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C O N T E N S

1. Biljana Predić, Maja Ivanović-Djukić METHODS OF SOLVING AGENCY PROBLEM	1
2. Dragoslav Kitanović, Miloš Krstić THE IMPACT OF FOREIGN EXCHANGE RATE ON THE ECONOMIC GROWTH OF SERBIA.....	13
3. Radenko Milojević, Marija Andjelković Pešić BUSINESS CULTURE AS ACCELERATOR OF BUSINESS EXCELLENCE MODEL IMPLEMENTATION.....	29
4. Branko Rakita, Dušan Marković MANAGING SOCIO-POLITICAL RISK, MARKETING AND BUSINESS ACTIVITIES IN FOREIGN COUNTRIES.....	41
5. Aleksandar Radivojević, Ivan Filipović, Vukašin Šušić SPACIAL AND FUNCTIONAL CHANGES IN THE MUNICIPALITY OF SOKOBANJA DURING THE SECOND HALF OF 20th CENTURY	57
6. Isidora Ljumović, Srđan Marinković, Vesna Milanović-Golubović CORPORATE REBRANDING FOLLOWING MERGERS AND ACQUISITIONS IN THE SERBIAN BANKING INDUSTRY	69
7. Marija Džunić EFFECTS OF SOCIAL CAPITAL ON THE EFFICIENCY OF SOCIAL OUTCOMES	89
8. Vladimir Dženopoljac CONTEMPORARY TARGET COMPANY VALUATION METHODS IN THE ACQUISITION PROCESS	103
9. Milica Radović SERBIAN STOCK MARKET TREND ANALYSIS FROM 1ST MARCH, 2006 TO 31ST MARCH, 2009.	115
10. Biljana Bogićević Milikić EMPLOYEE TURNOVER: CAUSES, CONSEQUENCES AND MANAGEMENT	131



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METHODS OF SOLVING AGENCY PROBLEM

PhD Biljana Predić*

PhD Maja Ivanović-Đukić*

Abstract: *Separating ownership from management in enterprises leads to the appearance of agency problem that is emphasized in large corporations with a great number of shareholders and where the power of top managers is excessive. Immoral behavior of managers towards shareholders can lead to a company's crash, loss of the life savings of shareholders and numerous economic and social consequences. In order to mitigate the negative impact of agency problem, a great number of measures are undertaken by enterprises. The aim of this paper is to explain measures that can be implemented in the enterprises of shareholder type for prohibiting immoral behavior of managers towards shareholders and thus, avoiding negative consequences of agency problem.*

Keywords: *management, shareholder, agency problem, Corporate Governance Code, shareholder value...*

Introduction

In large enterprises, where managing is extremely complex, the owners choose qualified persons-managers, who will lead the business (manage the enterprise). That way, it comes to the division of the management function from the ownership function. The job of managers is to manage business so to secure the continual increase of invested assets for owners. Since managers have their own objectives (maximization of their earnings, maximization of managerial influence and power), it can come to opportunistic and disloyal behavior of managers towards owners. The situation, when managers work to the satisfaction of their own interests at the expense of the owner's interests, represents the so called agency problem.

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Agency problem is evident in large corporations, where a large number of diversified assemblies of shareholders (from institutional investors to individuals with minor deposits) that do not have insight into the work of agents (managers) are present. On the other side, top managers of large corporations possess too much power and have benefits from their behavior, but that behavior is at the expense of shareholders and other stakeholders of the corporation. These problems have recently emerged, as some large enterprises, like “Enron”, for example, have bankrupted because of the opportunistic behavior of managers. The bankruptcy of the company “Enron” is considered as one of the biggest scandals in the US because of the immoral behavior of its managers, whereby the founder and chief executive officer of the company have been sentenced to life imprisonment.

The company “Enron” is not unfortunately a unique victim of the immoral behavior of managers and an example of obvious agency problem. There are many such examples in foreign and domestic practice. In order to eliminate or mitigate the negative impact of agency problem and incite managers to work in the interest of owners, a large number of measures are undertaken:

- forming of the control bodies monitoring the work of managers
- application of the Corporate Governance Code,
- connection of the rewards of managers to the earnings of shareholders and the like.

Control Bodies Monitoring the Work of Managers

Because of the division of the ownership function and the management function and opposite interests of owners and managers, a need emerges for controlling the work of top managers. External bodies perform the control of the work of top managers (auditors that control financial statements) as well as internal bodies. In an individual enterprise, the owner performs the internal control of the work of top managers. If an enterprise has many owners, which is the case of large corporations, then the bodies that control the work of top managers are chosen at the general meeting. Control bodies that monitor the work of top managers are not the same in all enterprises. There are mainly two models of internal control considering the work of managers: first degree and second degree models [1, p. 194].

First degree model of the internal control of top managers presumes that a board of directors controls the work of top managers. The members of the board of directors are elected by the assembly of shareholders. It is comprised of top managers, and often a top manager is elected the head of

Methods of Solving Agency Problem

the management committee. Besides top managers, within the management committee there are managers of the enterprise and business people from other organizations (managers of other enterprises, faculty professors, consultants, etc.). This model of control is dominant in enterprises in the US, Great Britain, Italy, France [2, p. 23].

In enterprises which use such a model of the control of the work of top managers, freedom of top managers is relatively high, since top managers (as representatives of management committees) control their work themselves, thus in turn negative consequences of agency problem manifest themselves. The justification of such a model involves lower costs and bureaucracy, since there is no hierarchical level of control above the level of the top management. In order to increase the objectivity of the control concerning the work of top managers and to reduce the potential malversation of top managers, people that are not part of the enterprise are elected for the members of the management committee so that they could objectively estimate the strategic decisions and behavior of top managers.

In the second degree models of the control of the work of top managers, there are two control bodies, the management and inspecting committee, whereby each can be dominant. When the second degree model with the domination of the inspecting committee is present, then the situation is as follows: the assembly of shareholders elects the inspecting committee composed of people from external environment, and the inspecting committee elects the members of the management committee, follows their work and defines the compensation. The management committee is composed mainly of the managers of the enterprise and its head is a top manager. This model is dominant in enterprises in Germany, Austria, Denmark [1, p. 194].

In enterprises in which this model of the control of top managers is present, there are potentially less possibilities of top managers to behave irresponsible towards shareholders owing to the greater objectivity of the control of their work and behavior. But, a great shortcoming of this model is in the fact that a hierarchical level emerges in the structure of management so that there are higher costs (compensations to the members of the inspecting committee).

In Serbian enterprises, a different variant of the second degree model is often present in which the assembly of shareholders elects members of the management and inspecting committee; whereby the inspecting committee controls the work of external controllers, while the management committee is responsible for the control of the work of top managers. The key obligations of the inspecting committee are to inform shareholders about:

accounting practice, statements and practice of financial reporting of the enterprise, alignment of business with legal and other demands of regulatory bodies, the independence, competence and ability of the enterprise's auditor, all the contracts made between the enterprise and members of the management committee, proposing the amount of the compensation to the auditor [1, p.195].

While the obligations of the management committee (member of which is generally a top manager) are to: a) perform the control of the accuracy of financial statements and information, b) formulate and implement the strategy of an enterprise and monitor the work of the executive committee and the administration of enterprises., c) establish and approve business plans of an enterprise, d) assemble the meetings and establish the agenda, e) further, terminate and abolish the authorization, power of attorney and similar acts of legal representation, f) prepare the drafts of decisions from the general meeting and control their implementation, g) define the date of establishing the list of shareholders with the right of participation in the general meeting, h) issue shares, options for acquiring shares and other securities, i) establish nominal value of any share and other property with previously acquired opinion of the certified auditor, j) elect the executive committee, give approval of contracts between the members of the executive committee and enterprise, establish their compensation and decide on the termination of their mandates or employment, k) establish the amounts of dividends, date and procedure of the payment of dividends, l) decide on other issues within appropriate performance of activities and business of enterprise with the aim of protecting the best interests of the enterprise and its shareholders, etc [3].

In enterprises where the model of the control of the work of top managers is present, the same problem appears as in the first degree models. Top managers as heads of the management committee control their own work, such that the control is not objective, which gives freedom to top managers to behave irresponsible way to shareholders. This problem can be solved by excluding top managers from the management committee, through which much greater objectivity of the control of the work of top managers is achieved, the ethicality of their behavior towards shareholders is incited and the impact of agency problem is mitigated [4, p. 123-127].

The creation of bodies controlling the work of top managers in enterprises of corporate type complicates the management process, but to a certain extent constrains the power of top managers and mitigates the negative impact of agency problem. Besides the direct control of top

Methods of Solving Agency Problem

managers, the alleviation of the impact of agency problem can be affected by the formulation and application of the Corporate Governance Code.

Corporate Governance Code

The Corporate Governance Code represents the set of written rules whose application can ensure good corporate governance. Good corporate governance presumes that the establishment of good relations between company managers, its management committee, shareholders and other stakeholders can enable the sustainable development of enterprise with the realization of the objectives of key stakeholders. Consequently, by formulating and applying the set of rules, the top management is motivated towards the realization of those objectives that are in the interest of the company, shareholders and other stakeholders. At the same time, the application of the mentioned rules should enable efficient monitoring of the business activity of an enterprise to all stakeholders. Some questions that comprise the codex of the most of organizations are related to: transparency of the work of the inspecting and executive committee and a high degree of the ethicality of behavior, equal treatment of shareholders, taking into consideration the expectations of other shareholders.

A good example of the Corporate Governance Code is that of the “Organizations for Economic Cooperation and Development” (OECD) from 2004. This Code has been conceived as a response to the request directed to the Council of the OECD at the ministry level to design, together with national governments and other relevant international organizations and the private sector, the set of standards and guidelines for corporate governance that will represent the basis for mutual management and reporting in the countries that are members of the OECD, but also in other countries in the region.

The standards should be directed towards the problems of management that have stemmed from the division of ownership and control. Key principles defined by the Code are related to [5]:

- securing the basis for the efficient framework of corporate governance,
- the rights of shareholders and key functions of ownership,
- equal treatment of shareholders,
- the role of interested parties in corporate governance,
- revealing of the data and transparency
- the responsibility of the management committee.

The first group of principles is related to the respect of legal and contractual obligations of an enterprise, since they represent the basis of efficient corporate governance. Besides respecting obligatory regulations that stem from the law or contract, it is desirable that the management of a company should formulate different standard guides (e.g. the codex of business ethics) that do not have the status of law or regulation, but are of elective character and can have a positive impact on the top management.

The second group of principles is related to the protection and alleviation of the creation of shareholders' rights. The application of these principles should enable shareholders: to secure methods of the registration of property, share transfer, timely and regular access to relevant information about company, to participate and vote at the general meeting, the choice and change of the members of the management committee, the share in company's profit, share in making decisions in amending statute and founding act or approval of additional shares, to be sufficiently informed about decisions related to thorough corporate changes etc. In one word, these principles should enable shareholders the realization of the objectives they have right to owing to the invested capital, and which cannot be realized directly because of the existence of a great number of co-owners. Besides, it is very important to secure the equal treatment of shareholders, which presumes that all shareholders can realize their rights, including those with small deposits. It is also necessary to secure full informing for shareholders that are detached from the enterprise, etc.

Besides shareholders, a good corporate management should have respect of the rights of other interest groups established by the law or mutual agreements and should incite active cooperation between companies and interested parties in the creation of wealth, employment and sustainability of financially healthy enterprises. Where interested parties participate in the process of corporate management, it is necessary for them to get timely and regular access to relevant, necessary and reliable information. It should enable interested parties to give the management committee their opinion about illegal and unethical practice without any restrain, while their rights remain protected.

Good corporate governance should secure timely and accurate announcement of material facts related to a company, including financial situation, property and company management. This presumes public revealing of: financial and business results of a company, company objectives, considerable share owning and the right of vote, compensation policy for the members of the management committee and key managers, information about the members of the management committee, including

Methods of Solving Agency Problem

their qualification, the selection process of the members of the management committees of other companies.

The framework of corporate governance should secure strategic managing of a company, efficient monitoring of the management by the management committee and responsibility of the management committee towards the company and shareholders. The members of the management committee should act on the basis of complete information, with good intentions, with attention to and concern of the best interests of the company and shareholders. In the cases where decisions of the management committee can influence in various ways different groups of shareholders, the management committee should treat all shareholders equally. This codex presumes that the management committee should apply high moral standards. In order to perform their obligations, the members of the management committee should have access to accurate, relevant and timely information.

The Corporate Governance Code of the OECD is the example of good conceived regulations whose application should secure good corporate governance and a high degree of ethicality of the behaviour of top managers and members of the management committee in order that the impact of agency problem could be mitigated. In Serbia, the application of the Corporate Governance Code is not a practice. This is validated by specific economic circumstances (in Serbia, since the 1990s the state and socially owned enterprises have been dominant, so it has come to the creation of corporations and the development of corporate governance much later than in capitalistic countries). Companies that are trying to build the image of responsible Serbian citizens, such as the enterprise “Metalac”, from Gornji Milanovac, have been among first to apply the Corporate Governance Code. The enterprise “Metalac” received the award for the most responsible Serbian citizen in 2008 as well as enterprises, e.g. the company “Tigar” from Pirot, that have strategic partnerships with foreign enterprises.

The Corporate Governance Code of the company “Metalac” is adjusted to the Code of the OECD. The Code of this company encompasses the rules that one should stick by in order to: protect the rights of shareholders, define the majority participation of independent members in the bodies of corporate governance (the management and inspecting committee), define the division of the functions of the head of the management committee and director general as a president of the executive committee as well as forming of the commission of the management committee, define the protection of the rights of small shareholders, the frequency of meetings of the management committee and the procedures of

scheduling meetings and the presentation of conclusions of the management board, transparency of work and the usage of the Internet.

The codex of corporate management of the company “Tigar” from Pirot involves several principle segments. They concern: updating of corporate principles in accordance to the changes, the rights of shareholders, key functions of property, amendments, capital changes, basic procedures concerning voting, and sale of assets, disclosure of data and realization of proprietary rights, equal treatment of shareholders, prohibition of illegal trade, the role of shareholders and other interested parties in corporate management, obligations and duties of the management committee, securing of the conditions for efficient implementation of principles, measures for solving disputes as well as measures for corruption prevention and bribe prevention, measures related to following legal regulations, money laundering, measures related to the engagement of consultants and establishment of general ethical principles.

As it has been mentioned, the Corporate Governance Code can differ across enterprises. Each enterprise includes those principles that can secure the basis of corporate management. In that way, a formal framework is created. It prevents the top management from managing the enterprise in the manner that does not secure the realization of the shareholders’ objectives by enabling shareholders and other stakeholders to use their rights and inciting the transparency of behaviour. Thus, the application of the Corporate Governance Code can be a very useful means of solving agency problem.

Connecting the Rewards of Managers to Shareholders’ Earnings

A very incentive method of directing interests of shareholders (alleviation of negative impact of agency problem) is the connection of compensations for managers to shareholders’ earnings. Connection of compensations for managers to shareholder yield leads managers to strive towards the maximisation of shareholder yield, which secures the maximisation of their yield. The convergence of the objectives of managers and owners is enabled as well as managers motivated to act in the interest of shareholders. For that reason, this way of reconciling the interests of managers and shareholders was often present in large companies in the last decades of the 20th century [6, str. 66-78].

The rewarding of managers on the basis of performance is one of the most popular modes of rewarding managers. The problem lies in the fact that the rewards are mainly related to the realized financial result in the period of one year, thus inciting the short term orientation of managers. In order to maximize their yield, top managers can strive towards efficiency or incite

Methods of Solving Agency Problem

different projects, whose effects can be seen in the period of one year and neglect activities that in the current period can negatively reflect on financial results, but can be extremely useful for the development of enterprises in the future [7, p. 91-104].

It is evident that the short term orientation of managers can prevent the growth and development of enterprises. In order to solve this problem, consulting firms have offered the standards based on value (such as Market Value Added-MVA, Economic Value Added-EVA, Total Shareholder Return-TSR, Cash Flow Return on Investment-CFROI, Shareholder Value-SV, Shareholder Value Added-SVA, etc.) that can be created in the long term. Compensations of all managerial levels can be related to added value. One of the measures based on the value that can be efficiently related to the compensation system of managers is shareholder value that has been developed by Alfred Rapaport and is promoted by the firm "LEK/Alcar Consulting Group" [8, p. 91-101].

Shareholder value represents the difference between the value of the company and debt; where the value of the company represents the sum of the present value of discounted cash flow for the defined period, residual values and values of marketable securities. Cash flow is the difference between the cash inflow, on the basis of sales revenue from the previous year, increased by the revenue growth rate and multiplied by the profit margin and reduced by the income tax and incremental rate of investment in basic and circulating assets. The cash flow is discounted by the cost of capital, which represents the weighted average debt cost and that of the capital. In establishing the cost of capital, the cost of debt can be easily found, but the problem represents the cost of capital. It can represent the expected rate of return on shareholders' invested assets. This rate is established by a contract and is relevant to be that way in order to attract investors to buy and hold shares of a company. It must contain the risk rate (interest rate on state securities) and risk premium that is different across companies [9, p. 132].

Rewarding of managers on the basis of shareholder value presumes the connection of the incentive part of compensation of managers to shareholder value that can be expected in realization of certain strategies and projects. This way, the management is motivated to perform the activities, the execution of which leads to the realization of shareholders' objectives; thus, the objectives of managers and shareholders are reconciled and agency problems eliminated.

A very useful method is the inclusion of managers in ownership over company. If a manager invests one part of his/her wealth in shares, the company he/she manages, including other shareholders, bears the risk of

losing the capital and accepts the orientation of shareholders. In that case, the objectives of managers are identified with the objectives of shareholders. However, the stand points on the acceptability of risk and behavior of shareholders and managers can be totally different, first of all, because managers have access to a larger amount of information in contrast to other shareholders, second, because shareholders have very diversified portfolio of securities, thus reducing the risk. For these reasons, the interests of managers and shareholders cannot ever be reconciled, but the negative impact of agency problem can be mitigated to a large extent.

Shareholders can influence the behavior of managers towards their interests by threatening to sell their shares which will in turn lead to the takeover of the company by another one. The takeover of a company is usually followed by the replacement of the management, which represents a threat to the management and a way of mitigating agency problem. The threat of takeover is a basic way of controlling top managers that might strive towards the fulfillment of their own objectives at the expense of shareholders. Each significant exploitation of shareholders is reflected in the decrease in the share price. The decreased price in contrast to the one that would exist with an efficient management offers the possibility of takeover by another company that would in most cases change the existing management. Active corporate control market represents the boundary of divergence between interest of managers and shareholders, thus serving as a counter-argument to the critique of “division of ownership and control”.

Labor market for managers is also an incentive mechanism of managers for making business in the best interest of shareholders. A top management sets and replaces the management committee, as a representative of shareholders’ interests. If a top manager does not work in the interest of shareholders and labor market for managers is developed, the top management is under the threat of being replaced. If the competition in the labor market for managers is pronounced, the management must take care of shareholders’ objectives, because its survival in the existing company as well as the alternative offering from other companies depends on its behavior and shareholders’ satisfaction [9, str. 5].

Conclusion

Irresponsible behavior of managers towards shareholders can lead to the failure of enterprises and places shareholders and other stakeholders in jeopardy. For these reasons, it is necessary to undertake different measures that can mitigate the negative impact of agency problem. No measure can

Methods of Solving Agency Problem

lead to the elimination of agency problem, but it can be mitigated by different measures.

The bodies controlling the work of managers are often introduced in enterprises. They are involved in making strategic decisions, monitor the work of managers and analyze reports on business activity. By constantly controlling the work of managers and preventing the decision making that can bring damage to shareholders, control bodies mitigate the impact of agency problem.

A very useful measure is the preparation and application of the Corporate Governance Code. The Corporate Governance Code represents a formal framework that enables shareholders to use their rights and incite the transparency of the work of a top management, whereby agency problem is mitigated. Also, a very useful method is the connection of the incentive part of compensations to managers to the earnings of shareholders. In that way, managers in striving to maximize their own earnings secure the earnings for shareholders.

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METODE ZA REŠAVANJE AGENCIJSKOG PROBLEMA

Rezime: Razdvajanje vlasništva od upravljanja u preduzećima dovodi do pojave agencijskog problema, koji je naročito naglašen u velikim korporacijama koje imaju ogroman broj akcionara, a moć top menadžera je ogromna. Nemoralno ponašanje menadžera prema akcionarima može dovesti do propasti kompanije, gubitka životne uštedjevine akcionara i brojnih ekonomskih i socijalnih posledica. Da bi se ublažilo negativno dejstvo agencijskog problema, u preduzećima se preduzima veliki broj različitih mera. Cilj ovog rada je da se objasne mere koje se mogu primeniti u preduzećima akcionarskog tipa za sprečavanje nemoralnog ponašanja menadžera prema akcionarima i izbegle negativne posledice agencijskog problema.

Ključne reči: menadžment, agencijski problem, akcionari, upravni odbor, kodeks korporativnog upravljanja, vrednost za akcionare...



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THE IMPACT OF FOREIGN EXCHANGE RATE ON THE ECONOMIC GROWTH OF SERBIA

Phd Dragoslav Kitanović*
Miloš Krstić*

Abstract: *The relation between exchange rate and stability and dynamics of real economy has in the past period and especially today occupied the attention of economic theoreticians. This is because different levels of economy marketability, from developed ones to the economies in transition, demand a very subtle monetary policy, which ensures dynamic economic growth. In the first part of this paper, there is a short review of epistemological aspect of this problem so that in the second part, we can proceed to the analysis of positive and negative ranges of the actual policy of the rate of dinar to the economic growth in Serbia.*

Keywords: *economic growth, exchange rate, purchase power parity, relative prices, currency appreciation, floating rate*

Introduction

This paper deals with the analysis of influence of the exchange rate on stability and dynamics of economic growth. In modern literature dealing with economy, this is a generally known fact; therefore, the attention of modern analysts is drawn to the following issues:

- a) the influence of exchange rate on economic growth tempo;
- b) the influence of the actual exchange rate on the change of economic structure;
- c) Are the regularities of functioning of a stable and developed system one thing, and the system which wishes to revitalize and transform, that is a system which is in an institutional vacuum, something else when it comes to monetary policy?

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d) What are the consequences of a controlled floating exchange rate when entered with a too aggressive exchange rate control into the zone of its overvaluing?

e) How to fill in the gap of the real overvaluing of the exchange rate and its bad influence on growth and structural economic changes?

If we have shortly pointed out to the scientific advisability of the question asked, its epistemological background is of special significance, therefore, we will elaborate on the concepts and terms which we are going to use.

Nominal exchange rate represents the price of one currency to the unit of other currency on the given market. For example, one dollar on our market is worth over 60.00 dinars. Therefore, 1 dinar = 0,0166 dollars.

The parity of purchasing power (the purchasing power of money) represents a sum of a currency in the units of other currency for purchasing on the market of both countries of equal amounts of the same goods. For example, for purchasing 1 kilo of bread in NewYork you would need 1 dollar, and in Belgrade 15 dinars (bread is of same quality and characteristics). The parity of purchasing power is 1 dollar = 15 dinars. Therefore, 1 dinar = 0,066 dollars.

The level of relative prices represents the ratio of prices in the two countries, in this case, you can buy one kilo of bread in NewYork or four kilos in Belgrade. Therefore, the parity of purchasing power seems to be reversely proportional to the relation of relative prices. The level of the New York bread prices makes 400% of Belgrade's, or 25% of NewYork's makes Belgrade's. In that way the real exchange rate represents the function, i.e. depends on the changes of price levels in two countries and on the changes in the exchange rate and their currencies.

If the external trade relations are conducted not only with one country but with more, the real exchange rate will be determined (complemented) with euro. It is obvious that for our further analysis it becomes crucial to know the importance of answering the question – what does the level of relative prices depend on? With the high level of abstraction the great variety of less important factors, and taking into consideration the diversity of the most important ones, the further analysis will be based on the following findings:

a) At the medium and long deadline monetary sphere has no influence on the real economy;

The Impact of Foreign Exchange Rate on the Economic Growth of Serbia

b) The productivity of work (every level of an economic growth has a corresponding level of relative prices) and the openness of the national economy to the world, in the long run and according to stability of action, represent the most significant factors of the relative price level, and also of real exchange rate;

c) The size of country's interfering, i.e. the country's intervention regarding pricing, tax and budget policy is the factor of medium deadline;

d) with the fixed exchange rate the monetary policy is not independent because it cannot influence the total money offering, but influences the composition of bank of issue balans assets;

e) In the regime of floating exchange rate, monetary policy becomes a powerful means of macro-economic regulating the economic flows. For example: expansive monetary policy enhances the social product (in the conditions when the real social product is below the potential) because, among others, it leads to lowering the interest rates, enhances export, etc. Therefore, on a short deadline, in the regime of floating exchange rate, monetary sphere has influence on the real economy;

There is no doubt that the exchange rate is influenced by many factors: from economic-political to monetary, and all the way to the happenings in the real part of economy. The exchange rate has a return effect on a number of economic movements. What kind of exchange rate is good to nurture to provide economic growth of a national economy is the question to which economists give various answers, even when they start from the same premises and facts and equal valuing of contributions of economic science. This is because many factors and mechanisms work when determining the exchange rate with different intensity on the economic growth. Especially, because one set of factors works in one, and the other in other direction, or there is a prominent effect of economic uncertainties. Setting your attention to one goal (for example, a stable exchange rate) leads to, or, increases, uncertainties of realization of other monetary policy goals etc.

