, i.e., the state and the companies. The most frequent problem is connected with the difficulty with which such states renounce influence over market processes. The state should primarily concern itself with creating the conditions for the free transfer of people, goods and capital, while the market participants themselves will manage in accordance with their abilities.

Following the democratic changes, the beginning of the transition process also brought transformations in the economic sphere – bringing ownership, structural and institutional changes and improved efficiency in business operations. Processes of privatization, liberalization, restructuring, institutionalization and stabilization were initiated. The most significant results of the initiated transition process in the economic sphere were the establishment of a market mechanism and changes in market relations in the economy (from mostly state-owned to private).

The competitive position of domestic companies, in view of their reputation on the global market, is extremely unfavorable. Domestic companies mostly have not invested sufficient business effort into creating a reputation, as an element that influences a company's market position and competitive ability. According to the global competitiveness index of the Global Economic Forum,⁴ Serbia ended the year 2009 ranked 93rd among 133 countries that the index follows, which represented a fall of eight places in a year's time. It ranks behind Slovenia, Montenegro, Croatia, Macedonia, Hungary, Romania, Bulgaria and even states such as Panama and Kazakhstan. In this region, only Bosnia and Herzegovina ranks lower, at 109.

Table 1: Ranking Western Balkan countries according to competitiveness in 2009

Country	Rank
Slovenia	37
Montenegro	62
Croatia	72
Macedonia	84
Serbia	93
BiH	109

Source: "Privrednici – država glavna kočnica", *Novac*, January 28, 2009, Belgrade, pp. 4-5

⁴ "Privrednici – država glavna kočnica", *Novac*, January 28, 2009, Beograd, pp. 4-5

Obsolete technology, poor quality, unattractive packaging and high prices are the main reasons why domestic products cannot compete even with those from neighboring countries. The processing, metals and electronic industries are the least competitive, having gone on for years with no technological renewal. Businesspeople believe that increased competitiveness would require tariff and tax relief, reduced state duties and electrical energy, gas and fuel prices. It is necessary to raise the level of technological equipment, since the average age of machines in Serbia equals 30 years, or 12 years over the regional average. Serbia's economy technologically lags behind the EU by 29.5 years. This was determined on a representative sample of 154 small, medium and large companies in six economic branches with similar production programs.⁵ Comparison was made with the textile, food, pharmaceutical, machine and chemical industries, as well as the construction material industry. Austria was taken as the criterion, being a country with similar natural, social and population characteristics as Serbia. Textile companies lag the most (35 years), followed by machine industry companies (34.5 years). The smallest lag is among pharmaceutical companies (21 years). Regionally speaking, equipment, tools and other means of production lag the most in the region of southern Serbia (41 years), while the best situation is in the Bačka Region (18 years). Belgrade is lagging by 20.5 years.

The World Bank also gives the Serbian market low marks in its *Doing Business* report, which has ranked countries by quality of business environment for seven years in a row. More precisely, differently from similar reports that evaluate regulations, *Doing Business* evaluates business practices (Table 2).

During the last five years, 80% of the domestic economy's growth has been based on three business sectors – finance, trade and telecommunications. Since these are all service sectors, they generate no direct exports. A similar trend can be observed in other developing countries. In order to stimulate exports, direct investment into the production sector is necessary. When compared to other Central and East European countries, Serbia has the lowest share of foreign direct investments. Serbia lags far behind Romania, Poland and Bulgaria, which rank among the top ten most attractive locations for investment. In 2008, foreign direct investments in Serbia equalled 4 billion euros.

⁵ "Srbija prema EU tehnološki zaostaje tri decenije", *Blic*, July 16, 2009, p. 11

Table 2: Ranking Western Balkan countries according to the World Bank report for 2009

Country	B-H	Croatia	Macedonia	Montenegro	Serbia	Slovenia
Total index	116	103	32	71	88	53
Business start-up	160	101	6	85	73	26
Building permits	136	144	137	160	174	59
Employment	111	163	58	46	94	162
Property reg.	139	109	63	130	105	108
Credit availability	61	61	43	43	4	87
Investor protection	93	132	20	27	73	20
Paying taxes	128	39	26	145	137	84
Cross-border trade	63	96	62	47	69	84
Contract execution	124	45	64	138	97	60
Business closure	63	82	115	44	102	40

Source: M. Paunović, *Poslovanje u Srbiji, Fokus – kvartalni izveštaj o institucionalnim reformama*, Centar za liberalno-demokratske studije, Belgrade, October 2009, pp. 8-12

According to the data of the International Standards Organization, in 2008 there were 2,091 organizations that had introduced the ISO 9000 quality management standard (source: *The ISO Survey 2008*). Regardless of the growth in the number of organizations that have introduced a quality management system and the development of a movement for quality in the domestic economy, the general results are still unsatisfactory. The results of a survey that analyzed the competitiveness of domestic companies (May-June 2007, the market of the Republic of Serbia), indicate the following:

- Surveyed managers listed the following as the main obstacles to the development of domestic companies' competitiveness: lack of knowledge – 24.8%, obsolete equipment and technology – 24.1%, inadequate use of modern management methods and techniques – 16.54%, insufficiently stimulative business environment – 8.27%, lack of financial capital – 8.27%, internationalization of domestic companies' business – 2.34%.
- Surveyed managers listed the following as necessary elements for the development of domestic companies' competitive advantage: permanent improvement of managers' and employees' knowledge – 20.74%, standardization of quality of doing business – 20%, development of an entrepreneurial culture in the business environment – 17%, investment in the development of national brands – 14.8%, development of the concept of corporate entrepreneurship within organizations – 8.88%.⁶

⁶ Z. Sajfert, C. Bešić, N. Petrović, "Uloga korporativnog preduzetništva u procesu unapređenja kvaliteta poslovanja domaćih preduzeća", *Zbornik radova međunarodne konferencije JUSK 08*, JUSK, Beograd, 2008, pp. 259-260

4. Analyzing the conditions for the development of entrepreneurship in the Republic of Serbia

The completion of the transition process of changing the economic structure of society, through privatization, a market economy, liberalization of foreign economic relations, etc., is the basic precondition for a successful integration into international economic flows. The transition process should arm economic actors in a transition country with the ability of autonomous operation on the market, participation in healthy competition and doing business in an international setting. In order to successfully transform a planned economy into a market economy, it is especially necessary to **strengthen the private sector** and its future development. The development of the sector of small and medium companies is very important for privatization, as it allows its acceleration – SMEs represent an autochthonous private sector, which allows the development of domestic private capital.⁷

The development of the SME sector represents an important priority for the domestic economy. The Government of the Republic of Serbia has adopted a Strategy for the development of SME competitiveness and innovation for the period of 2008.2013. This strategy should contribute to a further strengthening and efficient use of the SME sector's development potentials, which will have a positive effect on the economic growth of the Republic of Serbia. Such an orientation should contribute to increased competitiveness and exports, the strengthening of companies' innovation capacities, a dynamic development of employment and a more even regional development.

In the Republic of Serbia, small and medium enterprises make up 99.8% of all companies, employing 65.5% of the workforce, making up 67.6% of sales, and accounting for about 36% of the gross domestic product. In total exports, the SME sector has a 50.2% share, 64% in total imports, and 51.2% in investments in the non-financial sector. Micro-companies dominate in the SME sector, with a share of 95.6%, and account for almost 50% of those employed.⁸

According to last year's data, almost 40,000 small businessmen have closed operations, including 3,455 companies and 34,909 entrepreneurial shops. Entrepreneurs listed the following reasons for this increase in business failures: numerous state duties, slow collection of accounts receivables, lack of favorable credit and high interest rates. According to a survey of the National Agency for Regional Development, the main problem that entrepreneurs face is lack of funding, followed by administrative barriers. Practice shows a situation in which domestic entrepreneurs have problems with liquidity and their inability to collect

⁷ D. Đorđević, M. Anđelković, S. Bogetić, *Proces tranzicije i domaća privreda*, KAS, Beograd, 2002, www.politikas.org.

⁸ "Strategija razvoja konkurentnosti i inovativnosti MSP za period 2008-2013", *Official Gazette of the RS* no. 55/05, 71/05-amendment, 101/07 and 65/08, Beograd, 2008

their accounts receivables, while the state requires them to pay their obligations within a specified period. As a result, companies are becoming over-indebted to the banks, leading to their failure.

A large problem for the economy of the Republic of Serbia is the number of closed and bankrupt middle enterprises. The cause for worry lies in the fact that the closing of a middle enterprise means a loss of 50 to 250 jobs, which are difficult to create in practice. The National Agency for Regional Development has also conducted an opinion poll of MSE owners, who listed lack of funds as their main problem in doing business, followed by: administrative barriers, lack of a qualified work force, lack of harmony with standards, lack of market information, lack of information on technology.

The Government of the Republic of Serbia is intensively working on resolving the problems that are interfering with the basic pillars of the MSE development policy. One of its priorities is the so-called regulation guillotine, which, through simplifying or eliminating unnecessary procedures, should save the economy around 120 million Euros. Namely, estimates show that, due to complicated and unnecessary procedures, the domestic economy annually loses at least 180 million Euros. The realization of this program will depend on the competent ministries and their readiness to tackle this problem. In order to ensure faster and simpler company registration and business operations, the state has allowed the assignment of tax identification numbers (PIB) during the process of company registration with the Agency for Business Registration (APR), which should facilitate company start-up. Another new feature for companies is that the annual financial statement can now be turned in at a single place within the APR, which was not the case previously.

The Ministry of Economy and Regional Development and the Serbia Investment and Export Promotion Agency (SIEPA) have participated for several years as the main partners in the Support to Enterprise Competitiveness and Export Promotion project (SECEP). This project is financed by the European Union, as part of the technical aid earmarked for helping the Republic of Serbia develop competitiveness and promote exports. A portion of this program is the development of a chain of local suppliers, which allows domestic small and medium enterprises to become a part of multinational company chains. One of the main obstacles in this program lies in the fact that a large number of domestic SMEs lack the quality standards demanded by corporations. As a result, there are situations in which domestic suppliers are not able to meet the strict criteria set by corporations.

As support to starting one's own business, the Government of the Republic of Serbia has adopted a program of favorable credits for beginners. The planned amount available for start-up credits equals 2.2 billion dinars. In the period between 2007 and 2009, on the basis of applications through the Ministry of Economy and Regional Development, the National Employment Service and the Development Fund, 6,625 new companies were opened and 21,121 people

employed, which indicates that the program was justified. Also, through the Development Fund, entrepreneurs can apply for start-up credits in the amount of 500,000 to 1.3 million dinars, with an annual interest rate of 2.5% and a repayment period of 3 to 5 years, with a grace period of one year.

However, according to data of the National Employment Service (NSZ), **767,418 unemployed persons were registered** in February 2010, which is an increase of 16,000 compared to January. NSZ data for 2009 reveal that the young make up 26.7% of those on unemployment rolls, of which the largest number are young people between 25 and 29 years of age (94,380), followed by the 20-24 age group (78,640). These unemployment data indicate that the financial resources being set aside by the Government of the Republic of Serbia are insufficient to cover all those who need them. This is especially true for the young, who are society's most valuable resource.

As a part of its effort to stimulate young peoples' employment, the Italian government has given 1.2 million Euros of support to Serbia. The program of youth employment has also been joined by the NGO sector, including the Open Society Fund, which has provided the NSZ with 570,000 USD for solving the needs of 400 young people between 15 and 29 in the Borski, Raški, Braničevski and Severnobački counties.

Unfortunately, young people lack sufficient business experience, and domestic companies rarely decide to employ them, being of the opinion that too much time is needed for their practical training, i.e., that their introduction to practical work costs too much. As a result, the Government of the Republic of Serbia has decided to provide financial grants to companies that employ a certain number of unemployed people, as well as to launch a program of youth employment entitled "First Chance 2010," whose goal is to offer young people practical experience in companies on a voluntary basis for a period of three months, as well as employment of interns for the purposes of professional training for a period of 12 months.

Also, it should be emphasized that the state has been financially helping the formation of clusters and the development of innovation in the domestic economy over the past several years, thus helping advance competitiveness in the domestic economy.

5. Surveying attitudes of the young on starting their own business

A survey on **Analyzing attitudes and opinions of young people on starting their own business** was conducted in the period of September 15 to December 24, 2009, on a sample of 520 students of management. The survey results showed that **most of the students, 80.73%, would like to start their own business. The reason given by students for not starting their own business in 78.42% of cases was lack of the right idea**, which indicates that, within the context of promoting

the concept of entrepreneurship in universities and junior colleges, it is necessary to impress upon students the importance of developing entrepreneurial skills.

Most of the surveyed students (60.38%) would rely on their own means in starting their own business. The reason for such a stance may be found in students' lack of trust in banks and other institutions that offer funds for business start-ups. Favoring this conclusion is the majority opinion of surveyed students **that start-up credits offered by commercial banks are unfavorable (53.74%)**. Namely, students feel that start-up credits offered by commercial banks have excessively high interest rates (80.38%) and that it takes a long time before the actual funds are disbursed (14.42%). Data obtained in a similar survey performed in 2008 show that students are not satisfied with the terms of start-up credits (54.03%), with high interest rates being the biggest complaint (33.79%). A survey conducted in 2009 showed that more than half of the surveyed students **(53.18%) were not informed about the existence of stimulus funds for business start-up**. However, according to the survey data, **54.44% of the students were interested** in obtaining such funds. Obviously, what is needed is a constant effort to inform young people by way of the media, public presentations at universities and junior colleges that would help keep them up to date. In that way, young people will receive the right information about terms of credit and ways of receiving them. These promotional activities need to be joined by the Serbian Chamber of Commerce, the Belgrade Chamber of Commerce, the National Agency for Regional Development, the Ministry for Sport and Youth and other institutions whose goal is to support employment of young people and to enable them to start their own business.

The surveyed students indicated that they are most deficient in the following knowledge: **foreign languages (21.62%), the basics of entrepreneurship and small business (20.66%) and the basics of management (17.3%)**. These data serve as an excellent indicator that the young realize that, in addition to basic knowledge, they also need to be versed in foreign languages and business communication (13.32%) in order to run a business successfully. Namely, for a successful businessman, the skill of communicating within the company and with business partners is of decisive importance.

A vast majority of students (88.08%) think that the Republic of Serbia currently **does not provide an adequate environment** that would stimulate them in starting their own business. As justification for their opinion, students listed the following limitations that bind them: **excessive taxes (35.51%), an unstable political and economic situation (29.92%) and a long and complicated registration procedure (21.62%)**. In the 2008 survey, students expressed dissatisfaction (78.70%) with the environment for stimulating the young to start their own business. The biggest obstacles to starting their own business were the same as those listed in 2009, except that they were ranked differently: **an unstable political and economic situation (36.54%), long and complicated registration pro-**

cedure (13.75%) and excessive taxes (10.02%). On the basis of the data obtained in these two surveys, it can be seen that the precondition for improving the SME sector is the creation of an adequate environment that will stimulate the creation of new and the development of existing SMEs. However, three elements are necessary for the creation of an adequate environment: laws/regulations, institutions and entrepreneurial associations. In that sense, it is necessary to establish a consensus between the state and its institutions and the associations, towards the goal of creating an adequate environment.

The largest number of those surveyed (**88.08%**) **thinks that the state should play the key role in stimulating the young in starting their own business. They list the following ways in which the state can provide support: promoting the concept of young entrepreneurs (25.38%), favorable credits (23.08%), and market regulation (16.15%), laws/regulations relating to young entrepreneurs (14.42%), education and the development of new business centers (10.38).** This viewpoint was also supported by 90.78% of the students surveyed in 2008, and the suggested methods of support were the same, albeit with different priorities: **promoting the concept of young entrepreneurs (26.86%), training (15.10%), market regulation (14.71%), favorable credits (13.14%), and laws/regulations relating to young entrepreneurs (11.76%).** The experiences of developed countries, including those of the European Union, have been translated into special programs for stimulating the concept of young entrepreneurs within which a number of institutions cooperate, resulting in the practical enablement of young people to run companies. This represents an added difficulty for our own young people that lack such experience, so this is something that must be worked on.

6. The paths of developing entrepreneurial behavior in the market of the Republic of Serbia

The future of the global economy lies in allowing regions to bring in wealth from the rest of the world. This places demands on regions to have at their disposal highly educated and disciplined people led by a visionary leader, capable of communicating with the rest of the world.⁹ Among such regions are Hainan Island (southern China, Guangdong Province), Vancouver and British Columbia (Canada), Estonia, Ho Chi Minh City (Vietnam), the Maritime Region and Sakhalin Island (Russia), Sao Paulo (Brazil), Kyushu (Japan).

American marketing professor of Indian ancestry, Mahajan, author of the global marketing best-seller *The 86 Percent Solution*, says: "The state does not create business opportunities. Entrepreneurs create opportunities. Whatever the state does, it must stimulate entrepreneurship. In this extremely competitive marketplace, what is important is which entrepreneur has the better idea,

⁹ K. Ohmae, *Nova globalna pozornica*, Mate, Zagreb, 2007, p. 256

who knows how to realize it better. Entrepreneurship is not the monopoly of the French, Germans, Americans, Chinese and Indians. The Western Balkan region is full of entrepreneurs. The problem lies in the fact that Western Balkan states are small. They are faced with the challenge of how to grow further. In order to grow further, they must have a global vision, must be able to look at all of the rest of the world and search for opportunities on the global level.”¹⁰

Serbia has all the preconditions to become such a region in the near future, providing that its domestic entrepreneurs urgently change their business philosophy. Owners of capital and managers are the ones who need to set down new elements of competitiveness in domestic companies. It is necessary to abandon obsolete management policies and techniques and to adopt modern management techniques, as well as to learn from the experiences of global leaders and of companies from newly industrialized countries that have achieved exceptional success on the global market.

There is a line of thinking¹¹ that says that long-term competitiveness is not increased by subsidies to industry, by a favorable exchange rate, a positive trade balance or a low inflation rate. Rather, competitiveness is improved by improving business productivity. The role of the state in all that is to create equal conditions for all the market players, to protect ideas, innovations, and property, to help wherever the interest of the entire group, rather than of individual companies, is served and not to determine the winners and the losers in advance. A constant increase in the business productivity of domestic companies and the creation of equal conditions for all business actors are the essential, long-term recipes for overcoming the crisis, in the first place the transition crisis.

In the process of developing entrepreneurial behavior in the Republic of Serbia, it is necessary to undertake several means of improving the business environment so that present and future entrepreneurs can do business more easily, using the following elements:

- Creating a legal framework for a faster and easier business process for entrepreneurs, including young entrepreneurs;
- The existence of a strategy for developing the concept of entrepreneurship among the young;
- Credit support for the young in starting their own business;
- Stimulative measures for implementing a system of managing the quality (individually and by group) of integrated management systems, towards the goal of developing the competitiveness of domestic SMEs;
- A more active role of universities in helping entrepreneurs;
- Starting up more business incubators and business centers;

¹⁰ “Zemlje u razvoju novi marketinški eldorado”, *Novac*, July 11, 2009, Beograd, pp. 8-9

¹¹ D. Đorđević, M. Anđelković, S. Bogetić, *Unapređivanje konkurentnosti domaće privrede*, KAS, Beograd, 2003

- A greater engagement of entrepreneurial associations in promoting the concept of youth entrepreneurship;
- Promoting the entrepreneurial concept as a way of overcoming the problem in a transitional recession.

It is important to underline that the issue of the development of entrepreneurial behavior is something that must be the task of a number of interest groups, such as: the state through its institutions and ministries, the universities, entrepreneurial associations, and the media, which can exert a positive influence towards the creation of an adequate environment for starting small businesses.

As we have already mentioned, the Government of the Republic of Serbia has begun work on improving the business environment by accelerating the procedure for company registration, offering more favorable start-up credits, practical enablement of the unemployed, etc. What is necessary is to make a strategy of developing the concept of youth entrepreneurship at state level, encompassing several parts: training, practical application of knowledge, institutions for supporting the young, etc.

Training is especially important and requires special attention, as early as primary and secondary school, reaching its climax at universities and junior colleges. Certain programs are already being implemented in secondary schools, but still without sufficient support on the part of the state, the business community and trade associations.

The practical application of acquired entrepreneurial knowledge is a separate segment of training, with key roles being played by: the Serbian Chamber of Commerce, the Employers' Union, and the National Agency for Regional Development, the universities, the Ministry of Youth and Sports, and the Ministry of Economy and Regional Development. In this way, the young gain the necessary experience, which they can later apply in real life through work in their own or another company.

The promotion of the concept of youth entrepreneurship is a separate part in which a number of segments of society should participate: the media, entrepreneurial associations, the competent ministries, universities, students' associations. As part of the promotional activity, the young need to receive information on the concept of entrepreneurship, the importance of innovations for the entrepreneur, the use of certain tools for developing and applying business ideas. Good examples are programs of the European Union that devote special attention to these problems.

Also, at public panels at universities or junior colleges, successful domestic entrepreneurs could talk about their beginnings, their reasons for starting their own business and the difficulties they faced until reaching the optimum level. In this way, domestic entrepreneurs can stimulate the young to start their own

businesses, as well as uncover the various prejudices and preconceptions held by young people.

7. Conclusion

The entrepreneurial economy is a reality in the global economy, in which the number of competitors rises by the day. The global economy presupposes uncertainty. Also, it offers huge opportunities to organizations and individuals that are sufficiently courageous and agile to adjust. I. Adizes¹² rightly observes that success comes from “within.” If we are strong inside, we can solve any external problem and accept it as a good opportunity. If we are weak inside, then each external opportunity will be seen as a problem.

A national economy that supports an entrepreneurial spirit creates the conditions for increased productivity through investment in the individual ability of the individual in society, as well as each firm, regardless of its mode of organization and ownership structure. Interest among the young for starting their own business is growing throughout the world.

During the past ten years, domestic companies have been insufficiently competitive on the international market, and the effects of the global economic crisis have merely magnified the problem of domestic companies’ low competitive capacities. Domestic companies do not face competition only from companies from developed countries, before all those from the EU, but also from newly industrialized countries, such as China, India, Brazil, Mexico, and Turkey. Domestic companies must make a clearer conception of their development strategies, especially in accordance with European and global integrational flows, while the application of contemporary methods and techniques of management, such as integrated management systems, marketing relations and corporate social responsibility, are a basic prerequisite of successful market development.

The results of the above-mentioned survey point to the conclusion that the state must have a key role in this area on the domestic market, through the **adoption of certain documents (Youth Entrepreneurship Development Strategy, Action Plan for Developing Youth Entrepreneurship) whose goal is to promote the concept of young people as entrepreneurs.** These projects must also include the universities, the Serbian Chamber of Commerce and its regional chambers, the competent ministries and entrepreneurial associations.

¹² I. Adizes, *Upravljanje promenama*, Adizes, Novi Sad, 2006, p. 187

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EMPLOYEES' APPRAISAL AS AN INDICATOR OF THE QUALITY OF HUMAN RESOURCES MANAGEMENT IN ORGANIZATIONS IN SLOVAKIA

Abstract: *The paper is based on research results from our survey performed periodically, focused on HRM functions in organizations. The paper is based on the latest data collected on a sample of 225 companies, in 2008. The aim of the paper is focused on employees' appraisal and to provide the reader with brief review of HRM in Slovak organizations. We believe that employees' appraisal system may be considered one of the indicators of the quality of HRM in an organization. Properly designed and realized process of employees' appraisal is not only the necessary basis for successful employee performance management, but also provides valuable information for other Human Resources Management functions. The findings and conclusions published in this paper are based on our continuous research focused on HRM functions in Slovak companies. HRM functions, including the system of employees' appraisal, is being monitored since 1998. Later on we have entered the Cranfield Network, thus we are capable of an international comparison.*

Key words: *employee appraisal, performance, Human Resources Management (HRM), research findings, Slovak Republic*

JEL classification: J24, L20

1. Why do we understand employees' appraisal crucial when measuring the quality of HRM in an organization?

Performing employees' appraisal places great demand on input information. To gather information for employees' appraisal is quite a difficult task. It not only requires employees' cooperation, involvement of line managers, and properly trained HR generalists, adequate methodology and good timing, but above all mature corporate culture. The key to an effective and beneficial employees' appraisal system is in systematic approach. We consider the application of systematic approach to HRM crucial for successful fulfillment of its mission

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within a company. Therefore we believe we may consider focusing on employees' appraisal reasonable indicator of HRM quality in a company.

The paper is therefore focusing on the issue of well designed and applied employees' appraisal system as offered by theory and afterwards provides the reader with the practical point of view emphasizing the relativities among other HRM functions. Since it is based on the latest research results, the paper contains brief view into actual situation in HRM in Slovak companies.

2. Why do we consider the issue of appraising employees in a company so important?

One of the essential aims of Human Resources Management (HRM) is taking part in reaching companies objectives by managing its personnel. This means to obtain and keep quality, professionally capable, responsible and loyal workforce, and meanwhile to create a system of managing human resources in a company, where individual functions of HRM are in mutual association, unison. To hire qualified employees is not enough. Today, there is a need to anticipate their potential and expectation and orientate on their utilization and satisfaction.

One of the first formulations of the concept of HRM was created by Michigan's school (Fombrun, 1984). HRM was understood as a cycle of four functions provided in all organizations.

- Selecting employees
- Appraising employees' performance
- Compensation system
- Employee development

This model seems very amateur in conditions of business environment at present as well as it is not acceptable in modern HRM. However it emphasizes the necessity of creating employees' appraisal system and its place within the system of HRM in an organization.

At the end of lead-in of this paper, we find important to appoint the difference between managing employees' performance and their appraisal. Managing employees' performance is rather oriented to the future and development. Appraising employees requires looking behind and it is usually performed from the top to the bottom. We will focus on performing employees' appraisal more in details within this paper.

3. How should be employees' appraisal understood by managers today?

Before we start evaluating the process of appraising employees in Slovak companies, we need to define what is employee's performance, or how should employers understand this term. Employee's performance is not only the quantity and quality of his/her work, which is very often the mistaken opinion of many managers, but it also includes attentiveness, approach to work, work behavior, discipline in following safety measures, presence and absence at the workplace, relationships with colleagues, and other co-worker who an employee comes in contact with within performing his/her job. Simplified we can define employee's performance as the result of connecting abilities to perform the job, effort based on inner motivation, and organizational conditions of a workplace, which have been created and maintained for employees. Expected performance will not be accomplished if any of these conditions is missing. For instance, no matter how perfect the workplace equipped is and how qualified an employee is, if he/she is not willing to do the job, the performance will never be as expected (or as it could be if an employee was also internally motivated to work).

Appraising employees' performance is one of very important HRM functions, which is paradoxically very often underestimated by managers. Even if managers often know about its importance, the process of appraising employees' performance is just not something they are willing to pay as much attention to, as it requires. Correctly performed appraising employees' performance creates great assets not only for managers but for employees which makes it profitable for whole organization. Information obtained in this process is not only related to employee's performance at work, his/her potential and future needs, but it also provides HR managers with valuable information for identification education and development requirements, it motivates employees to improve themselves, it uncovers their strengths and weaknesses, it creates the basis for rewarding employees, career management and placing employees. One of the objectives of employees' appraisal is to ascertain whether the goals of employees are harmonized with the goals of the organization.

For better and more quality understanding of the importance of employees' appraisal system in an organization we are stating some information which can be obtained by correctly performed appraisal:

- Information about present level reached in performance of individual employees.
- Information about employees' interests, expectations and needs.
- Information about deficiencies and potential berries of employees' development.
- Finding ways how to support increase of employees' performance.
- Information basis for crating variable components of employees' rewarding.
- Finding ways for increasing employees' motivation.

- Information basis for identification of education and development needs of individual employees.
- Information basis for evaluating effectiveness of training activities.
- Information basis for employees' placement.
- Uncovering failings in recruitment and selection process.
- Information basis for personnel planning (knowing disposable inner resources.)
- Actualization of employees' personnel information.
- Improvement of relationship between employees and their supervisors.

4. The process of employees' appraisal

It is essential to understand that the manager should adequately prepare for appraising his subordinates. The very frequent mistake of managers is considering employees' appraisal easy and spending insufficient effort preparing for it, even if doing something well does not mean spending lots of time doing it.

The very first step should be setting the goal, i.e. determining the expected outcome of the process of formal employees' appraisal. Next step would be selection of methods which the manager wants to use. The most universal and most frequently used appears to be appraisal interview. The manager, indeed, should inform employees about their appraisal, in written and official way. This should happen approximately 10 days ahead, so they can properly prepare, and the date and time should come out as an agreement between manager and employee. It is not only polite, but this way the manager shows respect to employee's schedule, which proves that manager values his subordinate's work and treats him as a partner for reaching common goal.

Formal invitation to appraisal interview should at least contain following requisites:

- The name of employee who is invited.
- His work position.
- The period of appraising.
- The objective of appraisal.
- The time and place of appraisal.
- The estimated duration of appraisal.
- The name of the subject of appraisal and his position within an organization.

Every employee going through appraisal should be provided with the information regarding appraisal form, so he/she is enabled to prepare for the appraisal. There are many appraisal forms, and it is impossible to determine one as the universal, which could be recommended for any organization. Each manager

should have professionally elaborated appraisal form adjusted to each type of job within the organization. The purpose of providing employees with appraisal form is to give them proper information, which increases productivity of the appraisal interview.

Before the manager begins appraisal interview, he/she should be familiar with job description of appraised employee. Employees happen to be criticized for neglecting certain activities even if they are not covered in their job description. Managers often just didn't know. Well elaborated job description should not exceed one page and it should at least contain following requisites: characteristics of the job, responsibilities, work equipment and tools, work conditions, risks. Job description should be periodically actualized, or adjusted if any change appears. Another requirement on manager's preparation for appraising interview is to read over former appraisal form of the employee. This form should be part of personal file of individual employee. We can summarize all the documents, which should be the manager acquainted with as follows:

- Personal file of the employee.
- Job description of the employee's work position.
- Appraising form from former appraisal.
- Appraising form filled in by the employee.

Appraising interview could be performed in the manager's office, but we must realize, it is not impartial place. If we also consider the fact, that appraising interview is mostly performed by manager the immediate supervisor of employee, he/she could get unwanted feeling of inferiority, which could cause discomfort and could lead to negative influence on appraisal interview and depreciate its results. However, appraising interview should be performed a place with proper atmosphere and without disturbing influences.

5. Managers' mistakes which very often appear at appraising employees' performance

- Managers are poorly prepared for appraising interview.
- Managers do not inform employees about their appraisal in sufficient advance.
- Wrong choice of time and place for realization appraisal interview.
- Managers tend to approach extremely to the appraisal. They tend to be either too tough, or too charitable.
- Managers are afraid do appraise their employees, so they rather choose the average score for anyone.

- Managers are excessively influenced by first impression of appraised employees, which is mostly in their well-mannered behavior, appearance during the interview.
- Managers tend to compare themselves with appraised employee.
- Managers often have prejudices, for instance against women, specific category of employees, or even nationality, which leads to discrimination.
- Managers also often can not impersonalize and they tend to prejudice in favor of their favorite colleagues, relatives and friends at the workplace.
- Managers are influenced by results of former appraisal.
- Managers open the results of appraising to public. It is important to stay discreet when it comes to employee's appraisal. Such a failure from manager's side could have harmful impact on employee's professional and personal life.
- Managers do not appraise all employees according to the same rules.
- Managers appraise employees' performance on the basis of performance norms, which were not elaborated on the basis of quality job analysis.
- Managers do not allow employees to discuss their performance.
- Managers do not use obtained information in other HR functions. They perform appraisals just to be done.

6. Evaluation of appraising employees' in Slovak organizations based on results of the continues survey

The thorough model of the system of human resources management, its individual functions and their linkage, has been an object of the research of our team, consisting of educators, on ground of the University of Economics in Bratislava, for six years. We have begun with questionnaire based survey, which has been supported by Slovak Scientific Grant Agency. The survey has been performed only in organizations employing over 50 employees. Later on we have joined the Cranfield Network and we are now able to perform our survey in international extent.

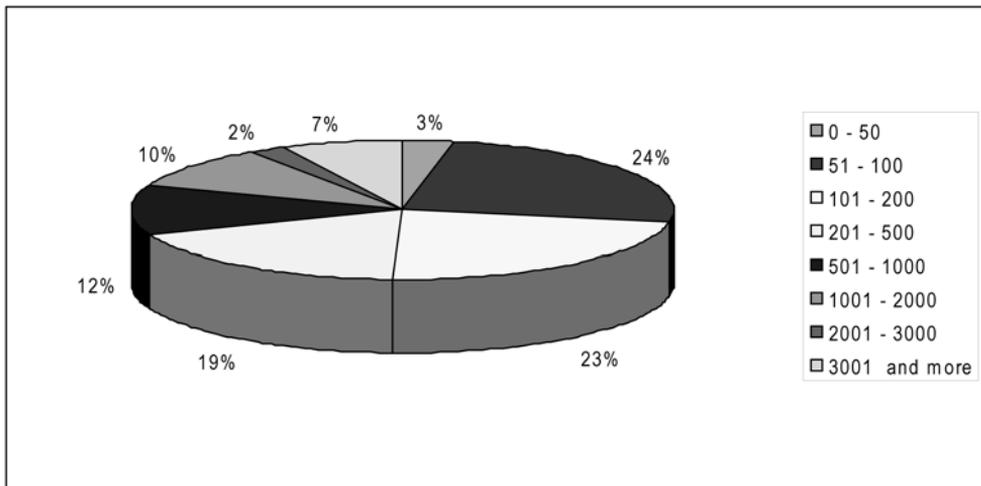
In our paper we are focusing on formal employees' performance appraisal as an indicator of quality of HRM functions. Our aim within this paper is to adumbrate particular features of HRM in Slovak companies focusing on their employees' appraisal system.

To introduce the sample we need to say, there was 225 companies participation on our survey in 2008. We've conducted the survey in whole country, but since the majority of Slovak companies are physically or officially registered in the region of the Capital Bratislava, also most companies participating on our survey have their seat there. Most of the companies are in private sector (87%). We included organizations in the public sector into our survey, since we find

interesting to discover the particularities of their HRM too. The size of companies in the research sample in 2008 according to number of their employees is shown in Figure 1, which shows that the major groups in our sample are companies employing 50-100, 101-200 and 201-500 employees (Figure 1).

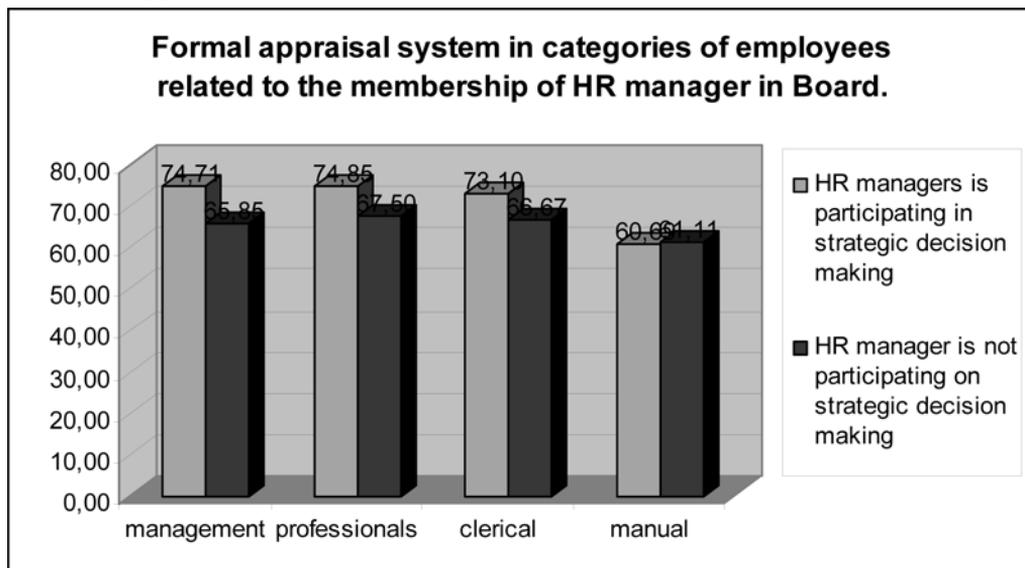
Since every company has its own system of employees' categorization, we have decided to use four unified categories, as follows: workers (manually working employees), clerical (employees in administration), specialists (technicians), managers (employees on managerial positions of any kind).

Figure 1: The size of companies within the sample for 2008 according to number of their employees



In our research we discovered there are still organizations in Slovakia, which are not using formal employees' appraisal system. As expected, the number of periodically and formally appraised employees is greatest in managerial category and the category of specialists. We believe this is caused by the tendency of organization to link employees' performance in these categories with their compensation more tightly than it is in other categories. In Slovak organization, we can observe tendency to increase variable component of wage and employees' participation on an organization's economic result. Even if we can evaluate the tendency of raising the number of formally appraised employees in Slovak companies, over the years of our research, positively, we still can not explain this improvement by intensifying linkage of appraising employees and the aim of providing them with their personal feedback and supporting them in their professional development.

Figure 2: How does the HR manager's membership on Board influences employees' appraisal?

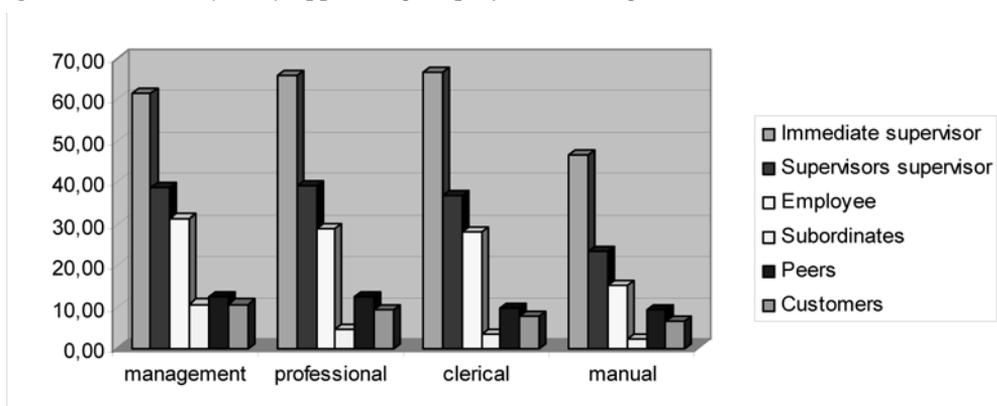


We asked a question, we how will be the amount of employees formally appraised influenced in case a company would approach to its employees' appraisal in more systematic way. We believe that systematic approach to HRM can be applied if the whole concept of HRM is being decided with the link to other functional lines of companies business. Therefore HR manager should be participating on decision making process from the very beginning, which means to have his/her place on Board or equivalent. We assume that if this precondition fulfilled, HRM will be carrying out the functions in more systematic and therefore more effective way. As we found out (Figure 2) the number of formally appraised employees raises in up to 10 percent in each category of employees, but manuals, in case HR manager is taking place in strategic decision making process on Board. It makes us believe it is being carried out more systematically and also linked afterwards to more HRM functions than just rewarding.

We can also see that manually working and clerical employees are less formally appraised, which has not changed much during the research period. This tendency is supporting our assumption, that organizations in Slovakia understand employees' appraisal rather as a source of information for setting compensation schemes and wage regulation than essential basis for managing employees' performance and development. Clerical and manually working employees are in Slovak companies very often paid by wage per hour. Since in rewarding employees in these categories there is no linkage between quality and quantity of performance and salary, besides the working time, organizations do not feel the need to perform appraisal of these categories of employees.

We can also assume that the organizations' perception of employee's appraisal is strongly influencing employee's understanding of appraisal activities. As mentioned above, it is very important for employees to understand that their appraisal should help them to uncover their strengths and weaknesses, to support them in their further education activities and to show their potential. According to our survey results, we believe that this is very rare employees' perception of appraisal system in their company, in Slovakia. Appraising is understood rather as unpleasant period of time, which just has to be survived and creates negative atmosphere in workplace. Very often it is tough responsibility for the managers too, because they do not see the opportunity to emphasize positive contribution to reaching companies' goals of their subordinates, but they believe, they just need to point out the failures in their employees' performance.

Figure 3: The subject of appraising employees in categories in 2008 (in %)



Appraisal process in all its phases is very strongly influenced by the choice of a person, who is responsible for appraising employees. To avoid as much subjectivism as possible it is suggested to properly combine possible subject of employees' appraisal. The partial object of our survey monitoring appraisal system in Slovak companies was also the issue of subjects of appraising employees. It is quite difficult to determine unambiguous proper person for appraising an employee's performance. We find the most competent person someone, who disposes of objective information about the job and optimal performance, who knows the employee performing the job and who is also able to stimulate the employee to improving his/her performance. This person should be able to turn information obtained in employee's appraisal to the employee's benefit and benefit of the organization as well.

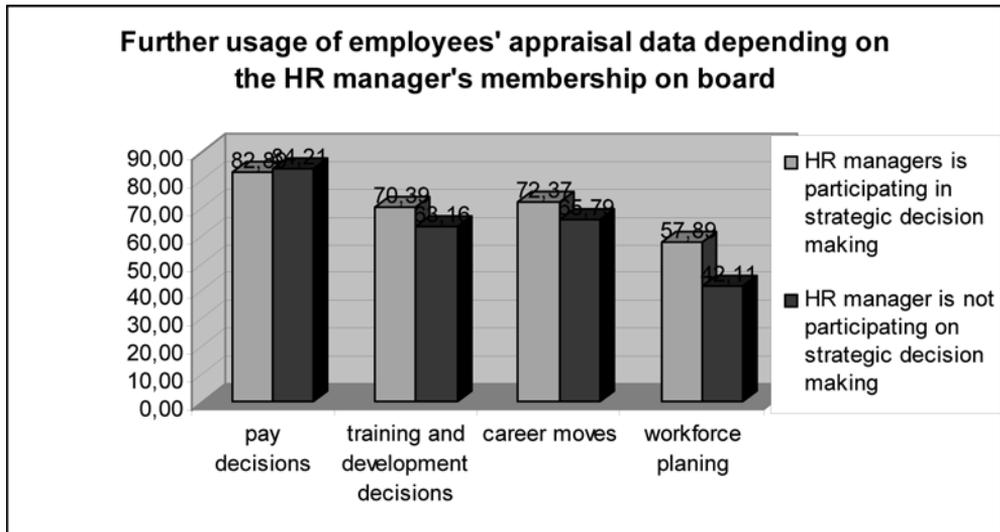
We can identify with the results of our survey (Figure 3), which confirm the importance of major participation of immediate supervisor in the process of his/her subordinate's appraisal. It should be immediate supervisor, who is

familiar with employee's responsibilities and who is able to provide him/her with the best feedback the performance. However, as stated above, to the process of employee's appraisal should be also invited other subjects, who have the ability to enrich appraising employee by different yet valuable point of view. According to the results of our survey we can observe quite rapidly increasing tendency in involving employees into the process of their appraisal. We are very pleased by this finding, since we believe that this means raising aim to gather objective (both-sided) information and improving the quality of appraisal system in Slovak organizations. Letting employees participate on their appraisal also prepares the basis for successful utilization of obtained information in performance management and other HRM functions as mentioned above, because employees are familiar with the goal of their appraisal, they are more likely to become identified with its results. The worst choice for an organization would be excluding an employee from his appraisal. The importance of systematic approach has also turned out to be supportive in raising the quality of HRM in the case of employees' appraisal. In our research we found out that if a company enables HR manager's membership on the Board, there is the aim of eliminating the subjectivism in employees' appraisal by involving more subjects in employees' appraisal in every category. In other words, companies are more likely to use 360degree evaluation then just to relay on immediate superior's opinion.

However we must admit that employees' appraisal performed in companies in Slovakia is still being understood as the "unpleasant" duty for employees as well as managers. In our research we also discovered that Slovak organizations still do not see the great potential of the utilization of information obtained in the employees' appraisal. We came to such opinion comparing the situation in Slovak companies to the international tendencies discovered on the basis of Cranfield project data. For instance only 44% of Slovak organizations stated, that they use information from their employees' appraisal for employees' education and development needs identification, whereas this percentage is doubled in organizations in developed countries of Europe. Another example, only one third of Slovak organizations have their employees' appraisal and employee's career planning connected by information. This is very low percentage comparing to European tendencies.

We found the issue of using data obtained within employees' appraisal an appropriate indicator of quality of the whole employees' appraisal process. Since the process may be time demanding, managers' soft skills demanding and also quite confidential task performed mostly annually or semi-annually, information obtained should not be left unused. In our research we've discovered that those companies who have involved their HR managers in strategic decision making process are subsequently using information gained in the employees' appraisal in other HR functions more then those who haven't. This makes their approach to their HRM more systematic and therefore more effective.

Figure 4: How does the participation of HR manager on strategic decision making process influence the systematic approach to employees' appraisal?



7. Conclusion

In the paper we've given demonstration of the importance of systematic approach to HRM in a company. The major precondition of such approach is in competencies, responsibilities and quality information support of HR manager within the company. Such precondition may be fulfilled by involving HR manager into strategic decision making process on the highest level of companies' hierarchy.

In the paper we have focused on employees' appraisal in Slovak companies, because we find this function very demanding in systematic approach to HRM. Input information, the process itself, and the output information of the process must be processed with highest professionalism and confidentiality, to bring expected results. It should also be coming out and be linked to almost any other HRM function, therefore it requires systematic approach and forces the whole concept of HRM to become systematic.

Despite the fact appraising employees' performance is very important HRM function; it has been underestimated in Slovak organizations, especially in former Economy system (Centrally planned economy). Even now HRM is mostly understood by employees and even in general as the area covering recruitment activities and wages. Tendencies in HRM clearly show, that proper timing and quality realization of employees' appraisal creates great assets not only for an organization but for its employees as well. The research results confirm that the importance of appraising employees is quite stable in Slovak organizations, which proves no improvement in this area of HRM over last decade. In the con-

clusion of the paper devoted to employees' appraisal, we need to emphasize the importance of linkage between its results and other HRM functions. The good news is that Slovak managers began to understand the urgency of systematically composed HRM and its application in their organization on behalf of gaining and keeping their competitiveness in present business environment.

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PROCESS AND CONTENT ANALYSIS OF STRATEGIC PLANNING IN ENTERPRISES IN SLOVAKIA

Abstract: *The article presents the results of research on strategic planning that was undertaken among the companies in Slovakia in the last quarter of 2006 and the first quarter of 2007. Questionnaires which analyzed structural inputs of strategic planning process were used with the aim to create strategic plan, its structure, realization and its well functioning. The research has shown that in spite of all problems connected with its undertaking, strategic plan is considered as useful part of planning process that helps in finding the way in complex and dynamic environment.*

Key words: *strategic planning, strategic plan, company, Slovakia*

JEL classification: L21, M21

1. Introduction

The purpose of strategic planning is to apply a formal planning system for creating a strategy. Strategic planning is not a substitute for strategic management, although it is not unusual to for these two concepts to meet. The main task of strategic planning is to formalize the strategic process in the company. The strategic plan integrates business activities and provides a timetable for their implementation. Strategic planning should not be an irregular isolated event which will culminate in a clear output. It should be rather a continuous activity that examines the planned tasks and the deadlines, and it should respond simultaneously to the rise of significant unplanned events (in the timetable/schedule).

2. Originality versus formalization

The formal planning system with its procedures, documents, and cycles encourages, but it also commits managers to work on the strategy. Creativity

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plays a key role, and it is also a sign of strategic planning. In contrast to the operational and implementation plans, (which are supposed to transform the main assignment for implementing a complex of activities), strategic plan has to invent the main assignment, discover and record it. Strategic planning is often accused of formality and stiffness, which can disable it in touch with real life. Plans (supposedly) age at the time of its completion.¹

We can respond in two ways to this often legitimate reprehension:

1. Appropriate formality is essential in the medium-sized and large enterprises. Otherwise arbitrary and ambiguous interpretation arises in fundamental matters with confusing consequences. There is a dilemma related not to the strategic plan, but to its content, structure, obligation and controllability. In this case a form of the plan is also a source of order.

2. The process of a plan's creation is more important than the plan itself. The planning process includes formulation of the objectives, analysis realization, strategy development, and the entire process of realization. It can be also understood as a space where new ideas are discovered and supported by analysis or contradicted by opponents. The planning process is also a place for discussion, contradictions and advice. In conflict situations, real motives can also be created, and sometimes alliances arise and perish. Deep and apparent arguments can appear for or against the plan. Planning is a process of original ideas, and there is a routine assessment of their realization. The planning process is a source of creativity.

Strategy (as a complex phenomenon integrating many factors) is immense without formalism and arguments. Strategic plan and its formal, explicit form encourage and also force managers to take a comprehensive and holistic view of the enterprise and its surroundings. Planning is a formalized procedure for the creation of results in the form of an integrated system of decisions. It focuses on the formalization as the key criteria that differ planning from other activities in designing or formulating strategy. There are three basic conditions of formalism:²

- Goals and objectives statement for the planning,
- Establishment of the power division and the responsibility for planning, implementation and control,
- Development of standardized planning procedures.

Plans help to program pre-defined strategies; therefore they can set direction and define the control procedure milestones which enable to assess the plan

¹ According to: H. Mintzberg, *The Rise and Fall of Strategic Planning: Reconceiving Roles for Planning, Plans, Planners*, Free Press, New York, 1994

² W. Ocasio, J. Joseph, "Rise and Fall – or Transformation? The Evolution of Strategic Planning at the General Electric Company, 1940 – 2006", *Long Range Planning*, 41 (3), 2008

implementation. Plans can also help in justifying analytically the strategic decisions. Plans can be used also to:³

- 1) Creating a synthetic vision of contexts and /or strategies.
- 2) Testing the importance of the proposed strategies.
- 3) Orienting imagination of managers in specific directions or to extend its field.
- 4) Providing multiple identikits drawing of possible strategies.
- 5) Describing the borderline strategy which readers should think about.

Paradoxical and contradictory claims are often put on strategic planning. Planning is expected to provide a broad vision, while at the same time it is expected to give attention to detail. Strategic planning is anticipated to be able to bring brave and sharp actions, while it can create partial adjustments. Assertive and swift actions are needed which are justified by thoughtful analysis. Boundaries of these paradoxes are the *dimensions of strategic planning*.⁴ *Symbolic planning* expresses mission, vision and intended strategy. It contains a strong incentive that encourages the enterprise on the road to the future. *Rational planning* is a comprehensive formal planning system of the enterprise from its goals, through the methods how to implement them up to the implementation. Rational planning integrates corporate ambition in to the system of plans, programs and calculations. *Transactive planning* is a degree of plan adaptation according to changing external conditions. It allows more informal incentives to enter the planning process, and therefore the plan can become a vibrant and evolving document. *Generative planning* can be represented as an extent to which the plan can encourage the product and process innovations. The plan is, in this case, the source of new and original ideas, and it also encourages creativity in the whole enterprise.

3. Data and methods of survey

The strategic planning survey was accomplished in the last quarter of 2006, and in the first quarter of 2007 among enterprises in Slovakia. Questionnaires were applied, and they analyzed strategic planning processes structuring inputs to strategic plan creation, the structure of the strategic plan, the realization of the strategic plan, and the effectiveness of strategic planning. The features and success of strategic planning were investigated through closed questions; the other studied parameters were identified through open questions. Each questionnaire was processed by only one external respondent through the cooperation with

³ M. Giraudeau, "The Drafts of Strategy: Opening up Plans and their Uses", *Long Range Planning*, 41 (3), 2008

⁴ P. Brews, D. Purohit, "Strategic Planning in Unstable Environment", *Long Range Planning*, No. 1, February 2007

the internal employees of the assessed enterprise. There were not any restrictive conditions, relating to size, industry type, personality, etc. during the enterprise selection process. The survey was done among 377 companies, and after rejection of incomplete or not properly processed questionnaires the pool was cut to 306 companies.

4. Survey results

The main **information sources** for the strategic plan creation are corporate statistical reports (78%) and the situation in the industry (73%). These sources are supplemented by corporate internal bookkeeping information (68%) and financial reporting (65%). The most important information sources outside the enterprise are corporate partners (57%), commercial databases (56%) and personal contacts with customers (51%). The formal corporate information system provides a basis for strategic plan creation in 65% enterprises within the pool. Preliminary information is considered sufficient and reliable in 54% of corporations. The most reliable systematic information within is information about competitors and customers (37%) and the results of marketing surveys (35%). In examining other relevant factors (that have an informal and non-systematic effect on strategic planning), the leading position was taken by intuition of initiators and participants of this process (61%). The leading position was followed by information about customers (58%), by communication with clients (52%), and by non-specific (yet detailed) empirical knowledge and experience (39%). Working with information is often connected with its saving and structuring into various kinds of databases (66%). The top manager plays the most important role in information evaluation and its interpretation within the corporation (65%). Information interpretation should be dealt with by all persons involved in the strategic planning process (44%). The appropriate ways to increase the effectiveness with the information is a systematic creation of information and analytical reports (56%) or building sophisticated fund information (53%). The introduction of business information systems (such as SAP) is 47% and regular accomplishment of surveys is 47%.

The **submitted strategic plan structure** to the survey was created from the objectives, instruments, sources and their documentary-based formalization. The most often-used **objectives** are increased turnover and profit (95%), followed by maintaining a good reputation (79%), and strengthening the position of the enterprise market (74%). Acquiring new customers is important (71%) together with leadership in technology or quality. Acquisition or development technology is 68% and search for strategic partners is 64%. Penetration and establishment in foreign markets is important to 60% of respondents. The objectives are achieved approximately by equivalent **approaches** in terms of their representation in busi-

ness practice. The most significant emphasis is connected with the sufficiency of qualified and experienced staff (67%), followed by the acquisition of new and lasting customers (65%). Good communication (64%) and precise definition of market segments (63%) are important as well. Business informatics (62%) together with adaptation to European standards (61%) and technology (59%) are also appreciated among corporations in Slovakia. **Resources** as part of a strategic plan should be used to improve the efficiency of business processes (59%), or human resources (57%). Sufficiency of own financial resources is important to 57% of the respondents. Corporations also initiated foreign sources (44%) and excellent own business know-how (32%). **Strategic planning documentation** consisted of planning forms, tables and calculations, which were identical to the documents of corporate financial analysis (71%), updated budgets (53%), plans of revenues and expenses (53%), capacity plans (49%) and income statement and loss plans (35%). Summary financial statements somehow, in many cases, replaced documentary display of the strategic plan.

The process of strategic plan creation belongs entirely to top management (79%). Specialized professional body (41%), external consultants (35%) and other professional services (21%) also participate in this process. The most commonly used analytical methods are SWOT analysis (57%), trend analysis (55%), analysis of market and customers (51%), PEST analysis and financial analysis (47%). Synthetic methods used to compile the strategy of the previous analysis is a relatively *terra incognita*. Respondents indicate more non-specified statements about the strategy formulation (59%) and method SWOT (57%) and SPACE applications (38%) for synthetic purposes. The majority of planning decisions are taken in as a result of competitive pressure (63%) and in response to new legislation (49%). The schematic process of strategic planning dominates (73%), and it contains the following phases: *acquisition and data collection – data classification – data summarizing – strategy creation*, including a timetable for drawing up the plan. To improve the existing practices in strategic planning it is recommended to establish professional strategic planning services (63%), and to use the enhanced version of the SPACE (48%), PEST (41%), SWOT (36%) methods and statistical method adaptation (42%), which would be able to respond dynamically to the changing environment.

Responsibility for the **strategic plan realization** is on corporate top management (72%), to a lesser extent. This task is given to temporary or permanent teams (45%) or this role is considered with varying degrees of participation of all components of the organization (31%). Short-term plans and budgets under the supervision of financial control (72%) are among the most-used tools of strategic plan realization together with standards, rules and procedures (55%). Incentive programs are used to change the traditional stereotypes and their alignment with the new strategy (35%), and outsourcing (32%) is applied due to lower efficiency of internal sources. The most common cause of strategic plan deviation is

actually the rising price of inputs and thus the cost raise (54%). The major causes of the differences may include delivery terms violation (51%) and a set of factors linked to the used techniques and technology (45%). Imperfect market knowledge and the impact of political and currency risks have approximately the same proportion (about 33%). The actual outcome of the planning process feedback comes mainly from customers (78%), suppliers (63%) and employees (63%). Business practice believes that effective strategic plan implementation would benefit from the application of advanced and innovative management techniques (62%), appropriate and flexible organizational structure (54%), the introduction of strict rules and procedures for the strategic plan implementation. Disciplined observance (50%) and improved communication between top management and other management levels (39%) are crucial as well. It is expected from the strategic plan to be able to provide transparent guidance in the business environment. The strategic plan also should enable fast adaptation to changes in the environment (75%), and it should increase the efficiency of the entire planning process (64%). The success rate of strategic plans was expressed by accordance of the planned parameter (external dynamics parameters) with the reality which followed the ability to predict the selected phenomena. It varied in the range of 60% to 80% of the target reality.

5. Discussion

Information resources: Statistics, financial accounting and reporting are considered to be some of the most important information sources for the strategic plan creation. Their advantage is the accuracy and completeness of the data. They investigate the sources of past performance, but they cannot predict the future.

Structure of strategic plan: This is a contradictory interpretation of the strategic plan content, perhaps with the exception of objectives. There is no any difference between the approach to achieving objectives and their sources, e.g. human resources were considered to be approaches while being sources as well. Strategic planning documentation did not exist as the individual form. It was usually replaced by the accounting and financial documentation, or by implementation plans documentation.

Process of strategic plan creation: The survey shows that companies are engaged in some the strategic planning activities, especially in basic analytical methods, but the strategy creation itself and process of strategic plan creation remain a secret. There is a lack of explicit representation of vision and mission in the planning process. Lack of inner incentive to work on the plan is obvious, because the majority of planning decisions are affected mostly by the competition and legislative changes. Business practice believes that the strategic planning process would be enhanced by the establishment of professional strategic

management services. After the euphoria of strategic management at the beginning of the 1990s, which should have filled in the gap after socialist planning, a disillusionment of strategic management arrived. This disillusionment, at the turn of the millennium, led to reduced professional strategic management services in the business sector. Bureaucratic understanding of strategic planning in the form of old bodies is just a partial action with unclear results. Strategic planning is the domain of line managers, and the support staff will depend on how these managers understand and manage planning.

Strategic plan realization: A significant proportion of the strategic plan deviation refers to external causes such as price inputs, delivery terms, the various market processes, and knowledge of the market. Due to internal reasons, corporations acknowledge only incorrect estimates of their own technical and technological possibilities. Perception of the reasons for deviations and failures is significantly technocratic, and one is unmarked with his/her individual interests and abilities as a potential source of failures in the process of implementing the strategic plan. Increasing the effectiveness of the strategic plan implementation is expected from the new management techniques and from the disciplined adherence with designated rules. Despite all the problems associated with its implementation a strategic plan is considered to be a useful part of the planning process, which helps to find a path forward in the complex and dynamic environment.

6. Conclusion

Formal plan expression in a standardized form helps to differentiate strategy from the strategic plan. Strategy is considered as an open-planning document, which is a source of both formal and informal skills and knowledge about the objectives and aspirations of owners and top managers. Strategy is also a document about the of external and internal environment development. Strategy is continually updated, systematically arranged, regularly inspected, analyzed and evaluated. The strategic plan is a closed document, which is a regular and time-lined output from a freely conceived strategy. It contains provided structure and time limits for related and derived tactical and short-term plans. Strategic plan is a formal instrument for the strategy implementation.

Strategic plan can be represented by a set of small number of selective targets with the strategy as a tool to achieve them and the strategy is supported and realized through the complex of business functions. Selective objectives express the most important (strategic) roles in given period, which is not linked to a specific functional area. This strategic plan is an extension of the functional areas with their own content and aggregate perception of the corporate business. Its objectives are created, e.g. from customers' investors', competitors point of view and also from vision, development trends, so it is not connected with the traditional

functional division of labour (which is marketing, finance, production and operation, human resources, etc.). Each business function is involved in the completion and implementation according to context and capacity. The plan should then be clear and operational.

The strategic plan can be designed as a set of all functional areas objectives of the business. Each functional area identifies its most important (strategic) tasks and projects them into the future. So, the plan can be a set of functional strategies, but priorities can be lost and everything is seemingly strategic. The plan can lose its structure and its action.

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INTRODUCTION OF EURO IN THE SLOVAK REPUBLIC - RISKS AND CHALLENGES -

Abstract: *The paper deals with the readiness of the country for the adoption of the common currency – Maastricht criteria and the impact of euro changeover on the economy of the Slovak Republic. It evaluates fulfilment of expectations connected with the euro changeover and the rate of their determination by the financial and economic crisis.*

Key words: *euro introduction, currency conversion, Slovak Republic*

JEL classification: E42, F33

1. Introduction

The implementation of Euro can be characterized in the following way:

- Euro (money) has the function of “lubricant” of economy and it is not decisive for its successfulness; (however on the other hand is stated: “Overall the introduction of Euro after 20 years could raise GDP by approximately 13 % in comparison with the situation without the introduction of Euro.”¹)
- The major effect of implementation of Euro can be seen in elimination of transaction expenses and market risk.
- The loss of independence of the National Bank of Slovak Republic (NBS) during the decision-making process connected with interest rates is a risk (also in relation with a relatively small and just transforming Slovak economy).

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¹ K. Kampová, J. Klučka, S. Strelcová, “Prijatie eura v Slovenskej republike”, in: *Krízový manažment*, 2 (6), 2007, pp. 48-51; *Zavedenie eura na Slovensku*, Správa o stave Národného plánu zavedenie Eura v Slovenskej republike; <http://www.nbs.sk>

2. Maastricht criteria and the development of their fulfilment in Slovak Republic

The formal condition of readiness of the country for the adoption of the common currency is the meeting of nominal convergence criteria – Maastricht criteria. Meeting of these criteria will ensure a balanced economic position of member countries of the European monetary unit.

The first two **criteria** are connected with the sphere of government finances; the ratio of the annual government deficit to gross domestic product (GDP) must not exceed 3% at the end of the preceding fiscal year. The ratio of gross government debt to GDP must not exceed 60% at the end of the preceding fiscal year.

Inflation rate criterion is important from the viewpoint of maintainability of the price level of the entering country. According to it the average inflation for 12 consecutive months (measured in accordance with HCIP), must not exceed the average of 3 EU countries with the best results in the sphere of price stability more than 1.5 %.

The next criterion is **the stability of long-term interest rates**. The nominal long-term interest rate must not be exceeded in more than 2% in the three member states with the lowest inflation.

Apart from these four criteria, the entering countries have to prove **the stability of currency** by the participation for a period of at least two years in the European Exchange Rate Mechanism, ERM II before joining the Euro zone. The ERM is based on the concept of fixed currency exchange rate margins, but with exchange rates variable within those margins.

On the basis of the data of Eurostat, the Ministry of Finance of SR and NBS, the analysts of VÚB have worked out the analysis of the fulfilling the convergence criteria and its results are summed up in the following chart:

Table 1: Fulfilling of Maastricht criteria²

Criterion and its fulfilling	Period of time			
	2005	2006	2007	2008
Government deficit (% GDP)	2,8	3,7	2,2	2,0
Fulfilling	✓	✓	✓	✓
Government debt (% HDP)	34,1	30,4	29,4	31,0
Fulfilling	✓	✓	✓	✓
Measure of inflation (%)	2,8	4,3	1,9	2,9
Fulfilling	✗	✗	✓	✓
Stability of long-term interest rates (%)	3,5	4,4	4,7	4,5
Fulfilling	✓	✓	✓	✓

² Plnenie Maastrichtských kritérií, http://www.euroservis.sk/Default.aspx?contentID=plnenie_maastrichtskych_kriterii

At the beginning of July 2008 Slovakia reached the last important “milestone” on its way towards Euro – the exchange rate determination. Before this date the financial analysts estimated it on the basis of premise that all the countries which were adopting the euro (with the exception of Portugal and Greece), were changing their national currencies on the basis of the stated central parity. This assumption was correct. On 8 July 2008 the Council of EU stated the official exchange rate which was the same as the 40-day-old central parity (30, 1260 SKK/EUR).

However the conversion rate was officially declared in the order of the official document of EU on 24 July 2008. This day was the most important for the entrepreneurs because 30 days after the declaration of the conversion rate they were obliged to use a dual price system, the prices had to be recounted and rounded to 1 cent according to mathematical rules. So since Sunday, 24 August 2008 the shopkeepers in Slovakia have had to state prices on the price tags both in euro and Slovak crown. In their shops they have also had to make the information about the conversion rate visible. This conversion rate has been applied on all the items in the shop.

3. The plan of euro introduction in SR and problem areas

Several events occurred from the date of acceptance of the National Plan of Euro Introduction (July 6th 2005) till the end of January 2006. These facts incurred necessity to update this plan. Next table shows activities which had to be done in process of euro introduction.

The first problems with the fulfilling the plan of the introduction of euro occurred in August 2008 and were connected with the assignment of the date when it was compulsory for economic subjects to state prices in both currencies – in Slovak crown as well as euro.

Initially a 30-day-period since the determination of official conversion rate by the Council of EU was stated. But according to the above mentioned information, the dual price system is compulsory 30 days after the declaration of the official conversion rate in the order of the Council Regulation (EC) – that means since 24 August 2008. Economic subjects reacted to these problems more or less positively because they had 2 more weeks for the alteration of price tags and for other preparations.

Correctness of dual pricing and the stating of the conversion rate is controlled by the Slovak Commercial Inspection in cooperation with Trade Licensing Offices. At the beginning the problems seemed to be more striking. There was uncertainty not only in the depiction of prices but also in the depiction of exchange rate.

Table 2: The process of Euro introduction in Slovakia³

1. stage – till the entrance to ERM II – fulfilled	
2005	Going through access procedures for the entrance to the mechanism of exchange rates ERM II
2. stage – from the entrance to ERM II to the decision about the entrance of SR to Euro zone	
28 November 2005	Entrance to ERM II
Till May 2008	Convergence reports of EC and ECB
May – June 2008	Evaluation procedure in European institutions
June 2008	Decision of Council of EU about the cancellation of exception
June 2008	Determination of conversion rate SKK/EUR by the Council of EU
3. stage – from the decision about the entrance to Euro zone to the entrance to Euro zone	
July – December 2008	Providing with the necessary amount of euro notes and mintage for the cash flow of SR
September – December 2008	Providing NBS and commercial banks with euro notes and coins
December 2008	Providing retail sector with euro notes and coins
July 2008 – December 2009	Compulsory dual pricing – all retail prices, payslips, pensions etc. will be compulsorily stated both in euros and Slovak crowns
Till 31 December 2008	Conversion of cash points, automatic and other coin and banknote operating machines
4. stage – after the entrance to the Euro zone	
1 January 2009	Euro is introduced at the same time to the cash flow as well as the cashless flow without the interim period by the so-called “Big-Bang Scenario” and becomes a legal currency on the territory of SR. Slovak crown becomes a partial unit of euro in the conversion rate stated by the Council of EU.
Till 16 January 2009	Dual cash flow – during a short period of a dual cash flow on the territory of SR it is possible to use euro as well as Slovak crowns as means of payment. However the Slovak crowns are not put back into the circulation but are gradually withdrawn from it, and processed on the premises of NBS.
From 17 January 2009	Continuation of exchange of Slovak crowns for euro coins and notes in the commercial banks and NBS. Slovak circulation euro coins are the valid currency in all countries of euro zone and circulation coins of other countries of euro zone are the valid currency in Slovakia. Banknotes are the same in the whole Euro zone.
Till 31 December 2009	Compulsory dual pricing
Till June 2010	Recommended dual pricing

³ Euro a Slovensko, www.nbs.sk

During the period 8-10/08 approximately a quarter of more than 20 thousand controlled shops struggled with shortcomings. The biggest problems were expected especially in small shops. And it proved true.

Another problem which became striking in December 2008 was the problem of the forward buying of euro cash. Entrepreneurial subjects had the possibility to order the necessary euro cash in commercial banks till the end of March 2008. A lot of smaller entrepreneurs did not use this possibility. According to the advice of bankers they decided to use euro packs. NBS prepared 1 200 000 pieces of starting euro packs which contained 45 pieces of euro coins with Slovak motifs. The value of one pack was 500 SKK (16.6 EUR). The number of euro packs was fixed following the Slovenian experience – there was a very small interest about the packs there. The situation in Slovakia was opposite.

4. Genesis of the attitude of entrepreneurial subjects and inhabitants on the introduction of euro

The published surveys were concerned with the analysis of the attitude of inhabitants and entrepreneurial subjects.⁴

The main positives connected with the introduction of euro for enterprises stated by respondents (in %):⁵

Table 3: *The main positives connected with the introduction of euro*

	SME*	Big enterprises
Elimination of transaction costs	42,5	81
Elimination of exchange rate risk	33,7	85
Simplification of doing business with partners in euro zone	28,2	24
New markets acquisition	15,8	0

Note: Every respondent stated 3 most important positives

* Small and medium enterprises

It results from the chart that SME found in the introduction of euro the strategic opportunity for acquiring the new markets. From this point of view big enterprises (global players) did not find any contribution.

⁴ L. Klučka, “Risk in Euro Currency Changeover”, *Transport*, III, Sofia, 2006, pp. 41-43; *Správa o stave Národného plánu zavedenie Eura v Slovenskej republike*, www.nbs.sk

⁵ K. Kampová, J. Klučka, S. Strelcová, “Prijatie eura v Slovenskej republike”, in: *Krízový manažment*, 2 (6), 2007, pp. 48-51; *Zavedenie eura na Slovensku*, *Správa o stave Národného plánu zavedenie Eura v Slovenskej republike*, <http://www.nbs.sk>

The main negatives connected with the introduction of euro for enterprises stated by respondents (in %):⁶

Figure 4: The main negatives (risks) connected with the introduction of euro

	SME	Big enterprises
Increasing of competitive pressure	46,5	22
Cost rise influenced by introduction of euro	57,4	54
Loss of markets	8,6	0
No or different negatives	10,7	15

It results from the chart that SME perceived the introduction of euro as a potential threat of the competition rising. Big enterprises perceived this risk at 50% in comparison with SME. The attitude of SME and big enterprises to the threat of increasing the costs under the influence of the introduction of euro was quantitatively balanced. Analogically big enterprises did not perceive the introduction of euro as the risk of the market loss.

In the period from March to June 2008 a repeated questionnaire survey was carried out with the Slovak entrepreneurial subjects. Its aim was to monitor the dynamics of the development of attitudes towards the introduction of the euro (as far as the possibility of its use the quality of handed back questionnaires varied).

From the obtained answers and their comparison with the results from 2007 we can come into the conclusion that:

- With regard to the objectively changed situation in SR the number of entrepreneurial subjects which assumed the preparation for the introduction of the project was rising,
- In the context of project managing the judging of the introduction of euro did not markedly change (however this fact could be influenced by a relatively high amount of respondents in the category *Micro enterprise* with 0 - 9 employees),
- As far as the expected impacts (turnover, profit, export) respondents were more uncertain in comparison with the past,
- When defining the negatives of the introduction of the euro there was no change (cost rise and increasing of the competition pressure).

⁶ K. Kampová, J. Klučka, S. Strelcová, "Prijatie eura v Slovenskej republike", in: *Krízový manažment*, 2 (6), 2007, pp. 48-51; *Zavedenie eura na Slovensku*, Správa o stave Národného plánu zavedenie Eura v Slovenskej republike, <http://www.nbs.sk>

5. Euro introduction in the Slovak Republic - experience

Experience concerning euro introduction can be summarized in the following way:

- Dual cash flow has represented a significant marketing aspect – its mastering has been a proof of abilities and preparation of the enterprise which has presented its reliability and respectability. Many entrepreneurial subjects (mainly small entrepreneurs) closed their plants and shops during this period.
- “Big Bang Scenario” policy in euro introduction decreases costs but increases pressure on preparation of entrepreneurial as well as non-entrepreneurial subjects.
- Resetting of ticket machines, cash points and other machines was solved by compromise – impossibility of application of dual cash flow was replaced by immediate euro changeover. Similarly the information function of gas stations was solved.
- There was a very good preparation for euro introduction and its implementation in shops and stores. The biggest problems were in the shops in regions with a higher percentage of non-adaptable citizens. There were some problems with dual pricing and application of dual cash flow, i.e. with accepting cash in both currencies but giving change only in euro.
- One big problem was with certificate stamps – market demand was higher than the real amount of printed stamps.
- Implementation of euro changeover was really one of the greatest investments of banks. The evaluation of this investment can be seen in a higher demand for credit cards and in the offer of products that take into consideration the specific situation in Slovakia, i.e. a huge amount of coins and ineffective and insecure manipulation with them.
- In the sector of passenger transport service the implementation of euro introduction caused delays mainly in the intra-municipal bus transport and it made transport companies to introduce payment by cards. Payment cards have reduced manipulation with cash which was strenuous especially for bus drivers.
- Conversion in banks was managed very smoothly – cash points operated from the very first day; but not all the denominations of banknotes were available. However, this was accepted by customers without problems. Conversion of banking systems did not make it possible to update e.g. permanent transfer order during the first three days of the year 2009.
- Promotion campaign (its costs were about 260 million SKK) was successful and met its target.
- Euro introduction had also positive effects on banks – during the first three quarters of the year 2008 deposits of citizens increased by about 51

billion SKK. The reason for it was a free and comfortable possibility of cash conversion on accounts.

- There were introduced so-called euro packs (the value of euro coins in the pack was 500 SKK) within euro marketing campaign. The original function of packs - new coins recognition - was changed into a suitable Christmas present which was in short supply. The same activity with euro packs in Slovenia was judged as unsuccessful – citizens did not have an interest in it. In Slovakia – on the other hand - one local government gave euro packs as Christmas presents to their retired citizens.
- Slovak people still face a dilemma: “How much money are we supposed to give a waiter as a tip in euro currency?”
- Terminology and using slang expressions in connection with new euro currency is in development, too.

After introduction of euro currency and the period of dual cash-flow a gas crisis started in the Slovak republic. Gas crisis together with financial crisis broke out into economic crisis and changed the priorities of many entrepreneurial subjects as well as their attitudes to euro.

At the beginning of the euro project (also discussed in European Commission) the sustainability of inflation was stressed. At present time inflation in the Slovak republic is under the level that was before euro introduction. Other currencies of Vishegrad countries (Czech Republic, Poland, and Hungary) have been losing their value and there are opinions of experts saying that in case that the Slovak republic did not apply euro, the exchange rate would be about 40 SKK/EUR. However, the situation in pro-export economy is not unambiguous - a weak Slovak crown would give exporters advantage over importers.

The reality of economic crisis is that the car market (as the most important commodity of Slovak economy) is in the strong competition. And at the same time because of decreasing the purchase effectiveness of target markets, the market potential which would eliminate the advantage of lower value of Slovak crown decreases, too. The actual question is the future after recovery. It can be assumed that markets will increase their requirements and at the same time the crisis will support mergers and acquisitions and it will also increase the competitive pressure on the car producers (Slovak-French-German-Korean).

Economic crisis has come to Slovakia in the third quarter of the year 2008. The consequences have been seen in decrease in economic growth, production (especially in the car industry) and in demand decrease. During the year 2008 many entrepreneurs invested money with argument that euro introduction would bring inflation. This attitude together with psychological affects has caused decrease in demand, GDP, and turnover; unemployment rise, and production cutting. A new framework of economic situation on micro and macroeconomic level has been created.

At present time euro is a factor of the financial stability of Slovak economy. However, the role of euro in the Slovak economy after the economic crisis ending is questionable.

6. Conclusion

The exact expression of the impact of euro implementation on the Slovak economy (as well as on the economy of other countries which joined EMU in preceding years) is not possible because at the time of this implementation there appeared roundly the phenomenon of the financial and economic crisis in the whole Central Europe. On the one hand it can be said that the reactions of Slovak economy on the euro adoption were influenced by the impacts of the economic crisis but on the other hand joining EMU has also enforced some manifestations of crisis.

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MAIN FACTORS AFFECTING THE DEVELOPMENT OF MONEY STOCK IN SLOVAKIA AND IN OTHER V4 COUNTRIES**

Abstract: *Since the middle of 2008 the effects of the global financial mortgage crisis has become significantly visible in Central European market. Besides this main factor the economic development is influenced by other important factors such as monetary integration, globalization and internationalisation. The aim of this paper is to draw attention to the development of money stock in the Slovak Republic, the Czech Republic, Hungary and Poland. Our opinions are based on the analyses of money stock in relation with other economic indicators in the connection with the reactions of individual central banks.*

Key words: *monetary policy, monetary instruments, money stock, demand for money, financial crisis, V4 countries*

JEL classification: E52, E58

1. Introduction

The current development of the world economy has been largely influenced by the global financial crisis. The crisis burst in the United States of America in the second half of 2007 in the mortgage banking sector. As a result of the interwoven status of financial intermediaries, the crisis has influenced other sectors including both the financial sector and the real economy.

Although its causes can also be found in the development of the U.S. economy prior to 2007, “the current crisis has had three precipitating factors: 1) mismanagement of financial innovation, 2) an asset price bubble that burst, and 3) deterioration of financial institution balance sheets”.¹ In the first half of 2008 its impact began to

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¹ F. S. Mishkin, “Is monetary policy effective during financial crises?”, Working Paper 14678, National bureau of economic research, Cambridge, 2009, p. 5

be felt in western European countries, whereas in the second half of 2008 it became also noticeable in the countries of Central and Eastern Europe. Apart from the crisis itself, the development of these countries has also been affected by other factors, such as globalisation, internalisation, economic integration and the increased openness of various markets. The aim of this paper is, in compliance with the above-explained, to analyse the evolution of money stock in the Visegrad Four (V4) and assess the possible risks associated with its further development in the future.

2. Monetary policy framework of V4

The institutional, strategic and operational direction of the monetary policy of the V4 is focused, more or less; on the acceptance of a single euro currency within the so-called economic integration (the Slovak Republic already joined the euro zone on January, 1, 2009). For this reason, the individual characteristics for each country are more or less similar or even identical.

In all cases, the central bank of a given country is responsible for the monetary policy of a given country, (Česká národní banka - ČNB, Narodowy Bank Polski - NBP, Magyar Nemzeti Bank - MNB, Národná banka Slovenska - NBS²), which according to the European Central Bank (ECB) standard seeks to ensure all four forms of independence, namely, financial, functional, administrative and institutional.

Concerning the monetary policy strategy, all these central banks monitor the transmission mechanism of inflation targets, in which the fundamental aim of monetary policy, over the medium term, is the effort to sustain the rate of inflation in a prearranged spectrum [Table 1].

Table 1: *Inflation targets of central banks in V4 countries*

	NBS/ECB	ČNB	MNB	NBP
Inflation target	Year-on-year increase in HICP below, but close to 2 % over the medium term	Annual CPI 2010, 1Q 1,4 % 2010, 2Q 2,1 %	Medium term target 3 % increase in CPI	2,5 % with permissible fluctuation band of +/- 1 %

Source: Author's own elaboration, data from www.nbs.sk, www.cnb.cz, www.mnb.hu, www.nbp.pl

Note: In the case of NBS, the inflation target is set for the entire Eurosystem.

² Eurosystem as a whole is responsible for the results of monetary policy in the euro area; the NBS together with the other national central banks in the euro area are responsible for its execution.

Table 2: Monetary instruments of central banks in V4 countries

Instruments of central banks	NBS/ECB	ČNB	MNB	NBP
Open market operations	Main instrument main refinancing operations (1W) Longer-term instrument Longer-term refinancing operations (with maturity 3 months) Structural operations Fine-tuning operations	Main instrument 2W repo tender absorbing liquidity Supplementary instrument Three-month repo tender absorbing liquidity (last in 2001 year) Fine-tuning instruments (foreign exchange operations and securities operations)	Main instrument 2W MNB-bill absorbing liquidity Fine-tuning instruments (tender and quick tender)	Main instrument 7day NBP money market bills absorbing liquidity Structural operations Fine-tuning instruments
Standing facilities	Marginal lending facility Deposit facility	Overnight marginal lending facility Overnight deposit facility	Overnight collateralised loan Overnight deposit	Overnight lombard loan Intraday credit facility Overnight deposits
Minimum reserves	Reserve requirement 0 and 2 %	Reserve requirement 2 %	Reserve requirement 2 %	Reserve requirement 3,5 %
Foreign exchange interventions	Fx-swap	Outright sales or purchases of foreign currency	Sale or purchase of foreign currency Fx-swap Foreign exchange repo transactions	Outright sale or purchase of foreign currency
Interest rates	Interest rate of marginal lending facility Interest rate of deposit facility Interest rate of main refinancing operations	lombard rate (for marginal lending facility) discount rate (for deposit facility) 2W repo rate (for 2W repo tenders)	Interest rate on O/N collateralized loan Interest rate on O/N deposit Base rate (for 2W MNB-bill)	Lombard rate (for lombard loan) Deposit rate (for overnight deposits) Rediscount rate (for minimum reserves) Reference rate (for 7day NBP Money market bills)

Source: Author's own elaboration, data from www.nbs.sk, www.cnb.cz, www.mnb.hu, www.nbp.pl

Note: In the case of NBS, it is about the instruments defined for the whole Eurosystem. Since the end of 2008, the ECB has implemented non-standard instruments to enhance to access of the contractual parties to liquidity.

These central banks, in the short term, affect liquidity through their instruments with a maturity of one day to two weeks. Concerning the applied monetary instruments, market or indirect forms of instruments are applied in excess, mainly open market operations (mainly repos and repo tenders with maturity from one day to three months), standing facilities, minimum reserves, and as the main operational tool for the regulation of national markets, the central banks use the so-called “key” interest rates (NBS – interest rate on the main refinancing operations, CNB – two weeks repo rate, MNB – base rate, NBP – reference rate).

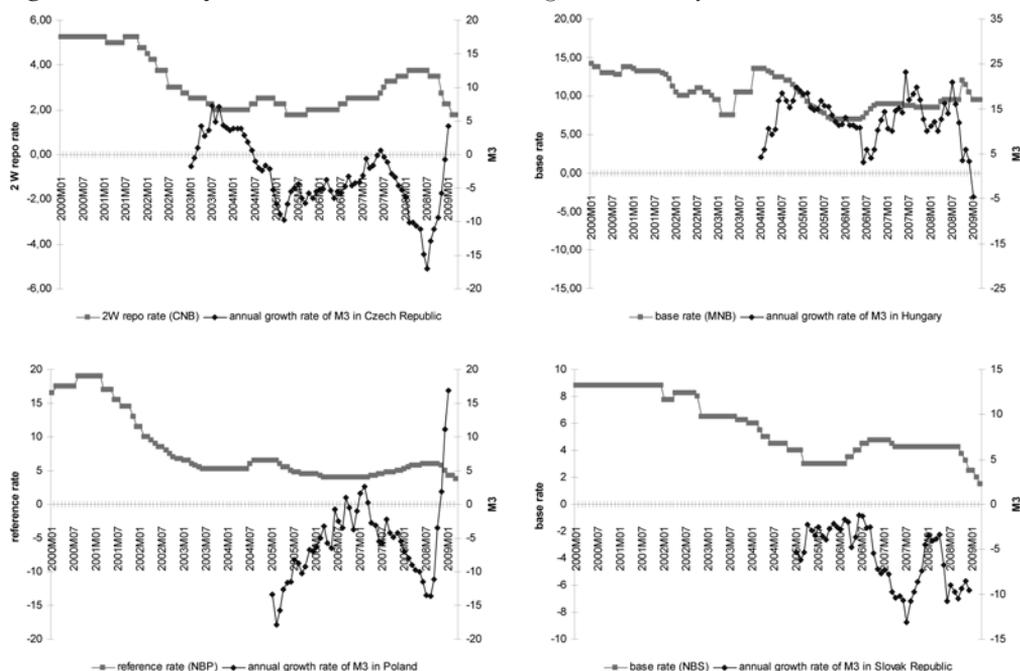
The central banks of the V4 apply the issuance of their own debt securities to manage liquidity in the long run.

3. Money stock developments in V4

The mechanism, by which it is possible to monitor the impacts of monetary policy on the money stock, can be traced through the influence of the central banks on market interest rates, exchange rates, equity prices, the credit stock of the banking sector and the expectations of individual economic entities. On the other hand, economic entities respond to the signals of the central banks by shaping the demand for goods and services in the form of decisions on consumption and investment.

Central banks, in the examined countries, have been forced to decrease their key interest rates due to the slowdown in financial flows in the domestic environment and the decline in the liquidity of foreign parent commercial banks. Since mid-2008 there has been only a single event signalling the increase in key interest rates. It was recorded in October 2008, when MNB responded to the depreciation of HUF with a primary interest rate increase, from 8.5 to 11.5%, but later it acceded to its manifold decline. Recent changes in interest rates indicate a continuous trend in the relaxing of the monetary policy. In April 2009 the key interest rates of the central banks were as follows, NBS / ECB 1.25%, 9.5% MNB, CNB 1.75% and 3.75% NBP. Money stock in the Czech Republic and Poland [Figure 1 - 4] positively reacted to the reduction in key interest rates. Whereas, in Hungary, the relaxing of monetary policy did not influence the money stock, in the case of Slovakia in the second half of 2008 there was a specific development. A significant impact on the money stock was due to the preparation for the conversion of the Slovak crown to euro (an increase of deposits of physical entities and businesses to facilitate and accelerate the exchange of currencies) rather than to the adjustment of interest rates of the NBS to the ECB levels. The reduction of the interest rates in the short term is permissible in view of the fact that in all countries there is a decrease in inflation [Figure 5 - 8].

Figure 1 - 4: Key interest rates versus annual growth rate of M3 in V4 countries (in %)

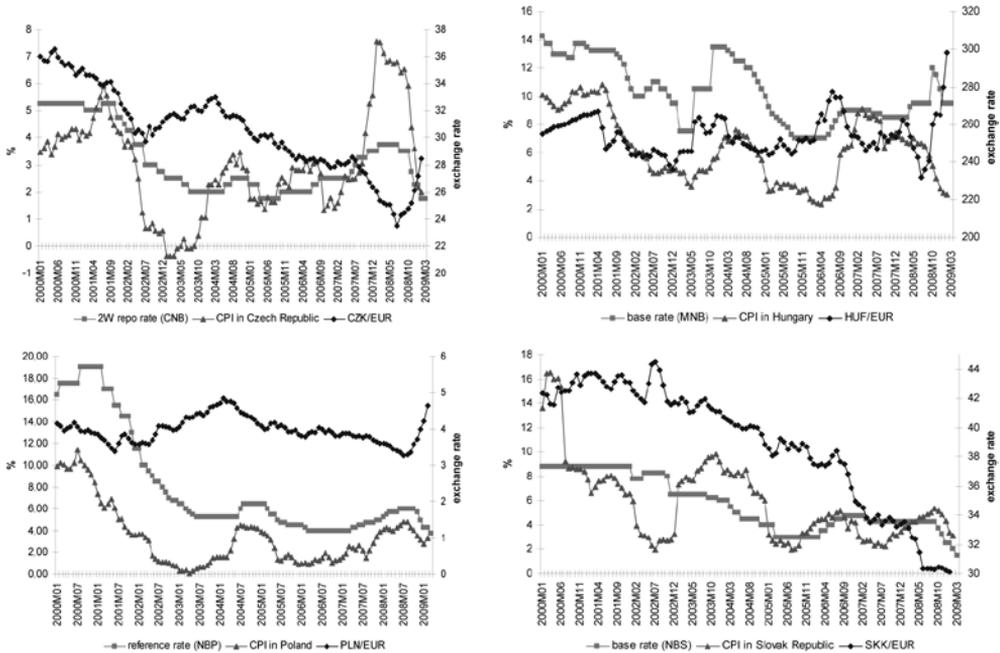


Source: Author's own elaboration, data from http://europa.eu/index_sk.htm

In the longer term, the monetary policy, on a larger scale, is shaped by the expectations of economic entities about the future evolution of short-term interest rates. In theory, this means that “if an interest rate hike by the central bank is expected to be temporary, longer term interest rates will not be affected to the extent short term rates change. On the contrary, if market expects higher rates will remain for longer period, long term yields increase more, thereby monetary policy may be more effective”.³ It is now a global trend to reduce the key interest rates of central banks to the extent of inflation decline. [Figure 5 - 8]. In the long term the financial crisis predetermines this trend also in long-term interest rates. Of course, if one takes into account how different countries approach the protection of their own markets, the risk of increasing inflation in the long term will bring about the increase of long-term interest rates, to which, with all probability, central banks will be the first to respond.

³ *Monetary Transmission in Hungary*, Magyar Nemzeti Bank, Budapest, 2006, p. 12

Figure 5 - 8: Key interest rates (in %), CPI (annual growth rate in %) and exchange rates in V4 countries



Source: Author's own elaboration, data from http://europa.eu/index_sk.htm

Note: To January 1, 2009 the key interest rate of NBS was the base interest rate which copied the rate of two-week sterilising repo tenders.

From the perspective of the development of exchange rates against the euro, a similar trend in the development of the Czech and the Slovak crown can be observed since 1999, which can be explained through the political interdependence of these countries in the past (the successor states of former Czechoslovakia), through their subsequent economic orientation, the cooperation of economic entities at all levels, the structure of foreign trade, cultural cohesion and consumption habits of their citizens.

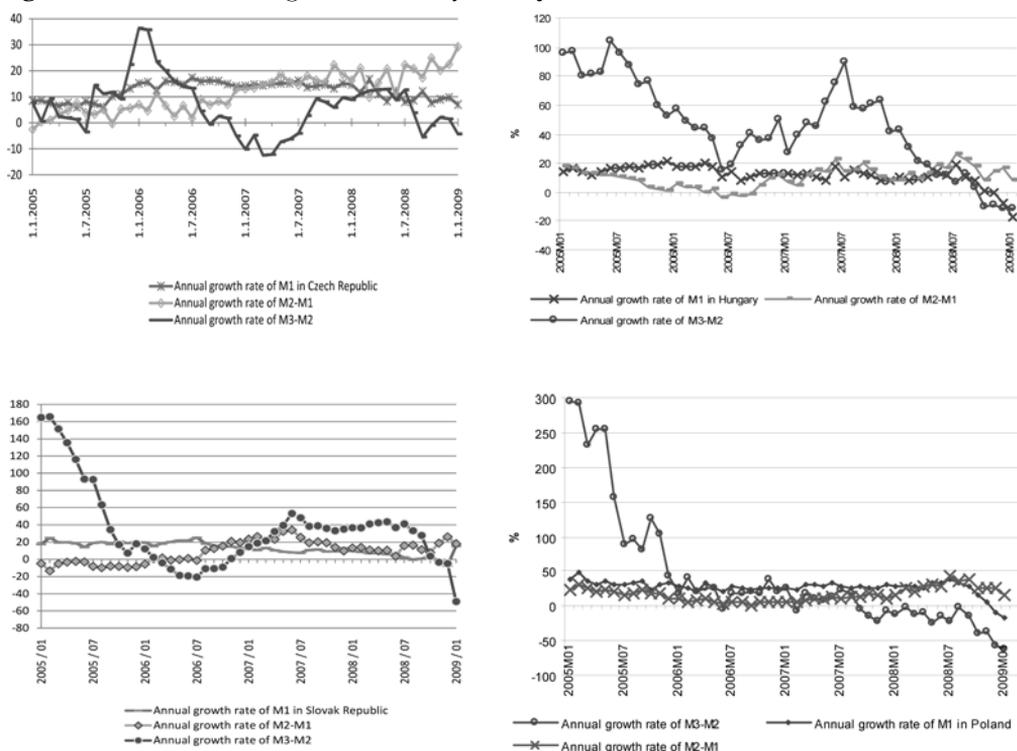
The exchange rates of the V4 to the euro in general (even HUF) maintained, till mid-2008, an appreciation trend, but the subsequent drop in demand both in foreign and domestic markets (high openness of these economies), as a result of the current financial crisis, caused a reverse tendency in their development (the Czech crown, the Polish zloty and the Hungarian forint started to signal a depreciation trend). In the case of the Slovak crown there were significant roles played by the preparation for the introduction of the single euro currency, i.e. the participation of SKK in the ERM⁴ system, the declaration of a fixed conversion

⁴ Slovak koruna was included in ERM II 25 November 2005 with central rate 38,4550 SKK/EUR with standard fluctuation band of plus or minus 15 % (32,6868 – 44,2233 SKK/EUR).

rate and the introduction of the euro into circulation by way of Big Bang (as well as into a non-cash and cash payment system). In this context, we can conclude that the entry of Slovakia into the euro zone on January, 1, 2009 meant for its economy a protection from the negative effects of the financial crisis.

To some extent, it is possible to examine whether the exchange rate is influenced by changes in key interest rates of central banks. The relaxing of the monetary policy in the V4 (decrease of key interest rates) has been reflected in the deterioration of their domestic currencies. In Hungary, “during the past 5-10 years the monetary policy has been able to influence the exchange rate. An unexpected 25 basis point rate hike on average appreciates the exchange rate almost immediately by 0.5-1 percent”.⁵ However, as shown in Figure 5 - 8, after the reduction of key interest rates, the decreasing inflation did not decline below the transition of the currencies in the Czech Republic, Poland and Hungary into the appreciation zone.

Figure 9 - 12: Annual growth rates of money demand in V4 countries (in %)



Source: Author's own elaboration, data from www.cnb.cz, www.nbp.pl, www.nbs.sk, www.mnb.hu

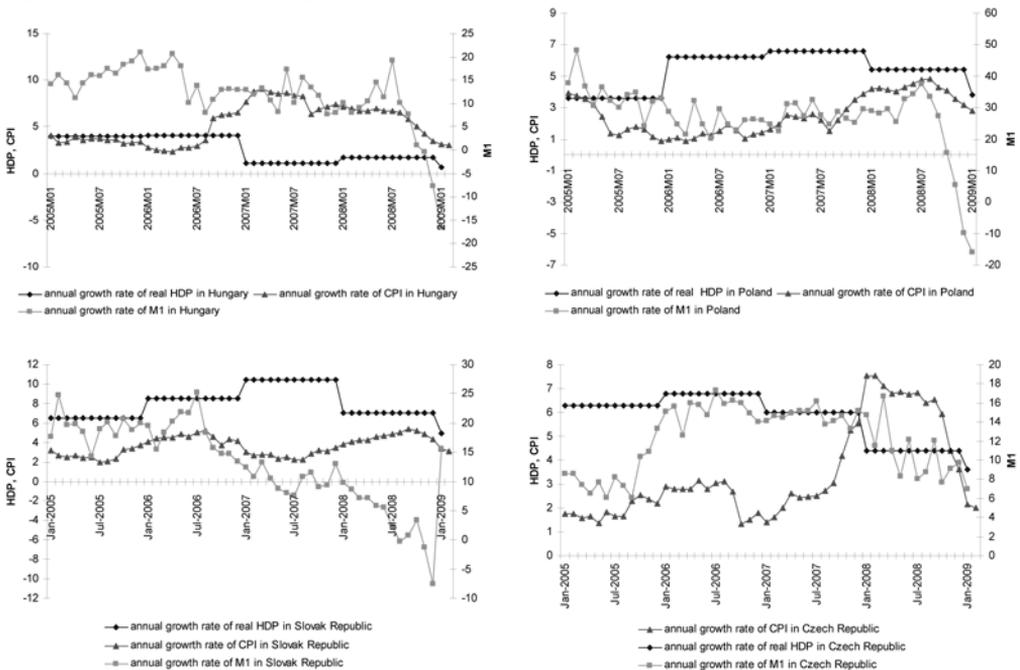
On 19 March 2007 central rate changed to 35,4424 SKK/EUR (lower rate 30,1260 – upper rate 40,7588 SKK/EUR) and on 29 May 2008 to 30,1260 SKK/EUR (lower rate 25,6071 – upper rate 34,6449 SKK/EUR).

⁵ *Monetary Transmission in Hungary*, Magyar Nemzeti Bank, Budapest, 2006, p. 14

The evolution of demand for money in the V4 indicates some trends in terms of motives of holding money. As shown in Figure 9 - 12, transaction demand for M1 has declined; under the influence of the financial crisis precautionary demand (M2 - M1) has increased and speculative demand (M3-M2) has taken a significant downward trend. This trend, since mid-2008 in the Slovak Republic, has been associated with the preparation for the introduction of euro into circulation; in Hungary, Poland and the Czech Republic with the depreciation of national currencies against the euro.

If we follow the evolution of demand for money, it is interesting to notice how the demand for money develops, which is measured by the individual monetary aggregates in relation to inflation and GDP [Figure 13 -16].

Figure 13 - 16: Annual growth rate of real HDP, CPI and M1 in V4 countries



Source: Author's own elaboration, data from http://europa.eu/index_sk.htm, <http://stats.oecd.org/WBOS/index.aspx>

The longest upward trend in real GDP was recorded only in Slovakia (until 2008) from V4. The negative effects of the global financial crisis began to be seen in real GDP in the second half of 2008 in the regions of V4.

In the case of Hungary, a strong increase, at the turn of 2007 – 2008, was related mainly to the historically high returns from agricultural production and the positive development of the structure of domestic consumption (household

credit boom persisted). Hungary fell into recession in the last quarter of 2008 (GDP fell by 1% and in the interim annual period it decreased by 2%). From the V4 Hungary has been most significantly affected by the financial crisis. There has been a rapid decline in exports, manufacturing and retail sales of durable goods. The Hungarian government has revised its forecast. The assumption is that the GDP will reduce by 3%, not by 1%, as was the original forecast; therefore, GDP in 2009 will reach the level of -1.7 to -0.2%.

The key factors affecting the development of GDP in Poland included the growth in consumption, investment, employment and high wages, the appreciation of the Polish zloty and as a result, the growth in domestic demand, particularly in import. These conditions, however, changed significantly at the end of 2008, when there was a decline in investment, industrial production and exports, and the rate of unemployment increased. According to recent official statements (on February 2009) in 2009 Polish GDP growth is expected to be less than 1.7%.

In the case of the Czech Republic in 2008, GDP reached a 3.5% annual growth, a value lower than the OECD forecast in our chart. In 2009 the Czech National Bank (CNB) assumes an interim annual growth of real GDP at the level of - 0.3%. The main factors of this development are mainly the decrease in gross capital formation (in particular, declining investment in stocks). Fixed investment growth has decreased due to a declining foreign demand and low profitability of enterprises. Household consumption and the contribution of net exports to GDP have decreased too.

Slovakia in terms of real GDP continues to maintain the best position among the V4. GDP in the SR, however, decreased from 9.3% in the first quarter of 2008 to 2.7% in the last quarter of 2008. Positive factors still maintain efficient consumption and the increase of stocks. The anticipation for 2009 in terms of the NBS is 2.1% of the GDP growth.

Let us return to our relationship between inflation, GDP and M1. Milton Friedman analyzed this relationship in the conditions of the U.S. in the 70s of the 20th century. He concluded that "the highest correlation for industrial production is for money leading M1 for three months and six months for M2. This was no surprise. What was a surprise was to find that the highest correlation for consumer prices was for money leading twenty months for M1, and twenty-three months for M2".⁶ Something similar was studied by Lorenzo Bini Smaghi, who argued that "in the euro area, the low-frequency component of M3 growth leads the low-frequency component of the HICP inflation by about two years."⁷

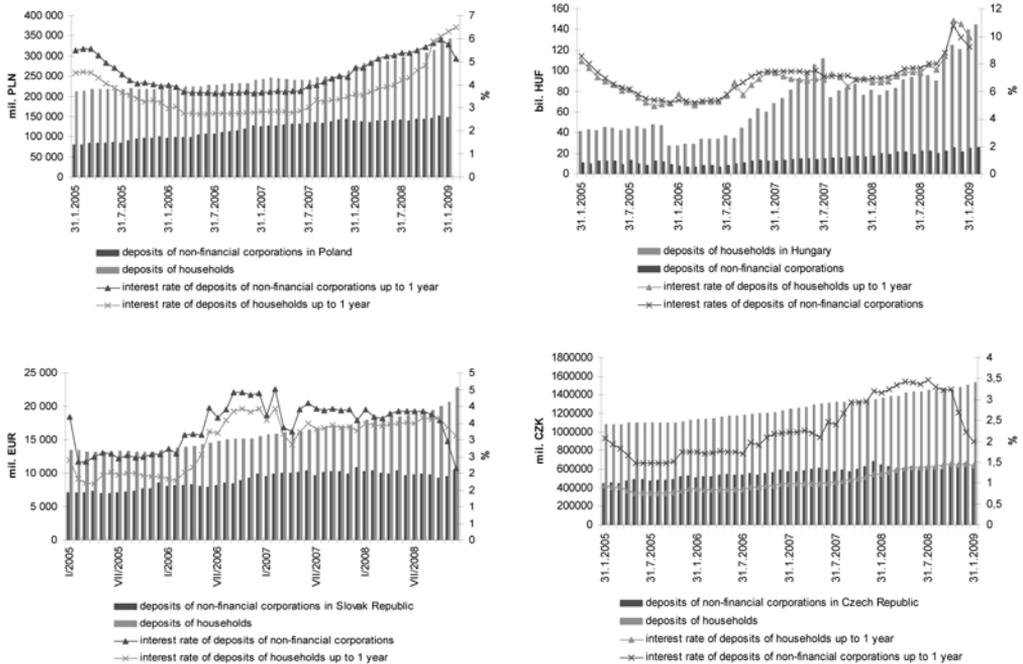
Based on the limited availability of the statistical database, we can not confirm these conditions in relation to the V4, but as shown in Figure 13 - 16, it can be concluded that aggregate M1 fell in line with the decline in real GDP (at

⁶ M. Friedman, "Have Fiscal and/or Monetary Policies Failed? Have Monetary Policies Failed?", *American Economic Review*, Papers and Proceedings, 62 (1-2), 1972, p. 15

⁷ B. Smaghi: "Three questions on monetary policy easing", 2009, p. 2

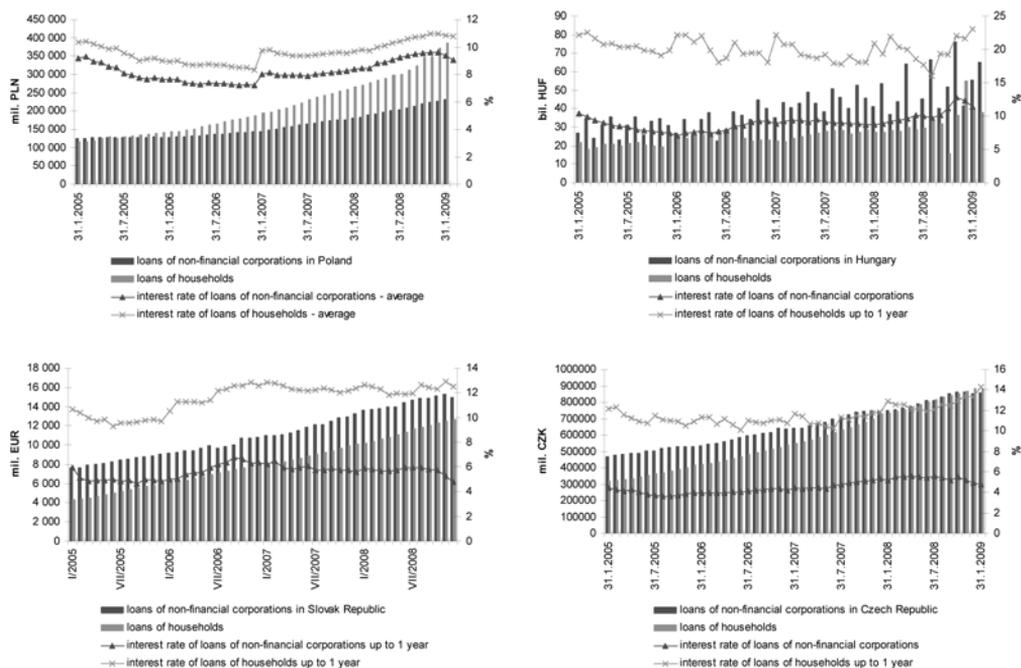
the beginning of 2009 in Slovakia M1 grew in connection with the introduction of the new currency EUR), but in the case of the relationship between M1 and CPI index it can be observed that the decline in M1 occurred before there was a decline in the CPI index. We can explain that the evolution of inflation in the V4 was affected mainly by external rather than internal factors (decline in oil prices and foodstuff).

Figure 17 - 20: Deposits of non-financial corporations and households in V4 countries



Source: Author's own elaboration, data from www.nbs.sk, www.cnb.cz, www.nbp.pl, www.mnb.hu

In all the V4, household deposits are significant; however, it was only in Poland, where there was no decline in the interest rates. Deposits of non-financial corporations also had an upward tendency, while there was a significant decline in the interest rates compared to rates to households.

Figure 21 - 24: Loans of non-financial corporations and households in V4 countries

Source: Author's own elaboration, data from www.nbs.sk, www.cnb.cz, www.nbp.pl, www.mnb.hu

In the case of loans, we can see a predominance of borrowings by non-financial corporations (except for Poland where the household loans are in excess). Interest rates on loans rose both in the Czech Republic and Hungary.

Financial institutions in Hungary are closely intertwined with financial institutions abroad. The formation of deposits and borrowings in foreign currency are regarded as being natural by individual economic entities. Banks acquired funds in foreign currency through swaps, but their maturity was shorter than of the loans for which they were provided, which caused liquidity problems for the banks. However, after the events in the foreign exchange market in October 2008, the growing problems with domestic and foreign liquidity led these banks to the fact that they increased their interest rates for loans and tightened lending conditions and also reduced their supply of loans in foreign currency. For Hungarian households' loans in Swiss francs used to be popular, not only for consumption but also for investment purposes.

In the case of Poland, the demand for money as measured by M3 in the first half of 2008 rose by 18% due to the interest of households in deposits in banks (due to high interest rates). On the other hand, both households and businesses

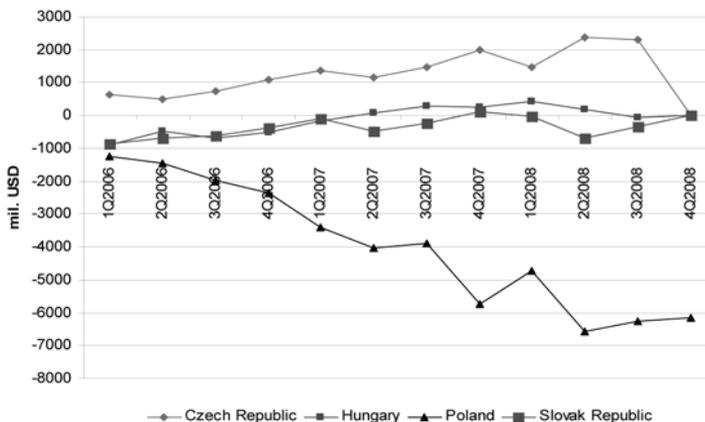
declared interest for loans both in the Polish zloty and the Swiss francs (particularly mortgages in Swiss francs).

4. Conclusion

The Central European region, namely the V4, has exhibited similar features of macroeconomic developments for a long time. It is therefore clear that the global financial crisis is similarly noticed in these economies. The only question is how economies manage to absorb the crisis, and therefore to what extent its negative effects will be seen. The impact of the financial crisis and the openness of these economies, have led to a decline in bank liquidity (liquidity transfers from subsidiaries to parent banks in the more developed parts of the world), export has declined (due to lack of liquidity, foreign demand decreases abroad) unemployment has increased (which has a negative effect on household income), which in turn has changed the structure of demand (import is declining, investment is decreasing and consumption has dropped due to a decline in wages), GDP has decreased (declining revenues from taxes and public deficit deepens).

As it is possible to read from Figure 25, in the second half of 2008, there was a sharp drop in exports, mainly in the Czech Republic, whereas in Poland this trend has already been present since the beginning of 2006. The financial crisis means a fall in demand from customers, a further decline can be expected both on the export and import sides (declining purchasing power of domestic consumers); on the other hand, the depreciation of currencies, to some extent, can enhance exports.

Figure 25: Balance of goods in V4 countries

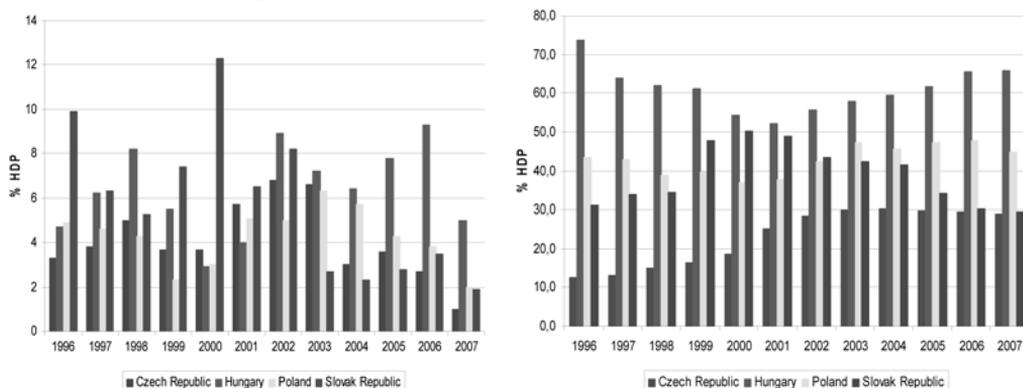


Source: Author's own elaboration, data from www.oecd.org/statsportal

In terms of the development of liquidity in the V4 it can be argued that these economies do not have problems with short-term liquidity (as the main instruments of monetary policy are the sterilizing repo tenders) but with long-term liquidity. Short-term instruments are of importance, there has been excessive sterilizing. Refinancing is applied only in the SR.

The crisis needed reactions from central banks. In addition to lowering interest rates, relaxing the conditions on the interbank market to maintain the necessary liquidity (reducing the rates of minimum reserves in Hungary); the central banks provided the necessary liquidity for the market by special operations in foreign currencies (operations between NBP, MNB and the ECB). Based on the declining inflation in the whole region the response of central banks to the problems of adequate liquidity is moderate. Although the relaxation of monetary policy was not operational in the reduction of interest rates on loans of financial institutions, on the contrary, they tightened lending conditions, and even increased the interest rates on loans; it is not possible to claim that the current monetary policy of central banks is not effective or is even unnecessary. As Lorenzo Bini Smaghi claimed "... in countries where the private sector, in particular the participants in the goods and labour markets, are less flexible in adjusting their pricing and wage behaviour in the face of exogenous shocks, the central bank will be slower in easing monetary policy when confronted with a slowdown".⁸ And Frederic Mishkin added "if the goal of the monetary authority is to offset the contractionary effects of a financial crisis like the current one, then it may need to pursue more aggressive monetary policy easing than normal."⁹

Figure 26: Deficit of public finance as a % of GDP **Figure 27: Public debt as a % of GDP**



Source: Author's own elaboration, data from <http://epp.eurostat.ec.europa.eu/tgm/refreshTableAction.do?tab=table&plugin=1&init=1&pcode=teina200&language=en>

⁸ L. B. Smaghi: "Three questions on monetary policy easing", 2009, p. 3

⁹ F. S. Mishkin, "Is monetary policy effective during financial crises?", Working Paper 14678, National bureau of economic research, Cambridge, 2009, p. 2

Central banks are aware of the medium-term objectives in the area of inflation, in the long term; however, low interest rates are unlikely to remain sustainable given the potential risk of growth of inflation due to problems in the real economy and public finances. To speak about the medium and long term these days, however, seems to be too early, since the financial crisis has just begun.

As for the evolution of public finances, the information available from Eurostat [Figures 26, 27] points to the fact that in 2007 in terms of the Maastricht criteria on public finances in an area of V4, Hungary is in the worst of situations (state budget deficit / GDP 5% and public debt / GDP 65.8%), other countries are meeting the prescribed debt ratios (CR 1.9% and 29.4%, 1% CR and 28.9%, Poland 2% and 44.9%). The financial crisis in the future will lead to decreases in revenues to the state budget, on the other hand, there will be increased expenses associated with the growth in the rate of unemployment, spending on public projects to support economic activity.

Finally - real GDP growth since the middle of last year in the V4 has decreased, unemployment has risen and nominal wages have also decreased. But due to the deterioration of exchange rates against the euro, anti-inflationary pressures have weakened. Developments in public finances support will the growth of inflation and central banks must be prepared for that, if they want to meet their medium-term objectives in the area of inflation. The relaxing of the monetary policy will not be endless, whereas the assistance from the state in the monetary policy will make the situation only worse. We need to prepare for the fact that Central Europe will fall into recession and it will be a question of a longer term, to find remedy to recover from this uncomfortable situation.

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THE AGIO IN THE KINGDOM OF SERBIA

Abstract: *One of the distinctive phenomena linked to money in circulation in The Kingdom of Serbia was the agio: a premium paid when purchasing gold for silver banknotes. Thus, the agio was an expression of the percentual depreciation of the national currency in relation to gold as an international means of payment. The opinions of contemporaries on the causes of the agio differed. After the State and National Bank expressed opposite views on the agio, the State limited the quantity of silver banknotes in circulation by law. This initiated a period of Government interventionism in the operations of the National Bank, which had negative effects on economic activity and macroeconomic stability.*

Key words: *agio, bimetallism, state interventionism, The Kingdom of Serbia*

JEL classification: N13, E42

1. Circulation of money based on bimetallism

Monetary theory and history are well acquainted with the fact that the existence of several different types of coined money in circulation, produced from different kinds of monetary metals, brings daily fluctuations in its exchange value, depending on fluctuations in monetary metal prices, coin quality, and the ratio of their supply and demand. As far back as antique Greece, Aristotle noted that when full-value money and money whose real value is less than the nominal value are put into circulation, the "bad money" will eventually displace the "good money." Much later Sir Thomas Gresham also came to understand this phenomenon, and formulated a law that was named after him: when two types of money circulate in a certain country, the less valuable money will remain in circulation, while the other will be hoarded as wealth or exported, which once again means that bad money displaces the good. It is easy to explain the causes of the said phenomenon: if a currency with a value lower than the nominal value is used as a medium of exchange parallel with the currency whose value is equal to the nominal value, everyone will seek to pay their obligations with the worse currency and retain the good one for as long as possible.

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During the 18th and the 19th centuries, in monetary systems based on bimetallism, i.e., the concomitant circulation of gold and silver currency, the monetary authorities always tended to set down a legally-based ratio between the value of gold and silver. This proved to be difficult to implement in practice, because the market value of silver often fluctuated, due to the constant opening of new mines. Countries whose monetary systems were based on bimetallism could draw on their practical experiences, according to which the best solution was to avoid legal regulation of the ratio between the value of gold and silver. For example, in France in 1803, the legalized ratio between gold and silver was 1:1.15. Until 1856, silver was in circulation, while a premium was paid for gold, called the *agio*. After that year, gold began to be hoarded, and the value of silver rose. As a result the legal ratio was disturbed, in the opposite direction.¹

With the appearance of money issuing banking, monetary systems based on bimetallism were faced with the problem of bimetallistic coverage of the money in circulation. The currency in circulation shared the fate of the monetary metal for which it was exchangeable according to the official rate. Namely, until World War I the gold standard ruled, and there could be no deviation from it: money issuing institutions issued banknotes, notes in their own name, obligating themselves to pay the bearer at any time he appeared at the bank window their face value, i.e., the amount to which the bank obligated itself vis-à-vis the bearer of the note. Money issuing banks issued notes against the specie held in their vaults. The public knew that the money existed in the bank and trusted that the bank would pay for its notes in cash. When trust in the issuers of the notes was firm, no one thought to exchange notes for specie, but rather handed them over to their creditors, who did the same in turn. In that way, the notes² circulated from hand to hand, very rarely getting to the bank for exchange.

“From the fact that paper money is rarely exchanged for specie, science and practice drew the conclusion that it is not always necessary to hold in the bank vaults a quantity of specie equal to the quantity of issued paper money, but that a much lower quantity of specie could be held in reserve for covering the bank’s obligations, if the paper money is securely placed and if the obligations of the bank’s debtors can always be collected easily and quickly. The bank can issue two or three times the amount of paper money than it has specie in its vaults, but the surplus of issued paper money must be placed in short-term and safe loans.”³ Thus, on the basis of specie, money issuing bank could issue two or three times as much paper money. In order to perform its economic function, the paper

¹ V. Dugalić, *Narodna banka 1884-1941*, p. 62

² Paper currency is a general term for notal money, i.e., for money produced in the form of notes. Banknotes are obligations issued by banks – in more recent times practically from the central bank – payable in definitive money of full value. In the beginning, they possessed only fiduciary status, but eventually gained legal currency. *Ekonomska enciklopedija*, 1986, Vol. I, p. 1056

³ *Privilegovana narodna banka Kraljevine Srbije 1884-1909*, pp. 143, 144

money had to be able to be unconditionally accepted in circulation by private persons and the state. Because of all this, money issuing institutions were subjected to state and public control, and had to abide by the existing regulations. In such conditions, the withdrawal of gold from circulation when its market price grew relative to silver would lead to a situation in which an agio was paid when purchasing gold, in the form of a premium in silver coins or in paper currency that was redeemable for silver.

2. The money issuing activity of the Privileged National Bank of the Kingdom of Serbia

The issuing of paper money was one of the most important passive operations of the Privileged National Bank of the Kingdom of Serbia. This privilege was set out in Article 7 of the Law on the National Bank of 1883. The method of putting banknotes into circulation was relatively simple: the National Bank disbursed the credits and loans it approved (on the basis of discounted bills and collateral) in the form of its banknotes, with which the credit users could meet their other obligations and make other payments. In order for the banknotes to hold value in circulation, it was necessary for those that accepted them to be confident that they could exchange them at any time for their nominal value. However, despite the excellent response during the subscription and payment for National Bank shares, the entry of the banknote into circulation caused problems. Serbia's economy and population of that time did not readily accept paper money. Even before the banknote was released into circulation as a means of payment, the National Bank had anticipated certain difficulties, as the banknote was a novelty for a people that had been using exclusively specie for payment since times immemorial. The people's distrust of paper money was magnified by adverse experiences with Austro-Hungarian paper money issued by the Austrian state and its central bank, which had waged an inflationary policy.

The paper money put into circulation by the Privileged National Bank was backed by gold, silver and other valuables. The gold and silver encompassed all the metal cash in the bank's treasury, which covered at least 40% of the entire value of the notes in circulation. The gold-redeemable banknotes had to be backed by metal cash that was at least three-fourths gold, while the silver-redeemable ones could be backed by either silver or gold, or mixed silver and gold. The 40% metal backing adopted by the Law on the National Bank of 1883 was a relatively strong one. By law, the values securing the paper money had to be safe and easily convertible to gold and silver. In the beginning, the bank issued only gold-backed notes, but soon began to issue silver-backed ones as well. While only the gold-backed notes were in circulation, the Bank had difficulties in maintaining the metal backing in the legally prescribed ratio, as the notes were constantly

extracting coined gold from the bank's vaults. Later on, once it put into circulation silver-backed notes, the Bank was able to constantly maintain full backing for gold-redeemable notes, meaning that they were backed by metal 100 percent, and that the Bank was able to pay out all the gold-backed notes with coined gold, without any effect on the metal backing for the silver-redeemable notes.

The money issuing of the Privileged National Bank was based on the principles of safety and liquidity, in accordance with the legally defined minimum of a 40% gold backing of the paper money in circulation. In peaceful and stable periods, the lowest rate of backing for the notes was achieved and there was little pressure on the Bank's windows to exchange notes for metal specie. Data from the National Bank's annual reports show that, at the end of 1900, the notes were 46.40% backed, and 45.38% in 1894, which was constantly above the legally defined rate. However, in unstable times or during bad crops, and especially in times of war, it was insisted that the backing for the notes had to be above the legally prescribed rate.⁴ The Bank consistently fulfilled its obligation of unlimited conversion of notes into gold coin, with only one exception. After the Balkan War broke out in 1912, the Bank had the right to pay out 25% in silver for gold-redeemable notes, which lasted until January 28, 1914. After World War I broke out, the National Bank suspended for the first time its obligation to pay banknote bearers in gold and introduced a compulsory exchange rate.

The Privileged National Bank of the Republic of Serbia began operations in 1884, by putting into circulation 100 dinar gold banknotes, whose value was, however, too high for Serbian conditions of the time. Not only was the populace not ready to accept the first Serbian paper money, but many monetary institutions and savings banks, such as the Fund Management Board, caused problems regarding its acceptance. However, it turned out that this first note issued by the Privileged National Bank had all the markings of "good money", since this national money issuing institutions strictly fulfilled all the obligations of the gold standard. "While the first Serbian paper money had difficulty coming into life, it was able to remain in circulation for a relatively long time, practically until the beginning of World War I. Out of the 50,000 notes that were put into circulation, only 1099 were to be withdrawn over 30 years, due to damage, which testifies to the exceptional quality of this, the first banknote of the National Bank. Additional testimony of its good quality lies in the fact that not a single case of forgery was registered during its three decades of existence. Officially, this first banknote of the Privileged National Bank of the Republic of Serbia was released

⁴ For example, after the Customs War that Austria-Hungary waged against Serbia, coverage equaled 73.97% at the end of 1906, 85.51% during the First Balkan War in 1912, and as high as 115.63% in the first year of World War I. V. Dugalić, A. Mitrović, D. Gnjatović, G. Hofman, I. Kovačević, *Narodna banka u Kraljevini Srbiji 1884-1914*, p. 34

into circulation in 1884, and withdrawn and finally retired on February 5, 1921. Only 73 notes were not withdrawn from circulation.”⁵

The first year of the Bank’s operations, when only the 100 and 50 dinar gold notes were issued, was marked by a weak circulation, which fell far short of its basic task. Economic circumstances were not favorable to the sustainment of the 50 and 100 dinar gold-redeemable notes in circulation. It was not until 10 dinar silver-backed notes were issued that the Bank could begin to meet its task. The silver-redeemable note was issued according to Article 11 of the Law on the National Bank, backed by metal specie and safe commercial and financial values, with the same ratio between specie backing and circulation that was set for the gold-backed notes. However, the issuing of gold-backed notes was not limited by law, while that of silver-backed notes was. According to amendments passed in 1885, when the silver-backed notes were introduced, no limitations were set. The Bank could issue two-and-a-half times more notes than the amount of specie it held in its vaults, whether they were gold or silver. The free issuing of silver-backed notes lasted until 1893, when a legislative interpretation limited the issuing of these notes to 10,000,000 dinars. Subsequently, quotas were adopted: first 25,000,000 dinars, then, later, 30,000,000 dinars. According to the last Law on the National Bank of the Kingdom of Serbia, of March 15, 1908, the circulation of silver-backed notes was limited in such a way that the maximum issuing was tied to the Bank’s paid-in capital. Thus, the Bank could put into circulation a fivefold value of notes relative to paid-in capital.

Thus, after initial problems, the National Bank’s operations had stabilized by the end of 1885, thanks especially to the introduction of the silver 10 note. The stronger banknote circulation helped intensify the entire bank’s operations: crediting of the economy and the state, interventions on the gold market and strengthening of the metal backing. The silver ten note saw the greatest circulation in autumn, at the height of the agricultural season. The annual growth in the circulation of silver paper currency equaled about 4 million dinars, while the differences in annual fluctuations were twice as large. The share of the gold-backed note in total money in circulation for the entire pre-World War I period was only about 5%, although the state had always favored it. The main shortcoming of the gold-backed note was that it was constantly being brought in for redemption.

⁵ J. Hadži-Pešić, *Novac Srbije 1868-1918*, p. 93

Table 1: *Circulation of National Bank of the Kingdom of Serbia banknotes with gold and silver backing, 1884-1914 (yearly value in millions of dinars)*

Year	Banknotes with gold backing	Banknotes with silver backing	Total circulation
1884	0,781,800	0.000000	0,781,800
1885	1,568,700	1,931,340	3,500,040
1886	0,437,550	5,301,320	5,738,870
1887	0,182,230	9,855,570	10,037,800
1888	0,141,350	13,937,010	14,078,360
1889	0,101,950	17,233,520	17,335,470
1890	0,082,300	23,393,140	23,475,440
1891	0,122,600	27,148,930	27,271,530
1892	0,160,450	28,714,000	28,874,450
1893	0,195,550	26,570,850	26,766,400
1894	0,548,000	24,515,580	25,063,580
1895	0,421,950	24,167,990	24,589,940
1896	0,659,150	23,802,010	24,461,160
1897	0,974,800	22,865,880	23,840,680
1898	0,364,150	32,780,440	33,144,590
1899	0,839,900	33,167,230	34,007,130
1900	0,849,150	35,029,470	35,878,620
1901	1,117,000	33,941,690	35,058,690
1902	2,123,750	34,689,700	36,813,450
1903	3,684,950	35,166,200	38,851,150
1904	3,142,200	34,874,990	38,017,190
1905	3,104,050	33,981,150	37,085,200
1906	2,278,650	27,952,140	30,230,790
1907	7,556,570	29,807,050	37,363,620
1908	3,373,840	47,038,010	50,411,850
1909	3,464,480	46,383,620	49,848,100
1910	7,037,260	42,617,370	49,654,630
1911	13,981,340	51,841,880	65,823,220
1912	5,336,440	88,288,860	93,625,300
1913	4,285,280	99,153,290	103,438,570
1914	3,665,120	163,595,970	167.261090

Source: *Narodna banka 1884-1934*, Zavod za izradu novčanica i kovanog novca (Mint of the Kingdom of Yugoslavia), Topčider, Belgrade, 1935

3. Monetary circulation and the appearance of the agio in the Kingdom of Serbia

The agio was one of the key phenomena tied to monetary circulation in the Kingdom of Serbia. The agio represented a premium paid for the difference between the nominal value of gold and the silver banknote, and was an expression of the percentual depreciation of the national currency in relation to gold as an international means of payment. Its at least occasional appearance is inevitable under a regime of bimetallism. Theoretically speaking, the agio would not exist if the money issuing bank had at its disposal all the currencies necessary by kind and quantity for the needs of monetary circulation and if one kind could always be replaced by another, in nominal value. Only in that case would the bearer of a silver-backed note not have to pay an agio in the course of exchange for gold specie. As far as gold specie is concerned, in the long term it cannot be present in greater or lesser quantity than that demanded by needs in circulation. If a greater quantity than necessary were to appear, prices would rise, leading to an increased import of goods and an increased export of gold, which would restore the equality of gold supply and demand. In the opposite case, if less gold than needed appeared in circulation, prices would fall, stimulating export of goods. The increased inflow of gold from abroad would then restore the balance between the metal's supply and demand.⁶

The agio for gold increased with the big and sudden rise in the circulation of silver-backed notes during the early 1890s. A price difference appears between the value of domestic money and money with which obligations can be paid on the international market in all countries with weak productivity and a large foreign debt. The greater the demand for the international means of payment and the less of it is available in a country, the more expensive it is. The agio was the difference that needed to be paid in domestic money for the international during the time of the gold standard, its level depending on the country's balance of payments. "During exporting season, international money flows into the country, it is readily available and cheaper to purchase and, as a result, the agio falls. As soon as exports stop, the money no longer enters the country and becomes more expensive, so the agio rises. Thus, the agio is the result of an insufficient amount of money with which obligations can be paid on the international market, i.e., gold."⁷ After the founding of the National Bank and after silver banknotes were put into circulation, the agio jumped, reaching almost four dinars for a single gold coin, the Napoleondor. Bad economic policies, low exports of primary products, large imports of processed goods and the accompanying greater export of gold, the disorderliness of state finances and a constant budget deficit resulted in a constant tendency of the agio to rise.

⁶ D. Gnjatović, V. Dugalić, B. Stojanović, *Istorija nacionalnog novca*, p. 195

⁷ *Privilegovana narodna banka Kraljevine Srbije 1884-1909*, p. 155

More was written on the causes of the agio than perhaps any other economic problem in Serbia, especially in the period between 1893 and 1903, when the agio was the highest. One of the most frequently cited reason for the existence of the agio was the supposedly large circulation of silver banknotes.⁸ The constantly increasing level of the Bank's activity, which could be noticed after initial difficulties, was best reflected in the increase in the average circulation of silver banknotes. The increased circulation broadened the scope of the Bank's business, which, however, brought on substantial criticism from the public, business and the state. "When, in the context of a series of bad years, unregulated state finances, a period of substantial state borrowing from abroad, as well as the internal political situation, an unprecedentedly high agio on gold appeared, popular opinion held that this was connected with the increase in the circulation of silver banknotes. Having in mind that the agio always caused unrest in the business world and a fall in confidence in commerce, it is understandable that its appearance had a disquieting effect on the public on this occasion as well. It was claimed that the National Bank was increasing the monetary circulation out of pure profit-taking reasons and that the agio was unnecessarily high."⁹ This kind of complaint was based on the fact that a large portion of the silver banknotes in circulation was not being used for crediting business but for the purposes of the Bank's gold buying and selling operations. "Everyone could see that an agio had to be paid for the gold that was being purchased for the Bank's silver notes. As a result, without observing things in greater detail and looking into the real causes for the agio, people began to clamor against the Bank's silver note, seeing in it and its increased circulation the cause of the agio."¹⁰ The Bank's management tried to explain that the silver banknote did not exert as much influence on the agio as the negative foreign balance of payments and bad state finances did. Data showed that the agio was the lowest when the circulation of the paper currency was the highest. Thus, groundless attacks on the Bank often replaced serious discussion on the matter.

The agio in Serbia was a result of bad financial and economic state conditions at the end of the 19th and the beginning of the 20th century. The primary problem lay in the unfavorable condition of state finances, which ran constant deficits over a 25 year period (1878-1903). Another cause of the depreciation of the national currency was the state's borrowing from the money issuing bank for the purposes of repaying its external debts. Foreign borrowing forced the state to purchase gold domestically and export it abroad in order to pay its debts. The reaction of the National Bank was in accordance with the spirit of its role of guardian of the national currency. More precisely, when the Bank's management noticed the agio's severe fluctuation and significant rise during times of

⁸ V. Dugalić, *Narodna banka 1884-1941*, pp. 54, 55

⁹ M. Vučković, V. Vuksanović: "Narodna banka 1884-1934", p. 31

¹⁰ *Privilegovana Narodna banka Kraljevine Srbije 1884-1909*, pp. 155, 156

foreign debt repayment, when the state purchased large quantities of gold, it immediately launched efforts to suppress the agio. Management knew that the agio couldn't be made to disappear, but it also knew that it could do much to stabilize it and reduce the price differences. The agio's fluctuations were causing the biggest damage. The only way to avoid strong fluctuations was to collect gold when sufficient amounts of it were in circulation and release it into circulation when its quantities fell.

Table 2: *The agio in Serbia 1886-1915*

Year	Agio	Year	Agio
1886	3.3%	1901	15.2%
1887	4.3%	1902	12.8%
1888	4.8%	1903	7.1%
1889	4.8%	1904	3.3%
1890	4.5%	1905	2.8%
1891	5.9%	1906	1.2%
1892	10.7%	1907	0.5%
1893	15.0%	1908	3.8%
1894	18.0%	1909	1.2%
1895	17.6%	1910	1.2%
1896	16.9%	1911	0.5%
1897	13.1%	1912	4.0%
1898	15.5%	1913	3.0%
1899.	12.6%	9/7/1914	16.0%
1900	14.5%	fall 1915	40.0%

Source: D. Gnjatović, V. Dugalić, B. Stojanović, *Istorija nacionalnog novca*, p. 196

An increase in the amount of gold banknotes in circulation brought a fall in the agio, which occurred during times of increased export revenues. If we compare movements in the circulation of gold banknotes with that of the agio, it is clear that the two phenomena were inversely proportional. As for the circulation of gold banknotes, it can be seen that in the ten-year period between 1891 and 1900, it equaled only 1.48% of the entire circulation, while in the period of 1901-1910, the period of the low agio, its share rose to 8.48%. The largest share of gold notes in circulation was recorded in 1911, when it equaled 17.7%. This was a year when exports were very lively, thanks to a new trade agreement with Austria-Hungary, and there was practically no agio.¹¹

¹¹ M. Vučković, V. Vuksanović, *Narodna banka 1884-1934*, pp. 24, 25

4. State intervention in the issuing activity of the National Bank

At the beginning of the 1890s, due to the constant rise of the agio, the royal government suddenly adopted a negative stance towards the silver banknotes and demanded that their quantity in circulation be limited. It was claimed that, by purchasing gold with its silver notes, the National Bank was increasing the gap between gold and the note. Another objection was directed against the policy of the metal backing of the silver note, with the interpretation that the Bank could use gold bullion as backing for its silver notes. The complaints against the circulation of the Bank's silver notes led to demands for an end to current practices and for the National Bank to use gold to back its gold notes and silver to back its silver notes.

In the course of the discussion on whether the circulation of silver banknotes should be limited, a legislative explanation of metal-based monetary issuing was requested. "Namely, the Bank's interpretation of Article 11 of the Law from 1885 was that gold could also be used as backing for silver notes. This led to a situation in which the metal backing and monetary circulation were in totally reverse proportion: gold dominated the structure of the backing, while 95% of the notes in circulation were silver. The Government had a totally different understanding of the said legal provision: the gold backing could be used exclusively for the issuing of gold notes, while the issuing of silver banknotes depended on their silver backing."¹² Both sides stubbornly held to their views, with the National Bank claiming that a different interpretation of the disputed article would demand the withdrawal of about 20 million dinars worth of silver notes from circulation. As no solution was being reached, a mixed commission was formed, equally made up of representatives of the royal government and the National Bank.

As a solution could still not be reached, a legislative interpretation was requested from the National Parliament, which at its session of December 13, 1893, decided that gold backing could serve only for the issuing of gold banknotes, and silver backing for the issuing of silver banknotes. This decision was approved by the king, and it was subsequently adopted by parliament. The legal provisions providing for silver banknotes to be backed exclusively with silver and, thus, requiring a reduction in their circulation, were based on the assumption that the cause of the high agio on gold lay in the quantity of such banknotes in circulation.

The legislative interpretation of the relationship between the backing and the type of banknote had long-term consequences. When the document was adopted, the silver backing equaled 4,000,000 dinars, which means that two and a half times as many silver notes, or 10,000,000 dinars worth, could be released into circulation. There were 30,000,000 dinars worth of silver 10 dinar notes in circulation at that time, or 20 million more than allowed. The Minister of the National Economy insisted that the notes be withdrawn over a five year period,

¹² V. Dugalić, *Narodna banka 1884-1941*, p. 55

leaving only a third of them in circulation. This could be achieved by an annual 20% reduction in credits, and the National Bank immediately went about this business, with the caveat that the “mandated deflationary policy would have very bad consequences for the national economy..” This marked the beginning of state interventionism in the operations of the National Bank.¹³

At the request of the Bank, on February 18, 1894, the Minister of the National Economy issued guidelines on the implementation of the legal interpretation of the decision that the gold backing was to serve only for gold-denominated notes, and the silver backing only for those denominated in silver. The deflationary policy had a negative effect on the crediting activity of monetary institutions, causing a sharp fall in economic activity. However, in spite of constant gold sales, the agio reached 19%, or 3.80 dinars per Napoleondor. Realizing the mistake, the national economy minister recommended to parliament that it void the disputed interpretation, which was accomplished on February 6, 1896, thus restoring the practice by which silver notes could be backed by both silver and gold. Also, the value of silver notes in circulation was raised to 25,000,000, regardless of the level of backing.