The importance of this short epistemological content may be determined by one short look at history. According to J.M. Keynes, the meaning of purchasing power parity is in fact that purchasing power of currencies is a more meaningful factor of macro-economy than the change in exchange rate, this because the purchasing power reacts more quickly to monetary policy of the country. Balasa and Samuelson leave the so-called Balasa-Samuelson effect. According to them, considering there are differences in the level of work productivity between the countries, in countries with high work productivity there are high salaries and high prices.

That is where the overvaluing of their exchange rate comes from related to the purchasing power of currency. This tendency has a long-term and stable character.[4, p.122]

Bejouli and McDonnald start from the thesis that the level of relative prices depends on the factors of real economy (work productivity), and therefore, monetary factors have insignificant influence. Their analysis has shown that the long-term trends of dynamics for real exchange rates are conditioned by nominal (monetary) flows. Their analysis, and the newest findings of economic science, refer to the conclusion that there is a gravity of exchange rate to the purchasing power of currency on a long-term. Nevertheless, that is the rule of only developed market economies, and not the developing countries, or those in transition. With them, this connection (tendency) is not confirmed. [4, p.122].

Current Exchange Rate and Price Stability

The main assignments of a central bank are to keep the stability of prices and stability of the financial system. In inflation economies, fixed foreign exchange rate plays the role of psychological anchor, because it obligates the central bank to a certain type of behaviour. This consistency in operating of monetary policy has for a result the improving of basic macro-economic indicators: certain credibility is created and reputation of leading anti-inflation policy; inflation expectations are diminishing etc.

Officially NBS applies the policy of controlled floating exchange rate which appears as a net consequence of offering and demanding of money on a financial market. In reality, it shapes the fixed foreign exchange rate which NBS keeps on a surreally high level by controlling the reference interest rate. In a word, in our conditions exists a fixed and overvalued exchange rate of dinar. Behind such policy stands a well-intentioned wish of NBS to release the national economy from the possible inflation.

NBS through increasing the interest rate on repo operations absorbs the growth of dinar liquidity with the financial subjects. This practically means that the level of reference interest is enough and rational reason for individual investors to redirect their limited resources to a high yield of treasury bills of NBS. The growth of demand for these profitable securities (which have become the usual “décor” of our economic environment) turn monetary means to a less liquid forms of assets, which lowers the amount of dinars in use. The reduced amounts of dinars in use, according to the ruling monetary theory which treats inflation as monetary phenomenon, implicates the fall of general level of prices.

The Impact of Foreign Exchange Rate on the Economic Growth of Serbia

If the struggle against inflation is a measure of success of the central bank, then NBS has done the following. From 2001 to 2007, prices in Serbia grew for about 300% and we are the absolute champions in Eastern Europe for that. In the second place there is Romania with the price growth of about 162%. If the list grows with the ex-USSR states, and at the same period only Belorussia noted the higher inflation than Serbian, the question that needs to be answered is: why haven't the expected effects of the anti-inflation policy appeared?

One of the most important reasons is an economic mutual-funding – mutual goods funding of national firms. In closer perspective, it is a process in which firms exchange goods and services mutually, but they don't pay for them. The exchange is made without the money while payment is prolonged without a deadline. The one who buys does not care about the price because of the forthcoming inflation gap, the real value of the debt will fall. The one who sells has to increase the price for expenses of financing and for the risks of not paying which are difficult to evaluate; therefore, it is always smarter to count in as much as possible. In this way, the monetary policy loses sense, and the prices grow also when NBS policy is restrictive.

Apart from that, the newest experiences explicitly point out that inflation is the result of monetary authority goals interaction and of market expectations, and that it should be looked upon as the problem of credibility. In the approach which points out credibility, inflation decreases only by connecting the national currency to the currency of a country with low inflation. Some European countries which were prone to inflation (such as Finland²) ensured the reputation and credibility by entering the EMU, due to German anti-inflation policy [9, p. 9].

Besides that, our statistics are set in such a way that they almost always overrate developmental scores, and very rarely or not at all, show them for real. Let us take, for example, the measuring the inflation. In economy, measuring the base and not the total inflation represents the skeleton of a successful monetary policy. Unlike the total inflation, which reflects the growth of all market prices, with calculating the base inflation the approach is selective. According to the rule, the base inflation does not encompass the prices of agricultural products and energy. Why? When there is a dry period, the prices of agricultural products could rise faster than other prices. If winter is extremely cold or the political situation in the Middle East is complicated, the prices of energy could be exuberant. All these short-

² By entering the EMU Finland has lost the possibility to lead a catastrophic policy of exchange rate, because of which it had inflation-devaluation cycles every ten years, which significantly reduced the competitiveness of economy and stability of Finnish economy.

term phenomena make the growth of total inflation. If the policy would make the tendency of the central bank to diminish the total inflation, the influence of the mentioned short-term disturbances on the food market and energy would be overrated. The total growth of prices would be a signal for overheating the total economy, which, as a result, would have the growth of interest rates and lowering the production investments and employment.³

The main flaw of the fixed exchange rate is the fact that it can cause misflow between the stable nominal exchange rate on one hand, and high national inflation on the other, which, in case of a speculative blow, leads to the breaking of regime and currency crisis. The stable nominal exchange rate⁴ emits to the owners of a short-term capital that an observed country is characterized by a drastically low level of foreign currency risk. In that way, that country becomes a magnet for attracting the speculative capital from abroad. But, when the inflation in the national economy significantly steps away from the inflation in the anchor country, the foreign speculative capital is withdrawn, leaving the economy in deep inflationary crisis. Then comes the dramatic increase in unemployment.

Misplanned and badly operated restrictive monetary policy benefits the fertilization of speculative banking capital. Namely, high reference interest rate on repo transactions of NBS (which in the first half of 2006 reached the speculative level of 23%) produced an explosive inflow of foreign accumulation, which came to Serbia with only one intent, and that was to multiply fertilize through buying and selling transactions with the treasury bills. The truthfulness of the presented thesis is easy to verify with empirical and mathematical-statistical argumentation. From 2006 to 2008 through repo operations huge excess of money was immobilized from use which was brought to Serbia through “national” banking system. The sum of that immobilized money reached, by the end of September 2008, the level of about 4.7 million dollars. That is an impressive amount. During the summer months of 2008, there was even more of that immobilized money, than the whole liquid monetary stock (aggregate M1). NBS paid substantial interest to that money.

³ In Serbia, the problem of statistical measuring is far more serious than in economically developed world. The reason is in much narrower definition of base inflation which in its structure does not include the prices of agricultural products, energetics, nor prices for some of the products which were in the state regulation regime (utilities, medicine, cigarettes etc). The real inflationary pressure is much greater also because of the overvalued dinar which artificially lowers the prices, and therefore inflation. (www. nkatic wordpress com. How to hide the truth about inflation)

⁴ In the period from 2001 to 2007 the value of dinar to the leading world currencies was changed for about 30%

The Impact of Foreign Exchange Rate on the Economic Growth of Serbia

In the period from 2001 to 2007, the rate of foreign currency reserves to monetary aggregates (Table 1) intensively grows, which testifies that the growth of monetary aggregates does not follow the growth of foreign currency reserves. In other words, the excess of dinar liquidity is sterilized with repo transactions. This has, as a result, the growth of expenses NBS on the grounds of servicing repo stock (which reached the value of 240 million euros in 2007). On the other hand, the owners of treasury bills have double benefit: based on the interest and on appreciation. These securities which stand still for years on business bank accounts with NBS and doing so earn a lot of interest, and which disappear from the country on the first sign of crisis (turned into foreign currency) make the core of speculative capital.

Table 1: Chosen economic indicators: The Republic of Serbia (values shown in dollars)

Financial risk	2001	2002	2003	2004	2005	2006	2007	2008
Reserves/ Primary money (M0)	1.91	1.93	2.77	3.19	4.57	5.28	5.11	2.53
Reserves/ Monetary stock (M1)	136	1.43	1.95	2.21	3.26	3.79	3.47	3.35

Source: Marinković, S., The choice of foreign currency regime: results and limitations, The annals of economy, no. 168, The Faculty of Economy, Belgrade, 2006, p. 84. (data until 2004) and NBS (for the last four years calculations of the author)

In the two-currency system, the reference interest rate is shown as unreliable and ineffective instrument of regulating liquidity. In that way, in April 2005 the so-called pitfall of liquidity was explained which melts the effects of monetary measures in a very short term, shorter than one month. By increasing the reference interest rate credit debts abroad, which later come on a foreign currency market making the relative value of dinar stronger, and thus increase the offering of foreign currency from the national savings. The conclusion is that the inflow of capital and the control of dinar liquidity by reference interest rate from NBS inevitably for repercussion has appreciation of dinar, regardless of its being covered with productivity growth or not.

Appreciation of national currency is a common companion of transition. In theory, the so-called "Toskovski dilemma" has been initiated. It articulates the dramatic the range between appreciation and foreign capital

inflow under conditions of high interest rates. That is actually one theoretical construction which lies on a presupposition about the beginnings of appreciation and the flow of foreign capital in conditions of high interest rates. Regarding this, the appreciation makes the real income of consumer become greater, which produces the growth of credit demand, which in the environment of high interests stimulates the inflow of speculative foreign accumulation [6, p.48].

Only in the stable and integral market is the growth of productivity in the sphere of real economy the only reason for growth of relative value of national currency. In such a market: foreign exchange rate is an exclusive consequence of relations between offering and demanding foreign currencies, and volatility of prices of national goods which have their place in the international trade, is equaled with movement of the world prices. According to all mentioned, the numbered conditions have not yet been enforced in our country; therefore, it is understandable why authorities do not manage to remove the *de facto* fixed exchange rate from the economical inflation pressures.

Foreign Exchange Rate, External Imbalance and Economic Growth

Normalizing of economic relations of Serbia with abroad by the end of year 2000 was at the same time as liberization of international trade which particularly became prominent at the middle of 2001. Cancelling the contingent and reducing the average weighted customs burden at the level of 10% lead to a dinamic increase of trade deficite and foreign debt. [10, p. 4].

The crisis in Serbia, in this phase, has no similarity with the crisis of demand which entangled most of the developed world. Having in mind the height and structure of the foreign debt, Serbian economy faced the debtor guilt. That is the reason why this paper has approached the analysis of economic and social consequences of economic reform concepts which have been applied since 2000.

The first dilemma which every developing country should solve is the choice of foreign currency regime. In the earlier literature about foreign exchange rate, the significant paradigm in the light of choice between the fixed and the flexible is the theory of optimal exchange rate area.

The theory of optimal exchange rate area gives criteria which two countries or more should fulfill as to completely use the advantage of fixed foreign exchange rate regime: it is about economies which are open to mutual trade; high mobility of scant resources, especially the mobility of labour force, and so in the environment of prices and earnings of rigid to

The Impact of Foreign Exchange Rate on the Economic Growth of Serbia

descending, every country has a diversified export sector so that the significance of specific shocks is reduced; economic cycles are synchronized and countries react symmetrically to the same kinds of shocks; there is a high degree of financial integrating and there are small differences appearing between inflation rate with main trade partner. [9, p. 8].

Small open economies which have insufficiently developed export structure of production are characterized by relatively high level of diversification (observed from the level of region). Geographic concentration of trade shows the closeness of countries' needs in a certain region and on the relatively developed mutual trade relations. Considering the aforementioned presuppositions, it is obviously impossible that the export sector of a certain country has a decisive role in regional exchange, and that at the same time the country with such export potential generates surplus, with the simultaneous deficit in the neighbouring countries. From the point of view of the current relations of exchange between the former states of the ex SFRY⁵, the optimal policy of fixed exchange parity at the level of region or at the level of individual country exists only if the differences regarding the level of foreign trade deficit are ephemeral. This condition, when it comes to relations between Serbia on the one hand and Croatia and Slovenia on the other, does not exist in statistics, about which undoubtedly testifies the following table.

Table 2: Exchange of goods of Serbia with chosen countries in 2007

	Export	Import	Total	Balance
Serbia/Slovenia	411.3	705.7	1.117	-264.4
Serbia/Croatia	331.1	527.4	858.5	-196.2

Source: <http://www.retailserbia.com/20080317114/vesti-iz-trgovine/srbija-slovenija-robna-razmena-milijardu-dolara.html>,
<http://www.ekapija.com/website/sr/page/158966>

In this kind of constellation of forces, further operating of policy *de facto* fixed exchange rate of NBS, would only deepen the gap between export and import and generate a range of other degenerative processes. In favour of the expressed attitude it is good to add also the significant falling behind of Serbia after developed countries in transition regarding the value

⁵ In Serbia and Croatia there is officially empowered a regime of controlled fluctuating foreign exchange rate, while Slovenia is a member of EMU, which practically enables the domination in exchanging of goods with Serbia and Croatia.

of export per citizen. For reaching the level of export per citizen in Slovenia, it is necessary that 10.4 percent Serbian export per citizen grows to the rate of 26.1, and that in the process Slovenian export per citizen stagnates!⁶

As it was already pointed out, for countries to create the optimal exchange rate area they must have high mobility of factors. The mobility of labour force in the region is very low, despite similar socio-cultural characteristics of the former Yugoslav states. This is one more good reason why the maintenance of exchange rate of dinar at a higher level negatively influences the economy of our country.

In open economies, when the government decides to increase its expenditure, there will be a growth of national demand and national product. Take Serbia, for example, whose percentage of import in GDP is almost 44% (2007). When the Serbian government increases expenditure, it is very likely that the largest part of that expenditure will relate to demand for imported goods. Therefore, the increase of public expenditure would implicate highly strong growth of foreign trade deficit, so it is clear that the expansion of national demand in this case would be quite unattractive instrument of economic policy. Nevertheless, the global macro-economic policy for the sake of dinar stabilization, and with tendency to constrain inflation, by keeping the overvalued exchange rate increases private expenditure which is the basic generator of inflation.

The country which continually generates deficit accumulates a debt to the rest of the world; therefore, it is obligated to pay higher interests to its loan givers. The deficit of current account is the basic factor of Serbian economy vulnerability and it is the synthesis of all misses of economic policy. Inherently unfavourable relation of import and GDP, on one side and the expansion of private expenditure, on the other side puts Serbia in the line of highly indebted countries.⁷ The servicing of foreign debt, burdens our future growth, so our relative position in the future will be as worse as we, thanks to forcing of growth through indebtedness, have improved it in the previous time period. [13, p. 213].

The misbalanced foreign economy balance, high inflation as an expression of inner misbalance and unemployment as a manifestation of

⁶ See, the strategy of the import increase of the Republic of Serbia for the period of 2008 to 2011, (<http://www.pks.rs/>)

⁷ According to the methodology of the World Bank the total amount of foreign debt is put in the relation with GDP and if the debt in one year has crossed 80% GDP in the referent year, the observed country is highly indebted.

The Impact of Foreign Exchange Rate on the Economic Growth of Serbia

structural misbalance represent the justified reasons for calling upon Marshal-Lerner condition which was produced from the equation 1).

$$NX = X - e IM \quad (1)$$

NX- net export;

X- export;

e – real exchange rate and

IM-amount of import

Based on equation 1) we get the real depreciation i.e. increase of the real exchange rate influences the foreign trade balance in three ways:

1. Export X: rise. Real depreciation makes Serbian products relatively cheaper abroad, which implicates the growth of Serbian export.
2. Import IM: fall. Real depreciation makes foreign goods relatively more expensive on the Serbian market.
3. Relative price of foreign goods e: rise. That increases the value of import.

To improve the balance of foreign exchange after the executed depreciation of dinar, it is necessary that the rise of import (the first channel) and the fall of import (the second channel), in the total sum compensates the rise of foreign goods prices (the third channel). The condition under which the real depreciation produces growth of net import is known as Marshall-Lerner condition.

From Marshal-Lerner condition comes the real appreciation of dinar can be especially painful for economy with such big extreme deficit. Imbalance of payment balance clearly suggests that dinar is highly overvalued. Namely, central banks sometimes intervene on the foreign exchange market to prevent the rise or fall of the national currency value. In the last two years, NBS mostly sold Euro, with the aim to prevent the fall of dinar value. But, the diverging and irrational policy of NBS leads to only speedy exhaustion of foreign reserves which were rapidly decreased in the period from 2007 to 2009.⁸

By interventions on the foreign exchange market, NBS punishes exporters because for the earned foreign currencies they get less than they would get if NBS did not intervene. On the other hand, by making it possible to buy Euro cheaper today, NBS subsidizes and rewards importers. Therefore, it can be concluded that the defense of unreal exchange rate

⁸ At the end of 2007, foreign currency reserves amounted to 10.9 billion euros, to fall to the level of 9.5 billion euros in May 2009,(www.nbs.rs)

represents idle spending of foreign currency reserves and prevents the process of leveling the balance-of-payment.⁹

In short-term, the depreciation is always traumatic. Why? It takes a certain amount of time for buyers to realize that the relative prices are changed. This is the reason why the value of import and export will probably adapt slower. So, depreciation at the beginning increases foreign trade deficit; the real exchange rate grows, but the amount of export and import at the beginner's phase remains unchangeable. After a while, export increases, import decreases, lowering thus the foreign trade deficit. Economists call this adaptation process J-curve. [2, p. 411].

It is forgotten that the degree of indexation of credit in one national economy is the only reliable measure of trust in the national currency. Namely, around 80% of credit given to citizens is indexed. By indexing a credit banks pass on the risks of exchange rates to debtors who are not capable of seeing and rationally valuating. That is why credits in Serbia are taken more lightly that they should, while on the other hand, external misbalance gets deeper. Through the general indexation the financial system loses flexibility which is the main reason for the existence of national currency.

Recently indexed credits prevent depreciation which is necessary and inevitable. "Strong" dinar is a currency which no one wants and in which value few believe. This justifies depreciation as a measure of monetary policy which would diminish the grown purchasing power of citizens. Adaptation to the new exchange rate is a process which takes time and victims, but gives results – the deficit of trade balance is decreased, slows down the growth of foreign debt and brings the increase of production investments and employment.

Depreciation is not maximally reliable nor always a successful measure of leveling the payment balance. On the contrary, continuous depreciation of inexpedient intensity leads to decreasing the economic activities. Namely, permanent depreciations as a part of contraction policy in one country not only lead that country to depression, but have bad effects on its neighbours. In the thirties of the last century each country which would face decreasing of economic activities would try by introducing customs and adequate depreciation of its currency to lower goods importing from the neighbouring countries. "And as certain countries decreased import, that is how they managed to "export recession to its neighbours." [16, p. 118]. Decreasing import in one country simultaneously meant slowing down of

⁹ www.nkatic.wordpress.com/Simple-as-mathematics/

The Impact of Foreign Exchange Rate on the Economic Growth of Serbia

export of the neighbouring country whose well-being crucially influences the efficiency of the first country. Therefore, contracted monetary and fiscal policies in literature are also called “Make yourself a beggar“. [16, p. 117].

„Today the investments based on imported raw materials and production materials (because of currency appreciation and low prices) are the most rentable. In terms of real exchange rate (imported raw materials and production materials will become more expensive) today’s investments will prove to be a lost cause“. [4, p. 124].

The deformed exchange rate produces disintegrated economy. Indeed, the overvalued dinar increases the expenses of negotiating and concluding the contract on the market. That is, the concept of current exchange rate policy brings suboptimal coordination of participants in the economic life and produces allocation conflicts among them – the growth of transaction expenses. The more prominent dinar appreciation the higher expenses of coordinating behaviour of individual economic agents.

The analysis of M. Olson has shown that the “domination of redistributive policies as a result of the impact of more powerful interest groups is an important factor of historical falling behind of certain countries and peoples [5,pg.86]. From the Olson thesis comes the conclusion that possibilities of predatory behaviour of privileged social subjects become more prominent if the social power is unequally distributed. “Unequal distribution of power means that there are points where it builds up in great amounts“. [14, p. 117]. The policy of overrated dinar exchange rate, practically enables big monopolists from the import sector of economy to gain not only by making new, verified values on the market or otherwise, but also by doing predatory, illegitimate and basically grabbing forcefully the values which represent contributions of other subjects. If it is to believe Olenik that the economy with the given institutional matrix of formal and informal norms is in the service of supporting reelection of existing bureaucracy which exists in the institutional structure, then it is obvious that the change of actual exchange rate is impossible without reforming the relations between the ruling party setting and the import lobby. In the procedure of basic removal of hard –coping barriers caused by suboptimal policy of foreign currency exchange, the best is to apply Pigou’s attitude on “dismissal of market.” This practically means that the country with its mechanisms of public revenue picks additional taxes from a subject who enjoys the extreme effects of foreign exchange policy of NBS, and then with such accumulated means to guide the economically inferior social layers.

Conclusion

The choice of controlled floating rate loses its relevance and advantage if with a too aggressive control comes into the zone of prominent overvaluing of the real dinar exchange rate. Market should be allowed to amend the value of exchange rate, i.e. accept the policy of gradual nominal depreciation of national currency and at the same time control the inflation. With this kind of policy, the gap of real overvaluing of national currency would be filled and its bad influence on the growth and structural changes in Serbian economy.

Considering that the policy *de facto* of the fixed rate has suffocated national production, drastically increased economy dependence on import and conditioned a number of other bad economic and social consequences – the defence of dinar over the spending of precious foreign currency reserves should be stopped. It is necessary to adopt and consistently apply strict criteria for indebteding the country, state firms and private banks.

Under the pressure of crisis and in fear of social disturbances, developed countries with a subtle building of new protection techniques do their best to protect their endangered economies. The protagonists of this new, “green” protectionism suddenly start to worry about ecological state of the planet and insist that the developing countries invest more in ecological protection. Thus, western countries by imposing new expenses lower the competition of developing countries’ economies and in that way ensure inner peace and much needed social peace. In the worst position, countries like Serbia will be found, which are outside regional integrations and without strong negotiating trumps.

Banks in Serbia have been paying the biggest interest rates for years, and they pay the least effective tax return in Europe. According to the last available data, the average interest rate has reached the level of 21% per year. The average interest rate on short-term credits for citizens has grown to 57%. Introducing additional bank tax, of about 10%, with cancelling of any tax benefits to the banking sector would have to be the first measures for helping the empty budget. Additional, reasonable measure would be limiting of the interest rate that banks can charge clients. The country has to protect its citizens and economy – not from the market and its laws, but from the anti-market whims of national monopolies and cartels.¹⁰

It is very important that the country lowers the hyperinflation to a low level (one figure inflation) – otherwise, any kind, especially serious

¹⁰ [www.nkatic.wordpress.com. \Banking heaven\](http://www.nkatic.wordpress.com/Banking%20heaven/)

The Impact of Foreign Exchange Rate on the Economic Growth of Serbia

improvement will be left out. But the policy of stabilization must not interact with the policy of economic growth. [1, p. 309]. Stabilization lowers the inflation, but its long-term operation slows the tempo of economic growth and brings poverty. Solid monetary policy which implies overvalued exchange rate of national currency and high interest rates cannot bring new jobs. This kind of policy only slows down every economic growth.

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UTICAJ DEVIZNOG KURSA NA PRIVREDNI RAST SRBIJE

Rezime: Veza između valutog kursa, i stabilnosti i dinamike realne ekonomije zaokupljala je pažnju ekonomske teorije i ranije, a posebno danas. Danas posebno, jer različiti nivoi tržišnosti privreda, od razvijenih do onih u tranziciji, zahtevaju vođenje vrlo suptilne monetarne politike kako bi se obezbedio dinamičan privredni rast. U prvom delu rada dat je kratak osvrt na epistemološku stanju ovih problema, da bi se u drugom delu analizirali pozitivni i negativni dometi aktuelne politike kursa dinara na privredni rast Srbije.

Ključne reči: rast, valutni kurs, paritet kupovne moći, relativne cene, apresirani dinar, fluktuirajući kurs.



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BUSINESS CULTURE AS ACCELERATOR OF BUSINESS EXCELLENCE MODEL IMPLEMENTATION

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Abstract: *The purpose of this paper is to introduce business excellence models and the philosophy that they are based on, but also to point out significance of business culture, as accelerator of business processes' improvement. This paper emphasizes characteristics of business excellence culture, as a supporter of implementation of business excellence principles and methodology for business processes' improvement. Since it is assumed that business culture in enterprises in Serbia does not have characteristics needed to support business excellence concept implementation, this paper, based on research results, contains recommendations for business culture transformation and promotes communication as the key factor of this transformation.*

Keywords: *business excellence, processes, improvement, business culture, communication, Serbian enterprises, privatization.*

Introduction

Every enterprise strives to find a place for itself in the specific market. As the market becomes more competitive, enterprises continually look for the ways for improvement of their products and business processes in order to keep or increase market share, and therefore, to increase financial results. Up to 1970's basic preoccupations of the enterprises were costs and productivity. But, when Japanese economic miracle appeared, it became clear that quality was factor number one for reaching higher business performances. Since then quality has become concern of many enterprises and topic of many researchers. As a consequence of that many methods and concepts for quality management and quality improvement appeared. At

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first, they were focused on quality control (inspection), then on quality assurance, quality management, and finally on total quality management. Concepts that appeared in the last decades, and which are focused on quality and other competitiveness dimensions, can be marked as business excellence models.