These changes had both positive and negative sides. The positive side was the resumed ability to issue silver notes that were not conditioned upon the structure of the backing, while the limit placed on the total circulation of notes proved to be negative. “The consequences envisioned by the Bank immediately after the Law was adopted already became evident in 1897. The crediting of autumn agricultural activities was stopped at their height, since the amount of money in circulation exceeded 25 million dinars in silver notes. As a result, the free quota was increased to 30 million dinars. The stoppage in economic activity slowed budget revenues, even as foreign debt obligations continued to come due. This led to the adoption of a new law on March 22, 1898, enabling the disbursement of 10 million dinars to the Main State Treasury over the set circulation limit. The return of the loan meant the withdrawal of an appropriate amount from circulation, leaving a total sum of 25 million dinars in circulation even after the return of the borrowed funds. Under the same conditions, i.e., that silver notes issued on the basis of a state loan would not fall under the set quota, a new 2 million dinar credit was approved to the state on August 20, 1900, at a 2% interest rate, the same as previously.¹⁴

5. The position of the Privileged National Bank regarding the agio in Serbia

Data show that the agio existed in Serbia even before the foundation of the National Bank, equaling 5-6% in 1866, around 5% in 1875 and 3-4% in 1880. In the year of the National Bank's founding, 1884, it equaled 4%. Its highest value

¹³ V. Dugalić, *Narodna banka 1884-1941*, p. 58

¹⁴ V. Dugalić, *op. cit.*, p. 59

was reached between 1893 and 1903, when the silver 10 dinar note was dominant in circulation. The National Bank had an money issuing function, so many of the critics held the view that it was the main culprit for the rise in the agio. Interventions on the gold market and the circulation of silver notes were being directly connected with the weakening of the dinar, giving rise to measures that limited the amount of silver-backed notes in circulation. Critics of the National Bank's policy held the view that the silver ten was the basic cause of the agio.

Defending itself from the fierce criticism to which it was exposed, the National Bank offered the following arguments: first, the 10 dinar silver-backed note was imposed by the government, against the will of the National Bank – the Bank's choice was a gold note. However, it turned out as time passed that the silver ten established total domination in monetary issuing and that monetary circulation could not be imagined without it; second, at the height of the debate regarding the agio, as new deposits of silver were discovered, the value of silver was constantly falling relative to gold. Global production of silver in 1895 increased by a factor of 4.01 relative to 1870, while gold production over the same period had risen 1.29 times. Rejecting the responsibility for the increase in the agio and denying the negative effect of the large circulation of silver notes, the Bank pointed out that the agio had reached its highest level precisely at the time when monetary circulation was the most limited, while falling in autumn, when the largest amount of notes was in circulation.¹⁵

The top management of the National Bank held the view that the basic causes of the rise in the agio in the said period were: the balance of payments deficit (1878-1903); state borrowing abroad (gold was being purchased on the domestic market for the purposes of foreign debt servicing); state borrowing from the National Bank, with the largest part of the issuing being placed into the crediting of state expenditures, leaving monetary institutions and businesses without capital; unstable political situation.

In its defense, the National Bank initiated a debate regarding which backing was better for the issuing of paper money, thus neglecting the more important question of the amount of notes released into circulation compared to what was actually needed. The excessive issuing of silver-backed notes pushed gold money out of circulation and caused the appearance of the agio. It is interesting to note that, after 1903, when state finances were put in order, the second half of the year always brought on a pick-up in the economy, due to the agricultural structure of the Serbian economy, leading to the disappearance of the agio through the establishment of a balance between the needed and the actual amount of money in circulation. In the first half of the year, on the other hand, economic activity would slow and, since the amount of money was not being reduced, the agio would start to appear in monetary transactions. For the sake of illustration, at the end of 1898, for example, about 33 million dinars were in circulation –

¹⁵ V. Dugalić, *Narodna banka 1884-1941*, p. 61

300,000 in gold and 32,700,000 in silver. If notes were issued solely on the basis of gold, such volume would require 13,200,000 dinars in gold. The Law on the National Bank left open the possibility of exchanging of up to 25% of gold in silver, meaning that 3,300,000 dinars in silver would have been sufficient. At that time, the Treasury held 9,300,000 silver dinars, or 6,000,000 more than necessary. The amount of 6,000,000 dinars in silver notes represented a surplus that was unnecessary in circulation, and the Bank should have withdrawn it. However, since that was not happening, due to the aforementioned reasons, a demand pressure for gold money ensued, which raised the agio to 12.65%.¹⁶

6. Conclusion

The state measures implemented in 1894, which limited the circulation of silver banknotes, threatened the essential task of the National Bank of the Kingdom of Serbia, to advance commerce and the trades with cheap crediting. State interventionism in the work of the National Bank brought on the rise of the agio, especially during autumn, when increased economic activity in the country required more money and credit. Practically speaking, the agio did not disappear until the outbreak of World War I, although it had begun to decline at the beginning of the 20th century, thanks to large improvements in the state's finances, the elimination of deficits, decreased state borrowing from the National Bank, increased exports and the inflow of foreign capital.

The decline of the agio at the beginning of the 20th century went along a line which, in the fall of 1905, revealed a disagio equaling 0.5%. Its appearance was influenced by increased agricultural exports, as well as the decrease in the state debt to the National Bank. The disagio would appear during autumn, between 1905 and 1908, when the state began taking on new debt. However, it should also be noted that, as an irregular phenomenon, the disagio would have presented a problem for the country had it appeared over longer periods of time. The appearance of the disagio, a premium paid in gold up to the nominal value in silver, was rare and lasted for short periods, so its practical significance was minor.

¹⁶ V. Dugalić, *op. cit.*, p. 62

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AN OVERVIEW OF GSA'S FRAMEWORK AND INTERRUPTION OF GAS SUPPLY

Abstract: *The purpose of this article is to draft an overview on gas contract which is the starting point for any discussion concerning gas market and gas market security in supply. It is widely known that security of energy supply is the most important issue of the new millennium and assuring the security of supply is vital for our society overall, particularly for countries like Serbia, which are forced to import the whole necessity of domestic energy demand. The authors deal with the framework, typically legal, of GSA and try to underline what parties should put in mind before signing a final, binding agreement and, at the same time, to be successful in attempting to minimize the risk of disruption.*

Key words: *gas industry, negotiations, Gas Supply Agreement, interruption of gas supply*

JEL classification: Q41, K12

1. Introduction

Natural gas was long considered to be a minor resource within the Petroleum Industry and not without reason. In comparison to crude oil, Net – backs¹ to Produces were significantly lower. Additional investment was need in the infrastructure for transportation and utilization. There was higher degree of regulatory intervention, particularly in the form of price controls.

This is not the case today. As a matter of fact, experience has shown that the formula for a successful Gas industry has four elements.

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¹ The effective wellhead price (wellhead price is known as the price received by the producer for sales at the well) to the product of natural gas, based on the downstream market price for the natural gas less the charges for delivering the natural gas to market.

First, a large indigenous supply is necessary to insure security of supply². Secondly, the industry must engage in aggressive marketing and expansion of pipeline systems. Thirdly, the presence of price constraints (regulatory or market) that make gas the lowest cost fuel. Finally, deregulation of the industry after market penetration to provide incentive for both exploration and cross-border trade.

Further, there are several reasons why natural gas resources are commanding world-wide attention. Assuming the current pace of consumption and that oil is replaced completely by natural gas, there are sufficient proved reserves of natural gas for the next 35 years. If the combined consumption of oil and natural gas were held at present levels of use, natural gas use could continue for 56 years³. Additionally, while 77 % percent of oil reserves⁴ are located in the Gulf, substantial proven gas reserves are situated in other regions.

2. Gas sale agreement

The GSA (Gas Sale Agreement) is the principle contract within gas industry. Despite each GSA is unique according to the extent of reserves, price⁵, volume and point-of-delivery⁶, there are two basic approaches.

² There are countries – and Serbia is one of them – which are totally dependent on import of gas, regardless of the specific use of gas (i.e. for generating electric energy or supply to electric plant), because they do not have domestic reserves and obviously it is not easy to compensate such lack in short term.

³ Source: BP Statistical Review 2004.

⁴ Remind that reserves are categorized according the limits of economic recovery by using the 3-P (Proved, Probable and Potential) methodology of the Society of Petroleum Engineers. Depending upon the reliability of well control data, the extent of reserves assigned to each category is stated either in Deterministic or Probabilistic terms. Usually only fields located in North America are given single or Deterministic values; whereas fields in other parts of the world have reserves expressed in Probabilistic terms (High = 90 percent, Low = 10 percent and Most Likely = 50 percent).

⁵ Pricing provisions can be complicated. Under indefinite Pricing, the price will be determined according to external references such as alternate fuels, contracts or markets. Sellers favour pricing clauses that maintain parity with other fuels, gas Producers and inflation. Where competing fuels are referenced, the gas price is set according to energy conversion factors so that gas is usually priced less than fuel oil and higher than coal. Unless the Seller is responsible for gas delivery, prices are at the Tailgate (Tailgate is the point where a gas transmission pipeline is interconnected to a gas processing plant) of the gas processing plant. The Seller deducts the cost of field gathering and processing in order to determine the Net-back price at the Wellhead.

⁶ It is essential that the contract designate a Delivery Point for both the transfer of physical control over the gas as well as transfer of title. Deliveries may be at the Wellhead, at an interconnection point on gathering line, at the Tailgate of a processing plant or at the City Gate (City Gate is known as location at which natural gas ownership passes from one party to another, neither of which is the ultimate consumer; the point at which interstate

The first approach is to use a Supply or Requirements⁷ contract. It is considered that a supply contract favours the Purchaser because the seller is obligated to secure additional reserves in the event that the initial source of supply is not adequate.

The alternate (and second) approach is a Depletion or Dedication of Reserves contract. A Depletion contract is considered to favour the Seller because the delivery obligation is specific to a formation or field. If the reserves are not adequate, the Seller will not be in breach of this delivery obligation.

GSA's are also categorized by the duration of the sales obligation. Long-term contracts will have a term of greater than ten years, with 20-25 years being common. Conversely, Spot contracts have duration of 30 days or less and are more common in mature markets.

The term and conditions of a GSA also vary depending upon whether the gas is delivered by pipeline or as LNG. There is a trend towards regionalization in contracts (North Sea, North America, etc). Government and trade associations, such as Gas Industry Supply Board (GISB) and the international Swaps and Derivatives Association of International Petroleum Negotiator (AIPN) also publishes a model GSA. Nevertheless, there is no single industry precedent and each contract is the result of the unique circumstances.

2.1. The obligation of the parties

Sellers and Buyers divide their respective obligations under these contracts between two categories. Firm obligations are the first category, meaning one of the parties holds an entitlement or commitment. The beneficiary has an enforceable entitlement and there are legal consequences if the contract is not performed.⁸

and intrastate pipelines sell and deliver natural gas to local distribution companies). Title and risk of loss passes from the Seller to the Buyer at the Delivery Point. This clause may also address physical pressure at which the gas enters the Buyer's system or other Delivery Point. Because gas pressures must be compatible between the pipeline system and the receiving station. This issue may also require the Buyer or Seller to install facilities to adjust the pressure as needed for delivery. Delivery Point pressure may also be covered in the specifications for gas quality.

⁷ A sale by a supplier to a purchaser in which the seller pledges to meet all of the purchaser's requirements, or the purchaser pledges to buy all of its requirements from the seller, or both.

⁸ Something similar we find according to civil law experience where there is the difference among "Result obligation" and "Means Obligation". In the case of "Result Obligation" the interested party has to pursue the outcome set out by the contract to fulfil the performance; instead by second type the interested party has to act just in fair, diligent and professional manner in order to avoid breach of contract (the extent of diligence depend on professionalism's level requested case by case i.e. the professionalism of a lawyer's obligation is higher than an obligation where the party has less qualification. In other words

Best Endeavour's/Efforts⁹ is the second category where the party, usually the Producer, need only act in a commercially reasonable manner. In this case, the Buyer has neither an entitlement nor enforceable commitment and accepts the risk that delivery will not take place.

The rate of delivery is most of significant obligation for the Seller and entitlement for the Buyer.

Delivery obligation has been measured according to annual, maximum daily or maximum hourly quantities. Some variation in this obligation may also be made to accommodate seasonal or other periodic changes by either increasing quantities or by deferring cargoes, as is the case for LNG.

Other aspects of the Seller's delivery obligation are the point-of-delivery, delivery pressure and minimum quality specifications. A commitment from the Buyer to Take-or-Pay (TOP)¹⁰ for a minimum annual quantity or Minimum Bill is closely related to the delivery obligations. It is common for a Purchaser with a TOP obligation to seek a reciprocal right to Make-up¹¹ this gas by requesting later delivery of possibly a refund of the payment later in the life of the contract. If the contract is for gas transportation, there can be a similar clause referred to as Ship-or-Pay, usually without Make-up rights.

Broadly speaking, in long – term contract the main drawback is the inflexibility in the face of demand and supply fluctuation. To mitigate this problem, parties will therefore stipulate specific clauses. Such a clause in practice could be an initial price as a floor on the value of the contract. It could be argued that

the lawyer has not obliged to win the case but it is obliged to assure to his client the best diligence effort).

⁹ Service offered to customers under rate schedules or contracts that anticipate and permit some interruption on short notice, generally in peak-load seasons, by reason of the claims of firm service customers.

¹⁰ The Buyer's minimum purchase obligation may be set at a percentage of ACQ (Annual Contract Quantity) unless the contract contains a Minimum Bill clause or requires payment of an annual Reservation Charge. If the Buyer does not take the requisite quantity, there is a deficiency and a TOP obligation is triggered. Correspondingly, if the Seller is unable to deliver the contract quantity or if the parties are experiencing Force Majeure, the Buyer is entitled to a reduction of TOP.

As a concession to the Buyer, the amount of gas attributable to the payment made for the deficiency can be subject to Make-up in subsequent years. Make-up rights can only be exercised once the TOP obligation for that year has been satisfied. Make-up rights can be stated either as a financial amount that is recovered at prevailing contract prices when the gas is delivered or a quantity of gas. In the later case, it will be necessary to adopt a system of inventory control to determine whether Make-up is on the basis of Last-in-First-Out (LIFO) or First-in-First-Out (FIFO) in order to properly account for the quantity of gas that is available as Make-up.

¹¹ A clause in a long-term gas sales contract that allows the buyer to call for delivery of gas paid for under a take-or-pay clause.

prices are rigid downward, but they can arise following price escalators, like pre-defined increases per year or petroleum price index.

Sometimes gas prices rise independently to economic rules and in such cases the growth is the consequence of geopolitical decisions where the price is used as a tool to be successful among international conflicts. In other cases the price rises just because the producer countries consciously prefer do not sell gas in order to pursue the maximum speculation. A further solution is the redetermination clauses which permit renegotiation of the terms of the contract at pre-determined intervals.

Apart from these specific price provisions, the non – pricing clause that has received much attention in the economic literature is the TOP (take-or-pay) which, as it is mentioned above, requires purchasers to pay for a specified minimum quantity of output, even if delivery is not taken.

Nowadays, there are two complementary analyses of take-or-pay provisions: the model of Crocker and Masten (1985, 1988, 1996) and that of Hubbard and Weiner (1986, 1991). While these latter authors interpret TOP clauses as risk-sharing instruments, Crocker and Masten argue that TOP obligations can be viewed “as a mechanism for effecting appropriate incentives for contractual performance”.

2.2. Special issues

After a brief introduction to GSA features and main parties obligation it is now possible to point out some special issues arise among GSA in general and GSA's parties.

Preliminary it is important to underline that as a fuel, natural gas, is purchased according to its energy value, but is produced and transported on a volumetric basis. This quandary is resolved by adopting measurement units that are energy-equivalent such as Gigajoule. Moreover, while a long-term GSA covers several years, it is performed in monthly installments where obligations are stated in daily or hourly intervals. In this respect, a GSA is treated as an Installment Contract, where the Buyer's rights are Entitlements rather than a legal interest in the gas held in the reservoir.

One of the most perplexing issues is that the price formula is agreed before the Cost of supply is actually known. Capital expenditures can represent as much as 90 percent of the cost for supplying gas. Sellers have taken a variety of approaches towards this issue. Buyers have agreed to use construction cost estimates in conjunction with engineering reviews as the basis for the cost of supply.

Another approach is to conduct a post-facto review of costs.

A third approach is to apply rate of return formulas that adjust prices in order to maintain contract rates for the return according to costs and quantities.

A return on rate base (RORB) methodology administered by a regulatory body can be used as well. Under the RORB approach, an administrative proceeding is conducted to determine if the price is to be adjusted.

Sellers and Buyers take different approaches when determining the price. Buyers look at the cost of alternative fuels. In addition to price stability, they want either a discount or to achieve an overall reduction in fuel costs over the life of the contract. Sellers look at the cost of production and try to achieve a Net-back price that will yield a satisfactory return on overall investment. The best method for resolving this difference is to exchange economic models in order for each party to understand the assumptions about development costs and market dynamics that are being made by their counterpart.

Some contracts attempt to balance the Buyer's TOP obligation of the inclusion of a send-or-pay obligation that places the Seller financially at risk for non-delivery. In some cases, the Seller will accept responsibility for the difference in the price of gas in the contract and the higher cost of any alternate fuel obtained by the Buyer.

Gas is paid for in arrears, after it has been delivered and utilized. As an installment contract, non-payment for a monthly invoice will not be regarded as a material breach of contract that gives rise to the right of determination. The GSA will include default provisions that give the Seller the right to suspend delivery for non-payment of a monthly invoice. However, under most default clauses there will be a 30 - day period before action can be taken. This still leaves a Seller with an exposure of one to two months of previously delivered gas before it can suspend or terminate the GSA for non-payment, in some cases, Buyer that are not considered to be creditworthy must either pay in advance, post a stand-by letter of credit or arrange some other form of credit support such as a Host Government guarantee.

The Buyer's remedy for delivery of non-specification gas may be limited to rejection. This is the traditional remedy available under Sales of Goods Acts, but is not well-suited where the trade is in natural gas that cannot be held for re-delivery to the Seller if it is defective. Also, the number for minimum quality specifications can mean that either the gas was low in thermal energy or contained a level of contaminants that could lead to corrosion of equipment. Some contracts address this issue by offering price discounts and allowing TOP credit for non-specification gas taken by the Buyer. A better approach would be to obligate the Seller to adjust gas plant operating efficiencies if the gas delivered fails to meet contract specifications for two or more consecutive months in the contract year.

Liberalized markets discourage the use of joint selling arrangements and long-term contracts, which are considered important to the security of supply. These issues tend to arise under competition laws. The best solution is providing for exemptions where it can be demonstrated that such arrangements will in fact promote public welfare.

Finally, in unbundled gas markets where supply is separated from transportation service, it may not be possible for a Seller to secure a contract for transportation services that has the same duration as the GSA.

3. Interruption in supply

After stressing GSA's main features and special issues arise by seller and buyer respective performances the authors will try to make an overview on interruption in supply.

The seller will usually become liable to pay liquidated damages to the buyer if there is an interruption in gas supply and the seller is not excused, which may be for reasons such as the buyer's failure to take delivery or Force Majeure. English law requires liquidated damages to represent a genuine pre-estimate of the loss that the parties may suffer. Courts will be sceptical of a very high and arbitrary figure imposed by way of liquidated damages.

Where the buyer has access to alternative energy supplies, it would expect liquidated damages to cover the additional cost of those alternative supplies. Where there is no viable alternative source of fuel, the buyer will argue that the liquidated damages ought to compensate it for the lost revenue under the downstream off-take contract, as well as the costs involved with shutting down and starting up the buyer's plant.

As an alternative, the seller may be obliged, or have the option to, supply free\discounted gas in a subsequent period and this gas will be sold at the short-fall gas price. It is also not unusual for GSAs to provide for unliquidated damages, subject to an overall limit upon the seller's liability.

The buyer should not be prevented from seeking supply of gas from alternative sources if supply under the GSA is interrupted. Usually reasonable conditions will be imposed, such as notice to the original seller and the requirement to resort to quantities that may be held in storage. The conditions should not be so onerous so as to expose the buyer to the risk of interrupting operation of the downstream project. This can be a difficult issue for negotiation. Buyers may be forced to commit to alternative supply arrangements for a fixed period, which can be difficult to estimate and match against the likely interruption under the primary GSA.

In the event of interruption of supply, there may be an option in favour of either the buyer or the seller to make-up the shortfall in a subsequent period.

3.1. *Extent of risk*

Title and risk of the gas is passed to the buyer at the delivery point, which be a precisely defined geographical location. The delivery point may be at the sellers gas production facility, the buyers reception facility, or the point of entry of exit

of a multi-user pipeline. Some GSA's specify alternative delivery points which will apply in different specified circumstances.

The key difference between the alternatives relates to which party will bear the risk of transportation of the gas, where the transport arrangements will be undertaken by a third party, it is important to consider the extent to which the GSA and the transportation agreement are back-to-back, particularly in relation to supply interruptions. Neither the buyer nor seller will wish to be exposed to mismatched risk between the transport agreement and the GSA.

Regardless of the delivery point adopted the transportation mechanics should be checked to ensure a suitable procedure that will work in practice.

3.2. Force Majeure

GSA's typically contain Force Majeure provisions, like many other commercial agreement. Occurrence of Force Majeure events excuses the party under Force Majeure from the failure to perform.

Force Majeure is usually defined as Acts of God over which the parties have no control. The definition is likely to include strikes, wars, riots, epidemics, landslides, floods, explosion, line freeze – ups and similar events. Force Majeure issues become complex when upsets occur at facilities operated by parties who are not participants in the contract.

Force Majeure clauses may be written in two basic ways. First, natural events and governmental actions can be listed as acceptable causes for invoking Force Majeure. Secondly, the clause can broadly describe the events that are either not reasonably within the control of the party claiming suspension or that the party is unable to prevent or overcome the condition by the exercise of due diligence. Under this approach, delays in acquiring right-of-way grants, permits or licenses, the inability to acquire materials and supplies and maintenance of facilities are excluded. Often, the Force Majeure clause does not address the question of whether the duration of the contract is extended according to the time period that parties were prevented from performing the contract. Considering that two different interpretations are possible, the potential ambiguity should be removed by allowing the duration of actual contract performance to be extended for a period that is equivalent to the duration of Force Majeure.

Since third parties are not in privity of contract, events that prevent them from performing processing or transportation operations will not be regarded as Force Majeure. *Alcor ltd. v. Continental Energy Marketing Ltd.* In these situations, the definition of Force Majeure can be extended to cover third party services, particularly if they have been arranged on the basis of firm service or the reservation of capacity.

3.3. Disruption of supply

The happening of certain clauses (e.g. non-payment or under delivery) will allow one party to deliver and default notice to the defaulting party. If the event is not remedied in the time given, the non-defaulting party may suspend performance. When the events become more serious, the right to terminate accrues. Termination events will usually include extended supply interruptions, non-payment of a material amount, delivery of off-specification gas, breach of a material obligation, insolvency, change in control of either party, extended events of force majeure, abandonment, termination of certain project documents/e.g. generating licence, off-take or transportation contract. The termination events should be material and where applicable, there should be reasonable cure periods.

Default caused by certain specified events will be excused e.g. default of one party caused by the other, force majeure, scheduled maintenance, emergency shut-down. If the buyer terminates for cause, it will usually have the right to seek compensation for the extra cost incurred in obtaining gas from an alternative source. If the buyer terminates for cause, it will usually be entitled to compensation – often calculated as a net present value of take-or-pay charges. There should be a provision specifying that termination shall not affect any accrued rights or obligations and which provisions of the GSA shall survive termination e.g. make-up rights for a limited period, liabilities, confidentiality, dispute resolution.

4. Conclusion

Both Government and industry argue that to ensure security of gas, a diversity of supply sources and entry points into the market is essential. For example there are projects planned to increase the EU's gas import and storage capacity, and long-term import agreements have been established with companies based or operating in several key gas producing countries.

Many European Governments believe that security of gas supply is achieved by having a fully marked for gas. This view is also supported by the European Commission and in June 2003 a new EU Gas Directive was adopted by the member states. The objective is to establish an integrated, liberalized European gas market with common rules on storage, transmission, supply and distribution of natural gas.

Particularly, there is criticism in order to consider the minimum period - level (two months) of gas storage provided by EU Directive sufficient to assure the security of gas supply in case of disruption. In such cases, i.e. as Serbia, the sufficient period – level to insure a gas storage able guarantee security of gas supply should be at least 12 months and Ministry of Mining and Energy of Serbia is already working on organize a gas storage with such capacity.

Nevertheless there is debate about whether a liberalized market will enhance or diminish security of supply. The total liberalization of gas market has to be carry on maintaining a steady public monitoring in assuring the best level of efficiency of way of managing private distributors. Latter have always to keep in mind they are working on service that is vital for society and because of that they “must” always put before society’s interest to the business’s private interest.

In Serbian experience the respect of society’s interest is pursued providing strict rules for top – managers of private companies in distribution market and particularly it is not allow to assure bonus to managers if, before, they do not show that distribution company has enough reserves to guarantee the security of supply. If the companies not fulfil such rule they seriously risk to lose the license - authorization for being on the market distribution.

The problem facing the gas industry, further, in the short term is not accessibility to gas but getting the gas to markets. It is estimated that 70 % of the world’s gas reserves lie within transportable distance (5,000 km) of Europe. Some commentators worry that some gas is likely to come from countries which may be less politically and economically stable than purchaser countries. However, countries supplying energy are dependent on the buying countries so it is in their interest to establish trade agreements with importing countries to ensure ready export markets. For example, over a 40 year period Algeria showed that it was a reliable gas supply to UK. The UK has also recently signed a long-term gas import agreement with Norway, and several UK companies have long-term gas and LNG contracts with suppliers in major gas producing countries such as the Netherlands, Malaysia and Qatar. In future, Russia, Algeria and Egypt are expected to become significant gas exporters to Europe.

Last but not least, it is important to point out that the issue of establishing agreements with gas producing countries needs to be managed accurately with the global gas “Peak”. As a matter of fact, analysts predict that the global gas production “Peak” will occur by 2020 – 2030¹². Production will continue after this time, but at lower rates. As global gas supplies decline it may become economically viable to switch to other forms of energy.

¹² Association for the Study of Peak Oil and Gas, www.peakoil.net

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THE ROLE OF HUNGARIAN HIGHER EDUCATION IN HUMAN CAPITAL PRODUCTION

Abstract: *Changing circumstances of the World's and EU's higher educational stage transformed the Hungarian higher educational system at the last years. The environment around higher education, as well as the social-economic space keeps transforming, together with the composition of students, the level of standards, motivation, and labour market demand. As a matter of fact the changing numbers of the applicants to different programmes and altering fields of training shows emphatic the major tendency. The study explains that Hungarian higher education institutions have succeeded more or less in trying to comply with the social and economic challenges they face in a global competition. They have a quite significant share in human capital production, ensuring the acquisition of a competitive professional knowledge in certain fields and in the most popular institutions.*

Key words: *higher education, human capital production, Hungary*

JEL classification: J23, D83

1. Introduction

The formation of knowledge-based economy and information society is a global social-economic process that aims at preserving competitiveness and at increasing added values. In this process, the production of high-standard services and products demands the re-programming of production structures and the availability of highly trained potential manpower. Only those economies and regions can keep up with global challenges that possess human resources of suitable quality and quantity. For this to be achieved, high level training and education are essential, their framework being ensured by the structure of higher education.

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The oldest function of universities is to produce human resource, i.e. train human capital. Higher education institutions have been crucial factors in European development since medieval times, but the priorities in their roles have changed many times in history, in relation with the ever changing demands of society and economy¹. The value of knowledge rose and human resource requirements changed in the post-Fordist economy of the second half of the 20th century, which had an effect on higher education as well. Economic, social and political transformations that are witnessed today boost the development of universities: unprecedented changes are experienced, especially as regards the new European higher education system.

The Lisbon Strategy approved at the March 2000 session of the Council of Europe considers human capital as the basis for economic development. The Strategy describes the formation of Europe's future as the creation of knowledge-based society, and sets out the duties of training and education in this perception. The role of higher education is re-validated, is given new functions, and there is also certain degree of shift in its priorities. Its institutions play a key role in three fields of research result utilisation: contribute to industrial co-operation, spin-off production; to training and education, especially for researchers; and to regional and local development.²

After the political transition, Hungary became part of the global circulation, and through its EU membership joined a number of international organisations, also becoming an active partner in forming the European Space for Higher Education. The expansion and rearrangement of higher education started in Hungary too, the tendencies being similar to those in Western-Europe. As there is a free flow of manpower, its competitiveness will become a central issue, but whether it can adjust its knowledge acquired in Hungarian education to current market expectations, remains a question. How does Hungarian higher education fit into European and global trends? To put the question in a broader sense: what can be done in order for Hungarian higher education to develop along European expectations, at the same time preserving its former advance gained in training scientists, as proved by the high number of Nobel Prize winning Hungarians we are all proud of? Can the Hungarian higher education system produce competitive human capital? How much a Hungarian degree is worth in Hungary? Which degree has high value in the labour market? Lot of such questions emerge in intellectuals thinking responsibly about the future of Hungarian society, as well as in the author of this study. Most certainly, the answer to these questions could be given in a series of lengthy studies, thus what we hereby undertake is focusing only, among the aforementioned major issues, on the role of higher education in

¹ K. Mezei, "Az európai egyetem mérföldkövei", in: J. Rechnitzer, M. Sramó (ed.): *Unirégió – Egyetemek a határ menti együttműködésben*, Pécs; MTA Regionális Kutatások Központja, Győr, 2007, pp. 74-80

² Communication by the European Commission, 2003

producing human capital. The methods through which this analysis can be made include studying the most recent Hungarian and international literature on education research, analysing statistical data, making secondary and control analyses of former studies, and inspecting various documents of higher education.

2. Changing higher education

Life-long learning, one of the most important achievements of knowledge-based society, evoked by demographic and economic changes means a great challenge for higher education. Transformation started in the second half of the 20th century when the academic type of Humboldtian university concept was replaced by higher education that was serving mass education. The number of people participating soon reached 50% of the age group concerned and 75% in a few Western-European countries (the target in Japan is 100%). Initially, the changes were driven by a demand for increased democracy. All this well illustrates that the transformation from elite universities into universities for the masses has not occurred as an intention to meet expectations, and that the new higher education system itself goes through constant changes. The environment around higher education, as well as the social-economic space keeps transforming, together with the composition of students, the level of standards, motivation, and labour market demand. The attitude of the state was initially supportive and paternalist – due to its apparent popularity for improving democracy –, but the inclusion of external financial resources and private capital soon became necessary. One result of that was that the regulating effect of market became expressed in higher education which traditionally was a public service. The market, thus, infiltrates into higher education with all its branches, transforming the traditional university model in a way that what follows is nearly large-scale industrial company structures and mechanisms. As the state withdraws, entrepreneur university status appears and spreads rapidly in Europe, in which the institutions are required, in addition to financing their activities, to act as boosters of economy.³ Conferences dealing with university organisation, too, are echoing with the re-formulation of the university model, leading towards a triple set of goals – education, research, innovation –, along which the 21st century functions of universities can be set out. Research and innovation gained particular importance as early as in the late 20th century. It is well known that universities have pursued significant research activities. In 2003, 34% of European researchers belonged to higher education institutions, and about 80% of all basic research in the continent are done by universities.⁴ However, co-operation with industry and the utilisation of research results as innovations is not effective enough.

³ I. Hrubos, “A 21. század egyeteme”, *Educatio* (15. évf.), 4. Szám, 2006, pp. 665-683

⁴ Communication by the European Commission, 2003

Besides the expansion of higher education, the other most important element of recent changes is the introduction of the Bologna process that started with the 1999 Bologna Declaration. Its essence is the harmonisation of training systems and the introduction of a multi-cycle training model. Though in various ways, the majority of European states have shifted from a dualistic training system to the new structure. The Bologna system has smoothed down the difference between the qualities of university vs. college levels, although there are countries in which one of the levels was dominant and only that level was affected by the transformation. In the new, triple-level higher education system it is particularly the first level that fulfils the requirements of labour market, whereas the Master level serves as the second stage, serving specialisation, in many cases the acquisition of a new degree. The traditional academic/scientific type of knowledge transfer appears in the latter stage, and most prominently, in the third, doctoral level.

Because of the spreading of mass education and the Bologna reforms, the character of training also goes through a transformation: just like in public education, the capacity building and the improvement of skills gains higher importance – especially at the basic level –, whereas lexical knowledge becomes a lower priority. The acquisition and possession of competencies is an immense advantage in labour market. Nevertheless, it is difficult to associate content with the term “competence”, as it apparently includes all types of knowledge ranging from language knowledge and communication skills to abilities to work in a team. Curriculum development in such directions is how competitive higher education expresses its preference for practical knowledge instead of elite knowledge, and thus serve labour market. This is because if education produces knowledge capital that proves to be useful for the economy and thus is well paid by the employer, the training institution will become more attractive, a preferred target for students to apply to. This further increases the prestige, as well as the incomes, of the institution. This is how higher education that used to be the haven of science becomes a servant of market. The question raised by professors used to the traditional concept of knowledge transfer, thus, is inspiring: how deep science can sink in this new system? Of course, it will not disappear, just that the transfer of knowledge and culture is done in a different structure.

There have been serious debates going on since the 1990s, discussing whether higher education resting on new grounds and performing the mass-production of competitive human capital proceeds against academic expectations that rely on a traditional knowledge base. One of the key elements of relevant knowledge is scientific knowledge, and it is difficult to transfer or improve knowledge without doing research, especially basic research. Today, in most of the countries in the world, including Hungary, scientific research is pursued in (i) national academic and (ii) higher education institutions. Those research results must be utilised in education, and in the Bologna system this can be achieved only by doing true science, more precisely: as part of Master and Doctoral studies. Through the

R&D activities of the institutions, research results will become incorporated into education, and will also appear in the innovation market. Other elements of relevant knowledge include those competencies that are required so as to be able to enter the labour market, and this knowledge is ensured by the lower, basic level of higher education. In this sense, the three-level higher education (which could quite as well be regarded in Hungary as having four levels, if vocational studies are also regarded) can be separated into two distinct stages, whereas the first level (basic level) provides general competencies plus vocational training that ensures competitive training qualifications in the labour market. In the global arena of post-Fordist economy, true and competitive human capital is produced during Master-level and doctoral studies.

One special feature of higher education throughout the world is the competition for students, which gives almost all of the higher education institutions an international aspect, moreover competition starts to win students from abroad. It is especially the portfolio of the US that attracts applicants, mostly from Asia: Europe still has not become a real competitor in this respect. Among the consequences of the aforementioned process one certainly has to mention the issue of quality or quality insurance, a novel segment of transformed higher education. Amidst the competition relations and market conditions touched upon earlier, universities take up almost factory-like operating mechanisms, not only because of the industrial type quality insurance systems but also due to the mass production of higher education degrees and degree holders. It is not without reason that universities are often labelled as “knowledge factories” or “degree factories”. Such attributes are perceived as contrasting academic traditions, yet it must be understood that higher education institutions cannot escape newer and newer reforms that make them meet new social expectations. Quite obviously, globalisation does affect their existence and operation as well as transforms their functions, particularly determining human capital production in which it is essential to adapt well to international labour market.

3. Characteristics of higher education in Hungary

At the turn of the 1990s, the Hungarian political transformations lead to the development of market economy and democratic political relations, although there were some contradictions in the process, of varying significance. Because of the struggle to overcome the heritage from Kádár’s communist regime, and due to difficulties in the transition process, the country had to face a series of social and economic problems. It was important for the governing powers to increase the rate of education, to provide trained manpower, so as to adequately serve the demands of market economy and accession to European processes. Transformations in the Hungarian higher education system during the past two decades

have affected, in addition to the structure, the content as well. Of course, behind these changes there are also the rearrangement of the social-economic status quo in the past 20 years, and the transformation of the environment around higher education. Yet, one must bear in mind that this route is not unique, as the transformations are highly similar to what goes on in other countries of the world, even if the global trend is followed with a degree of lag.

3.1. *General characteristics, tendencies, fitting into the European system of higher education*

It must be noted, however, that Hungarian higher education differs from the European in several aspects, especially as regards Western-Europe; therefore it is difficult to compare statistical data. Whereas the European concept of “higher education” is much broader, in Hungary it is university and college education that is understood as such (although the Bologna process can help eliminate difference between the two, and new elements can also be incorporated). Another difference is that the period of studies is shorter in Europe; therefore the number of students per any particular period is also lower. On the contrary, the number of people completing their studies is higher in Hungary, as is indicated by the greater number of state-approved higher education degrees.⁵

After becoming a member state of the EU, Hungary joined the programme aiming at establishing a uniform European space for higher education, then, as a stage of this, introduced the Bologna training system. The series of education reforms opened up a wide gate for young people wishing to continue their studies, and higher education slowly transformed from being an elite training institution system into a mass-producing training structure. All this has meant a series of new challenges for Hungary. Among these, there are some crucial issues that have been continuously discussed since the political transition, sometimes even becoming a popular issue, yet the final answers and solutions are still to be found out: the issue of numbers, i.e. whether or not we need so many degree holders. Do we need so many higher education institutions with training going on in them? In this study we are trying to look at these questions as well, with regard to the objective set out in the introduction.

The introduction of the double-level secondary education certification system in 2004 can be regarded as a measure serving the easier admission of an increased number of students to higher education. According to the regulations of the new secondary education leaving exam system, applicants do not need to pass an entrance examination any more, but instead their admittance or rejection is decided by the higher education institutions based on their secondary school

⁵ Gy. Fábri.: “Oktatás és tudomány felsőfokon: A magyar felsőoktatás hosszú évtizede, 1988-2002”, in: P. Lukács (Ed.), *Felsőoktatás új pályán. Oktatáskutató Intézet*, Budapest, 2003, pp. 46-88

results and scores of one or two leaving exam subjects they had earlier selected. Ranking, thus, is based clearly on the system of secondary school requirements, only a few higher education institutions requiring an eligibility test or practical exam. As a result, students can be admitted to the majority of institutions, especially to programmes of larger universities and colleges with high reputation, only with high scores. Other institutions attract students having lower scores with the lower level of expectations. The system operates in a way that it stabilizes the existing structure, i.e. it provides better chances for institutions that are in an advanced situation anyway and do not face the problems of low admittance rates. However, because of the currently existing normative financing system, the institutions aim at increasing their numbers of students, thus some schools, in order to survive, cannot but admit students with very low, minimum-level scores. This can lead to the dilution of the entire pool of higher education. We believe that it is the labour market that will perform the true selection among higher education institutions, and its result will appear clearly in about 5-10 years.

The number of people entering higher education in Hungary has been increasing in the last two decades. In the second half of the 1980s the total number of students studying at universities and colleges grew by only a few thousand each year, but after 1990 there has been a radical expansion. Two factors are crucial in causing this: firstly, governmental politics had an important role in that higher number of people was allowed into the system, and, secondly, there was a considerable increase of the secondary school teen-age population. The latter factor is fading out and turning around with the beginning of the 21st century. According to demographic parameters, the decreasing trend is considerable, thus the decline can be compensated only by people older than 19, already working but still not possessing a degree. For the year 2015, the following situation can be anticipated: primary school will be completed by cca. 100000 people annually, of whom 80000 per year will be admitted to secondary schools, and the certificate of secondary education will acquire by approximately 70000 individuals per year.⁶

The number of people participating in higher education has grown to four times as many as in 1990/91, the peak occurring in 2005 (Table 1). Since then the number of applicants has decreased, partly because of demographic reasons, partly due to the fact that less people want to obtain a new (or the first) degree from the older age groups. However, as the number of MSc programmes continuously increases, it is expected that possibly more people will aspire for new university degrees. In 2007/2008 altogether 398000 people pursued their studies in a total of 71 higher education institutions (31 state-owned, 26 faith-based and 14 managed by civil foundations). The number of higher education students decreased by nearly 19000 compared to the figure in the former year, whereas the number of those participating in full-time programmes followed an increasing trend (Table 1).

⁶ J. Pálincás, *A magyar felsőoktatás és tudományos kutatás fejlesztésének koncepciója* 2004. április 17

Table 1: Numbers of students in various types of higher education in Hungary

Year	Institutions	Acad. Staff	Students	Higher level vocational	Basic level higher educational	University level educational	College level educational	Undivided training	Specialized further education	Doctoral (PhD, DLA)
1990/1991	77	17302	108376			47498	54889		5989	
1995/1996	90	18098	195586			70153	109412		12565	3456
1999/2000	89	21249	305702	2153		107794	171203		20250	4302
2000/2001	62	22873	327289	3464		113513	181527		22033	6752
2001/2002	65	22863	349301	4474		117947	195291		24558	7030
2002/2003	66	23151	381560	6128		124606	216581		26815	7430
2003/2004	68	23288	409075	7219		133274	233673		27074	7835
2004/2005	68	23787	421520	9122		138169	240297		25991	7941
2005/2006	71	23188	424161	10498	15072	138994	226566		25066	
2007/2008	71	22376	397704	12398	146723	87703	109390	14591	18762	7153

Source: Hungarian Central Statistical Office – Stadat system, edited by Mérei A.

Note: In 2007/2008 the number of people participating in master programmes was 984.

Among the students 86.4% pursued their studies in state universities 5.9% in faith-based institutions, and 7.7% in schools run by civil foundations. Currently, 57% of the students study at the 8 major Hungarian universities. A new phenomenon in higher education is that the number of people pursuing their studies after or simultaneously with work is growing. Probably, such a rate indicates changes that are associated with life-long learning becoming popular. Parallel with this, the number of people studying in full-time programmes decreases, and, of course, the rate of those involved in part time, correspondence courses and distance learning increases. In comparison with earlier years, the number of students paying tuition fees for their studies also grows. More than 50% of students in full-time programmes pursue their studies in a self-financed form. Besides the continuing increase in the number of institutions, another new feature is the further differentiation of higher education. As implied by the Act on Higher Education (1993), universities regained the right of granting DSc. PhD-level education, in accordance with international requirements, was also started in Hungary. Another change was the appearance of higher level vocational training within the structure of higher education. The increase in the number of students was not fully followed by an increase in academic staff, with the ratio of students per professor growing to threefold the value in 1990 (18 in 2008).

This boom in student numbers occurred together with a 15% increase in the number of higher education institutions (from 77 to 89). Just on the contrary, the next decade brought about a drop in number of institutions, this change being due to the organisational transformation around the year 2000, i.e. university integration. As it is seen from statistical data (Table 1), despite a yet low rate of higher education admissions in the year of political transformations, the network of Hungarian higher education at that time consisted of 77 institutions (19 universities and dozens of colleges), the greatest problems being spatial and administrative disintegration and low student numbers. It was mostly the specialised universities that had to transform their portfolios of higher education programmes, to meet the expectations of market and economic demands. New higher education institutions were created, partly due to the fact that certain types of training such as heavy (chemical) industrial engineering, mining engineering, and metallurgical engineering have lost their earlier importance. New universities were thus created on the already existing structural foundations in two county seat cities: Miskolc and Veszprém. Science universities of traditional structure, too, have launched quite a number of new programmes, often with affiliated schools. Such experimental measures have led, in certain places, to the creation of new faculties. The demand for higher education programmes increased extraordinarily as of the second half of the 1990s. All these phenomena had a positive effect on the improvement of institutions and the creation of new ones (mostly civil foundation operated and faith-based ones). The institutional structure continued to broaden; affiliated faculties and specialisations

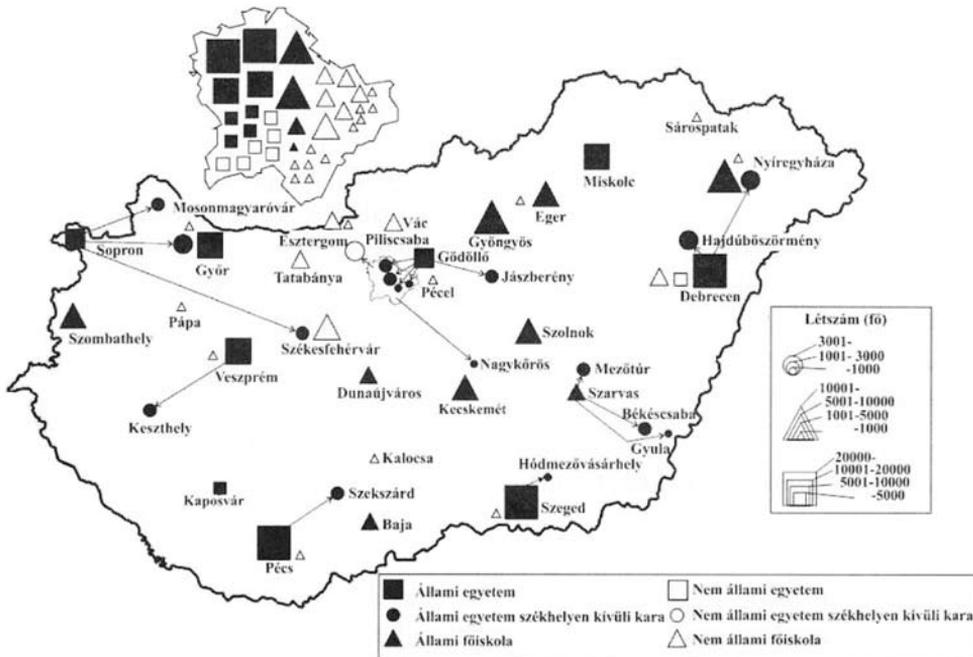
were established in many of the middle-sized towns. No new state-owned higher education institution was established, however, until the year 2000. All in all, the number of institutions had grown from 77 to 89 by the end of the decade. This growing but also disintegrating process and structure was then reassessed by the ever greatest organisational transformation programme of higher education, called integration. By the amendment of the Act on Higher Education in 1999, the formerly existing independent universities, faculties and colleges were united to form 11 regionally distributed state universities (the four Art Colleges could keep their sovereignty at a university level, and military higher education institutions were united in a new National Defence University). Also, seven new colleges were created by merging formerly separate institutions, whereas some colleges in towns of the countryside (mostly teacher training schools) continued to work on their own. The integration programme included, in addition to the unification of administrative and management structures, bringing in transferability and true co-operation in training and research, as well as eliminating parallel programmes. The institutional structure that was established on 1st January 2000, created a modern institutional network of higher education. One of the most important arguments for such integration was the need for a less divided system. This affected most of all, the former colleges part of which decided to choose different routes parallel with integration – or sometimes in an opposite direction.⁷

Currently, in 2009, there are 70 higher education institutions operating in Hungary, of which 12 universities, 11 colleges and 5 higher education art schools are under the supervision of the Ministry of Education, whereas the rest are managed by churches, civil foundations or are supervised by other ministries. The transformation of the spatial structure of this system went through along with the enlargement of the institutional system, the increase in the number of state-financed student vacancies, and the change of training forms and character (Figure 1). Among the planning and statistical regions, the largest number of students is admitted by the Central-Hungarian Region including the capital Budapest (nearly 180000 people in 2005), whereas the lowest number of people study in institutions of the Western-Hungarian Region (about 33 000 in 2005). If the regional distribution of changes in student numbers is analysed in comparison with an earlier point of time, it appears that the greatest growth occurred in Central-Transdanubia (5800 in 1994, followed by 30000 in 2005). The changes are spectacular not only in respect of figures but spatially as well. Today there is not a single county seat in Hungary without a higher education institution,

⁷ Zs. M. Császár, “Felsőfokú oktatás” in: M. László, N. Pap (Ed.): *A közszolgáltatások szervezésének alternatívái*, Lomart Kiadó, Pécs, 2007, pp. 103-115

and even most of the middle-sized towns have either a training institution or an affiliated organisation of one of the universities or colleges.⁸

Figure 1: The locations of higher education institutions in Hungary



Source: J. Rechnitzer, M. Sramó, "A felsőoktatás európai és magyarországi trendjei", *Unirégió: Egyetemek a határ menti együttműködésben*, Pécs – MTA Regionális Kutatások Központja, Győr, 2007

The currently existing highly divided system is well illustrated by higher education admission figures in 2009. The four major science universities (Lóránd Eötvös University: ELTE – Budapest; and the universities of Debrecen, Szeged and Pécs), together with the Budapest University of Technology and Economics made up about nearly half of the students admitted to state-financed programmes. Students belonging to the other half were admitted to one of the remaining 64 institutions among which several could not fill up their quotas. Besides certain faculties of the above four major universities, the other smaller institutions had even greater problems with some of their programmes or departments in that they are too small to be profitable. Questions keep arising in higher education

⁸ J. Rechnitzer, M. Sramó, "A felsőoktatás európai és magyarországi trendjei", *Unirégió: Egyetemek a határ menti együttműködésben*, Pécs – MTA Regionális Kutatások Központja, Győr, 2007, pp. 23-28

discussions whether or not the prestigious elite programmes with European reputation but with low student numbers should be closed down such as Turkish Studies, Japanese Studies, Philology of Classics, etc. But it is also becoming a question how those natural science programmes could be kept alive that have continuously decreasing numbers of applicants. Diminishing student numbers, thus, appears as a serious problem everywhere. Keeping their survival in mind, most of the universities have their hopes lying in students that pay tuition fees, but these numbers, too, keep decreasing year after year. In the competition for admissions it appeared that smaller institutions, mostly colleges, can hardly keep up with larger ones: despite launching new, seemingly marketable programmes, the number of students applying and admitted continued to decrease. According to forecasts, the true trial for these institutions will start two years later when the number of students graduating from secondary schools will be less by 20000. If the current tendency continues, it may turn out that larger schools, especially the ones in Budapest attract the majority of applicants, allowing only the universities in regional centres to survive.⁹

The greatest changes within the transformation process of Hungarian higher education were the declaration of willingness to join the European Space for Higher Education and the approval of the Bologna Declaration. Transition to the new system of training has implied a number of changes, except for the legal, medical and art programmes which continue in the former structure, with a single training cycle. The basic level of training provides real possibility for acquiring practical knowledge and competencies in a relatively short period. Currently it appears that, unlike formerly when college-level education proceeded in this scheme, now students with better chances in the labour market are being trained (the first batch of such students graduated in the summer of 2009, thus experience and survey results are still not available regarding the value of their degrees). The number of people applying for Master level education was less than anticipated which might signify that actually it is the applicants committing themselves to more serious, scientifically prestigious programmes that undertake such types of further education. However, still there are a number of accredited basic level training programmes which are not really marketable, which means that the student will inevitably participate in the next level of the training cycle, with an attitude of waiting on a “parking route”. A new element in the Hungarian higher education structure is higher level vocational education. It was launched in Hungary a little late, in 1998, although in other, Western-European countries it has been a programme with huge masses participating. Currently, higher level vocational education accounts for 26% of total student numbers, and the figure continues to grow.

One should not overlook the research activities pursued in Hungarian higher education institutions, especially universities. The need for such activi-

⁹ *Heti Világgazdaság*, 2009

ties, the demand from the side of participants of economy for R&D programmes together with their financing possibilities, as well as the aim of joining international Framework Programmes together encourage the institutions to reconsider their research activities. Unfortunately, the contribution of R&D to the GDP still remains very low (dropping to 0.97% in 2008), and universities have not seriously started to take such routes. Although the majority of traditional academic research institutions do undertake these assignments, there are many examples in the world for universities playing important roles. Such an initiative appears to be unfolding in the city of Pécs in the field of health, medicinal and environmental industry, with a major investment also being associated: the creation of the new Science Building.

Scientific activity is, in many cases, a potential indicator for the ranking of universities, the number or proportion of academic staff members with scientific achievements (PhD, habilitation, DSc) being an important factor in such rankings. The numbers of publications and citation indexes can also serve as a basis for comparisons. The former indicator follows a decreasing trend, partly caused by the fact that due to the growing number of students, professors have less time for doing research¹⁰

Hungarian higher education institutions are under increasing economic and political pressure. There is a peculiar combination indicated by the triad of state, market and autonomy, and although the 2005 Act on Higher Education provided an extended autonomy of institutions than formerly, it is the regulating effect of market that dominates these relations. Financing is a key issue in this complexity. The share of the state is becoming lesser, and the involvement of project funds, external works and market-oriented research is more and more important. In addition to all this, international challenges also need to be given attention. Globalisation raises new questions, to mention only a few of them: international mobility of human capital, the prioritised economic importance of research and technology transfer. Thus, some of the expectations from higher education institutions are now determined by international market. Hungarian higher education must comply with this new situation, possibly having to regard competitiveness as one of the most important aspects.

Today it is discussed again whether there is need for so many higher education institutions in a country with a population of only 10 million. Besides the 8-10 universities and colleges with high student numbers there are several other institutions that provide training for only few hundred students. According to certain recommendations it would be reasonable to expect, based on competitiveness indicators, the state financing of 6-7 universities that qualify internationally in the first 500 and fulfil the criteria of a research-and-training university. It appears from the ranking list of the world's first 500 universities,

¹⁰ Gy. Fábri, "Oktatás és tudomány felsőfokon: A magyar felsőoktatás hosszú évtizede, 1988-2002", in: P. Lukács (Ed.), *Felsőoktatás új pályán*, Oktatókutató Intéze, Budapest, 2003, pp. 46-88

produced by Jiao Tong University (Shanghai) that only very few of Hungary's universities would meet the standards and receive state funding. In 2004 the ranking included, among Hungarian institutions, the University of Szeged (SZTE), Eötvös Lóránt University, Budapest (ELTE) and the Budapest University of Technology (BME). In 2008 the same list had only two Hungarian entries: SZTE and ELTE, with positions in the range 303-401 (the ranking considers scientific quality firstly). These ranking results clearly suggest that time has come for Hungarian higher education to undergo major transformation. The time of quantitative changes is now over, and the improvement of quality has become timely. Looking at the tendencies of the past two years and the anomalies in the highly divided institutional system, it appears that only a rearranged structure can bring renewal and European recognition for Hungarian higher education. Necessarily, this will entail the transformation of the currently existing system, carefully regarding the three objectives of higher education: training, research and innovation. Within this new structure, the Hungarian Academy of Sciences and innovative pursuers of R&D in various fields, together with distinguished universities of science can become capable of producing values that will make Hungary attractive for Europe as well as the whole world. There are certain ideas according to which 2-3 higher education institutions should be re-organised and state-financed besides the existing universities in each region, which could meet the labour market demands of the region both in the narrow and the broader sense, run practice-oriented basic-level training, and have accredited placement (practice) institutions¹¹ According to the concept formulated by the Hungarian Rectors' Conference and the Hungarian Academy of Science, the qualitative improvement of higher education is essential in order for the institutions to be able to compete internationally, for their degrees to have higher value in labour market, for their research output to grow, and thus the institutions themselves contribute effectively to the development of the Hungarian society. For these to be achieved, the introduction of quality and output evaluation is recommended, an important precondition to quality and output-based subsidy which will appear besides normative state subsidies relying on student numbers. According to their proposal, the common elaboration of quality and output evaluation criteria has to be started as soon as possible, in a form that allows partial differentiation between various disciplines. Based on such an evaluation that would involve the levels of faculty, institute and department or research unit, "place of excellence" titles would be awarded. An institution as a whole will be awarded the "research university" title put forward in the Act only if the majority of its units have been declared as places of excellence. (*Közlemény a magyar felsőoktatás minőség- és teljesítményelvű fejlesztéséről*, 2009 – Communication about quality and output improvement in Hungarian higher education 2009). The concept and the initia-

¹¹ S. Magda, R. Magda, *Globális válság – oktatás- kutatás Fejlesztés és finanszírozás*, 2009, pp. 13-22

tive is currently awaiting detailed elaboration, and will be helpful in creating and operating true research universities, but does not give an answer to the problem of Hungarian higher education as a whole.

3.2. Hungarian higher education in numbers

The huge boom in student numbers has a great degree of difference among various branches of training. In the early 1990s, it was humanity and law faculties that experienced major growth in the numbers of applicants, and the case was similar for institutions providing economic, technical and agricultural types of training¹². This change in interest was a new phenomenon, because student numbers at humanities, natural sciences and economics were very low in the years of state communism. After the political transitions, the most dynamic increase in the number of applicants was experienced in economic studies. As shown by statistics, students at institutions providing technical type of training also had high representation in Hungarian higher education. This had to do with the fact that such schools were offering certain subject combinations as well that included economic and business subjects (Ladányi A, 2001).

Table 2: *Distribution of students among fields of training, 2001-2009*

Percentages of students participating in various fields of college- and university-level education		
Field of training	2001/2002	2008/2009
Teacher training, education science	15,1	8,1
Arts	1,5	2,1
Humanities	7,4	8,3
Social sciences	9,5	8,8
Economics and management	21,4	25,5
Law	5,6	4,9
Natural sciences	1,7	3,4
Computing and information science	3,5	3,7
Technical sciences	13,9	14,7
Agriculture	3,6	2,6
Health and social care	8,1	9,3
Services	8,1	8,5
Total	100	100

Source: Edited by András Mérei, on the basis of the Education Yearbook.

¹² G. Neuwirth, *A középiskolai munka néhány mutatója 1997*, Művelődési és Közoktatási Minisztérium, Budapest, 1997

As a general observation it can be stated that in comparison with former years, almost all of the higher education institution types have had an increased number of applicants since the early 1990s, the only exception being day-care and teacher training colleges where the number of applicants was lower in absolute figures too (yet, still remaining high in a European comparison). Though following slightly different admission policies, the various institutions generally could open their gates wide, thus the growing number of applicants was accompanied by an increase in admissions too.

When looking at the professional structure of higher education, some minor elements of transformation can be experienced. The number of people applying for basic level training programmes indicates that teacher training (for elementary schools and day-care institutions) is becoming less popular, and there are certain fields that have remained strikingly popular: social sciences, economics and law, the latter two belonging to the most attractive ones despite the saturation of labour market in these fields (Table 3). However, when looking at full-time master programmes, it strikingly appears that the priority ranking of the various fields is changing gradually. The field of humanities and philosophy has the highest priority, followed by social sciences, and the third place is occupied by the fields of teacher training and economic science (both with a rate of about 14% of applicants). The fifth field is natural sciences attracting 12% of applicants to full-time programmes. Although here there is quite a degree of specialisation, it may happen (e.g. among training programmes of social sciences or natural sciences) that the degree obtained in basic-level training will not be marketable in labour market, thus entering into the master level will be almost inevitable. It is also possible, though, that when applying, students had the aim of studying science and acquiring a higher level of knowledge after secondary school, and that was why they applied for the basic level training of the aforementioned fields of science (research looking at the personal motivation of applicants to master level programmes still needs to be done). The former belief that in Hungary there is low interest in technical and natural sciences, seems to be denied as indicated by tendencies both in basic level and in master level education. It is also important to consider that politicians dealing with higher education have been communicating recently towards potential students, in various forums and through various media, that there is high demand for people with higher-level qualification in technical fields; moreover they also raised the admission quotas to such fields.

Table 3: Number of applicants to different programmes *

Ranking 2009 (2008)	Major / subject	Number of applicants 2009 (difference compared with 2008)	Difference compared with 2008 in % (mean difference = +22,5%)
1. (1.)	tourism	5042 (+886)	+21.3
2. (2.)	business and management	4302 (+370)	+9.4
3. (4.)	engineer- information technologist	3067 (+592)	+23.9
4. (3.)	communication and media studies	3007 (-60)	-2.4
5. (9.)	finance and accounting	2978 (+1069)	+56.0
6. (7.)	law	2660 (+693)	+35.2
7. (10.)	mechanical engineer	2580 (+739)	+40.1
8. (5.)	commerce and marketing	2352 (+206)	+9.6
9. (8.)	medical doctor	2100 (+161)	+8.3
10. (6.)	psychologist	1929 (-81)	-4.0
11. (13.)	electric engineer	1575 (+295)	+23.0
12. (16.)	nursing and health care	1527 (+502)	+48.9
13. (11.)	international economics	1477 (-57)	-3.9
14. (15.)	programming computer technician	1424 (+312)	+28.1
15. (14.)	andragogy	1375 (+257)	+23.0
16. (17.)	architect	1282 (+342)	+36.4
17. (12.)	international studies	1276 (-27)	-2.1
18. (26.)	technical manager	1141 (+493)	+76.1
19. (20.)	English studies	1067 (+252)	+30.9
20. (23.)	criminal administration	1065 (+369)	+53.0

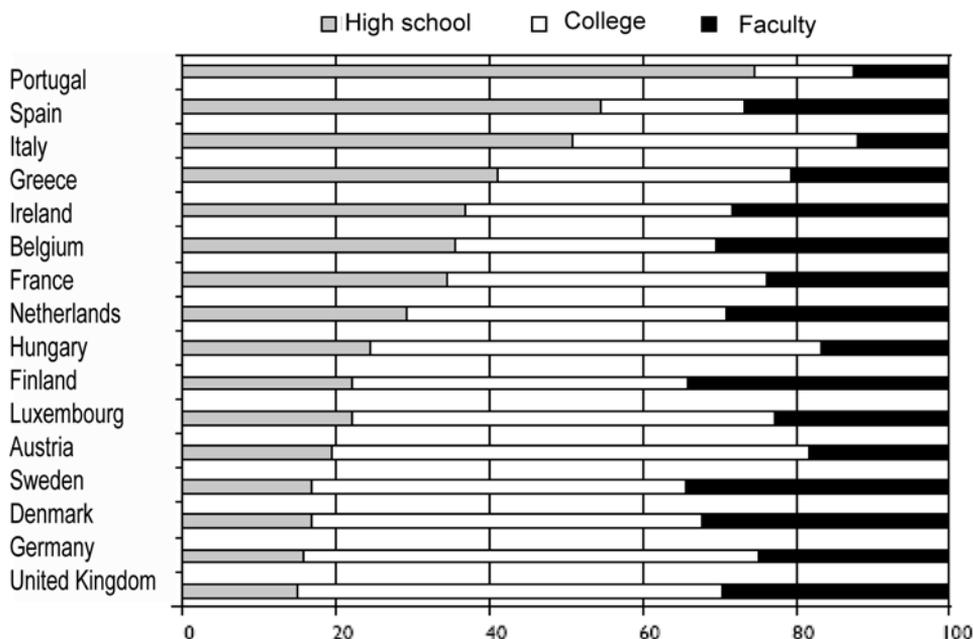
* Note: Full-time basic level or undivided training programmes are considered, based on application forms submitted to institutions indicated by the applicant as highest priority. First 20 most popular programmes.

Source: felvi.hu, 2009

When looking at higher education application data of the current year of 2009 it clearly appears that part of the students prefer fields that have higher prestige and possibly ensure a higher standard of living, such as tourism, economics, information technology and law. Also, the attractive power of the media has remained considerable: strikingly many people have applied in recent years to the communication or media science related programmes running in most of Hungary's higher education institutions. The good perspectives of being employed abroad have made the medical doctor and nurse careers increasingly popular.

It is also worth looking at how Hungarian higher education is positioned in the international environment. In its publication "Education at Glance", OECD's Directorate for Education releases annual data on international comparisons of education, including statements about Hungarian higher education. As it has been mentioned earlier, the number of people acquiring higher education degrees has increased considerably. This has an effect of growing education qualification levels in Hungary, yet they remain well below the OECD's average. The proportion of the population between the ages 25 and 64 with higher education degrees in Hungary is 17% in contrast with an average 26% in the OECD (Figure 2). The proportion of younger people (aged 25-34) with higher education qualifications is 20% in Hungary, whereas in the older population (aged 55-64) is 15%, which means that education levels have been successfully increased as a result of the expansion in the last 15 years. Current tendencies of higher education enrolment, however, may suggest that Hungary will proceed faster in the years to come. This means a sudden increase in the case of higher education degrees awarded, as already indicated by the change of the number of people obtaining degrees from 29% to 36% (between 2004 and 2005), these figures complying with the OECD average. The report confirms the finding that has been already mentioned in connection with the choice of subjects i.e. the most popular fields selected by students studying various disciplines are humanities, business, law and services, with more than 50% of university degrees being awarded in one of these subjects. Hungary has the lowest relative proportion of natural science higher education degree holders (695 among 100000 employed people between the ages 25-34), this figure being lower than in any other OECD country, hardly reaching half the OECD average value. Since 2007 the government has tried to compensate this backwardness by expanding enrolment quotas for these disciplines (see above).

Figure 2: Proportions of people with different levels of education qualification in the age-group 25–64 in Hungary and the EU-15 countries, 2004 (%)



Source: *Education at a Glance*, 2006

An important observation pronounced in the OECD report is that international students are present in Hungarian higher education with low but increasing numbers. Because the number of higher education students coming to Hungary (13601) is much higher than the number of outgoing students (7906), Hungary is a net importer of students in higher education. In Hungary, 2.7% of the students in higher education are international students (in contrast with the OECD average of 6.7%), the numbers having increased by 37% between 2000 and 2005 (average 93% in OECD countries)¹³. One explanation for such low rates is that the number of programmes offered in foreign languages is relatively low, only the medical faculties having more such courses. The majority of international students studying in Hungary arrive from Hungarian populations outside the state border, from Romania, Slovakia and the Ukraine. It could be quite graphically illustrated how young people from various areas across the border tend to choose universities near the country border, in addition to Budapest. Among foreign students the most popular subjects they can choose are health care and social care, these disciplines taken by about quarter of all the foreign students. The number and proportion of students from Romania are strikingly high in

¹³ *Education at a Glance*, 2007

basic and doctoral programmes, the latter having low representations of the other five countries, respective to their proportions¹⁴The most popular target for Hungarian outgoing students are Germany (36%), Austria (14%) and the United States (12%). With appropriate foreign language knowledge and higher mobility, the numbers can be increased in this respect, too.

The 2007 and 2009 reports of Education at a Glance makes very useful observations from the aspect of one of the major subjects of the present study. According to one, the income advantage of people with university degree is much higher in Hungary than in any other OECD country. Compared to Hungarian people with only upper-secondary education qualifications, the income advantage of university degree holders between the ages 30–44 is 125%, this figure being the highest comparative value among all of the OECD countries. People with higher education qualifications in Hungary have much better chances of finding a job: in the age-group of 25–64, 83% for higher education qualifications in contrast with 70% for upper-secondary education qualification. The 2009 issue of Education at a Glance attempts to translate the economic value of education into figures, at the levels of the individual and the society, respectively. On the former side, there is higher income and a lower chance of unemployment, ensured by a higher education degree. On the other side, there are the society's costs of training someone, the lost wages and the associated contributions. The balance comes out to be positive in all of the OECD countries, moreover, in Hungary (along with Poland and the Czech Republic) the net value of the degree is outstandingly high. Acquiring a higher education degree will bring USD 128000 for any Hungarian man, whereas in Sweden it will result in only USD 18000. Surprisingly, the profit from awarding higher education degrees is considerable at a macro-economical level, too. Investment into higher education is balanced later by taxes and contribution amounts of higher wages, and the lower amounts of social benefits paid, due to lower unemployment. The expected profit for the society in Hungary is twice as much as the average for the OECD. Altogether it appears that investing into higher education is profitable for both the individual and the society.¹⁵

3.3. The value and use of higher education degrees in Hungary

As shown above, acquiring qualifications and degrees in higher education institutions becomes a goal – reached whether easily or more difficultly – for an increasing number of young people. But why is a degree important and how can one use it? It is well known that the value of a degree is closely related with the economic level and the social value system of the country. In present-day Hungary, just like in other developed societies, people are required to have a degree

¹⁴ Zs. M. Császár, J. Németh, *Egyetem és régió - A Pécsi Tudományegyetem szerepe a régió felsőoktatásában*, Földrajzi Értesítő -LV. évfolyam 1-2, Füzet, 2006, pp. 141-158

¹⁵ *Education at a Glance*, 2009

in order to be able to take a number of different types of positions. The proportion of people holding university degrees had grown to 36% by 2005, this figure being in line with the OECD average. The reputation or appraisal of a degree can be analysed from several aspects. Researchers of the National Admissions Office to Higher Education took one possible method and analysed the appraisal of various occupations requiring degree qualifications, based on their material-existential and social reputation. From the opinion of the students questioned, a quite clear picture showed up in the ranking of the offered ten typical occupation types making up for the majority of Hungarian degree holders. In the case of material values, five occupation types had considerable mention rates, of which four are striking. Nearly half (45.7%) of the answerers consider the material value of law-related occupations to be outstanding. Computer technicians, technical engineers and economists follow closely, with quite similar mention rates. Although many people thought that the profession of doctors was also a profitable one, the picture about doctors' existential appraisal is more contradictory. The rest of the occupation types had very low mention rates which shows: there are hardly any students thinking that primary and secondary school teachers, sociologists, natural scientists or agricultural engineers have high reputation as reflected by their wages (www.felvi.hu).