1. Business Excellence Models

Japanese are the first ones who have recognized the value of quality and who dedicated themselves to quality improvement. Their business results confirm that quality does not increase costs, but value. On the contrary, quality improvement decreases some costs, especially the costs of poor quality, which include detection costs, costs of internal failures and costs of external failures.

Business excellence models assume continual business processes improvement. In modern conditions there will be place only for enterprises that adopt disciplined, customer-focused and process-based approach to quality improvement. This approach has to be based on the principle “*In God we trust, all else bring data*”¹¹. Significant characteristic of these enterprises is business culture that supports business excellence achievement or continual processes’ improvement, and is marked as business excellence culture.

Business excellence philosophy has to be integrated into enterprises’ processes that represent sources of competitive advantage. Business excellence philosophy and principles must be embedded in everyday activities. Therefore, business excellence can be observed from strategic and operational aspect. Strategic and operational aspects are connected. Operational aspect assumes change of traditional control into self-control and excellently performing of everyday activities. It can be accomplished only if business culture supports the change of the way control is performed. This means that traditional culture has to be transformed into business excellence culture, and that lead us to strategic aspect of business excellence. If researchers, who analyze business excellence models, put more emphasis on culture, as a support for achieving business excellence, and less on the tools, which these models recommend, they will find out that these concepts have many things to offer managers in order to make decision-making and implementation process easier for them.¹²

¹¹ Antony J., *Six Sigma: A Perspective on the Future*, Manufacturing Engineer, February/March, 2005, pp. 26.

¹² Erwin J., Douglas, P. C., *It's not difficult to change company culture*, Supervision, November, 2000, Vol. 61, Issue 11, p. 23.

Business Culture as Accelerator of Business Excellence Model Implementation

2. Business Culture as Invisible Foundation for Business Excellence

Business culture represents the set of attitudes, values and beliefs that are enacted on a day to day basis in an organization¹³ or, more simply the way things are done in an enterprise. In modern conditions an enterprise has to create business culture that incorporates learning and innovation, and provides well defined infrastructure for improvement projects implementation. In traditional culture, there were specialists who took care of the improvements. In business excellence culture, improvements are task of every employee and, therefore, they are widespread throughout the enterprise.¹⁴ If culture does not change or transform, then the improvement initiative will be reduced to statistical tools usage, which is not sufficient for successful improvement implementation.

Employees' specialization in a specific field was very important in the period of mass production and it was considered as a way for providing higher productivity. However, today higher productivity is usually connected to higher level of business and processes' quality, and not only to specialization.

In accordance with previous, employees should be familiar with the tasks of their colleges, especially ones that are their internal customers or suppliers. In this way employees have a clear picture of enterprise's strategy and vision, which enables them to understand their contribution to strategy implementation. Based on the previous, it can be said that customer focus does not mean only focus on demands that come from external customers, but also focus on demands of the internal customers or employees that carry out the activities which follow. This kind of approach assumes replacement of functional orientation with process orientation.

Business culture transformation depends a great deal on managers' behaviour. The main reason for that is the fact that initiative for business excellence model implementation comes from managers and therefore their attitudes about business culture and its changes have a great influence on success of the implementation. It means that managers are the first ones who should change the way they behave themselves in order to make appropriate climate for business excellence model implementation and, also, in order to show the other employees that changes are necessary. In that way managers' behaviour represents an example for other employees' behaviour.

¹³ Mathews S., *Six Sigma Culture and Personality*, www.teamtechnology.co.uk/six-sigma.html

¹⁴ Crom S., *Six Sigma Culture: Better Processes and Problem-Solving*, <http://europe.isixsigma.com/library/content/c050615b.asp>

Important characteristics of business excellence culture are: full commitment of all employees, knowledge sharing, on-going learning and innovation, trust and mutual respect between employees regardless of position, empowerment and participation of employees in decision-making process, managers' support, managing by facts. Probably an enterprise will not be able to provide all of mentioned characteristics in short period of time, but culture change is not an easy task and needs some time and persistence. Some of differences between traditional and business excellence culture are shown in Table 1.

Table 1: Some differences between traditional and business excellence culture

Aspects of Culture	Traditional	Business excellence
Work orientation	Departmental, functional and/or task	Process flow and customer-output related
Who defines what needs to be improved	Senior managers and department managers	Senior and department managers plus process owners and other workers
Leadership for improvement	Functional managers	Champions and improvement specialist
Who has skills to develop and implement solutions	Specialists (e.g., engineers) and managers	Specialists plus project leaders, team members and managers
Improvement methods/tools used	The most familiar ones	Suggested by modern management models
Degree of operator involvement	Ad hoc	Widespread through Yellow Belt training
Project management discipline related to improvement	Variable	Gate reviews at each step of DMAIC methodology
How performance is measured	Actual versus budget	Impact on Xs (causal measures) that affect Ys (outcomes)

Source: Six Sigma Culture: Better Processes and Problem-Solving, www.isixsigma.com/library/content/c050615b.asp

3. Communication as Manifestation of Business Excellence Culture

Concerning that one man, no matter if he works at the bottom line or manages, does not know everything, it is obviously why communication is essential for any business excellence initiative success. This kind of communication represents internal communication. Internal communication makes sure that employees are informed and engaged, and breathes life into

Business Culture as Accelerator of Business Excellence Model Implementation

what might be seen by someone as a technical process. Communication is needed for successful realization of the improvement projects, but also for acceptance of the business excellence philosophy. In that way communication is necessary for achieving operational and strategic excellence.

Acceptance of business excellence philosophy can be very difficult if employees are not informed about its principles and methodology, and especially about the necessity of changes. In order to convince employees that change is necessary, managers must communicate with them. By sharing knowledge and giving each other support in performing everyday activities, employees gain new knowledge and ideas about how to improve the way of working tasks realization. In that way communication represents the source of new ideas for the future improvements.

If business culture is “friendly” it means that it is acceptable for anyone to make mistakes and not to be punished for that.¹⁵ Instead of punishment, the employee who has made mistake needs help and support in order to avoid the same mistake in the future. This kind of treatment of the employees demands change of managers’ attitudes about relationship with their subordinated. The relationship based on command and control does not give results in modern conditions. On the contrary, business excellence philosophy confers establishment of the relationship between managers and their subordinated employees that can be described as “friendship on the distance”. It means that employees are free to ask their superiors (managers) anything concerning their tasks, but also to explain the failures of the existing way of performing activities and to propose ideas and present possible, a new way of realization of the same activities. In that way employees are not just machines, which accept orders from managers and implement them without asking any questions and without thinking about them. They perform activities by “thinking” about the way they are structured and performed, and not “without thinking”.

Besides internal communication, very important segment of business culture is external communication. External communication is essential for creating relationships with external stakeholders, especially customers¹⁶ and suppliers. Actually, communication with customers is crucial for successful implementation of business excellence models. According to business excellence models, quality begins with customers, because customers have

¹⁵ Andjelković Pešić M., Janković Milić V., *The Possibilities Of Practical Implementation Of Regression Analysis In Location Choice*, Journal of Tourism, Romania, 2008, No. 5, pp. 2-6.

¹⁶ Andjelković Pešić M., Janković Milić V., *The Possibilities Of Practical Implementation Of Regression Analysis In Location Choice*, Journal of Tourism, Romania, 2008, No. 5, pp. 2-6.

to be asked what quality means for them. In that way, customers are included in improvement of existing processes and products, but also in creating or designing of new ones. Communication with customers has to be permanent, because their needs and wishes are subject to change and an enterprise must always be informed about these changes in order to meet them as fast as it is possible. Thanks to permanent communication with its customers, an enterprise will be informed about their satisfaction or complaints. Accomplishing customers' satisfaction is the best scenario, but if customers are not completely satisfied it is better for an enterprise to hear their complaints than to avoid listening to them. If there are no complaints for a certain period of time, it does not always mean that all customers are completely satisfied. Sometimes it can mean that customers are so disappointed that they do not want to waste their time on complaints. In that case, team empowered for improvement has to find the way to reach customers and through communication with them provide information about their disappointment and how to turn it over into satisfaction. In that way, communication with customers has to provide information about their wishes and demands, than information about changes in their demands, and also information about their satisfaction level or disappointment and about reasons for that kind of situation. Communication with customers is important because only permanently satisfied customers become loyal customers, and loyal customers represent significant part of enterprise's intellectual capital, and therefore, significant part of its market value.

4. Business Culture in Serbian Enterprises

Business culture in the most enterprises in Serbia still swallows the consequences that derive from social ownership. Serbian economy was characterized as "contract economy" with no or certain presence of market principles and conditions. The most of enterprises in that period of time were socially or state owned. Some of them went through ownership transformation and some are still in restructuring process. Ownership transformation can be identified with privatization.

Privatization represents a procedure of selling of one part or the whole socially or state owned enterprise. Instead of simplex living on subventions, enterprises become private owned, capable to contribute to continual production and employment growth.¹⁷ Concerning some disadvantages of socially and state owned enterprises, privatization brings improvement and the following effects: opening new jobs, economic growth,

¹⁷ Andjelković Pešić M., Djordjević S., *Izazovi privatizacije preduzeća u Srbiji*, Poslovna politika, 2006, April, pp. 21.

Business Culture as Accelerator of Business Excellence Model Implementation

regular payment of pensions, welfare programs, rising the standard of living, stimulation of local development and growth, financing programs for economic and environmental development, and denationalization.¹⁸

Though part of socially (and state) owned enterprises has been privatized they still suffer from the “social” syndrome. In socially owned enterprises employees were treated like some kind of owners, but the explicit owner was missing. As a consequence of that, motivation for reaching business excellence was missing, too. In that way, socially owned enterprises in Serbia have been showing that private property is one of the conditions for enterprises’ efficiency.

One of the problems of Serbian enterprises is no precise definition of employees’ responsibility. For that reason mistakes are usually transferred to the other employees. Transfer of mistakes and responsibility for them is a consequence of functional organizational structure. This can be very big problem if there are processes which extend over few functions, because no one is responsible for the whole process, but only for its activities which are performed inside certain function. For that reason, it is necessary to transform function based structure into process based structure, because the second one implies identification of process owner, the employee who will be responsible for the whole process and who will coordinate work of functions or organization units involved in realization of concrete process. Identification of responsibilities is important not only for rewording or punishment of the employees, but also for learning about mistakes and avoiding them in the future.

According to results of research conducted in December 2008,¹⁹ the most of enterprises consider demands of external customers, but a great number of them do not have a practice of considering demands of internal customers. Nevertheless, it is not rare situation that employees on lower positions or employees who perform tasks subordinated to other employees, because of envy or jealous, purposely do not perform their task properly, so that their internal customers have problems with performing of their own tasks (72% of respondents at least once were confronted with problems caused by the intentional failure to execute tasks of other colleagues). In order to stop and prevent purposely sabotage, managers must introduce control points at the “problematic transfer points”. In that way, if employees

¹⁸ www.pa-serbia.co.yu

¹⁹ This research comprised 35 enterprises. The sample has been chosen randomly from the population of enterprises that were privatized after the year 2000. Respondents were managers and operators.

do not complete their tasks properly, they will defray consequences themselves and not their internal customers.

When employees realize that, even if they do not have direct contact with external customers, they affect their satisfaction, they will try to forget and exceed envy and then there will be no need for control points and this is exactly the thing that concerns business culture. For those employees that were part of socially owned enterprises it is very difficult to change habits and customs and to give up previous business practice. It means that change of business culture in enterprises in Serbia is not an easy task, but it certainly is the task that must be completed, because culture affects efficiency and productivity and, consequently, reaching business excellence.

5. Influence of Business Culture Transformation on Employees

Employees usually have fear of something new and they may consider new value system and a way of behaviour like a treat, and, in that kind of situation, results of their work may be even worse. In order to avoid that, managers must take one step at the time and slowly introduce business excellence philosophy and to courage employees to observe changes as new possibilities and not as threats.

Important “defect” of culture in Serbian enterprises is lack of innovation significance awareness (even 94% of respondents considered innovation as “job” of senior management or research and development). Employees should change their habits and time available for breaks they should use to “think” about work and how it could be done more efficiently. Lethargy of employees can be resolved by empowerment.

Here appears some kind of closed loop, because one of the business excellence culture characteristics that enterprises in Serbia do not have is empowerment (66% of respondents considered that they should have greater empowerment in relation to the execution of activities entrusted to them). Empowerment assumes giving employees the power to make some decisions that managers or their superior usually prepare for them. In that way employees will be included in decision-making process and not only in its realization. By empowering employees, managers will receive their commitment which is very important part of business culture and significant factor of improvement implementation success. Empowerment of employees demands previous acknowledgement, because it is necessary to arm employees with certain knowledge and information needed for decision-making. Empowerment and acknowledgement will lead to trust and trust contributes to greater involvement and commitment of employees. If

Business Culture as Accelerator of Business Excellence Model Implementation

enterprises in Serbia manage to resolve mentioned closed loop, they will certainly find a way for reaching business excellence.

In order to make a successful change of business culture in Serbian enterprises, organizational and leadership problems have to be solved. The most of these problems are based on individual behaviour, which is connected with the needs which can be described like:

- Inclusion behaviour, which concerns establishment of contacts with employees,
- Control behaviour, which regards the realization of the impact on others,
- Openness behaviour, which concerns discussion about employees' feelings and thoughts.²⁰

Analysis of individual behaviour is important for raising the employees' self-confidence. When employees have negative feelings about themselves they usually use some defence mechanisms. This kind of behaviour consumes large amounts of employees' energy and, consequently, large amounts of enterprise's energy, which can be directed into productive usage. As employees become aware of consequences of defensive behaviour, the chances to achieve higher levels of self-esteem are greater.²¹

Among all mentioned problems concerning culture characteristics in Serbian enterprises, there is lack of communication between employees or, more precisely, lack of communication related with tasks that employees are supposed to accomplish (only 15% of the respondents pointed out that during the break they talk to other employees about the realization of activities and problems that occur during the realization). Communication between employees during breaks and even during working hours is certainly present, but this kind of communication has to be reduced or completely eliminated in account of communication that considers business problems and the way the work is performed. In that way, employees will be able to understand significance of other employees' work, which will lead to mutual respect and esteem. Also, this kind of communication is productive, because it means sharing knowledge and information between employees and, in that way, it can lead to ideas for improving activities and processes they are involved in. Therefore, this kind of communication is in function of organizational learning.

²⁰ Mathews S., *Six Sigma Culture and Personality*, www.teamtechnology.co.uk/six-sigma.html

²¹ Mathews S., *Six Sigma Culture and Personality*, www.teamtechnology.co.uk/six-sigma.html

Concerning previously mentioned it can be said that culture in enterprises in Serbia is far away from business excellence culture, but it does not mean that it cannot be changed. In fact, in lot of small private enterprises, managers, who are usually at the same time owners of the enterprises, have been trying to implement components of business excellence culture into everyday activities (according to mentioned research results). The most of this kind of managers are former employees of socially owned enterprises, who apprehended “defects” of culture in socially owned enterprises and for that reason have been trying to avoid that “defects” in their own enterprises.

Conclusion

Culture is something that cannot be mandated. It needs to be introduced with clear vision and articulated so that it is clearly understood what is to be expected. Culture can significantly affect potential success of business excellence model implementation. Inadequate guidance of employees’ behaviour, in sense of absence of analysis of their behaviour and presentation the results of analysis, can contribute to useless time consuming. In that kind of situation, misunderstanding and frustrations are not rare, and, consequently, usage of some defence mechanisms. Useless time consuming, misunderstanding and defence mechanisms lead to unproductive channelling of energy.

According to some authors (Erwin, Douglas, 2000), business culture is the main reason for business excellence models success or failure. It means that if business culture in an enterprise is transformed into business excellence culture it is going to act as accelerator of business processes’ improvement and, consequently, as a significant factor of competitiveness and value created for all stakeholders, including customers and employees.

Business excellence culture means that employees have to try to:

- Complete tasks in the best way they can be done,
- Treat employees who accomplish activities that follows as their internal customers,
- Use every available moment for thinking about improvement of the existing way of performing activities,
- Communicate with other employees in order to understand their contribution to enterprise’s success, but also in order to collect ideas for improvement of their own performing,
- Share knowledge and information and contribute to organizational on-going learning, and to support other employees in their endeavour to business processes’ improvement,

Business Culture as Accelerator of Business Excellence Model Implementation

- Empower other employees in order to involve them into improvement process and to provide their commitment to improvement,
- Establish relationship that can be defined as “friendship on distance”, which assumes trust and mutual respect.

In order to change business culture, managers in Serbian enterprises have to change their attitude about their subordinated and let them speak about problems they face every day and about ideas how to fix those problems. If communication between managers and their subordinated employees is missing, a lot of potential ideas will be lost forever. Mutual respect and trust are necessary for creating business excellence culture.

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POSLOVNA KULTURA KAO AKCELERATOR IMPLEMENTACIJE MODELA POSLOVNE IZVRSNOSTI

Rezime: Cilj ovog rada je da ukaže na značaj implementacije modela poslovne izvrsnosti i prihvatanje filozofije na kojoj oni počivaju, ali i da istakne značaj poslovne kulture, kao akceleratora unapredjenja poslovnih procesa. U radu su istaknute karakteristike kulture koja je usmerena ka poslovnoj izvrsnosti, u smislu podrške prihvatanju principa modela poslovne izvrsnosti i metodologije za unapredjenje procesa (koju ovi modeli sugerišu). Imajući u vidu da se polazi od pretpostavke da poslovna kultura preduzeća u Srbiji nema karakteristike potrebne za podršku implementaciji modela poslovne izvrsnosti, rad sadrži preporuke za transformaciju poslovne kulture i promoviše komunikaciju kao ključni faktor ove transformacije.

Ključne reči: poslovna izvrsnost, procesi, unapredjenje, poslovna kultura, komunikacija, preduzeća u Srbiji, privatizacija.



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MANAGING SOCIO-POLITICAL RISK, MARKETING AND BUSINESS ACTIVITIES IN FOREIGN COUNTRIES

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Abstract: *Globalization, the characteristic of the end of the 20th and the beginning of the 21st century, is manifested in liberalization of international economic relationships and multidimensional interdependence of national economies. A new business environment has been created and it encourages companies to internationalize their operations in the form of foreign investments. Social and political risk involved with foreign investments is much higher than the one involved with export and technology transfer strategies. Unlike other risks, political and social risks cannot be completely transferred to a third party. Due to this limitation, a very detailed analysis and active political and social risks management are required. Strategic partnerships in the form of joint ventures represent an active political and social risks management measure, but they also influence other measures of this kind.*

Keywords: *globalization, joint ventures, political and social risk, risk management*

Introduction

Process of globalization and economic liberalization are characteristics of today's business environment. These processes comprise most of the countries with the exception of few countries that insist on the principles of socialism and/or economic nationalism. Process of globalization is characterized by the rising interdependence of national economies which creates multidimensional web of economic, social and political entities based on the principle of "chain reaction". We can conclude that today's business environment is characterized by global competition which requires that every participant use strategic approach in making

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business decisions. Disregard and negation of changes in the competitive environment, often radical, turbulent and not highly predictable lead to competitive inferiority.

On the one hand, this new business environment has created vast array of business opportunities, but on the other, it has created stiffer competition and higher level of the risks involved. Companies' response to this new business environment is internationalization of their activities in order to take advantage of liberalization of economic relationships on the global level, and formation of strategic partnerships with the aim of risk sharing.

After the huge socio-economic and political changes, during the 1990s, many countries that had highly restrictive policies regarding foreign investments liberalized their laws. These once unavailable markets suddenly became available to foreign investors. Many of these countries are still characterized by high political and social risk. Regardless of that, foreign companies have invested hundreds of billions USD in these markets. Before making any decision, investors obtain a detailed analysis of the exposure to political and social risk and create the risk management strategies. One of the measures within these strategies is investment-based partnership, where the partners share the necessary financial resources, which significantly lower the exposure to social and political risk. By combining information, knowledge, resources and contacts companies create a firm ground for joint political and social risk management.

International Business Environment as a Source of Socio-Political Risk

Foreign investors, especially large multinational companies (MNC), tend to maximize return on investment by adjusting themselves to or by having an influence on, within their own capabilities and external limits, socio-economic business circumstances. Type of the system of government is one of the crucial factors that determine a host country's attitude towards a foreign investor and vice versa. An attempt to directly influence the system of government of a host country is considered to be an incorrect strategy and can have long-term negative consequences for a foreign investor's business reputation. Correct strategy of a foreign investor is the one based on previous and proactive analysis of the political situation. Foreign investor should observe and estimate the socio-political environment of his home country, the host country and the international political environment. According to this, a foreign investor is under the influence of domestic, foreign and international politics.

Host country – foreign investor relationship is very complex because host country appears as a regulatory organ (it passes laws), strategic partner (via state owned companies and the organs of government) and competition

Managing Socio-Political Risk, Marketing and Business Activities in Foreign Countries

(via state owned companies). As the level of foreign investor's business activities increases, the influence of home country's policy becomes more important. It is important to point out that though it is officially proclaimed that foreign investors have domestic status, in practice they come across discrimination at the very beginning. Investors whose home country is on bad terms with the host country are especially victims of discrimination. Also, various official and non-official political groups aim their activities at them. These groups believe that foreign investors act on their home country's behalf.

Investor's home country policy has a strong influence on his/her business abroad. Though it seems it is in home country's interest to encourage its companies to invest abroad, it is not always the case. Companies are actually often criticized by domestic political organizations, workers unions and non-governmental organizations. "Export of workplaces" is what is often criticized and disapproved of. Though it has not been practically or theoretically proven, workers organizations claim that foreign investments, especially in countries with cheap workforce, lead to a decrease in number of workplaces and wages in company's home country. Governments in home countries put pressure on investors in order to influence the level and quality of foreign investments, and in accordance with the established political aims. By means of regulations and indirect pressure, home countries influence the choice of target market and export of capital and technology. The USA has banned its companies from investing in countries that, as they believe, violate human rights and support terrorist organizations (Cuba, Iran, Lebanon, Syria etc).

Foreign investors must also adjust their business activities to global politics. During the "cold war" investors from the West had to pay attention to the East – West relationship when forming joint ventures with companies originating from countries that signed the Warsaw pact. Analysis of host country's relationships with International organizations, such as NATO, OECD, IMF, etc., is of major importance, too.

Types of Socio-Political Risks

Changes in political and social environment are inevitable and foreign investors are aware of it. Evolutionary and gradual changes are acceptable for foreign investors and most of them avoid investing in countries characterized by often and radical political changes. Radical and unpredictable political changes create an air of uncertainty and have direct influence on making investment decisions.

Unexpectedly, on August 7, 2008 Georgia, the USA ally, tried, by means of military forces, to take control over the separated province of South Ossetia, which enjoys the Russian Federation support. In response to this, Russia dislodged Georgian military forces from South Ossetia and occupied one part of Georgia. The EU initiated negotiations which lead to peace, but failed to reach political solution to this conflict. The Russian Federation recognized the independence of South Ossetia and Abkhazia, on August 26. The war between Georgia and South Ossetia and Russia became a global political conflict. Due to the rising tension between the USA and Russia political risk in Russia as well as in Kavkaz, a region extremely rich in oil and natural gas, increased. A number of foreign investors sold their investments and left Russian market.

The RTS 1 Index is an index of 50 Russian stocks that trade on the [RTS Stock Exchange](#) in [Moscow](#). Table 1 shows the values of RTS 1 Index in August 2008.

Table 1: RTS 1 Index values

Date	Value	Value changes	Trade volume inUSD ²²
8/29/2008	1,646.14	-0.47%	39,237,339
8/28/2008	1,653.99	4.09%	27,973,707
8/27/2008	1,589.05	0.63%	44,191,390
8/26/2008	1,579.12	-4.16%	28,775,379
8/25/2008	1,647.67	-3.17%	20,510,288
8/22/2008	1,701.61	-1.21%	34,516,291
8/21/2008	1,722.41	0.52%	41,451,558
8/20/2008	1,713.50	1.66%	41,402,626
8/19/2008	1,685.60	-5.21%	48,051,229
8/18/2008	1,778.29	-0.40%	11,885,706
8/15/2008	1,785.36	-0.55%	18,475,908
8/14/2008	1,795.23	1.08%	21,633,435
8/13/2008	1,776.06	-1.54%	42,861,728
8/12/2008	1,803.82	3.49%	45,250,417
8/11/2008	1,742.96	1.18%	52,668,898
8/8/2008	1,722.71	-6.51%	46,764,850
8/7/2008	1,842.58	1.54%	26,947,290
8/6/2008	1,814.60	0.14%	48,887,715
8/5/2008	1,812.00	-4.42%	45,342,795
8/4/2008	1,895.86	-2.36%	77,472,723
8/1/2008	1,941.73	-1.27%	30,384,921

Source: www.rts.ru/en/index/stat/dailyhistory.html?code=RTSI

²² Trade volume encompasses trade volume of stocks that make RTS 1 Index

In August 2008, value of RTS 1 Index decreased by 15.22%. The value of the index especially went down after significant military and political actions. On August 8, one day after Georgia's invasion on South Ossetia, RTS 1 Index lost 6.51% of the value. Similarly on August 26, the day when Russia recognized the independence of South Ossetia and Abkhazia, the value of the Index decreased by 4.16%. Political solution for conflict was not reached till the end of September 2008 and relationship between Russia and USA worsened. Due to this the value of the Index kept falling down during September. At the end of the second week in September the value of the index was 1,341.75 points. This value was 30.9% lower than on August 1 [17]. The withdrawal of foreign capital was a threat to stability of exchange rate and The Central Bank of Russia had to react by selling foreign exchange reserves. According to the report of the Central Bank of Russia, on September 1, the value of foreign exchange reserves was 581.6 billion USD which was a decrease of 14.3 billion USD comparing to August 1 [15].