Table 4: *Appraisal of occupations based on their material values**

mention rate of occupations	(%)
lawyer	45.7
computer technician	41.6
technical engineer	39.9
economist	38.4
doctor	26.0
agricultural engineer	3.8
sociologist	2.2
natural scientist	1.6
secondary school teacher, humanities	0.5
primary school teacher	0.2

* Note: Mention rates of the most highly appraised occupations – two occupations had to be mentioned by each answerer; N (number of answerers) = 7,805.

Source: www.felvi.hu

Interestingly, the picture is different if the social appraisal of the same occupation types are considered. Although the two points of view are most probably interrelated, the answers of the students did indicate considerable difference

between them. Nearly $\frac{3}{4}$ of the answerers thought about the doctor profession as one of the two most well known and highly valued ones, the figure being the highest by far. Doctors were followed in the analysis by lawyers, one with a high reputation in terms of incomes as well. According to the analysers of the survey this is due to the fact that the “doctor” title awarded to law degree holders has a high reputation just like the title of medical doctors. The judgement of computer technicians was interesting in the results: while they are among the most well-paid degree holders according to many, their social prestige is ranked much lower (www.felvi.hu).

Table 5: *Appraisal of occupations based on their social values**

mention rate of occupations	(%)
doctor	71.1
lawyer	53.5
technical engineer	20.3
economist	20.2
natural scientist	10.2
computer technician	7.9
secondary school teacher, humanities	5.7
primary school teacher	4.6
sociologist	4.3
agricultural engineer	2.3

* Note: Mention rates of the most highly appraised occupations – two occupations had to be mentioned by each answerer; N (number of answerers) = 7,765.

Source: www.felvi.hu

If all these are considered together with the rank of the most popular subjects selected by applicants in the 2009 higher education admissions, it appears that the chosen directions of specialisation in higher education are influenced firstly by material-existential factors. High income is the most important factor, meaning that a well-chosen degree is a secure investment in future. As found out by a survey covering 150 multinational companies in Hungary performed by Watson Wyatt, a HR and marketing research consulting company, a fortunate entrant starting out in his/her profession can expect a gross amount of HUF 317000 (cca. EUR 1150) as a monthly wage. According to a survey by the Hungarian Chamber of Commerce and Industry in 2008, the expectable starting wages among professions sought after by businesses are as follows: people with economic qualifications HUF 210000-280000 (EUR 800-1000), computer

technicians HUF 250000-350000 (EUR 900-1200), technical engineering HUF 170000-190000 (EUR 600).

Another survey (*Following Graduates*, 2009) looked at the value of degrees, and the results obtained seem to be confirming the conclusions of the former investigation. The analysis looking at the expected value of higher education degrees shows that the greatest value of a degree is the possibility to avoid unemployment and earn more. Accordingly, the strongest expectations for students as regards the benefits of their degree are financial security and prosperity. The third most important aspect is that a degree can ensure increased freedom and a more unbound life, as well as it can open up opportunities for working abroad. Prestige values such as high reputation associated with higher education degree or possibilities to win a leading position in their job were considered to be less important by the students questioned¹⁶).

Based on the above facts it is important to look at how the knowledge provided by various higher education institutions is accepted by labour market. Is the great increase in the number of people with higher education degrees in harmony with the absorbing capacity of labour market? These are important questions that, in practice, will influence the chances of new graduates to find jobs, and will determine the quality of jobs they will have access to. However, it is difficult to exactly define the output of Hungarian higher education, because the system lacks a feedback mechanism, i.e. career follow-up tracking after graduation¹⁷. This calls the attention to the weak connection between higher education institutions and the user side. The government can also be blamed for the missing career follow-up system: although in 2006 its use was made obligatory, no financial resources were allocated, preventing the majority of institutions from performing their duty. There are, however, some initiatives, such as the professional study series having been performed by the Budapest University of Technology for years, the results of which are communicated widely among students, as well as they can directly influence the strategic development of the institution. Also, in most of the universities and faculties, the administration keeps asking their graduated students about where and in which field they found a job and what position they were given, with special attention to how they could utilise their knowledge gained at the university, to their income and other details of launching their careers. Yet, this is not the same as an organised career follow-up system, or something that would provide assistance in finding a job, as would be expected by graduated students.¹⁸ From the investigation launched by the Pannon University of Veszprém it appeared that it is the courses of communication, foreign language and computer

¹⁶ www.felvi.hu

¹⁷ Gy. Fábri, "Oktatás és tudomány felsőfokon: A magyar felsőoktatás hosszú évtizede, 1988-2002", in: P. Lukács (Ed.), *Felsőoktatás új pályán. Oktatókutató Intézet*, Budapest, 2003, pp. 46-88

¹⁸ www.felvi.hu

science that provide students with a type of knowledge they can use in their jobs. However, exactly these are the subjects students either do not have in their training programme or are dissatisfied with. Pannon University wanted also to know what type of experience graduates gained about searching for a job and about becoming employed. It was found that students could normally find a job in 1-3 months, but the lack of adequate practical training and the insufficient foreign language knowledge were serious problems.

Based on those said above, the question arises whether labour market can be planned at all, and the structure of training can be responsively and flexibly modified based on feedback from the market. Is it necessary or worth at all to forecast the demands for certain fields of specialisation? The debate on this question has been going on for long among people dealing with the economy of education. Examples from the West – from France, the US, the Netherlands – indicate that if such forecasts are continuously updated, the system will be feasible (Vámos D, 2002). In the case of Hungary we believe that it would be very difficult to come up with plans and well-based recommendations for an economy that is extremely exposed to the effects of globalisation and is still characterised with very weak market achievements. Currently, the only objectives that can be reached directly are that the government continuously revises higher education admission quotas in certain fields, and that programmes that provide training with too general scope and with no practical aspect are not supported by the Accrediting Committee, especially in the basic level of trainings.

Regarding the true value of a degree, two very important factors must be carefully considered which have been pointed out earlier: one is lower unemployment rate and the other is the relatively high income (the latter factor was discussed in relation with its comparison with OECD countries, too). Statistical data on European countries have been indicating for decades that the representation of people with higher education qualification in the unemployed population is much lower than that of people with secondary or primary education levels. Looking at the Hungarian situation, one can observe a slightly increasing trend (growing from 3.9% of the total number of unemployed people in 1998 to 7.8% in 2004), but the curve is turning downwards again (dropping to 4.5% in 2008). The change in these proportions after 2006 is probably caused by the modified regulations rather than the actual decrease in the number of people seeking employment. As signified by statistical data and results of other surveys, newly graduated people can normally find a position after a more or less short period of unemployment.¹⁹

¹⁹ Z. Györgyi, *Munkaadók és diplomák-ekvivalencia és kompetenciák*, *Educatio* 2, Szám, 2007, pp. 256-270

Table 6: Annual average numbers of newly graduated people seeking employment

Annual average numbers of newly graduated people seeking employment in certain fields of occupation (2004-2008)					
	2004	2005	2006	2007	2008*
Health	44	66	80	91	62
Financial management	123	156	136	109	86
Legal & law enforcement	207	242	198	144	62
Economist	536	649	537	414	273
Engineer	882	997	816	643	448
Teacher	1123	1218	1020	758	460
Sports & culture	147	174	149	151	118
Information technology	41	42	36	32	23
Social	113	129	128	113	73
Human sciences	58	77	74	73	44
Natural sciences	53	75	77	80	55
Administrative	257	309	265	317	305
Total	3584	4134	3516	2925	2009

* Note: 2008 first semi-annual data

Source: Edited by András Mérei, from 2009 data of the State Employment Agency.

From Table 6, it appears that although the number of unemployed people decreased in all fields, information technology continued to be the sector with the lowest rates of unemployment. For people with health qualifications, too, the chances of finding a job are similarly good. It must be noted, however, that the highest number of unemployed people were recorded in fields that have the highest number of higher education graduates anyway, such as in technical and economist occupations. The transformation of employment structure occurred together with an increase in the required level of qualifications. The increasing demand for degree holders, as measured in a growing number of new jobs, was also expressed by the fact that occupations requiring degrees were gradually saturated with people having higher education qualification, and part of the office administration jobs were occupied by degree holders. This also meant that many of the secondary school graduates were pushed out from administrative type of occupations i.e. from the job type they formerly dominated.²⁰ From macro-economical data it appears that obtaining any type of higher education qualification results in a more secure employment status for the individual than with secondary or primary educational level.

²⁰ G. Kertesi, J. Köllő, "Felsőoktatási expanzió, diplomás munkanélküliség, és a diplomák piaci értéke", Budapesti munkagazdaságtani füzetek Bwp 2005/3, p. 20

In analysing the value of a degree, it is important to find out about what the requirements of labour market are. An investigation performed in 2006 by the Higher Education Research Institute focused on this issue. We have tried to check the statements of this study by analysing the job advertisements of the most well known Hungarian weekly economic magazine - *Heti Világgazdaság*: a total of 300 advertisements were analysed in 5 issues of the year 2009). Apart from a few minor exceptions, we came to the same conclusions as the study, the differences being partly due to the fact that 3 years passed between the two investigations during which time Hungarian economy and labour market went through some changes, moreover, our analyses was performed in the year of a global crisis. In addition, the advertisements we were looking at were published in an economic magazine that means relatively higher advertising costs for the employers, thus the pool whose expectations could be compared with the results of the research institute was smaller. Moreover, they had a larger sample size of 10000. Our aim has been to confirm the statements of the research institute, and provide some additional findings. According to the research, the job advertisements do not generally emphasise qualification requirements, yet one third of them expects the candidate to have a university degree. This indicates that in Hungary where higher education has a dual tradition, employers show preference for higher levels of qualification, and statistics also show that unemployment rates, too, are lower among university graduates than among college graduates. This is partly due to the longer training period, increased selection and the healthy competition relations during university studies. In the long run, the transition to the Bologna training system will probably cause a higher differentiation of expectations. According to the analysis performed by ourselves, the only precondition for taking the advertised jobs was higher education degree, with no specific differentiation made by employers between its levels. Nevertheless, today we can find a few advertisements with either BSc or MSc being preferred by the employer. As to the specific field of the degree, part of the advertisers do not indicate specific areas, e.g. in the case of assistants or regional agents, but the majority indicate a certain specialisation as the condition for taking the position. Mostly it is economic, technological, computer technical and commercial areas where candidates are sought after. Among different competencies, language knowledge is a basic requirement in all of the advertisements, mostly an intermediate level of English, but the knowledge of another or, in some cases, more languages is an advantage. Computer literacy – basic user competence – appears in an increasing number of advertisements as one of the required basic requirements, as was particularly striking in the analysis performed by ourselves. Practical experience is expected in many cases, this condition causing the greatest difficulty for fresh graduates in finding a job. The most marketable professional qualification is provided by those universities that organise practice or placement for the students as part of their training programmes. As we have indicated earlier, it would be essential

to include periods of practice (controlled by the relevant professional chambers) in the new, multi-level training system and basic level programmes. Good communication skills, too, are among the expectations in certain fields such as commercial regional agents or salesmen, etc. A series of additional competencies also appear in the advertisements such as problem solving and organising capacities, or the ability to work as part of a team. According to both the research institute results and our survey, it appears that an increasing number of additional competencies are required besides the traditional expectations when employers advertise their positions. It would be important to clarify which of these can be acquired in higher education or as early as in primary education, and which are the ones that have to be developed or acquired by the individuals themselves. It has become clear that language competence, computer literacy and the above mentioned abilities are not to be acquired as part of higher education. It can be a beneficial fact that competence-based education has been introduced in primary education which has meant that a number of such competence elements have been selected for being improved which will later be expected by employers as a labour market competence (team work, problem-solving ability, etc.).

It is worth looking at how graduates judge their chances in labour market, from a Hungarian as well as a European perspective. According to the findings of a survey (research staff of the National Admissions Office to Higher Education), the majority of university students have a positive attitude as regards their expectations for the future. Clear differences between various types of opinion appear in relation with various specialisations and social backgrounds. The chances are viewed most positively by students of technological and medical universities, while the most pessimistic are participants of agricultural, natural science and humanities programmes. The latter have the worst opinion about their universities regarding the question how the institution provides a firm basis for further individual success. Cultural capital and good social relations ensured by parents with higher level of qualification or an intellectual status contribute to more optimistic perspectives, and, quite understandably, fields with greater inherent social mobility (humanities, agriculture) remain with less promising perspectives. However, the role of the higher education institutions themselves in establishing good chances for their students in finding a job is not to be overlooked either. Besides the quality of knowledge capital provided by the programmes, the reputation of the university and its professional prestige, career chances are clearly influenced also by the way students are managed in the higher education institutions. From those written above it appears that the distribution of young people on the basis of their positions in labour market is influenced by the type of training they received. Labour market shows, on the one hand, the current status of graduated student availability and demand for different professions and specialisations (i.e. which fields are the most/least sought after), and it also shows the distribution of fresh graduates wanting in highest /lowest numbers

to find jobs, in relation to their mother institutions. According to the survey by Péter Galasi, it is the jobs in the economic, law and medical fields that are the most attractive from the aspect of incomes and social appraisal. If the relative proportions of people employed, unemployed and trained in various disciplines are analysed, the values of different degrees will clearly be seen. It is medical science that has the smallest rate of unemployment and the lowest number of people studying further on. The worst indicators appear for people having graduated in agricultural sciences. The highest number of people continuing their studies after their first graduation is recorded in the case of humanities, this fact suggesting that these people often try to obtain an additional qualification in order to have better employment chances ²¹From data analysed above and from the re-interpreted surveys it clearly appears that the situation has not really changed since 2003 in that three higher education qualifications – economists, lawyers and medical doctors – are the most welcome higher education graduates in labour market (with better salaries and relatively low unemployment rates), the field of technology being an additional, highly appraised qualification.

Finally, let us take a look at which higher education institutions provide students with competitive degrees, offering them favourable opportunities in labour market. For this, it is worth analysing the rankings of different institutions. The international ranking of higher education institutions has been a popular practice since the early 2000s, its practical importance being ensured by the fact that publishing such ranking information most probably influences applications to universities and colleges, and, at the same time, statistics on application data have an effect on the rankings themselves. Thus, producing rankings has an education political significance as well (Török Á. 2006). Several university rankings have been published recently. For the scope of our study, it is the somewhat different method used by the weekly magazine “*Heti Válasz*” that seemed to be the most relevant as a basis (ranking lists are compiled as an unweighed average of 6 indicators (5 in the case of college level training). Elements of the indicator system: 1. applications in excess (“over-application”); 2. opinions from employers; 3. opinions from HR consulting companies; 4. results of national Scientific Student Workshop conferences (indicator not used in law, economy and college level programmes); 5. relative proportions of students vs. professors; 6. composition of the academic staff). From the aspect of employment possibilities, this ranking is the most useful one, but because it is compiled separately for various fields, it casts light onto the training quality of higher education institutions of only one discipline at a time. Though in an indirect way, it provides an assessment on which Hungarian universities and colleges are the ones that produce the most highly competitive manpower. The ranking of the economic field is lead by Corvinus University in Budapest. In accordance with public opinion, Eötvös Loránd University (Budapest) is leading among law universities. In information

²¹ P. Galasi, *Fiatal diplomások a munkaerőpiacon – Educatio*, 2003, pp. 227-236

science it is the Budapest University of Technology, and in communication programmes it is Eötvös Loránd University that have first positions.

This ranking includes the same two Hungarian entries that are listed among the global list of best universities ranked on a scientific basis.

4. Conclusion

As a result of social, economic and political changes, the traditional academic type of higher education went through a transformation. Besides social needs, political measures as well as demographic reasons have also contributed to the spreading of mass production in higher education. In the globalised world of the 21st century, higher education, too, became market-centred. European universities working in the new Bologna system as degree-factories have tried to fulfil the needs of mass training and elite education at the same time, as well as serve labour market. Hungarian higher education, too, has gone through radical changes during the two decades after the political transformations. The route we are taking is not unique, as it is much similar to the re-arrangements taking place in many other countries throughout the world, following the global trend with varying degree of lagging. Hungarian universities and colleges have become different from what they used to be at the time of the political transition, in their operation and organisational structure as well as in the content of their programmes. The number of students has grown to almost four times as many as before, and the number of institutions followed a dynamic growth until the integration in 2000 (although similar trends have been observed during the past 9 years too). Along with growth trends in quantities, new functions and structures of training have also come to life, and mechanisms typical of market relations have gained space.

As shown by various surveys, statistical data and the analysis performed by ourselves, higher education degrees have had prestige and reputation in Hungary in the years after the turn of the centuries. The greatest value of a degree is its contribution to avoiding unemployment and to earning more. From looking at the value of various higher education qualifications, it appears clearly that candidates most welcome by labour market are from the fields of economy, technology, computer science and commerce, and there is also a continuing demand for people in health care, especially doctors. Higher education ensures the required qualifications for labour market, although in certain fields there is an excess in numbers (fields of law, humanities, teacher training).

As a summary, we can point out that Hungarian higher education institutions have succeeded more or less in trying to comply with the social and economic challenges they face in a global competition. They have a quite significant share in human capital production, ensuring the acquisition of a competitive

professional knowledge in certain fields and in the most popular institutions. However, after a period of continuous quantitative growth, there is need for qualitative improvements as well. Competitiveness has become a focal issue from many aspects including scientific quality as well as labour market implications.

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ART, ECONOMY AND THE MARKET THE “AESTHETIC SYNDROME” AND MARKET RULES

Abstract: *As the ruling socio-economic relation of today's age, the market does not represent the most adequate framework for an authentic and free development of the traditional aspects of art. By being brought into connection with the market and money, art is drawn into the field of economy, with which, by its nature, it is not very close, which breeds many uncertainties. New media and their market influence have practically opened an ever bigger gap between the artistic and the monetary value of artwork. The market and its criteria definitely play a more decisive role than actual creative scope when it comes to material compensation for artistic work.*

Key words: *art, economy, market, money, use value, aesthetic value*

JEL classification: D46, Z11

*Everything is turning into merchandise, from paper, to convictions, to the
writer's ideas and feelings.*

Balzac

1. Introduction

The art world has always been immersed in the questions of economic existence and its relationship with the market and money. In a time in which the market has grown into the ruling socio-economic relation, many doubts and questions of this kind are gaining even more currency. Both artistic theory and practice, excepting the creative industry sector, more or less agree that the market is not the most appropriate framework for an authentic and unimpeded development of artistic creativity.

By being brought into connection with the market and money, art is drawn into the field of economy, to which, by its nature, it is not very close, which breeds many uncertainties, from those that are the result of a conceptual-terminological

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lack of clarity to moral dilemmas and condemnations on account of the entrance of money into the sphere of art. In fact, we are here dealing with, on the one hand, with a specific form of aesthetic syndrome in the form of the art world's self-sufficiency and, on the other, continuous questions and doubts regarding the interests in the name of which money is being given to art and what, in turn, art is expected to give back.

In spite of the all-encompassing and universally accepted rule of the market, it seems that many unique features of artistic creation are nevertheless giving signs of a need to establish different, specific conditions of socio-economic reproduction – certainly different from those determined exclusively by economic or market reasons. We are not here talking only about differences having to do with the lower market efficiency of artistic creation relative to other forms of endeavor, but about a different expression of important relations and processes that characterize the market in the field of art and culture. The specificities are so numerous and significant that they must be seriously viewed in a segmented way, including the differences that exist in defining the concept and contents of traditional artistic practice in relation to so-called economic-cultural endeavors, i.e. the culture industry.

Understanding the position and market existence of art requires an interdisciplinary approach, a synthesis of the culturological, sociological, economic, cultural-political, aesthetic and psychological, creative-experiential aspects. Expertise in recognizing merchandise and economic relations is insufficient, as are understanding and feeling for the aesthetic as an individually and socially acceptable and desirable function of a work of art.

The market relates to the socio-economic relationship within which the process of exchanging goods for money and money for goods takes place.

Art is a specific form of human creative activity, based on the creator's aesthetic and entire life's experience. This activity is objectified in material, sensually accessible and specifically structured sensual objects.

Through what categories is a functional relation between these seemingly unconnectable social contents established? This is one of the key questions that lead us toward an understanding of the economic dimension and market position of art.

2. A market somersault, or how a work of art attains the characteristics of merchandise

Before finding a satisfactory answer to the previously posed question, it is first necessary to take a position regarding the following conceptual categories: artistic work, goods, price, money, use value, market value, work of art, exchange value and artistic value.

Artistic work This is a specific form of human labor, and represents the most general basis that allows a product of artistic work to appear as a good, for its specific use value to be able to be expressed by way of market value. "Artistic work differs from the work of a producer of ordinary goods in that it is defined by its expressive qualities rather than its functionality or quantity of technical authority that it possesses."¹

When it comes to *use value* (which in our subject represents the aesthetic dimension of a work of art), the invested creative work is valid only in the qualitative sense while, when it comes to market value, this work has only quantitative features, since it has already been reduced to human work without further quality. The connection between art and work is twofold: *art is both a form of work and a product of work*.

Market value Since the market value of work is exclusively quantitative, it is possible to bring into correlation each type of work – simple forms of production that encompass so-called *simple work* with the most complex activities, among which artistic creation. Simple work is a standard against which all other more complex work is valued as a form of multiplication of simple work. Valuation is accomplished by equalizing a larger quantity of simple work with a lesser quantity of complex work. This equalization is accomplished through the *market*. In other words, products or goods created as a result of simple or complex work are equalized by way of the market.

Merchandise This is any product of human labor slated for exchange (for money or general merchandise). Any product of human work, including artistic work, acquires its status as merchandise through its *exchange value*. "Such a value is manifested when two or more (kinds of) products enter into a certain mutual relationship, the very relationship that manages commercial exchange on the level of *barter* and whose development creates a *market*."²

Exchange value gains autonomy in money – "an abstraction is executed here: by becoming autonomous in relation to each separate body of merchandise, exchange value also becomes separated from each separate need, providing only a quantity-bounded power over all specific qualities to the one who disposes of it."³ Thus, on the market, the product is first turned into merchandise with an immanent tendency of transforming into money – "here goods must make their somersault, perhaps breaking their neck in the process. Thus, the exchange value that is connected to the body of merchandise cries out to be saved in the form of money."⁴ However, it should be clear to us that a work of art acquires the characteristics of merchandise not only because work was invested in its creation but primarily because it contains a significant artistic or aesthetic value, which can

¹ V. Kodelupo, *Tržišna komunikacija*, Clio, 1995, p. 120

² R-L. Feručo, *Jezik kao rad i kao tržište*, Rad, 1981, p. 104

³ V. Fric Haug, *Kritika robne estetike*, Istraživačko-izdavački centar SSO Srbije, 1981, p. 8.

⁴ *Ibid*, p. 17

take part in exchange and acquire market value. From the standpoint of market values, the fact that the primary nature of artistic work is different is not important – “Fine art as a human activity is mostly process-oriented. It is more accommodated to express what the artist deems appropriate and to provide him with internal satisfaction than to represent merchandise slated for the market, which bring external rewards.”⁵

Price The most direct equalization, i.e., the equalization of one type of merchandise with others, is accomplished by way of price. The price is a monetary form of merchandise, i.e., the quantity of money that should be paid for a certain unit of merchandise or service. “This transformation of the artistic value of a work into monetary value actually represents the basic precondition for it to also begin its *artistic activity*; the market, merchandise, money – these are the unavoidable intermediaries between the artist and the experienced.”⁶ For this reason, *money* is a general good, a universal equivalent in exchange. Money exists in the place of physical merchandise and facilitates, quickens and generalizes exchange. In accordance with the aesthetic syndrome that characterizes it, the world of art to a great extent resists monetary valorization. The examples are countless. We will remind of one that gained great attention and opposing public reactions: about ten years ago, Russian conceptual artist and performer Alexander Brenner expressed his resistance to commercialization by spraying over Kazimir Malyevich’s painting “The White Cross” with a drawing of the symbol of the US dollar. Did anything change on the art market subsequently and what was the epilogue of this event? What occurred was something that could be expected in the world of the market economy. Brenner wound up in jail, while Malyevich’s painting additionally gained in price after restoration.

Use value Each good or product of human labor has a goal to satisfy certain human needs, and this characteristic is defined as use value. In principle, the human relationship towards use value is a primary relationship; however, commercial-monetary practice puts the relationship towards *market value* into primary focus, relegating the relationship towards use value to the background. The goal of production is sale. Thus, production for the market becomes more primary than production for the satisfaction of human needs. Money stands between the artist-producer and the experienced-consumer. Through the action of market relations, the artist becomes the *seller* and the experienced the *buyer* of a work of art. A primarily *aesthetic relationship* transforms into a *proprietary relationship*. The function of money in relation to artistic work in market relations is contradictory, being both positive and negative. Money makes it possible to exchange a work of art with any other form of human labor. On the other hand, since money is the quantitative essence of human work expressed in the form of price, it appears as a totally different sort of value in relation to artistic

⁵ I. Adžes, *Menadžement za kulturu*, Asee books, 2002, p. 14

⁶ M. Ranković, op. cit., p. 99

value as the essential value of a work of art. Artistic value represents the qualitative and prices the quantitative essence. Price expresses the quantity of contained simple socially recognized work in the product and it totally abstracts, as is the case with other merchandise, aesthetics as the use value of a work of art.

Artistic value is a qualitative set of a work's characteristics and specificities, accomplished totally independently of the quantity of work spent in producing the work that is the carrier of the artistic value. Although a work of art achieves the status of a socially recognized work only on the market, the market is not always the right and reliable place to adequately determine and valorize artistic value.

A work of art realizes social affirmation on two bases:

- According to the level of its artistic value,
- According to the price it fetches on the market.

The first base is usually expressed through the evaluation of criticism and other forms of social recognition, but the artist is also concerned that his work realizes a satisfactory material valorization or market price. We are obviously dealing here with two different, often mutually opposed ways of social valorization of artwork: social recognition and market price. Many works that have garnered significant social and expert-aesthetic recognition have not received adequate valorization on the market, and vice versa. In any case, in a society with developed market relations, *money* appears as a symbol of real value and, at the same time, the true symbol of the value of work. Standing between two types of social valorization, socio-aesthetic and market-based, the artist must seek both. Aesthetic valorization provides him with moral and market appraisal with material recompense for his work. These are two mutually very distant poles, between which stand numerous, very complex processes and influences. Some originate from the area of economic and market behavior, while others come from the still more difficult to explain aesthetic, experiential sphere.

Very often, extra-aesthetic reasons determine the price of a work of art, after which it succeeds, by referring to the affinities of the public, to acquire affirmation of its aesthetic value as well. For, it can always be said: "It cannot be that this work has no artistic value, having achieved such commercial success!" The point is, a work of art manifests itself in a twofold way. In one sense, it does not represent a piece of merchandise while, in another, it does. From the standpoint of its creation, as a product of aesthetic objectification, a work of art is not merchandise, and that is its essential, primary determination.

Once it has been created, it can become merchandise when it appears on the market with a price. This is a secondary determination, a subsequent, added characteristic. For example, the writer's work is to "produce ideas," which, if placed in the context of creating surplus value as a special type of work (through publishers and bookshops), becomes a type of production work, while the writer becomes a production worker. Thus, a writer is not a production worker in the

essence of his activity, but in a subsequently accomplished effect of that activity, in the context of certain economic relations.

3. The relationship between the use value and market value of a work of art

As already said, merchandise is any product of human labor intended for exchange but, at the same time, it is also an object that, through its characteristics, satisfies any type of need. The *qualitative* and the *quantitative* dimension of merchandise stand out amongst a series of characteristics, thus establishing its use and market values – “the structure of merchandise and the entire consumer system are based on a dialectic between use value and market value.”⁷

Use value, i.e., the usefulness of specific merchandise, stems from its abilities to satisfy a particular human need. This is its qualitative dimension.

Market value is a changeable relationship, within which the use value of one kind of merchandise is exchanged for the use value of other kinds of merchandise. This value is expressed as a quantitative relationship, while the goods themselves carry various qualities. The value of a good is measured by the quantity of work necessary for its production, while the quantity of work itself is measured by its lifespan. However, as is known, the artistic value of a work is not measured by the quantity of work necessary for its creation. The quantity of invested work and spent energy are not proportional to the artistic or, better said, aesthetic value of the work of art. The usual measure of work quantity when it comes to the evaluation of artistic value is not applicable. A larger quantity of work does not always bring greater artistic or aesthetic value. Aesthetic value as the use value of a work of art is conditionally comparable to the use value of any other product of human labor.

The market value of a work of art, however, abstracts the use value of the work of art (just like any other product), thus abstracting the work’s qualitative characteristics. The key problem with the market valuation of artwork is that it creates an illusion that aesthetic valorization is included in the market appraisal of artwork, i.e., in its price formation, and that the price of artwork is the equivalent of its aesthetic value – which is in fact untrue.

The market mechanism itself ignores the aesthetic value (use value) of artwork because, by its nature, the market relationship is quantitative rather than qualitative. What is certain is that artwork acquires the status of socially recognized work only within the framework of market exchange. In accordance with merchandise-monetary logic, this means that artwork that is created and reproduced outside the bounds of market relations is not socially recognized and, thus, not socially useful, regardless of its aesthetic dimension.

⁷ V. Kodelupi, op. cit., p. 68

However, especially in art, market logic will never completely change the fact that man is that primary agent that determines meaning and assigns it value. Thus, objects themselves are not the carriers of definitive meanings and values. That is why objects (merchandise) will be treated from the standpoint of the direct satisfaction of a need, either as merchandise on the market, or as a symbol, or as an object of a ritual endeavor, and the like.

The existence of artistic or aesthetic experiential needs is a prerequisite for establishing any sort of positive relationship between the public-user-buyer and a work of art. Since such needs belong to the so-called sphere of "higher" or "secondary" needs, it is illusory to expect the existence of this type of need among all who come into contact with artistic creation. Thus, if such needs do not exist, then motives that would drive an active stance towards art should not be expected to exist, either. Especially, we cannot talk about appraisal in any sense, since the existence of art and aesthetic experience are not understood as a given in that concrete value system.

A second, equally important question of significance for appraisal in art, relates to the ruling view that artistic creation in a literally practical sense does not produce any tangible results that improve life's conditions, does not "solve" any problems and difficulties directly related to human existence. As a rule, all products of human labor are expected to serve a purpose, while art is a "servant who does not know how to do anything useful" (B. Pekić). It is thought that the absence of pragmatism is what distinguishes artistic from most other activities through which man resolves the problems of his existence. Although economics, on whose terrain we are considering art in this section, are also cognizant of so-called external effects (positive or negative externalities),⁸ it is closer to the truth to say that the true functions and role of art are in fact not comprehensible to everyone. The functions of art are numerous: cognitive, educational, predictive, hedonistic, intuitive, communicative, suggestive, compensatory, cathartic, socializing, entertaining, etc."⁹

Finally, the impossibility of establishing unified value parameters (both aesthetic and market-oriented) in art is also a product of the basic imperatives of artistic creation – *individuality and originality*.¹⁰ Creative originality, which represents an important quality and value of a work of art, stems from a concrete and unrepeatable artistic individuality. In art, it is impossible to establish even an elementary level of the general and the common – either in the creative or in

⁸ They appear when costs and market prices do not reflect or do not wholly encompass all the costs incurred in the production of a good or service.

⁹ See: L. Stolovič, *Suština estetske vrednosti*, Grafos, 1983

¹⁰ As such, the original in art is determined only in relation to the existence of the conventional. Without the existence of the conventional, it would be impossible to notice originality. The process of repetition turns the original into the conventional. Absolute originality does not exist, since all originality in its inception makes use of a series of conventional elements.

the experiential domain. Instead, there are countless specificities for which it is impossible to find a common equivalent. In terms of value, both creative interpretation and aesthetic experience can be relativized in countless ways. In the conventional sense, the category of the aesthetic is most often identified with the concept of the *beautiful*. Still, even that fact is not of great help when it comes to the appraisal of artistic creation. This is confirmed by a thought recorded long ago (in 1760): “For beauty is one of nature’s great secrets, whose effect we all see and feel, but a clear, general conception of its being belongs among the still undiscovered truths. Were this concept to be geometrically clear, people’s judgments regarding the beautiful would not differ, and it would be easy to acquire conviction about true beauty.”¹¹

4. Specificities of the existence and aesthetic appraisal of a work of art

The products of artistic activity can be artistically objectified in various ways and, having this in mind, we distinguish between the ways of their existence and of establishing a relationship with the market, i.e., the public, the users.

One form is an *aesthetically directly active existence*, possessed by the works of those types of art in which the results of work are ultimately objectified – literature, architecture, painting and applied arts. These works by themselves allow direct contact with the receiver.

A second form is an *aesthetically indirectly active existence*, possessed by the works of the types of art the results of whose creative work are not ultimately objectivized – scenic-musical arts, theater and film. The existence of these works comes in two forms:

- The first, passive form, which is insufficient to allow a direct and aesthetically complete contact with the receiver (a musical score or drama text), and
- The second, active form, which comes about when the passive form of the work’s existence is activated with a certain direct act – a musical interpretation that activates a composer’s work; the work of a director and actors, which brings a drama into an active position; the technical projection of a film track, which activates a work of film, etc.

Thus, the ways of objectification in art are various and complex, bearing a direct effect on the modes of their appearance on the market, i.e., on their form of presentation.

We already spoke about the question of aesthetic value as a category of the specific use value of artwork. It is important for understanding the market position of artistic creation. Throughout history, countless attempts have been under-

¹¹ J. J. Winckelmann, *The History of Ancient Art*, p. 90 (Serbian translation).

taken to find reliable criteria that would enable aesthetic valorization in art, and it can be definitely said that none has succeeded thus far. Of course, that does not mean that this question should not continue to be a subject of consideration, writing and conversation. It is a well known fact that sculptors in ancient Greece, seeking to create the perfect human body, first measured the most beautiful men and women and then created their truly magnificent sculptures by using the average of the said measures.

In his study, "An Introduction to the Fine Arts – Elements of Fine Art Expression,"¹² our prominent fine arts pedagogue and art historian, Pavle Vasić, points to a series of ideas and attempts to distinguish, separately analyze and evaluate the various elements of fine art expression.

L. B. Alberti (1404-1472) proposed three groups of painting elements:

- Contours,
- Surface ratios,
- Modeling bodies of light

Leonardo da Vinci (1452-1519) was also a proponent of a tripartite division:

- Drawing,
- Spiritual expression,
- Color.

Agostino Caracci (1558-1601) laid out the rules that every good painter had to master – "the *drawing* of the Roman school, the *movement and shadows* of the Venetian school, the *color* of the Lombardian school, Correggio's *fearsome style*, Raphael's *orderliness*, Tibaldi's *decorum and solidity*, Primaticcio's *learned inventiveness* and Parmigianino's *charm*."

The French art historian and theoretician, Roger de Pilles (1633-1709) went the farthest, attempting to establish a *system of evaluation in the fine arts* on the basis of four criteria measured on a scale from 0 to 20 points:

- Composition,
- Drawing,
- Color,
- Expression (psychological expression).

Vasić notes that de Pilles' table refers to value judgments in art that were current in the 17th century, nevertheless adding that "their application regarding certain artists is not unconnected with the judgments we hold regarding those same artists today." Still, Vasić insists on a final conclusion that "many judgments have

¹² P. Vasić, *Uvod u likovne umetnosti – elementi likovnog izražavanja*, Narodna knjiga, Beograd, 1959, p. 7

since been changed or revised, e.g. on Le Brun, Venius, Rembrandt.”¹³ In spite of its schematicism and unreliability, de Pilles’ attempt also had its good sides: “He allowed artwork to be analyzed in a way that was free of its exclusively thematic content and allowed the possibility to evaluate and examine certain elements from which it is composed – its structure. It turned out that one can talk about a drawing independently of its representative role, that expression – the psychological expression of figures – can also be subjected to criticism, just like the composition – the ordering of elements that connects and encompasses them all.”¹⁴

Still, doubts remain as to whether tables and numbers can be used to interpret the true scope of the complex act within which a work of art is created. Numbers are very important and many disciplines are founded upon them. It is often said, not without reason that “the truth is a number.” However, other than as an auxiliary means, they stand completely out of the context of the very essence of art, especially its aesthetic parameters. No kind of homogenization or standardization is possible in the domain of aesthetics, as those are attributes of industrial production that also exist in the domain of commercial, industrialized artistic production, the so-called creative industries.

When taking an overview of the entire history of attempts to determine the overall value of artwork by way of evaluating certain elements of fine art expression, the following two elements of fine art expression prevail:

- drawing and
- color

Still, it always turned out that each school of art had a different view regarding the advantage and the greater or lesser meaning of a particular element – “neoclassicism championed the superiority of the drawing... the romanticists put color before drawing,” after which followed the judgment that “the kingdom of color was coming – Impressionism, Neo-Impressionism.”¹⁵

Further in his analysis of fine art elements of significance for the aesthetic evaluation of artwork, referring to the views of various authors, including our aestheticist Milutin Borisavljević,¹⁶ Vasić points out the importance of the *geometrical spirit* in the aesthetic experience of a work of art: “Nature excites us aesthetically at a certain moment when chance reveals it to us in an *exceptional order*. This order in nature that impresses us matches man’s characteristic *need for organization*... nature is beautiful only in relation to art. When it is *ordered by chance*, it appears beautiful to us; then it is like a work of art.”¹⁷ For, “our cognizance

¹³ P. Vasić, op. cit., p. 8

¹⁴ Ibidem

¹⁵ Ibid., p. 9

¹⁶ M. Borisavljević, “Problem simetrije u arhitekturi”, *Umetnički pregled*, No. 1-2, Beograd, 1940

¹⁷ P. Vasić, op. cit., p. 14

regarding the outside world are based on a geometric system, which is a mere creation of the human spirit."¹⁸ Furthermore, in establishing such a tight connection between the spirit of geometry and the aesthetic within a single, human spirit, it is claimed (Borisavljević) that "symmetry is one of the fundamental laws of beauty. It is a Greek word (ζυμμετρια), which means equability, an attractive ordering of a whole... To say that a painting is symmetrical, placid and balanced is the same as to talk about our own placidity and balance. The aesthetic phenomenon is composed of that same expression of placidity and balance."

According to historian and aesthetics H. Wölfflin (1864-1945), the demand for symmetry stems from the disposition of our own body. We are organized in a symmetrical fashion and we demand this symmetry from other bodies, because it is in accordance with our nature. Thus, at the same time, symmetry is both a human-corporeal and a sensual phenomenon, which is the basis for the claim "that symmetry of things suits our own symmetry of body and senses."¹⁹ "The explanation of symmetry as an aesthetic phenomenon lies in the fact that the eyes immediately recognize the equality of symmetrical parts. This ease stems from the clarity of their relationship of equality. This equality also implies order as an important aesthetic fact."²⁰ Borisavljević adds another phenomenon to symmetry, the *golden mean* which, although asymmetrical, is characterized by "clarity and ease of perception" and "the most beautiful relation of imbalance," the ratio of 1:1.618 (rounded off as 3:5).

Thus, in the above viewpoints, symmetry and the golden mean stand out, not only as the laws of the fine arts but also as measures of aesthetic values. Still, it seems that the aesthetic value of a work of art is not reliably and definitely tied to any separate, essential value.²¹ Although insistence on this in the domain of aesthetics was the greatest, it has not been confirmed that the "beautiful" is a universal aesthetic value.

The general principle of determining aesthetic value starts from the position that the central standpoint of judgment is the one reserved for the *observer*. This principle implies the question: where does the artist's role begin, and where does it end? The artist is the creator of a work that encompasses a sensory collection of colors, shapes, sounds or movements, producing a final situation open to judgment. However, the state of the completed work of art is not only an *observable situation*. Is the observable level the one where the experience of a work of art is exhausted? Certainly – no. A work of art has observable characteristics but, at

¹⁸ Ibid, p. 15

¹⁹ P. Vasić, op. cit., pp. 20-21

²⁰ P. Vasić, op. cit., p. 22

²¹ Russian critic and publicist D.I. Pisarev states that "aesthetics as a discipline does not make any sense, since the category of the beautiful does not have an objective interpretation but depends on individual taste."

the same time, it is a mental entity. What happened with the *mental situation* in which it came about and whose expression it is, and how does it produce a related but new experiential mental situation? Does this process take place in the domain of the objective and subjective civilization experience that belongs both to the artist and the experienced? Who are the keepers of the treasury of this experience? How is the “harmony or consensus between the idea in the spirit of the observer and the idea in the spirit of the artist” established?²²

In the so-called hermeneutical triangle of art, comprised of the artist, his work and the experienced, the primary place certainly belongs to the artist, who is the carrier of the creative energy that produces the work of art, a new aesthetic value. It can thus be claimed that “in the aesthetic sense, nothing takes precedence over the artist. That is why it appears that the artist is the one that carries aesthetic value within him, which he then bestows upon an object... the artist is the creator of aesthetic value; he is the one who creates both their principles and their laws... The source of aesthetic value is seen in him. We can, thus, talk about the artist’s aesthetic experience... that is why we can approach the entire set of aesthetic problems from the aspect of the artist-creator.”²³ However, it is no less right to say that “there exists an existential continuum of art at the base of which lies the experiential continuum of entire generations of art experiences throughout the world. They make the world of art living and effective.”²⁴

5. The market appraisal of artistic creation

The fact that the art market is very old does not ease the problem of understanding the principle of the market valuation of artistic creation. The market that we are talking about today, including the art market segment, very much differs from the market of times past, before all in its dimensions, but also in many other aspects. As such, it has a relatively new tradition, whose beginnings and development are linked to the mass, industrial production of capitalist society: “When production for the market suppresses and reduces production for the direct needs of the producer himself, what occurs is an alienation and general objectification of human relations, beginning with the production process and going all the way up to the most subtle forms of man’s spiritual activity, and artwork becomes merchandise on the market of cultural-artistic values, subjected to the necessities of supply and demand, competition and the monetary valorization of its essentially monetarily immeasurable artistic value, which is nevertheless subject to daily practical monetary appraisal.”²⁵

²² P. Vasić, op. cit., p. 81

²³ M. Zurovac, *Djetinjstvo i zrelost umjetnosti*, Prva knjiga, Plato, Beograd, 1997, p. 8

²⁴ M. Ranković, *Sociologija umetnosti*, Umetnička akademija, Beograd, 1967, p. 60

²⁵ M. Ranković, op. cit., p. 95

It is thought that the market has always set some sort of “measure”²⁶ against which artistic creation was evaluated. In spite of various efforts, just as in the case of aesthetic valorization, this “measure” has never been reliably set to this day, which has not, however, essentially interfered with the functioning of the art market.

In marketing theory it is emphasized that, in the process of setting the prices of artwork and services in the sphere of art in general, the effect of Engel’s Laws should be kept in mind,²⁷ as they explain the dependence of demand in art on income levels.

Engel’s first law indicates that the proportion of money spent on food is in inverse proportion to income – the lower the income, the greater the percentage set aside for food.²⁸ Engel’s second law says that rising income directly increases economic capability, increasing the proportion of money set aside for art, education, tourism, hygiene, etc.

What this says is that any reduction in income has a direct and important bearing on the reduction in demand for artistic products, while the demand for food products essentially remains unchanged. The effect of these laws should certainly be born in mind when forming the price of artistic products or tickets for cultural-artistic manifestations, if one is to support the social interest according to which artistic products should be accessible to the greatest number of people possible, regardless of their economic capacities.

Let us now return to explanations regarding the direct functioning of the art market.

If we start from the previously stated observation that the art market, in spite of its millennial existence, has, thanks to its huge development, become a socially relevant phenomenon only in the newer, industrial age, the following question arises: wasn’t this development the result of differences between traditional forms of artistic creation and contemporary forms of artistic production, which have taken on industrial characteristics? Or, has the general growth in consumption and its development into the dominant form of social behavior influenced the expansion and development of market relations in the sphere of art as well?

In addition to important differences in the process of creation, it seems that traditional arts and creative industries, i.e., artistic disciplines whose practice is

²⁶ In Dutch 17th century painting, the “price of an ox” is mentioned as a reference value in barter trade, amounting to 60 guilders, in comparison to which a Rembrandt painting cost 90 guilders.

²⁷ Ernest Engel, German statistician and economist, 1821-1896

²⁸ A specific amount of money is needed for the purchasing of food. When earnings are smaller, then the proportion of costs of purchasing food in total costs is percentually larger. If earnings are growing, then the costs of purchasing food make up a smaller percentage of total spending, and more money remains for other forms of consumption.

realized in an industrial type of process, are also characterized by differences in the sphere of consumption, i.e., the market existence of the present age.

Each work of art carries within it two different dimensions:

- The external, objective or material (*corpus*), and
- The internal, spiritual or aesthetic (*animus*).

In spite of this general characteristic, significant differences between certain branches of art can be observed.

As we have already emphasized, in some artistic disciplines the works are a result of a final aesthetic objectification (fine arts, applied arts), and their material dimension has an *original* and, most often, *unique* character that belongs to that work exclusively. With the finalization of the creative act, these works are ready for market valorization. To buy such a work on the art market means not only to buy an object, an artifact, but the totality of its value, which also encompasses its originality and, of course, its aesthetic characteristics, i.e., its specific artistic worth. The purchase transfers *ownership* over an original work of art, but the buyer does not become the holder of the copyright to the work of art and does not have the right to use it economically or as a means of business. The buyer, i.e., the new owner of the work of art is also limited in his rights to change or destroy the purchased piece – which does not exist as a limitation in the ownership of any other type of object. The copyright remains the property of the author, including the “right of sequence.”²⁹

Other works of art have a passive form of aesthetic objectification (music, scenic arts), which are transferred from a passive to an active existence by way of succeeding actions. In the phase of the passive form of aesthetic objectification, these works have the character of artistic originals, which is necessarily valorized. This valorization is not the only or the final one, as these works of art will continue a further, active existence. The works that belong to this group are not, upon the completion of the creative act, subject to definitive market valorization. Their active existence does not necessarily have to reach mass production. These can also be works whose active existence requires artistic interpretation – theatrical performance of a dramatic text, orchestral performance of a musical work, etc.

Thus, the originality, uniqueness and unrepeatable character of a work of art is the first point that must receive valorization. This is a general axiom of the appraisal of artistic creation and its distinction from other forms of human endeavor.

The second moment of valorization relates to the *aesthetic value* of a work of art. As we have seen, this is the most delicate question. This valorization is

²⁹ According to the “right of sequence”, the artist has the right to 3% of the price of each succeeding sale of his original work that its former owner has received for it. It lasts as long as the entire copyright – during the author’s lifetime and 70 years after his death (it is inherited). According to our law, all sales transactions are subject to the right of sequence. In France, the right of sequence also lasts for 70 years after the author’s death, with a 2-4% remuneration, depending on the selling price of the work.

accomplished on a very broad and complex plane, which also extends into the historical context. However, this valorization is carried out by art criticism, the expert artistic public, the artists themselves and, finally, the public, i.e., the users, consumers, buyers, clients, etc. From here, signals are emitted towards the market, which will bring them into connection with the state of supply and demand and other market and economic mechanisms.

The third question of market valorization, which is also important, as it concerns the largest portion of the art market, is related to production of a mass character and industrial characteristics. We are talking about works that have traveled the path, by way of an industrial process, from an active or passive form of aesthetic objectification to mass production.

These works must achieve a twofold valorization on the market:

- As results of original artistic creation, and
- As products of mass industrial production.

The first level is attained in the domain of *copyright*, which is supposed to valorize the originality and aesthetic scope of the work in question – a valorization that stems from the field of art. The purchase of a copyright is a purchase of the right to use a work of art, without purchasing the right of ownership over the original work of art.

The second level of valorization relates to the application of the general principles of costs, efficiency and profitability, which apply for all types of industrial production intended for the market.

The final, market value of a product appears as unitary. "The value of a work of art is formed at the juncture between the field of art and the market. Aesthetic values are formed and reconsidered on the field of art, while the market is the place where transactions are carried out and prices formed. In spite of the fact that each has its own system of determining value, the two networks are closely mutually dependent."³⁰

New media and their market influence have practically allowed an additional deepening of the basis for creating a gap between the artistic and the monetary value of artwork. The market and its criteria definitely have a greater bearing on remuneration for artwork than does its true artistic scope.

6. Conclusion

After the above considerations, the question of the market valuation of art appears somewhat clearer, but we still cannot claim that we have succeeded in totally resolving it. This impossibility simply stems from the vary nature of artistic creation, which is not open to any sort of unification and normativity. In

³⁰ R. Mullen, *Umetnost i tržište*, Clio, 2001, p. 5

addition to the fact that the artistic component itself belongs more to the irrational than to the rational sphere, being, thus, incongruent with rational understanding, the very concept of art has become so diffuse and unbounded in the present age that it is very difficult to say where the field of art ends and other forms and activities begin.

It seems that the greatest market certainty exists when we are dealing with artwork that belongs to the cultural heritage or legacy, when we are dealing with secure, historically affirmed values – if, of course, no doubts exist as to their authenticity, which is a rare occurrence.

In terms of its relations with the market, artistic practice is clearly and unambiguously differentiated into the commercial – the creative industries and the non-commercial – the fine arts. These differences are already manifested and evident in the teleological sense, i.e., in the domain of the differing *purposes and goals* of commercial and non-commercial artistic activities. To the traditional differences between these two sectors, the contemporary era has also added the *technological differences* that characterize them.

Statistical insight into the development of the art market indicates its constant growth, which is greatly similar to the growth of the market transactions that accompany industrial forms of production. These changes have produced a series of negative implications in the world of traditional artistic disciplines. The accommodation of art to the laws of the market and profit-seeking behavior has mostly been connected with art's departure from its primary social mission, which, in a certain sense, is leading it to self-negation and, viewed more broadly, is leading humanity to the collapse of the core of its greatest humanistic potentials.

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ENDOWMENT MANAGEMENT IN SERBIAN SOCIETY IN TRANSITION CONDITIONS

Abstract: *This paper deals with the problem of endowment management in Serbia in transition conditions. After the concepts of endowment, foundation and legacy are explained, social changes in Serbia that affect the changes in the social position of public institutions in question are identified. Special attention is given to the cultural dimension of the problem in order to comprehend the importance of endowment development in Serbia.*

Key words: *endowment management, transition, Serbia*

JEL classification: H41, D64

*All of us die only once, but great people die twice:
once when they disappear from the earth,
the second time when their endowment falls into ruin.*

(Ivo Andrić, "Bridge on the Drina")

1. Introduction

The history of culture and art, both here and throughout the world, is replete with examples of the dependence of the spiritual sphere on the economic power of individuals, their affinities and tastes. Many works of art, buildings and collections have come about thanks to the favor of rich benefactors and the striving of affluent people to immortalize themselves in culture and leave to future generations "monuments more permanent than bronze". Although such gestures are primarily guided by private motives and personal desires, they most often do not clash with the authentic functions of culture, nor do they limit or interfere with what may be referred to as genuine cultural policy. In the more fortunate cases, various forms of patronage in culture have brought on a strong blossoming of certain artistic branches, allowing the material power of individuals (or ruling classes) to miraculously transform itself into a spiritual energy that lasted for centuries. In the art of the Renaissance, we find such examples in the patronage

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of the Florentine Medici family (15th and 16th centuries), while in the cultural history of the Serbian people these can be found in the famed endowments of the medieval Nemanjić dynasty (ruled from the second half of the 12th century to 1371). Even when they are a result of totally personal propensities and affinities, thus produced cultural-spiritual values still succeed in crossing the boundaries of their particular historical epoch and reaching all the way up to modern times, including our own, as accomplishments that make a significant contribution to the shaping of the entire spiritual configuration, and especially the cultural and moral identity of particular cities, regions and states.

As remarked by French encyclopedist Voltaire (18th century), who counted the Renaissance era among the happiest in human history, the patron elevates himself through the very act of elevating art; he praises the artist, instead of the artist praising him. A more recent researcher of the social history of art, A. Houser,¹ sees this complex relationship in the following way: the artist is allowed to be in the limelight, so that the reflection may also fall on the patron.

The principles of contemporary cultural policy, which seeks its goals in a very broad range, define the overall social interest globally; it is thought that any effort to broaden the spaces of freedom, encourage the creation of new spiritual goods, secure the health and beneficence of many, peace and prosperity, has a universal character. Under conditions when cultural activity and artistic creativity cannot survive merely on declarative freedoms and bare spontaneity, various forms of patronage significantly direct cultural flows towards spaces of optimal possibilities and appear as an important prerequisite for the release of creative energy.

In everyday media, and even professional communication, we often encounter a conceptual indistinctness of terms connected with philanthropic organizations. Endowment, foundation or legacy? Benefaction, patronage or kitorship? Are these different words for the same phenomenon or do they denote certain particularities? A similar problem appears when trying to understand individual patronage in culture: Maecenas, donator, sponsor.

2. Terminological clarifications

Endowment is a complex concept and term that encompasses several determinants of meaning, before all the following concepts: benefaction, foundation, Maecenate and legacy, as well as several derived meanings from these terms, i.e., their social and legal interpretations.

The comprehension and understanding of the concept of *endowment* is most often tied to a monastery or church, usually from feudal times, or to some other

¹ A. Houser, *Socijalna istorija umetnosti i književnosti* (A. Houser, *A Social History of Art and Literature*), Kultura, Beograd, 1962, p. 318

structure built for the salvation of the soul, for good remembrance, having to do with a noble, good deed, i.e., an act of benefaction.

Endowments make up a significant dimension of the Kosovo myth, the central myth of Serbian history and poetry; both the private and the public life of the Kosovo heroes were centered around endowments. In answering the rhetorical question, “Whither has Tsar Nemanja’s treasure gone” (as in the poem “Saint Sava”, Vuk, II, poem 23), the folk poet lists numerous monasteries-endowments. The most prominent historical and mythological personages (Saint Sava, Miloš Obilić and Princess Milica) talk of endowments in the folk poems.

In its fifth volume (p. 711 and 712), the SANU Dictionary (SANU – Serbian Academy of Sciences and Arts), precisely defines seven different meanings of the word *endowment* (*zadužbina*), the base one being: “a beneficent institution or foundation whose goals (usually humanitarian and educational) were defined by its founder; the property or funds donated by the founder for that purpose.” It is added that, “according to old beliefs,” a noble deed is done “for the salvation of the soul”; the fifth given meaning is that of “zadušje” – literally “for the soul” (“a rich feast after the funeral”). According to the folk poem about the building of the Ravanica monastery, Princess Milica chided Prince Lazar for not building an endowment for himself like the Nemanjićs did. When the prince subsequently decides to build Ravanica, the nobles hail his intention with the words: “Build it, prince, it will be for your soul / and for the health of Tall Stevan” (Prince Lazar’s son and successor – trans. note) (Vuk, II, poem 35).²

On p. 391, the newer, single-volume “Dictionary of the Serbian Language” from 2007, gives basically the same, albeit somewhat briefer meaning of the word *endowment* from the SANU dictionary.

According to the “Lexicon of the Serbian Middle Ages,”³ an *endowment* is a concept that in a broader sense denotes “all things that a particular person donated to a church or monastery, for the salvation of their soul.”

The multifariousness and appropriateness of meaning in the interpretation of the concept of *endowment* stems from the noblest human strivings of the one who is engaged in endowing towards a vision of the future and, before and above all, spirituality, as well as various life’s, earthly needs, towards a particular enrichment of society: to come into contact with a book, to build a bridge that allows the crossing of a river, to quench thirst, to find peace in a temple of God, monastery, or a public library.

Legally speaking (Pre-draft law on endowments and foundations, Article 2), in terms of the provisions of the law that is to be adopted, an endowment is defined as a “legal entity without members, to which its founder has designated a

² V. Stefanović, Karadžić, *Srpske narodne pjesme*, book two, Prosveta, Beograd, 1958

³ *Leksikon srpskog srednjeg veka*, edited by Sima Ćirković and Rade Mihaljčić, Knowledge, Beograd, 1999, p. 204

certain property (base property) for the purposes of the beneficial realization of a public (generally beneficial) or private interest and goal not prohibited by the Constitution or by law.”

The meaning of the word and term **foundation** is derived from the Latin verb *fundare* – to found, founding something new; in Latin, the word *fundatio* also denotes an institution founded for the purpose of long-term goals as a public good.⁴ Having come about as a legal form of donation in the feudal historical legacy, it was tied to the acquirement of a noble title and the granting of a portion of the royal holding. The later meaning of the concept expanded to the donation of works of art to the church and its temples. At the root of the word *foundation* lies the French term *fond*, derived from the Latin *fundus*.

The Italians use the term *fondazione*, the Germans *Stiftung*, the Russians *fond*, and the Croats *zaklada*. In South Slavic lands that were under Turkish occupation (Serbia, Montenegro, Bosnia and Herzegovina, Macedonia, Bulgaria), endowments existed, and occasionally still exist, under the name of *vakuf* (from the Turkish word *vakif*, or the Arab *waqf*); the dictionary of Klajn and Šipka refers to them as “endowments among Muslims that are used for religious and humanitarian purposes.”⁵ The Qur’an, the Muslim holy book containing Muhammad’s teachings, numbers charity or voluntary humanitarian work among the three most important obligations for the faithful.

According to Cutlip,⁶ a *foundation* is a non-government, non-profit organization with its own funds, founded with the goal of providing aid through the granting of stipends and monetary aid to other non-profit organizations for educational, social, religious, cultural or other beneficent activities.

Independent foundations (according to the same source) are established by individuals, families or citizen groups, granting larger or smaller sums of money towards the fulfillment of a certain goal.

Social foundations (same source) receive gifts from various donors who are interested in sponsoring programs in their social community.

In Western European cultures, the concept of a *foundation* refers to cultural initiatives that are basically encompassed by our own word for endowment (*zadužbina*). If a foundation is established with funds from corporate capital then, from the standpoint of conceptual meaning, we are not talking about an endowment.

The concept of a *foundation*, as a means of benefaction characterized by the markedly personal character of endowment, is of a newer date and is not sufficiently rooted in Serbian culture.

⁴ I. Klajn, M. Šipka, *Veliki rečnik stranih reči i izraza*, Prometej, Novi Sad, 2006, p. 1349

⁵ I. Klajn, M. Šipka, op. cit., p. 245

⁶ S. M. Katlip, A. H. Senter, G. M. Brum, *Uspešni odnosi s javnošću* (S. M. Cutlip, A. H. Center, G. M. Broom, *Effective Public Relations*), Službeni glasnik, Beograd, 2006, p. 498

Certain global foundations have a testamentary origin. At the end of the 19th century, Swedish chemist Alfred Nobel willed a portion of his wealth (about \$10 million) for the purposes of rewarding scientific discoveries, literary creation and the political struggle for peace. The awards are international in character rather than narrowly national.

In Great Britain, for example, foundations have a long tradition. According to one source, they number more than 100,000.

The best-known foundations in the U.S. are the Ford, Rockefeller and Carnegie foundations, which have at their disposal large material resources for the fulfillment of a wide range of goals. In 1926, the Carnegie Foundation built the "Svetozar Marković" student library in Belgrade, which is still in function today. The founder of the foundation, American industrialist of Scottish descent, Andrew Carnegie (1835-1919), published his "Gospel of Wealth" in 1900. Their main thesis was that "the man, who dies thus rich, dies disgraced." He donated his excess wealth to humanitarian purposes voluntarily and joyfully, mostly to the founding of libraries, not only in the U.S. but in other countries as well.

Current Serbian laws contain numerous gaps in this area. The Pre-draft law on endowments and funds defines a foundation as a legal entity with no members or base property founded for the purposes of a beneficent realization of the public interest and a goal not prohibited by the Constitution or by law (Article 2). Due to the incomplete definition and absence of a more precise elaboration of the various modes and varieties of endowment, practice brings a series of unbridgeable difficulties. Some of the problems already begin when determining the name (type) of the endowment, which is the basic element of identification, not only in the legal sense.

A **legacy** is a part of tradition and the legal heritage; its name descends from the Latin word *legatum*, meaning "behest, bequest." In ancient Rome, this term also denoted a vicar of an imperial province or his closest deputies. In today's linguistic corpus, a legacy is "a will by which the testator leaves his property or a portion thereof to someone who is not his legal successor, bequest."⁷

Organizationally speaking, today's legacy relies on an already existing institution; it has a cultural but not a legal subjectivity. Its field of activity and circle of users is testamentarily determined in advance.

A *legatee* is a person to whom a legacy is bequeathed, on who receives a legacy, while the one that bequests it, the testator, is the *legator*.

In more recent times, large corporations or companies are playing an increasingly significant role in the development of endowments, and the term used to describe their role in supporting beneficent, humanitarian, cultural, educational and similar goals is *corporate philanthropy*. This form of philanthropy is not new, not something that is a product of modern, complex 20th century society, but it has experienced a new social bloom in the last three or four decades.

⁷ I. Klajn, M. Šipka, *Veliki rečnik stranih reči i izraza*, Prometej, Novi Sad, 2006, p. 694

The term “corporative” (Lat. *corporativus*) is something that refers to a group, corporation, something of a joint, common nature.

3. Transformation of the entire social environment

Under conditions of a mutual intertwining of economics, politics, technological development, demographic shifts and social changes of the most various kinds, non-profit organizations are dependent on communications with various segments of the public. Public support may be genuinely decisive for the outcome of volunteer work in those areas in which the state no longer has a monopoly over the achievement of goals in the general interest, for example in culture.

Public relations gain special significance when a cultural endowment comes into conflict with external forces or threats: through the reduction or repeal of state funding, the withdrawal of donors or under some other form of pressure that would include social changes or reforms, etc., which may threaten it or put an end to its activities. Under conditions of an increasingly complex social and economic situation, public relations establish and maintain an environment necessary for the endowment to secure autonomy and the means for fulfilling its mission; they help create public-political opinion, and stimulate philanthropic cooperation and donorship.

The management of endowments in the midst of crises that are hitting transition countries, in times when culture is “losing its aura” and is being “dispensed to all of society,”⁸ is a complex process, within which the following must be done to connect the work of endowments with the general public:

- Ensuring the survival and active functioning of endowments by adjusting their work to the dynamic of huge economic and social changes on local and global levels;
- The reaffirmation and spreading of the culture of philanthropy;
- Making stronger connections with target audiences and the spread of philanthropic ideas and activities;
- Informing the broader public on the traditional groundedness and goals of endowments;
- A revision of earlier habits and ways of thinking; and
- Adjusting to changes in the legislative corpus as a whole.

The almost fifty years of deterioration of the ideals and goals of endowing in Serbian society (1945-1992) have left a modest or, better said, disappointingly low level of consciousness regarding the beneficent activities of endowments in the past, both on national and local levels, as fundamental values on which the future, spirit and idea of endowing would be able to rest.

⁸ J. Đorđević, *Postkultura*, Klio, Beograd, 2009, p. 5

The process of renewal and affirmation of endowing in Serbia can be traced back to 1992, when the Endowment of Ilija M. Kolarac in Belgrade was given back its endowment status and private character. Less than eight years later, the process of changes in Serbia's economic system would begin, before all in property relations, through the transformation of social property into private property, which would in turn generate all other changes, including those in the areas of social and cultural policy.

The new owners of formerly social property, former members of the class of "working people," have become wealthy individuals. Since endowing is dependent upon wealthy or more affluent individuals, the transition period in Serbian society is coming face to face with the new character or profile of a wealthy individual to whom, in most cases, the goals of philanthropy are either foreign or remote.

However, this period is also generating great expectations in terms of a general betterment of the entire societal being. Such expectations are also rightly being transferred to the area of endowing, with reliance on activities on the part of the state and its legislative, educational and cultural institutions, of endowments themselves, the media sphere and the cultural public.

A part of that hope was expressed in the conclusions of the public debate on the Pre-draft law on endowments and funds (February 2009):

"The primary goal of endowment management in the transition period is to create a contemporary framework for philanthropy and endowing, where key solutions and efforts are partially left to endowments themselves, and partially to cultural institutions, both on state and local level.

This work is exceptionally demanding and responsible, requiring great financial resources and, of course, much of the philanthropic energy that characterizes endowing, and pertains to two areas: restoration of the present state and the creation of a modern framework as a foundation for the future of endowing."

Namely, in the context of the existence and development of a culture of philanthropy, only economically strong and independent actors can be founders of endowments. Their appearance and numerousness are closely connected with the level of the development of the economy, private initiative and the law, the legal regulation of property relations in society, which directly leads to the appearance and development of endowing. In that sense, it is very important that the changes in the essential structural and functional aspects of the social totality take place as a continual (rather than a campaign-like) process, in a relatively balanced way in all areas (economic, political, cultural and social).

4. The cultural dimension of social changes

The transition period is characterized by a series of radical, not always carefully conceived social changes, which often lead to the destruction of the existing social and economic systems in the name of a vague future. In such circum-

stances, the cultural dimension of transition is repressed by the technological, economic and political dimensions of the process. In an interview given to the Belgrade daily "Politika" (March 21, 2009), Milena Šešić-Dragičević (Head of the UNESCO Chair in Interculturalism, Art Management and Mediation) was asked how it was possible to count on the philanthropy of individual donors and firms (corporations) in Serbian society, which is undergoing a period of radical social and ownership changes:

"In the next year, we will not be able to count on either sponsorship or philanthropy. Here, the state showed its despicement for philanthropy by extinguishing the tradition of endowments, first nationalizing philanthropically donated institutions and then showing its lack of respect for them. Today we have many legacies that are not in function, as well as unresolved problems, and no one knows whether something that has been donated to the state as capital in the sphere of art will not be privatized in ten years, and its purpose changed."

A survey of the existing state of endowing has produced disheartening results.

In the publication "Lessons of Past Times," which presented the results of a survey on philanthropy conducted in 2007, Branka Pavlović started from the existing state of affairs and pointed out the possibilities that would open up through a reaffirmation of endowments and the culture of philanthropy.

According to this survey, the level of knowledge regarding philanthropic activities, especially past endowing activity, and even post-1992 events, is very modest.⁹ Lofty examples from the history of endowing in Serbia, from the Nemanjićs to the middle of the 19th and the beginning of the 20th centuries, have to become the subjects of a systematic campaign. And the media are the ones primarily responsible for familiarizing citizens with the concepts of philanthropy, endowments, funds and foundations, for spreading knowledge and, by extension, consciousness regarding the significance of their beneficial effect on the entire being of our people.

An illustrative example of society's lack of care for the property and testamentary will of endowers can be seen in the fate of the Endowment of Miloš Crnjanski, one of the greatest writers in the Serbian language. A year after Crnjanski's death (1893-1977), his widow Vidosava, sensing the nearness of her own demise, willed 150,000 German marks in savings for the establishment of an endowment that would preserve the memory of the great poet, essayist and prose and travel writer, by publishing his works, giving an award carrying his name to a domestic writer for a first book in one of the fields in which Crnjanski distinguished himself, and the "Stražilovo" award for the best student essay on Crnjanski's work.

"For me, life would still have meaning and significance only if I were able to contribute to the preservation of the lasting memory of that rare and exceptional

⁹ B. Pavlović, *Tragovi prošlih vremena*, BCIF, ISC and USAID, Novi Sad, 2007, p. 46

personality, whose works have reached the very peaks of Serbian literature,” wrote Vidosava Crnjanski in her last will and testament.

Crnjanski's endowment has gone on for a full three decades without a permanent address, about 90% of the willed money has been made worthless by inflation, while a portion of Crnjanski's manuscripts still lies in boxes, unstudied and unprocessed in accordance with modern textology. The apartment in which the Crnjanskis lived was taken by the Vračar municipality after their death, instead of being used in testamentary purposes. After being housed in the National Library of Serbia for several years, the Crnjanski Endowment had to be moved to a room in a private attorney's office and, when that temporary arrangement expired, the Endowment was taken in by the Writers' Association of Serbia in Belgrade, in the old building that serves as its headquarters, where it is presently hosted in an uncomfortable room of about ten square meters, accessible by a narrow, dark passageway containing a toilet on its right side and a washstand on the left.

The appeals of the Writers' Association and the Serbian cultural public for a permanent location for the Miloš Crnjanski Endowment have so far fallen on deaf ears.

The Crnjanski Endowment is registered under number 25 in the Register of Endowments in the Culture of Serbia, held in the Ministry of Culture (which hosts a total of 113 institutions).

The Endowment of Ivo Andrić was established according to a similar model, legally termed *inter vivos* (the fact that the Crnjanski Endowment was established after his death, by his widow, does not change anything in the basic and formal sense). Endowments established in such a way contain fewer programmatic and legal dilemmas; by way of a last will and testament, the endowment becomes a legal entity with its own legal and material existence, founded on resources that make up its substrate, oriented towards the fulfillment of a defined, publicly beneficial goal.

The Andrić Endowment began work on March 12, 1976, in Belgrade, carrying out the will of the great Serbian and Yugoslav writer (1892-1975), winner of the Nobel Prize for Literature (1961), to have his legacy “preserved as a whole and used, in the form of a legacy or endowment, for general cultural and humanitarian purposes.” The endowment is located in a separate house in the center of Belgrade and has solid conditions for work. It organizes academic gatherings on various aspects of contemporary literature, awards the annual “Andrić Award” for a short story or story collection written in the Serbian language, helps translators of Andrić's works into foreign languages, publishes the “Ivo Andrić Endowment Booklets” magazine and appears as the patron of numerous literary and other manifestations, especially those that include pupils and students. Documents, books and materials about the life and works of Ivo Andrić are collected

and studied within the Endowment, while its pleasant garden hosts chamber theater presentations and smaller concerts.

Differently from most other such endowments, the Andrić Endowment owns the rights to the author's works and has the sole right of approving their publication, both at home and abroad, which has significantly strengthened its material position and increased its public influence and presence. The Endowment has three employees, and its work is managed by the Managing Board, under the chairmanship of Academician Radovan Vučković and the management of the poet Dragan Dragojlović. The Endowment is registered under number 2 in the Endowment Register.

It is interesting to note that Andrić himself behaved like a great endower and philanthropist during his lifetime. Even before his Nobel Prize, he regularly helped libraries and cultural institutions, while donating the greater portion of his Nobel Prize money to the National and the University library in Sarajevo. Testimony to his morally lofty understanding of the act of giving is provided in the letter he wrote from Herceg Novi on April 8, 1965, to Mitar Bakić, director of the Sarajevo library (according to R. Popović¹⁰):

In connection with our conversation of April 5th in Sarajevo, I have checked the state of my finances here, in accordance with which you may enter the round sum of 19,000,000 (nineteen million) into the text of my letter.

The text of the letter can be the same as the last time. *My one and only personal condition has been and remains that no publicity should be given to the donation or reception of this donation. Once you return to Sarajevo, you may only, if you find it necessary, give the raw fact to the "Oslobođenje" newspaper, without any praise or comment, but it would be even better without that (italics M.A.). Comrade V. Vinterhalter, who had a differing opinion, now agrees with me wholeheartedly. Therefore, that is how we shall do it. So long, with greetings, yours..."*

Endowments established to exist after the testator's death are legally referred to as *mortis causa* (in Latin, *mortuus* means dead, and *causa* means cause, reason). Such institutions are founded on the basis of the bequeather's clear will and undisputed lifetime property, but attain their legal status and begin their life only after his death. This type of endowment occasionally gives rise to unpleasant disputes with real or imagined successors. An example of disputing the last will and testament of the bequeather is the will of Ilija Milosavljević Kolarac; the prominent historian Milan Đ. Milićević wrote about the attempts of the cousins of the great Serbian philanthropist, who died in October 1878, to dispute the contents of his will. It was not until 1881, after the decision of the appellate court,

¹⁰ R. Popović, *Andrićeva prijateljstva*, Dečje novine, Gornji Milanovac, 1992, p. 276

that the will came into force and the already assembled Board could begin managing Kolarac's funds.¹¹

Another endowment of this type (*mortis causa*) came into life in Serbia in 2004, the "Dositej Obradović" Endowment, founded in honor of the great writer and educator (1742-1811), Serbia's first minister of education, founder of the Great School and author of the famous song "Vostani Srbije" (Serbia Arise!). At the opening of the Great School, whose small ranks included pupils such as Vuk Karadžić, the future reformer of the Serbian language and alphabet, and Aleksa, son of the leader of the First Serbian Uprising, Karađorđe, Dositej gave his well known address, which opened with the following message: "In time, you will become leaders among the people, judges and directors, and it is upon you that the general commonweal, honor and glory shall depend!"

The founders of this endowment, whose purpose is to study the works of Dositej Obradović and their cultural and educational significance, were the Hemofarm pharmaceutical company, Matica Srpska, the Cultural-Educational Community of Serbia and the Institute for Literature and Art (Belgrade). Drawing on the capital and reputation of the Hemofarm company, the Endowment has so far published the complete works of Dositej Obradović in six volumes, organized several scholarly gatherings devoted to his works, bought and restored Dositej's house of birth in Čakovo (in the Romanian portion of the Banat region), granted numerous awards to secondary school students within the competition "He learns as he walks, gazing at the centuries" (the motto at the base of Dositej's monument in Students' Park, Belgrade), etc. As proposed by the Endowment, a postage stamp and mail envelope bearing the image of Dositej Obradović was issued, while the National Bank of Serbia issued gold and silver coins with the image of the great creator, law-giver and educator in 2007. The seats of the Endowment are in Belgrade and Vršac, and the Hemofarm Company bears the basic costs of its operations and activities. For the purposes of financing concrete program actions, the Endowment bids for funds made available by the ministries of culture and education, or turns to sponsors. Dositej Obradović did not leave any material property behind him and, due to the expiry of the copyright, the publishing of his works does not bring in funds either here or abroad. The president of the "Dositej Obradović" Endowment is Miodrag Babić, president of the Hemofarm Company, and the manager Mirjana Dragaš.

On the occasion of the 2009 Universiade in Belgrade, a document exhibit entitled "Dositej in Belgrade – the Path of Higher Education," was held in "Znak pitanja" ("Question Mark"), the oldest Belgrade tavern, which Dositej frequented from 1807 to his death. The occasion gave birth to the idea that the tavern be turned into a museum under the patronage of the City Museum, or to become the seat of the "Dositej Obradović" Endowment. The final decision regarding the

¹¹ M. Đ. Miličević, *Ilija M. Kolarac, dobrotvor srpske prosvete*, Kolarčeva zadužbina, Beograd, 1896, p. 96

fate of the old tavern and the eventual home of the endowment devoted to one of the most educated people of his time rests on the city authorities of Belgrade.

Our own time, burdened by the most various contradictions, has given successful birth to the “Andrejević” Endowment, a unique institution in the Serbian cultural space. It is devoted to the development of Serbian educational leadership, i.e., to supporting talented scientists and to the publishing of their first scientific and expert works. It was founded by Dušanka and Kosta Andrejević, both university professors, in September 1994, and registered a year later. In its fifteen years of existence the Endowment has published about 800 doctoral dissertations and master’s theses, winning the status of the most productive publisher of scientific literature in Serbia. In the last several years, the Endowment has published more than 50 scientific monographs per year, and planned to issue 90 new, previously unpublished works of mostly young PhDs, magistrate and masters degree holders in 2009.

Although a result of private initiative and founded with private capital, over the years the “Andrejević” Endowment has gathered around itself hundreds of benefactors of various profiles (companies, cultural and scientific institutions, universities, individuals). Works to be published are selected in public competitions that are organized twice a year; so far, 27 contests have been held for PhDs, magistrates and specialists, and two for master’s degree holders. The Scientific Council of the Endowment is headed by Academician Ljubisav Rakić, while more than 150 prominent scientists from Serbia, among whom 19 academicians from the Serbian Academy of Sciences and Arts (SANU), are engaged in its editorial boards and other organs. All editorial and reviewing activities within the “Andrejević” Endowment are performed on a voluntary basis, which gives additional affirmation to its founding goals.

The founders and associates of the “Andrejević” Endowment, especially Dr. Kosta Andrejević, president of the Managing Board, have been visibly engaged in the public debate regarding the Pre-draft law on endowments and foundations. Prof. Andrejević thinks that the law is essentially anti-endowment; in his opinion, the kind of selective philanthropy for which the law provides won’t contribute to the advancement of this field and massive investment into generally beneficial goals. Among the law’s shortcomings are that it ignores the position of Serbian endowments outside of Serbia, and that it fails to mention the problem of restitution of endowment properties confiscated after World War II. Prof. Andrejević’s entire exposition on this subject, which includes a series of critical notes on the pre-draft law and the entire social climate that surrounds the institution of endowments in today’s Serbia, can be found on the well-visited site www.zandrejevic.rs, which also contains other information about this institution’s activities, including the fact that the Endowment plans to publish an electronic version of the most valuable scientific works from its production, as well as to initiate the publication of a scientific periodical of international import.

The “Marketing Srbija” magazine (number 19, year 2007), gave the following description of the present state of endowments in Serbia:

“Many endowments throughout Serbia are not marked; they are neglected, while the founding capital from which they could eventually be renewed no longer exists. Data are lacking on many of them, nor is it known where they might be found, which has destroyed the basic premises, goals and reasons of the endowers, who established them in order to have them permanently serve, marked by their own name, the future of their people...”

Such a state of affairs requires from the national and local cultural institutions, existing endowments, funds, foundations and legacies a series of continuous and fundamental activities directed towards the renewal of existing institutions and the development of a consciousness regarding philanthropy as essential dimensions for the future of the people’s culture.

The very concept of transition is, in the opinion of Zagorka Golubović,¹² neutral and does not necessarily define the direction and character of societal development. If we are talking about a democratic transition, especially in our case, it must be founded on an all-encompassing transformation of the present way of life, and must not be limited only to economic and political reforms. The state of existing endowments can be improved and philanthropy can gain renewed vigor through a program of synchronized changes in society as a whole, including its cultural dimension.

5. Legacies as unfinished endowments

Within our legal and cultural systems exists the institute of legacies (from the Latin word *legatum* – record, bequest), which is a sort of insufficiently articulated endowment with its own property and founding goals, but without full legal subjectivity.

The “Economic-Legal Dictionary” incompletely defines a legacy as “a designation for a certain benefit that a testator wills to a certain individual from his estate.”¹³ The “SANU Dictionary” (Vol. XI, p. 287) defines a legacy as “an order, provision by which the bequeather, testator leaves to a certain individual a certain thing, property or right from his estate.”

Even though they are oriented towards socially beneficial goals, it is indicative that legacies have not been sufficiently recognized under present law; neither the old nor the new law on endowments (more exactly, its Pre-draft) mention legacies at all or, by extension, the precise conditions for their establishment, operations and development. Only the Law on Inheritance of the Republic of

¹² Z. Golubović, “Kulturni preduslovi demokratske tranzicije”, in the collection *Kultura i razvoj*, Beograd, 2004, p. 102

¹³ *Ekonomsko-pravni rečnik*, BMG, Beograd, 2000, p. 283

Serbia (Art. 141) and the Law on Inheritance of Republika Srpska (Art. 108) mention legacies, in the chapter referring to inheritance of bequeathed property. The Serbian law, which forms the basic source of material inheritance law, was adopted in June 1995, and published in the "Official Gazette of the RS," no. 46/95. Law professor Oliver Antić deals with legacies, albeit in a narrower legal sense, without touching upon their culturological dimension, in his book "Inheritance Law."¹⁴ According to Antić, a legacy is a kind of "singular succession" (as distinct from "universal succession"); regardless of the worth of the legacied valuables, a legacy can be defined only in the form of a bequest, and expressed in the strictly prescribed form reserved for wills. A legacy encompasses the legator, the onerate (the bequest's debtor) and the legacy end user – gift receiver (legatee). Any departure from these rules may give cause to the annulment of the will and, thus, the legacy.

Despite their insufficiently precise positioning in our legal and cultural system, for decades legacies have represented an important mechanism through which, by their own will, people have been able to perform beneficent deeds, taking their place in the memory of future generations.

Property forms the basis for the legacy's creation, existence or disappearance. However, here legacies do not function as legal entities and, strictly speaking, do not dispose of their own, separate property. In the organizational, material and legal sense, a legacy is reliant on the cultural institution to which it has been attached. That institution is obligated to adhere to the field of activities defined by the legator, to conserve and increase the property and diffuse the radiation of the initial idea. In our own circumstances, due to the said legal void, we encounter the most varied examples. There are not a few cases of neglecting, even running roughshod over the bequeather's ill, but there are also examples of legacies that function in both real and symbolic ways, in accordance with the provisions of the bequest.

Thus, the legal dispute upon whose conclusion the House of Legacies will finally be able to move into its space in Knez Mihailova 46 in Belgrade, which was granted to it back in 1981, by way of a donation contract, has been going on for years, and has still not been concluded! The house of writer Veljko Petrović, at Teodora Drajzera 32 in Belgrade, with a personal library of 3200 books and a collection of 390 paintings and pieces of applied art, received as a gift in 1970, has yet to be opened to the public and exists in an incomprehensibly neglected state! The house-atelier of painter Petar Lubarda, which was contractually donated to the Belgrade city authorities after the artist's death in 1974, is in a similar state; according to the latest news, a project of reconstruction is being produced, and Lubarda's legacy is to open for visitors in 2010.

Over the decades, the city of Belgrade has received gifts from 21 donors who expressed the wish that their deed be immemorialized in the name of a legacy.

¹⁴ O. Antić, *Nasledno pravo*, Službeni glasnik, Beograd, 2009, p. 263

These are movable and immovable objects of great value. Movable objects include artistic-historical works, archive material, film material and rare books, while immovable objects include cultural monuments, cultural-historical spaces, archeological sites and places of significance. The City Museum manages Belgrade's legacies; these include, among others, the legacies of Paja Jovanović, Petar Konjović, Toma Rosandić, Risto Stijović, Jovan Cvijić, Branimir Ćosić, Branislav Nušić, and others (together with the above-mentioned Lubarda and Veljko Petrović). A legal process is currently underway at the First District Court in Belgrade over the ambitions of several parties to interfere with the will of the painter Olja Ivanjicki (1931-2009), who bequeathed her works of art to the city of Belgrade.

A specific kind of legacies exists in Belgrade under the name of "special libraries." These are the libraries of prominent artists and public personalities given by way of a special will and, more rarely, libraries purchased with funds of the bequeathers. There are 36 such libraries under SANU's roof, with tens of thousands of select titles. The books often contain dedications, which serve as testimony of dynamic (and sometimes dramatic) creative friendships. Topping this list are the libraries of Milutin Milanković, Branko Ćopić, Marko Ristić, Danilo Kiš, Vasko Popa, Bishop Sava Vuković, and others. Among the legacies of our contemporaries, under PB 19, is that of Miroljub Todorović, prominent artist and the founder and theoretician of Signalism, a Serbian avant-garde style that came into being four decades ago, with the ambition of revolutionizing numerous branches of art, especially literature and painting.

The "Svetozar Marković" University Library in Belgrade, itself built in 1926 as a legacy, hosts 28 separate legacy libraries. It took in its first special library in the year of its founding, the library bequeathed by Petar Budmani, Slavistics professor and academician (1835-1914), who also bequeathed his expert library and his house in Castelferretti, near Ancona, to the Serbian embassy in Rome. The Ministry of Foreign Affairs donated this library in 1925 to the newly founded University Library. Petar Budmani's legacy was added in 1980 with the gift of the composer Nikola Hercigonja, who was his cousin.

The University Library is also home to the legacy libraries (sometimes together with writing utensils, work table and other objects) of the greater endower Luka Ćelović, Karađorđe's grandson Božidar Karađorđević (died in Paris in 1908), historian Dimitrije Ruvarac, writer Branimir Ćosić, diplomat and scientist Stojan Novaković, writer Isidora Sekulić, Academician Aleksandar Belić, and others. It also hosts around 2000 publications of Andrew Carnegie, who built around 3000 libraries throughout the world.

Since 2002, the University Library has also hosted the legacy of the above-mentioned Miroljub Todorović, the neo-avant-garde artist (PB 28), who also founded a legacy at the Historical Archive in Belgrade in 2004. Besides the books of the founder of Signalism as well as of members of this artistic style, the legacy also contains about 2000 letters of prominent artists from all over the world,

including letters and works of Raul Hausman, one of the founders of the Berlin “Dada” (end of the second decade of the 20th century), famous performance artist Bob Cobbing, our own Marina Abramović, Oskar Davičo, and others.

The legacy libraries bequeathed to the Belgrade Archive are occasionally exhibited to the public, while the others are accessible only to rare visitors and researchers. Many precious donated libraries are neglected and difficult to access. Due to lack of space and partly due to the socio-cultural climate unfavorable to this type of benefaction, the University Library “Svetozar Marković” has announced that it will no longer be able to accept libraries for gifts!

These are the reasons why many valuable libraries belonging to prominent creative personalities and public workers, which could aid not only in the reconstruction of their lives but of the spirit of the time in which they created, are often sold to antique book shops in pieces, and occasionally even as old paper, by the kilo!

This fact serves as yet another testimony to the spirit of the times and the limbo in which our legacies currently exist, lacking both legal and cultural subjectivity.

6. Endowments and the reshaping of existing cultural models

A brief history of Serbian endowments shows that endowers very often found creative motives in the general interest and that they established endowments (funds, foundations, vakufs and other related forms of philanthropic activity) in those areas and for those social needs that were of priority value: development of science, education, healthcare, humanitarian aid. Through the centuries, a belief developed in the mind of the Serbian people that there is nothing nobler than to leave an endowment behind. This belief was translated into the saying, “A gold coin gains in shine if it’s in an endowment.” The opening speech of Academician Aleksandar Belić on the occasion of the opening of the Kolarac National University (1932) contains an interesting illustration of a patriotic relation towards the people and of service in the people’s interests: “Just as Greek ethics viewed the one who did not aid in the progress of his people as being almost guilty in front of them, so has our own national ethic inseparably bound the individual’s view of life’s goals with the needs of the national whole.”¹⁵

In a socio-economic, cultural and legal environment that was not always favorable to donor activities, and in which the media often affirm lifestyles that are basically opposed to the philanthropic spirit, Serbian endowments have been able to overcome various limitations, crises and resistances (occasionally even those of an ideological character), winning the status of legal entities whose founding, existence and activities are aimed at the fulfillment of the most varied

¹⁵ *Društvo znanja*, collection of texts, Zadužbina Ilije M. Kolarca, Beograd, 2009, p. 240

general socio-beneficial goals. Although there are many different types of endowments according to form of internal organization, source of funds and basic orientation (private, public, independent, social, etc.), under the influence of Anglo-Saxon law we have also placed them in the category of non-profit organizations, which emphasizes the fact that they were not founded for the purpose of making and distributing profit, but in order to direct profits (if they at all exist, in the narrow sense of the word) towards the achievement of universal and, in any case, generally beneficial social goals. In other words, with this type of organization, the accumulation of the initial capital and profit-taking are in the function of achieving generally beneficial goals, rather than being a goal in itself.

On the basis of a comparative-legal review of the position of certain endowments in Serbia's culture, it may be concluded that there is still no satisfactory balance between endowments' goals and the legal-economic and other means at their disposal. In theoretical works on this topic there is a complete consensus that the establishment of such a balance would not only be a guarantee of the consequent fulfillment of the wills of endowers (founders, legators, ktitors) but also of endowments' permanence, their rootedness in the social, economic, legal and cultural environment.

In the area of social and tax policy, there is no clear evidence of the Serbian state's commitment, grounded in the contemporary experiences of democratic countries, to make large improvements in the position of endowments and the reaffirmation of the philanthropic spirit. Although the tax status of non-profit organizations in Serbia is dealt with in six separate laws, the existing solutions are not favorable for either individuals or groups that desire to transfer a portion of their material wealth to endowments and humanitarian funds. Practice has shown that the current tax laws place additional burden on donations, even to the point of double taxation in certain cases!

In countries where culture is approached as a precious system of values, views and behavior, endowments have long since secured more favorable tax treatment. In a comparative study of cultural policies in the cities of San Francisco, Barcelona and Montreal, researcher Benoit Lafortune offers an interesting evaluation of systemic regulations that affect the life of cultural institutions. In the chapter "Fiscal policy in the service of the culture system,"¹⁶ the author points to the example of San Francisco, in which fiscal policy is a part of an overall city development strategy; private foundations and philanthropic associations that choose to register in this city are freed of paying taxes for the first five years (p. 200). All large construction or renewal projects are submitted to the San Francisco Art Commission for the purposes of control and issuing of permits ("towards the goal of developing the city's cultural heritage"); a curiosity worth noting is the fact that it is prohibited to build fast-food restaurants in certain city quarters, in order to preserve old, heritage buildings as well as the cultural-historical uniqueness of

¹⁶ B. Lafortin, in: *Javna i kulturna politika*, Beograd, 2002, p. 199

the quarters. For our topic, it is indicative that in San Francisco there is a clear obligation to serve public notice of any larger investment projects, along with the practice of having the media follow such actions closely and in great detail.

In Greece, the law makes a distinction between legal entities with profit-making goals and those with non-profit goals, including endowments, which enjoy certain tax benefits.¹⁷

Under the conditions of the “narrow-gauge transition in Serbia,”¹⁸ culture has not been designated as a referent framework outside of which no social relationships or individual behavior of society’s members can be constituted. Cultural models are not defined as a “meaningful framework for the orientation and integration of a community,”¹⁹ which means that no legal corpus has been developed that would act as a system of stimulating, enabling and regulating the philanthropic behavior of individuals, groups, companies and corporations. To be sure, certain progress was made with the Pre-draft law on endowments and foundations (2008). Article 7 of this act provides that the state, autonomous provinces or local governments have the right to grant tax and other benefits for the foundation and development of endowments that operate in the public interest, as well as to free endowment resources from taxes and contributions (paragraph 2 of the same article). Unfortunately, although the final version of the proposed Law was sent to the Serbian parliament in March 2009 for debate and adoption, proceedings regarding it have not even begun. Although the National Parliament occasionally acts as a “flow boiler” (S. Antičić) and often achieves “Stakhanovite records” (in only one day, May 29, 2009, 57 laws were passed!), it is difficult to predict when this law, which can be numbered among the acts that represent a cultural prerequisite for a democratic transition, will come on the agenda.

In recent years, social relations and, with them, the cultural sphere, have been entering a phase of fundamental reshaping, making way for a new, uncertain historical period, without the “old” order having ended. In the context of globalization, under which scholars include a number of social processes, dynamism and development, which are transforming the current state of affairs into a firm interconnection of economic, political, cultural and ecological flows, thus “changing the forms of human contacts,”²⁰ culture is losing the aura it once had in modern times, and is ceasing to represent a separate, and the most valuable area of human activity. We are entering a period that J. Đorđević named as *post-cultural* in his eponymous book (p. 6), i.e., a historical epoch in which culture (more precisely, post-culture) is distancing itself from the concepts of value, universality, quality

¹⁷ E. Alfondari, A. Nardone, *Associations et fondations en Europa – regime juridique et fiscal*, Juris service, 1994, p. 241

¹⁸ Z. Golubović, *Kulturni preduslovi demokratske tranzicije*, in the collection “Kultura i razvoj”, Beograd, 2004, p. 105

¹⁹ Ibidem

²⁰ J. Đorđević, *Postkultura*, Klio, Beograd, 2009, p. 410

and independence in relation to economic and political powers. The post-culture of the new time is calling for a revision of earlier cultural habits and ways of thinking of people who have been caught unprepared for the changes brought by the development of science, technology, and the political and economic global restructuring of the world. Thus the need for a "change in perspective" and the spreading of an interpretative field fenced off by newer cultural studies.

This new field of research of cultural phenomena is multidisciplinary and intermedial, because it encompasses the knowledge and methods of previously distant but presently firmly intertwined disciplines, which, besides political science and economics, encompass literature, anthropology, linguistics, sociology, philosophy, psychology and mediology.

Therefore, endowments in culture in general, and especially those in Serbia, have to carefully follow the dynamic of the large, often contradictory social, economic and political changes on the local and global levels; in maintaining an active relationship with reality, they must not neglect the extra-temporal and universal meanings of culture.

Although the state, here and everywhere else, looks benevolently upon the readiness of individuals, groups or corporations to take on the partial care of public affairs, the activity of volunteer and non-profit organizations is being confronted with a series of internal and external barriers. Our research sought to classify and explain the nature of the difficulties that accompany the work of endowments in culture, whose mission cries out for stronger social support.

Under conditions in which the needs for actions on the part of non-profit organizations exceed earnings, it is necessary to create a legal, political and general cultural framework, in which cultural endowments will build an even firmer public prominence and reputation. Our research has shown that the affirmation of goals that have a universal character can be used to create a public policy that would make possible a stronger development of endowments in culture. Through the cultivation of philanthropy among the young (through the educational and media system), better communication with potential benefactors and strict control and public monitoring over endowment operations, the risk from the instrumentalization and extinguishment of the freedom of the creative act is excluded, that is, undesirable confrontation between the spiritual and physical existence of cultural creators is avoided.

New information technologies (including web sites, e-mail, mobile telephony and latest generation information packages) favor efforts to establish broader communications with potential philanthropists, as well as better control of the operations of philanthropic organizations; the public work of endowments, everywhere subject to the control mechanisms of the state and of civil society, will allow them to not only exist as palpable proof of a glorious and free past, but also as a sort of a defensive moral and cultural rampart, invincible against the winds that historical circumstances (and troubles) might bring to the Serbian people.

In light of the fact that cultural endowments have a constant need to attract new benefactors and their funds, public relations play a key role in creating the necessary socio-economic and cultural ambiance for the fulfillment of non-profit goals. In our work, through analyzing the experiences of several leading cultural endowments in Serbia, we have pointed out the specificity of the communicational tools that are important for winning over the broadest segments of the general public. It turned out that, regardless of the various models of founding and various results of passage through transitional contradictions, the media are an unavoidable target audience for all cultural endowments in Serbia, which are now faced with the imperative of establishing an even better quality relationship with them.

That communication must be constant, well organized and mutually motivating, in order to win the broadest public confidence in the work of philanthropic organizations, improve the reputation of the non-profit sector as a whole and increase the army of people of good will, ready to aid public goals in various ways, including competition by way of cultural values and by leaving a portion of their property “to the benefit of the fatherland.”

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THE RISK-FREE INTEREST RATE AND BUSINESS FINANCE IN SERBIA: LIMITATIONS AND POSSIBLE SOLUTIONS

Abstract: *The risk-free interest rate affects company financial and investment decisions. In Serbia, the determination of a risk-free interest rate is faced with different problems. The paper discusses the importance of the risk-free interest rate in business finance, limitations in determining the risk-free interest rate and possible ways for overcoming those limitations.*

Key words: *risk-free interest rate, discount rate, business finances, financing, investments*

JEL classification: G12, O16

1. Introduction

The risk-free interest rate is the foundation stone of business finance, and there is practically no financial model that does not have the risk-free interest rate as its base. Thus, quality financial decision-making in Serbia requires an analysis and estimation of the domestic risk-free interest rate. In this paper, we will emphasize the importance of the risk-free interest rate in business finance, consider specific problems in determining the risk-free interest rate and analyze possible solutions in the Serbian context.

2. Significance of the risk-free interest rate in business finance

Finance is founded in an analysis of the mutual dependence of money, time and risk. In business finance, these relations are incorporated into theory and practice of both finance and investment. The value of companies or projects is set on the basis of discounting expected future cash flows to the present value, with the discount rate directly depending on the risk-free interest rate. The determi-

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nation of the costs of share capital and debt capital and, thus, the costs of (total) capital are based on the risk-free interest rate, just like the various criteria for evaluating and choosing investments that require comparison between expected returns and costs. At their base, portfolio theory, the setting of financial derivative prices, the determination of an optimal financial mix and many other important financial concepts and models contain the risk-free interest rate.

This being the case, it is somewhat surprising that so little attention is devoted to the risk-free interest rate in theory, practice and literature.¹ Most often, considerations, and even concrete calculations, end with the first association at the mention of the risk-free interest rate – that it is the interest rate offered by the state, i.e., its finance ministry, during the issuance of its securities. Although this is not inaccurate at its base, some additional questions need to be answered: which state-issued security do we consider from the standpoint of its maturity (one-month, one-year, ten-year or some other)? What if the state issues securities denominated in different currencies – which interest rate do we choose? Certain states may not issue securities, so what would be the non-risk interest rate in that case?

Before we analyze the above questions, we will make an overview of basic business finance concepts in which the risk-free interest rate plays an important role, which will be of use once we start elaborating our work.

Financial and investment decisions require a precise calculation of the cost (price) of capital. The cost of (total) capital is obtained by adding up the costs of individual sources of capital – share and debt capital. The cost of share capital is determined by the rate of return expected by investors in company shares. Since the capital asset pricing model (CAPM) is the standard way of estimating return on shares, then the cost of share capital is also determined according to the CAPM. Concretely, this means that the cost of share capital is obtained by adding the premium for investing in risky company securities (risk premium on shares) to the non-risk interest rate, where the significance of the risk premium is adjusted by the ratio between company share risk and market risk:

expected return = risk-free interest rate + beta*risk premium

$$E(R_i) = R_f + \beta_i (E(R_m) - R_f)$$

where: $E(R_i)$ is the expected return on company shares or the price of share capital, R_f is the risk-free interest rate, $E(R_m)$ is the expected return of the market portfolio (market index) and β_i is the measure of the market (systematic) risk of the share, i.e., the risk that cannot be eliminated by portfolio diversification (calculated as the ratio of the covariant between the return of

¹ See, for example, referential textbooks in this field: James Van Horn and John Wachowicz, *Fundamentals of Financial Management*, and Zvi Bodie, Alex Kane and Alan Marcus, *Essentials of Investments*.

a concrete share and the market index and the variance of the market portfolio). It should also be born in mind that the difference between expected return on the market portfolio and the risk-free interest rate (the expression in parenthesis with which beta is multiplied) shows the risk premium for investment in shares (instead of in risk-free instruments). The risk premium shows how much investors demand in order to decide to invest with an average equity risk and renounce risk-free return.

From the equation that describes the cost of share capital, it can be seen that the result depends on the calculated risk-free interest rate, the beta and the risk premium. The calculation of the latter two elements – the beta and the risk premium – is not simple, which is why it attracts the attention of many researchers, much greater than that attracted by the risk-free interest rate.

Just as the cost of share capital is equalized with the rate of return demanded by investors for investing into a company's shares, so is the cost of debt capital represented by the interest rate paid by the debtor for a loan or for issued bonds. The interest rate on a particular market will differ from debtor to debtor, depending on their particular credit ratings – the less favorable the credit rating, the higher the premium on the base (risk-free) interest rate. Thus, the risk-free interest rate is the starting point for the cost of debt as well, after which the concrete cost (price) of the source of financing is corrected with the appropriate risk premium. Similarly to the case with share capital, the analysis of capital costs is oriented toward the correct determination of the debtor's credit rating (and risk premium), while the risk-free interest rate is taken over automatically.

Since the costs of share and debt capital depend (i) on the risk-free interest rate, then it is clear that the cost of (total) capital (WACC – weighted average cost of capital) will also be determined by the level of the risk-free interest rate. If we denote the price of share capital with k_e and the price of debt capital with k_d , then the cost of company capital will equal:

$$WACC = w_e k_e + w_d k_d,$$

where w_e and w_d are the weights of share and debt capital in total capital (i.e., the market values of share capital and debt capital in the total market value of the capital).

Decisions on company investment depend on whether the expected return on investment exceeds the costs of share or total capital. If we are guided by returns on share capital, then we should invest if the rate of return exceeds the costs of share capital. When the project analysis is based on return on capital, then the return is compared to costs of capital. If the net present value of the project is taken as the investment criterion, then the effect of the risk-free interest rate is reflected in the fact that the discount rate, which is necessary for the discounting

of expected cash flows to the present value, actually represents the cost of capital. It is obvious that, independently from the investment criterion, the choice of the risk-free interest rate directly affects company investment decisions.

At the end of this overview of the significance of the risk-free interest rate for various business finance decisions, it should be emphasized that the direct calculation of securities prices, as well as values of companies, relies on the risk-free rate. Thus, the value of the zero-interest state bond (discount bond) is calculated by discounting its nominal value, where the bond interest rate is used as the discount rate (r) in the period of maturity (N):

$$V_{bond} = \frac{\text{nominal bond value}}{(1+r)^N}.$$

Bonds that bring periodic interest (coupon bonds) to the investor have the following value:

$$V_{bond} = \sum_{i=1}^N \frac{\text{interest}}{(1+r_i)^i} + \frac{\text{nominal bond value}}{(1+r_N)^N}.$$

The value of the company share, if we assume an indefinite company lifetime and a stable growth of dividends at a rate equal to g_N , is obtained in the following way:

$$V_{share} = \frac{\text{expected dividend}}{(k_e - g_N)}.$$

Finally, one of the ways of determining company value requires that future free cash flows towards the company be discounted to the present value through the use of the appropriate discount rate, i.e., the company's cost of capital. If the discount rate is smaller, the obtained company value will be greater, and vice versa – a higher discount rate will reduce the present value of the company. It is clear that, for example, a decision about the acquisition of a particular company can be made depending on the estimated value of that company, which ultimately also greatly depends on the chosen risk-free interest rate during the calculation of the requested value.

3. Limitations and uncertainties in the process of determining the risk-free interest rate

In order to define a risk-free financial instrument, we should remind ourselves that risk in finance is measured by deviations achieved from expected results. The bigger the variance (or standard deviation, as the root of the vari-

ance) of the achieved results around the expected result (as the mean), the bigger the risk of investment. Thus, with risk-free investment, it is certain that the realized return will be equal to the expected return. This will be achieved only if: 1) there is no credit risk and 2) there is no reinvestment risk.²

In order for a financial instrument (security) to be risk-free, there must be no possibility that the issuer of the security will not fulfill his obligations. This principle excludes all private issuers since, even in the case of the most respectable ones; there is a possibility of non-fulfillment of obligation. The only securities that might be risk-free are state securities (more precisely, ministry of finance bills and bonds), thanks to the fact that the state can always resort to the ultimate solution – printing money. However, practice has shown that even the state is not always a safe debtor, as there have been occurrences where it has refused to repay certain debts or when it has not been able to service its foreign currency-denominated debt.

A second condition for a risk-free instrument, which is often neglected, is the absence of reinvestment risk, which comes about when the planned period for the investment differs from the dynamic of the return of the risk-free instrument. For example, the investor is estimating the return on a ten-year risky investment and needs a risk-free interest rate for that period. There is a ten-year state bond on the market that rejects annual interest. The bond is risk-free in the sense that there is no issuer credit risk, but there is a reinvestment risk. Namely, the bond investor earns interest and must reinvest each year (the investment horizon is ten years). Since it is not certain under what kind of circumstances the return on interest will be able to be reinvested each year, it is clear that the total ten-year return on the bond will not be known in advance. Since there is a variance in the expected return, the condition of expected and realized return being equal has not been satisfied and, thus, the state security is not a risk-free instrument. It would be a risk-free instrument only if it possessed different characteristics – a ten-year couponless state bond is what is needed. With this bond, return is realized once, at maturity (it is equal to the difference between the lower purchasing and the higher nominal value that is paid out after ten years), and there is no reinvestment risk, which means that the investor's profit is certain and the security can be characterized as risk-free in the full sense of the word.

If we accept that the necessary preconditions for a risk-free instrument are an absence of credit risk and reinvestment risk, then the risk-free rate will be variable, depending on the investment period. The interest rate offered by a one-year state bond will be the risk-free rate for a one-year investment period, a five-year couponless bond for a five-year investment, and so on. If the state does not issue couponless bonds of varying maturity, there is still a way for an ordinary

² An author who has considered the concept of the risk-free interest rate in great detail is Aswath Damodaran. This portion of the work deals with ideas presented in: A. Damodaran, "What is the Riskfree Rate? A Search for the Basic Building Block", Working paper, Stern School of Business, New York University, 2008

bond (with periodic interest rates) to be “transformed” into a couponless bond. The interest rate for couponless bonds can be drawn from the market prices of bonds and the nominal interest rates indicated in them. By equalizing the values of the couponless and the coupon bond, we obtain:

$$\frac{\text{nominal value of the couponless bond}}{(1 + r_{\text{couponless bonds}})^N} = \sum_{i=1}^N \frac{\text{coupon interest}}{(1 + r_{i,\text{coupon bond}})} + \frac{\text{nominal value of the coupon bond}}{(1 + r_{N,\text{coupon bond}})^N}$$

From here it is easy to calculate the interest rate of the couponless bond ($r_{\text{couponless bonds}}$), since the coupon interest rate is known and we are equalizing the nominal values of the couponless and the coupon bond with the known market price of the coupon bond.

Thus, if the state issues ordinary bonds of various maturities, it is not hard to calculate the risk-free couponless interest rate (i.e., the true risk-free interest rate) of the same maturities. A. Damodaran (2008)³ gives a comparative overview of coupon and couponless interest rates for periods between 1 and 10 years on the US market in September 2008. It can be seen that the coupon rates differ from the calculated couponless rates. The investor would have to choose the couponless rate as the risk-free interest rate (due to the reinvestment risk) for the appropriate investment period. If, for example, he needs a risk-free interest rate for an eight-year investment, then the rate of 3.79% (rather than 3.25%) will be applied.

Table 1: Difference between coupon and couponless rates

Year	Coupon rate	Bond market price	Couponless rate
1	1.50%	100.00	1.50%
2	1.75%	99.00	2.2739%
3	2.00%	98.00	2.2739%
4	2.25%	97.50	2.9411%
5	2.50%	98.00	2.9543%
6	2.75%	99.00	2.9510%
7	3.00%	98.00	3.3789%
8	3.25%	97.00	3.7884%
9	3.50%	99.00	3.7174%
10	3.75%	98.00	4.1522%

Source: A. Damodaran, “What is the Risk free Rate? A Search for the Basic Building Block”, Working paper, Stern School of Business, New York University, 2008, pp. 7-8

³ A. Damodaran, “What is the Riskfree Rate? A Search for the Basic Building Block”, Working paper, Stern School of Business, New York University, 2008

In the above table it can be seen that risk-free interest rates differ depending on maturity (ranging between 1.50% for one year to 4.15% for ten years). That means that, as already said, investors should use various risk-free interest rates depending on the expected investment period. This rarely happens in practice, since investors tend to use a single risk-free interest rate regardless of whether it is a short-term or a long-term investment. At first sight, this looks like a big mistake, since it is not the same whether the risk-free rate is set at 1.5% or at 4.15% when expected return is calculated. However, a mistake can be avoided if the interest rates for different maturities do not differ too greatly (the return curve does not have a steep upward slope). Another possibility that relativizes the use of different rates for different maturities is the obtainment of an excessive risk premium (deviation of the average market return from the risk-free interest rate) when calculating the cost of short-term capital. This is indeed common in short series.⁴ In that case, the overvalued risk premium would spoil the result (expected return) in the same way as an inappropriately chosen risk-free rate. At the end of the day, it usually turns out that there is not a large difference in the obtained expected rate. For example, if the one-year risk-free rate equals 2% and the ten-year risk-free rate equals 4%, while the one-year risk premium equals 6% and the ten-year risk premium equals 4.5%, then the expected return (cost of share capital) with a one-year horizon will equal 8%, and with a ten-year horizon 8.5%. Therefore, the difference is not great.

We may conclude that on a market with the usual characteristics (a gentle upward slope of return), investors can use a risk-free interest rate of a single maturity for different investment periods. Although this is not the most correct solution in the methodological sense, a tolerable deviation is calculated. Differing risk-free rates (according to maturity) should be used if the return curve has a negative slope (which means that short-term interest rates are higher than long-term interest rates, which is unusual), or if it has an exceptionally sharp upward slope.

The question is, which risk-free rate is the most appropriate to use in case we opt for a single rate for all investment periods? The choice primarily depends on the nature of the concrete calculation for which the risk-free interest rate is used. If the return is estimated by investors with a high turnover of securities, then a one-year risk-free interest rate can be used. The longer the period of investment and expected cash flows, the longer the maturity of the risk-free rate that should be used. In the process of company valuation, an unlimited investment period is assumed, so it is desirable to use at least a ten-year risk-free interest rate. If the difference between the return on ten-year and thirty-year bonds is small, then it is not wrong to use the ten-year risk-free return regardless of the maturity of the investment. In any case, it is not good to automatically use short-term

⁴ A. Damodaran, "What is the Riskfree Rate? A Search for the Basic Building Block", 2008

interest rates in the process evaluating investment (in shares, companies, bonds, projects) with a longer term of return.

The next question that deserves attention is the choice of state whose issued security and interest rate should be observed. Namely, there is a wide choice of state securities with a maturity of, say, ten years, and they yield a different interest rate. Thus, on February 18, 2010, the market interest rate for ten-year US bonds equaled 3.625%, 3.750% for Great Britain, 1.300% for Japan, 3.250% for Germany, 4.250% for Italy and 6.55% for Greece.⁵ It can be observed that the interest rate for state securities denominated in British pounds was almost 2.5 percentage points higher than for those denominated in Japanese yen. Even more interesting was the difference between rates for Greek and German securities, denominated in the same currency (euro), where the difference came all the way to 3.3 percentage points. The question is why there are differences both between state interest rates denominated in different currencies and those denominated in the same currencies? Does this have an effect on the choice of risk-free interest rate in business finance?

The differences between state interest rates can partly be explained by the different expected national rates of inflation, and partly by the states' different credit ratings.

At the same credit risk level, states with a higher expected inflation will offer higher interest rates on their securities (Great Britain based on the previous data), while states with low inflation will offer a lower interest rate (Japan). It comes out that company value is not uniformly determined. It will have lower present value if a higher interest rate is chosen, and a higher value if a lower interest rate is chosen. If it is in the British investor's interest to assign a lower value for a Japanese company (because, for example, he intends to buy it), then he will apply the British interest rate; conversely, if he uses the interest rate on Japanese securities, then he will get a higher value for the same company.

However, the above discussion loses sight of the fact that expected cash flows are also observed when determining value. Towards the goal of obtaining true value, it is proper to express cash flows and the discount rate in the same currency. Thus, in the previous example, the cash flows of the Japanese company should be estimated in British pounds, like the discount rate. Since higher inflation is expected in Great Britain than in Japan (thus the higher British interest rate), then the growth rate of expected cash flows will be higher than the cash flows estimated in yen. In addition to their real growth, cash flows will additionally grow nominally due to inflation. Thus, it will turn out that what the British investor gained by using the British discount rate (a lower value for the targeted Japanese company) will be lost due to the more highly valued cash

⁵ Data taken from http://online.wsj.com/mdc/public/page/marketsdata_europe.html, accessed: 18/2/2010

flows in pounds (a higher value for the Japanese company). Thus, if we act in a methodologically correct way and cash flows and the discount rate are quoted in the same currency, then it is unimportant which state interest rate is applied, since the calculated value will be the same in both cases. A distorted value will be obtained only if the investor uses one currency to calculate cash flows, and another for the interest rate.

Another important conclusion comes out from the above discussion: when choosing the country whose interest rate will be used in business finance, it is not important where the seat of the investor or company is located, or in which state the project is being undertaken. What is important is the currency in which future cash flows will take place. Thus, for example, if a Serbian company issues bonds denominated in dollars, then the US state security (with a specified maturity) will be the one relevant for the bond buyers, not the Serbian rate for state securities. This is because the cash flows are expressed in dollars instead of in dinars. Although it seems illogical at first sight that the value of a Serbian company's security is estimated on the basis of the interest rate in the US, we should recall that the risk-free rate represents only a part of the cost of capital; each additional risk of the issuer in Serbia will increase the risk premium and, thus, the ultimate discount rate. In this case, the discount rate will represent the sum total of the US risk-free rate and the Serbian risk premium. If the risk-free interest rate were also to rise above the American for the amount of the issuer's risk, then it would turn out that the risk premium was calculated twice: once in the risk-free interest rate and once in the risk premium added on to the risk-free interest rate.

Just as higher inflation increases expected cash flows and, thus, eliminates the effects of a higher state interest rate, it turns out that it makes no difference whether the nominal or the real interest rate is used in the calculation. If the real interest rate is used (instead of the nominal one of which we have been speaking), then the cash flows must also be expressed in their real amount. In this way, the effect of inflation will be excluded from both the components necessary for calculating the value and the same result will be obtained as if the nominal interest rate and nominal cash flows were used.

In addition to inflation, a second reason for distinguishing between interest rates on state securities is credit risk. Even though, by definition, state interest rates should be totally free from credit risk that is not the case in practice. Investors estimate that the bonds of some states carry greater risk than those of others. Data show that the Greek and the German state interest rates give different yields, even though both securities are denominated in euros (which mean that the effect of inflation on the calculation of value is equal). It is obvious that Greece is perceived as a more risky state than Germany; the market thinks that there is greater probability that Greece will not be able to fulfill its obligations. Such an outcome is not surprising when we have in mind the public finance dif-

faculties, social problems and political instability that have befallen Greece in the first months of 2010.

Since it is clear that, besides inflation, state interest rates also reflect credit risk, the question is whether they can be equalized with risk-free interest rates without a second thought, as is often done, and as it comes out from the basic assumption of the risk-free financial instrument. In other words, should the state interest rate be accepted uncritically as a risk-free interest rate for the calculation of value in business finance? Clearly, the answer is – no. Let us remind, when there is a probability that the issuer will not meet his obligations, then the expected return is not equal to the future achieved return and, thus, such an issuer's security cannot be accepted as risk-free, and its yield as a risk-free return. That is why the part that reflects the credit risk of the state must be eliminated from the interest rate on state securities. Only in this way can a risk-free interest rate be obtained, one necessary for a proper calculation of various values in business finance. Barring that, we would once again come into a situation in which credit risk is calculated in twice: once when the base interest rate is formed (which should be risk-free), and a second time when the issuer's risk premiums are formed. How can we estimate the degree to which the interest rate on state securities is higher than the risk-free rate when credit risk exists?

In order to obtain a risk-free interest rate from the market interest rate on state securities, it is necessary to determine the premium for the credit risk of the state that is issuing the securities. By subtracting the premium from the state interest rate, we obtain the risk-free interest rate. The premium on the state's credit risk is most often estimated on the basis of the state's credit rating, which is determined by one of the world renowned rating agencies. What is analyzed is how much worse the rating of the state issuing the bonds is than the best (AAA) rating, and this is the measure in which the credit risk margin is calculated. For example, Serbia's rating with Standard and Poors (in 2009 and early 2010) was BB-, which by itself does not mean much.⁶ Once we review the group of states with the same rating as Serbia (Kenya, Honduras, Paraguay, Cambodia, Venezuela, Surinam), we can see the premium contained in their own bonds (if these states have issued them), which can, at least roughly, reflect on the expected premium on the Serbian bonds.

A second possible way to estimate a state's credit risk is to look at the market for credit default swaps (CDS), instruments that were created to insure state bond holders from risk (by buying CDS, they collect a predetermined sum from the seller of the CDS if the state fails to meet its obligations). A review of the CDS can help estimate the state's risk (the lower the price, the lower the risk) and, similarly to the case with credit rating, the premium offered by a state with a similar CDS price can be used to estimate the premium of other states.

⁶ <http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245206091751>, accessed: 22/2/2010

Difficulties in estimating credit risk can come about due to a large difference between a state's credit rating and the price of its CDS. Thus, in early February 2010, according to the price of CDS, Argentina had the highest credit risk in the world (1036 base points for ten-year bonds, which means that the cost of insuring an investment in an Argentine bond worth ten million Argentine pesos cost more than a million pesos a year), while the country had a B rating. On the other hand, Ukraine had a lower rating (CCC+) but also lower priced (and lower risk) CDS (885).⁷ Thus, estimates of credit risks and credit risk premiums can completely differ, depending on the indicators we are viewing: according to CDS, Argentina deserves a higher premium while, according to agency credit ratings, Ukraine does. As a result, when analyzing a national economy's rating, an analyst must monitor several different indicators in order to objectively evaluate the state's relative position and in order to set the premium for the state's credit risk in the most precise way possible.

How to estimate the risk-free interest rate in a state when that state does not issue long-term securities? This is not a rare occurrence, since state governments can borrow in various ways (from banks, international institutions, other states), without issuing securities. We can consider three ways of overcoming this problem. The first is used in business finance fairly often, even though it is wrong. What happens is that investors take the interest rate of a developed country (because it is well known), and then convert future cash flows denominated in the domestic currency by using the market exchange rate. Such a solution is not good, since it implicitly uses two different rates of inflation: the foreign one is contained in the interest rate of the foreign state, while the domestic is contained in the estimate of domestic cash flows. If domestic inflation is higher than the foreign one, then the cash flows will be overvalued and the discount rate undervalued.

The second way is better, since future cash flows are converted into foreign currency by using expected future exchange rates, for which it is assumed that they will change in accordance with relative inflation in the two states. This is the way to overcome the problem of inconsistency in estimating nominal values in cash flows and the discount rate. However, even in this case, we still do not get the reference domestic interest rate but only accomplish that the values (of shares, bonds, companies, projects) are expressed more objectively in the foreign currency. If the issuer wants to offer a new security on the market, denominated in the domestic currency, he will not have the local risk-free interest rate as the starting basis for calculating the costs of capital. It would be best if both the cash flows and the discount rate were expressed in the domestic currency.

The domestic discount rate can be estimated by noting the risk-free investor earnings when reviewing foreign interest rates, and then adding the expected inflation rate in the domestic country to that interest rate. In addition to this

⁷ <http://verlorenegeneration.de/landerisiken-im-uberblick/>, accessed: 22/2/2010

method, it is possible to calculate the domestic interest rate from known market values: spot rate, forward rate and foreign interest rate. This makes use of the fact that the forward rate is determined by the spot rate and the relative difference between the domestic and the international interest rate (over the covered interest parity), so the unknown value – the domestic interest rate – is obtained from the remaining known values. If there are no forward transactions or forward rates (at all or with an appropriate maturity) on the domestic market, then it is clear that the domestic interest rate will not be able to be calculated in the described way.

Finally, we should point out the dilemma that business finance often faces. The risk-free interest rate can have strong variability, either because price adjustments on an undeveloped market are often dynamic, or because of an unstable domestic or international environment. As a result, the calculated values in business finance will also be unstable. The risk-free interest rate may seem too high to investors during certain periods and too low during others (from the standpoint of investor experience and the interest rate trend values). Analysts tend to change a (precisely calculated) risk-free interest rate with their own estimate. Although at some point it may be clear that the risk-free rate will either rise or fall in the future, it is not good to use the anticipated change in place of the current value. Calculated values in business finance should match the values that are current at the time of calculation. The future risk-free rate may be higher or lower, so it will be necessary for other necessary input values (which determine the cash flows) to be adjusted along with the discount rate. For example, the analyst may think that the discount rate is too low and that a somewhat higher rate should be applied. It may actually turn out that the discount rate was too low, but due to low inflation. A higher future discount rate may be a result of rising inflation. It will then be clear that the future cash flows will be bigger than it seemed during times of low inflation (and a low discount rate), and that it was unjustified to adjust only the discount rate upwards. Rising cash flows should also have been anticipated.

4. Possibilities for overcoming limitations

In the previous part of the work, all the various aspects of determining the risk-free interest rate for the needs of business finance were analyzed. All are necessary for the purposes of thinking about the risk-free rate in Serbia; some are important for the calculation of its current value, while others will become current with the development of the domestic financial market.

Choosing a risk-free interest rate in Serbia is complex, primarily because Serbia does not issue long-term dinar-denominated state securities, i.e., finance

ministry bonds. It is, therefore, necessary to consider an alternative way of determining the risk-free rate.

Of the existing securities that could serve as a basis for analyzing a risk-free interest rate, each has its advantages and disadvantages. The oldest are the old foreign currency savings bonds, which were issued electronically in 2002 in the amount of 4.2 billion Euros, with various maturities all the way up to 2016, and which were denominated in Euros. The old foreign currency savings bonds are the only debt securities in Serbia that have reached the secondary market. So far, they have had their shortcomings. The yield curve has been inverse (short-term yields higher than long-term ones) almost during the entire observed period, primarily thanks to the fact that they could be used as payment during the privatization process. The scale of trade has been rather modest, with a downward trend – in 2009, total trade volume for bonds of all maturities came to about 440 million Euros (which is half the volume from 2008 and a fifth of the volume from 2007). In January 2010, the trade volume of the bonds of all maturities equaled a mere 1.8 million Euros. The average yield for bonds of all the maturities during the last three years has ranged between 4.0 and 6.5%. On February 23, 2010, the yield for the bonds that matured in 2010 equaled 5.85%, in 2011 4.40%, in 2012 4.18%, in 2013 4.23%, in 2014 4.16%, in 2015 4.32% and in 2016 4.05%.⁸

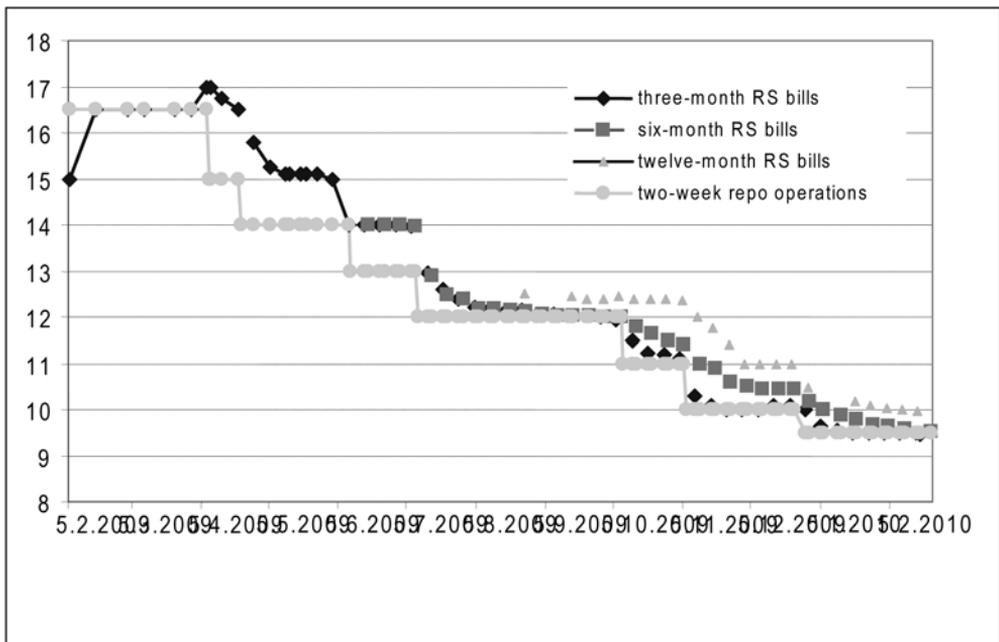
A second type of state security, in a broader sense, is the treasury bills of the National Bank of Serbia. Since September 2006, the NBS has waged a new monetary strategy, centered around two-week repo operations. These open market operations are carried out in such a way that the NBS sells treasury bills that offer a certain interest rate (the NBS reference interest rate). Only commercial banks can buy the NBS treasury bills. Thanks to the attractive interest rate, the bills have been in high demand over the last three and a half years. The initial reference interest rate equaled 18%, then fell by the end of 2007 to 9.5%, rose again to 17.75% (in November 2008), only to fall into a downward trend since February 2009. Since the beginning of 2010, the reference rate has equaled 9.5%. The nominal annual returns that commercial banks earned from the treasury bills ranged between 9.5% and 18%. Such high interest rates tied up large bank funds – at the end of September 2008, the repo stock (the value of purchased and deferred NBS treasury bills) exceeded 245 billion dinars, or 3 billion Euros at the then exchange rate, which was the highest registered value since repo operations began. After the auction of February 17, 2010, the repo stock equaled about 123 billion dinars, or about 1.2 billion Euros.

A third type of security in Serbia's financial system is the Republic of Serbia state bill, i.e., short-term treasury (finance ministry) debt security. February of last year marked a new beginning for treasury bills since, with the aid of a new trading platform, intense collection of budget funds via the issuance of short-term securities began. First to be issued were three-month bills (at the first auc-

⁸ http://www.belex.rs/trzista_i_hartije/hartije/obv, accessed: 25/2/2010

tion, the interest rate equaled 15%), and later (since summer of last year) six and twelve-month bills began to be issued as well. Differently from the case with NBS treasury bills, these were open to all investors, legal entities and private individuals. The interest rates declined with time. At auctions held between February 17 and 23, the interest rate for three-month bills equaled 9.47%, for six-month bills 9.53%, and for one-year bills 9.98%.⁹ A slightly positive yield curve has been observed; along with the fact that, when determining the interest rate for the treasury bills, the Ministry of Finance followed the dynamic of the NBS reference rate quite closely (with NBS actions being followed by treasury reactions). The fact that the treasury bills were also attractive is shown by the fact that their issuance attracted about 110 billion dinars in the space of a little more than a year.

Figure 1: Interest rate for RS state bills (of various maturities) and for NBS treasury bills



Source: data of the National Bank of Serbia (www.nbs.rs) and the Treasury Directorate (www.trezor.gov.rs).

Having reviewed the available state-issued securities on the Serbian market and guided by what was laid out in the previous part of the work, we can make certain conclusions.

First, there are no long-term dinar-denominated securities. The only securities with a maturity of over one year are the old foreign currency savings bonds,

⁹ <http://www.trezor.sr.gov.yu/izvestaji-sa-aukcija-cirilica.html>.

which are euro-denominated. However, the daily trade volume of these securities in the second half of February 2010 amounted to a negligible 80,000 Euros at most, when it existed at all. Still, the fact that their owners wish to keep them in their portfolios (even after the wave of privatization) tells us that they are satisfied with their 4% earnings in Euros over a space of several years. Owning the old foreign currency savings bonds is a sort of a hedge, protection from risk of change in the exchange rate, since it is a placement that guarantees income in Euros, thus at least partially reducing exchange rate exposure.

Second, in addition to their maturity, another shortcoming of the NBS treasury bills is that only commercial banks can invest in them. This means that the NBS bills cannot be used for comparison between investment alternatives, which is a prerequisite for being able to think about any price as a reference price in business finance. Also, the treasury bills are limited due to the lack of secondary trade in them. The discovery of their market price in secondary trade would provide important information in estimating the risk-free interest rate in Serbia. The information that can be "read" from the trade dynamics and prices of the NBS and treasury bills is the following: after the initial rush for state-issued securities (in the case of the NBS bills), due to the high dinar-denominated earnings they offered and, especially, due to euro-denominated earnings in the period when the dinar grew in strength (at one point in September 2008, banks' earnings in Euros reached 70%¹⁰), banks' interest in them partly decreased as interest rates fell (in the case of the NBS bills) while, on the other hand, the continued demand for treasury bills (which have almost come to equal the repo stock in value) tells us that investors are satisfied even with a 9.5% return when they don't expect high inflation (the NBS inflation target for 2010 was 6 ± 2 percentage points). Real earnings, thus, come to about 3%.

Third, a flat (in the case of the treasury bills) or even negative yield curve (in the case of old foreign currency savings bonds) shows that investors prefer short-term placements. This is a reflection of the lack of confidence in long-term macroeconomic stability. As a result of such a situation, and this was discussed earlier in the work, a bond of one maturity should not be accepted for determining the risk-free interest rate for different accounting periods. It is better to use securities with a larger number of maturities to determine various discount rates.

Fourth, the market for (NBS and treasury) bills has experienced radical interest rate changes. Data shows that they were almost halved in the period of only one year (from 17% to 9.5%), but that it is also easy to turn the trend around (NBS bills). In such conditions, it is difficult to accept any interest rate as the reference rate for accounting in business finance. Still, we should be reminded that it is not good for the risk-free interest rate to be set arbitrarily. It is a result of various mechanisms and relations between economic values at a given moment, which means that it will be changed in some future period, along with the remaining

¹⁰ *Kvartalni monitor*, No. 14/2008, Fond za razvoj ekonomske nauke, p. 49

inputs. If all those changes are not taken into consideration, then it is not good to arbitrarily adjust only the interest rate.

Finally, is it possible to answer the question regarding what the risk-free interest rate in Serbia is? Unfortunately, it cannot be said, as is the case with developed countries, that it is the interest rate for ten-year state-issued securities. These simply do not exist, for two reasons: first, the public does not believe in long-term macroeconomic stability and, second, in a euroized economy, it is hard to impose the dinar as a long-term choice. In the short term (up to one year), conditions have been created to start from the interest on treasury bills in determining the risk-free interest rate. At the end of February 2010, interest rates for one-year bills issued by developed countries were extremely low, reaching historic minimums below 1% (0.35% in the US). In less developed EU states which are not members of the euro zone, the highest interest rates came to about 9% (9.40% in Romania, 8.79% in Bulgaria, 8.81% in Latvia, according to January 2010 data).¹¹ The difference of 8 percentage points relative to the lowest interest rates can be ascribed to the less developed countries' inflation and credit risk. Among other countries, we should point to the example of the Czech Republic, where the one-year rate for state bills equals 2.10%.

When estimating the annual risk-free interest rate in Serbia, some other factors that affect the level of interest rates in the country should also be born in mind.¹² Generally speaking, states with more dynamic economic growth (as a rule undeveloped economies, at a lower development level and in the process of convergence with more developed economies) have higher interest rates. In addition, if a future fall in interest rates is expected, then the current price for bills and bonds will be higher (because they are more valuable at present, offering a greater yield than they will in the future). In Serbia, the dynamic fall in interest rates over the past year, along with issuer's (NBS) announcements that the rate for bills might continue to fall, have shaped expectations of a future fall in interest rates. On top of this, the risk of the economy and the populace has increased during the current crisis period, which means that state securities represent a "safe harbor" for investors. According to the so-called Vienna Agreement of 2009, the commercial banks obligated themselves not to take foreign currency out of Serbia (in amounts greater than they take in), which means that state securities can be seen as a good investment for the available money in Serbia's financial system.

Due to all of the above (the convergence process, the expected further fall in interest rates, attractiveness of state securities in comparison with increasingly risky other placements), it can be estimated that interest rates, including the risk-free interest rate, in Serbia are at a higher level than in more developed states. For

¹¹ <http://nui.epp.eurostat.ec.europa.eu/nui/>, accessed: 25/2/2010.

¹² F. Mishkin, *Monetarna ekonomija, bankarstvo i finansijska tržišta*, Data Status, Beograd, 2006, pp. 95-99

this reason, we estimate that the current annual rate of about 9% contains a risk-free interest rate of 3% and an expected inflation rate of 6%. Therefore, for a term of one year, a 3% interest rate can be accepted as risk-free in Serbia. To this is added a spread that depends on various macro and micro-risks. At this moment, the nominal short-term interest rate, i.e., the discount rate for business finance needs, cannot be lower than 9%, since this is the level of the state interest rate. Within an analysis, a two-digit discount rate would have to be applied for companies from Serbia, even though we are talking about (only) a one year period.

When it comes to the long term, there is no other choice than to estimate the risk-free interest rate in Serbia on the basis of foreign interest rates. No CDS are on offer for Serbia, so the state's credit risk cannot be estimated in that way.

By looking at the bond issuances of states with the same rating as Serbia's (BB- according to Standard and Poors), it can be seen that the market interest rate for ten-year state bonds ranges between about 10% (Kenya) and 13.75% (Venezuela).¹³ The interest rates for ten-year bonds at the beginning of 2010 ranged between 3.3-3.5% (US, Canada, Germany, Holland, Sweden, Finland, Austria), and 13.8% (Latvia).¹⁴ In Romania it equaled 9%, Lithuania 8.2%, Hungary 7.6%, Bulgaria 6.6%, Poland 4.3%, Czech Republic 4.3%. The link between interest rates and credit rating can be seen in the following table.

Table 2: *Interest rates for ten-year state bonds and state credit ratings*

	Interest rate for ten-year state bonds	Rating (Standard and Poors)	Spread above the German interest rate
Romania	9%	BB+	5.7 p.p
Latvia	8.20%	BBB	4.9 p.p
Hungary	7.60%	BBB-	4.3 p.p
Bulgaria	6.60%	BBB	3.3 p.p
Poland	6.13%	A	2.9 p.p
Czech Republic	4.30%	A+	1.0 p.p
Serbia	?	BB-	?

Source: <http://www.standardandpoors.com/ratings/sovereigns> i <http://www.ecb.int/stats/money/long/>, accessed: 26/2/2010.

As expected, it can be seen in Table 2 that there is a strong link between credit rating and interest rates. Almost as a rule, countries with a lower credit risk offer lower interest rates. Thus, the interest rate for Czech securities (A+ rating) is only about 1 percentage point higher than the least risky interest rates. Romania has

¹³ <http://www.centralbank.go.ke/securities/bonds/manualresults.aspx> and <http://www.bloomberg.com/markets/rates/brazil.html>, accessed: 26/2/2010

¹⁴ Except for Japan, where the long-term interest rate is 1.3%.

the worst rating (BB+, which is above the Serbian BB-), which results in a spread (above the German ten-year interest rate) of 5.7 percentage points.

Having the above relations in mind, it can be estimated that the risk-free long-term interest rate in Serbia equals 3.5%, and that a state security should give an additional return (spread) of at least 6 percentage points. Thus, the discount rate for long-term state securities should be about 10%, and even higher for the corporate sector (depending on the risk premium). The risk-free interest rate on the German level actually reflects the conclusion from the previous section of the work – that an appropriate foreign risk-free interest rate is used for cash flows in a foreign currency.

It should be born in mind that interest rates all over the world are at a very low level, which is a consequence of the exceptionally expansionist monetary policies introduced after the global crisis broke out. A rise in interest rates is inevitable: it is already occurring relative to the most critical months of the crisis, but it remains unknown when this process will accelerate and how high interest rates will rise.

Long-term dinar-denominated bonds can be issued in the process of the de-euroization of the domestic financial system. Towards the goal of reducing the role of the euro in Serbia, increasing the efficiency of economic policy and reducing business risk, it is necessary to strengthen the role of the dinar in financial transactions. This cannot be done by force but only through market mechanisms, and the issuance of dinar securities is of the utmost importance in this process. Then we will obtain new information on risk-free interest rates.

Since foreign securities are inevitably used when making long-term business finance decisions in Serbia, it bears repeating that the other elements in the analysis (cash flows) must also be evaluated in terms of foreign currencies. This means that future dinar cash flows need to be converted according to the future (expected) exchange rate, which is not an easy task. There is no developed forward foreign currency market in Serbia, which would be able to provide us with more precise information. The smallest mistake that can be made in estimating the future exchange rate would be to suppose that the nominal exchange rate will follow relative inflation (in Serbia and the euro zone).