Political risk encompasses 'sovereign risk', the risk that the sovereign will interfere with a firm's ability to pay its investors as promised, but also other forms of political, economic and country specific risks that affect the profitability of an investment in a foreign country and that would not be present if the country had a more stable and developed business environment and legal institutions [7, p. 2]. This interpretation of political risk disregards the fact that the source of political risk can be both the home country and the broader environment. Different kinds of sanctions can be imposed due to home country's policy which significantly increases the risk. Current affairs in the region can influence political risk of a country despite the fact that it is not directly involved.²³

Social risk refers to social categories and events, such as corruption, accidents at work, environmental incidents, which increase the tension between the company and the local residents, an infringement of workers rights, etc. All this can lead to an unfavorable business reputation and heavy financial losses. Nevertheless, social and political risks overlap and it is sometimes impossible to observe them separately [2, p. 33].

There are two groups of political and social risks foreign investors are exposed to: 1. risks affecting property 2. risks affecting financial transactions and business operations [12, p. 108 – 112].

Risks affecting property are: 1. confiscation 2. expropriation 3. nationalization 4. domestication. As the main reason for taking away assets

²³ Poor tourist season in Turkey due to war in Iraq

from foreign investors, governments name support to economic growth. In their opinion foreign companies only take care about making profit and that can be an obstacle to economic growth of host countries. In most cases, taking the assets away from a foreign investor leads to inefficiency, lagging behind in technology and uncompetitive position in the global market. Due to these defects, governments have been applying these measures rarely in over the past 20 years.

Confiscation is a governmental measure where the government takes property away from investors without compensation. This measure is applied rarely and countries sometimes use it in basic industry. Nowadays, confiscation is more a legal than economic measure. It is usually applied to take away the property gained by criminal deeds.

Expropriation is a governmental measure similar to confiscation. The only difference is that the investor receives certain compensation. In practice most often these compensations do not cover the price of the expropriated property. Serbian Expropriation law requires that the compensation for expropriated property, in the public interest, be not less than its market value [13, p. 1].

Nationalization is a governmental measure where investor's property is put under the control of the government in the best interest of the state. The investors receive compensation that often does not cover the market value of the nationalized assets. The government applies this measure in order to alter the socio-economic polity or the relationships within an industry (oil fields, construction industry, financial sector etc.). In August 2008, in accordance with the proclaimed strategy of "new socialism", the Government of Venezuela, after the oil fields, nationalized foreign cement companies, too. The Holcim Ltd. received 552 million dollars in recompense for nationalization of 85% of their subsidiary in Venezuela, and Lafarge received 267 million dollars in recompense for nationalization of 89% of their subsidiary. Mexican company Cemex, the leading cement manufacturer in Venezuela, rejected 650 million dollars recompense claiming 1.3 billion dollars. Since the negotiations failed the authorities under the National Guard occupied and confiscated the premises of Cemex. In the meanwhile, the government announced their intention to nationalize the financial and telecommunications sector of the company [16].

Domestication is a governmental measure where a foreign company gradually becomes local. Foreign investments gradually transfer into state-owned properties. Series of governmental measures increase the local share in the capital and management. The goal of this measure is to increase local share in capital, management and profit [4, p. 161]. From a foreign

investor's point of view this measure is the most acceptable because it is gradual and predictable.

The risks which affect transfer of resources and business operations are usually political, but can be social too. These two types of risk sometimes cannot be analyzed separately.

Transfer risk is a consequence of governmental measures which enable foreign investors to repatriate their profits and capital in order to decrease deficit in the balance of payments. Nevertheless, this type of risk has been lowered recently since many countries give legal guarantee to foreign investors of the repatriation of their profits and capital.

When it comes to taxes, state and company interests are at opposite ends. On the one hand government tends to collect as much revenues as possible, but on the other hand, companies tend to evade taxes without breaking the law. Governmental tax policy measures directly influence profitability of a foreign company. Constant and unpredictable tax policy changes, with the aim of covering budget deficit, can discourage foreign investors. Companies apply various measures to evade paying taxes and transfer prices proved as the most efficient. This measure enables companies to transfer profits to countries known as "tax paradise" but it can cause tension between the host country and the company.

Corruption is another prominent feature in transition economies, and it is a highly significant socio-political problem which affects all aspects of society. Corruption is defined as an arrangement that involves an exchange between two parties (the demander and the supplier) which: a) has an influence on the allocation of resources either immediately or in the future; and b) involves the use or abuse of public or collective responsibility for private ends [8, p. 769]. Degree of corruption in host country is of great relevance to foreign investors. Corruption can cause additional costs for foreign investors and uncertainty about the implementation of project. International non-profit organization Transparency International publishes *Corruption Perception Index*. This Index is based on the level of corruption perceived by business people and country analysts in 180 countries. The score is based on integrity ranking, where 10 equals totally clean and 0 highly corrupted countries. According to the report of Transparency International for 2008 the most corrupted country in SEE was Bosnia and Herzegovina with 3.2 *Corruption Perception Index* value, and it ranks 86-92 on the list. On the other side is Slovenia with 6.7 *Corruption Perception Index* value, ranking 26 on the list. Serbia, Montenegro and Albania have the same value of *Corruption Perception Index*, 3.4, and they rank 81-85 on the

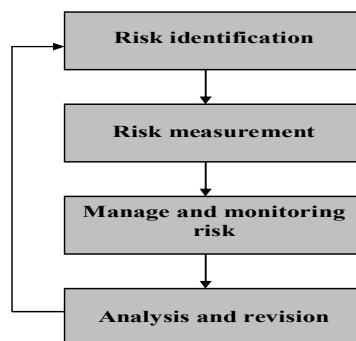
list [18]. All this leads to conclusion that the level of corruption in the Balkans is significant social risk for foreign companies.

A boycott of foreign investors and products is closely related to the activities of government as well as various non - governmental organizations. Economy in most of the today's countries is based on the free market principles and the direct boycott of foreign products occurs rarely. Instead, there has been a rising trend of an indirect boycott in the form of promotion of domestic companies. With the aim of promoting domestic products, a campaign with the slogan "Buy domestic" was conducted in Serbia. The campaign slogan in Croatia was "Buy Croatian – be croational". These campaigns had short-lasting effects and were a form of boycotting foreign companies. Boycott of foreign products can also be initiated by various non-governmental groups, and its effects can significantly overcome the effects of those initiated by government.²⁴

Ways of Reduction in Political and Social Risk in International Business and Marketing

Political and social risks are usually not considered when evaluating foreign investments. It is often impossible to quantify and include them in discount rate which is used in valuation of projects by DCF method. According to the research conducted by the American Institute of Certified Public Accounts (AICPA) 84% of companies do not include political and social risk in valuation of projects abroad [2, p. 37]. A simple model can be used to simulate political-social risk analysis and management. It consists of four steps shown in Picture 1.

Picture 1: Political and social risk management model



²⁴ On the website of the Islamic Union of Podgorica there was a list of Danish products to be boycotted. This was due to the offensive cartoons ridiculing Islam first published in Denmark and later on worldwide. Similarly, Kosovo Albanians' organization named "Self - determination" called for a boycott of Serbian products.

Managing Socio-Political Risk, Marketing and Business Activities in Foreign Countries

The first step is identification and analysis of potential social and political risks. In this paper, only the types of social and political risks that occur most often were mentioned. Task of management is to identify all the potential social and political risks that can appear in a target country. The following step is political and social risk measurement. It is necessary both on the level of economy as well as on the level of industry. Companies often hire agencies specialized in political and social risk measurement and forecast. The most important publications in this field are *International country risk guide* published by Political Risk Services of East Syracuse and *Country risk* published by Economist Intelligence Unit, subsidiary of Economist. Countries are ranked from 0 (no political and social risk) to 100 (extremely high political and social risk). Besides these agencies some consulting companies, international organizations and companies specialized in foreign investments and export insurance issue publications on political and social risk in specific countries.

The World Bank has been publishing World Governance Indicators since 1998. This publication comprises six dimensions of political and social risk in 212 countries. These dimensions are: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption. They are ranked from 0 to 100, where 0 is the lowest and 100 is the highest value. Interviews with companies and experts from both developed and developing countries and data obtained from scientific institutes, non-governmental agencies and international institutions are used to calculate the values of the dimensions. The next table shows the values of all six dimensions for the Balkans from 2005 to 2008.

This table shows that Bosnia and Herzegovina, Serbia and Macedonia are the least politically stable countries in the Balkans. In Bosnia and Herzegovina, political instability is due to the conflicts among the entities, in Serbia it is due to lack of political consensus and the process of separation of Kosovo, while in Macedonia it is due to the tension between Macedonians and Albanians and the negotiations with Greece regarding the official name of the state. Countries which are EU members or expected to become soon are characterized by higher political stability.

The third step is manage and monitoring risk. This step includes three processes: 1. risk avoidance 2. insurance and 3. active risk management. If the estimated political and social risk in a country is extremely high, company can avoid investing in that country. Insurance against political and social risk is one of the measures companies apply when doing business with companies from high risk countries. USA companies can insure themselves against these risks in state agencies, such

as OPIC or private insurance companies. Insurance premiums are exceedingly high, and it is very hard to specify all kinds of risk in the insurance contract. Besides insurance against political and social risk, companies should also apply an active risk management. Active risk management comprises measures and activities that help a company adapt to the new environment and decrease exposure to political and social risk. All these measures can be classified in four groups: 1. choice of the form of investment and the way of financing 2. corporate social responsibility 3. local economy stimulation 4. political neutrality and tactful lobbying.

Table 2: Political and social risk dimensions for the Balkans

	Year	Rang (0-100)							
		Albania	Bulgaria	B&H	Croatia	Montenegro	Romania	Serbia	Macedonia
Voice and Accountability	2008	51.4	65.8	48.5	60	56.2	59.1	54.8	53.3
	2007	49	67.3	51	60.1	56.3	59.6	55.3	53.8
	2006	48.1	63	53.4	59.1	48.6	62.5	54.3	54.8
Political Stability	2008	45.4	58.8	25.8	66.5	68.8	55.9	28.2	33.9
	2007	35.1	59.1	26.4	64.4	35.6	55.3	22.6	30.3
	2006	32.2	58.7	28.4	59.1	33.7	54.8	23.6	24.5
Government Effectiveness	2008	44.5	58.2	35	69.6	56.8	50.2	47.8	50.7
	2007	43.1	57.8	21.3	68.7	48.3	50.7	46	46.4
	2006	35.5	58.3	34.1	70.1	46	57.8	47.4	52.1
Regulatory Quality	2008	57	73.4	48.7	66.6	52.1	67.6	47.3	58.4
	2007	55.8	69.9	44.2	64.6	45.6	66.5	40.8	54.9
	2006	51.7	66.8	39.5	62.9	31.7	64.4	41	52.7
Rule of Law	2008	32.5	51.1	43.5	55	53.1	53.5	41.1	45.4
	2007	28.1	51	40.5	55.2	48.1	50.5	39.5	43.8
	2006	26.7	50	40.5	52.9	38.1	49.5	35.2	42.9
Control of Corruption	2008	39.1	52.1	45.8	61.8	47.8	57	53.1	54.5
	2007	35.7	54.5	43.9	59.4	42.9	56	47.8	50.2
	2006	28.6	57.8	48.1	60.2	39.8	54.4	46.1	45.1

Source: http://info.worldbank.org/governance/wgi/sc_chart.asp#

Joint venture with local partner, as a form of investment, can significantly minimize exposure to political and social risk. Host countries often tend to limit foreign investor's share in capital. By applying these measures countries control foreign capital inflow into certain industries²⁵ and try to obtain the spillover of foreign technology and know-how. Nevertheless, MNC sometimes avoid joint ventures with local partners because of the possibility of uncontrolled spillover of the effects of the transferred technology and know-how [10, p. 458]. MNC prefer full

²⁵ Military industry, mass media, natural resources etc.

ownership of the project, if the local policy allows it. It has been proven in theory that joint ventures with local partners are good choice in politically instable countries. India, which has partially liberalized foreign investment policy, and where due to political instability there is a possibility of restoring the restrictive measures²⁶, is an example which justifies joint ventures with local partner, though the effects can be expected in the future. If a foreign investor who owns superior technology has, due to restrictive foreign investment policy, to choose between joint venture with local partner and granting a license, the first one proves to be a more profitable option [9, p. 20]. Foreign investor has right to fixed income as well as royalty payments depending on licensee's revenues gained by license using. There is no possibility of nationalization and the risk uncontrolled spillover of technology and know-how is increased. Joint venture with local partner significantly decreases the risk of nationalization, even if the changes in the government policy cause restrictions on foreign investments. It also lowers the possibility of an unauthorized use of transferred technology. The partnership with local investor also helps foreign company deal with domestication. Namely, foreign investor and local partner can make a deal by which the local partner, by paying adequate compensation, acquires majority stake in the joint venture. In order to protect their investments, foreign investors tend to make advantage of local partner's political contacts. Besides the form of investment, one of the measures that can influence the level of exposure to political risk is the way of financing. Taking out loans on the local financial market significantly decreases the likelihood of nationalization. Nationalization of a company primarily financed by domestic resources directly inflicts losses on the domestic financial institutions, which can shake the whole financial market. Financing foreign projects by local resources is not always possible due to the restrictions imposed by governments. In countries with high probability of nationalization foreign investor should avoid investing in fixed assets and lean upon leasing them, especially from local parties.

Corporate social responsibility means that foreign companies contribute to the interest of the whole society. The message foreign companies have tried to send to the public is that they intend to completely integrate with the local community. In order not to be recognized as an irresponsible community member many companies tend to improve the social consequences of their activities. Nevertheless, the results turned out not to be as productive as expected for two reasons: 1. from companies'

²⁶ Even though the regulations in India allow international joint ventures in the air transport industry, Indian government refused to ratify the Tata – SIA joint venture.

point of view responsible social behavior and profitability are at opposite ends 2. companies think about social responsibility in generic way, separately from implemented corporate strategy. Most of these measures are neither strategic nor operative but cosmetic: advertising campaigns, sponsorship of individual activities, public relations etc [11, p. 79]. Companies often make donations to events or institutions of great importance to local community to decrease exposure to political and social risks. Strategic partner, due to its close relationship with local community, selects events or institutions to be supported. Local partner's task can also be to communicate to the public and government the unobtrusive but clear message that foreign investor is socially responsible. This way foreign investor becomes a responsible member of the society without excessive publicity, and social responsibility is not seen as self-advertisement.

Local economy stimulation includes various business arrangements between foreign investor and local companies such as hiring local workers, especially the qualified ones, hiring local suppliers and subcontractors etc. The importance of these measures increases if the local factors are hired not only within the host country but also abroad. These measures will have a positive effect on export, i.e. balance of payments, which will increase company's importance to local economy. Local partner plays a very important role here. Since he/she is familiar with the market his experience is irreplaceable when choosing suppliers, subcontractors, or hiring and training workers. MNC, especially those planning to invest in developing countries, are often under the pressure of governments in these countries to form joint ventures with local partners. This way, developing countries try to obtain the spillover of new technologies [1, p. 106]. Strategic partner has a web of contacts with local companies that are capable of and interested in participating in research and development projects. Foreign investor sends the message that he/she is interested not only in work intensive, but also in technology propulsive projects with local partners. The aim of these measures is to persuade the host country's government that the foreign investor is of great importance to local economy.

Political neutrality and tactful lobbying are parts of a long-term strategy of every company. Political believes should not be expressed in public, while tactful lobbying via specialized lobby agencies, strategic partners and the organs of the government of the home country is recommended. Local partner's political influence sometimes can be that powerful to significantly decrease political risk exposure.

Political and social risk management strategy is implemented to avoid the unfavorable influences of the environment or to change the

environment. There are two major types of this strategy in theory and in practice: 1. low intensity strategy 2. high intensity strategy [5, p. 185]. Which of these will be implemented depends on the level of the exposure to political and social risk. When the joint venture with local partner is a part of an integrated system, the influence of the local environment can cause more serious repercussions than the mere loss of property and sale on the local market. If one link in the chain is broken the whole system suffers immeasurable consequences.

Low intensity strategy is implemented by companies that are exposed to low political and social risk. These companies make partnerships with companies that have similar goals and conjointly lobby organs of government on national level. The aim of this strategy is to avoid attracting attention and being a target of political actions. By forming partnerships, companies firm their position in negotiations with the government, decrease lobbying costs and expand the range of political contacts. Political influence of the local partner is of great importance here. Company can also form a strategic partnership with other foreign investors to lobby conjointly.

High intensity strategy is implemented by companies that are exposed to high political and social risk and tend to manage it actively. The purpose of this strategy is to create the web of broad spectrum of stakeholders. The aim is to form stakeholder webs on local, regional and national level. The web of stakeholders is a permanent resource of information and the means of minimizing exposure to political and social risk. It is desirable that all the stakeholders within the web should have identical goals. Stakeholders with different goals should not be excluded because they can be an important source of information. Implementation of this strategy requires considerable resources and since it is applied on local, regional and national level it can cause an unfavorable reaction of the environment. Local partner's contacts and knowledge are of crucial importance for implementation of this strategy. These are not only political contacts but also the contacts he has established with other stakeholders.

Companies can implement these two strategies simultaneously. Those implementing the high intensity strategy can join the web of companies with similar goals, seeing this web as a missing part of a broader web. Similarly, companies that initially implement low intensity strategy can evolve including new stakeholders in the web. The relationship with local partner is the basis of implementation of these two strategies. Foreign investor merely develops his own web on the basis of already existing local partner's web of social and political contacts and his knowledge of the local community.

Finally, analysis and revision represent the last step in the implementation of the political and social risk minimization strategy. Companies have to do the analysis of their risk management strategy periodically and make revision to it if needed. At this stage companies analyze the results and possible new risks. The results of this analysis may require modification of the existing one or creation of a new strategy. This stage is very important because today's business environment is characterized by radical and turbulent changes and the strategy has to be adjusted to it.

Conclusion

Today's business environment is characterized by globalization and economic liberalization. These two processes have created a range of new possibilities as well as threats for companies. Companies try to make use of these possibilities via internationalization of their business. Internationalization, especially in the form of investment, exposes companies to political and social risks in home countries, host countries and on the global level. There are two major types of social and political risks: risks affecting foreign investor's property and those affecting financial transactions and business operations. Due to the widespread principles of free market, governments rarely take foreign investors' property away, though this measure has not been completely abandoned, and act indirectly in their own interest.

No matter how government and social groups influence company's business operations, its response to the challenges should be a strategic approach. Companies first have to identify all possible political and social risks. Today's business environment is characterized by radical and unpredictable changes which makes it difficult for foreign companies to identify all present and future political and social risks involved with foreign investments. After this companies measure the exposure to the risks. These two steps are crucial for the success of the political and social risk minimization strategy. At this stage companies often hire agencies specialized in political and social risk measurement and forecast. The following step is manage and monitoring risk. This step includes: 1. risk avoidance 2. insurance 3. active risk management.

Active risk management comprises the measures by which companies, on the basis of the data obtained in the previous stages, try to minimize the exposure to political and social risk. These measures are: 1. the form of financing and financial resources management 2. corporate social responsibility 3. local economy stimulation 4. political neutrality and tactful lobbying. Companies implement different combinations of these measures.

Joint ventures with local partner, as a form of financing, make the implementation of other active risk management measures much easier. Governments rarely nationalize joint ventures of foreign and local companies, especially if the foreign investor takes minority stake. Local partner's knowledge, information and contacts help foreign investor deal with political and social risk. A web of stakeholders that every company creates on local, regional and national level is a very useful source of information and knowledge crucial for the political and social risk management.

At the last stage companies analyze the effects of the created and implemented strategy and the changes in the business environment that influence the exposure to risk. According to the results of the analysis, managements improve the existing or create a new strategy.

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UPRAVLJANJE SOCIO - POLITIČKIM RIZIKOM, LOKALIZACIJOM POSLOVANJA I MARKETINGA U INOSTRANSTVU

Rezime: Globalizacija, karakteristična za kraj XX i početak XXI veka, manifestuje se liberalizacijom međunarodnih ekonomskih odnosa i multidimenzionalnom povezanošću nacionalnih ekonomija. Na ovaj način kreirano je podsticajno poslovno okruženje za internacionalizaciju poslovanja putem investiranja u inostranstvu. Investiranje u inostranstvu nosi sa sobom veću izloženost političkom i socijalnom riziku u odnosu na izvozne i strategije transfera tehnologije. Za razliku od ostalih, politički i socijalni rizici se ne mogu u potpunosti transferisati na treću stranu. Usled ovog ograničenja neophodna je vrlo pažljiva analiza i aktivno upravljanje političkim i socijalnim rizicima. Strateška partnerstva u vidu zajedničkih ulaganja predstavljaju aktivnu meru upravljanja političkim i socijalnim rizicima, ali imaju uticaj i na ostale mere upravljanja.

Ključni izrazi: Globalizacija, zajednička ulaganja, politički i socijalni rizik, upravljanje rizikom



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SPACIAL AND FUNCTIONAL CHANGES IN THE MUNICIPALITY OF SOKOBANJA DURING THE SECOND HALF OF 20th CENTURY

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Abstract: *The paper analyzes the changes of demographic, functional and physiognomic characteristics of the municipality of Sokobanja. Municipality of Sokobanja is part of the Zaječar District, and one of the most important municipalities in that part of Serbia, according to its functional capacity. From the demographic viewpoint, Sokobanja represents the largest and according to the functions, the most important settlement of the same municipality. The closeness and a direct influence of Niš and Zaječar have determined, to a great extent, the course and level of the development of Sokobanja.*

Keywords: *function, changes, development, depopulation, changes of functional development.*

Introduction

Urban settlements in Serbia are the center of socio-economic development. These are, regardless of size, usually polyfunctional centers, with different economic and non-economic functions. The network of settlements, developed in a particular space as whole, urban settlements should be considered:

- As the center of the spatial organization of production, exchange, consumption and services, on the one hand, and the organization of socio-

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economic life of the population, on the other hand as the part of the network surrounding villages;

- As the center at which are concentrated different economic and non-economic functions, and the town using its functional capacity appears as a factor in initiating, encouraging and directing the development of the surrounding villages (Veljković, A., 1991).

Accordingly, the city should be seen as pole of the socio-economic development of certain territories. Spatial-functional impact of the town on to the immediate and wider environment is reflected in the transformation of villages (socio-economic, functional, demographic, etc.) based on the process of urbanization and development of various activities on the one hand, and the process of depopulation and land reclamation, on the other hand. At the same time, the change of the functional capacity transforms the spatial, morphological and demographic structure of urban settlements.

Traffic and Geographical Position

Sokobanja is situated in the central part of south-eastern Serbia, 58 km northeast of Nis and 80 km south of Zaječar. The town is located in the valley with the same name, in the tectonic-erosive expansion, downstream from the canyon of Moravica which goes through Ozrensko-devička karst surface. The basin is bounded on the north by the mountain Rtanj (1567 m nv), the Ozren mountain on the south (1100 m nv), the Devica mountain on the east side (1070 m nv), and from the west and southwest by Rozanj and Bukovik. Naturally predisposed road that goes by the valley of the river Moravica splits into two directions, one on the southwest direction, through Bovan gorge to the Morava basin, and the other towards the east through the gorge of Skrobnica towards the Timok basin. Sokobanja is the center of the naturally predisposed roads between the Morava and Timok basin. On that basis, its valorization for the development of urban settlements depended on the number of socio-historical factors and their reflection in the space. The whole traffic geographical position of the settlements is favorable. The part of the regional road Aleksinac-Sokobanja-Knjazevac goes through Sokobanja and links the surrounding settlements with the high-road E-75, the major road in Serbia, on the one side and with the regional road Knjazevac-Zaječar-Kladovo, on the other.