5. Conclusion

This work considered the methodological challenges in the process of determining the risk-free interest rate and the ways of fixing the risk-free interest rate in Serbia. In the context of the state of affairs in Serbia's financial system, the limited supply of state securities, prices of bills and bonds on international capital markets, the annual real dinar-denominated risk-free interest rate in Serbia is roughly estimated to be 3%, and 3.5% for ten-year euro-denominated bonds. The

interest rates for state bills and bonds are obtained by adding on the spread to risk-free interest rates, with the minimum estimated spreads, determined on the basis of expected annual inflation and Serbia's credit rating, being 6 percentage points for dinar bills and 6 percentage points for long-term bonds.

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MARKETING STANDARDIZATION VERSUS DIFFERENTIATION IN INDUSTRIAL MULTINATIONAL COMPANIES IN SLOVAKIA

Abstract: *This paper focuses on the main dilemma of international marketing: – the problem of marketing standardization versus differentiation in Slovak multinational industrial companies in international markets. The focus was on factor analysis related to these marketing strategies. In addition, it identifies the possibility of individual marketing instruments (4Ps) for marketing standardization in international markets. We analyzed all basic 4Ps and tried to choose the most important and eligible instrument for marketing standardization and differentiation in foreign markets.*

Key words: *international marketing, standardization, differentiation, Slovakia*

JEL classification: L15, F23

1. Introduction

Currently, it is apparent that many companies have an international orientation to their business activity. Many companies do business domestically, but they place a priority on international markets as well. These companies apply international marketing strategies which satisfy the company's needs, while at the same time satisfying customers in various markets.

Business environment is characterized by constant change and ongoing long-term processes of globalization of the economy. Accelerating economic development in recent years led to continuous increase in competition within the domestic market but also in foreign markets. Slovakia contains various industrial companies with a highly concentrated production, which try to establish and strengthen their positions in foreign markets. International business has become a necessity for a large number of enterprises in Slovakia, which was enhanced by the processes of globalization and by the growth of international competition. Entering European Union together with adopting Euro has a pro-

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found affect on companies in Slovakia. International marketing and its application represent a key part of successful corporate management of all international companies in Slovakia

2. Standardization and differentiation in international marketing

There are basically two distinguishable strategies applied in international marketing: marketing standardization and marketing differentiation. The basic reason for applying standardization is that multinational companies should think globally and apply integration access worldwide. Standardization application in marketing means, to a great extent, that companies should apply the four basic marketing instruments (4Ps) in the same way worldwide and ignore national specialties in individual markets. Simply put, companies which apply marketing standardization offer the same product, promote it identically, and price and place it almost equally worldwide as well. International companies try to apply standardization strategy worldwide due to the great impact of Economies of Scale, which can lower their total costs. In the end, standardization also benefits customers by lowering prices.

Currently, only a small number of international companies are able to implement global marketing strategy consistently, and the application of standardization is more the exception rather than a regular phenomenon. Almost every international company takes into account (in higher or lower level), regional or local conditions which are typical to the differentiation. The strategy of differentiation is supported by strong market variety, especially by market individualism, or market uniqueness, which encourages the application of marketing differentiation. Marketing differentiation presents higher satisfaction of customers' wants and needs, but the customer has to pay more for such a product.

This paper focuses on the main dilemma of international marketing: – the problem of marketing standardization versus differentiation in Slovak multinational industrial companies in international markets. The focus was on factor analysis related to these marketing strategies. In addition, it identifies the possibility of individual marketing instruments (4Ps) for marketing standardization in international markets. We analysed all basic 4Ps and tried to choose the most important and eligible instrument for marketing standardization and differentiation in foreign markets.

3. Data and methods of survey

The main objective of this paper was to identify marketing standardization and differentiation application in Slovak multinational industrial companies.

In order to fulfil our main objective, we conducted a survey among 197 Slovak multinational industrial companies. We directly addressed the questionnaires to the 50 largest export enterprises in Slovakia, and we got a response from 17 companies. (The return of questionnaires was 34%, which represents 17 companies out of 50). There were not any restrictive conditions, relating to size, industry type or any other conditions during the enterprise selection process. The rest of the survey was represented by 180 companies, and these companies were randomly picked. The responses were investigated through open and closed questions, and the impact of various factors was identified through the scale system (The factors varied in scale, ranging as follows: no impact, weak, medium, and very strong impact).

The research consisted of two parts. In the first part we focused on the main factors which lean toward marketing standardization, and then to marketing differentiation. In the second part of the survey the special attention was especially devoted to individual marketing instruments (4Ps) and their applicability for standardization or differentiation in international markets.

To achieve the basic objective of this paper the following partial goals needed to be achieved:

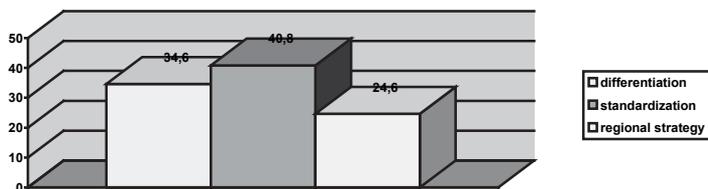
- To examine the major factors toward marketing standardization in foreign markets,
- To explore the key factors toward marketing differentiation,
- To identify the most appropriate marketing instrument/instruments for marketing standardization application in foreign markets.

4. Survey results

The results were evaluated by the SPSS program (Statistical Package for the Social Sciences), which is used extensively for marketing research.

Companies which operate in foreign markets usually use marketing standardization or differentiation. Literature in some cases also mentions a third strategy, which is in-between the two mentioned basic strategies. It is called a “regional strategy”, which is frequently applied within the region of several countries that are characterized by a high degree of similarity. For this reason, we also examined the application of regional strategy in foreign markets. The results are shown below.

Figure 1: Marketing strategies used among industrial multinational corporations in Slovakia



We found out that marketing standardization is the most common used strategy in foreign markets (40.8%) which mean the application of identical, or similar marketing strategies for all foreign markets. It is obvious that companies see advantages of this strategy and apply marketing instruments identically worldwide. The production in large quantities and total cost reduction is the engine of multinational companies, which lean toward standardization. Marketing standardization should not be understood only with regards to product policy, but it can be seen in the same way in the promotion policy with customers in various foreign markets. Distribution and pricing is done in various foreign markets.

Differentiation is also often used among multinational companies in Slovakia (34.6 %). Adapting marketing instruments to local customers is a way of satisfying a customer's needs and wants at a much higher level than through marketing standardization. Foreign markets vary and sometimes, due to different legal matters, standardization application is not always possible, so companies see the benefits in the adaptation to the local customer. They try to get higher profits due to higher prices, which are a reflection of better needs and wants satisfaction. Some foreign markets are so different that ignoring these differences would mean a total failure in those markets.

Almost one quarter of the analysed companies use the regional strategy, within countries with certain similarities (24.6%). Application of the regional strategy means the basic utilization of the strengths of both strategies. To put it another way, the regional strategy applies standard procedures in regional markets, while reflecting on the higher satisfaction of local customers as compared to global customers).

Multinational companies which apply *standardization* in foreign markets are influenced by various factors. Examination of these factors was crucial, since these factors greatly affect the application of marketing standardization. We evaluated these important factors: the nature of production (connected either with the production of final goods or with the products used as investment for other production), cost savings in several functional areas, planning and control, inventory reduction and consolidation of customer requirements. The following

table shows the importance of these factors among the analysed companies and their relation towards standardization.

Table 1: *Impact of factors related to marketing standardization among industrial multinational companies in Slovakia*

Factors of standardization	No importance (%)	Low importance (%)	Medium importance (%)	Strongest importance (%)
Characteristics of production	1.2	9.6	36.5	52.7
Cost savings in R&D	15.9	28.0	37.2	18.9
Cost savings in production	3.0	15.8	46.7	34.5
Cost savings in communication	6.0	29.3	41.9	22.8
Simplifying planning and control	3.5	28.8	47.6	20.0
Inventory reduction	13.7	42.3	32.7	11.3
Unification of customers' requirements	5.4	20.2	42.3	32.1

Results show that the characteristics of production is the most important factor related to standardization. It is obvious that the type of product can greatly affect the decision-making process related to marketing. Marketing instruments are used in a different way for a final product than for the product which is used in production for another company. Therefore, the product itself is a precondition for either standardization application or differentiation application. Standardization is most easily applied for investment products, such as construction machinery, machine lines, or others. Cost savings in production is the second most important factor of standardization among selected companies. Companies tend to see total costs savings only in this functional area. This action is understandable, but companies should have wider attempt in saving costs and they should to cut costs in other functional areas as well. R&D savings are not crucial for companies due to still lesser expenses into this area in comparison with formal EU countries. Unification of customers' requirements can be considered to be the third factor of importance towards standardization. Companies have noticed that customers, for many reasons, have more similar expectations towards products, and they offer identical or similar products in various foreign markets. If customers are similar, then their needs and wants can be met in an identical manner. We can say that the unification of the customers' require-

ments in various foreign markets greatly support marketing standardization. The fourth factor is cost savings in communication policy. Communication policy is not as important as production policy. Multinational companies in Slovakia still sometimes underestimate the impact of promotion, or they lack the know-how in this area. Other factors toward standardization play a lesser role in marketing standardization, because their impact is either low or medium.

Marketing differentiation takes into account particular local conditions of the market to satisfy the wishes of local consumers. In most cases, the adaptation of professional marketing instruments means that multinational companies differentiate the products and their attributes, offer different prices on foreign markets. Additionally, they use different distribution and communication policy, depending on the market. As a reward for these efforts, companies charge higher prices.

Various factors towards differentiation were examined as well. We focused on these factors: market requirements, macro-economic differences, the legal system, socio-cultural differences, differences in customers' preferences, behaviour of the competition towards the local market, marketing infrastructure, and technological adaptation. The following table shows the importance of these factors among analysed companies and their relation towards differentiation.

Table 2: *Impact of factors related to marketing differentiation among industrial multinational companies in Slovakia*

Factors of differentiation	No importance (%)	Low importance (%)	Medium importance (%)	Strongest importance (%)
Market requirements	2.5	3.8	29.3	64.3
Macro-economic differences	4.5	12.9	56.1	26.5
Legal system	7.7	26.3	40.4	25.6
Socio-cultural differences	14.2	29.7	34.2	21.9
Differences in customers preferences	5.8	21.3	41.3	31.6
Adaptative behaviour of the competition towards the local market	2.6	7.7	49.7	40
Marketing infrastructure	6.5	29.9	50.0	13,6
Technological adaptation	5.2	32.0	39.9	22.9

Results proved that market requirements are critical for differentiation. If customers desire a specific product a multinational company should respect this fact. Otherwise, the company can lose a customer and the company is replaced by other company which is able to satisfy customer's wants on higher level. There-

fore, analysed companies in Slovakia should conduct a market research to analyse foreign markets more in details (to know what the local customer want) and more frequently as well. Adaptive behaviour to the local market is the second strongest factor connected with marketing differentiation. Multinational companies from Slovakia are usually not “leaders” in foreign markets, and they seek to apply a similar adaptive strategy and follow their competitors in the industry. This means that, if successful competitors apply differentiation in foreign markets, other multinational competitors are likely to use a similar strategy. Macroeconomic differences can be considered to be the third and fourth factor together with differences in customers’ preferences. A multinational company cannot afford to ignore macroeconomic differences, and due to many differences in the economies (e.g. customer purchasing power), it is essential to take these differences into account. Different customer preferences “force” multinational companies to adapt marketing instruments to local markets. This factor proves the importance of marketing researches on various markets to know the potential customers’ needs and wants. Although other analysed factors have less importance with regards to differentiation, still, they need to be considered as well.

After identifying the importance of key factors related to marketing standardization and differentiation, we examined the basic marketing instruments (4Ps) in terms of the possibility of marketing standardization. We wanted to know which marketing instrument is the most suitable for marketing standardization in foreign markets. We did not examine marketing instruments for differentiation, because, usually, marketing instruments suitable for standardization are not suitable for differentiation and vice versa. The results of basic marketing instruments analysis are shown in the table below.

Table 3: Suitability of marketing instruments related to standardization among industrial multinational companies in Slovakia

Marketing instrument (4Ps)	No importance (%)	Low importance (%)	Medium importance (%)	Strongest importance (%)
Product	1.6	6.5	29.6	62.4
Promotion	4.9	23.2	48.1	23.8
Price	7.7	30.6	38.3	23.5
Place	4.4	26.0	55.8	13.8

Results of the research confirmed that the best marketing instrument for standardization in foreign markets is the **product**. A standardized product can be offered in foreign markets because its characteristics and quality, and the way it is used are the same in foreign markets. Taking into account the percentage of the two highest ratings of importance (strongest and medium), 92% of multinational companies considered the product to be an easily standardized tool

without any substantial differences in several foreign markets. Promotion can be considered the second most important marketing instrument related to standardization application. We need to say, though, that we expected the results of the research to be higher (especially in the level of strongest importance). We were surprised by the relatively high results achieved by Place – as marketing instruments in this regard. But according to our results, it is the third most important factor related to marketing standardization among analysed companies in Slovakia. Identical distribution channels application is a recent trend which can be seen in distribution in several foreign markets in order to achieve costs reduction. Price is relatively the least suitable marketing instrument for standardization. Still, we can say, that multinational companies have started to think about standardization in price policy additionally, due to economic difference elimination e.g. among EU countries.

5. Conclusion

Marketing standardization is the most often applied strategy in foreign markets among multinational companies in Slovakia. Standardization is represented by an identical, or similar, marketing approach for foreign markets. Cost reduction due to Economies of Scale is the most important reason for multinational companies, which lean toward standardization. Differentiation is also often used among multinational companies in Slovakia. Adapting marketing instruments to the local market is a way of satisfying customer needs at a much higher level than through marketing standardization. The advantage of this approach is the opportunity to charge higher prices, because of a higher satisfaction of customer needs and wants through a “tailored” product. Several factors affect both strategies of marketing standardization and marketing differentiation in foreign markets. Some of them have a great impact on multinational companies; the other ones can affect the companies only slightly.

Expert marketing theory considers product policy to be the most suitable marketing instrument for standardization in foreign markets. Communication policy is also considered to be an appropriate instrument for standardization. This paper verified both these theoretical opinions through the survey within multinational companies in Slovakia. We found out that product policy is exclusively the most important marketing instrument suitable for marketing standardization. Promotion is the second most important marketing instrument for marketing standardization.

Both marketing strategies (marketing standardization and marketing differentiation) have their own advantages and disadvantages. In practice, there is no universal conclusion as to which strategy is the most suitable and most often applied in international markets. Despite different advantages related to both of

these marketing strategies, we cannot say that these strategies represent contradictions in international marketing. They coexist, and the most important task for any multinational company is to determine the right level of standardization or differentiation, not only for the company's sake, but also for the sake of the customer.

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BASIC CHARACTERISTICS OF CHINESE MANAGEMENT FROM THE INTERCULTURAL POINT OF VIEW

Abstract: *The previous year has seen the development of more vivid political and economical relations between the People’s Republic of China and the Republic of Serbia. In the context of such present and potential future relations, there is a need to learn more about the characteristics of Chinese management. An understanding of the intercultural aspect of Chinese management and specific ways of negotiation will help secure Serbian businesspeople a more competitive place on the PRC market.*

Key words: *intercultural management, ways of negotiations, China*

JEL classification: L21, O53

1. Introduction

In its basic characteristics, Chinese management greatly differs from management in neighboring countries, even those with a similar tradition and experience. For this reason, it is necessary to become acquainted with the characteristic way of doing business in China, in order to be able to properly conduct business with Chinese partners and achieve good business cooperation. In order to explain the intercultural aspect of Chinese management in the right way, it is first necessary to explain the concepts of culture and intercultural management.

2. Theoretical overview

2.1. *The concept of culture*

The word culture comes from the Latin verb *colere*, which means to cultivate, refine or nurture. There are many definitions and meanings of culture, and the word is used in sociology, philosophy, art, as well as in the areas of economics and agriculture.

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Anthropologists were among the first to study the concept of culture. Frequently quoted, among the numerous authors who defined culture, was anthropologist Edward Burnett Taylor: "Culture or civilization... is a complex whole that encompasses knowledge, belief, art, law, morality, customs and all other capabilities and habits acquired by man as a member of society."¹

Expert literature that deals with the origins of the concept of culture as well as its definition, often cites the example of authors Kroeber and Kluckhohn, who quoted 164 definitions of culture in their monograph, "Culture: A Critical Review of Concepts and Definitions,"² classifying them into descriptive, historical, normative, psychological, structural or genetic categories. With due respect to all the cited quotes and explanations given in their book, the authors gave their own definition of the concept of culture: "Culture consists of models of behavior, explicit and implicit, acquired and transmitted with the aid of symbols, representing a specific achievement of human groups, including their embodiment in artifacts; the essential core of culture is made up of traditional (i.e., historically derived and chosen) ideas and values that were specifically connected with them; on the one hand, cultural systems can be considered to be products of action and, on the other, as prerequisites for further action."³

Famed Dutch sociologist Geert Hofstede, who in the course of his scholarly work dealt extensively with national cultures and cultures that exist within organizations but differ on the basis of national culture, thinks that "culture is collective mind programming that distinguishes the members of one group from those of another."⁴

In the book "Interkulturni izazovi globalizacije" ("Intercultural Challenges of Globalization") by Mića Jovanović and Ana Langović-Milićević, it is said that, from the standpoint of organizational management, another good definition is one according to which culture is the acquired knowledge and experience used by people in the development of their social behavior.⁵ The authors, however, add that, in their view, the most complete definition of culture is the one according to which "culture is an integral part of the entire social and individual life, the sum of all significant human legacies, material (so-called material culture) and spiritual (so-called spiritual culture), without which human society could not exist even in the simplest forms of organization (proof of that are the so-called primitive societies, whose spiritual culture was frequently more developed than their material culture)."⁶

¹ D. Mojić, "Organizacije i nacionalna kultura", *Sociologija*, Vol. XLIX, No. 4, 2007, pp. 356-357

² The monograph was first published in 1952.

³ D. Mojić, "Organizacije i nacionalna kultura", *Sociologija*, Vol. XLIX, No. 4, 2007, pp. 356-357

⁴ M. Jovanović, A. Langović-Milićević, *Interkulturni izazovi globalizacije*, Megatrend University, Belgrade, 2006, p. 24

⁵ M. Jovanović, A. Langović-Milićević, *ibidem*.

⁶ M. Jovanović, A. Langović-Milićević, *op. cit.*, p. 16

2.2. The concept of intercultural management

The said definitions of culture were presented in order to better explain the concept of intercultural management. Namely, the process of the globalization of international business has caused the term intercultural management to be used more and more frequently in professional and scholarly literature, as a concept that is supposed to explain the connections, similarities and differences that exist in national cultures, and are reflected in the business environment. In Anglophone literature, the only disagreement concerns whether to use the prefix *cross*, *inter* or *comparative* before *management*. However, since the prefix *inter* has been to a large degree accepted in our own literature that is what will be used in this work.

What is meant by inter-culture and what by intercultural management? Inter-culture is a crossbreeding and mixing of the knowledge and experiences of people from different cultural communities all over the world.⁷ It is clearly noticeable that the prefix “inter” denotes a set of different cultures that are inter-mixing and permeating each other, thus creating new social values, new forms of communication and new value systems.⁸

In explaining the concept of inter-culture, the most frequent point of departure is the culture model given by Geert Hofstede (in the book “Culture’s Consequences: Comparing Values, Behaviors, Institutions, and Organizations across Nations”), on the one hand, and Fons Trompenaars and Hampden-Turner (in the book “The Seven Dimensions of Culture”), on the other.

Geert Hofstede is the most frequently cited author in Serbian academic public life in the area of interculture and intercultural management. His studies, which have been applied in more than 70 countries so far, show how national cultures influence a company’s organizational operations.⁹ He says that culture has five basic dimensions that explain intercultural differences, and these are:¹⁰

1. Power Distance Index (PDI) – marks the level to which less powerful members of an organization or institution (such as a family) accept and expect power within the group to be distributed unequally. In addition, this power distance is defined more from the standpoint of those who are less powerful than

⁷ M. Jovanović, A. Langović-Miličević, *Interkulturni izazovi globalizacije*, Megatrend University, Belgrade, 2006, p. 24

⁸ S. Isaković: “Manifest novog doba”, *Megatrend revija*, Vol. 1, br. 1, 2004, pp. 237-240

⁹ Hofstede used the research he conducted for IBM to formulate this theory. Hofstede worked for IBM from 1967-1973. Namely, IBM was already a big company by then, and was having problems with the results of its branches in various countries. IBM standards and work procedures were the same for all, but the results very much differed. Since the employee educational structure was more-or-less the same in all the countries, Hofstede came to the conclusion that it was the differences in the **national cultures** of IBM employees that were causing the differing business results.

¹⁰ Cited and translated according to: www.geert-hofstede.com, accessed: 2/7/2010.

from the standpoint of those who possess power. In that way, the index suggests that the social level of inequality is accepted both on the part of the followers and those who are powerful. Power and inequality are an integral part of any society and anyone with any kind of international experience will be conscious of the fact that all societies are unequal, but also that some societies are more unequal than others.

2. Individualism (IDV) – the opposite of collectivism. Together they mark the level to which individuals in a society are integrated into groups. On the side of individualism are societies within which the ties between individuals are weak, i.e., everyone is expected to fend for themselves and their immediate family. On the side of collectivism are societies in which people associate and gather around a strong, cohesive group from birth, often an extended family (with aunts, uncles, grandmas and grandpas) that protects them in return for absolute loyalty. Here the word collectivism does not have a political connotation, as it pertains to a group, not the state.

3. Masculinity (MAS) – has its opposite in femininity, and pertains to the division of roles among the sexes. An IBM study has revealed that a) female values are less mutually distinct between different societies than male values, and b) male values differ from country to country, ranging from very self-confident and competitively oriented (being, thus, totally different from female values) to modest and caring, akin to the values possessed by women. In countries where masculinity prevails, women are more self-confident and more ambitious than in countries where femininity prevails.

4. Uncertainty Avoidance Index (UAI) – describes a society's tolerance for uncertainty. The index shows the level to which the members of a culture feel insecure or secure in uncertain situations. Under uncertain situations are meant new, sudden situations that differ from the normal, usual ones. People who live in cultures that seek to avoid uncertainty do that by strictly respecting the law, rules and safety measures, while on the philosophical and religious levels they believe in a single absolute truth. Cultures that accept uncertainty are more tolerant towards other cultures whose opinions differ from their own, and seek to have as few rules as possible. As for the philosophical and religious levels, they are relativists and allow people to have a number of different convictions.

5. Long-Term Orientation (LTO)¹¹ – as opposed to short-term orientation. This fifth dimension was established during a survey of students from 23 countries, conceived by Chinese students. Frugality, economy, persistence and tolerance are the features of long-term orientation, while short-term oriented cultures have the following characteristics: respect for tradition, fulfillment of social obligations, and protection of another's personality (their name). Both the

¹¹ Long-term orientation is the new, fifth dimension of culture; in the original research there were four of them.

good and the bad characteristics of this dimension can be found in the teachings of Confucius.

A second way of explaining the concept of inter-culture was provided by Fons Trompenaars and Hampden-Turner. Just like Hofstede's, their list of cultural dimensions primarily helps business people throughout the world to recognize that individual national cultures differ and aids their understanding of them. Their model starts from the premise that culture has seven dimensions:¹²

1. *Universalism/particularism* – pertaining to whether more power within a society is wielded by strict rules of behavior or by relations between people. In Universalist societies, people tend to submit to generally accepted laws and values, while in particularistic societies friendly relations are placed above laws and general norms of behavior.

2. *Individualism/communitarianism* – pertains to whether people are seen as individuals or as parts of the community. Individualism denotes cultures in which people are primarily self-reliant and put their own selves first, while in communitarianism the individual is seen as a part of society and the community is placed above them.

3. *Specific/general* – pertains to how responsibility is transferred onto people. In societies that accept specific responsibility, responsibility is defined by way of contracts, standards and rules. In others, the general comes before the individual; thus, the focus is not on individual responsibility but on the functioning of the society or group as a whole.

4. *Affectiveness/neutrality* – pertains to the human characteristic of displaying emotions in public. In affective societies this phenomenon is normal, while in neutral societies emotions are not so strongly displayed in public, i.e., they are controlled.

5. *Self-directedness/external (nature) directedness* – pertains to how people view nature and the world around them. With the first group, people view themselves and society as superior to nature; in the second group, there is no subordinate relationship and it is emphasized that people have to coexist with nature in harmony.

6. *Gaining social status on the basis of results/inheriting social status* – pertains to the fact that, in some cultures, individuals secure a place in society by their own merit and achievement, while in others the individual's place is determined at birth.

7. *Tasks are performed one at a time/multitasking* – pertains to the fact that the former group views time as being segmented into smaller sequences, while the latter group views time as something flexible and intangible.

¹² www.provenmodels.com/580/seven-dimensions-of-culture/charles-hampden-turner--fons-trompenaars, accessed: 2/7/2010.

While researchers and scholars generally agree about what intercultural is, there is no consensus regarding whether it is at all necessary to study intercultural management and, even if it is, how to standardize research and draw general conclusions. Some authors have gone so far as to claim that intercultural management is a conspicuously ethno-centric or parochial construct produced by American researchers who, by creating this term and then explaining it, sought to transfer intercultural to the domain of organizational management.¹³ Although such views can be accepted as true to a certain extent, the present globalized way of doing business serves as convincing testimony against such claims.¹⁴

According to Nancy Adler, "Cross-cultural management is the study of human behavior in organizations in different cultures and nations of the world. This discipline seeks to describe organizational behavior within countries and cultures, compare the organizational behavior of countries and cultures and, perhaps most importantly, study the interaction of people from different countries who work within the same organization or the same work environment."¹⁵

Raghu Nath, who uses the term comparative management as a synonym for cross-cultural management, points out that, in the broadest sense, comparative management primarily, studies similarities and differences between business and management systems from different contexts. However, in addition to this, the author also accepts the narrower, often used definition of comparative management as the study of organizations from different countries and cultures.¹⁶

Mića Jovanović and Ana Langović-Milićević think that "intercultural management is a process of the imposition, mixing, acceptance and mutual expectation of cultural values between different civilizations, towards the goal of business globalization."¹⁷

The next portion of this work will deal with the characteristics of Chinese management, viewed through the prism of inter-culture.

¹³ For more on this topic, see: D. Mojić, "Organizacije i nacionalna kultura", *Sociologija*, Vol. XLIX, No. 4, 2007, pp. 356-357

¹⁴ When Parker Pen was marketing its ball point pens in Mexico, the slogan that was supposed inform customers about the pens went: "It won't run in your pocket and embarrass you." However, the company used the word *embarazer* for embarrassment or bringing into an uncomfortable situation, which changed the slogan into: "It won't run in your pocket and make you pregnant." Such examples serve to show businesspeople how a bad translation, communication or understanding of other peoples can harm their business.

¹⁵ D. Mojić, "Organizacije i nacionalna kultura", *Sociologija*, Vol. XLIX, No. 4, 2007, p. 351

¹⁶ D. Mojić, op.cit., p. 352

¹⁷ M. Jovanović, A. Langović-Milićević, *Interkulturni izazovi globalizacije*, Megatrend University, Belgrade, 2006, p. 23

3. Origins of the specificities of Chinese management

The rise of China has drawn the attention of researchers to the specificities of the Chinese way of business. These specificities comprise three factors: (a) spiritual heritage, (b) succession of ways of developing the country and (c) the creation of modern entrepreneurship – the “open door” policy.

3.1. *Spiritual heritage*

China has a long tradition as a state, and the first written evidence about its existence are 4000 years old.¹⁸ During its long history, China has almost always been independent and self-sufficient, which has endowed the Chinese people with a very specific culture and tradition. It is very hard to choose the proper references to describe this people, but the most important one is certainly Confucianism.

Confucianism has been and remains one of the most important and most influential schools of thought in China, and its influence has been felt and disseminated throughout Asia. As the first private school in China, it was founded by the thinker Confucius. It is interesting to note that, although his legacy comprises four great works, only one of them, “Spring and Autumn Annals,” is his own, while the remaining three, “Analects of Confucius,” “Great Learning” and “Doctrine of the Mean,” are the works of his students and grandchildren.

Confucianism is more of a code of behavior or a general approach to life than a religion. The most important postulates of Confucianism, which have also influenced ways of doing business, are reflected in the following relationships:

- 1) Ruler to ruled – the ruler expects absolute loyalty and obedience from his subjects. Subjects must never doubt his decisions and, in return, he must take into consideration their needs and wishes, and work on providing a better life for them.
- 2) Husband to wife – the husband rules over his wife, like a god that rules over people. The wife must be faithful and obedient, and is obliged to serve her husband’s sons. In return, the husband is obliged to provide for all of his wife’s life’s needs.
- 3) Parents to children – children must be obedient and listen to their parents without complaint. Parents must raise and educate their children, while the children must care for their parents in their old age, love them and respect them.
- 4) Old to young – younger generations must respect the older ones due to their years and age, and this postulate is the key element of Confucian ethics.
- 5) Friend to friend – this is the only relationship within Confucianism characterized by equality. Friends should be sincere, loyal and ready to help

¹⁸ B. S. Babić, *Ekonomija Azije*, Megatrend University, Belgrade, 2007, p. 316

each other. Insincerity between friends is not allowed and, if present, requires punishment.¹⁹

Researchers pay special attention to Confucianism as a feature of Chinese management. How has Confucianism shaped the Chinese economic environment? In their monograph "The Intercultural Challenges of Globalization," Mića Jovanović and Ana Langović-Miličević write: "The basis of the Confucian humane science and the essence of its moral credo are reflected in the following principles. Before all, harmony in social relations, *collectivism* and cooperation in interpersonal relations, *desire for learning and understanding* centered around: the cultivation of a model of behavior based on *humaneness* – "zhen," a *feeling for duties and obligations* – "yi," *respect for the elderly* – "xiao," *loyalty* – "chung," and *feeling for joint and family life* – "li."²⁰

3.2. Successive ways of developing the country

All the way up to 1912, China was an empire. In that year, the rule of the Manchu dynasty came to an end.²¹ After this, the country became a republic, which lasted until 1949, when under Mao Zedong leadership a revolution was carried out, which had an all-encompassing effect on China's, political, economic, social and cultural life.

The revolution brought the Chinese Communist Party to power. Under Mao Zedong leadership, the party began to implement wholesale social and economic reforms. The first reform cycle began in 1949, the second lasted from 1953 to 1956, the third from 1956 to 1961, after which came the Cultural Revolution, between 1966 and 1977. Mao Zedong died at the end of 1976. Under the subsequent leadership of Deng Xiaoping, a totally new and different transformation of China began, culminating in 1993, with a transition from an almost totally planned to a mostly market economy.

The years in which Mao stood at the head of the People's Republic of China were characterized by the following: agrarian reform was carried out, the foundations of industrialization were set, a planned way of directing economic development was established, the rule of law was proclaimed and collective management was developed. The reforms went according to plan up to 1958, when Zedong decided to make the "Great Leap Forward" and accelerate the country's development. All private land and means of production were collectivized; peasants were organized into people's communes, while a sizeable portion of peasants was transferred to work in steel production. However, the reform turned out to

¹⁹ S. El Kahal, *Business in Asia Pacific*, Oxford University Press, 2001, pp. 128-129

²⁰ M. Jovanović, A. Langović-Miličević, *Interkulturalni izazovi globalizacije*, Megatrend University, Belgrade, 2006, p. 149

²¹ B.S. Babić, *Ekonomija Azije*, Megatrend University, Belgrade, 2007, p. 316

be quite unsuccessful and was ended in 1961, after which began a new policy of “adjustment.” The Cultural Revolution, which ensued five years later and lasted until Mao’s death, had the goal of settling accounts with the part of the public that desired better relations with capitalist countries and the restoration of the private sector. Also, the Cultural Revolution sought to modify the cultural spheres of society.

After Mao’s death came reforms that were not totally opposed to all of Mao’s reforms but definitely had a different character.²² The bases of these reforms were reflected in:

- Political reforms: full trust in public opinion, trust in facts, along with the democratization of society, and
- Economic reforms: agricultural reform, with increased peasant autonomy; expansion of small and middle entrepreneurship; attraction of foreign investment; state control over only the important financial, big industrial and public companies.

As a result of the reform, positive economic results were quickly felt, which formed the preconditions for the strengthening of private Chinese entrepreneurship, as well as for more serious investment on the part of foreign companies.

3.3. Origins of modern entrepreneurship – the “open door” policy

As a prerequisite for the implementation of the new policy of economic development, a political and social transformation of China first had to take place after Zedong died. Namely, during Mao’s reign, China initially had excellent relations with the USSR. These, however, gradually cooled (primarily in the political and economic sense), and the country came to rely exclusively on its own powers in its development. This could function only up to a point, after which different views came into currency, to the effect that there were things outside of China that China could learn from others (“learning from the Barbarians”). However, such thinking was not a novelty in China. After losing the Opium War, which represented a great sobering for this large, powerful country, China realized that, in some things, the outside world had advanced farther than it had. The right conditions for a restoration of this ideology were formed at the beginning of the 1980s, when “Barbarians” were allowed to invest in China and its know-how, within the scope of “four special economic zones.”

The Special Economic Zones (SEZ) were coastal areas, the only places where foreigners were allowed to invest in China. Initially, the SEZ only had mixed companies, i.e., companies with half Chinese and half foreign capital. The reform of 1986 (second wave of reform) changed this and permission was given for totally

²² “Mao’s successors tallied the results of Mao’s rule in the Chinese way: Mao Zedong was 70% right and 30% mistaken.” - B.S. Babić, op. cit., p. 363

foreign-owned companies to open, followed by a series of incentives to firms that opened their factories there.

The third wave of reform tied to SEZ began in 1992, labeled as the “great stride forward”; this was the moment when China intensely launched exports to foreign markets, and began increasing the participation of foreign direct investments on its territory. In that way, slowly but surely, China began to accept and adopt Western knowledge and to use it for the development of its own economy.

4. Strategies of China's development

PR China has used two strategies in its development: the “strategy of forced development” and the “strategy of comparative advantages.”²³ According to the *strategy of forced development*, the state authorities concentrate on the development of heavy industry. The point of the strategy is to, with the aid of heavy industry; earn the necessary funds that will enable them to develop other industrial branches. This method places priority on economic rather than on financial profitability. The *strategy of comparative advantages* is totally reverse, as it first develops the production of consumer goods, allowing for faster capital turnover, which is then invested in heavy industry. Poor countries usually have a deficit of capital and a surplus of labor and, by investing into consumer good industries, which are labor-intensive; they turn over capital more easily and obtain a higher profit rate than they would by using the forced development strategy.

4.1. Strategy of forced development

In establishing PR China in 1949, the Chinese leadership of the time opted for the strategy of forced development. At that time, the country was very poor, with a social product structure in which the participation of agriculture was 90% and that of industry only 10%.²⁴

There were three basic reasons why China's leadership opted for this strategy:²⁵

- 1) Within the global economy, the countries that were economically developed at the time had a high proportion of heavy industry in their total production. Influenced by this state of affairs, many underdeveloped countries, including China, launched rapid industrialization in order to improve their position in the international economy.

²³ The explanation will be given on the basis of: B. S. Babić, *Ekonomija Azije*, Megatrend University, Belgrade, 2007, p. 389

²⁴ B.S. Babić, *Ekonomija Azije*, Megatrend University, Belgrade, 2007, p. 390

²⁵ B.S. Babić, *ibid.*

- 2) The second reason lay in the fact that China was at war with Korea at that time and threatened by opponents from Taiwan, so it had to engage in arms production. Also, in the periods that followed, China was blockaded both by the West and the USSR, so it had to turn inward, to things that it needed at the time – and that was heavy industry.
- 3) The third reason was practical. The government was aware that 90% of the populace lived in rural areas and had small buying power. The question was: for whom to produce and to whom to sell consumer goods, if there was no one to buy them?

4.2. Strategy of comparative advantages

As time passed, bad economic results forced China, more out of necessity than out of choice, to switch to the strategy of comparative advantages. The necessity was reflected in the fact that the previous strategy had resulted in a budget deficit, imbalances in the balance of payments and inflation. The new direction of economic development allowed the government to take advantage of the vast availability of cheap labor in China and to pay that labor force, which, in turn, would purchase goods with the money it earned, and the money would then be reinvested in the economy. Thus, capital turned over many times more than it had previously, the profit rate for everything (from production to sales) rose, and funds were invested in profitable endeavors rather than in state-supported firms that were doing poorly. This gave a new impulse to Chinese entrepreneurship.

The latest statistical data on China show that it is one of the rare economies in the world that is still showing positive results in the midst of the great global crisis, partly thanks to this strategy of development. Although Western and Chinese statistical data do not match completely, whichever results we observe, they are more than positive. This is additionally confirmed by media reports about China investing money in other economies, for example in various African countries or Greece.

5. Specificities of Chinese management

Before the Chinese economy and state opened up to foreigners, there was sparse data in foreign scholarly and professional circles about the true picture of the Chinese economy and, by extension, the Chinese system of management. As a result, the first works on this topic did not start to appear until the mid 1980s. As time passed and business became globalized, a spate of books, editions and collections of works on the topic of the Chinese economy and management has flooded the global book market. In Serbia, this topic has received

incomplete treatment,²⁶ the probable reason being Serbia's own problems over the past twenty years, which turned public attention to other matters. Now that Serbian-Chinese relations are undergoing a new phase of strengthening, more space is being reserved for this issue.²⁷ Since members of the domestic scholarly community have not had much chance for extended stays in China, where they could personally confirm the research of Anglo-American researchers, the presentation of Chinese management in this work will primarily be based on Anglo-American literature.²⁸

The basic characteristics of Chinese management that will be presented here are connected with Chinese national culture, the ancient teachings of Confucius, as well as its past and, to a certain extent, present system of doing business – “market communism.” Thus, the basic characteristics of Chinese management are:

- 1) *Guanxi* and connections
- 2) Family firms
- 3) Mianzi
- 4) The middle way – a holistic approach to time and performance
- 5) Indirect competition
- 6) A specific way of communication and negotiation

5.1. *Guanxi and connections*

In his book “Inside Chinese Business,” Ming-Jer Chen writes: “There is no direct English translation of the word *guanxi*, and this fact has created great confusion about its true translation. The conventional translation of this word, *connections*, shows only one aspect. *Guanxi* truly comprises connections, but before all connections defined by reciprocity and mutual obligations. Ideally, these connections are accompanied by a sense of voluntarism and personal respect and acceptance.”²⁹ *Guanxi* was also often understood as a bribe or a form of corrup-

²⁶ Exceptions to that rule were: M. Jovanović, A. Langović-Milićević *Interkulturni izazovi globalizacije*, B. Babić *Ekonomija Azije*, *Kultura* magazine and two issues on that subject - *Kina – svila na putu*, as well as the book by A. Novačić, *Kina – Zmaj na Olimpu*.

²⁷ The Republic of Serbia just had a noted presentation at the EXPO 2010 in Shanghai, where Serbia was accorded special treatment, being amongst a small number of countries with their own national week at the fair. During the past year, the number of diplomatic visits has also intensified, including visits by the Serbian president and prime minister and a return visit by the Chinese president.

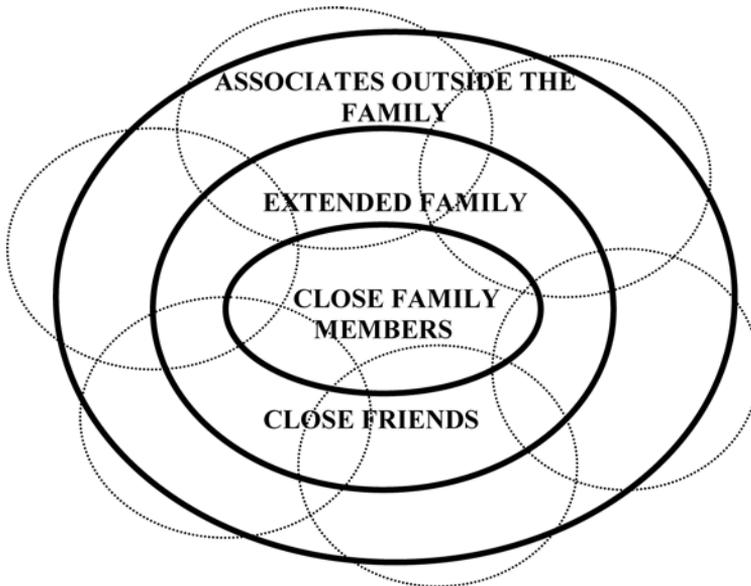
²⁸ Here it is important to emphasise that researchers of Chinese ancestry who are now second or third-generation immigrants in the West think that the business practices of the Chinese in the homeland and those who have lived abroad for generations somewhat differ. The differences are less of an essential than of a practical nature. This work deals with management practice in China itself. For more on this, see: M. J. Chen, *Inside Chinese Business*, Harvard Business School Press, Boston, Massachusetts, 2001.

²⁹ M. J. Chen, *Inside Chinese Business*, Harvard Business School Press, Boston, Massachusetts, 2001, p. 46

tion that exists in China but, in fact, it is more based on a system of informal connections.

Thus, the process in the order of *guanxi* is the following: if a company wants to make good business in China, it must establish contact with businesspeople in China (it is unimportant if they are Chinese or some other nationality) who possess informal ties with other people who can help this company's business. The system of recommendation is here very important. If a company does not have businesspeople in China with good *guanxi*, it probably won't do well on the Chinese market. However, it is not enough for representatives of some company to be merely introduced into this system of connections. The most important thing, when the time comes, is for the service to be repaid to the one that helped in the same, preferably even bigger measure. This system of connections is not something that can be given or passed on to someone, but is something that is acquired over a lifetime. For example, the problem some international companies have faced was that, when an employee left he would also take his *guanxi* with him, leaving the company with big problems on the market due to the loss of previous connections.

Figure 1: *Guanxi connections*³⁰



There are many types of *guanxi*, and they will be presented in Figure 1. The first type of *guanxi* connection is one established between immediate and extended family members, which the Chinese consider to be the most important.

³⁰ Presented according to: M. J. Chen, *Inside Chinese Business*, Harvard Business School Press, Boston, Massachusetts, 2001, p. 46

Also, when one is not a member of the family but is a person of trust, they can also belong to this circle. The second type of *guanxi* is achieved with associates outside the family, with whom one has important ties and relations. These are relationships such as those formed between classmates, members of the same group or organization, or with friends of friends. The third type includes foreigners. This is not a relationship that is established quickly, and requires time to develop.

Hence, the system of making connections and acquaintances (based as much on good business cooperation as on a system of good friendly and human relations) is one of the key factors of successful business on the Chinese market.

5.2. Family firms

There are two basic reasons why, even in the 21st century, family firms are still the primary business form in China. The first reason lies in the fact that China used to be a predominantly poor, agrarian country in which only families could secure a normal life. Namely, family members mutually helped and protected each other, whether from the weather or from the state. The second reason can be found in Confucian thought, which gave the family both a functional and a moral dimension. Confucius thought that the family must be the basis for the construction of morality and the creation of mutually dependent, helping connections. Accordingly, the Confucian state is not oriented towards the welfare of the individual but towards the welfare of society, i.e., the state.

The four basic characteristics of the traditional Chinese way of doing business are:³¹

- 1) Family-managed business – the typical Chinese company is led by a single person, usually the one that founded the business, whose successors hold the key positions in the company.
- 2) The dominant business leader within the family – the one who founded the company has the exclusive right of making the final decisions. It is sometimes hard for businesspeople working on the Chinese market when they are negotiating with people in high positions in companies and the key member of the organization is not present, for they do not know what the latter is thinking. The leader of the family has a circle of close family members and associates with whom he consults, but ultimately makes all the decisions by himself.
- 3) Specific roles and obligations of family members – in accordance with the Confucian codes, the family is always in the first place. Before all, this is reflected in the fact that all the family members must repay their ancestors by successfully guiding the family business. The responsibility

³¹ M. J. Chen, *Inside Chinese Business*, op. cit., pp. 24-33

and respect that are displayed in the process must not be brought into question. In order to avoid argument between family members regarding business, conflict between successors is resolved either by dividing different functions within a firm doing business in China or, if business is conducted in more than one country, sending the members off to different countries. Thus, harmony in family relations must not be disrupted.

- 4) Family companies are financed by the family alone – Chinese family firms are mostly self-financed, instead of by banks or other financial institutions. This ensures their business independence relative to economic or political trends, but also serves to partly conceal business results.

5.3. *Mianzi*

The five basic relationships within Confucianism were already presented earlier in the work. Another integral component of Confucian relationships is *mianzi*. The literal translation of this word would be “face”³² but, in the spirit of our own language, it would be closer to “honor.” What does this imply? *Mianzi* marks the fact that the individual in the system of social relations and roles accepts and respects rules that are pan-societal, and these rules pertain to the individual’s behavior and what society expects from them. What is important to emphasize in this situation is that the preservation of *mianzi* is reciprocal, i.e., one must not endanger someone else’s face or honor. When you stain someone’s honor, it means that you have also stained yourself. On the business level, this means that businesspeople who operate in China must speak to their associates in a different way, less openly than is customary in Western business practice. When it is necessary to commend someone, it should be done indirectly, along with a commendation of everyone else, so that associates will feel honored and respected in an appropriate measure. When seeking to save the *mianzi* of someone who has done something wrong, then it is done in a confidential conversation, with indirect suggestions concerning what was done wrongly.

5.4. *The middle way – a holistic approach to time and performance*

The Mandarin word for China is *Zhong guo*, which in translation means the Middle Kingdom, and in the philosophical sense it means adherence to the principle of “being in the middle,” i.e., maintaining a balanced and integrated life of one’s own, as well as of the world in general.³³ The term incorporates Confucius’ view that it is necessary to have one’s own balanced, middle way – a way without extremes, where everyone will act modestly and properly.

³² S. El Kahal, *Business in Asia Pacific*, Oxford University Press, 2001, p. 184

³³ M. J. Chen, *Inside Chinese Business*, Harvard Business School Press, Boston, Massachusetts, 2001, p. 85

Within the framework of this type of worldview, we will present two indivisible ways of looking at the middle way: the holistic approach and the paradox approach.

The holistic approach to life pertains to: a) looking at the entirety of things (as opposed to the Western way of thinking, where the whole is segmented into parts, here parts are assembled into a whole); b) establishing harmony (the people, objects and the world around us must be in harmony); c) achieving performance while respecting harmony (individual interest cannot be achieved at the expense of the community); and d) a holistic view of time (long-term view of things and relations).³⁴

The paradox approach is reflected in the well known symbol of yin and yang. Thus, each good also contains something evil, while each evil also contains something good, and they cannot be separated from each other.

Such an approach to life sometimes makes decision-making more difficult among the Chinese, causing problems in communication and problem-solving for Western managers on the Chinese market. Why? Because, even when something bad happens, the Chinese think it was for a reason, which slows down decision-making and the consideration of solutions.

5.5. Indirect competition

Among other things, Confucius' teaching stresses that it is necessary to have measure in everything, and that one should not stand out. This principle has also been transplanted to the business world.³⁵ There are a number of ways in which this principle is applied in business practice. First, when working on foreign markets, Chinese companies try to avoid excessive exposure and try not to threaten their main competitors. They feel that conflicts that can develop on such occasions may absorb too much of their time and, more importantly, money in resolving them. Second, no matter where they operate, most Chinese companies work with cash instead of cards or credit. Cash allows them to be discreet and for most of their business to be secretive, while giving them the financial freedom not to be dependent on others. Third, as a result of such a principle of indirect competition, as we might call it, the Chinese often invest in neglected market niches and uncharted markets.³⁶ The idea is, by operating in narrow market

³⁴ In China, in addition to the official, Gregorian Calendar, the solar/lunar calendar, which measures time in 60-year cycles, is also still in use. To the Chinese, time is a relative concept, so they do not have past and future tense in their language. According to: M. J. Chen, *Inside Chinese Business*, Harvard Business School Press, Boston, Massachusetts, 2001, p. 94

³⁵ Those versed in Chinese history think that indirect competition and secretiveness are also partly the result of the long years of communist rule in the country, where private property was confiscated and then restored a number of times.

³⁶ The government of the Republic of Serbia must take this piece of information into account if it wants to increase investment volume from PR China in Serbia, since we are one such market.

niches and little-known markets, to be the first in that city, country or region, thus securing a good competitive position at the start.

5.6. *Communication and negotiation*

Most Anglo-American managers have stated that their main problem in doing business in China is one of communication.³⁷ As already mentioned, the Chinese language has its specificities, with which those who are doing business in China must be familiar. One of the more frequent problems is that words such as *yes* and *no* do not always have that specific meaning, but may have a series of meanings.³⁸ Also, the first person singular, *I*, is practically never used; instead, the plural *we* is used, or people talk about themselves in terms of the relationship they have with you personally, e.g. *your student* or *your colleague*. In addition, the saving of face or honor, as already mentioned, means that whenever a question is posed to someone, it is done in an indirect form and with a slightly changed meaning.³⁹ Non-verbal communication is also different from the Western, since face and hand mimicry are minimal, while affective gestures are unacceptable. Gifts, which it is desirable to present to business partners in China, must first be refused several times by the Chinese host, only to be accepted at the end, in order to play out the expected norm of behavior.

As far as negotiations are concerned, here, too, the postulates of Confucianism apply, although they are fortified with specific tactics for closing business deals rooted in Sun Tzu's famous strategies of war and set down in his work "The Art of War." Thus, these strategies, which pertain to the winning of wars, are today successfully applied in corporate wars or, better said, in making business deals. Conducting long negotiations in order to find out everything necessary about the opponent, not allowing the opponent to know your true intentions to the end, turning the opponent's strengths into weaknesses, negotiating exclusively on domestic (Chinese) terrain, are only some of the possible strategies that Chinese entrepreneurs may use with those with whom they are doing business.⁴⁰

³⁷ L. Beamer, "Bridging Business Cultures", *China Business Review* 25, No. 3, 1998, p. 54

³⁸ M. J. Chen, *Inside Chinese Business*, Harvard Business School Press, Boston, Massachusetts, 2001, p. 131

³⁹ For example, instead of asking someone, "Why are you an hour late for our appointment," or "I've lost an hour because of you!" it is better to ask, "Is everything all right with you and your family?"

⁴⁰ Sun Tzu, *The Art of War* (Serbian translation: C. Sun, *Umeće ratovanja*, Mono i Manjana, Beograd, 2009).

6. Some additional points about the business culture in China

By applying Hofstede's research techniques on China, the following results have been obtained.⁴¹

- 1) The highest marks in all of Asia for long-term orientation (118). Thus, frugality, economy, tolerance and perseverance are quite pronounced in China, where these characteristics are stronger than anywhere else in Asia.
- 2) The power distance index is also high (equaling 80, while for most other countries, PDI equals 57.5), which marks a deep societal division between those who have power and those who do not.
- 3) Individualism is at a very low level (IDV equals 20, while the average is 48.5), i.e., the collective comes before the individual. This can be explained both by the influence of the Communist Party and by Confucius' teachings about the role of the family.
- 4) Chinese culture is masculine (MAS equals 66, while 50 is the upper limit of the feminine), which means that masculine values such as ambitiousness and advancing prevail.
- 5) The uncertainty avoidance index is slightly below average (UAI equals 40, while for most countries it is around 60), which means that they accept uncertainty and do not resist changes and new things.⁴²

7. Conclusion

China has achieved its "economic miracle" primarily by relying on human resources (devoted employees, highly skilled and socially responsible entrepreneurship and highly efficient management), but also on investment in consumer industries (transition to the comparative advantages strategy).

Chinese management is under the absolute influence of Confucianism which, in tandem with "market communism," produces a totally new and unique form of management.

The main ingredients of Chinese management that set it apart from other ways of doing business are of domestic origin: *guanxi*, family businesses, *mianzi*, holistic approach to time, the cult of harmony and sacrifice for the community.

The Serbian economy has great possibilities for doing business with China, both in the form of direct Chinese investment in Serbia, and in the form of

⁴¹ www.geert-hofstede.com, accessed: 2/7/2010.

⁴² In comparison with China, Serbia has the following indicators: PDI equals 86 (similar to China's, which is 80), individualism is 25 (in China it is 20, so we match up here as well, MAS is 43 (in China it is 66, meaning that they are a masculine while we are a feminine society), UAI in Serbia is very high – 92 (in China it is 40, which means that uncertainty is absolutely something to be avoided in Serbia, while in China it is accepted as a normal part of life).

domestic export to China. In order for this cooperation to take place in the right way, and so as to avoid misunderstandings in communication, our businessmen, as well as those working in state administration, must learn the basic norms of communication and negotiation with the Chinese.

The Chinese approach to management and business is different from other types of Asian management, such as the Japanese or the Korean. Although China is presently oriented towards foreign direct investments, the influence of Anglo-American management has not yet been reflected in their business practice, and traditional characteristics of doing business have been maintained.

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THE POWER AND IMPOTENCE OF CRISIS MANAGEMENT IN FACING MODERN CRISES

Abstract: *Crises are a constant of human social history. With the development of human knowledge, capabilities for coping with crises have been enhanced. However, at the same time, in the contemporary globalized, connected, interdependent hi-tech environment, in which all processes are accelerated, the very nature of crises is changing and they attain completely new attributes. Whether we call them modern or fundamental crises, they put crisis managers to a very serious test, revealing the limited scope of traditional thinking about crises, as well as the impotence and even counterproductiveness of classic tools of crisis management. There is a need for a creative multidisciplinary approach and a search for new answers for these new kinds of crises.*

Key words: *modern crisis, fundamental crisis, crisis management*

JEL classification: D74, H69

1. Introduction

The fact that crises and conflicts are a constant of social life is totally in accordance with Hegel's remark that "history is not the soil of happiness." The names and dates of great crises and conflicts mark entire epochs, and they have influenced changes of societies, cultures and civilizations. In spite of the fact that, at the beginning of the 21st century, human knowledge is multiplying quite rapidly and man's power over nature appears limitless, Ulrich Beck has warned that modern man is presently living in a "risk society," obsessively preoccupied with his security and very sensitive to the slightest sign of its imperilment. The crime against American citizens of September 11 has brought down the illu-

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sion of invulnerability of the great and powerful. Dialectic is being manifested through the twofold role of new, sophisticated technologies that, on the one hand, contribute to securization but, on the other hand, carry with them new possibilities for the occurrence of catastrophic events. From today's perspective, the consequences of some new technologies, such as, for example, genetic engineering cannot even be fathomed. The concentration of populations in large urban conglomerates and increasingly complex infrastructures are also increasing the vulnerability of communities to classic natural catastrophes. Finally, the contemporary world, although bound together more than ever in history, is still far from being a conflictless, harmonic community, as there are still deep structural gaps between the rich and the poor – as well as other types of divisions, on cultural, race, tribal, ethnic and religious bases – which produces a high potential for conflicts and clashes of various intensities and durations. In addition, power and wealth as the fundamental “values” of contemporary civilization, grounded in certain archetypal matrices of man as the master of nature, possessing absolute ontological priority, are leading planet Earth to the edge of destruction, which is testified by the modern challenges and threats from anything from nuclear holocaust to global warming and climatic changes that may usher in a new Ice Age.¹

The permanent refinement of weapons of war (billions of dollars per day are being spent globally on technologies of war)² and the constant threat of nuclear and ecological catastrophe have made the post-modern world into a “global risk society” (U. Beck), in which the activities of single countries dramatically affect populations outside their borders. This also applies to devastating crises such as natural catastrophes, international and internal disruptions in the supply of vital products and services, industrial and nuclear accidents, accidents on airplanes and ships, laboratory experiments that spin out of control, clashes and other social conflicts, terrorist attacks on prominent leaders and ordinary citizens, hijackings of trains, airplanes, ships, hunger and infectious disease epidemics. All these represent a serious challenge for social theory, as well as institutions of social control, in the first place the police and other security system actors. At the same time, these real and devastating events represent a challenge for social, political and ruling elites, and bring into question the philosophical, social and moral nature of political leaders, societies and the global community, causing changes whose intensity was previously unthinkable. Memories of the clashes in Brixton, the catastrophes of the Challenger space shuttle and Chernobyl, the sinkings of the Estonia and the Achille Lauro, the AIDS epidemic, etc., are accompanied by fear, sorrow and fury, but also questions: Why did that happen? Could catastrophe have been averted? Who is responsible? The answers

¹ S. Milašinović, Ž. Kešetović, *Krizni menadžment*, Kriminalističko-policijska akademija, Beograd, 2009

² For more, see: Milašinović et al., 2008

are often incomplete; proof is often not accessible for closer examination, while public opinion mostly tends to forget quickly.

Still, it must be said that our thinking on crises has evolved. The understanding of catastrophies and destruction as divine punishment³ has become more-or-less obsolete, although even today many Africans speak about AIDS in this manner. Rational-scientific explanations of causes, matrices and characteristics of crises are predominant in contemporary thinking.⁴ Regardless of that, crises and catastrophies will continue to surprise us in the future. It is time for these events to be taken seriously, time to learn from them and to apply new knowledge in order to avoid such events in the future, or at least limit their damaging effects.

Therein lays the meaning of the establishment of crisis management as a new field of research and scholarly discipline, which came about in Western countries mostly in the second half of the 20th century. The techniques and methods that have been developed within this discipline have chiefly shown themselves successful in the prevention and handling of classic (“normal”) crises. However, modern society, as an extremely dynamic environment in which only changes are constant and certain, has itself effected changes in the nature and character of modern crises, which are occurring under frameworks that are completely different from those of classic (“normal”) crises. A consequence of this fundamental change is the fact that tried and true responses to classic crises are not only becoming inefficient in countering modern crises, but are often even counterproductive. They are not a part of the solution but, in fact, become a part of the problem.⁵

In the said context, modern crises, which are fundamentally different in their essence, phenomenology and effects, represent a specific kind of challenge, both for scholars and researchers, as well as crisis managers and heads of administration, especially in police and other agencies responsible for rapid reaction, non-profit organizations and companies.

2. Classic and modern crises

The modern concept of crisis stems from medical literature, in which it denotes a dangerous state of health of an organism, from which it cannot recover without permanent damage, outside intervention or basic restructuring, as its defensive (immunological) mechanisms are not sufficient to pull it out of cri-

³ In his epochal work, *De Civitate Dei*, St. Augustine explained one of the greatest catastrophies of the old world – the fall of the Roman Empire – theologically, i.e. by the fact that Rome was an “earthly city” (*civitas terrena*) and not a “city of God” (*civitas Dei*) (Augustine, 1982).

⁴ A. Boin, C. Kofman-Bos, W. Overdijk, “Crisis simulations: Exploring tomorrow’s vulnerabilities and threats”, *Simulation & Gaming*, Vol. 35, No. 3, 2004, pp. 378-393

⁵ For more, see: Ž. Kešetović, *Krizni menadžment*, Fakultet bezbednosti – Službeni glasnik, Beograd, 2008

sis. Social scientists borrowed this basic medical metaphor in order to describe crises in economic, political, social and cultural systems. Although there is no consensus regarding its meaning, crisis is a very popular and broadly used term. It is even claimed that the term's popularity is causing difficulties in its definition. That is not surprising, since even those engaged in researching the crisis phenomenon do not consider themselves to be crisis researchers. The crisis field is badly defined, appearing as a confused mixture of scholars from various disciplines (sociology of catastrophe, public administration, political science and international relations, political and organizational psychology, as well as technical specialists such as computer scientists or epidemiologists). As to who is inside and who is outside, that depends on the person defining the field. Complicating things even further is the fact that the following terms are being used to denote various kinds of negative or dangerous events, often without a clear awareness regarding mutual relations and definition limits, and as absolute synonyms denoting the concept of crisis, especially in the English language:

- adversity, i.e. an extraordinary event caused by factors that are not under control, having as a consequence the imperilment of the lives or health of humans or animals, as well as material damage,
- an event that was not predictable (contingency),
- accident, denoting an event caused by the human factor, including technology, which extends beyond the limits of the technical-technological plant in which it occurred,
- major incident, which denotes any event that may cause death, injury, property damage, environmental changes or disruptions in the normal functioning of society, and whose activity and consequences cannot be prevented, mitigated or repaired by society's available means and capacities, and especially the terms,
- disaster, which denotes a catastrophe caused by natural factors, and
- An extraordinary (urgent) situation (emergency).

However, the meaning of these terms remains problematic, as well as the response (reaction) that they require.

There exists extensive literature on the topic of crisis and, thus, many definitions that partially overlap and partially diverge. Crisis is too complex a phenomenon to be easily defined. Adversity disrupts normal conditions and creates confusion, while specialized agencies are charged with restoring everything to a normal state. However, when adversity overcomes normal boundaries, we enter the world of crisis.

Since the phenomenon of crises has attracted the attention of a large number of researchers from various scholarly disciplines and fields (economy, history, politics, medicine, ecology, psychology, etc.), the concept of crisis itself, in addition to certain general characteristics (a situation that has reached a critical

point and a juncture leading to either a better or a worse outcome), is often used in quite specific meanings that are characteristic for different fields of research. Thus, psychology talks about crisis of personality, medicine about crisis as the culmination of severe disease (or crisis in a country's health system), while ecology refers to a critical endangerment of the environment. Even within the framework of the same scholarly discipline, e.g. economics, there are differences in the way the concept is used; thus, macroeconomics talks about crisis as a reversal in a previously regular economic trend cycle, while microeconomics talks about it as an endangered state of a company or an individual economic actor.⁶

As a part of efforts to harmonize differing perspectives, the term "crisis" is usually used universally, i.e. as a concept that encompasses all types of negative events. Within a still broader scope, the term crisis is applied to situations that are undesirable, unexpected, unpredictable and almost unthinkable, which produce disbelief and uncertainty. Referring to the numerous definitions in the International Encyclopedia of Social Sciences, James Robinson concluded that they are either overly precise and specific and, thus not broadly applicable to different situations, organizations and actors, or too broad, i.e. borderless in their meanings, which makes it hard to distinguish between crisis and non-crisis.

Paul t'Hart has given a contemporary definition of crisis, saying that it is "an unpleasant event challenging decision-makers to respond under conditions of hazard, time constraint and unpreparedness." Crisis is "a serious threat to the basic structures or fundamental values and norms of the social system that, under conditions of time pressure and very uncertain circumstances, demands the making of critical decisions." This definition has two important characteristics. It is claimed that one of its distinct advantages is that it can be applied to all sorts of disruptions (ecological threats, breakdowns of information-communication systems, economic crisis, intrastate conflicts, prison mutinies, regional wars, factory explosions and natural catastrophies). The characteristic itself demands a multidisciplinary approach in understanding crises. Second, this definition directs our attention towards decision-making – crises are viewed as opportunities to make critical decisions.

A classic crisis was a devastating event causing death, serious injury or some other form of damage. It was a clearly defined event, with a relatively clear beginning and end, cause of destruction and victims. Such events continue to happen and continue to cause damages and despair. However, their causes are now much better understood and their consequences much smaller due to the existence of complex organizations that deal with them on a routine and professional basis. Classic crises have become routine crises that fall within the boundaries of acceptable risks of modern society.

The modern crisis is totally different from events that are usually studied under the concept of crisis. It has *endemic* characteristics: the modern crisis is

⁶ Ž. Kešetović, *ibidem*

a logical correlate of increasingly complex systems that, out of technological, financial or political reasons, cannot keep pace with the demands of security. The modern crisis is, by its nature, *complex*: it consists of new combinations of known crises that point to solutions which, however, show themselves to be the sources of escalation. Moreover, modern crises have a tendency of *self-perpetuation*, the process turns into a charmed circle that feeds on uncertainties regarding causes and causal chains. There is no return to normalcy, as future crises reappear in changed forms. The terrorist attack of September 11 is an example of a modern crisis. It quite clearly showed that future crises will greatly differ from those we know today. The modern crisis is a product of the society in which we live. The development of new technologies, globalization, demographic changes, the media society and the expending of natural resources are just some of the forces that will shape new and incomprehensible crises in the near future. As to whether these future crises will also become catastrophies that will partially depend on our ability to develop societal capacities for institutional crisis management.

The modern crisis is also a result of our values and ways in which we perceive threats. Ulrich Beck pointed out that, more than threat of destruction, today's risk society is characterized by an obsessive fear of security threats.⁷ It is also a logical consequence of dominant trends, such as transnationalization, mediatization, technological development and declining state authority, which have greatly shaped and continue to shape our society.

More and more, crises are being defined in *transnational* terms. We have already grown used to the global scope of developing disasters: two world wars, worldwide economic recession and current ecological trends demand a global outlook. Problems may at their source be local or national, but direct or long-term consequences of catastrophies and crises spread over countries and continents. The largest number of great catastrophies and crises of the past decade already point to the significance of this transnational dimension. Until the Chernobyl catastrophe, the catastrophic scenario for nuclear power plants was nationally bounded, with international consequences subordinated to national preoccupations. However, the spread of the radiation wave from Chernobyl, which caused great damage in many countries of northern and Western Europe, highlighted the cross-border risks and consequences of modern crises. Following the breakup of the USSR, one of the Western countries' greatest worries has been the very bad state of nuclear plants in Russia and other East European countries.

Crisis may spill over from a local region into the international arena but, more than ever before, they can represent partial manifestations of problems that are by their nature global. The most conspicuous examples are ecological trends (depletion of the ozone layer, global warming, and acid rains) that are expanding and, according to some experts, endangering the survival of the planet, requiring international action and the investment of huge resources. At the same time,

⁷ U. Beck, *Risk Society: Towards a New Modernity*, Sage, London, 1992

the planetary nature of the problems is generating substantial insecurity. Negative effects that used to be constrained to national borders, such as the endangering of the environment and economic stagnation, are increasingly affecting the political and social situation in neighboring countries. In Africa, mass migrations and waves of refugees reflect the artificial nature of state borders that came about as a result of conflicts. Chemical accidents, air pollution, computer crime, monetary crises and viral diseases also do not respect national borders.⁸

A subjective view of catastrophe and crisis can be summed up in a version of the Thomas theorem: "If a man defines a situation as a crisis, it will be a crisis in its consequences." When citizens or the authorities define or proclaim a difficult situation as a catastrophe or a crisis, it can decisively influence the further course of events. Labeling a situation as a crisis can produce exaggerated vigilance and exaggerated reactions, from collective stress to the making of key decisions on the part of the competent authorities. On the other hand, it may also demand collective energy and the activation of rules of procedure in emergency situations, as well as norms required for effective crisis and catastrophe management.

The modern crisis has its own version of the Thomas theorem: If CNN defines a situation as a crisis, and then it will truly be a crisis in all its consequences. The media have become one of the key forces that rule the world of crises, linking the spot at which the crisis originated with the rest of the world.

The media have a tendency to give extensive coverage to two categories of events. First, they are interested in an ominous perspective and ongoing megacatastrophies with a great number of potential or actual victims and great physical damage. Second, the media show special interest in typically subjective categories of crises, marked by frenzy, panic and collective stress, which can weaken the normative structure of society.

The sudden and ever more rapid *development* of information-communication *technologies*, satellite communications and the Internet has contributed to a dramatic change of our perception of temporal and spatial limitations. This technological progress has consequences both for the causes and the characteristics of crises. For example, our technological systems have become so sophisticated and compressed that even a small glitch in their functioning can cause a breakdown of the entire system. Technology has become so complex that its users often do not understand how it works, which makes discovery and correction of errors in functioning more difficult. The successful design of technological systems requires a tight linkage of elements, which increases the chances of a chain reaction. This explains why an error on a valve and a broken warning light may together lead to a nuclear accident.

⁸ Another candidate for future crises are certainly biotechnologies, since it is only a matter of time before experiments with creating new organisms get out of control. - E. Quarantelli, "Another Selective Look at Future Social Crises: Some Aspects of Which We Can Already See in the Present", *Journal of Contingencies and Crisis Management*, Vol. 9, No. 4, 2001, p. 234

The development of these immanently high-risk technologies also influences the potential scope of crises. This applies to supper-carriers in the transport industry – from the Estonia ferry disaster with almost 900 victims in September 1994, to modern airplanes with capacities of 600 to 800 passengers – as well as to incidents in nuclear power plants. Increasing dependence on computer systems is making our social and economic systems more and more vulnerable. And they themselves are threatened by hackers and cyber-terrorists.

The wholly new dimension of high-risk technologies directs our attention to the area of medical technology and genetic manipulation. The consequences of this development will not be comprehended until several generations pass, but their influence may be irreparable. This kind of development may profit from the growing discrepancy between mega-science and the knowledge or understanding of those who make political decisions.

In the Western world, *the role of the state has declined* during the past few decades. Instead of the usual prerogatives held by the civil authorities in times of crisis, today's definitions of the tasks that the public authorities should perform in order to prevent crises, prepare for them or fight them, are pretty unclear and problematic. This political and administrative trend has consequences on the causes, characteristics and consequences of crises.

To the declining role of the public authorities should be added the increasing tendencies towards saving and managerism. Namely, as a result of crises of their performances, budget overruns and falling legitimacy in the eyes of the public, new governments that have adopted as their creed the doctrine of New Public Management have been elected in Western countries. Among the means undertaken to "achieve more with less" were spending reductions and reevaluation of priorities. Another means was improvement in public management. In an atmosphere of saving and reform, the measuring of prevention or reductions of potential crises received less attention than an already existing problem (which could be labeled as an endemic crisis of public administration). Declining resources affect the numbers of personnel, maintenance activities, repairs, tests and training, planning – in short, many factors that might cause a crisis through interaction. Since it is much harder to quantify the benefits from the activities of crisis management than the costs it demands, it is probable that such activities are underestimated, which may further lead to a reduction in funds allocated for this purpose.

A significant counter-development is the growth in the number of participants now entering the crisis arena: private companies are augmenting the traditional but declining role of the state. In other words, responsibility for crises is becoming divided between public and private actors. For example, public safety is increasingly dependent on private security companies. Crises in large organizations have become an almost exclusive domain of managers-consultants. It has become understood that government actors can be a significant cause of public and private crises.

When a crisis occurs, the public turns to the public authorities expecting decisive action, momentary alleviation and long-term leadership. The public authorities are caught between their limited abilities to secure effective crisis management and an increased readiness by a portion of the public to review the government's actions and assign it guilt when it deems it necessary. In times of crisis, critical stances toward the government and its actions can quickly translate into falling legitimacy. Loss of support is not only connected to what the public authorities have done during the crisis: it also lowers the ambitions of the public authorities related to the prevention of future crises. The role of the public in the crisis arena becomes a part of the charmed circle.

Arjen Boin and Patrick Lagadec have given a very interesting comparative overview of classic (traditional), modern and future crises.⁹

Characteristics of traditional crises

- A known, isolated event, within the framework of conventional hypotheses;
- The situation is perceived as manageable (technically, economically, socially);
- Costs are relatively easy to calculate, while recovery is possible in the context of already tried systems;
- Limited duration;
- Codified intervention procedures with which specialists are well acquainted;
- Limited number of interveners, all of whom are specialists for one aspect of the problem;
- Clearly defined roles, responsibilities and hierarchy, known to the agencies of intervention.

Characteristics of the modern crisis

- Great consequences (effects), affecting a large number of people;
- Large economic price, overwhelming the capacities of classic insurance systems;
- Without precedent (new), generic and combined problems that affect vital resources;
- An avalanche-like dynamic due to multiple resonating phenomena;
- Poor response on the part of emergency systems, obsolete, inapplicable, even counterproductive procedures;
- Extreme uncertainty, which does not lessen during the entire crisis period;
- Long duration, with threats that change over time;
- Convergence, i.e. a large number of actors and organizations appear on the scene;
- Critical communication problems: with responsible organizations, the public, the media, victims;
- Significant dangers of all kinds.

⁹ Boin and Lagadec, 2000, pp. 185-191

Characteristic of future crises

- Existence of a pre-crisis and a post-crisis time, with irreversible change;
- Breakdown not caused by a single specific event, with a global resonance of various forms;
- Basic procedures, as well as those that are usually not questioned, are no longer applicable: e.g. fundamental principles, identities, contexts, actors, rules of the game, defense mechanisms, knowledge – all these tools must be reconsidered and problematized;
- Breakdown brings repeated, increasingly frequent crises that suddenly crystallize, occur and disappear in a seemingly incomprehensible and random manner;
- Strongly and deeply rooted in the system's imbalance, breakdowns are even more resistant to conventional treatment;
- Since “decomposition” is the most conspicuous, the prevailing impression is that of a general process of decoupling, of disintegration that is almost impossible to stop;
- Breakdown permeates the entire field of operations. Fundamental problems react in concert, preventing all isolated treatment. There is a sense of loss.

Similar in many elements to the concept of modern crisis is the concept of *fundamental crisis*, which was introduced into the scholarly arena by Stephan Gundel who, in attempting to construct a new typology of crisis, started from the criteria of manageability and predictability. These crises are the most dangerous kinds of crises because they are unpredictable and because it is impossible, i.e. very difficult to influence them. Responses to them are unknown or insufficient, and because they appear suddenly and/or are incomprehensible to the actors, it is practically impossible to prepare for them. Crises of this type are rare but, due to their combination of unpredictability and limited or total absence of possibility to influence them, they are potentially extremely destructive. The problem does not only lie in the fact that it is impossible to evaluate all the parameters necessary for preparing for such crises – before all time, place, probability or countermeasures – but also in the fact that there is also a high degree of uncertainty on the part of the experts. While conventional or unexpected crises occur as spatially-temporally isolated events, fundamental crises often begin suddenly but last a long time, undergoing changes in the process. Due to the breadth and duration of the crisis, in the majority of cases with an international dimension many organizations, communities or individuals enter the scene as victims or rescuers.

In addition to unexplainable natural and technological catastrophies, social crises also find their place here. The most frequently cited example is that of the terrorist attacks against the US on September 11, 2001, an event based in an astounding criminal intention and planned in detail, difficult to predict due to its unusual staging and secret preparations, and almost impossible to influence due to the irreversible effects of the attack. Future fundamental crises can grow

out of the use of genetic engineering, a relatively uncharted field that carries dangerous risks and unexplainable future development.¹⁰

3. Managing modern crises

The settled way of dealing with crises was directed toward recovery through a combination of flexibility, improvisation and ingenuity of individuals, groups and society. Over time, both practitioners and scholars have tried to encompass the best practices of crisis management within standard operating procedures, checklists, organizational structures and job descriptions. In an important sense, crisis management has become standardized.

However, the changeable nature of contemporary crises has direct implications on crisis management. Namely, the administrative repertoire of strategies of prevention and intervention is not adequate for contemporary crises, which are increasingly complex and interdependent. Moreover, the conventional organizational model of coordination is inadequate for interaction with the proliferating multitude of organizations and individuals engaged in the process of crisis management. The increasing politization of the crisis process is placing new demands before crisis managers. The traditional strategies of crisis management – confidentiality, executive privilege, closedness – are losing ground under conditions in which an awakened public wants to know details. Judicial procedures will follow the search for causes and instigators. Increasing competition among various media will further strain the capacities of crisis authorities to gain support for the preparation and strategy of intervention. In short, the new crisis demands a new way of thinking.

Future crises will demand preparations that will encompass strategies directed towards recovery, as well as those based on anticipation. If there is agreement about the fact that recovery is the key for dealing with future crises, it is necessary to organize for that recovery in an adequate way, i.e. facilitate a quick, flexible, innovative and effective response when a future crisis occurs.

As crises become more and more complex and transnational, the need for elasticity in relation to prevention will also grow. Of course, the chances for the occurrence of “routine crises” could and should be minimized, on the basis of general knowledge and specific lessons learned from earlier crises. However, putting an exaggerated accent on prevention leaves the social and political system exposed to effects of new forms of crises. Thus, the balance between prevention and elasticity represents a real challenge for crisis managers.

The preparation of preventive measures and the planning of activities to be undertaken in case of crisis were for a long time in the domain of responsibility

¹⁰ S. Gundel, “Towards a New Typology of Crises”, *Journal of Contingencies and Crisis Management*, Vol. 13, No. 3, 2005

of managers and mid (meso) level operative agencies. Work in this field had the characteristics of bureaucratic routine far removed from the hurry and conflicts characteristic for “high” politics. The new context of risk and crisis management is totally different. The perspective that fits the new forms of crisis management emphasizes socio-psychological challenges and assumes the existence of great media attention, which inevitably carries the event into the political arena. In that context, the very labeling of certain social circumstances or concrete events with the term “crisis” becomes a political act. As a result, it is no longer a routine bureaucratic job but a challenge for political leaders and the highest management.¹¹

However, crises in general, and modern ones in particular, create situations that cannot be predicted and which demand responses that are not programmed. The main challenge does not lie in tactical problems but in the very survival of activities, i.e. of the institution itself. Therefore, the highest management of the organization must take the helm in a very foggy environment. They must determine key goals, reorganize priorities, rethink their relations with stakeholders, clarify their communication strategy – in short, they must secure the cement that keeps the organization intact. Managers often see this as the task of personnel responsible for security rather than their own. Since the matrix of future crises is unknown to them, they tend to apply the classic model in the new context. However, future crises carry new challenges with them. Managers take on risk if they do not stop some of the regular activities that have an effect on the crisis. At the same time, they risk their jobs or companies if they halt these activities without strong reasons (in which they are not and cannot be certain), which means that all this resembles the piloting of an airplane in the midst of a tornado. They have to be trained to anticipate the disappearance of given, basic rules, to sketch a new vision, to recombine stakeholders into new coalitions, to avoid key errors in communication and decision-making. According to Arjen Boin and Patrick Lagadec, the imperatives that may help an organization prepare for the unknown are the following:

Secure the awareness of the highest management – the first and necessary step is to place the problem of crises and breakdowns on the agenda of the highest management. Their awareness can be developed through workshops and simulations devoted to new crises and the decision-makers’ new responsibilities. The goal is to build new attitudes: toleration for open, joint consideration

¹¹ Of course, crisis management must not remain the exclusive domain of government officials. As experience has shown, in many crisis management cases, government officials and their agencies would not have achieved results without the aid of intermediary organizations. In the phase of acute crisis response, emergency response groups compensate for the lack of leadership from official sources. For the legitimization and implementation of difficult decisions, crisis managers require the support of voluntary associations. The resources of private corporations can serve as a vital complement to public agencies. - Boin, A. – t Hart, P. – Stern, E. – Sundelius B., *The Politics of Crisis Management – Public Leadership under Pressure*, Cambridge University Press, Cambridge, 2005

of possible and uncertain situations; thinking about the decision-making process in the absence of clear knowledge; understanding the need for internal and external communication in situations of uncertainty or total ignorance over an extended period of time; managing complex systems by adapting the coexistence of conflicting logic.

Development of adequate operative capacities – in order to facilitate recovery, the following organizational capacities have to be developed:

- The ability to follow and notice unusual signals and signals of weakness;
- A system of providing crisis information able to process relevant information to and from central organs of management;
- An ability on the part of organizational units responsible for crisis action to alarm and mobilize all employees, with the support of all parts of the organization;
- An ability to act in the technical sense after the first alarm: all actors must be prepared to solve technical and strategic problems in complex and uncertain circumstances;
- An ability to act in case of crisis decentralization: securing such organizational structures as to enable the greatest possible number of actors to have access to the system capacities that are to respond to the crisis.

Engagement in continual preparations – experiences, earlier research and contributions in this field point to several signposts toward effective preparations: continual application of experiences from practice. Each crisis episode should be precisely analyzed in a constructive spirit in order to identify and understand a series of events that occurred at the beginning and in the course of the crisis. Direct lessons should be drawn immediately, which means that the analysis should also cover the functioning of the decision-making support system. In that sense, international exchange of experiences is especially useful.¹²

- *Tests and simulation training* – it is necessary to prepare a continual training program, not just for well-known crises but also for destabilizing surprises. Two types of tests should be developed: very short, for the purpose of creating mobilizing reflexes among teams and more complex, in order to develop polymorphic abilities that will be necessary for managing during times of crises.
- *Training* – it is very important for different managers to undergo appropriate types of training. Since their mandates and responsibilities differ, so should their preparations. We are talking about managers who have

¹² After an ice storm destroyed the electrical power grid in southern Quebec, Canada, in January 1998, the French electrical company EDF (Electricité de France) sent a team to study the problem and the solutions applied by the Canadian government agency Hydro Quebec. Less than two years hence, France was hit by two consecutive storms that destroyed a part of the electrical power grid. EDF reacted quickly, as the nature of the problem was immediately clear to them, as well as key mistakes that should be avoided.

a key political role during crises; managers in crisis organizational units who will be running complex systems; spokespeople; experts who will be moved from their laboratories to face TV cameras in order to give their expert opinions.

- *Learning among the actors themselves* – since crises are processes that are happening between complex networks, it is necessary to expand the learning process to the outside world: meetings, learning from experience, investigating unpredicted vulnerabilities – all these are mechanisms that should not be limited only to the inside. A continual expansion of the circle of included actors is necessary.
- *Personal inclusion of members of the elites* – since crises affect the fundamental elements of the mission of the organization and its structures, nothing serious can be accomplished without the permanent inclusion of the leaders of the organization. The entire situation around the preparations and the learning process changes when the “chief is also on the inside”. That, however, requires the overcoming of the rooted conviction that persons in high positions within the organization should not learn about crises and crisis management and that they should not participate in crisis simulations.
- *General preparations for intervention* – spectacular plans and projects that are not realistic and are hard to apply drain energy, budgets and good will. It is necessary to gradually engage resources and introduce tests, while continually including more and more actors.
- *Mastering key processes* – in uncertain situations, solutions must be based on a deep understanding of the organization’s internal functioning. In today’s world, when managers typically possess general and not specialized knowledge, crisis preparations should also encompass the methodology of project management.¹³

Also interesting are the suggestions for facing fundamental crises that Stephan Gundel gives to managers. He is conscious of the fact that it is hard to give recommendations about how to fight against fundamental crises or even how to prevent them because most significant future events are unknown and often impossible to predict. Organizational preparedness and rules of security must function under conditions of a high degree of uncertainty, which is a serious problem, the more so since countermeasures can have undesirable side effects. Thus, the most important task that is being set is the forming of expert groups for all possible future crises, with the task of exploring appropriate countermeasures (Gundel, 2005).¹⁴ Mitroff and Alpaslan have given some advice regarding how to

¹³ Boin and Lagadec, 2000, p. 186

¹⁴ S. Gundel, “Towards a New Typology of Crises”, *Journal of Contingencies and Crisis Management*, Vol. 13, No. 3, 2005

facilitate the work of these groups or other managers that deal with fundamental and abnormal crises within organizations. According to their observations, randomly chosen models of various crises and their combinations, so-called internal assassins or spy games and the exchange of experiences with managers from other companies can open the way to efficient planning and preparations for still-unknown future crises (Mitroff, and Alpaslan, 2003). Even though these concepts are undoubtedly useful, preparations are not enough if nothing is done beyond them, since some probable future fundamental crises will demand expert knowledge and scientifically proven countermeasures, which is an almost impossible challenge for managers in crisis-prone companies. Thus, the significance of expert knowledge in expert groups should not be overestimated, either.

Regulatory rules must be in place in early phases – e.g. those related to preventing illegal weapons trading as a component of terrorism. However, the essence of the problem is often unknown, or the problematics are such that it is impossible to regulate them with rules or, on the other hand, detailed regulations may in fact prevent the desired technological progress.¹⁵

The complexity of contemporary crises makes it more difficult for managers to evaluate the true nature of a crisis. The crisis manager is constrained by the essential complexity of the conditions and characteristics of an undeveloped crisis, as well as by the uncertainty of results. According to Turner, uncertainty of response may be a product of “an initial lack of information or a wrong initial classification, or due to a change in the nature of the incident itself in the course of its development”.¹⁶ The resulting disharmony between the definition of the situation and its current characteristics undermine the crisis response. Crisis managers believe that they are solving the crisis, while a careful analysis of the situation shows otherwise. Crisis managers usually need a certain amount of time to adjust their definition of the situation.

Crisis managers fluctuate between direct action and long-term effectiveness. Traditional repertoires of crisis management are marked by a preoccupation with the “here and now” – i.e. with acute threats that should be dealt with. The consequences of initial decisions pale in the background of ongoing events. However, the modern crisis is more a long-term process than an event. Long after a crisis has begun, crisis managers are faced with problems that may take on the shape of a “crisis after a crisis.” For example, a relatively minor incident such as an oil spill or a gas leak may have long-term effects that are more difficult to manage. Such crises do not fit into the traditional repertoire of crises. The consequences of today’s crises tend to be lasting and intensive, just as during an acute crisis,

¹⁵ For example, if someone wishes to control the dangerous development of genetic engineering, strict supervision or legal provisions are a better way of preventing fundamental crises than the prohibition of genetic engineering in its entirety, which would probably prevent medical progress or channel a part of these activities into illegal waters.

¹⁶ B. A. Turner, *Stepping into the Same River Twice: Learning to Handle Unique Management Problems*, Middlesex University Inaugural Lectures 2, 1992, p. 10

while leaders are under the pressure of informal investigations, provocative journalism, insurance-related demands and legal (including criminal) proceedings that are initiated against them.

4. Concluding remarks

By the nature of things, response to a crisis is a serious challenge, since uncertainty is one of its basic characteristics.¹⁷ A crisis demands critical decisions that must be made in extremely unfavorable circumstances, at the same time generating obstacles to the process of quality decision-making, while the usual everyday problems exponentially multiply. All this is multiplied thanks to the nature and character of modern crises. Crisis managers must solve complex dilemmas without the information they require in an unstable organizational environment and under conditions of serious stress. If one were to review the dilemmas that come about in the course of crises, crisis management could be deemed an impossible job. For example, as early as the initial phase of the crisis, the crisis manager must decide whether he is in fact dealing with a crisis or merely with a signal of a coming crisis. From limited and fragmented information he must conclude whether he is dealing with the entire story or only its beginning. That dilemma has as its consequence the distribution of resources: should all resources be directed toward what appears to be the beginning of the crisis, or should one wait until a more comprehensive picture of the situation is gained. That dilemma becomes even sharper during so-called conflict crises.¹⁸

Under circumstances marked by intense emotions it is not possible to make an impartial diagnosis of what has happened. Crises are most frequently treated as results of political mistakes. Under such circumstances, post-crisis investigations are less concerned with learning and more on placing blame (the so-called blame-game). Journalists and ordinary citizens think that someone should be held responsible for the errors and deficiencies that led to the crisis. Politicians know that and respond by way of improving their defense routines, such as searching for plausible denial and improving their public communication skills. The more time is spent on these mechanisms, the less is left available to leaders to make use of the potentials of the bygone crisis for learning purposes.

The above characteristics of modern crises show that they are a challenge par excellence for contemporary managers, exposing the content and organizational deficiency of the classic crisis management repertoire and philosophy, and putting to a serious test the abilities of individuals, teams and entire organiza-

¹⁷ Ž. Kešetović, *Krizni menadžment*, Fakultet bezbednosti – Službeni glasnik, Beograd, 2008

¹⁸ For example, war and terrorism are accompanied by disinformation campaigns, sudden attacks and multiple arenas.

tions. However, they must accept the challenge and achieve the broadest possible cooperation and partnership in the search for creative responses, since the acceptance of the fatalistic alternative of leaving oneself to fate would mean an admission of one's own powerlessness and a return to premodern ways of dealing with crises as products of Divine will.

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TRANSNATIONAL COMPANIES – A GLOBAL EMPIRE

Abstract: *Owners of big capital have the power to create the market and convince consumers that it is exactly their products and services that they need. They are the “transnational elite”, a global empire. On their chess board stand all: TNCs, states, science and technology, government and nongovernment organizations, and world public opinion.*

This paper has two goals: first, to offer a statistical survey of available data on transnational companies and the GDP of certain states; second, using a comparative method to demystify transnational companies and their role as planners and creators of a global empire, i.e., their genesis, work method and mutual interactions, as well as interaction with certain states, intergovernmental organizations and certain interest groups. By the method of content analysis, insight was gained into theoretical, normative, curricular and other literature related to the research topic, allowing the collection of relevant data on numerous aspects of the investigated phenomenon.

Key words: *transnational companies, global economy, World Bank, International Monetary Fund, World Trade Organization*

JEL classification: F23, E01

1. Introduction

It would be hard to believe, at the beginning of the 21st century, that there is anyone living anywhere in this world covered with radio and TV signals who has not heard of one of the following companies: Coca-Cola, Nike, Microsoft, Samsung, Nokia, McDonalds, etc. Hidden behind the glamorously packaged advertisements that propagate improvement in overall quality of life on our planet are global monopolies and an eternal race for ever growing profits.

The motto “capital knows no fatherland” was not launched, as is usually thought, by neoliberals during the 1980s. Guided by centuries of the experience (i.e., fabulous profits) of the English crown, which invested in opium production

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in India and its placement on the Chinese market, the said motto was invented by elite bankers, owners of big capital, when they decided to destroy imperial Russia by financing the Bolshevik revolution. They subsequently repeated this while arming Hitler, pushing humanity into a world war, and always repeat it when in fear that their carefully concocted plans for making profit or achieving geostrategic comparative advantages on “controlled” territories will in any way be jeopardized (Panama, Lebanon, Iraq, Kuwait, Yugoslavia, Afghanistan, Iran, etc.).¹

The world as we know it today is shaped by the big capital in possession of financial and non-financial transnational corporations, capital that uses the sovereign state only for protection, i.e., a place for securing legality of work, capital for which intergovernmental organizations (UN, IMF, WB, WTO) serve only as levers of pressure.

According to the latest available aggregate data, about 78,000 such companies were identified in 2006, with available assets of over 51 trillion US dollars, total sales of 25 trillion dollars and 73 million employees – compared to the aggregate GDP of all the world’s countries for that year of 48.504 trillion dollars. According to the latest published data on a group of 2000 global companies, just the top ten non-financial transnational corporations ranked by total sales realized 2.533 trillion in sales in 2007, which is more than the aggregate BDP of 161 countries according to IMF data for 2008. At the same time, the assets of the 30 largest financial transnational corporations (from the same group of 2000 global companies from 2008) amount to 48.883 trillion dollars, or more than the world’s 2007 GDP.²

2. The concept and origins of transnational corporations

Transnational corporations³ are the basic agents of the globalization process. Through large financial investments, transfer of existing or new technologies and the starting of new production processes in various countries, they achieve

¹ According to: T. Petković, *Poslovna špijunaža i ekonomsko ratovanje – globalna ekonomija i ekonomska diplomatija*, second edition, Protexi Group System, Novi Sad, 2009, p. 243

² T. Petković, *Globalna ekonomija i poslovna diplomatija*, School of Business and Professional Studies, Čačak, 2009, pp. 148-149

³ The term *transnational corporation* was launched by the United Nations Organization and has been in use since the 1980s, as distinct from the term *multinational corporation*, which IBM launched in the early 1960s. The basic difference in these terms lies in the founding capital, i.e., the management share package: with multinational companies, the capital is national, while that of transnational companies is of global origin. According to: T. Petković, *Globalna ekonomija i poslovna diplomatija*, School of Business and Professional Studies, Čačak, 2009, p. 129. The abbreviation TNC will be used in further text, out of practical reasons.

their strategic goals, which can be exclusively economic (in the profit-making sense) or geopolitical (in the sense of creating global power).⁴

According to a general definition, a TNC is a company founded in a home country, which does business in a number of national economies through its foreign branches,⁵ with the aid of which it can round out a certain business process (concern) or engage in various businesses (conglomerate). Representative offices in other countries opened for the express purpose of distribution of merchandise are not considered to be TNC branch.

The essence of the success and expansion of TNCs is basically quite simple: they disperse production in search of low costs (cheap labor and rich, still unexploited natural resources), and then efficiently integrate it through their international network, thanks to their low transportation and telecommunications costs.⁶ For these companies, there are no transport and customs barriers, nor barriers in terms of standards – “one can produce and sell anywhere on the planet.” Production takes place where production costs are the lowest; sales are achieved where the biggest profits can be realized, while profits are booked where taxes are the lowest.⁷

2.1. Origins of TNCs

The beginnings of the modern TNCs can be traced to the conquests of the British Empire and the appearance of the British East India Company,⁸ which began its economic penetration of India in the 18th century, where it established

⁴ I. Đorđević, “Globalization and Economic Underdevelopment”, *Megatrend Review*, Vol. 3, No. 2, 2006, pp. 139-161

⁵ In contemporary terminology, the terms *branch and affiliate* are used, denoting the property of the home TNC in another country. Branches are created as newly-opened representative offices, while affiliates are companies that already exist in another country, which have been taken over by the TNC, through the purchase of the controlling share package. According to: T. Petković, op. cit., 2009, p. 140. As precise data are lacking regarding the relation of TNC branches and affiliates, we shall use the term branch in further text, which will apply to both.

⁶ According to: D. Tvrđišić, *Transnacionalne organizacije i bezzavičajnost*, <http://www.pravoslavljje.org.yu>.

⁷ National income tax laws do not represent a barrier for TNCs, since they can book their investments as credit and, through intra-corporate transfer prices, significantly change the tax base level. In the end, they can always found parent companies in “tax haven” countries – countries whose laws or lack thereof allow the creation of off-shore financial centers, where taxes and other dues can be avoided and which are thus, favorable for engaging in various opaque financial transactions.

According to: T. Petković, *Poslovna špijunaža i ekonomsko ratovanje*, Public Triton, Vršac, 2006, p. 213

⁸ Even at that time, the company’s profits far outstripped the combined annual profits of General Motors, Ford and Chrysler in their best years. According to: J. Coleman *The*

its strongholds. Its private ownership over vast tracts of territory was eventually incorporated into the British Empire. A similar role was played by the Hudson Bay Company in North America and the Royal African Company in Africa. For example, Congo was initially ruled by a private company, whose main shareholder was the Belgian king himself.⁹

Modern TNCs came about on the territory of the US as a consequence of expanding economic activity, new technologies, communication development and the narrowing of the domestic market due to increased internal competition, and as a result of the appearance of foreign competition. Namely, years of ideological drum-beating about the American democratic and consumer society brought a large number of companies into the market game, leading to falling prices as a result of the fight for product placement, which, in turn, led to a turning to foreign markets in search of profits. This brought on a new question: how will a sovereign state react to a foreign company? The answer lay in opening a company on the territory of that sovereign state, which would be under the control of the parent company while also being a part of that state's economic system. This approach led to a veritable explosion in FDI,¹⁰ i.e., to an enormous outflow of funds or technology transfers to locations worldwide.

Other developed countries followed in the footsteps of the US, multiplying the number of both TNCs and their branches.

Conspirator's Hierarchy: The Committee of 300 (Serbian translation: *Hijerarhija zaverenika: KOMITET 300*, Narodna knjiga Alfa, Beograd, 2005, p. 103).

⁹ According to: V. Dimitrijević and M. Stojanović, *Međunarodni odnosi – osnovi opšte teorije*, Nolit, Beograd, 1979, p. 132

¹⁰ Foreign direct investments (FDI) are, according to M. Vidas-Bubanja, defined as all forms of capital investment into a certain company abroad, through which ownership control is attained over the company. Lipsey defines them as capital invested in real estate or profit reinvestment, or connected in some other way with various inter-company transactions. Generally speaking, FDI denotes ownership of assets of an economic entity in another economy. The dominant definition of the subject of direct investment provided by the IMF and adopted by the OECD avoids mention of investor control in favor of a much more ambiguous concept. "Direct investment is a category of international investments that reflects the goal of an actor in one company to achieve a lasting interest in a company with a seat in another economy (the actor is the direct investor, while the company in another economy is the company of direct investment). Lasting interest implies the existence of a long-term relationship between the direct investor and the company and a significant degree of influence on the part of the investor in managing the company."

According to: R. Lipsey, *Foreign Direct Investment and the Operations of Multinational Firms: Concepts, History and Data*, Working paper 8665, National Bureau of Economic Research, Cambridge, 2001

3. The power of transnational companies

The fact that, in their business strategy, TNCs view the entire world as an economic whole, lays bare the full power of TNCs. Their comparative advantage lies in the fact that they are supranational entities that are able to organize their production cycle in such a way as to minimize production inputs and significantly increase outputs. They achieve this by carrying out activities such as sales of products and services, product servicing, legal affairs and public relations on a strategically determined and targeted national market, while everything else, including production, distribution, marketing, business financing, development-planning functions, price policy and management, and international tax planning for the entire TNC is done centrally, from a single place.

TNCs base their business on production, services and big finance (banking sector). Thus, we can talk about *financial* and *non-financial* TNCs.

In both cases, huge capital is engaged. Within UNCTAD,¹¹ the UNO has organized a special commission that monitors all accessible data on TNCs, issued through the WIR.¹² According to the data for 2006, about 78,000 TNCs were identified, with more than 780,000 branches and 73 million employees, assets of over 51 trillion US dollars and total sales of about 25 trillion US dollars.¹³ For comparison's sake, the estimated GDP for all the world's countries in 2007 amounted to 54.395 trillion US dollars.¹⁴

If we consider only the Fortune 500 global companies (Table 1), we will see that in 2008 they achieved sales of 23.618 trillion US dollars and that, among individual states, the US had the most companies on the list (153). However, if we take into consideration the single EU market, then we can see that there were 182 companies from that region on the list (the table shows Europe but, as Switzerland and Turkey are not a part of the EU, their number is not 197 but 182).

¹¹ United Nations Conference on Trade and Development

¹² World Investment Report – issued annually by the United Nations Conference on Trade and Development, which, along with the “Fortune 500” and the “Global 2000” is the basic source of the data on which this work is based.

¹³ Source: UNCTAD: *Development and Globalization: Facts and Figures 2008*, United Nations, Geneva, 2008, p. 30

¹⁴ Source: International Monetary Fund, World Economic Outlook Database, April 2008

Table 1: Overview of the number of companies and their home countries from the "Fortune Global 500" in 2008

Country	Number of companies	Percentage of total %	Total revenues in mil. \$	Total revenues (in %)
USA	153	30.60	7,738,909	32.77
Japan	64	12.80	2,596,697	10.99
France	39	7.80	2,110,283	8.93
Germany	37	7.40	2,084,790	8.83
Great Britain	34	6.80	1,748,913	7.40
China	29	5.80	1,144,331	4.85
South Korea	15	3.00	621,092	2.63
Canada	14	2.80	343,205	1.45
Switzerland	14	2.80	628,710	2.66
Netherlands	13	2.60	923,518	3.91
Spain	11	2.20	451,269	1.91
Italy	10	2.00	604,300	2.56
Australia	8	1.60	225,444	0.95
India	7	1.40	221,074	0.94
Sweden	6	1.20	153,029	0.65
Taiwan	6	1.20	171,449	0.73
Belgium	5	1.00	246,558	1.04
Mexico	5	1.00	192,772	0.82
Brazil	5	1.00	213,673	0.90
Russia	5	1.00	246,118	1.04
Austria	2	0.40	46,269	0.20
Denmark	2	0.40	84,363	0.36
Ireland	2	0.40	46,166	0.20
Norway	2	0.40	106,915	0.45
Finland	2	0.40	90,614	0.38
Belgium/Netherlands	1	0.20	164,877	0.70
Britain/ Netherlands	1	0.20	55,006	0.23
Luxembourg	1	0.20	105,216	0.45
Malaysia	1	0.20	66,218	0.28
Poland	1	0.20	17,567	0.07
Portugal	1	0.20	17,331	0.07
Saudi Arabia	1	0.20	33,678	0.14
Singapore	1	0.20	27,558	0.12
Thailand	1	0.20	51,193	0.22
Turkey	1	0.20	39,392	0.17
TOTAL	500	100.00	23,618,497	100.00
EUROPE	197	39.4	10,196,648	43.17
NAFTA	172	34.4	8,274,886	35.04
APEC	307	61.4	13,638,659	57.75
BRIC1	46	9.2	1,825,196	7.73

Source: <http://money.cnn.com/magazines/fortune/global500/2008/countries/...html>

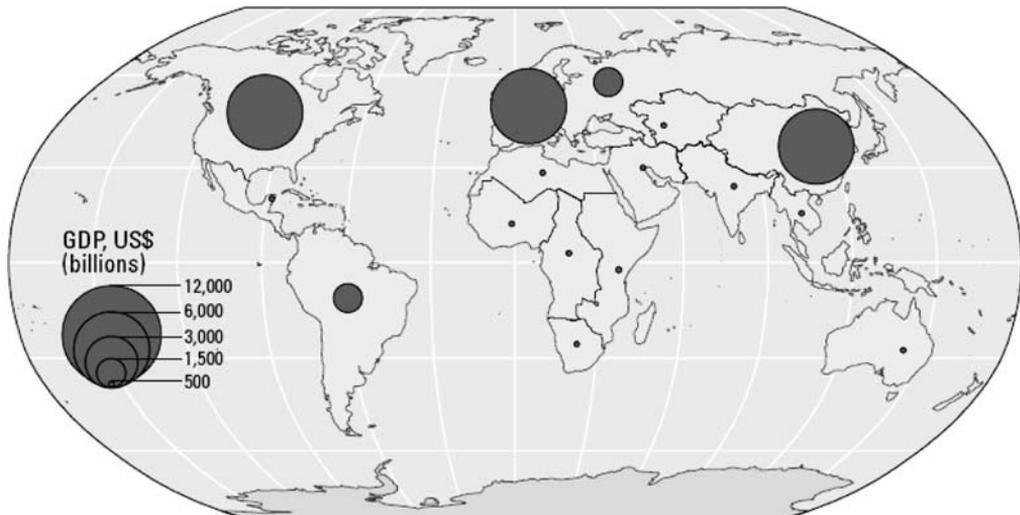
If we look at the geographic distribution of TNCs from this category, we obtain identical data, which is even more strikingly shown in Figure 1. Namely, in the category of the 25 most profitable TNCs, as well as in the category of the biggest 50, not a single TNC originates outside of Europe, North America and the Far East. Only in the category of the biggest 500 do we observe the appearance of TNCs from India and Brazil, but here European and APEC countries dominate as well.¹⁵

Figure 1: Geographic location of some TNCs from the “Fortune Global 500” category



Source: <http://money.cnn.com/magazines/fortune/global500/2008/imaps/index.html>

Figure 2: Geographic presentation of the concentration of global GDP in 2006



Source: The International Bank for Reconstruction and Development / The World Bank: *World Development report 2009, Reshaping Economic Geography*, Washington, DC, 2009, p. 97

¹⁵ Asia-Pacific Economic Cooperation – established on 7/11/1989, to advance trade and investment in the Pacific region, comprising 21 countries: Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Phillipines, Russia, Singapore, USA, Taiwan, Thailand and Vietnam.

If we return for a moment to analyzing Table 1, it is evident that the TNCs from the said groups enjoyed the greatest revenues: EU 9,500 billion US dollars, with a 38% share of total revenues of TNCs from the “Fortune Global 500” category, NAFTA¹⁶ countries 8,274 billion dollars and a 35.04% share, while those from the APEC countries had revenues of 13,638 billion dollars, or a 57.75% share.

If we compare Figures 1 and 2, we come to the conclusion that TNCs do indeed have a proportional influence on GDP, with palpable differences between regions, where the EU, US and the Far East countries standing out.

Using the same sources (“Fortune 500” for TNCs and the World Development Indicators database of the World Bank, as of 10/9/2008), we produced a table (Figure 3, with countries in boldface) and learned that in 2007, of the 100 largest economies, 55 were states, while the remaining 45 were TNCs.

If we look at the revenues of Royal Dutch Shell, we can see that they are bigger than the individual GDPs of Belgium, Sweden or Indonesia. The same can be said for Exxon Mobil in comparison to Poland and Switzerland, or Wal-Mart in relation to Norway, Saudi Arabia or Austria. At the same time, Royal Dutch Shell’s revenues exceed those of the 89 poorest countries by 5 billion US dollars.¹⁷ If we take into account that 185 sovereign countries are entered into the global development data base, then we can say that this TNC has bigger revenues than the aggregate GDP of one half of the world.

What is interesting, however, is that the next 30 spots (101-130) are taken up exclusively by TNCs, while the next country to be ranked is at 131, Slovakia, with a GDP of 74.93 billion US dollars.¹⁸ This leads us to the conclusion that TNCs are more evenly distributed in their division of markets than sovereign countries in their development. And, let us remember, the so-called new world order is supposed to rest on the evenly distributed development of both regions and sovereign countries.

¹⁶ North American Free Trade Agreement – concluded on 17/12/1992, with the goal of removing trade barriers, promoting fair competition, increasing investment possibilities and protecting intellectual property rights. Comprises Canada, the US and Mexico.

¹⁷ Compare: World Bank, World Development Indicators database, revised 10 September 2008, and http://www.forbes.com/lists/2009/18/global-09_The-Global-2000_Sales.html.

¹⁸ Ibid.

Table 2. GDPs of the world's largest economies and the revenues of the most powerful TNCs, 2008, in billions

1.	USA	13811.20	42.	Total/France	223.15
2.	Japan	4376.70	43.	Portugal	220.24
3.	Germany	3297.20	44.	ING Group/Netherlands	213.99
4.	China	3280.00	45.	Hong Kong	206.70
5.	United Kingdom	2727.80	46.	General Electric/USA	182.52
6.	France	2562.20	47.	Malaysia	180.71
7.	Italy	2107.40	48.	Colombia	171.97
8.	Spain	1429.20	49.	Czech Republic	168.14
9.	Canada	1326.30	50.	Romania	165.98
10.	Brazil	1314.17	51.	Nigeria	165.69
11.	Russia	1291.01	52.	Fortis/Netherlands	164.37
12.	India	1170.96	53.	Chile	163.91
13.	South Korea	969.75	54.	Israel	161.82
14.	Mexico	893.36	55.	Singapore	161.34
15.	Australia	821.71	56.	Volkswagen Gp. / Germany	158.40
16.	Netherlands	754.23	57.	ENI/Italy	158.32
17.	Turkey	657.09	58.	AXA Group, France	156.95
18.	Royal Dutch Shell/ Netherlands,	458.36	59.	Sinopec-China Petroleum/China	154.28
19.	Belgium	448.56	60.	Dexia/Belgium	153.35
20.	Sweden	444.44	61.	General Motors/USA	148.98
21.	Indonesia	432.81	62.	Ford Motor/USA	146.28
22.	ExxonMobil/USA	425.70	63.	Philippines	144.12
23.	Poland	420.32	64.	Pakistan	143.59
24.	Switzerland	415.51	65.	HSBC Holdings/UK	142.05
25.	Wal-Mart Stores/USA	405.61	66.	Ukraine	140.48
26.	Norway	381.95	67.	Hungary	138.18
27.	Saudi Arabia	381.63	68.	Algeria	135.28
28.	Austria	377.02	69.	Daimler/Germany	133.43
29.	BP/UK	361.14	70.	United Arab Emirates	129.70
30.	Greece	360.03	71.	New Zealand	129.37
31.	Denmark	308.09	72.	Egypt	128.09
32.	South African Republic	277.58	73.	Allianz/Germany	127.24
33.	Iran	270.93	74.	ArcelorMittal/Luxembourg	124.94
34.	Toyota Motor/Japan	263.42	75.	Deutsche Bank/Germany	124.78
35.	Argentina	262.33	76.	AT&T / SAD	124.03
36.	Chevron/USA	255.11	77.	Carrefour Group/France	121.04
37.	Ireland	254.97	78.	E.ON/Germany	120.74
38.	Finland	246.02	79.	Honda Motor/Japan	120.27
39.	Thailand	245.81	80.	Hewlett-Packard/USA	118.70
40.	Venezuela	228.07	81.	Generali Group/Italy	118.39
41.	ConocoPhillips/USA	225.42	82.	Valero Energy/USA	118.30

83.	GDF Suez/France	115.59	96.	Samsung Electronics/S. Korea	104.42
84.	PetroChina/China	114.32	97.	Kazakhstan	103.84
85.	Bank of America/USA	113.11	98.	IBM/USA	103.63
86.	Hitachi/Japan	112.49	99.	Nestlé/Switzerland	103.01
87.	Peru	109.08	100.	Kuwait	102.09
88.	Siemens/Germany	108.76			
89.	Nissan Motor/Japan	108.46			
90.	BNP Paribas/France	107.96			
91.	Berkshire Hathaway/USA	107.79			
92.	Crédit Agricole/France	107.75			
93.	Nippon Telegraph & Tel/ Japan	107.02			
94.	Citigroup/USA	106.66			
95.	McKesson/USA	106.64			

Source: World Bank, World Development Indicators database, revised September 10th 2008, and http://www.forbes.com/lists/2009/18/global-09_The-Global-2000_Sales.html

3.1. Financial TNCs

Financial TNCs include exclusively companies from the banking sector, i.e., companies that deal in short-term or long-term placements of money or securities. They are, at the same time, the movers of global investment (production) and creators of global geopolitics for, let us remember, it was they that put up the motto “capital knows no fatherland,” thus distancing themselves clearly from the state, which they can influence through the world’s most important central banks,¹⁹ as well as through the World Bank and the International Monetary Fund.

¹⁹ Deutsche Bank has its own representative and strong positions in the European Central Bank, while the US banks listed on the table have shares in the US Federal Reserve Bank and, through it, influence the Washington Consensus (FRB, IMF, WB the US Treasury Department). Also, a large number of financial TNCs do joint business with the World Bank, securing for it the capital that it lends to less developed countries for financing infrastructure works and other profitable projects.

Table 3: Global financial TNCs with assets of over 1000 billion \$, 2008 and 2005

Financial TNCs	Home country	Assets 2008 (billions \$)	Assets 2005. (billions \$)
Royal Bank of Scotland	UK	3,490.80	776.82
Barclays	UK	2,947.84	923.67
Deutsche Bank	Germany	2,946.88	987.96
BNP Paribas	France	2,888.73	1,482.83
HSBC Holdings	UK	2,520.45	1,498.02
JPMorgan Chase	USA	2,175.05	1,198.94
Crédit Agricole	France	2,064.17	1,244.38
Citigroup	USA	1,938.47	1,494.37
Mitsubishi UFJ Financial	Japan	1,931.17	1,009.51
UBS	Switzerland	1,894.85	1,572.71
ING Group	Netherlands	1,853.39	1,364.20
Bank of America	USA	1,817.94	-
Société Générale Group	France	1,572.73	999.79
Mizuho Financial	Japan	1,545.23	1,332.05
UniCredit Group	Italy	1,482.98	920.87
Allianz	Germany	1,329.96	1,133.77
Banco Santander	Spain	1,318.86	943.89
Wells Fargo	USA	1,309.64	-
Fortis	Netherlands	1,282.47	858.13
ICBC	China	1,188.08	-
Sumitomo Mitsui Financial	Japan	1,114.89	928.60
Credit Suisse Group	Switzerland	1,089.61	1,011.50

Source: http://www.forbes.com/lists/2009/18/global-09_The-Global-2000_Assets.html for 2008; UNCTAD: *World Investment Report 2007, Transnational Corporations, Extractive Industries and Development*, United Nations, New York and Geneva, 2007, for 2005, p. 235

If we analyze the data from Table 3, which shows the global financial TNCs with assets greater than 1000 billion US dollars in 2008 and 2005, we will note that, with the exception of Switzerland, all draw their origins from former colonial powers: Spain, Italy, Netherlands, France, Germany, United Kingdom, USA, China, and Japan. These banks have assets worth 41,704 billion US dollars, which exceeds the total world GDP, excepting the United States.

3.2. Non-financial TNCs

As already mentioned, *non-financial TNCs* base their business on production and services, either through rounding out a certain business process (concern) or through the performance of different business activities (conglomerate).

Looking in terms of sectors, non-financial TNCs engage in various kinds of global business, such as oil production, processing and sales, gas delivery, automobile, pharmaceutical and electronic industry, production of steel and electrical equipment and, more recently, telecommunications and computer hardware and software.

In order to prove the above we will use Table 4, which shows the sectoral representation of the 50 most profitable non-financial TNCs in 2008. As we can see, the oil and gas production sector is the most represented, with 14, the pharmaceutical sector with 7, telecommunications 6, computer equipment (hardware and software) 5, motor vehicle production 4, and steel, equipment, food, beverages and cigarettes with 3 TNCs. If we look at the share of TNCs from the oil and gas production sector among the 50 most profitable non-financial TNCs in 2008, we can see that they make up 28% of this group. However, if we look at their share in total profits (610.53 bil. \$), then the figure is 40.33%.²⁰

Table 4: *The 50 most profitable non-financial TNCs by sector in 2008 (billions \$)*

Rank	Company	Country of origin	Sector	Profit
1.	ExxonMobil	USA	Oil and gas production	45.22
2.	Gazprom	Russia	Oil and gas production	26.78
3.	Royal Dutch Shell	Netherlands/UK	Oil and gas production	26.28
4.	Chevron	USA	Oil and gas production	23.93
5.	BP	UK	Oil and gas production	21.16
6.	PetroChina	China	Oil and gas production	19.94
7.	General Electric	USA	Conglomerate	17.41
8.	Microsoft	USA	Software production	17.23
9.	Toyota Motor	Japan	Motor vehicles	17.21
10.	Nestlé	Switzerland	Food, beverages, cigarettes	16.91
11.	BHP Billiton	Australia/UK	Steel industry	15.39
12.	Total	France	Oil and gas production	14.74
13.	Petrobras-Petróleo Brasil	Brazil	Oil and gas production	14.12

²⁰ The sector of oil production, processing and sales is not only a global business, but a geostrategic goal of the economies of all countries, on which their foreign policy is also based, which especially pertains to the G-7 countries. During the last 20 years, the share of the BRIC countries in the division of oil and gas resource "spoils" has especially grown.

14.	Procter & Gamble	USA	Cosmetics	14.08
15.	Wal-Mart Stores	USA	Retail	13.40
16.	Vodafone	UK	Telecommunications	13.30
17.	Johnson & Johnson	USA	Medicines and biotechnology	12.95
18.	ENI	Italy	Oil and gas production	12.91
19.	AT&T	USA	Telecommunications	12.87
20.	IBM	USA	Computer equipment	12.34
21.	Orascom Construction Inds	Egypt	Construction	11.83
22.	China Mobile	Hong Kong/China	Telecommunications	11.49
23.	Rosneft	Russia	Oil and gas production	11.12
24.	Telefónica	Spain	Telecommunications	10.57
25.	Porsche	Germany	Motor vehicles	9.80
26.	Lukoil	Russia	Oil and gas production	9.51
27.	ArcelorMittal	Luxembourg	Steel industry	9.40
28.	Vale	Brazil	Steel industry	9.28
29.	GDF Suez	France	Equipment production	9.05
30.	Roche Holding	Switzerland	Medicines and biotechnology	8.41
31.	Novartis	Switzerland	Medicines and biotechnology	8.30
32.	Pfizer	USA	Medicines and biotechnology	8.10
33.	Siemens	Germany	Conglomerate	8.05
34.	Hewlett-Packard	USA	Computer equipment	8.05
35.	Samsung Electronics	South Korea	Computer equipment	7.87
36.	Merck & Co	USA	Medicines and biotechnology	7.81
37.	Cisco Systems	USA	Computer equipment	7.49
38.	Sinopec-China Petroleum	China	Oil and gas production	7.43
39.	ENEL	Italy	Equipment production	7.37
40.	Unilever	Netherlands	Food, beverages, cigarettes	7.00
41.	Philip Morris International	USA	Food, beverages, cigarettes	6.89
42.	Occidental Petroleum	USA	Oil and gas production	6.86

43.	GlaxoSmithKline	UK	Medicines and biotechnology	6.72
44.	Volkswagen Group	Germany	Motor vehicles	6.52
45.	Verizon Communications	USA	Telecommunications	6.43
46.	Nippon Telegraph & Tel	USA	Telecommunications	6.36
47.	National Grid	UK	Equipment production	6.34
48.	StatoilHydro	Norway	Oil and gas production	6.20
49.	AstraZeneca	UK	Medicines and biotechnology	6.10
50.	Honda Motor	Japan	Motor vehicles	6.01
TOTAL				610.53

Source: http://www.forbes.com/lists/2009/18/global-09_The-Global-2000_Prof.html

4. Levers of pressure

The origins and development of the “global empire” ruled – as we have seen – by TNCs, have been marked by the striving for global domination, primarily on the part of Great Britain as the elder brother and the US as the younger brother. Although informal interest groups were trying to impose their own foreign policy orientation in both countries²¹ and, thus, establish global domination, they did not succeed in this until near the end of World War II, at the Bretton Woods Conference, at which “it was decided to found the International Monetary Fund and the International Bank for Reconstruction and Development.”²² These institutions represent the main pillars of economic globalization as, we might say, the basic levers for exerting pressure on underdeveloped and developing countries and, if we add to them the GATT (today’s WTO) and certain interest groups,²³

²¹ Here we are directly referring to the Council for Foreign Affairs, which was initially primarily conceived as an institute. It was founded on June 29, 1921, as a “private non-governmental organization.” Financed by private capital, primarily of the Rockefeller family, the Council soon became a center for recruiting the highest state officials, including US presidents. The Council’s initial purpose was to enable big capital to influence US foreign policy. Its “kitchen” cooked up the Marshall Plan, the Bretton Woods Agreement and, subsequently, the formation of the Atlantic Council, which would give birth to NATO. According to: S. Avramov, *Trilateralna komisija Svetska vlada ili Svetska tiranija*, third edition, Nova Evropa, Beograd, 2006, pp. 17-27

²² B. Ilić, *Međunarodna ekonomija i finansije*, VPŠ Čačak, Beograd, 2006, p. 194

²³ US Council on Foreign Affairs, Bilderberg Group, Trilateral Commission, Masonic lodges, G-7, etc.

along with non-government organizations, we will get the picture of the levers used by TNCs in creating a “global empire.”

4.1. International Monetary Fund

The International Monetary Fund (IMF) was founded in order to secure international monetary and financial cooperation in the field of international payments, exchange rates and providing aid in eliminating short-term imbalances in member states' balance of payments.

However, the very fact that the IMF has been based in Washington DC since its inception, as well as the possibility of an American veto on its decisions, have turned this transnational financial organization into a “political institution”²⁴ that has placed itself in the service of US geopolitical and geostrategic interests since the adoption of neoliberal economic doctrine. Namely, the adoption of the Washington Consensus has produced the so-called shock therapy recipe.²⁵ In order to approve credit for some country, the policy of blackmail or coercion is frequently used, along with meddling in the economic and political systems of the credit seeking country. This was best felt by the transition countries, which have paid billions of dollars for their transition from a centrally planned (socialist) economy to a market economy and, hence, accession to the EU, being mostly stripped of their state property in the process. The path of development under the patronage (i.e., ultimatum) of the IMF has caused, and continues to cause, an enormous gap in the balance of payments, increased external indebtedness and, what is worst, increased unemployment.

Examples of the above are numerous, but the most conspicuous ones are certainly from our neighborhood, or our own example. Before the killing of Nicolae Ceaușescu, Romania did not have a foreign debt. This is a country with sufficient oil reserves and agricultural production to meet its own needs. Eighteen years later, Romania has a balance of payments deficit of 23 billion US dollars and a foreign debt of 74 billion US dollars – but it has become a member of the EU. Each newly born Romanian is already 3500 dollars in debt. The former SFRY owed a total of 22 billion dollars in 1991. It then fell apart and, 16 years

²⁴ J. Stiglitz, *Globalization and its Discontents* (Serbian translation: *Protivječnosti globalizacije*, SBM-x, Beograd, 2002, p. 175).

²⁵ The conditions for receiving IMF assistance are, first of all, fiscal discipline, reduced public spending (especially social outlays), tax and banking system reform, privatization, deregulation, a rigid exchange rate policy, trade liberalization, foreign direct investments and property rights, which are parameters that even economically much stronger countries would not be able to achieve. Such a conceived model has produced disastrous results in almost all the countries in which it has been applied (Mexico, Chile, Argentina, Russia, Hungary) with the exception of Poland, the Czech Republic and Slovenia, which did not adhere strictly to IMF ultimatums.

later, its former federal republics, which have since become independent states, have a total debt of 144 billion US dollars.

4.2. World Bank

What is today usually recognized as the World Bank²⁶ is also a creature of the Bretton Woods Agreement. The International Bank for Reconstruction and Development (IBRD) began work on June 26, 1946.

The US government has had the biggest influence on the WB.²⁷ Besides having the biggest quota and the most votes (also with veto power), the presidential function is also reserved for an American, as are numerous spots in the Bank's bureaucracy, and the Bank also gathers securities of its funds on the US financial market.²⁸

The WB characteristically places credits for infrastructure works or large investments into an economy (as well as for debt servicing), on the condition that the contractors are from the ranks of member states. Thus, since the end of 1995, of the total loan funds spent outside the borrower countries, 83% have been spent in developed countries (21% in the US, 14% in Japan, 11% in Germany), and only 15% in developing countries.²⁹ In light of this, the large sign on

²⁶ The term *World Bank Group* (WB) refers to a group of five financial institutions:

- International Bank for Reconstruction and Development (IBRD), founded in 1946;
- International Finance Corporation (IFC), founded in 1956;
- International Development Association (IDA), founded in 1960;
- International Center for Settling Investment Disputes (ICSID), founded in 1946;
- Multilateral Investment Guarantee Agency (MIGA), founded in 1988.

Under the term World Bank, we are solely referring to the IBRD and IDA.

²⁷ Interestingly, Keynes, the chief of the British delegation at the Bretton Woods Conference, proposed that, if it had to be in the US, the seat of the IMF and the WB should not be in Washington DC, in order to at least partially reduce the influence of the US government. The only concession made in that sense was in that the US accepted that the IMF president would always be a European.

²⁸ Although Yugoslavia participated at the Bretton Woods conference and wound up among the victors of World War II, "Yugoslavia did not get its first loan until 1949, in the amount of only \$2.7 mil. for equipment import, followed by two more: in 1951 for \$28 mil. and 1953 for \$30 mil. These loans were approved on the condition that Yugoslavia regulate its prewar debt and that it not go into debt over a certain limit. Later on, during the 1950s, Yugoslavia could not use IBRD loans, due to the disputed claims of mostly US banks regarding bonds issued by the Kingdom of Yugoslavia. Wall Street was pressuring the IBRD not to approve loans to Yugoslavia until it had regulated its obligations. When speaking about Wall Street influence, it should be born in mind that, at the time, the Bank was securing most of the funds needed for its activity precisely by placing its own bonds on the American capital market." According to: P. Jovanović Gavrilović, *Međunarodno poslovno finansiranje*, Faculty of Economics, Belgrade, 1994, p. 165

²⁹ B. Ilić, op. cit., p. 202

the wall of the main WB hall, which says “our dream is a World without poverty” appears like a “bitter joke, even raw cynicism.”³⁰

4.3. World Trade Organization

The so-called Havana Charter was adopted at the Havana Conference in 1947-48, providing for the founding of the International Trade Organization (ITO), towards the goal of creating conditions for international trade cooperation. However, instead of the ITO, the General Agreement on Tariffs and Trade was adopted, calling for freedom of international trade. After the founding of the IMF and the World Bank, the adoption of the GATT completed the constitution of the basis for the post-war international economic order based on liberalism, which suited developed capitalist countries.

Negotiations within the GATT framework were carried out in rounds, of which the Uruguay Round was certainly the most important,³¹ resulting in the creation of the World Trade Organization. The goal of this intergovernmental organization is to multilaterally approve most favored nation status in trade relations to all its members, with the goal of reducing all tariffs to 1%.

Views regarding this global organization are diametrically opposed. Critics disapprove of its close ties to MNCs and TNCs via various committees (in the case of the US, among the members of the Trade Negotiations Committee are representatives of gigantic corporations such as IBM, ITT, Bethlehem Steel, Mobil Oil, HP, General Motors, Boeing, Dow Chemical, Amoco, etc.),³² claiming that its framework is used to eliminate barriers to international investment and competition in a way that favors the biggest players. On the other hand, WTO's proponents claim that many of the provisions of the agreements generated by this organization favor developing countries,³³ in the sense that they allow them

³⁰ Z. Vidojević, *Kuda vodi globalizacija*, “Filip Višnjić”, Institut društvenih nauka, Beograd, 2005, p. 91

³¹ What is especially significant is that this was the first time that the United States had made compromise with developing and underdeveloped countries, even though it had threatened to leave the negotiation process, which lasted from 1979 to 1994, or a full 15 years.

³² J. Mander and E. Goldsmith, *The Case Against the Global Economy* (Serbian translation: *Globalizacija – argumenti protiv*, Clio, Beograd, 2003, p. 295).

³³ Differently from other international institutions, WTO decisions are made by consensus. Only when it is not otherwise possible, decisions are brought according to a two-thirds or three-fourths majority. During majority voting, the one-country-one-vote system is applied (in other international institutions, such as the IMF and the WB, the number of votes usually depends on the country quota, which in turn depends on its economic strength). More than three-fourths of WTO members are developing and transition countries. The Republic of Serbia is not a member of the WTO, although Yugoslavia (whose legitimate successor the Republic of Serbia is) was a full-fledged member of the GATT. Membership in this organization is not mandatory, but accession to the EU is, among other things, conditioned upon WTO membership.

more time for the implementation of certain agreements, that the least developed countries are not obliged to adhere to all the provisions, while the preferential treatment accorded to developing countries is seen as an exception to the clause providing for most favored nation treatment.

In any case, it is a fact that the US, as the undisputed leader, has the luxury of finding ways to circumvent WTO rules, in tune with its own interests and under the motto “trade is good, but imports are bad.”

5. Conclusion

When the average viewer watches TV in the evening and sees the “Just do it!” commercial, does he know that this product is made by 12-year old children working for 0.19 dollars an hour? Is the general global public aware of the conditions in which a third of humanity is working? Do we know that the “Black Continent” is filled with countries in which people earn less than one dollar a day?

Predrag Bijelić has noted that TNCs and the state are inversely related: as the power of the TNCs rises, the influence of the state falls. What he could not say precisely is whether TNCs are actors of international negotiation. Does the answer perhaps lurk in the fact that Exxon Mobil’s annual profits are greater than the GDP of a country with 10 or 15 million people?

The world as we know it today looks like an inflated balloon preparing to burst. The fact is that the UN is not functioning like it should, either, that the world’s top financial and other organizations are not in the service of most of humanity. It is illogical that the savings of Chinese citizens are financing the American war machine and that the dollar is being printed “mercilessly.”

It remains an open question as to what the world will look like in the future. It is a fact that, of the four domains of global American superiority – military, economic, technological and cultural, according to Brzezinski the US now retains dominance in only one, the military. Taught by this experience, owners of big capital, with their financial and non-financial TNCs, are waiting to see whether the United States will take the path to socialism and a centralized economy, and Russia and China the path to imperialism. Waiting and withdrawing their capital. We, too, are waiting.

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PRIVATE AND PUBLIC CAPITAL PARTNERSHIP IN THE FINANCING OF INFRASTRUCTURAL PROJECTS

Abstract: *Growing infrastructure needs in the last few decades have made it necessary to partially finance infrastructure projects from private sources. Since the motives of private capital in project financing and realization may significantly differ from those of the public authorities, it is of crucial importance to define clearly the direction and magnitude of cooperation between the private and the public sectors in the planning, building, financing and operation of infrastructure systems. However, the State plays a key role in managing and developing concessions and public-private partnerships through its institutions and organizations, regardless of the range of authorization delegated to the private sector. The main reason for this definitely lies in the high socio-economic value of infrastructure projects. Thus, when financing infrastructure projects with both public and private sources, it is necessary to determine and precisely define in advance the responsibilities and obligations of all project participants, particularly those linked to security, quality and level of user fees. In this paper, we present basic models of public and private sector cooperation in the financing and realization of infrastructure projects as well as organizational forms of public-private partnership (PPP).*

Key words: *public-private partnership, infrastructure, project financing*

JEL classification: H54, G38

1. Introduction

In the past few decades, the need for financing infrastructure projects in many countries throughout the world has been growing more rapidly than the

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sources of funding,¹ i.e., sources of capital from which these projects could be financed. T. Merna and C. Njiru² have concluded in their study that developed countries set aside \$200 billion, or 4% of their national output, one fifth of total investments and 40-60% of public investments into infrastructure.

Public funds and countries' borrowing capacities are becoming insufficient to satisfy growing needs for infrastructure.³ As a result, many countries have begun to harmonize and design legal regulations that will encourage private sector participation in the development, financing, operationalization and co-ownership of infrastructure projects. The idea of including private firms in the realization of traditionally public infrastructure projects has given birth to the appearance of public-private partnerships.⁴ According to Miller and Lessard,⁵ at the end of the previous millennium, the private share in total infrastructure investment varied between the lows of 9% and 13% in Germany and France and the extreme highs of 47% and 71% in the US and Great Britain, respectively.

The partnership of public and private capital is not a form of monopoly. More precisely, this type of cooperation cannot be realized without legal regulations, since this type of financing requires a precise definition of the responsibilities, rights and obligations of the participants from both the public and the private sectors, especially those tied to safety, quality and user fee level (i.e., profitability).

Since the motive of private actors in the realization of infrastructure projects lies in earning an adequate rate of financial return, which should be proportional to that potentially available by investing in other projects of similar risk, the structure of private and public capital partnership is formed in such a way as to ensure such a result. Thus, it can be said that partnerships of state and private capital are joint investments in which entrepreneurs and the state cooperate, pooling their strengths in order to ensure that the realization of infrastructure projects will be faster and more efficient.

More precisely, the idea behind this approach can be defined as an attempt to improve the efficiency and innovativeness of infrastructure project realization, through the engagement of a private sector that is prepared to contribute to the improvement of public services at a substantially lower cost.⁶ Project engage-

¹ N. Gil, S. Beckman, "Infrastructure Meets Business: Building New Bridges, Mending Old Ones", *California Management Review*, 51 (2), 2009

² T. Merna, C. Njiru, *Financing Infrastructure Projects*, Thomas Telford, London, 2002

³ H. Smit, L. Trigeorgis, "Valuing Infrastructure Investment: An Option Games Approach", *California Management Review*, 51 (2), 2009

⁴ The World Bank and the International Finance Corporation: *Investing in the Environment*, The World Bank, Washington, D.C., 1992

⁵ R. Miller, D. Lessard, *The Strategic Management of Large Engineering Project: Shaping institutions, Risks, and Governance*, Massachusetts Institute of Technology, IMEC Research Group, 2003

⁶ J. E. de Bettignies, W. T. Ross, "Public private partnerships and the privatization of financing: An incomplete contracts approach", *International Journal of Industrial Organization*, 27

ments initiated on the basis of public and private capital investment vary between the exclusive participation of private capital, but with government approval and guarantees, and investments in which private sector partners are recognized as financial support to the state in project sponsorship. The extremes of purely public and purely private financing do not fall into the domain of public-private partnership.

In accordance with the above, the inclusion of the private sector is becoming increasingly frequent, especially in the area of infrastructure projects, within which transportation projects serve as perhaps the most representative examples of such partnership. By their nature, toll booths, bridges, airports and railroads accumulate sufficient revenues from user fees to become attractive to the private sector, while being of crucial importance for the development of a socio-economic community.

2. Alternative ways of infrastructure financing

According to the opinion of numerous authors, neither totally public nor totally private financing, realization and management of infrastructure projects are sustainable over the long term.⁷ Hodge and Greve⁸ note that almost all relevant definitions begin from the assumption that the model of public-private partnership is good, being founded on the benefits of both the private and the public sectors.

The financing of infrastructure projects is traditionally secured from several different sources:

- State sources (donations, loans or loan guarantees);
- Suppliers of investment equipment (mostly construction firms and equipment suppliers);
- Bilateral and multilateral funds (through donations and loans);
- Lines of credit (securing adequate credit support for the main sponsor);
- Capital investment from private sources, from the issuance of securities on the part of institutional investors.

The last two categories are especially sensitive, not only to conditions characteristic for the capital markets, but to the credit value of companies on the market. This is all the more so because most developing countries do not have at

(3), 2009, pp. 358-368

⁷ J. B. Miller, Applying Multiple project Procurement Methods to a Portfolio of Infrastructure Projects, *Procurement Systems: A Guide to Best Practice in Construction*, E&N Spon., 1999

⁸ G. Hodge, C. Greve, *The Challenge of Public Private Partnerships: Learning from International Experience*, Edward Elgar Publishing Ltd., London, 2005

their disposal either the financial sources or a credit rating sufficiently adequate to allow them to finance their most important infrastructure projects.

Therein lies the reason why such countries must seek sources of financing in the private sector. Some countries have made progress in that regard, and analyses show that a large regional concentration of public-private partnership contracts has been formed, primarily in Latin America, followed by Southeast Asia,⁹ which indicates the presence of private capital financing of projects by way of concessions, and the approval of loans based on the strength of projected project cash flows.

3. The structure of partnership financed by public and private capital

Different forms of partnership for financing projects through the partnership of public and private capital are especially significant in the field of infrastructure. The structure of such partnerships is quite multifarious, but all of them are centered on the responsibility, risk and returns that the project brings.¹⁰ Definitions of public-private partnership vary, but all of them share certain characteristics: (1) public-private partnership always concerns the cooperation of two or more parties (of which at least one is of a public character); (2) each party is a principal; (3) the relationship is long-term, stable and based on mutual or complementary benefits; (4) each participant transfers material or non-material resources into the partnership; and (5) risk and responsibility are distributed among all the sides in the partnership.¹¹

According to Finnerty,¹² the specific nature of each project requires an appropriate partnership structure, depending on the answers to the following questions:

- Who will be responsible for designing and building the project?
- Who will secure the funds for building?
- Who will arrange the financing?
- Who will be officially responsible for securing the project assets, and for what period?
- Who will manage the project funds, and for what period?
- Who will be responsible for securing all of the planned revenues from the project?

⁹ A. Akintoye, M. Beck, C. Hardcastle, *Public Private Partnerships: Managing Risks and Opportunities*, Blackwell Publishing Company, London, 2003

¹⁰ European Commission: *Guidelines for Successful Public Private Partnership*, 2003

¹¹ A. Akintoye, M. Beck, C. Hardcastle, *Public Private Partnerships: Managing Risks and Opportunities*, Blackwell Publishing Company, London, 2003

¹² D. J. Finnerty, *Project financing: asset-based financial engineering*, John Wiley & Sons, Inc., New Jersey, 2007

In the case of exclusively private funds, the answer to all the above questions should be provided by the party performing the project from its own funds. However, infrastructure projects can have a mix of public and private responsibility. For example, a private company may be responsible for the design, building, financing and operationalization of the entire project. In such circumstances, the state will not secure any capital, i.e., it won't take on the responsibility for securing the revenues, but will be responsible for the activity of the project after its realization, i.e., in the following period of about 40 years.

Public-private partnership (PPP) is an evolving concept. From rudimentary partnerships characterized by a high level of informality, public-private partnerships have transformed into a contractual and institutionalized relation of the public and private sectors, encompassing a wide range of organizational models.¹³ Some of them include significant state and private responsibilities connected with planning, financing and realization.

Numerous varieties of new models of public-private partnerships have been developed, in order to deal with various challenges placed before public-private partnerships in specific situations and sectors. Consequently, the synergy created within the partnership can be expanded into specific niches of infrastructural development.¹⁴

Models of public-private partnership differ depending on the participation of private capital in the project responsibility and will, thus, be presented in the work in accordance with that criterion. It is easily observable that the list of models is not complete, but that the basic structure is included:

1. Permanent franchise model – a model financed by private capital investors, who manage the project on the basis of a government-approved franchise. The investors retain right to the assets, and the entire financial aid connected with the project's realization is secured by the private investors. The government assures the safety and the quality of the service and, perhaps, the fee for using the good or service.