Sokobanja is the economic, cultural and administrative center of the municipality. The Municipality consists of one town and twenty four villages. According to the spatial plan of Serbia, the Municipality of Sokobanja is an integral and functional part of the Zaječar district. Proximity and impact of Niš and Zaječar to the greatest extent determine the up today

Spacial and Functional Changes in the Municipality of Sokobanja During the Second Half of 20th Century

development of this settlement. The most intensive demographic, physiognomic, socioeconomic and functional changes in this settlement are related to the second half of the twentieth and the beginning of the twenty first century.

In the previous development of Sokobanja, roles in the functional organization of settlements of municipality can be seen in the following:

-Sokobanja is a place that has the character of the tourist resort, but according to the financial parameters it works as a settlement that achieves the dominant revenue from the economy, but from public activities as well (public administration);

-Sokobanja has characteristics of a pole of concentration of population and economic activity, which is insufficiently used to increase its functional capacity;

-Non existing strategy of the development of spatial capacity and contents on the local level is the major problem in connecting Sokobanja with Zaječar and Niš areas. It also reflects on functional and demographic development of the whole municipality.

Changes in Spatial and Morpho-Physiognomic Characteristics of Settlements

Territorial development of Sokobanja is conditioned by terrain morphology and relief predispositions of the main communicational direction in this area. Since the beginning, territorial development of Sokobanja had no plan at all. According to V. Kojic, Sokobanja at the beginning of the twentieth century, according to the urban structure, belonged to the category of irregular settlements. Such settlements have appeared spontaneously and their important features were irregular scheme of curvy streets of different width, shapeless blocks and housings. The settlement developed on both sides of the regional road Aleksinac-Sokobanja-Knjaževac, which is also the main street in town. Topographical position of the settlements is determined by the morphology of terrain. Namely, the settlement is developed on the valley sides of Moravica, and the watershed between Moravice in the north, Gradašnice in the south and Železovac in the east.

Sokobanja is the settlement of half-compact type and spatially develops in high altitude zone of 300 to 350m. (Dakic B. 1967th). Contemporary urban and physiognomic composition of Sokobanja unites more suburban units: Sokobanja, Banjica, Čučunje, Drenjar, Glogan,

Koviljaca, Podina, Čuku, Kršina. Urban area of the municipal territory has increased from 20 km² at the beginning of the twentieth century to 34 km² in 1992. (General urbanistic plan).

Spatial and morpho-physiognomic structure of settlements in the second half of the twentieth century has not significantly changed. This is influenced by unfavorable demographic processes in the municipality and poor functional capacity of Sokobanja to receive a number of migrant populations. With the strengthening of tourism and administrative functions in the 1980s of the twentieth century territorial expansion of Sokobanja is a little bit emphasized.

According to the urban master plan, all suburban units are divided into two zones: the central city and suburban zone. The central city zone includes the protection zone of direct thermal sources and in this zone is also located the nucleus of this settlement tourist resource. The central urban area consists of urban sections: Center (10 ha), Banjica (8.2 ha) and Čuka (0.8 ha). The suburban zone covers the largest area of the settlement (19.5 km²). Aside of the zone of living and working, there are significant areas under forest and agricultural land in the suburban area. Marginal parts of Sokobanja represent a combination of urban and rural ways of life.

Changes of the Demographic Component of Spatial-Functional Development of Settlements

Sokobanja is a settlement with a long continuity of populating. Throughout its history Sokobanja has often changed its importance and role, but has always been a dominant place to which gravitated all other villages from the entire Sokobanja basin. The town initially represented the local trading center for agricultural, livestock and craft products from the nearest environment. Much later, in the complex socio-economic conditions of the development, Sokobanja transformed to the center of regional importance. At the beginning of the second half of the nineteenth century (1852nd year.), Sokobanja had the characteristics of the rural town and represented the most important settlement of the Sokobanja district. "The geographic advantages, the needs of state administration, the opportunities provided by modern transport, all these factors make that at the focus of specific regions towns appear as a necessary means for satisfying various needs of the region" (B. Kojić, 1970). Its origin and development, as well as any other town at that time, Sokobanja based on the favorable traffic position and the role of a mediator between agrarian settlements of the Sokobanja basin. Sokobanja had the status of the largest settlement according to the census of 1910 (1580 cit.), 1921 (2198 cit.), 1948 (3,720 cit.) and 1953 (3984 cit.).

**Spacial and Functional Changes in the Municipality of Sokobanja During the
Second Half of 20th Century**

Table 1. Development of the Population

	1953.	1961.	1971.	1981.	1991.	2002.
Municipality of Sokobanja	24.621	24.285	23.932	23.394	21.984	18.571
Sokobanja town.	3.984	4.227	5.554	7.204	8.439	8.407

Data source: Republic Statistical Department of Serbia, Census books,
The period of 1953-2002. , Belgrade.

The second half of the twentieth century was marked by dynamic changes in spatial and social mobility of the population of the Sokobanja basin. The processes of industrialization and urbanization have caused the transfer of population from the agricultural hinterland to Sokobanja, which on the other hand also started the demographic, spatial and functional development of the only urban settlement in the municipality. Increased influx of rural population leads not only to increasing populating of Sokobanja, but also to significant changes in its geographic character. Dynamic demographic development of Sokobanja was significant during the period that followed the 1970s of the twentieth century. According to the census of 1971, Sokobanja had a population of 5554 and in 2002, it numbered 8407 citizens. Thanks to the development of certain functions, primarily industry and tourism, Sokobanja, unlike other settlements in the municipality has managed to maintain a certain demographic stability. Average annual population growth rate of Sokobanja in the period 1971-2002 amounted to 0.8 ‰, while in the same period, the annual growth rate of the population of the municipality was less favorable, and amounted to -0.6 ‰. Until the last decades of the twentieth century, Sokobanja was the center of population growth. However, due to great economic and social crisis, the last decades of the twentieth century and the beginning of the twenty-first century were marked by stagnation of economic and demographic development of settlements. The decline of natural population growth and intensifying emigrational process contributed to the demographic stagnation of Sokobanja and reduction in the total population of the town. Sokobanja developed as the depopulation settlement in the final intercensal period. In the period 1991-2002, the annual population growth rate of Sokobanja was -6.1 ‰, which primarily was the result of negative natural growth (-3.9 ‰) and negative rates of migration balance (-0.9 ‰) (Radivojevic, A.2009.).

Negative demographic changes in the second half of the twentieth century resulted in the substantial changes in age structure. Concentration of certain functions of Sokobanja managed to partially mitigate the process of aging population, which was during the whole second half of the twentieth century characteristic of the entire territory of the municipality. However,

the last decades of the twentieth century and the beginning of the twenty-first century were marked by stagnation of this demographic structure, too. With an average index of the population aging of 1.65 and coefficient of the aging population of 26.5 people, demographic structure went from the stationary type, characteristic for the beginning of 1950s of twentieth century (1953 year.) to the stage of demographic aging process, at the beginning of the twenty-first century (2002)

Functional Transformation

Due to the regressive effects of demographic processes in the municipality of Sokobanja during the second half of the twentieth century, new network of settlements was formed with certain functions and influences on the spatial organization in the region. Spatio-functional structure of the network of settlements is basically polarized with a single pole of development in Sokobanja, which also has the highest functional capacity and is being gravitated to by the entire territory of the municipality.

Traffic-favorable geographical position made an impact on certain functions to concentrate in Sokobanja. Farming, crafts and trade occurred in that period as factors of development. The town developed rapidly between the two world wars, and the significant factor of development was agriculture. A significant decline in agricultural function and reduced share of agriculture population in the total demographic structure happened after the Second World War. The share of agricultural population has been reduced from 25.4% to only 2.3%. in the period from 1953 to 2002 (Radivojević A. 2008). Sokobanja, among all the settlements in the municipality, experienced the greatest functional changes in the period after the Second World War. Territorial range of functions (administrative, cultural, administrative, educational, health, trade) is not crossing municipal boundaries. Industrialization which began in the late 1960s encouraged intensive functional development of Sokobanja. The process was intensified in the late 1970s and early 1980s of the last century. Several industrial buildings were built (primarily small food processing factories), and it was a period of intense development of spa tourism in this region (J. Jovanović A. Radivojević, 2006). Many facilities of the tourist infrastructure were built (hotels, motels, resorts), which initiated the process of development of the service industry, and therefore, the functional transformation.

Functional transformation of the settlement took place simultaneously with the strengthening of secondary and tertiary sectors of the economy. In 1953, Sokobanja had the characteristics of an agricultural-services economy settlement, according to the functional typology. The share of active population in the primary sector fell from 38.5% to 5.3% in

**Spatial and Functional Changes in the Municipality of Sokobanja During the
Second Half of 20th Century**

the period 1953-2002. The highest growth of the active participation of the population that works in tertiary and secondary sector activities took place at the same period. This trend caused Sokobanja to develop as an agricultural-service industry settlement in the period 1953-1971. The share of the secondary sector increased from 5.6% to 15.5%, while the share of tertiary sector increased from 5.2% to 37.2% in the period 1953-2002. Such a transfer of the active population towards this activities caused Sokobanja to develop as a service-industrial-agrarian settlement in 1991.

**Table 2. Active Population According to Activity in the Period 1953-2002
(According to the Type of Settlement)**

Census 1953.		
	Municipality of Sokobanja	Sokobanja town..
actively population	17152	1743
Primary	15381	776
%	89,7	44,5
Secondary	957	325
%	5,6	18,6
Tertiary	814	639
%	5,2	36,7
Census 1971.		
	Municipality of Sokobanja	Sokobanja town.
actively population	16400	2248
Primary	13084	505
%	79,8	22,7
Secondary	1328	605
%	8,1	26,9
Tertiary	1988	1138
%	12,1	50,6
Census 2002.		
	Municipality of Sokobanja	Sokobanja town.
active population	7183	2709
Primary	3383	135
%	47,1	4,9
Secondary	1125	632
%	15,7	23,3
Tertiary	2675	2007
%	37,2	74,1

Source data: Census of 1953, Basic data on population, settlement information for the administrative division of 30.06.1958., Book XV, Federal Statistical Department, Beograd 1960th; Population and housing census in 1971, Federal Statistical Department, Beograd., Census of households and dwellings in 2002., activity and gender of the active population that performs occupation, Book 6, Republic Statistical Department, Belgrade 2004.

The year of 1991 was the year of great economic stagnation in the economic development of Sokobanja, which was marked by tertiarisation of the economy on a weak basis. The share of primary sector, compared to the previous census period was reduced from 22.7% to 4.9%, while the secondary participation increased from 18.6% to 26.9% and the tertiary from 50.6% to 74.1% of the total active population. Sokobanja became a center to which most agrarian settlements in the environment gravitated. This was caused by functional transformation of Sokobanja. Existing functions of Sokobanja, especially in the second half of the twentieth century, proved to be insufficient, so the demographic stagnation became one of the main consequences of the functional and economic vulnerability of settlements. Sokobanja failed to strengthen significantly in socio-economical and functional way, and thus to ensure the redistribution of economic activities and population in their municipality in the second half of the twentieth century. This resulted in significant emigration of active working population, in aging of population and the weakening of the economic power of the town and the municipality.

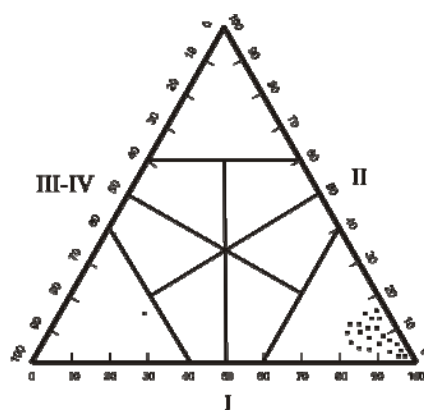


Chart . Ternary diagram²⁷ of Sokobanja for the year of 1953

²⁷ To show changes in position in the functional typology and functional affiliations of each individual settlement, and the dynamics of their functional transformation model o ternary diagram was used. Method of correlative or ternary triangle is most acceptable for the purposes of this analysis for several reasons: 1.it takes into account a combination of features in the structure of activity, not only specialization based on the leading (dominant) function, 2nd in combination, within the fields of the triangle, we can see that the leading features, can also determine the changes that have occurred in the functional type of settlement, during the analyzed period; 3rd provides objectivity.

Spacial and Functional Changes in the Municipality of Sokobanja During the Second Half of 20th Century

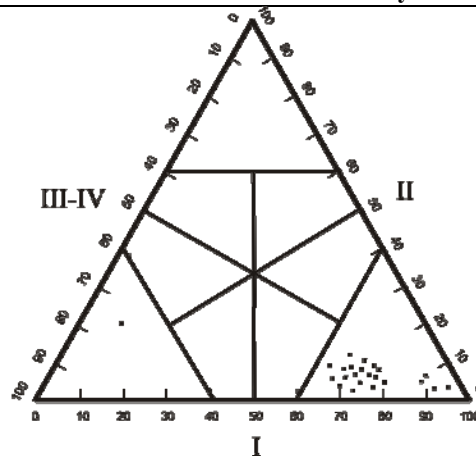


Chart 1 Ternary diagram of Sokobanja for the year of 1971

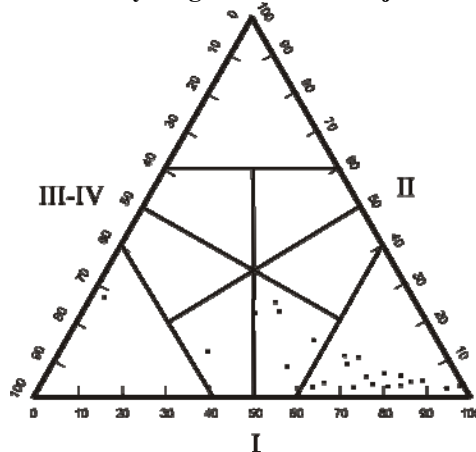


Chart 1 Ternary diagram of Sokobanja for the year of 2002

Conclusion

Spatial and functional development of Sokobanja, during the second half of the twentieth century, has led to significant changes in the geographical character of the entire territory of the municipality. Negative changes have led to outstanding polarization effects, which caused large differences between Sokobanja and agricultural hinterland. Throughout the second half of the twentieth century, population concentrated in Sokobanja and thus, villages demographically emptied. Sokobanja became a pole of attraction and concentration of spatial-functional relationships. On that basis,

its intensity and territorial range field of its influence and gravitational effects were established. Power and the territorial scope of its functions do not exceed municipal boundaries. Functional capacity of Sokobanja has become the only driver of modern geographic changes in the territory of the municipality. However, based on the correlation between demographic characteristics and the achieved level of functional development, we can conclude that the previous development of Sokobanja was insufficient. Sokobanja had the attributes of a less urbanized municipal center in 2002, according to the socio-economic criteria. Sokobanja has a low functional capacity and weak positive impact on socio-economic transformation of its environment, which, manifested in substantial migration to neighboring and distant urban centers, during the second half of the twentieth century. Based on this spatial-functional development, Sokobanja can be characterized as poorly urbanized enclave in the agricultural and rural environment, formed by the concentration of population from rural villages of the municipality and by the concentration of the basic city-required functions, at the beginning of the 21st century.

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**Spacial and Functional Changes in the Municipality of Sokobanja During the
Second Half of 20th Century**

**PROMENE U PROSTORNOM I FUNKCIONALNOM RAZVOJU
SOKOBANJE U DRUGOJ POLOVINI XX VEKA**

Rezime: U radu su analizirane promene demografskih, funkcionalnih i fizionomskih obeležja Sokobanje. Opština Sokobanja je integralni deo Zaječarskog okruga, i po svom funkcionalnom kapacitetu predstavlja jednu od najznačajnijih opština pomenutog regiona. Sokobanja predstavlja najveće i po funkcionalnom kapacitetu najznačajnije naselje istoimene opštine. Blizina i direktni uticaju više većih urbano industrijskih centara, a prevashodno Niša i Zaječara, u velikoj meri su uticali na tok i nivo razvoja Sokobanje.

Ključne reči: funkcija, promene, razvoj, depopulacija, funkcionalna transformacija.



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CORPORATE REBRANDING FOLLOWING MERGERS AND ACQUISITIONS IN THE SERBIAN BANKING INDUSTRY*

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Abstract: *This paper analyses international and domestic mergers and acquisition trends and the problem of corporate rebranding in the banking sector. After 2000, Serbian banking market has gone through a lot of changes. One of the most important changes is the entrance of multinational banks into the domestic market. It is necessary to establish the level of owner and business restructuring influence on bank reputation, in the sense of new corporate image definition. For that purpose, four strategies of corporate rebranding have been defined on the Serbian banking market example*

Keywords: *corporate rebranding, mergers and acquisitions, banking sector*

1. Introduction

Mergers and acquisitions (hereafter M&A) in the banking industry have lost focus due to the global economic crisis, because almost all the world's industries, especially financial, focus on reducing losses incurred. Nevertheless, new developments in the world economy could not happen without M&A, but in this case they came as the result of "rescue" of troubled financial institutions. In the U.S., banks, such as *Bear Stearns* and *Washington Mutual* were acquired by *JP Morgan* and *Merill Lynch* by

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Bank of America. In Germany *Landesbank Baden-Württemberg* took over *Sachsen LB bank*. Continuance of financial institutions mergers and acquisitions trend is expected in order to "rescue" the financial sectors all over the world. Identical trend was perceived in developing countries, with special emphasis on countries in transition, where merger or sale to a strategic partner was a way of survival for small state and private banks. Given that fact, purchase or acquisition of already existing financial institutions, improves their performance, managerial skills and strengthen their competitiveness.

Organizational structure of banks and other financial institutions is changing, as a result of M&A, and the effects are reflected in the strategic planning and positioning area, scope of activity and on application of modern business strategies in the financial sector. Corporate strategy and business model change follows after the change of ownership and management structure, thus increasing the adaptability to constant changes in the environment and improvement of business performance. Changing of bank name and building its image is often consequence of ownership change, namely merger or acquisition when the current name does not match the strategy of further development. The choice to keep the current name after takeover by the other bank is the result of the assessment whether rebranding would have negative effects on the image of the bank, rather than keeping the name.

The process of creation of a new name requires a high budget and development of strategies, determining the time when to start and when to end rebranding. It updates the question of selecting bank rebranding corporate strategy as a result of mergers and acquisitions.

2. Mergers and Acquisitions in the Banking Sector

2.1 What Defines Mergers and Acquisitions in the Banking Industry

The concept of mergers and acquisitions is used as a generic term for the transfer of ownership rights, which describes the various business transactions. Mergers are form of ownership restructuring, building a single legal entity, in terms of two companies or two banks that merge assets and business operations. It is usual that merger is carried out between the companies, or banks of the same size. Acquisition (takeover or a buyout) is business transaction in which stronger, bigger company or bank buys another, usually weaker, to fulfill different interests. Acquirer is buying either shares, or assets of a small company, that in turn loses its economic independence and legally ceases to exist.

Corporate Rebranding Following Mergers and Acquisitions in the Serbian Banking Industry

Mergers and acquisition as a way of spreading business across national borders, involve ownership restructuring, and often, management restructuring. Sometimes, they are motivated by better use of resources and increasing profitability in order to maximize the value of the company.

It is believed that the M&A intensified under the influence of three factors [16, pp. 36-37], namely: changes in technology, changes in regulations, and growth of financial institutions.

Changes in technology, primarily relate to the use of the Internet in daily operations. Wide use of the Internet and new information technologies has reduced the cost of doing business. New technologies based on the Internet have a "turbo" effect on the entire financial sector, and intense pressure on many financial market participants.

Changes in regulations primarily relate to changes in legislation, especially in the U.S. and Japan. At the beginning, these states allowed mergers and acquisitions within the sector (inter-sector M&A), and later beyond them. The encouraging role of new financial legislation is expected in the field of M&A in all regions of the world.

All banking clients are constantly demanding better conditions and looking for better service. Efficiency as a principle is achieved through static and dynamic component. Static efficiency is reflected in the provision of services at the best terms and price, and dynamic means the introduction of new, quality products and services through a strategy of "cream-skimming" from the market. In response to the constant pressure to achieve dynamic and static efficiency, financial markets have developed and converged. Nowadays, financial institutions achieve growth through expansion to new geographical areas, introduction of new services and attracting a larger number of clients. In order to achieve this, banks are merging or buying one another. Conditions that have changed stimulate external growth, which in the form of M&A implies a review of a strategy of positioning and the need for rebranding.

2.2 Comparative Overview of Mergers and Acquisitions by Region

Each region has its own specificity in terms of mergers and acquisitions. They are reflected in the number, value, type and intensity of M&A.

According to UNCTAD (1996, 1999), the value of mergers and acquisitions was 2 times higher at the end of the twentieth century, in relation to their beginning. Most of these transformations were carried out

among companies from developed countries, so that their participation in the purchasing side was 97.8%, and on the sale side over 88% in 1998 [12, p. 92]. During this period, the mergers and acquisitions marked the automotive industry (e.g. *Daimler* and *Chrysler*, *BMW* and *Rover*, minority takeover of *Skoda* from *Volkswagen*, *Nissan* from *Renault*, *Isuzu*, *Suzuki*, *Saab*, *Fuji Heavi* from *General Motors*,) pharmaceutical industry (national merger of American companies *Pfizer* and *Warner Lambert's*, British companies *Glaxo Wellcome PLC* and *SmithKline Beecham Plc*; merger of German and English companies *Hoechst Marion* and *Merell Dow*) and telecommunications sector (Concern *AOL-Time Warner* was created by merging *America Online* and media company *Time Warner*, the experience of the German *Mannesmann* and British-American Group *Vodafone AirTouch's*) [12, p. 106 and 125]. In the field of banking, M&A took place within the national borders of certain countries (experience of French bank *Banque Nationale de Paris*, which bought the part of *Bank Paribas*).

In the eighties, European mergers and acquisitions dominated banking sector. This fact was largely backed up by creating Euro market and introduction of the euro as a currency. It was rationale, as till the 1980s the European financial markets were stable and very strictly regulated, the public stake in the banks had important function, and any domestic banking sector and market has had a national character.

The value of the initial mergers and acquisitions in the territory of today's European Union (EU) was low and they were conducted within national borders. Thus, the process of concentrating financial institutions as a result of these changes occurred in small European countries such as Holland and Denmark, creating strong national institutions that were competitive in the domestic market. On the other hand, the rest of the state property privatization, created a good basis for increasing the number of institutions that are attractive for mergers and acquisitions [6, p. 13].

According to the European Central Bank, in the period of 1995-2000, 80% of European financial mergers and acquisitions were carried out in Germany, Holland, France and Austria, so one can conclude that these countries were pioneers of European ownership restructuring.

In the meantime, the number and value of international mergers and acquisitions within the EU and beyond has grown. Need to increase investments in countries surrounding the EU, with special emphasis on ones in transition, was the primary motive of these changes. M&A expansion in transitional countries was realized often by acquisition. The aim was to gain an additional profit, or say pick up the cream from countries that did not have modern banking practices.

Corporate Rebranding Following Mergers and Acquisitions in the Serbian Banking Industry

The number of M&A in Europe was lower, but still very substantial; between 1996 and 2005, European banks made 816 acquisitions for a total value of 682 billion euro [20, p. 3]. Although full scope of these arrangements was made, the hidden spirit of nationalism and the need for "national champions" was held, there are still so called large national banks, which slowed down further arrangements in the financial sector, primarily in banking.

Mergers and acquisitions in the U.S. had a different character than those in Europe, as they were consequences of limitations, imposed by national legislation. Bank Holding Company Act, passed in 1956, prevented the horizontal merger of banks and other financial institutions. Other imposed restrictions related to the expansion of branch network outside the national boundaries of the federal state where the bank was registered. Adopting Riegle-Neal Interstate Banking and Branching Efficiency Act in 1994, limitations regarding interstate banking were abolished, that led to greater possibility of mergers and acquisitions. Furthermore, introducing Gramm-Leach-Bliley Act – GLBA in 1999, or so called financial modernization act, innovations in U.S. legislation were introduced. Glass-Steagall Act (1933) that prevented M&A of investment and commercial activities, ceased to be valid.

As consequence of imposed restrictions, financial institutions in the U.S. have gone through three phases of mergers and acquisitions. The first phase was characterized by mergers of small regional banks to increase their efficiency. The number of banks from 15,000 (16,000 according to some data [15, p. 1.]) reduced to around 8,000, but the number of branches and other organizational units increased. The number of such mergers and acquisitions was large, but their value was small. The second phase is marked by merging institutions in the insurance sector, initially in the national framework. International mergers were motivated by need for dispersion of activities and risks, new markets and increase in efficiency and profitability. Only after the adoption of modern law, the U.S. market had entered the third phase, marked by M&A between commercial and investment banks, between banks and companies for asset management, between banks and insurance companies. Finally, it is possible to create a structural form of financial institutions under the laws of business logic and market demand, not based on any legal restrictions.

Market liberalization is allowing the entry of multinational banks and stimulates foreign direct investment in the banking sector in transitional countries, thus opening the possibility of improving the quality and quantity of credit supply. Advisory Committee for the international financial

institutions, by the U.S. Congress, in 1999 proposed that the free entry of multinational banks is supposed to be one of four criteria for qualifying for loans by IMF.