The permanent franchise model is the most flexible of all, as it allows the securing of private sector funds through the issuance of securities. In any case, from the aspect of innovativeness of projects and presence of economic risk, the market for securities – both debt and equity securities – is available only if the project has already operated successfully for a period of several years and has an acceptable profitability rate.

¹³ C. Koch, M. Buser, "Emerging Metagovernance as an Institutional Framework for Public Private Partnership in Denmark", *International Journal of Project Management*, 24 (7), 2006, pp. 548-556

¹⁴ M. Milosavljevic, S. Benkovic, "Modern Aspects of Public Private Partnership", *Perspectives of Innovations, Economics and Business*, Vol. 3, 2009, pp. 25-28

2. The BOT model – BOT project may be described as a project based on a concession granted on the part of the party granting the concession (usually a public or state agency) to a consortium or concessionaire (usually from the private sector), which is supposed to “build” (which includes financing, design, project implementation management, etc.), “operate” (including operation and business management of buildings and facilities, maintenance, provision of services, fee collection in order to cover the financial and investment costs), and “transfer” the building or plant in operational condition and without additional costs to the concession granting party at the end of the concession period.¹⁵ BOT-based infrastructure building schemes have gained in importance over the past several years. In return for reclaiming ownership, the state most often seeks (limited) credit support for loans that accompany the project.

3. The DBFO model – *Design-Build-Finance-Operate* (DBFO) model, is a type of financing in which the private entity is expected to design, finance, build and operate the project. In almost all cases, the public sector retains ownership over the infrastructure objects, while DBFO models vary in practice in terms of the degree of financial responsibility transferred onto the private sector.¹⁶ A long-term leasing contract gives the private entity the right to use the project’s infrastructure and to draw earnings during the lease period. After the expiry of the leasing period, the public authority operates the project infrastructure autonomously, or hires another party to do it in its name.

4. The BBO model – *Buy-Build-Operate* (BBO) model is a form of financing infrastructure projects by which a private company buys an already existing facility, modernizes or expands it, and uses it as a profit-oriented public facility. Undeveloped, damaged or overly congested highways, bridges and airports are good examples of projects requiring this kind of financial structure. The BBO model will perhaps prove to be especially interesting in the coming years, as many public facilities will require repair or expansion.

5. The LDO model – *Lease-Develop-Operate* (LDO) is a model of project financing by which a private company leases an already existing, state-owned facility and its land. The private company then uses (exploits), develops and operates the facility in accordance with a contract on earnings distribution, together with the host government over a certain time period. The host government retains the right of legal ownership. The LDO model is exceptionally attractive when private actors lack the capacity of fully paying the purchasing price of the

¹⁵ M. M. Kumaraswamy, X. Q. Zhang, “Governmental Role in BOT-led Infrastructure Development”, *International Journal of Project Management*, Vol. 19, 2001, pp. 195-205

¹⁶ US Department of Transportation: *PPP Options, Federal Highway Administration*, 2006: <http://www.fhwa.dot.gov/policy/2006cpr/pdfs/chap13.pdf>

existing facility (as is the case with e.g. the BBO model). The LDO model is, at the same time, very useful in distributing risk between representatives of the public and private sectors, when there is certainty that the project will also incur some monetary losses.

6. The “additional adjustment” model is a form of project financing based on the idea that private companies can often be an option of expanding existing state-owned facilities. Private companies own the legal right of ownership, or part ownership. The most important advantage of this model lies in the fact that it facilitates shared ownership, as well as the fact that the private company is not responsible for any debts previously incurred for the building of the central facility.

7. The “temporary privatization” model is a form of project financing where a private company takes over operation and maintenance of an existing state-owned facility, e.g. a bridge that needs repair. The private company then proceeds to expand or repair the facility, runs it and collects the fees, until it covers the costs of expansion or repair (including a reasonable return on invested capital), or until the temporary franchise license expires, after which the legal ownership rights are restored to the state.

8. The “speculative development” model is a form of project financing based on the identification of still unidentified social needs. With the approval of the host government, the project company initiates the procedure of planning and of securing licenses at its own expense, fully assuming the accompanying risk. Much later, after the project company furnishes proof of the project’s feasibility and develops a usable design, the host government takes part in some process adjustments and may also contribute to the financing of the project. This model has been tested in various forms on several projects in the US.

9. The model of “capturing value” seeks to increase the share of benefits brought by private investors through participation in commercial activities intended for public use. For example, the value of land and earnings from its sale can be increased, which results in the creation of added value when taxes are levied, from which other projects, e.g. in the field of transportation, can be subsequently financed. Since actors from the private sector are not interested in creating any added value, capturing of value is often achieved by a “non-working” partnership between the state and economic actors, i.e., by creating special taxes or monetary limitations tied to new projects.

Existing economic actors, as well as potentially new actors, can be taxed on a one-time basis or on the basis of a rate set in accordance with the value of their property, which increases along with property value. The taxes, or collected fees, are then distributed into funds for the financing of certain projects of signifi-

cance for the development of the country's infrastructure. In certain cases, the inflow is sufficient to support the issuance of state bonds, which may occasionally provide additional capital needed for financing a new infrastructure project.

10. The "user fee" model is specific in the sense that the government of the host country, or its public authority, participates in the signing of a contract with the project company. The user contract thus obligates the host government to make sufficient payment for all the contingent projects tied to the main project. Only after the project is realized, the host government receives its "user fee", i.e., its money is returned.

The "user fee" model of financing is usually used in the course of connecting with large investment projects financed from private sources, intended for public use. The model exposes the public authority to the credit risk that accompanies the project. Thus, the contract itself often contains a clause by which the public authority issues a loan guarantee for the project.

4. Legal provisions that negatively affect the partnership of public and private capital

All the models of project financing, except the "capturing value" model and the "user fee" model, put private actors in the position of the leading entity in the areas of project planning, financing and operation. According to Kwak,¹⁷ it is necessary to establish a well-defined but not overly bureaucratized legal and administrative business environment. The initiative and readiness of the private sector to participate in projects of public significance greatly depends on the complexity of social, economic, legal, ecological and other conditions.

Most legal provisions regarding public-private capital partnership are encumbered by a common shortcoming – the misallocation of high costs and risks between the public and the private sector, especially in the early phases of project realization. Inadequate risk distribution and lack of an environment in which private sector partners can obtain an adequate rate of return on investment can lead to dissolution of the partnership.

Legal provisions that discourage the inflow of private capital in the realization of infrastructure projects, for which the public sector is most often responsible, are, according to Finnerty,¹⁸ most often based on the following:

¹⁷ Y. H. Kwak, Y. Y. Chih, C. W. Ibbs, "Towards a Comprehensive Understanding of Public Private Partnerships for Infrastructure Development", *California Management Review*, 51 (2), 2009

¹⁸ D. J. Finnerty, *Project financing: asset-based financial engineering*, John Wiley & Sons, Inc., New Jersey, 2007

- Demanding the possibility of amending already agreed-upon legal approvals within the project contract, after the negotiation process with the state agency has already ended, which creates a very unfavorable and uncertain environment. This type of partnership is referred to as an incremental partnership.¹⁹ Namely, the private investor is in a situation in which he is expected to assume the risk pertaining to delays, contract modification and the removal of agreed-upon items from the contract, for all the cost-connected items included in contract-related negotiations with the public sector.
- Demands on the investor to secure significant funds through the issuance of bonds or to secure significant monies for insurance. In such circumstances, private sector investors are expected to invest substantial funds in planning, designing and approving the issuance of securities on the basis of which capital for the project will be secured. As the securing of funds through the issuance of securities most often pertains to the issuance of bonds, it is clear that securing guarantees for such securities will bring increased costs, as well as increased financial risk. Consequently, the project may turn out to be totally unacceptable for the private sector. Still, it should be emphasized that it is possible to secure a franchising act for ordinary bonds, where the speed of building the facilities is clearly and precisely outlined, and whereby the government's agency costs are controlled, and cooperation with private sector investors is defined. However, the level of funds that are necessary to set aside for insurance from certain types of risk is sometimes unacceptable for private sector investors, due to the high costs they have to incur. Namely, adequate insurance coverage must be accurately set so as to enable the restoration of the facilities to their original purpose, and so that the debt connected with the project can be returned in its entirety following events such as natural catastrophes, caused by fire or quakes.
- Allowing relative exemptions from various forms of restrictions that may be imposed by a future political structure that sponsors the project. By exposing the public-private financing of the project to certain types of risk, future policy is changed, especially policy that may create unexpected competition in the project's realization and, thus, increase the project's economic risk connected with inadequate realization of future earnings. This may prevent the realization of the project, that is, the financing of the project itself on the part of the private sector.
- Allowing (or demanding) momentary regulation in case certain problems arise, by precisely defining the fee rates, i.e., the rates of return on investment. The fee rate or the leading rate of return should be agreed in

¹⁹ M. Milosavljevic, S. Benkovic, "Modern Aspects of Public Private Partnership", *Perspectives of Innovations, Economics and Business*, Vol. 3, 2009, pp. 25-28

advance and be under the supervision of an agency that controls the costs and deals with private sector investors. Thus, for example, public use of transportation facilities is difficult to predict, as these are projects that are substantially more price sensitive compared to electrification or water supply facilities. As a result, potential investors in the area of transportation infrastructure and similar projects require insurance against potential losses during the construction phase, which means that the commission that evaluates the feasibility of facilities intended for public use will not be able to anticipate even the initial operations.

- Barring the local government from participating in the realization of the project. Often the capacity of the project to be financed from private sources depends on the readiness and ability of the local government to secure a certain level of financial, as well as political support. Thus, investors may think that the local government should completely finance the project's realization, without analyzing the amount of funds necessary for that endeavor. Private sector investment certainly contributes to and helps the local government to successfully realize projects of significance. Such participation also aids in the imposition of changes projected and planned by the host government. Thus, the reduction of public-private partnership may result in a higher risk level for the country and for the project itself.
- Demands on private investors to use or improve the use of the government's procurement methods. Considering the fact that private capital is exposed to risk, private sector investors have the right to insist on the most efficient way of performing public procurement. Procurement is regulated by the government and most often includes a tendering process that accommodates the participation of actors from the private sector.
- Demands on the part of government for a detailed project design before the building process can begin. Experience has shown that designing, i.e., a technique by which the building process begins even before a detailed plan is completed, brings savings in the construction phase of the realization of a public good or service. In that sense, waiting for a government permit regarding the acceptance of a detailed plan before initiating the building process can only increase the costs of the project's realization.

5. Provisions that support partnership based on the engagement of public and private capital

According to Finnerty,²⁰ some legal provisions help improve business operations and risk control, thus providing support for partnerships based on the engagement of public and private capital. They are based on the following:

- They allow private investors to propose a sustainable and development-oriented project (i.e., they do not force the private investor to choose between those that the public authority has already defined and set as priority goals). Due to their profit-orientedness and motivation, private investors are often more motivated than state agencies to identify and locate attractive opportunities related to development projects.
- Securing government support in the process of planning, permit collection, securing land and resolving conflicts that may arise between members of the government and the agency issuing the permit. The comparative advantage of the host government lies in the fact that the local government of a specific region can significantly contribute to the process of improving the project's realization.
- Use of the host government's partial or complete research connected with the environmental surroundings and land. The high cost of producing studies related to the project's ecological contribution often represents a powerful leverage, which basically attracts private sector investors to participate in the realization of infrastructure projects.
- Securing loans to cover the project's capital costs. Such loans improve the project's financial feasibility by reducing the amount of funds that need to be obtained from private sources. Also, they allow the public sector to participate in the distribution of earnings that the project brings under positive circumstances.
- Securing the legal basis tied to projects that are the result of private initiative. The building of airports and highways often encompasses added insurance tied to employee safety. Road tolls often bring special problems, due to which state patrols that control the highways must be accorded a certain advantage. In such circumstances, the state can (and often does) approve these services on a contractual basis.
- Defining the differences related to taxes connected to regional or state outlays, and postponement of their payment. Delayed payment of taxes often represents a way in which the state can invest in a project without directly investing financial resources.
- Exempting projects that are realized on the principle of partnership from certain taxes, if they are connected to the purchase of materials neces-

²⁰ D. J. Finnerty, *Project financing: asset-based financial engineering*, John Wiley & Sons, Inc., New Jersey, 2007

sary for project realization. Many states make tax exemptions when it comes to incoming materials necessary for project realization, since that is a form of investment in infrastructure owned by the state or local government. In that sense, this principle is often used in the financing of infrastructure projects with public (state) and private capital.

- Defining the limitations related to badly projected sources of financing (the project's liabilities). In many countries, the government as the supreme organ enjoys a higher level of protection for the placement of its financial resources into infrastructure projects than do private investors.
- Securing the free (or subsidized) use (by lease or sale) of state land or acquiring the right to that land on the basis of relevant provisions. Generally, it can be said that the granting of land for use is basically the simplest way for the public sector to participate in the realization of specific infrastructure projects. However, at the same time, it also represents the biggest obstacle for private investors. In that sense, it is very important to adequately use the influence at the government's disposal in such situations.
- Approving the commercial side of the project. The commercial aspect is an accompanying part of carrying out infrastructure projects. The earnings gained through commercial activity can make the project attractive even in circumstances in which it would be totally unacceptable to investors in the financial sense.

6. Conclusion

Project financing is a potentially useful way of promoting the development of a country's important resources, i.e., of building facilities and providing services of significance for its development. The use of project financing in certain situations depends on whether that type of financing ensures the lowest costs during project realization, taking into account social benefits and costs, as well as the benefits and costs to private capital investors.

Governments throughout the world have accepted partnerships based on the engagement of public and private capital in the financing of projects, as a moving force for the realization of various services, such as activities tied to the improvement of education, transportation, health care, as well as their correction. Guided by the experience of Great Britain as a pioneer in this field and its experience in financing projects of socio-economic significance from private funds during the early 1980s, the concept of public-private capital partnership in the financing of infrastructure projects has been, in the meantime, accommodated and accepted on all levels of implementation in countries throughout the world.

There is no single definition related to financing through the partnership of the private and public sectors. Depending on the country being considered, the

term covers various forms of transactions, where the private sector is given the right to operate over a longer period of time, to bear the responsibility traditionally reserved for the public sector, beginning with short-term contracts (which are characterized by limited sources of capital or where there is no capital at all), concessionary contracts (which may provide for the design and building of basic capital assets together with providing a wide range of servicing and financing of the complete construction and operation), all the way to joint investment with shared ownership between the public and private sectors. Generally speaking, partnerships between the public and private sectors fill the space between the traditional realization of projects and total privatization.

The partnership of public and private capital is a mode of financing which greatly contributes to the overcoming of problems that characterize infrastructure projects of countries, especially those undergoing processes of development and economic advancement. It is certain that, under such circumstances, various forms of capital structuring are feasible, especially when risk and return on investment are acceptable for both participants in the realization of the project. It is especially important to note that the level of interest of private investors will depend on the risk and the rate of return on investment, to the extent that these are deemed reasonable and acceptable.

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TRANSITIONAL PRIORITIES OF SERBIA IN THE LIGHT OF EUROPEAN INTEGRATION

Abstract: *The Western Balkan countries are passing simultaneously through two processes which are mutually complementary: the transition process that characterizes all countries with a formerly planned economy, and the process of association and accession to the European Union. However, due to political instability, institutional weaknesses and economic difficulties, Serbia trails the rest of the region on its European path, having signed the Stabilization and Association Agreement only in April 2008. The paper deals with the achieved level of Serbia in meeting the economic requirements of the European Union, which are at the same time internal transition requirements. Causes of the poor state of the economy are identified in the work and we also provide guidelines and recommendations for the further continuation of the reform process.*

Key words: *economic transition, EU association conditions, Serbia*

JEL classification: P21, O19

1. Introduction

According to provisions of the European Union's founding acts, every European state can become a member of the Union, on the condition that it fulfills certain criteria required for membership. However, it is customary that, before full accession, countries receive associate status, as preparation for the more complex obligations and rights further down the road. Association and accession are not the same: they represent two different sets or rights and obligations, of which one precedes the other.

Association with the European Union can be defined as the highest form of cooperation that can be established between non-member states, on one side, and the European Union, on the other. The process is centered upon an Association Agreement concluded between non-member states, on one side, and the European Union and all the individual member-states, on the other. Negotiations on the agreement are conducted by the European Commission. In order for a country to become a member of the European Union, it is necessary for it to fulfill the appropriate criteria, previously defined by the European Union. There

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are general criteria that all countries seeking to join the European Union must fulfill, named the Copenhagen Criteria.

In June 2000, in Ferrera, the European Council set down the goals of the full political and economic integration of Western Balkan countries, thus recognizing them as potential and serious candidates for European Union membership. In Copenhagen in 2002, the European Council reaffirmed this approach and stressed the determination of the European Union to support the region in its efforts toward full accession to the Union. During the years that followed, the Council in Brussels announced on several occasions that the future of the Western Balkans lay in the Union.

In the context of European integration and our country's relations with the European Union, it is important to analyze both the preconditions and the conditions for membership. Preconditions refer to the process of stabilization and association, i.e., the Stabilization and Association Agreement, while conditions for membership acceptance refer to the fulfillment of the Copenhagen Criteria, with the proviso that the obligation of partial fulfillment of the Copenhagen Criteria is already contained in the Stabilization and Association Agreement. Thus, it is evident that the two processes overlap.

2. Copenhagen Criteria

At the summit in Copenhagen, it was decided that the countries of Central and Eastern Europe could become full members of the European Union if they so desired, with acceptance being conditioned upon the fulfillment of the prescribed goals. In addition to these criteria, the Western Balkan countries would have to fulfill additional criteria pertaining exclusively to them.

The Copenhagen Criteria are:

- Political criteria – stability of the institutions that ensure democracy, the rule of law, respect for human rights and minorities;
- Economic criteria – the existence of an efficient market economy and the ability of companies to withstand the pressures of competition that integration will inevitably impose;
- Other criteria – ability to take on the obligations that come with membership, including the ability to follow the goals of political, economic and monetary union, which, in fact, means the acceptance and implementation of the Union's legal legacy – the *acquis communautaire*.

An additional criterion, directly connected with the building of the necessary administrative capacities, was adopted during a European Council meeting in Madrid, providing for:

- The ability to implement European Union legal regulations through efficient administrative and judicial structures (judicial and administrative capacities).

When evaluating political criteria, the Commission analyzes conditions in numerous areas: the political system, the legal system (especially the judiciary), human rights, minority rights, the existence and pervasiveness of corruption, media independence, etc. In our case, the fulfillment of the political criterion represents the precondition for the implementation of the Stabilization and Association Agreement.

The second, economic criterion is quite demanding, since it requires the implementation of macroeconomic and microeconomic reforms. The evaluation on the fulfillment of the economic criterion is based on two sub-criteria: 1) existence of a functional market economy and 2) the ability to face the pressures of competition and market forces within the European Union.

The third, legal criterion requires the incorporation of European regulations into national laws and the adoption of new or the revision of existing regulations. The process of harmonization with the *acquis* is complicated, since the *acquis* contains about 80,000 pages, and separate negotiations are held between each candidate country and the Commission. In order to simplify such a complicated negotiation process, the *acquis* is divided into 31 chapters, which are successively negotiated, one chapter at a time, during the process. The fourth criterion extends from the third, requiring the building of the judicial and administrative infrastructures necessary for a more efficient implementation of the *acquis*.

The fulfillment of all four criteria is the European Commission's yardstick for evaluating the candidate country's progress. After a country applies for admission to the European Union, the European Commission makes a decision, on the basis of the Copenhagen criteria, on the beginning of membership negotiations.

3. The Stabilization and Association process

After the fall of the Berlin Wall, the European Community had a unified strategy regarding all the countries of Central and Eastern Europe. It was only later that it started to differentiate its policy toward the countries of Southeastern Europe. Finally, at the end of the 1990s, it shaped a special strategy for the Western Balkan countries within the framework of a regional approach, called the "Stabilization and Association Process". The process contains three basic elements: a Stabilization and Association Agreement, a conditional policy defined by the European Union within the Copenhagen Criteria, and economic and financial aid given by the European Union to countries involved in the process,

through pre-accession funds (CARDS, ISPA and SAPARD until 2006, and the IPA fund in the 2007-2013 period).

The economic aid provided by the European Union consists of financial support for the renewal and reconstruction of countries entering the process and, at a later stage, for implementing reforms being carried out in the function of fulfilling the Copenhagen Criteria. The Instrument for Pre-Accession Assistance (IPA) has five components from which various projects may be financed: reconstruction, institutional renewal and building; cross-border cooperation; regional development; fight against unemployment and rural development.¹ The first two components are open to all the countries undergoing the process, while the remaining three are accessible only to those with candidate status. At the same time, the process imposes a series of political and economic conditions, meaning that the Western Balkan countries must reach certain economic, political and institutional standards. This includes the development of certain values, such as the development of democracy, human rights and a market economy. These conditions are the same as those given as criteria for admission. This once again means that the European Union, conscious of these countries' backwardness in almost all areas, has foreseen a number of ways to prepare the Western Balkan countries for future accession to the Union.

The Stabilization and Association Agreement is the basis of the eponymous process, and represents a specific form of Association Agreement. It is an obligatory agreement applying exclusively for the six Western Balkan countries. The Agreement regulates political, economic and trade relations between the European Union and the signatory country all the way up to the moment of its entry into the Union, encompassing provisions that can be categorized into nine chapters:

- Political dialogue;
- Regional cooperation;
- Free movement of goods;
- Movement of labor, company founding, provision of services, capital;
- Harmonization of laws in certain areas;
- Cooperation in the areas of the judiciary and internal affairs;
- Cooperation policy;
- Financial cooperation;
- Institutional arrangement for implementing the Agreement.

Stimulating the political, economic and institutional stabilization of the Western Balkan countries and the entire region contributes to the establishment and strengthening of a stable European order based on the European Union as its core. The attainment of this goal requires democratization, the rule of law, respect for human and minority rights and freedoms, reform of state adminis-

¹ B. Todorović, M. Davidović, Z. Srećić, *Ekonomsko-privredni vodič kroz Sporazum o stabilizaciji i pridruživanju*, ISAC Fund, Belgrade, 2009, p. 9

tration and institution building, improved cooperation in economic and other areas such as the legal system and internal affairs. In that sense, special attention is paid to the strengthening of national and regional security.

Leaving aside the political aspect of the Stabilization and Association Agreement, its essential element is the establishment of a free trade zone. In Serbia's case, the zone will be established in a transition period of six years from the day the Agreement comes into force. Its coming into force means the abolishment of all tariffs, quantitative limitations and similar measures regarding the export of industrial and agricultural products to the European Union. The only exceptions to this trade regime are in the domain of a certain number of textile, agricultural and steel products. Also abolished will be tariffs and quantitative limitations on imports from the European Union, with tariffs on industrial and agricultural products gradually being reduced until the expiry of the set transition period. In other words, the market of the European Union opens up much more quickly in favor of associate countries.

For most of the Western Balkan countries, the fulfillment of the economic conditions represents the biggest problem, as these are countries with a tradition of planned economies. Even though it is facing large problems in the implementation of economic reforms, Serbia has much larger problems in the fulfillment of the political conditions. Great political changes and instability are preventing reforms in all other segments of life.

4. The case of Serbia

The process of stabilization and association represents a path to the European Union, where association represents only the first stage, and accession the second, while the fulfillment of the Copenhagen conditions and the implementation of the Stabilization and Association Agreement are presented as conditions for membership.

Association consists of:

- Holding meetings of the Consultative Working Group;
- Producing a positive Feasibility Study;
- Negotiating and concluding a Stabilization and Association Agreement; and
- Implementation of the Stabilization and Association Agreement.

Accession encompasses:

- Sending a membership application to the Union;
- Receiving candidate status;
- Negotiation and conclusion of an Agreement on Accession to the Union; and
- Membership in the Union once this agreement comes into force.

After the changes of October 2000, Serbia expressed readiness to begin negotiations on concluding a Stabilization and Association Agreement. The association process practically began in 2001, when a Consultative Working Group was established with the task of reviewing the situation in areas of significance for the stabilization and association process and, on that basis, issuing the appropriate recommendations and guidelines.² However, unforeseen delays in adopting the Constitutional Charter and the formation of the State Union of Serbia and Montenegro moved the deadlines connected with the association process. As a result, an Enhanced Permanent Dialogue was established in July 2003, which represented a new mechanism for cooperation between the European Union and Serbia-Montenegro. The Enhanced Permanent Dialogue was established so that the time until the beginning of negotiations on the Stabilization and Association Agreement would be used creatively.³

During 2004, Serbia's parliament passed a Resolution on Association with the European Union, while the EU Council of Ministers began to implement the "two track" model of negotiation. The two tracks referred to the possibility of negotiations on concluding the Stabilization and Association Agreement with both the State Union of Serbia and Montenegro and its member states, concerning issues that fell under their respective jurisdictions. Based on the work of the Consultative Working Group and the Enhanced Permanent Dialogue, the European Commission concluded in its report on the Feasibility Study of April 2005 that Serbia and Montenegro were prepared to begin negotiations on concluding a Stabilization and Association Agreement. The European Council accepted the European Commission's positive report and recommended that it produce guidelines for the negotiations.

In June 2005, the Government of Serbia adopted its National Strategy for Accession to the European Union. The National Strategy defines a work program and the coordination of the activities of all actors involved in the association process, so that the necessary reforms would be implemented in the fastest and most efficient way possible.

Negotiations on the Stabilization and Association Agreement officially began in October 2005, but the European Commission interrupted them in May 2006, because Serbia had not fulfilled its obligations regarding cooperation with the International Criminal Tribunal for the Former Yugoslavia (ICTY). After the Republic of Montenegro exited the S-M State Union, the Republic of Serbia adopted a new constitution, which came into force in November 2006. In February 2007, after parliamentary elections in Serbia, the European Council welcomed the Commission's preparedness to resume negotiations on the conclusion of the Stabilization and Association Agreement with the new government

² P. Paskvale: "Odnosi EU i Srbije", *Megatrend revija*, Vol. 6, No. 1, 2009, pp. 73-84

³ B. Budimir, V. Međak, *Vodič kroz pridruživanje Srbije Evropskoj uniji*, ISAC Fund, Belgrade, 2008, p. 47

in Belgrade, on the condition that it undertakes concrete and productive measures for full cooperation with the ICTY. After a period of political instability, a government was formed in May 2007, and it proceeded to fulfill the prescribed obligations soon after.

On the basis of the Council's conclusions from June 2007, in which the new government's efforts and activities were commended, the Commission resumed negotiations on the Stabilization and Association Agreement, which was initialed in November 2007 in Brussels and, together with the Interim Trade Agreement, signed in April 2008, at which occasion it was emphasized that full cooperation with the ICTY remained as the condition for the full realization and implementation of the Agreement.⁴ The National Program for the Integration of Serbia into the European Union was adopted in October 2008, while the unilateral implementation of the Interim Trade Agreement began in January 2009.

5. Serbia's achieved level of fulfillment of the economic requirements

When evaluating the fulfillment of the economic criterion, the European Commission analyzes two sub-criteria: 1) the existence of a functional market economy and 2) the ability to face the pressures of competition and market forces within the European Union.

5.1. Existence of a functional market economy

The existence of a functional market economy within a country is evaluated on the basis of the following elements:

- Is there a consensus on the most important elements of economic policy;
- Has macroeconomic stability been established, including price stability, sustainability of public finances and external balances;
- Is the market balance a result of the free movement of market forces (i.e., are prices and trade liberalized);
- Have the barriers for the free entry and exit of companies from the market been removed;
- Is the financial sector sufficiently developed to channel savings into productive investments.

The bases of economic policy – Monetary policy in the transitional 2001-2008 period was oriented toward achieving and sustaining the stability of prices and the financial system. Since mid-2006, the National Bank of Serbia (NBS) has implemented the new monetary policy through a regime of targeted inflation,

⁴ *Report on the progress of the Republic of Serbia for 2007*, working document, Commission of the European Union, Brussels, 2007, p. 2

by way of a reference rate on repo operations as the base instrument. However, the current monetary regime only resembles a targeted inflation regime, while the realization of monetary policy goals is additionally encumbered by the fiscal policy that has been waged thus far.

Fiscal policy was expansionary in the 2006-2008 periods, as support to the ruling structures in an atmosphere of political instability. The excessively loose fiscal policy contributed to the growth of external imbalances and inflationary pressures. A tightening of fiscal policy was announced in 2009, as an anti-crisis measure to counteract the influence of the global economic crisis on Serbia's economy. Generally speaking, the macroeconomic policy is not balanced, lacking sufficient fiscal limitations.⁵

Table 1: *Macroeconomic trends*

	2002	2003	2004	2005	2006	2007	2008
GDP, real growth in %	4.2	2.5	8.4	6.2	5.7	7.5	5.4
Industrial production, growth rate	1.8	-3.0	7.1	0.8	4.7	3.7	1.1
Current account deficit (without donations) in % of GDP	11.5	9.6	14.1	10.1	13.1	16.2	17.4
Foreign trade deficit in % of GDP	21.0	20.3	27.2	20.8	21.0	22.9	-
Unemployment rate in %	14.5	16.0	19.5	21.8	21.6	18.8	14.7
Inflation in %	14.8	7.8	13.7	17.7	6.6	10.1	6.8
Average net wage, real growth in %	29.9	13.6	10.1	6.4	11.4	19.5	3.9
Work productivity, growth in %	6.0	3.7	7.9	5.3	8.0	8.8	-
External debt in % of GDP	67.1	62.3	54.3	64.2	63.3	60.2	64.4
FDI in % of GDP	3.0	6.7	3.9	5.9	14.4	5.4	-

Source: *Bilten javnih finansija (Public Finances Bulletin)*, Ministry of Finance, Belgrade, April 2009, p. 14; M. Bošnjak, "Makroekonomske neravnoteže kao izazov ekonomske politike", *Trendovi*, RZS, Beograd, December 2008, p. 10

Macroeconomic stability – The high economic growth rate was achieved at the expense of a growing current account and foreign trade deficit, a high rate of inflation, low domestic savings and a high external debt. The problem does not lie in the existence of the deficits themselves but in their levels and their chronic character. Serbia's economic growth was achieved thanks to growth in aggregate demand (before all domestic demand), based on fiscal and credit expansion. With the onset of the global economic crisis, domestic and export demand fell, leading to a slowing of economic growth. On the other hand, the disharmony

⁵ Report on the progress of the Republic of Serbia for 2008, working document, EU Commission, Brussels, 2008, p. 26

between domestic demand and supply is the cause of the high current account and foreign trade deficits. Domestic demand is outpacing domestic supply, which is the central cause of high imports and the accompanying foreign trade deficit. The existence of a weaker supply relative to demand is the result of the delayed beginning of the transition process, inconsistencies in the privatization process and an unfavorable environment for investment.

The high foreign trade deficit of over 20% in the 2002-2008 periods was attained despite high rates of export, due to even higher import rates. Growth of imports was based on the rapid rise in wages, high public spending and a sharp credit expansion. On the other hand, the unsatisfactory level of exports was the result of the low competitiveness of domestic products, its bad structure and concentration on only six countries. Over 80% of Serbia's exports are placed on the markets of the European Union and CEFTA. Of that, about 50% of the exports to the European Union go to three countries: Italy, Germany and Slovenia. On the other hand, 90% of the exports to the CEFTA countries go to Bosnia and Herzegovina, Montenegro and Macedonia. Such a high concentration of exports on only a few countries negatively affects further export growth.⁶

The share of external debt in the GDP in the 2002-2008 periods was relatively high. On the one hand, the share of the public sector's external debt in the total external debt gradually fell while, on the other, the share of the private sector's external debt grew. The cause of the growth in the external debt of the private sector lay more in the growth in domestic company borrowing abroad than in borrowing by banks. In the 2008-2009 periods, the global economic crisis and NBS measures slowed the tempo of private sector borrowing, leading to a change in the structure of the external debt in 2009, which reflected increased borrowing by the state and decreased borrowing on the part of private companies and banks.

Table 2: *External debt structure by sector (in %)*

Sectors/years	2003	2004	2005	2006	2007	2008
Total external debt	100.0	100.0	100.0	100.0	100.0	100.0
Public sector	76.9	68.7	59.0	43.1	34.4	30.6
Private sector	23.1	31.3	41.0	56.9	65.8	69.4

Source: www.nbs.rs

Sustained single-digit inflation has yet to be achieved, even though it represents a key factor of macroeconomic stability. Mostly two-digit inflation has been registered, while single-digit inflation was achieved in 2003, 2006 and 2008. The basic reasons for price increases were credit expansion, growth in domestic demand due to growth in wages and public spending; jumps in the prices of

⁶ Strategy for increasing Serbia's exports in the period of 2008 to 2011, draft, Department for Economy and Finance, Belgrade, p. 12

crude oil, base metals and raw materials throughout the world; the correction in the disparities of domestic regulated prices; growth in the prices of agricultural products and food; lack of competition. Under conditions of an expansionary fiscal and moderately restrictive monetary policy, the high inflation was accompanied by appreciation of the dinar, which reduced the competitiveness of the economy, distimulated exports and generated growth in the current account deficit. Before all, the strengthening of the dinar was caused by high capital inflows from abroad.⁷ However, the external and internal crises brought on a sudden depreciation of the dinar in the period between October 2008 and February 2009, which had a negative effect on the economy and on business certainty.

The rate of unemployment has maintained a fairly high level over the years, without downward tendencies, which is the result of a slow strengthening of the private sector and huge shortcomings in the economic structure. Conditions additionally worsened at the end of 2008 and during 2009, under the influence of the global economic crisis on Serbia's economy. In addition, additional growth in unemployment may be expected in the first years of the implementation of the SAA and the creation of a free trade zone. Wage movements are another important aspect of the labor market. The 2002-2007 periods saw very dynamic growth in gross and net wages, which was not accompanied by a proportional growth in productivity. Such a dynamic of movement in these categories led to a rise in labor costs in Serbia, which essentially meant a reduction in the competitiveness of the economy and exports. That is why one of the key priorities of labor market reform is the harmonization of real wages with growth in production and productivity.

Liberalization – Since 2001, under the considerable influence of international factors (IMF, EU, World Bank), Serbia has been implementing a policy of a general liberalization of economic relations, especially of external economic relations. That in itself is good, but not if the liberalization is quick, insufficiently prepared and conceived, and if it does not take into account the country's economic structure and specificities. The badly executed liberalization, i.e., the lack of an institutional framework that should ensure the growth of the competitiveness of the economy, has led to a significant worsening of macroeconomic stability.

Private sector development – Rapidness of privatization is an important condition for a successful transition. The end of the privatization process was initially anticipated for 2004. However, it soon became evident that this was an excessively short period, so the deadline for the end of privatization was moved to 2007 for social companies and 2008 for public companies. However, even these

⁷ Milosavljević, S., 2007, "Tekuća privredna kretanja u Srbiji početkom 2007. godine i očekivanja do kraja godine", *Kako završiti privatizaciju u Srbiji*, advising session, Scientific Society of Economists, Academy of Economic Sciences, Faculty of Economics, Belgrade, p. 18

deadlines have been violated, leading to a new decision by which the privatization of social companies was supposed to be concluded in 2009. Most probably, due to delays in the implementation of the privatization process, new deadlines will once again be set. Now the end of privatization is slated for 2011, by when the privatization of portions of large public systems, such as the Electrical Power Company (EPS), Telekom (the state telecommunications company), JAT Airways and the Galenika pharmaceutical company.

Table 3: *Company privatization results*

	2002	2003	2004	2005	2006	2007	2008
No. of companies sold	212	641	241	311	281	344	291
Revenue from sales	319.3	840.3	158.4	376.6	276.4	482.3	302.0
Investment	320.2	319.8	100.7	101.6	313.5	130.6	64.7
Social program	145.8	128.3	2.6	0.0	0.0	0.0	0.0

Source: *Bilten javnih finansija (Public Finances Bulletin)*, Ministry of Finance, Belgrade, April 2009, p. 23

The results of privatization in Serbia are reflected in its chronic tardiness, insufficient inflow of privatization-generated funds, bad use of privatization revenues, frequently broken privatization contracts, falling number of employees and the anemic results of privatization in terms of increased employment and overall efficiency of companies and the economy.

In early 2009, the private sector's share in total production was still at an unsatisfactory 60%. State and socially owned companies still make up a large portion of Serbia's production, while private companies have a majority share in the area of trade. The absence of a greater private sector share in production represents a barrier to the development of competitive domestic products. In addition, unsustainable public companies still represent a great burden for public finances. Generally speaking, in spite of the achieved progress in privatization over the past years, a competitive and dynamic private sector has still not been fully established.

Entry into the market and exit from it – With the passage of years, the business environment has improved due to access to cross-border financing and trade, and the Law on Bankruptcy is now being implemented. However, it is still possible to additionally improve procedures for issuing permits, ownership registration, contract execution and business closures. In spite of slight improvement, onerous bureaucratic demands and complex laws continue to obstruct entry to the market and exit from it.⁸

⁸ *Report on the progress of the Republic of Serbia for 2008*, working document, Commission of the European Union, Brussels, 2008, p. 31

Legal system – Over the past nine years, Serbia has carried out significant institutional and structural adjustments. According to Article 82 of the Constitution of the Republic of Serbia, Serbia's economic order is founded in a market economy, an open and free market, entrepreneurial freedom, the autonomy of economic actors and the equality of private and other types of ownership. More than 400 systemic laws for regulating a market-based economic system have been adopted. However, legal predictability and trust in the legal system are still limited, especially when it comes to the effective implementation of ownership rights. In addition, widespread corruption and various criminal activities have a negative effect on the business environment and the work quality of public services. Before all, the legal system is suffering due to slow and unproductive judicial procedures; weak case management and limited administrative capacities. Such conditions discourage economic actors from taking their cases to court and undermine the efficient implementation of creditor rights.

Financial sector development – An important result of banking sector reform has been the reduction of the number of banks. Thus, as of 2008, 34 banks were operating on the territory of Serbia, as compared to 50 at the end of 2002. The number of banks with majority state ownership is still 8 (out of a total of 34), while 20 banks are now majority-owned by foreign shareholders. Six banks are majority-owned by domestic private individuals or legal entities. This shows that the process of selling private banks to foreign ones was taking place parallel to the privatization of banks with majority state capital. The process of bank privatization and selling resulted in the consolidation of the banks. Thus, the five largest banks in terms of assets make up 46.5% of the entire banking system. Generally speaking, although competition among banks has been well established, the formation of cartels and concentrations that can disrupt the competitive environment is still possible.

In 2008, the banking sector in Serbia made a net profit of 32.3 billion dinars, a 44.5% increase in comparison to 2007, which testifies to the profitability of this field. Since the banks' credit expansion is mainly oriented toward the general population sector, the prices of credits for the domestic economy are extremely unfavorable. Thus, approved credits to the general public increased from 2.8 billion dinars in 2000 to 396.9 billion dinars at the beginning of 2009, while in the same period credits to companies (excluding public companies) grew from 180.6 billion dinars to 725.4 billion dinars.⁹ The reason for this lower level of company borrowing from domestic banks lay in the fact that they borrowed abroad, where credit terms were more favorable. This resulted in the high indebtedness of the general populace at home and of domestic companies abroad.

The structure of the insurance sector has continued changing with the privatization of socially owned insurance companies and the arrival of new foreign

⁹ Source: www.diplomacy.bg.ac.yu/pdf/20090420_PKapor.pdf

investments. With the privatization of the second biggest insurance company (DDOR Novi Sad) in 2007, foreign ownership in the insurance sector increased significantly. Overall progress was made in the development of the financial sector; however, the reform of the banking sector did not have a wholly positive influence on the real sector.

5.2. Capacities for facing the pressures of competition and market forces within the European Union

A country's ability to face competitive pressures and market forces within the European Union's single market is evaluated on the basis of the following elements:

- The existence of a functional market economy, with a sufficient degree of macroeconomic stability, which should provide economic actors with stability and predictability for their decisions;
- The possession of a sufficient amount, with the accompanying costs, of human and physical capital, including infrastructure, education and science, and further development in these areas;
- The degree of influence on the part of the state and the legal system on the competitiveness of the country's economy, by way of trade policy, competition policy, state aid, support for small and medium companies;
- The degree of trade integration with the Union achieved by the country prior to expansion;
- The share of small and medium companies in the total number of companies in the given economy.

Existence of a functional market economy – A decline in macroeconomic stability accompanied by increased political instability has contributed to the creation of a less stable and less predictable decision-making climate for economic actors. The functioning of the market is negatively affected by frequent state interventions and a lack of healthy competition.

Human and physical capital – The achieved progress in the reform of the educational system is insufficient, i.e., the implementation of the Bologna Process is inadequate and slow. The state universities are overburdened with bureaucracy, while their curricula and programs are mostly outdated. Public spending for education over the years has equaled about 3.5%, which is significantly below European Union levels. The growing gap between the supply and demand of qualified labor represents one of the main barriers for increasing foreign direct investment and the development of new industrial branches.

Foreign direct investment (FDI) equaled 11.5 billion euros from 2002 to March 2009, mostly as a result of privatizations and acquisitions, and much less in the

form of greenfield investments. Concern regarding the current inflow of FDI also exists because investments had mainly entered the sector of non-tradable goods: banking, insurance, energy, telecommunications, real estate and retail trading. From a development perspective, the most important investments are those that stimulate competitiveness and exports. While large inflows into the non-tradable goods sector often leads to credit expansion and rising real estate prices, leading in turn to rising wages and a shift of resources from tradable to non-tradable goods, and a rise in the current account deficit. In that regard, Serbia remains a country with one of the lowest shares of tradable goods in the region of South-east Europe.¹⁰ FDIs in Serbia are not export-oriented but dominantly oriented towards the acquisition and conquering of the domestic market, which is why they contribute very little to export growth and the reduction of the foreign trade deficit. On the whole, FDI inflows into Serbia are insufficient, both in quantity and structure, and are below the country's absorption capacity.

The infrastructure – the road network, railroads, ports and airports – is inadequate for the needs of a modern economy.

Sector and company structure – The 2001-2008 periods saw dynamic growth in the service sector in Serbia, which was accompanied by a rise in its share in the GDP from 55.7% to 64.2%. Especially high growth in share was attained in the areas of telecommunications, wholesale and retail trade and the financial services sector. At the same time, the share of industry fell from 24.8% to 20.4%, while the agricultural sector's share in the GDP fell from 15.7% to 11.8%.¹¹ In the context of employment, as of 2008, 50.2% of all employed persons worked in the service sector, while 29.3% were employed in industry and 20.5% in agriculture. Up to 50% of those employed are still working in state and socially owned companies, and the grey economy sector is still important. On the whole, the tempo of structural adjustment is lagging due to the slow process of reform.¹²

Influence of the state on competition – State-controlled monopoly structures are still present, such as the prohibition on oil derivative imports in order to protect the oil refining industry from foreign competition. A tendency of better control over state subsidies has been observed. However, the Law on the Control of State Aid was not adopted until 2009, which has delayed the establishment of the appropriate monitoring mechanisms on the part of the Commission for State Aid Control. Thus, we still have numerous cases of selectively granted state aid.

¹⁰ B. Begović, B. Mijatović, M. Paunović, D. Popović, *Grinfield strane direktne investicije u Srbiji*, Center for Liberal-Democratic Studies, Belgrade, 2008, pp. 18, 23

¹¹ Izveštaj o razvoju Srbije 2008 (Report on Serbia's Development), Republic Development Bureau, Belgrade, 2009, p. 19

¹² Report on the progress of the Republic of Serbia in 2007, working document, EU Commission, Brussels, 2008, p. 24

State and social monopolies have been replaced by private monopolies because privatization was carried out in an atmosphere of unregulated competition. The existing legal solutions (Law on the Protection of Competition from 2005 and 2009) cannot resolve the inherited situation, since Serbia's market has already become monopolized. On the other hand, Serbia's competition policy is non-existent, i.e., there is no document, analysis or plan that affirms its existence. Yet, all processes tied to the implementation of the Law on the Protection of Competition are a part of the entire process of harmonizing Serbia's laws with the law of the European Union and are not a part of any separate policy (Serbia's competition policy).

Economic integration with the European Union – The European Union market is important for exporters from Serbia due to a more favorable treatment that allows a large number of products to be exported without tariffs, including a large number of products exported under preferential status. As a result, in the first seven months of 2007, exports to the European Union rose 35% compared to the year before, making up 58% of total exports, while imports from the European Union grew by 31%, making up 56% of total imports. The realization of the Stabilization and Association Agreement will lead to even stronger cooperation and integration between Serbia and the European Union.

Influence of small and medium firms on the domestic economy – Small and medium firms make up 99% of the total number of economic entities, and provide for up to 60% of the total number of jobs. In spite of improvements in the business environment, barriers for small and medium firms are still present, such as a low level of solvency, over-indebtedness and limited access to long-term financing.

6. Priorities of the reform process in the coming period

Serbia has made certain progress in the direction of establishing a functional market economy, but is still not able to deal with the competitive pressures and market forces within the European Union. Table 4 provides insight into the key priorities of the reform process in Serbia, towards the goal of fulfilling the economic conditions.

Table 4: *Reform priorities*

Area	Guidelines and recommendations
Macroeconomic policy	Carrying out a fiscal policy oriented towards the maintenance of stability, including wage policy in the state sector, whose goal is fiscal consolidation through low inflation and external sustainability; improving monetary policy with the goal of maintaining price stability in order to reduce and stabilize inflation, better coordination of economic policies and strategies.
Exports	Growth in export competitiveness, change in its structure, and geographic diversification of the export program; improving the conditions of export financing and insurance; improving Serbia's image.
Liberalization	The liberalization of the remaining regulated prices with the goal of improving the efficiency of market mechanisms and resource distribution; continued adjustment of the foreign trade regime to WTO and SAA rules.
Privatization	Finalizing the privatization of large public systems and resolving the position of 400 small public utility companies; revision of disputed privatizations; better protection of workers' rights in privatized companies and in the privatization process
Market barriers	Quickening the exit of unprofitable companies from the market; overall simplification of bureaucratic procedures.
Legal system	Reducing the quantity and improving the quality of legal regulations, lowering the costs of their implementation and improving the system of controlling their execution; adopting a Law on restitution
Financial sector	Continued development of the capacities of the banking sector in order to secure its competitiveness and long-term competitive financing; strengthening transparency in the banking sector and education of banking service users; strengthening of financial control in order to ensure a stable financial sector.
Educational system	Adapting educational profiles to the demands of the labor market; correcting the disbalances between practice and the demands of the Bologna Declaration; building of mechanisms to improve intra-sector mobility and recognition of prior education; promotion of permanent education and adult additional training and education.
Foreign direct investment	Financing and attracting FDI in production-oriented businesses and exports; promoting the country, targeting investors and improving the overall investment climate in order to attract greenfield investments; active preparation for a new wave of investments that will arrive after the end of the global recession.
Industrial policy	Adopting a new industrial policy in accordance with the demands of the European Union; stimulating the building of industrial clusters.
Competition	Drawing up Serbia's competition policy; strengthening the independence of the Commission for the Protection of Competition; adjusting the right to competition to the needs of the Serbian market; conceiving state aid control so as to protect competition.
Economic integration	More active preparations for implementing the SAA, realization of the free trade zone, financing the costs of the process and informing broader segments of society about the coming changes

7. Conclusion

Serbia is currently in the initial phases of realizing the Stabilization and Association Agreement. The Agreement does not make Serbia a member of the European Union but does represent a basis for Serbia's inclusion into the membership process. The advantages of the Agreement and its possibilities are reflected in the fact that it provides the framework, direction and guidelines, as well as financial resources for more rapid overall reforms in Serbia.

Serbia's path to the European Union matches the internal process of transition, which is why Serbia is especially interested in fulfilling the pre-accession conditions. Serbia has made significant progress in the fulfillment of the economic demands thus far, but it is still unprepared to successfully deal with the pressures of competition and the market forces within the European Union. Unfortunately, Serbia has done less in this regard than the remaining countries in the region, which means that it will be faced with serious structural reforms, the settling of macroeconomic imbalances and institutional ordering.

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A NEW PAGE IN THE HISTORY OF HIGHER EDUCATION IN SERBIA

*An essay on the book by Professor Mića Jovanović Božinov, PhD
“The Mind Reigns – A History of Megatrend University 1989 – 2009”
Megatrend University, Belgrade, 2010*

A monograph on Megatrend University recently appeared in print under the resounding title *The Mind Reigns – A History of Megatrend University 1989 – 2009*. Its author is Professor Mića Jovanović, rector, creator and founder of this prestigious institution of higher education.

The monograph contains twelve chapters, which give a concise description of individual phases in the development of the oldest and largest private university in Southeastern Europe – from the founding of the “Megatrend” Business School, all the way up to 2009, the 20-year anniversary of the existence and work of Megatrend University.

The monograph’s functional composition, with an accent on the most important facts, allows the reader to follow the history of the creation and growth of Megatrend University in a concise way. The well conceived, functional chapters are titled so as to allow the reader to efficiently “scan” the text and successfully follow the developmental phases of the Megatrend project, as it is usually termed – *from idea to realization*. These phases were the following: *Beginnings, Prehistory, “Megatrend” Business School, Tempus, Undergraduate Studies and Further Development, Always a Step Ahead of Others, Megatrend University of Applied Sciences, Megatrend University – Phase II of Development, Adulthood, A Step Ahead of Everyone, The First Twenty Years of Megatrend University and Megatrend University after Twenty Years*.

The chapter titles themselves are already indicative of the “thorny path to the stars” taken by Megatrend University in its development. This institution’s creative and cosmopolitan spirit has been developing since 1983 – when the “Emberstar” consulting company was founded, as a sort of “forerunner” to today’s Megatrend – from its international promotion in 1987 and 1989, all the way up to the present day – affirming, in the process, the highest standards of

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teaching. The basic paths of Megatrend's development policy comprised modernization of learning, acquisition of knowledge and artistic skills, evaluation, and the application of what has been attained. Built into the foundation of the project was the far-reaching idea of making a contribution to the development of social, economic and spiritual creativity through knowledge and the modern education of young people. In the process, the key in the creation and work of this institution – which can also be marked as the driving force behind its initial and present development – is embodied in the slogan of always being “a step ahead of everyone.”

As a public, independent and autonomous higher education institution, Megatrend University has turned a new chapter in the history of higher education in the Republic of Serbia. The “biography” of Megatrend University is at the same time a reflection of the dramatic social changes during the 1980s, which heralded fundamental reforms in proprietary relations and opened the way to the establishment of private educational institutions.

In social conditions in which not a single private educational institution existed in the Republic of Serbia, much creative ability, courage and political imagination was needed to find a model for the establishment of the first private higher education institution in this region – the future Megatrend University. One of the useful experiences that helped in this process was tied to the “Emberstar” consulting company, which provided consulting services and organized seminars for introducing innovations in the work of the management of large British automobile companies and the British business public as a whole.

As personally testified by Professor Mića Jovanović, it all began on August 24, 1980, with the opening of an account in London's Barclays Bank, for the purposes of founding the “Megatrend” – London consulting organization. The well chosen name of this organization, which now has a worldwide reputation, became the first Serbian brand in the field of education. New not only in name but in spirit, it was the fruit of Professor Jovanović's futuristic imagination, making association with new big trends in the field of education that were yet to come. As a contribution to the history of the study of modern ideas and epochal tendencies remains the fact that the famous American futurologist John Naisbitt published his bestseller *Megatrends* three years later, using, as it turned out, the same association in conceiving this term.

The initial moment of Megatrend University's development process and activity is tied to December 27, 1989, which was the day when the competent ministry gave official approval for the beginning of the work of the first higher education institution of the future Megatrend University – the “Megatrend” Business School. From today's perspective, that moment was not significant only for the history of Megatrend University, but for the history of higher education in the Republic of Serbia as a whole.

In its initial phase, after the example of its precursor, this institution provided consulting services and organized lectures for the management cadres of successful domestic companies and the domestic business public, with the lecturers being eminent international management experts. As the monograph relates, that was an undoubtedly historic moment, as lectures in the field of the contemporary concept of management and work organization were, in the social context of the time, something totally new and unfamiliar. Those seminars, with their interactive teaching, discussion, workshops and solutions to concrete problems from practice, laid down the path for the future method of work that fused with the business and organizational concept of Megatrend University.

The engagement of experts and participation in international gatherings and conferences was a successful concept: it turned out that international exchange of experiences in business is one of the most efficient ways to allow the interaction of various civilizations and cultures, and the enrichment of contemporary society with new business experiences. Such a dynamic and open approach brought, among other things, international affirmation to Megatrend, which was recognized in 1990 in London as a consulting-educational institution, while a year later it became a full member of the global organization when it received international accreditation. This event represented an exceptional international recognition not just for Megatrend but for Professor Mića Jovanović, who was elected to membership of the Executive Committee of the reputable Euro-Asia Management Studies Association (EAMSA).

In reconstructing the history of Megatrend, as in all great histories, the author of this monograph also plays the role of discreet educator. The motto of his work can truly be associated with the classic slogan “through the thorns to the stars” and, in that sense, this book represents both a great lesson and a firsthand tribute to perseverance. And, even when the basic battle for a new educational concept was safely won, there was no time to rest on one’s laurels. Although the Megatrend project had garnered undoubted recognition among both the domestic and the foreign public, the battle for an essentially innovative and anticipatory project continued. There ensued hard work on the development of higher education in an environment of transition, war and UN sanctions. In such a context, one had to secure the means for implementing innovations, not only in the area of management but also in the area of institutional education, establish new educational standards, secure space for operations. In addition to all that, under conditions of a centralized state, one had to expand the activities of the “Megatrend” Business School to other study centers in other cities in the Republic of Serbia.

In analyzing the initial experiences in the work of Megatrend University, the author indicates that the experience from the initial and developmental periods has been built into Megatrend’s creative matrix, crystallizing into a specific kind of business lesson. Everything that characterized the development process

of Megatrend University from the very beginning and contributed to the quality of its work is also present today. According to Professor Mića Jovanović, these are the “four support pillars” of development – outstanding professors (“brain trust”), contemporary curricula and programs, modern textbooks and strong international cooperation. In addition to all that, faith in success and a good reputation regarding the quality of studies, together with the application of new educational technologies, have helped the overcoming of many administrative and competitive barriers, as well as the achievement of “mission impossible” in the social conditions of the time – increasing the number of students and the official opening of the Graduate School of Management in Zaječar, in accordance with the official decision of the Ministry of Education of July 22, 1996, by which this institution joined the higher education system. Already in 1997, there ensued the opening of the Faculty of Management in Zaječar, as well as the achievement of a pioneering project at the end of 1997 – distance learning within the “Megatrend” Business School in Belgrade.

The founding of the School of Agriculture in Negotin, the Institute for New Technologies, the Faculty of Business Studies and the Faculty of Geoeconomics opened the way to the founding of Megatrend University of Applied Sciences, seated in Belgrade, Makedonska St. 21, by the decision of the then Ministry of Higher Education of June 20, 2000.

The obtaining of official approval for the opening of Megatrend University was a sign of high recognition and represented a reward for long, exhausting years of work and the united collective spirit of the professors, eminent international experts and the entire Megatrend staff who, as can be gathered from the monograph, “breathed as one.” Nevertheless, before all, success came as a result of the inexhaustible energy and professional experience of Professor Mića Jovanović who, even in the most difficult circumstances, found ways of being “a step ahead of others.” In that sense, recognition also became an obligation – the earned reputation had to be justified, which was accomplished with the introduction of a new concept of education – virtual studies.

The Megatrend Virtual University developed between 2000 and 2002, and its first generation numbered about 200 students. Communication between students and professors was modernized – direct or indirect communication with the relevant professor was made possible, which was a big step forward, not only here, but in the world at large.

The reputation earned worldwide was affirmed in 2005, at the occasion of Megatrend’s fifteenth anniversary, when the French education ministry approved two-year studies at the first Serbian higher education institution in Paris (Institut de Management de Bozinoff). In the same year, in cooperation with the Canadian Royal Roads University, Megatrend University of Applied Sciences introduced graduate studies in the field of civil aviation management, two franchise programs with the School of Business Management in Grenoble (Bachelor of

International Business and Master of International Business), and the Faculty of Art and Design, while the Faculty of Biofarming in Sombor received approval for work four years after having applied for accreditation. The further development of Megatrend University allowed it to gain the reputation of the largest and oldest private university in Southeastern Europe, after 20 years of operation. The university currently enrolls 25,000 students, with 615 professors with a doctorate and 147 assistants with master's degrees being responsible for the quality of studies.

This stride into the world was accomplished not just by introducing innovations but – as Professor Mića Jovanović points out – by “promoting beauty and brains,” for Megatrend University had already provided scholarships for the best students for years before that (starting with academic year 2005/2006, they were schooled from the University budget, which was a novelty for private universities), as well as for less materially well-off students, top athletes and those talented in various fields. The University's students have won numerous medals in domestic and international competitions in sports, knowledge, culture and art, being worthy representatives of not only Megatrend University of Applied Science but of our country as well.

Thus, the reputation of Megatrend University grew from year to year, and the awards kept coming, to the University itself, the students and the professors (in 2005, Professor Mića Jovanović was awarded the Golden Badge of the Belgrade Cultural-Educational Association for his contribution to education and culture in Serbia, in 2006 the important “Golden Link” award for a lasting contribution to the culture of Belgrade, and in 2007 the International Socrates Award for intellectual achievement in the 20th century, along with numerous other awards). This period also saw the addition of new University buildings, the construction of new facilities, increased student enrollment, the opening of TV “Metropolis,” and an increased media presence. This good reputation spread to the rest of Europe as well, making this a prestigious private university on a global scale, with a recognizable name and quality.

The monograph *The Mind Reigns* is a vivid, firsthand testimony of the origins and development of Megatrend University. The author is also the main protagonist of this exciting story about a persistent struggle for new trends in the areas of knowledge, science and education. Appearing as both witness and “accomplice” in the creation of an institution of vital importance for the development of our society, and especially for the advancement of the young generation, the author is also an uncompromising analyst and an unimposing educator. A special feature of Jovanović's approach to the topic is certainly his dispassionate insistence on facts and data. All the claims, observations and qualifications in the monograph are backed by facts and valid documentation. Many documents are directly presented in the book – as facsimiles or clearly cited sources, or by way of scrupulous reconstruction. In that sense, the book's pages serve to “resurrect” the lively pulsating social and political milieu of the last decades of the

20th century – that watershed when history's turbulent winds strongly shook this soil.

For future students of this time, Mića Jovanović's monograph *The Mind Reigns* will represent a first-class and reliable testimony, an unavoidable document on the basis of which the newer history of higher education in Serbia, as well as its social life, can be reconstructed.

Having grounded the monograph's contents on scrupulous factography, Professor Jovanović did not, however, avoid subjective commentary regarding certain phenomena, tendencies and even personalities that, in one way or another, appear as actors in the book. These excursions into the sphere of personal impression, the citing of collocutors, and even the mild and, one might say, typically pedagogic invective directed toward certain individuals that were considered in a critical context, form a part of the general picture and complex milieu in which the great story about the founding and growth of an institution such as Megatrend University took place. These intimations in the text stand as testimony of the author's insistence on the principle of truthfulness and the objectivity of the spoken.

The narrative method in the text of the monograph mostly belongs to the model of the popular scientific style, which is certainly a good choice, as the book is intended for a broad circle of readers – from the student population to expert and academic circles. In that context, we should certainly emphasize the visual and aesthetic characteristics of this, in all aspects expertly and creatively conceived monograph, whose exceptional design, textual format, accompanying supplements, documents, photos and illustrations satisfy the highest standards of specialized publicist literature. At the same time, with the guiding idea and experience gained through its reading, it can serve as a guide to successful business – revealing to us the secret of achieving success in almost impossible conditions.

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ADMINISTRATIVE LAW

*An essay on the book “Administrative Law” by Prof. Mirko Kulić, PhD
Megatrend University, Belgrade, 2010*

Having recognized the shortcomings of the theoretical approach in the current administrative law milieu, Prof. Mirko Kulić took up the task of producing a textbook that we can without reservation qualify as a valuable contribution to the already existing corpus of literature in this field. The textbook “Administrative Law” moves within the coordinates of the author’s interpretation of the educational mission: to make a clear concretization of the otherwise dispersed subject matter of administrative law and make it accessible and attractive to students. This, of course, is not the sole feature of this knowledgeably written work, whose value should be considered from two viewpoints which, in their integration, ultimately testify to the work’s multiple perspective. Namely, its systematic approach and consequent conciseness make it attractive reading even for an audience that is not obliged to master administrative law as exam material while, at the same time, serving as a way of prodding our expert public from intellectual passivity and indifference. The author’s responsibility is all the greater having in mind the subject matter’s fundamental importance. We can say that the author’s academic virtuosity has ensured that “Administrative Law” made successful choice of the areas to be included within the limited confines of a textbook, which were then arranged and structured guided by the needs of young people who are making their first, tentative steps in the academic research milieu.

“Administrative Law” was published in January 2010 by Megatrend University in Belgrade, and is used as required reading at the Faculty of Public Administration, which is what guided the author’s approach in articulating the subject matter in the proper context. Professor Kulić treats the institutes of administrative law in a very subtle manner, appealing to readers’ understanding in an innovative, plastic and understandable way, using his evident erudition as a legal writer.

The textbook contains 311 pages, systematized into five harmonious wholes that offer a path to the revitalization and modernization of this academic discipline in our domestic conditions. The topics that are treated by chapter are

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explained with illustrative examples that serve as a bridge between the concept and its possible application in practice. The thematic framework and contents of this expert work, on the one hand, and the language with which they are communicated to the reader, on the other, offer a pleasant and balanced thinking environment.

The studiousness of the general introduction justifies the academic legitimacy of this scholarly text. Prof. Kulić's literary inspiration is obviously grounded in his need to tackle the acute, chronic difficulties that accompany the profiling of the basic determinants of administrative law, rejecting mechanistic acceptance of improperly defined categories. The author's analytical approach to expert phenomena at the very beginning of the work gives birth to ripe synthetic conclusions. Prof. Kulić's textbook makes no concessions to rhetoric or flowery style, incomplete or ambiguous sentences, provocatively or polemically intoned remarks. Instead, the text represents a moderate and precisely formulated synthesis of accepted scholarly knowledge, written in an academically grounded, literarily correct and clear language style. In the general section, the author approaches administrative law both as a branch of law and as a scholarly discipline, presenting in greater detail the concept, subject and task of administrative law, the methods of administrative law science and, finally, seeking to distinguish administrative law from other branches of positive law, such as constitutional, tax, criminal, civil and other law. Through his comparative understanding, the author underlines their compatibility as well as their differences, thus leading the reader into the spectrum of further possible aspectual elaboration and particular viewpoints. In further text, Prof. Kulić makes a productive overview of the theoretical concept of administration, distinguishing between the legal-political, socio-technological and modern approach, without neglecting the modern theoretical concept of administration that can be experienced in the functional and organizational concept. Guided by interest in the practical application of concrete legal norms on administrative work and organization, the author also deals with the content-based and terminological relationship between the theoretical and the positive legal concepts of administration. In this general portion, we also find a useful qualification of elementary tools for mastering legal-administrative matter. In presenting each of its individual institutes, Prof. Kulić seeks to understand the *ratio* of its origins and genesis, and its subsequent material and procedural evolution.

Prof. Kulić's ability to tackle demanding and dynamic subject matter and present it in an exceptionally fruitful way is especially evident in the part dealing with substantial concepts, where he makes the legal-administrative relationship and the legal-administrative norm, as the primary institutes to be mastered, understandable and inspirational for the reader. He points to the characteristics that are inherent to the legal-administrative relationship which, at the same time, distinguish it from other forms of legal relationships, as well as to the legal-

technical characteristics of legal-administrative norm – which has proven of great use in understanding its nature. The general portion ends with a fragment devoted to the sources of administrative law, in which the author appeals for a clear distinction between material and formal sources and then, in the domain of the latter, makes a further distinction between direct and indirect sources.

In the second part as well, the author successfully constructs a foundation for giving direct, constructive instruction to students. Professor Kulić had no pretensions of making his textbook into a repository of the entire body of legal-administrative theory or regulations. Instead, he founded his methodological approach in a summary of useful knowledge, whose adequate interpretation will steer students away from fruitless efforts in preparing for their exams. In this segment, the author deals with the organization of state administration, especially the concept of state administrative organs, their classification and administrative organization, followed by a critical, dispassionate and uncompromising treatment of the state administration in Serbia, where special attention is devoted to the principles of state administrative organ activity and their organization (ministries, administrative organs within the ministries and separate organizations), administrative districts, and cadres (ministers, state employees and appointees). Here, Prof. Kulić emphasizes that the modern state must be freed from the legacy of stereotypical fears of highly qualified, expert and professional cadres. The section goes on to treat non-state administration, i.e., the carriers of public authorization in Serbia and, finally, the relationship between state administrative organs and other organs, such as the National Parliament, the Government, etc.

The third part of the textbook is devoted to the activities of public administration, its tasks, administrative regulation, contracts and acts, administrative activities and liability for damages arising from administrative activity. This part of the text, like the preceding ones, is replete with facts, definitions and concepts founded on postulates of scholarship and objectivity. The author's intention to present new and original insight into areas that have often been marginalized is quite apparent.

The penultimate portion of the textbook, which is also its longest section, is filled with information, emphasizing to practitioners the importance of acquiring new knowledge and the practical application of newly adopted skills. This part of the text contains the pragmatic knowledge that, by definition, students will find of the utmost importance. Professor Kulić uses understandable terminology, stripped of unnecessary comment; thus, the subject matter is interpreted in a spirit that corresponds to contemporary circumstances, accompanied by frequent use of primary sources, testified by the impressive number of listed references. Such a scientifically and methodologically moderated approach serves as indubitable confirmation of the author's highest level of expertise.

In the portion dealing with administrative procedure, Prof. Kulić makes an inspired exposition of its concept and significance, making the point that it is precisely the rules to which public administration actors must adhere in the process of applying material-legal regulations from the field of administrative law to concrete cases that should be qualified as administrative procedure. This is followed by an exhaustive treatment of various types of administrative procedure, distinguishing between the general and the special, of the basic principles of procedure prescribed in the Law on Administrative Procedure (also emphasizing their legal significance), followed by observations regarding actors that participate in administrative procedures, and a consideration of the mechanism of communication between the organs and the other participants in administrative procedure (submissions, summonses, minutes, information on the procedure process, delivery). There is also a very studious and innovative treatment of the modes of decision-making competencies in administrative procedure. The subsequent pages of this portion are reserved for deadlines, restoration to the previous state, maintaining order and, finally, the costs of administrative procedure as its integral part.

The effective analysis of administrative procedure of first instance – which, according to the author has the goal of determining the legally relevant factual state of affairs and bringing decisions upon party request – avoids doctrinaire trivialities and digressions that might encumber the text. Prof. Kulić quite authentically presents the standard course of procedure. In further text, the thematic areas are devoted to second instance administrative procedure, special administrative-legal procedure and administrative executive procedure.

Near the end, prof. Kulić's conceptually consistent text passionately promotes some exceptionally important content matter – the concept, types and subjects of administrative dispute, its participants and other details, offering a definition of the administrative dispute as a means of judicial control of the work of public administration and protecting legality and the rights of private persons and legal entities.

The authority enjoyed among the expert public by prof. Kulić, as an author with an impressive opus and of thoughtful insight, along with the names of the highly eminent reviewers of the work serve as guarantees for the quality of this textbook. Although it initially appeared as premature, the bold prediction given upon reception of this work has been proven correct, thanks to the author's fruitful academic integrity. The importance of this book as a base for further education lies in its coverage of a respectable amount of administrative content from the standpoint of the needs of modern legal studies, justifying the conclusion that this work represents an integration of a modern textbook and a valuable contribution to the identity of administrative law.

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