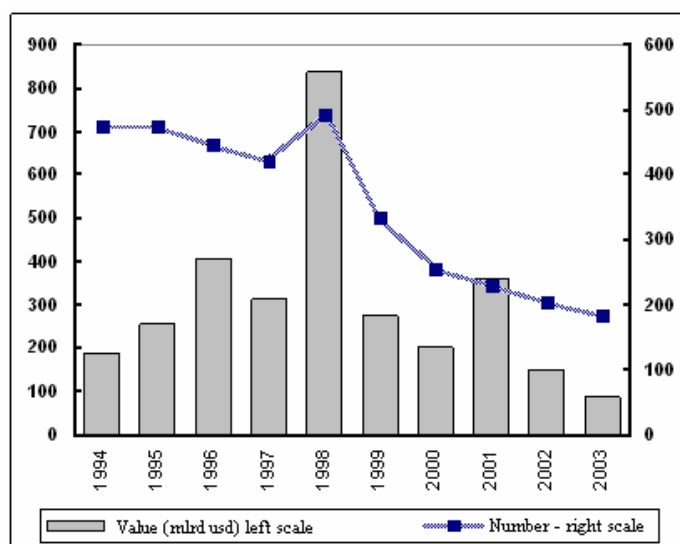


Figure 1 Value and number of merger and acquisition in the U.S. in the period 1994-2003 (Source: Pilloff, 2004, p. 3.)

Two significant factors that affected the entry of multinational banks in transition countries are fragility of the financial system (in terms of underdevelopment, instability and poor infrastructure) and privatization of the banking sector. Process of the banking sector transformation led to increase of multinational banks presence, because there was no capital base for independent recovery of the country. Next identified contribution of multinational banks was in form of expertise in the field of investment banking, in order to improve the privatization of other sectors, by improving the quality and liquidity of securities issued and by increasing number of other financial market participants.

Restructuring was initiated in Serbia in 2001, as the need for rehabilitation of existing banks, and later, due to legal constraints, as the only solution for the entry of foreign banks. During the period 2001-2009, 41 M&A deals were realized.

Table 1 shows the number of domestic and international mergers and acquisitions across regions. One can observe that the majority of M&A to the beginning of the 21st century occurred in the domestic market in all observed regions.

**Corporate Rebranding Following Mergers and Acquisitions in the Serbian
Banking Industry**

**Table 1 Number of merger and acquisition (value of more than 500 million
USD) in regions of the world and the number of MSA in Serbia**

Type of merger and acquisition by regions	number
Mergers and acquisition in excess of 500 million USD within the U.S. market in the period 1985-2002	362
International mergers and acquisition in the U.S. that exceed the amount of 500 million USD in the period 1989-2002 ²⁸	33
Mergers and acquisition in excess of 500 million USD within the markets of Europe in the period 1986-2002	302
International merger and acquisition of Europe in excess of 500 million USD in the period 1989-2002 ²⁹	89
Mergers and acquisition in excess of 500 million USD within the markets of Latin America in the period 1992-2002	16
Mergers and acquisition in excess of 500 million USD within the Asian markets in the period 1985-2002 ³⁰	32
International merger and acquisition within the markets of Asia, which exceeds the amount of 500 million USD in the period 1989-2002 ³¹	3
Merger and acquisition within the Serbian market in the period 2000-2009	17
International mergers and acquisition in the Serbian market in the period 2000-2009 ³²	24

3. Creation of a New Name (Brand) Following Mergers and Acquisitions

Well known brand, as a personal feeling about a product, service, person or company, together with clear emotion tied to the identity of the brand, maximize business results through the growth of market share, customer base and profitability.

Competitive positioning based on image uses symbolic material, which has to be reported to the environment by communicating, and in that case only a dynamic management of this process can develop competitive

²⁸ Companies that were taking the US financial institutions were mainly from the UK and Japan.

²⁹ Companies that are taking the European financial institutions were mainly from the USA, a small number of them from Australia, Argentina and Brazil.

³⁰ Countries represented in mergers and acquisitions were mainly Brazil, Mexico, and Chile.

³¹ Companies that were acquiring the American financial institutions were mainly from the UK and Japan.

³² The international merger and acquisition includes all acquisitions of Delta Bank, because it is a company that wasn't registered in Serbia, but as a foreign bank, although her owners were residents of Serbia

advantage. The goal of creating a proper image is to promote a clear picture of the company over the future by communicating that need to reach any interested in this process. In order to achieve this, projected image must accurately represent the firm and be consistent with the character of its business offers. Thereby, on image of the corporation influence tangible elements, such as products and services, distribution channels, the name, logo and other elements that realizes communication with the environment, together with intangible elements, such as business policy, corporate culture, ideals and beliefs of employees, the image of the organization in the media, and culture of the country of origin [14, pp. 42-44]. Corporate image is closely related to the organizational business reputation. Both elements are perception of corporate identity, deliberately created by communication with the environment. These elements together represent a significant factor of competitive advantage. In the financial services sector image and corporative brand potential are further enhanced. Because of the offer homogeneity, clients are often unable to reliably estimate the advantage of different competitor offers. It is estimated that for complex banking products and services, these elements are basic initiators of customer loyalty [11, p. 63].

Real image is one that sends a clear message about the specific nature of an organization and its business offerings. Sometimes, it is necessary to work on repositioning the image and its transformation. Mergers and acquisitions are often reason for such activities, and often recognized value of corporate brand may be the very motive for M&A, or a source of economic efficiency of such actions.

The importance of the brand, particularly in the financial sector increases with level of markets and business activities liberalization. According to Brand Finance database (data from 2008, 2009)³³ protagonist of international brand development are countries of BRICK³⁴ block, amongst them in financial sector lead the Asian brands such as *China Construction Bank* and *Bank of China*. These two prominent Asian financial institutions have found their place among the top 50 world brands, such as *Google*, *Coca-Cola*, *Louis Vuitton*, *Microsoft*, *Marlboro*, etc. We should not neglect the Russian brands in the financial sector, which are strengthening in the global market. *Moscow Bank*, which operates in Serbia, for the last few years entered the "top" 250 most famous world brands, while

³³ Brandz Top 100 is a global study that identifies the strongest brands around the world. The study is conducted by Millward Brown, once a year since 1998. List of top 100 brands was first time published in the Financial Times on April, 2006. Since then it is regularly published.

³⁴ Brazil, Russia, India, China and Korea

Corporate Rebranding Following Mergers and Acquisitions in the Serbian Banking Industry

in Russia they occupy 15th place. In 2008 the value of brands, as the amount generated income on the basis of recognizable name increased by 16%, despite the current financial crisis.

In the Serbian financial sector, the process of branding should be given great importance because of bad experiences that users of banking and financial services had in the nineties, when the confidence in the bank system was completely lost. In order to restore clients' confidence, transformation of the banking sector begun in 2000. Some domestic banks were privatized and financial sector opened its boundaries to the world market and large inflow of funds into existing and new banks. In early stages of the transformation process, forms of foreign capital have appeared in the form of "*de novo*" banks, which brought with them their own corporate image. After a short period, due to legal constraints, mentioned strategy was changed to the strategy of purchasing domestic banks, when the process of rebranding, gained importance.

The aim of corporate image re-determining when purchasing existing banks was a break with the bad experiences, and identifying the client financial needs, in order to increase the number of services that customers use, and achieve long-term relationship between banks and clients. Evidence of that we can find in the central bank's data, according to which at December, 31st 2008, 75.3% of total banking assets belonged to the banks majority owned by foreign counterparties.

Bank M&A, creates the need for redefining business identity of purchased or new entity. Although mergers and acquisitions processes are different, the re-determination of corporate identity has little difference, and the same phenomenon is occurring in both processes. There are several varieties, related to the change of name and image.

According to Lambkin and Muzelec (2008), rebranding can occur at three distinct levels in an organization. The first level, the so-called corporate rebranding refers to the renaming of a whole corporate entity. Frequently, it is a consequence of significant strategic change in the company, and in this paper is analyzed in the context of mergers and acquisitions in the banking sector. The other two levels include the rebranding of business units and products. Rebranding of business units includes a name change or the visual identity of only one part of the company. In the banking sector, this usually occurs when a financial institution buys another, which is specialized for a particular segment of financial industry. For example, when a commercial or universal bank buys investment and keeps the existing name of the new business unit. Re-

determination of the name and visual identity of individual products and services is a tactical move prompted by a desire to be recognizable brand on a global level, to achieve economies of scale in marketing and communication in order to benefit from spilling brand image in all areas [10, p. 334].

Having in mind that in this paper corporate rebranding is accessed as a result of M&A in Serbia banking sector, it is necessary to explain the basic directions of the events related to the name and image of the institution itself after the merger or acquisition process. They include the following:

- After the M&A of banks A and B, new entity inherits the name and corporate image of acquirer, $A, B \rightarrow B$;
- After the M&A of banks A and B, new entity uses both names, joint name AB, $A, B \rightarrow AB$;
- After the M&A of banks A and B, new entity inherits the name and corporate image of old bank A, $A, B \rightarrow A$;
- After the M&A of banks A and B, new entity receives a completely new, different name, $A, B \rightarrow C$.

In practice, combination of these changes can occur. At the beginning, new entity can keep the old name $A, B \rightarrow A$, and after a few months or few years to begin to use both names, $A, B \rightarrow AB$, in order to receive the acquirer name at the end $A, B \rightarrow B$. Example could be found in Serbia within acquisition of Atlas Bank by Piraeus Bank (Greece). Reason for this complicated process is that changing of name and image to favor of foreign still unknown bank will influence negatively on clients.

The first strategy, known in the literature as a strategy of "backing the stronger horse" [10, p. 334] is the most present strategy in the Serbian banking market. Using this strategy management makes the cut, or quick transition from one corporate image to another, so there is a real problem of loss of identity, and thus clients. In this paper, we analyze the period of 2001- second quarter of 2009. The findings are represented in Table 1. 92.6% of M&A in the Serbian banking sector has had form of backing up stronger horse (see details in Appendix 1). World practice has the same results regarding change in name and corporate image of banks and other financial institutions. As a rule, banks choose this way of re-determining the corporate image due to well known name (image) of acquirer. In such cases, the bank usually has a small value of assets, a small number of clients and small market share. It goes in favor the fact that M&A of big institutions can not be done quickly, and management can't make a shallow cut, if for no other reason then because of the business volume.

Corporate Rebranding Following Mergers and Acquisitions in the Serbian Banking Industry

It is worthy of attention to analyze the changes in the Serbian banking sector during 2001. We can observe that 12 mergers and acquisitions happened, some of them were between domestic and others were between domestic and foreign banks. It is interesting that all the bank opted for the strategy of "backing the stronger horse" and that almost all were acquired or merged with another bank to survive and improve their financial performance, namely for implementation of financial restructuring. This phenomenon is characteristic of M&A which occurred in the United States during the financial crisis of 2007. All acquired banks have been taken to avoid liquidation, while the strategy was keeping the name of acquirer (for details see the introduction). Analyzing the first phase of Serbian transition noticeable fact is that most banks, which originally appeared as acquirers, later were taken over, mostly by foreign banks. All mergers and acquisitions, other than *Depozitno-Kreditna* bank by *Hypo Alpe-Adria Bank* had referred to the mentioned character.

The world famous cases of rebranding by "backing the stronger horse" strategy are *Washington Mutual* and *Bank United Corp.* (2000), *Bank of America Corp.* and *Fleet Boston Financial Corp.* (2004), *J.P. Morgan Chase & Co.* and *Bank One* (2004).

Exceptionally strong banks like *Bank of America* and *HSBC*, which in their history had a significant number of mergers and acquisitions decide for the above-mentioned strategy. The problem of rebranding is resolved by method that could identified in line with manner in which Alexander of Macedon unlaced "Gordian Knot" - simply breaking all ties with the brand, purchased by the bank.

Following strategy, retaining both names, in Serbia, except in the case of *Meridian-Credi Agricole Bank*, had a transient character. By number, these cases are in the second place with 9.7% (Table 1). This strategy is implemented when both banks have competitive advantage. For example, acquired bank may have a large customer base, or a famous brand in the home country, and the acquirer good reputation. Acquirer is usually afraid to lose customers, so he decides to retain both names. In this way, competitive advantages of both banks are exploited and the synergy is achieved. This strategy is also used as a transitional strategy in the transformation of A, B → B. The world's most famous example of this strategy is the *Chase Manhattan Corporation* and *JP Morgan & Co. Inc.* In Europe, a very famous merger of this type is a merger between *Banca Intesa* and *Sanpaolo Group*, creating a brand *Intesa Sanpaolo* in 2007.

Third form happened in Serbia only once, in the case of *Vojvođanska banka* and *National Bank of Greece* (NBG). Transient nature of these changes, when the acquirer uses the name of acquired bank, and later changes is to its own, happened 3 times or in percent 7.3 (Table 1). This variant of rebranding is chosen when acquired bank has favorable image and good reputation in the home country. In this way, acquirer is not risking and safely retains the market position and customer base, which is usually considerable.

In the case when bank initially retains the existing name or uses both names, and later changes the name and corporate image to acquirers, new bank management has identified the fear of losing certain number of clients, and in this sense it is needed a long period of transformation and transition from one to another name.

The world famous mergers and acquisitions of this type are: *Firststar Corporation* and *U.S. Bancorp*, when the name of the *U.S. Bancorp* was retained and *Wachovia Corp.* takeover by *First Union Corp.* when the name of *Wachovia Corp.* was retained (both in 2001). Creation a brand new name as a result of M&A so far has not happened in the Serbian banking practice. Lambkin and Muzell (2008), justify this strategy in the cases when there are enough different types of successful products, so it is easier to create a new name and new image [10, pp. 335]. In this variant there are more chances for success. Creating an entirely new name *Tolland Bank New Alliance* followed after acquisition of *New Haven Savings Bank* by the *Savings Bank of Manchester*.

According to Paul Deals, brand and image advisor for the Belgian KBC group, before approaching corporate rebranding, management considers four criteria: market share, the potential of the existing names, acquired bank and available financial resources (budget) [19, p. 76].

In the case of acquiring banks with small market share, but strong name brand, it is not recommended to change the name. If the bank is not to long on the market and there is no strong brand, but has great potential to make a good brand, then it is not necessary to enter rebranding process. When the three financial institutions in the Belgian market, merged creating a unified KBC Group, the management board of the newly established company did not approve a budget that was required, and this had consequences for the duration of rebranding process. To achieve the level that every single bank had before the merger, it was necessary three years to pass. In the first year, the KBC Group helped people to accept a new brand. In the second year, they started the larger marketing campaign. Only in the third year, they began with the construction of a new brand.

Corporate Rebranding Following Mergers and Acquisitions in the Serbian Banking Industry

Table 2 Analysis of rebranding processes in Serbian bank

	Total (%)	Temporary (%)
A, B → B	92.7	83.0
A, B → AB	4.9	9.7
A, B → A	2.4	7.3

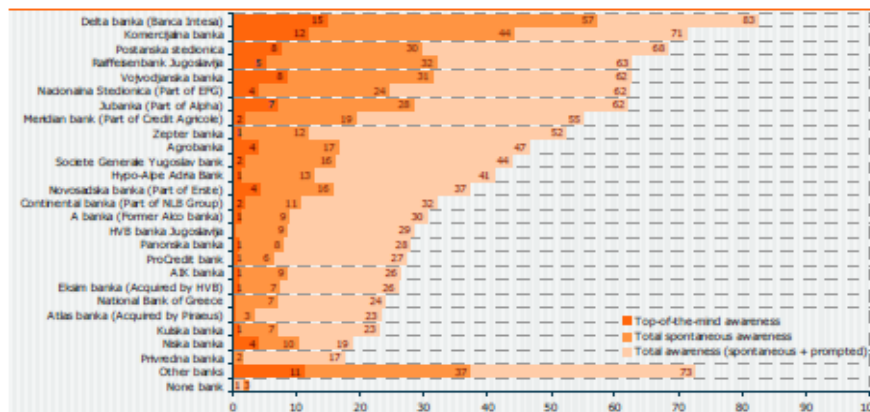


Figure 2 Popularity of banks in Serbia (Source: GfK, 2006, www.gfk.com)

It is interesting, that although the majority of the population chooses the foreign bank, namely banks majority-owned by foreign entities, that these banks are not best known in Serbia. According to research conducted by GfK Group, Figure 2, domestic banks are dominant regarding popularity. This is the reason why foreign banks in Serbia visibly change the appearance of corporate symbols, but unofficially choose to use both names in the business. As an example can be given from acquisition of Delta Bank by Banca Intesa, where the old address www.deltabanka.co.yu is still active, but the site is identical to the one at www.bancaintesabepgrad.com.

4. Conclusion

The largest number of M&A in the 21st century occurred in the domestic market in all regions of the world. New mergers and acquisitions in the banking sector have arisen as a result of "rescuing" troubled financial institutions.

Bank M&A are usually motivated by better use of resources and increasing profitability, as well as the possibility of increasing the value of the company. Changed external conditions stimulate growth, which in the form of mergers and acquisitions implies a review of a strategy of positioning and the need for rebranding.

Rebranding as a consequence of ownership change is occurring in the case when existing name or brand no longer satisfies its development strategy and needs. Acquired bank usually has a small value of assets, a small number of clients and small market share. In the case of takeover or merger of large banks, transforming the name and image can not be done quickly.

In developed countries, where financial markets are saturated, branding is one of the crucial factors for achieving the desired level of market share. However, the transitional markets are capital short, where reliability, financial strength, stability and price are especially appreciated, while the brand itself is not a decisive factor. With development of financial market, branding of financial services in Serbia will become increasingly important. In addition, it is evident that only four banks from top worlds 50 are operating in Serbia (Intesa Sanpaolo, Societe Generale, Credit Agricole, Unicredit).

Management assessment and its goals are basis for financial institutions to engage in a process of rebranding. Type of rebranding, completely new name for the new entity, is justified in cases where banks offer different services that are not very successful, so it is easier to create a new name and new image, which is expected to have more chances for success. Strategy to keep both names is implemented when both banks have a competitive advantage, and it usually happens in the case when two institutions merge. Strategy to keep the old name after taking over is the result of the assessment that the rebranding would have greater negative effects on the image of the bank. The last mentioned strategy has only once occurred in Serbia, because the confidence in the banking sector was severely compromised and associations of a local bank did not provide any security. It is certain that this factor had the most significant impact in choosing the new name of the bank; hence the majority of foreign banks decided to change the name of the bank into their own, thus opening a new chapter in relations with clients which is associated with trust, safety and long-term relationship.

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Corporate Rebranding Following Mergers and Acquisitions in the Serbian Banking Industry

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Appendix 1 M&A in Serbian banking market during 2001- second quartile 2009.									
2002									
DOMESTIC					INTERNATIONAL				
Acquired	Acquirer	New bank	Type		Acquired	Acquirer	New bank	Type	
1 As banka	Raj banka	Raj banka	A, B → B	1	Depozitno-kreditna banka	Hypo-Alpe Adria banka	Hypo-Alpe Adria banka	A, B → B	
2 Banatska banka	Univerzal banka	Univerzal banka	A, B → B	2	Tigar banka	Delta banka	Delta banka	A, B → B	
3 DTD banka	Metals banka	Metals banka	A, B → B						
4 Dunav banka	Komercijalna banka	Komercijalna banka	A, B → B						
5 Inoprom banka	Jubanka banka	Jubanka banka	A, B → B						
6 Jugobanka AD Kruševac	Komercijalna banka	Komercijalna banka	A, B → B						
7 Srpska razvojna banka	Vojvođanska banka	Vojvođanska banka	A, B → B						
8 Tamiš banka	Centrobanka	Centrobanka	A, B → B						
9 BB Tistenička banka	Srpska regionalna banka	Srpska regionalna banka	A, B → B						
10 BB Užička banka	Vojvođanska banka	Vojvođanska banka	A, B → B						
11 BB Vranjska banka	Niška banka	Niška banka	A, B → B						
12 BB Vršacka banka	Novosadska banka	Novosadska banka	A, B → B						
13 Inex banka	Kapital banka	Kapital banka	A, B → B						
14 Somborska banka	Kapital banka	Kapital banka	A, B → B						
15 Tr banka	Kapital banka	Kapital banka	A, B → B						
2003									
DOMESTIC					INTERNATIONAL				
Acquired	Acquirer	New bank	Type		Acquired	Acquirer	New bank	Type	
☒	☒	☒	/	☒	☒	☒	☒	/	

**Corporate Rebranding Following Mergers and Acquisitions in the Serbian
Banking Industry**

Appendix 1 M&A in Serbian banking market during 2001- second quartile 2009 (continued)									
2004									
DOMESTIC				INTERNATIONAL					
Acquired	Acquirer	New bank	Type	Acquired	Acquirer	New bank	Type		
				Poljoprivredno-	Delta banka	Delta banka			
				1 investiciona banka	EFG banka	EFG banka	A, B → B		
				2 Post banka	Volksbank	Volksbank	A, B → B		
				3 Trust banka	LHB banka	LHB banka	A, B → B		
				Prva preduzetnička banka					
2005									
DOMESTIC				INTERNATIONAL					
Acquired	Acquirer	New bank	Type	Acquired	Acquirer	New bank	Type		
§	§	§	/	§	§	§	/		
2006									
DOMESTIC				INTERNATIONAL					
Acquired	Acquirer	New bank	Type	Acquired	Acquirer	New bank	Type		
1	DDOR banka	Metals banka		1	Atlas banka	Pireaus banka			
2	Srpska regionalna banka	Credy banka	Credy banka	2	Continental banka	NLB banka			
				3	Delta banka	Banca Intesa			
				4	Jubanka	Alphabank			
				5	Novosadska banka	Esste bank			
				6	Meridian banka	Credi Agricole			
				7	Nacionalna štedionica banka	EFG banka			

Appendix 1 M&A in Serbian banking market during 2001.- second quartile 2009 (continued)						
2007						
DOMESTIC						
Acquired	Acquirer	New bank	Type	INTERNATIONAL		
1	Centro banka Export-Import banka	Laiki banka	Laiki banka	Laiki banka	New bank	A, B → B
2	banka	HVB banka	HVB banka	HVB banka		A, B → B
3	NLB banka	LHB banka	LHB banka	NLB LHB banka		A, B → AB
4	Nova banka	Findomestic banka	Findomestic banka	Findomestic banka		A, B → B
2008						
DOMESTIC						
Acquired	Acquirer	New bank	Type	INTERNATIONAL		
1	A banka	KBC banka	KBC banka	KBC banka	New bank	A, B → B
2	Niška banka			OTP banka		A, B → B
3	Kulska banka			OTP banka		A, B → B
4	Zepter banka			OTP banka		A, B → B
5	Panonska banka Vojvodanska banka	Banca Intesa	Banca Intesa	Banca Intesa		A, B → B
6	NLB Continental banka	NBG	NBG	Vojvodanska banka		A, B → A
7		NLB LHB banka	NLB LHB banka	NLB banka		A, B → B

**Corporate Rebranding Following Mergers and Acquisitions in the Serbian
Banking Industry**

**KORPORATIVNO REBRENDIRANJE KAO POSLEDICA
SPAJANJA I PRIPAJANJA U BANKARSKOM SEKTORU**

Rezime: U radu se analizira trend svetskih i domaćih spajanja i pripajanja banaka, kao i problematika korporativnog rebrendiranja u oblasti bankarstva. U periodu posle 2000. godine bankarski sektor u Republici Srbiji doživeo je mnogobrojne promene, od koji je najznačajnija ulazak multinacionalnih banaka na domaće tržište. Neophodno je bilo utvrditi u kojoj meri vlasničko i poslovno restrukturiranje utiče na reputaciju banke, u smislu ponovnog određivanja korporativnog imidža. U tu svrhu prikazane su četiri osnovne strategije korporativnog rebrendiranja na primeru srpskog bankarstva.

Ključne reči: korporativno rebrendiranje, spajanja i pripajanja, bankarski sektor



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EFFECTS OF SOCIAL CAPITAL ON THE EFFICIENCY OF SOCIAL OUTCOMES

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Abstract: *In recent literature, social capital is treated as a factor of various social and economic outcomes. Social capital can produce effects only in the second-best world, ie. in the presence of deviations in relation to the optimal conditions, such as externalities, free-riding, information asymmetries, imperfect competition and the like. Given the numerous benefits it produces for individuals and the society, it is assumed to be a resource that should be maximized. However, social capital creates both benefits and costs, so social groups may own too much social capital or have a lack of this resource from the aspect of social efficiency, which leads to a conclusion that there are various kinds of social capital and that from the social aspect it is a resource to be optimized, not maximized. The positive effects of this specific kind of capital are identified in its function as a basis of social control, family support, as well as providing benefits based on social connections in the community and overcoming information asymmetries. There are also some less desirable consequences of social capital, such as redistributive effects, deepening income inequalities and political tensions, polarization of society, compromised autonomy of individuals.*

Keywords: *social capital, efficiency, social networks, public goods, information asymmetry*

Introduction

Just like there are unsolved dilemmas concerning the sources and different dimensions of social capital, the same happens when it comes to the consequences that this phenomenon causes. Since various definitions have stressed different aspects of this concept, this is reflected on all the potential consequences that are attributed to him. As there is no consensus in the

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literature about the ownership of social capital - individual or social, it can be discussed about both individual gains of social capital, but also about its social effects [Inkeles, 2001]. Studies that explore individual yields of social capital, mainly analyse various achievements of individual members of a society, to fight out for certain scarce resources, such as enrollment in a good university or finding a good job, which depends on the shape and quantity of available social capital (social connections, family support, etc.). However, most studies on social capital emphasize the idea that it allows society to achieve goals that in the absence of social capital would not be possible, so that it is a principle of value added. Research of the individual effects of social capital does not mention this topic, focusing mainly on competitive abilities of individuals to participate in the allocation of a fixed pie. It is therefore far more appealing and relevant to deal with the society level effects of social capital, in terms of added value that it can produce.

In addition, even if social capital is understood as a private good, it produces extensive positive and negative externalities [Fukuyama, 1997]. Social capital in a specific group or network produces positive externalities, by teaching individuals about social virtues such as honesty, reciprocity and mutual dependence in relationships with other people. On the other hand, negative externalities are expressed as a result of strong solidarity within the group, which is being built at the expense of non-members, and can lead to fragmentation, conflict and hostility with the rest of society.

Individual and Social Outcomes of Social Capital

In the present literature, social capital is treated as a factor of various social outcomes (in addition to economic growth), such as: stability of democracy [Inglehart, 1999, Fukuyama, 1997], civil participation [Keefer, Knack, 1997, La Porta et al. 1997], the efficiency of public institutions [OECD, 2001], the provision of public goods [Durlauf, Fafchamps, 2004], crime prevention [Wilson, 1988], the general state of human health [Putnam 2000, Rose 2000], education [Portes, 1998, OECD, 2001], the welfare of children and the general welfare [Uslaner 2002, Bjørnskov 2003, 2006], social inequality [Durlauf, Fafchamps, 2004]. At first glance, one could say that social capital, given the numerous benefits it produces for individuals and the society, is a resource that should be maximized. Namely, "if a little trust, social participation and cooperation is a good thing, shouldn't there be more of it?" [Woolcock, 1988]. The answer is not so simple because social capital has its "dark side" in the sense of situations where strong and long-term civil groups can stifle social development by providing themselves a disproportionate share of social resources, or inhibit the progress of individual members by imposing obligations that prevent their participation

Effects of Social Capital on the Efficiency of Social Outcomes

in wider social networks [Olson 1982, Portes and Landolt 1996]. This indicates that social capital creates both benefits and costs, so social groups may own too much social capital or have a lack of this resource from the aspect of social efficiency, and suggests that there are different types of social capital. Therefore, from the social aspect, it is a resource to be optimized, not maximized.

Woolcock's idea of a unified conceptual framework for resolving theoretical and policy dilemmas of social capital [Woolcock, 1998] could be helpful in explaining the various social effects produced by social capital. Namely, it is about defining four dimensions of social capital, which relate to two opposing concepts: embeddedness, which originates from the studies of Polany and Granovetter, and refers to the fact that all forms of exchange are inherently embedded (rooted) in social relations; and autonomy, in terms of the degree of freedom of group members to communicate with non-members and to act according to broader values and norms from those adopted in the group. Given the weaknesses that both these concepts exhibit if viewed separately, the author integrates them into a single framework and gives them new features, setting them at different levels of observation. Embeddedness at the micro level, which includes links between individuals within the group, gets the name integration, while at the macro level, representing the state-society relations, it is expressed as synergy. Autonomy, on the other hand, gets the next two manifestations: connectedness at the micro-level (connections with individuals outside the group) and integrity on the macro-level (institutional competence). In this way, four separate scales of value and sixteen profiles of social capital are received. Thus, combinations of the four dimensions are responsible for different developmental outcomes, from "anarchic individualism", which implies the absence of all dimensions, at one end to the "useful autonomy" which is another extreme, in terms of high availability of all four dimensions. This way, same dimensions of social capital can serve in various developmental purposes, when combined with other dimensions.

There are views that, if we want to clarify the possible consequences of social capital, we need first to identify the conditions in which social capital may have some significance [Durlauf, Fafchamps, 2004]. Namely, for social capital to lead to Pareto efficiency, there must be an equilibrium that in the absence of this resource is not Pareto optimal. This means that social capital can have effects only in the second-best world, ie. in the presence of deviations in relation to the optimal conditions, such as externalities, free-riding, information asymmetries, imperfect competition and the like. In order to produce positive outcomes, it is necessary that social

capital alleviates or compensates for some of these inefficiencies. Also, there are only few ways for social capital to bring the given the situation closer to the Pareto optimum. Some of them are: solving problems of coordination in a situation with multiple Pareto-ranked equilibriums, changes of individual incentives, opening additional roads for the information flows.

The most common example of how social capital can help solve the problem of social inefficiency is the production of public goods, where trust is considered a necessary ingredient. In most cases, this process is organized by the state, through taxation, and here trust does not play a significant role. However, the state cannot provide public goods in all situations. Association of parents and teachers that exist in U.S. schools are a typical example of how the involvement of parents in school activities positively affects students' success, because the students gain the conviction that their parents care about their education [Coleman, 1988]. The participation of parents, on the other hand, requires trust in order to resolve disputes and eliminate free-riding. Required voluntary participation of parents is a public good that cannot be provided by state intervention. In underdeveloped countries, state intervention in the production of public goods is often theoretically possible but practically impracticable, either because of the limited tax base or organizational capacity. In these cases, collective action could substitute state intervention. Certainly, since the collective action can not be based on the power of state compulsion, the presence of trust is necessary for its initiation and organization. The implementation of collective action also requires leaders, who would be able to persuade members of the group to participate in the production of public goods. In the absence of trust and leadership, it is more likely that government intervention will still be a better solution. Also, projects that are successful in certain local communities due to their strong engagement can not be copied in other communities if their local leaders are weak.

It can be concluded that social capital need not be the only mechanism for solving the problems of social efficiency. There are alternative tools for resolving problems of coordination, change of individual motives and advancement of social exchange technology - this function can be performed by contracts or state intervention. Certainly, there is a large number of cases where social capital acts as a cheaper and simpler solution [Bowles, Gintis, 2002]. However, it is not the only solution, so the research of its social role still needs to control the effects of other potential institutional solutions. Therefore it is of very important to explore the ways that, in the presence of social capital, socially efficient outcomes can be achieved in suboptimal environment.

The Positive Effects of Social Capital on Social Efficiency

In sociological literature, there is a clear classification of positive as well as negative consequences of social capital [Portes, 1998]. The first of the positive social roles of this resource is that it represents a source of social control, i.e. social capital created through strong social networks is a means of parents, teachers and defensive institutions for the maintenance of discipline and order, which makes formal forms of control unnecessary. Another positive role of social capital is that it is also a source of parental and family support, which enables the transfer of existing social capital on offspring. Finally, perhaps the most important effect of social capital, and certainly the most common feature that is assigned to it, is providing benefits on the base of network connectivity outside the immediate family, which corresponds to Bourdieu's understanding of social capital as a resource that is acquired through network membership. This effect of social capital is most often used as an explanation for the different approaches to employment, occupational mobility and entrepreneurial success. The term "strength of weak ties" [Granovetter, 1973] refers to the influences of weak social ties in the function of the informal system of business recommendations. There is also an opposed opinion [Lin et al., 1981] that the "strength of strong ties", i.e. strong social networks are the main factor of individual progress, which is particularly true of connections between immigrants and the so-called ethnic entrepreneurship.

The theory of social capital has generally accepted the importance of social ties and networks for enhancing social efficiency - whether it is a production of public goods, or better organization of the market. One of the important potential functions of social capital is the ability to solve problems of inefficiency caused by asymmetric information, which is inevitable attribute of human society. As a result of its presence, there is a disruption or prevention of social exchange, whether because individuals that could realize potential benefits from trade can not find each other, or because they do not trust one another enough to be engaged in the transaction. In both cases, a mutually beneficial exchange is not implemented. Efficient search for partners and encouraging trust between them can be achieved through formal institutions, but also due to interpersonal relationships (transfer of important information through oral communication, repeated interactions that go in favor of both parties in the transaction). The best example of the role of social capital in raising social efficiency may be the often mentioned example of informing market participants about the potential employment or workers. In this market, unlike the securities market, there is no adequate institution that enables circulation of updated information on employers and

those seeking work. The role of interpersonal relations in the channeling of this information becomes crucial, and the largest number of jobs is filled by personal recommendations and oral communication. In addition to the networks of social relations, trust can also perform impact on social efficiency. Namely, particularized trust, which is built over a longer period of time based on repeated interactions between individuals can affect the restriction of social exchange only within the finite, closed groups (often called clubs). This mutual isolation between groups reduces the efficiency in terms of prevention of mutually beneficial transactions between them. On the other hand, generalized trust produces superior effects in terms of efficiency, since it is established more quickly and with lower costs, and since it implies "thinner" relations of trust, but with a large number of individuals inside and outside the specific social network. It is about the so-called weak or overlapping ties with non-members, whose intensity and structure enable intensification of exchange relations.

When talking about positive social outcomes of social capital, one can not dispense with his influence in the field of health. Even the classical sociologists studied the links between the number of suicides and the degree of social integration of individuals, with the conclusions that the number of suicides increases in times of rapid social changes, when there is a weakening of social bonds. There are more recent studies that indicate the relationship between social ties and health and personal well-being of people, with the controlling influence of social, racial and demographic characteristics of individuals [Putnam, 2000]. The length of life is also determined by certain degree of social connectedness, in the sense that social networks provide support and care in old age, which reduces the physical and mental stress and empowers individuals to fight against the disease. On the other hand, social isolation may precede health deterioration, which is the cause, not a consequence of the disease. As for the general welfare, individuals usually point out that good relations with family members and friends are the main prerequisite for personal satisfaction, even more than money or fame. Based on the study of individual variations related to physical and emotional health of people done in Russia [Rose, 2000], it was proved that the degree of connection with other people as a significant factor as the amount of household income or education level. General health and well being of individuals in a society is certainly a social resource, with significant tangible and intangible consequences. Related to this is certainly the welfare of the youngest in the society, and there are reports that social capital is second most important, after poverty, for the quality of life of children, in the form of lower rate of teenage pregnancy, death and inactivity. There are testimonies about the widespread abuse of children in

Effects of Social Capital on the Efficiency of Social Outcomes

neighborhoods with lower degree of social cohesion. Also, social cohesion of parents is often relevant for overcoming the emotional and behavior problems in later life of children.

Social norms and values related to social capital may also be relevant in explaining differences in crime rates between countries. Social capital has a role in discouraging criminal behavior and rewarding and directing social energy. Societies that are characterized by anonymity and limited knowledge of people from the environment, are also the societies with higher levels of crime and violence, as implied by the research in this field. Informal social control and cohesion between individuals in the neighborhood environment, as well as mutual trust and neighborly altruism are important factors of reduction of violence and crime.

Social capital can cause significant consequences for the effectiveness of state structures and public institutions [Putnam, 1993, 2000]. Based on extensive analysis and evaluation of institutional performance in twenty Italian regions, the author concludes that the effectiveness of regional management structures depends on the intensity and forms of social association (civil associations). Voluntary civil associations foster social and civil skills, which Putnam calls the "school of democracy." Different forms of civic participation have a role in raising trust and cooperation, which positively influences society and economy. Therefore, cultural differences in civil engagement, i.e. social capital embedded in the norms of civil society is a factor of superiority of northern institutions in relation to the southern Italian regions. Long term absence of civil culture in the southern parts of the state, which by Putnam originates since the Middle Ages, condemned them to poverty and institutional inefficiency. Data on voter behavior, tax evasion and civil and political engagement show that social capital affects the performance of state institutions, and research results show correlation coefficient of 0.92, between indicators of civil society and institutional performance. Countries abundant with trust have effective local management structures, taking into account the effect of other social and economic factors.

Trust and engagement in voluntary associations, by some authors are recognized as factors of stability of democracy and the most recent European democratic transitions [Fukuyama, 1997; Inglehart, 1997]. Social capital, understood as a matter of rational action with roots in religion and tradition is proved by Fukuyama to be essential for the modern economic and political institutions. Namely, he believes that institution building requires the presence of social capital, which complicates the relationship between culture and institutions. Not every society is able to create a state

bureaucracy that will be efficient, transparent and professional. Therefore, he emphasizes the example of East Asian countries that have in the last twenty years, achieved higher rates of growth compared to other developing countries, ascribing this not to the choice of specific economic policy, but to the quality of institutions. Societies in which people are used to cooperation and joint work in large organizations will be more likely to develop strong and effective state institutions. In the process of social development, social capital also acts as the necessary support for democracy [Fukuyama, 1997]. Although in recent years dramatic changes in opinion occur about the relation between democracy and growth, the arguments in favor of "authoritarian transition" implying that technocratically enlightened dictators use their power to implement unpopular but necessary reforms, today appear very rarely. Democracy isn't undoubtedly the best for economic growth, but there are certainly very few alternative solutions that provide the same level of legitimacy to governments in developing countries. State authority is mainly derived from public support of its citizens, so that many countries that have apparently seemed strong, such as Indonesia or the Soviet Union, proved to be weak inside, because of the lack of legitimacy, while Poland and South Korea successfully implemented unpopular economic reforms. As democracy is now a fact of life, says Fukuyama, social capital becomes a critical factor in its success, because without civil society there is no democracy. Social capital is what allows individuals to associate in order to defend their interests and meet the collective needs. If liberal democracy is the context in which the majority of the developing countries will try to stimulate growth, then social capital is a key determinant of the strength and health of such a political framework.

These outcomes of social capital are based on the fact that social capital is the cause and that direction of impact starts from social capital to its consequences. However, the ability of researchers to establish the exact direction of influence is quite limited, which can be exhibited by the example of a specific study of the impact of social capital on the sustainability of the democratic system [Inglehart, 1997]. As a measure of the consequences of social capital (the sustainability of democracy), the author has used a number of years of continuous rule of the democratic institutions from 1920-1990 in 39 different countries. As a measure of the cause, i.e. social capital, here the author used indicators of trust, membership in social organizations, equality in income distribution. In combination with other indicators, measures of social capital in a given study proved to be the cause of most of the variation in the duration of democratic systems. However, it is necessary to be careful and not assume that such a correlation establishes also the causal link, which happens when on the basis of these results we conclude that, for example,

Effects of Social Capital on the Efficiency of Social Outcomes

"income equality is factor that leads to the stability of democracy." This is a reasonable assumption, but there is also the possibility that the long democratic experience led to greater equality, which is the opposite of the first probable assumption. The conclusion that can be made without any doubt is that indicators of social capital and the stability of democracy exhibit the same direction of movement, while it can only be assumed what the cause, and what the consequence is, as well as there is a possibility that both phenomena are caused by some third factor. This is especially true for phenomena that are observed and measured in the same historical moment. A similar example is related to the impact of social capital on the quality of management structures - while some authors consider social capital as the cause [Narayan, Cassidy, 2001; Putnam, 1993], others consider it a consequence [Healy et al., 2001]. However, any attempt to solve the problem of the cause - consequence relation, or to discover the nature of social capital as dependent, independent or intermediate variable, in the one-way, "positivist" way is at start doomed to fail because it ignores the complexity of social phenomena and processes [Adam, Roncevic, 2003]. Choosing between one or the other opinion means accepting that the social systems are linear and ignoring very significant feedback mechanisms, which are more the rule than the exception.

The Negative Consequences of Social Capital

Many research studies start from the assumption that social capital is a resource that shows positive effects on social efficiency, so empirical research is modelled by this assumption, in the sense that they measure the volume of assumed positive influence. If the investigation proves the absence of the positive impact of social capital, it is simply classified into neutral factors. However, the same mechanisms of social association that are assumed to cause a positive outcome, can produce some less desirable consequences, which is necessary to point out in order to avoid pitfalls of presenting social networks, social control and collective sanctions as strictly positive social phenomena [Portes, Landolt, 1996]. Most important negative consequence of social capital is that strong ties, apart from providing benefits for members of certain groups, also allow the prohibition of access to non-members. The same ties that improve the efficiency of exchange within the group, implicitly limit the possibilities of outsiders. The best known and most common examples of using social ties for the economic progress of the group are the monopolies of ethnic groups in certain areas of production or trade: monopoly of Jewish diamond traders in New York, the domination of Cuban immigrants in many economic sectors in Miami, or control of Italian, Irish and Polish immigrants in the construction business in

American cities. All those who do not belong to a given group, are excluded from opportunities to share existing knowledge and to use existing connections. While this form of "abuse" is directed at achieving the economic progress of the group, there is the possibility that by using social capital, the group can limitate the success of its members' business initiatives. Namely, any solid connection that can be found in communities with high levels of mutual solidarity of members, who are often family-related, can cause significant free-riding problems, given that less capable members of such structures, thanks to the ruling norms, impose all kinds of requirements upon successful members and live in their account, reducing their effectiveness. Social capital of economically unsuccessful members consists precisely of privileged access to resources of others, whose opportunities for efficient business operations are thus significantly reduced.

Also, the intense social ties and strict implementation of local norms in individual communities can influence the reduction of the autonomy of the individual and his privacy. In smaller communities where everyone knows each other, the level of social control is so strong that it becomes restrictive when it comes to personal freedom and independence of members of the community. Although social control is desirable in principle and produces positive effects in terms of freedom of leaving children on the street or buying food in local stores on deferred payment, we should not lose sight of the potential repressive character of the strong social connections. Finally, the strong correlation within a group may be based on common negative experiences and confronting the social majority. In such cases, individual members success undermine the cohesion of the group, since the group is based on fostering norms opposite to the general social norms. Mafia, prostitution channels, gambling, gangs of criminals are just some examples that show how involvement in social networks can produce undesirable social outcomes.

Therefore, it can be concluded that social capital produces significant distributional effects, which may not always be fair, except in the case that some group or network covers the entire community. Otherwise, only members who learn from their experience of exchange within the group about the gradual exclusion of possibilities for connecting with non-members will collect the benefits of social capital [Durlauf, Fafchamps, 2004]. Thus, different social groups have different access to educational opportunities, employment, health care. Of course, there is the possibility that the deepening of income or wealth inequality of specific social groups induces the decline of social capital, i.e. that influences between these two factors are two-way - inequality and weakened civil engagement reinforce

Effects of Social Capital on the Efficiency of Social Outcomes

each other [Putnam, 2000]. Creating strong connections within the social groups stimulates polarization of society and allows certain groups to control the others, along with the growing inequality and political tensions. Societies polarized along ethnic, class or language barriers inevitably face the risk of social fragmentation [Collier, 1998].

Concluding Remarks

One of the reasons for social capital to take up so much space in economic analysis is the assumption that this specific social resource produces significant effects on various social and economic outcomes. Since the research of individual returns of social capital deals with individual achievements and abilities of individuals to participate in the allocation of a fixed pie, it is far more appealing to study the society level effects of social capital, in terms of added value that social capital can produce. In this sense, there are many social phenomena that are supposed to be improved thanks to the presence of social capital: stability of democracy, political and civil participation, the efficiency of public institutions, the production of public goods, prevention of crime, the general state of human health, education, children welfare and general welfare, social inequality, along with a series of economic phenomena that can be determined by different combinations of social capital dimensions.

In order for social capital to act in the direction of improving social efficiency, it is necessary that there is a source of inefficiency, such as problems of coordination, inadequate technology of social exchange, or the need to alter individual incentives. The positive effects are identified in its function as a source of social control, family support, as well as providing benefits based on social connections in the community. As a great deal of social inefficiency stems from the problems of exchange caused by asymmetric information, social capital plays a useful role bridging the information barrier. In this way, social capital makes one of the possible alternatives for solving various problems of social inefficiency, in addition to contracts, property rights or state intervention.

Caution when choosing an adequate solution is required also because of potential less desirable consequences of social capital, such as redistributive effects, deepening income inequalities and political tensions, polarization of society and compromised autonomy of individuals. Therefore, it is reasonable to assume that, despite many positive social outcomes that social capital can cause, it is a resource to be optimized, not maximized.

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EFEKTI SOCIJALNOG KAPITALA NA EFIKASNOST DRUŠTVENIH ISHODA

Rezime: U savremenoj literaturi, socijalni kapital se tretira kao faktor različitih društvenih i ekonomskih ishoda. S obzirom na brojne koristi koje socijalni kapital proizvodi na individualnom i društvenom nivou, pretpostavlja se da je u pitanju resurs koji treba maksimizirati. Međutim, socijalni kapital kreira i koristi i troškove, tako da društvene grupe mogu posedovati i premalo i previše ovog resursa sa aspekta društvene efikasnosti. To vodi do konstatacije da postoje različiti tipovi socijalnog kapitala i da je to resurs koji treba optimizirati, a ne maksimizirati. Pozitivni efekti socijalnog kapitala identifikovani su u njegovoj funkciji izvora društvene kontrole i porodične podrške, koristima koje pruža na osnovu društvene povezanosti u okviru zajednice i prevazilaženju asimetrije informacija. Takođe postoje i neke manje poželjne posledice socijalnog kapitala, u vidu redistributivnih efekata, produbljivanja nejednakosti u dohotku, jačanja političkih tenzija, polarizacije društva, ugrožene autonomije pojedinaca u grupi.

Ključne reči: socijalni kapital, efikasnost, društvene mreže, javna dobra, asimetrija informacija.



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CONTEMPORARY TARGET COMPANY VALUATION METHODS IN THE ACQUISITION PROCESS

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Abstract: *The quality of strategic decision-making process depends on the quality of basic decision inputs. In terms of investment decision-making process, the quality of decision inputs is determined by the adequately evaluated value-creation potential of certain investment alternative. The acquisition of a company can be treated as an investment. It is necessary to assess the value-creation potential of the target company and its alignment with strategic future of acquiring company in order to evaluate the value-creation potential of such an investment properly. We will present two contemporary methods relevant for this field, real options technique, which promotes the concept of strategic learning and management decision flexibility, and method based on economic value added, which represents widely used modern performance measure within corporations.*

Keywords: *valuation, acquisition, real options, economic value added*

Introduction

Valuation of different strategic alternatives represents very important activity of strategic management. In addition, it reflects the quality of managerial decision-making process and the quality of strategic action. Investment activity of an enterprise cannot be separated from the issue of strategic alternatives valuation. As any other business decision, the merger & acquisition (M&A) strategy also requires the use of certain target company valuation methods. The essence of M&A strategy valuation is adequate valuation of a target company, in the present, as well as in the future time periods.

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The contemporary management paradigm can be described as focusing on the concepts of managerial flexibility and shareholder value maximization.

Managerial flexibility stands for dynamic relation towards contemporary management decision-making process, which is quite opposite to the traditional which was constituted on the assumption that the decision that were made in the past were irreversible, no matter what circumstances occurred. The managerial flexibility concept materializes by using the real options method.

On the other hand, the shareholder value maximization imperative implies the introduction of a new performance measurement system, which is represented by the concept of Value Based Management (VBM). VBM encourages the adoption of modern performance measures, which relies on the economic profit concept, instead of traditional accounting profit concept. The most important and widely used modern performance measure is Economic Value Added (EVA).

The purpose of this paper is to present the practical side of contemporary investment alternatives valuation methods, revised according to the case of acquiring a certain company (target company). The management has a wide range of different valuation methods at hand, such as methods based on company book value, market value, free cash flow (FCF) and discounted cash flow (DCF). Nevertheless, the management should also consider using the real options method and valuation based on EVA. The adoption of two methods mentioned above would certainly increase the management decision-making process and therefore make the cases of acquiring target companies more transparent.

There will be a practical review of target company valuation in terms of real options and EVA.

Real Options and Target Company Valuation

Real options method is the modern tool for investment projects valuation, which is appropriate for the use in turbulent and dynamic environment. The main aspect of the method is the fact that it pays special attention to managerial flexibility. Managerial flexibility is a managers' discretionary right to alter the decision-making process according to the additional information gathered about the certain project's uncertainty [1, p. 374]. In other words, possible alterations in decisions caused by new circumstances must be added the initial valuation of a strategic option. These possible alterations may contribute to increase or decrease in the final value

Contemporary Target Company Valuation Methods in the Acquisition Process

of a project. Many companies use the real options in everyday decision-making. Some of them are *General Motors*, *HP-Compaq*, *Boeing*, and *AT&T*. Bearing in mind the fact that mergers & acquisitions are a special form of investment project, the real options method may be successfully implemented in the target company valuation procedure.

For the adequate presentation purposes of real options method, we need to discuss different aspects of a company's strategic future. As we move from the simplest form of strategic future to the most turbulent and least predictable one, the need for application of a valuation method, which incorporates these different forms of the future in analysis, increases. Four categories of strategic future are as follows [2, p. 504-507]:

- known future
- limited options future
- future with large number of options
- unlimited options future

The known future rarely occurs. The occurrence of a certain phenomenon can be predicted with high level of certainty by the use of extrapolation methods. Limited options future stands for limited number of outcomes of a certain strategic decision. The limited number of existing options can be narrowed down to fewer ones that are more acceptable than others are. This situation makes the decision-making process easier. The future with large number of options is characterized by higher degree of uncertainty and the need for incorporating the aspect of flexibility into the managers' behavior. This type of situation occurs within the emerging industries. Unlimited options future is the most difficult to forecast and manage. This type of future is composed of new situations that make previous knowledge and experience less relevant. The level of uncertainty is the highest. As we move from the known future towards the unlimited options future, the necessity for managerial flexibility increases which implies the use of real options method. Different types of strategic future are presented in Figure 1.

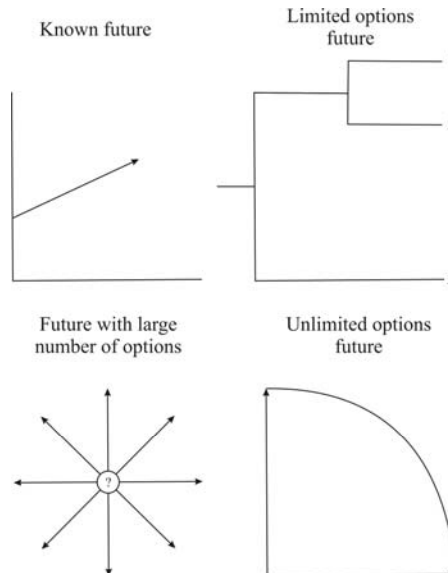


Figure 1 – Types of strategic future [2, p. 505]

Real options method relies on concept of learning as an important element of decision-making process. The key assumption is that company's management is able to make better business decisions when the uncertainty level decreases with the passage of time. For example, discounted cash flow analysis assumes delivering of a static investment decision and a situation in which management faces the irreversibility of a decision that was made in the past [3, p. 10]. However, the reality of business decision making is quite different. Bearing in mind managerial flexibility, decision that was made in the past can be revised according to the estimated increase in the project future value. Managerial flexibility (real options) incorporates [1, p. 377]:

- delay option
- abandonment option
- sequential investment option and
- production adjustment option

Options mentioned above are at managements' disposal in the process of evaluation the merger & acquisition strategy. In the process of target company valuation, management of acquiring company should increase the basic value with projected outcomes of possible future strategic options. This explanation resolves the question of implementing M&A strategy when discounted cash flow analysis has negative result. Managerial

Contemporary Target Company Valuation Methods in the Acquisition Process

flexibility contributes to the increasing the value creation potential of a certain project in the future (Figure 2).

Delay option is the possibility of postponing the project investment (for example, investment in a specific aspect of target company's business after integration) in order to acquire additional information. The opportunity cost of such delay is the level of possible cash inflow that may be realized if an investment was exercised immediately.

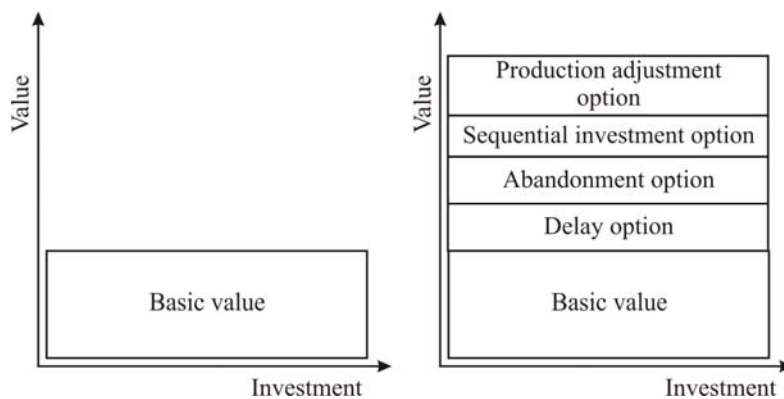


Figure 2 – Traditional valuation approach vs. real options valuation concept [1, p. 376]

Abandonment option entails refraining from further project investment in order not to experience projected losses. This option also implies realization of project's liquidation value. Sequential investment option is best suited for situations where investment can be divided into several phases (for example, construction of a building). The beginning of following phase is directly affected by the quality of previous phase. Investor may quit the project if new relevant information is gathered. Production adjustment option represents the option category, which implies correction of volume and structure of production. The most important types of options within this category are capacity expansion and capacity divestment, according to the market trends, expansion and shortening of production cycle duration, according to the competition actions.

Figures 3, 4 and 5 show the practical example of real options in the case of mergers & acquisitions. Acquiring company has paid \$300 million for the target.

Vladimir Dženopoljac

Year	0	1	2	3	4	5	6	7	8	9
OPTION TO ACQUIRE IMMEDIATELY										
Company CF	PROJECTED TARGET COMPANY CASH FLOW (\$ million)									
Successful acquisition	- 300	30	35	40	45	50	55	60	65	
Unsuccessful acquisition	- 300	-5	-5	-5	-5	-5	-5	-5	-5	
Weighted CF										
Successful acquisition (60%)	0	18	21	24	27	30	33	36	39	
Unsuccessful acquisition (40%)	0	-2	-2	-2	-2	-2	-2	-2	-2	
Expected CF	-300	16	19	22	25	28	31	34	37	
Expected NPV, year 1-8, 15%										-166
Expected RV, 13%, growth rate 5%										159
Total expected NPV										7

Figure 3 – M&A valuation with real options method – option to acquire immediately [4, p. 290]

Net present value (NPV) is calculated with the assumption that the discount rate is 15%. Residual value (RV) of a project is calculated within the limits of constant growth model, with the expected 5% growth rate. In addition, it is necessary to emphasize that the acquiring company's management has assumed two different cash flow scenarios: successful acquisition cash flow and unsuccessful acquisition cash flow. Each scenario is linked with the option of immediate acquisition, option of later divestment and option of delaying the acquisition. NPV of option to delay the acquisition is discounted at the end of the first year, while the other two options are discounted from the year zero.

Year	0	1	2	3	4	5	6	7	8	9
OPTION OF LATER DIVESTMENT										
Company CF	PROJECTED TARGET COMPANY CASH FLOW (\$ million)									
Successful acquisition	-300	30	35	40	45	50	55	60	65	
Unsuccessful acquisition	- 300	-5	-5	-5	-5	-5	-5	-5	-5	
Weighted CF										
Successful acquisition (60%)	0	18	21	24	27	30	33	36	39	
Unsuccessful acquisition (40%)	0	-2	-2	150	0	0	0	0	0	
Expected CF	-300	16	19	174	27	30	33	36	39	
Expected NPV, year 1-6, 15%										-75
Expected RV, 13%, growth rate 5%										167
Total expected NPV										92

Figure 4 – M&A valuation with real options method – option of later divestment [4, p. 290]

Contemporary Target Company Valuation Methods in the Acquisition Process

Mentioned Figures show that the highest NPV option is the option of delaying the target company acquisition. In case of selling or liquidating the target company, NPV of the project is \$92 million. Therefore, the acquisition should be undertaken with the respect of later selling or liquidating the target company [4, p. 291].

The main advantage of real options method is the fact that it takes into consideration the managerial flexibility in the decision-making process. The “traditional” valuation methods (for example, discounted cash flow method) assume that the decisions made in the past are static and irreversible. However, real life implies that decisions are eligible to alterations according to changing environment, which is characterized by high degree of uncertainty. Therefore, a company’s management is very cautious since the changes in the environment induce changes in business decisions. In case of valuation of investment decisions using so-called deterministic methods, the “intrinsic” value of a project would be underestimated [3, p. 66]. The only obstacle in terms of efficient implementation of real options method is its sophistication and imperative of possessing additional skills and knowledge by the management team.

Year	0	1	2	3	4	5	6	7	8	9
OPTION OF DELAYING THE ACQUISITION										
Company CF	<i>PROJECTED TARGET COMPANY CASH FLOW (\$ million)</i>									
Successful acquisition	-300	30	35	40	45	50	55	60	65	70
Unsuccessful acquisition	-300	0	0	0	0	0	0	0	0	0
Weighted CF										
Successful acquisition (60%)	0	0	21	24	27	30	33	36	39	42
Unsuccessful acquisition (40%)	0	0	0	0	0	0	0	0	0	
Expected CF	-300	0	21	24	27	30	33	36	39	42
Expected NPV, year 1-6, 15%										-146
Expected RV, 13%, growth rate 5%										180
Total expected NPV										34

Figure 5 – M&A valuation with real options method – option of delaying the acquisition [4, p. 290]

Target Company Valuation Using Economic Value Added (EVA)

This segment of the paper will focus primarily on the issue of applying Economic Value Added (EVA) on valuing M&A strategies. The essence of EVA application on valuation the M&A strategies is discovering

the sources of value creation in these transactions, as well as valuation strategic decisions.

Companies create value by investing in projects, which are expected to give returns above the cost of capital. That is, the volume of created value represents the difference between present value of a company's future cash flows and the volume of capital invested in that company. EVA is a periodic company's value creation measure. This measure is often used in the process of valuation a company's performance and its strategic decisions. In addition, EVA is used to value the performance of different strategic business units (SBU) as well as in the field of formulating adequate models of management compensation schemes, which fully comply with shareholders' interests.

EVA is the difference between net operating profit after taxes (NOPAT) and capital charge (volume of invested capital multiplied by weighted average cost of capital). According to EVA approach, a firm creates value if mentioned difference exceeds zero in a certain period. EVA approach to valuation allocates the total NPV of a project (represented by present value of free cash flow) on each period of that project. Shareholders will receive extraordinary returns in case of unexpected EVA growth [5, p. 84].

Figure 6 illustrates the situation of valuing target company using the EVA approach. In terms of adequate value estimate, the valuation process will begin with earnings before interest, taxes, depreciation and amortization (EBITDA) in a given period. After deduction of amortization and taxes (and after adding back the tax earnings) we calculated NOPAT. If we assume that, the weighted average cost of capital (WACC) is 10.03% we can calculate capital charge, which is needed for adequate calculation of target company's EVA. By discounting values of EVA with the rate 10.03%, we get present value of EVA (6,377.44) in a given period. The computation would not be complete without taking into account value creation potential after the given period (after year 2011), which is represented by the EVA projection after year 2011.³⁵ Initial capital value is estimate based on corrected book values and it represents an approximation, although it does not have any impact on firm value. This is caused by the fact that higher level of initial capital implies lower value created on a yearly basis, and vice versa.

³⁵ EVA projection after year 2011 = $\text{NOPAT}_{2011}(1+g)/(\text{WACC}-g) - \text{PV}_{2012}(\text{Capital charge})$, where g stands for estimated future growth rate, and PV stands for present value

Contemporary Target Company Valuation Methods in the Acquisition Process

End of year	2006	2007	2008	2009	2010	2011
EBITDA	19,901.00	28,699.00	34,711.00	36,205.00	39,112.00	42,052.00
Amortization	10,695.00	10,775.00	12,132.00	14,238.00	15,286.00	16,295.00
EBIT	9,206.00	17,924.00	22,579.00	21,967.00	23,826.00	25,757.00
Tax	3,521.00	6,856.00	8,636.00	8,402.00	9,113.00	9,852.00
Tax savings	0.00	402.00	331.00	281.00	301.00	322.00
NOPAT	5,685.00	11,470.00	14,274.00	13,846.00	15,014.00	16,227.00
WACC (10.03%)		11,327.00	11,521.00	12,278.00	13,012.00	13,920.00
EVA		143.00	2,753.00	1,568.00	2,002.00	2,307.00
Present value of EVA (10.03%)						6,377.44
EVA projection after year 2011						168,793.00
Present value of projected EVAs after year 2011 (10.03%)						104,653.00
Total present value of EVA						111,030.44
Initial capital						112,906.00
Target company value						223,936.44

Figure 6 – Target company valuation using the EVA approach [5, p. 86-87]

Total company value of almost \$224 million is a solid basis for making final decision regarding entering the M&A negotiations or not. This value puts a brighter perspective on target company's value creation potential, while at the same time gives the management an idea about the limits of target company's purchase price. Acquiring company management should not base its initial offer on the estimated value presented in the example, because the market value of a target is probably less than calculated value. The calculated value is useful primarily for purposes of adequate evaluation of certain firm's attractiveness, as well as for identifying strategic fit between the two companies entering the business combination. Main disadvantage of EVA valuation is the fact that it does not show the level of market premium that should be paid in the case of successful integration. EVA approach will be preferred in the case of exercising internal growth [6, p. 88]. Mentioned disadvantage is linked with earlier remark that EVA cannot serve as a basis for making initial takeover offer, but only as a tool for estimating the future value creation potential of a target company.

The essence of estimating the target company value creation potential is the process, which consists of more necessary decision inputs comparing to DCF analysis, real options method or EVA approach. The best (and the hardest) option which might help realize the ultimate shareholder objective (value creation), is being one step ahead of the competition in the sense of being informed and being able to recognize weak signals so to better estimate potential of value creation of a target firm. It is quite often expected that the paid premiums exceed the net positive effect of a business combination [7, p. 30-37]. It is very important to see the positive effects that may come from synergistic effects in potential business combination. These positive effects are known as the “hidden value” of integration.

Concluding Remarks

M&A strategy represents significant investment activity of large number of companies. As the form of external growth, which is characterized by more rapid growth tempo and business diversification, acquisitions may significantly affect the value creation process of an acquiring company as a whole. Value creation depends directly on visible and hidden potentials of target company. These potentials must be adequately estimated and identified in order to give quality hints in negotiations about possible business combination. There are many different valuation methods at managements' disposal for this purpose. Main disadvantage of so-called “traditional” methods and methods based on DCF approach is the static character and disregard of the value maximization for acquiring company's shareholders. These disadvantages are minimized with the use of real options method and EVA valuation approach. However, these methods suffer from certain flaws as well. Real options method is modern and sophisticated, which implies extra management knowledge, while EVA approach does not give a clear idea about the initial offer level. In another words, EVA approach gives rough approximation of target firm's value creation potential in the future. The disadvantage that is common for both methods is the fact that they do not take into account potential synergy effect. This certainly does not mean that they should not be applied in the cases of potential acquisitions. Still, it is necessary to enhance the analysis by incorporating synergy of a future business combination.

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SAVREMENE METODE VREDNOVANJA PREDUZEĆA METE U POSTUPKU AKVIZICIJE

Rezime: Kod donošenja investicionih odluka, kvalitetno odlučivanje pretpostavlja pravilnu procenu vrednosnog potencijala određene investicione alternative. Preuzimanje preduzeća se može tretirati kao svojevrsan investicioni poduhvat. Za adekvatnu procenu vrednosnog potencijala takve strategijske akcije, bitno je proceniti potencijal stvaranja vrednosti preduzeća mete i mogućnost uklapanja u strategijske planove preduzeća inicijatora preuzimanja. Kvalitet procene vrednosti ciljanog preduzeća ima direktan i neosporan uticaj na uspeh poslovanja novonastale poslovne kombinacije, bez obzira da li se radi o spajanju ili pripajanju. U radu će se prezentovati savremene metode vrednovanja ciljanog preduzeća, i to metod realnih opcija, koji promovise strategijsko učenje i menadžersku fleksibilnost u odlučivanju, i metod vrednovanja baziran na dodatnoj ekonomskoj vrednosti, koja predstavlja široko primenjivano savremeno merilo performansi akcionarskih preduzeća. Radi boljeg uočavanja prednosti i nedostataka navedenih metoda procene vrednosti ciljanog preduzeća biće dati praktični primeri vrednovanja.

Ključne reči: vrednovanje, akvizicija, realne opcije, dodata ekonomska vrednost



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SERBIAN STOCK MARKET TREND ANALYSIS FROM 1st March, 2006 TO 31st March, 2009

Milica Radović*

Abstract: *The paper examines the possibility of a trend analysis method application in the stock market in Serbia. Technical analysis and trend concept primary thesis have been set forth. In the trend analysis a method of two moving averages as well as a Moving Average Convergence Divergence (MACD) have been applied. A trend is an observed value direction of movement. Moving average is a method by which a course of a phenomenon is spotted and it shows a direction of its movement. The above mentioned moving averages identify the establishment of a trend, a stoppage of the existing one, a change and an establishment of the new one. One of the indicators that confirm the direction and give the first signals of a trend weakening is a MACD indicator. The author has analyzed a value movement dynamics of the Belgrade Stock Market common share index, i.e. Belexline trend from 1st March, 2006 to 31st March, 2009 by the application of two moving averages method: an intermediate term of 50 days and a long-term one of 100 days in the stock market in Serbia.*

Keywords: *stock market, corporation, anticipation, Belexline, trend, moving average, MACD.*

Technical Analysis Basic Postulates

Technical analysis studies the movement of share prices, market index (or some other financial instrument) in the past for the anticipation of the price movement in the future. A term "price movement" is often used instead of a term "market movement" to indicate that despite the prices, the trading volume and interests as an integral part of market analysis have also been analyzed. Technical analysis is based upon the assumption that on the

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basis of the price movements in the past conclusions can be drawn upon the price movement in the future.

Charles Dow is considered to be the founder of the technical analysis. Towards the end of 19th century he established the basic assumptions which the technical analysis is based upon. His company Dow Jones was the first one to follow the price movement systematically. Although Charles Dow never wrote a book about his theory himself, the series of his editorial articles that were published in the Wall Street Journal laid a foundation of a contemporary technical analysis at the turn of 19th to 20th century. The above mentioned foundation has not lost its significance even today despite the appearance of an up-to-date computer technology of numerous and even more complex, new technical indicators. There are three basic assumptions which the technical analysis is based upon:

- market trends are taking into account all the information available
- prices move in trends
- the past is repeating itself

The basis of technical analysis lies in the assumption that *the market takes into account all the information available and evaluates all events that are relevant*, as well. It means, that all the factors that influence the price (macro-economical, political, fundamental ones, investors expectations, etc.) have already been included in it. From all the above mentioned, it can be concluded that for the future price movement, it is sufficient to study the price movement that occurred in the past and not the reasons why the prices fall or rise. It is believed that the price movement is the result of a supply and demand change. If a demand is greater than supply, the prices go up and if the supply is greater than demand then the prices go down. The reasons why the change in supply and demand occurs are not of any significance to the technical analysis, however, a graphical representation of the price changes in the past and their proper interpretation in the present are of great importance to it. On the basis of the price graphic representation analysis and other technical indexes (indicators), it can be concluded and anticipated which direction the prices will move into, in the future.

Technical analysis assumes that the stock prices, index values or financial instrument move in trends, and not incidentally. The basis of this assumption is that the prices follow certain rules that repeat themselves in cycles. *Prices move in a direction of an established trend until the trend changes*. Once established the trend will probably continue its movement before it comes to its change again. This is in fact the first one of Sir Isaac

Newton's laws of motion adapted to the market. It means that the stock prices movement will continue in the same direction until the trend changes.

A basic assumption is that many patterns, that appeared in the price graphic representations in the past will repeat themselves in the future, as well i.e. *the future is a repetition of the past*. During the last one hundred years numerous patterns, that constantly repeat themselves, have been established and classified by the pattern analysis of the price graphic representations. The patterns reveal the market psychology that can be based upon optimism i.e. price growth expectation or pessimism i.e. price decrease expectation. The patterns are a psychology conduct reflection in the markets that do not have a tendency to change. It is considered that the patterns will function in the future in the same way they did in the past.

The technical analysis value is in its applicability today. It is applied in different markets for different financial instruments and in different periods of time. Technical analysis principles do not depend upon the market, field, company or time horizon of an analysis. The basic starting point in the technical analysis is a trend analysis, that is why this paper has started its analysis from the Belgrade stock market common share index trend, BELEXline.

A Trend Concept

A trend concept is one of the most important principles in technical analysis. *A trend is a direction in which the share price or index value moves*. That motion is not in a straight line but it is characterized by a consecutive up and down (zigzag) motion, during which the peaks and bottoms are being formed. The direction of those peaks and bottoms makes the trend. Depending upon whether the above mentioned peaks or bottoms move upward or downward a movement direction is spotted. An upward trend is characterized by a series of peaks and bottoms that have consecutively greater values. A downward trend has a range of peaks and bottoms with lower values, which is shown in Figure 1. A period without a trend or a non-trend is a period (also called a horizontal trend) in which the peaks and bottoms are parallel to the horizon or to a base line and within a limited range.



Figure 1. Ascending and descending trend [10]

Irrespective to the direction of a trend in the market, Dow distinguishes three types of trends:

- primary (long-term)
- secondary (intermediate one)
- minor (insignificant or short-term one)

A primary trend is compared with high and ebb-tide of the sea, a secondary one with the waves of the one and a minor one with a ripple of the sea. The primary trend shows the main motion, that usually takes a year or more. During the primary trend certain price corrections occur that are opposite to a primary (main) trend movement. The above mentioned movement is called a secondary or intermediate trend, that lasts from several weeks to several months. After the above mentioned correction the market continues its movement in the main trend direction. The least oscillations, that represent a daily price fluctuations and the secondary trend correction are called minor trends or changes of the day and they can move in the same or opposite direction to the primary trend.

Depending on the primary trend direction of movement on ascending(*bull*) or descending(*bear*) trend is defined. The technical analysis recommends different strategies depending on the current trend. The main assumption of the technical analysis is that when an ascending trend occurs buying is recommended or “long position” taking and when the opposite descending trend occurs selling is recommended or “short position” taking.

According to the Dow’s theory a long-term ascending (primary)trend consists of three phases:

- accumulation phase
- public participation phase and
- distribution phase

The first phase of an ascending trend is called *the accumulation phase* during which informed investors enter the market and begin with gradual purchases. This phase was preceded by a descending trend during which everything had seemed pessimistic and most of the participants withdrew from the market expecting further drop in prices at the time. Values are underestimated in the market, negative news included in the price, pessimism present in the one as well as the aversion to the risk which represents a favorable opportunity for the purchase. It is usually said that “the intelligent money is the first one to enter the market” at this phase.

After the first phase, the accumulation one, during which the informed investors have positioned themselves in accordance with their

Serbian Stock Market Trend Analysis from 1st March, 2006 to 31st March, 2009

expectations, the second one, *the public participation phase* begins. In the above mentioned second phase the pessimism disappears due to the positive news announcement (revenue growth, profit, etc.). At this stage a large number of participants in the market notices that the descending trend has been finished and that a period of price growth began, instead. So, as a result of the above mentioned, more and more participants make their investments in the market causing further growth of prices. The above mentioned phase is generally the longest one and leads to the largest growth of prices.

The distribution phase means that the market is in an extremely strong trend, the business climate and consumer confidence have substantially improved themselves, the companies have achieved significantly better financial results and “an illusion upon an endless trend” has taken over in the market. “The intelligent money” withdraws from the market at this phase, while the beginners with the least experience and knowledge are just entering it, hoping to realize the bearings as they used to be in the past. Only the best news are represented in the public that thus strongly encourage a desire for quick and easy profit with the participants that trade in the market for the first time. Therefore, the steepest price increase usually occurs at this phase, exactly.

In the analysis of a trend, the trend lines that point out the existence, direction and strength of a trend are used. An ascending trend line is drawn to join the two adjacent bottoms. According to the ascending trend definition subsequent bottoms and prices are above the trend line. A descending trend line is drawn in a descending trend by joining the first two peaks in a row. The prices in the descending trend are moving below the descending trend line.

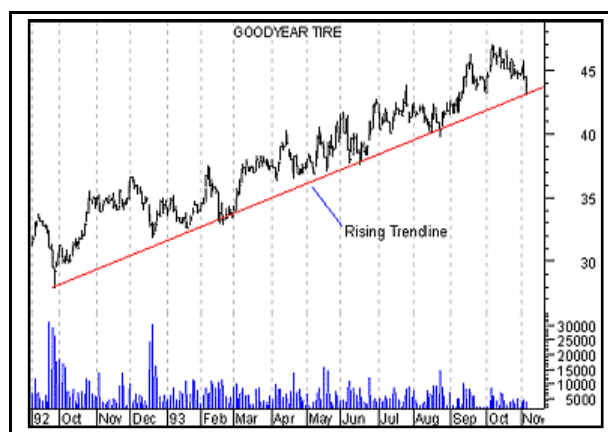


Figure 2. An ascending trend line [1, p.23]

In the ascending or descending trend the prices “rebound” from the trend line. The ascending trend line represents a “support” since the purchase overcomes the sale at that level of price due to which the price increases i.e. “rebounds” itself from the trend line.



Figure 3. A descending trend line [1, p.24]

A descending trend line represents a “resistance” since at that level the selling line overcomes the purchase one and the price decreases, i.e. “rebounds” from the trend line. The purchase is usually recommended in an ascending trend when the price rebounds from an ascending trend line (a rebound is a “buy” signal), i.e. the sale in a descending trend when the price rebounds from a descending trend line (a rebound is a “sell” signal). In both cases a price movement in a primary trend direction is expected after the price rebound from the resistance line.

A trend line has a stronger significance if a trend line retains its direction for a longer period of time. In addition, when a price “rebounds” from the trend line several times, its significance becomes greater. Each “breakthrough” of a trend line is the first signal of a trend weakening and at the same time a warning that the current trend is at its end. If the breakthrough occurs more often the signal becomes more significant.

Moving Averages

Moving averages method is one of the methods used in the technical analysis and it is included in the methods that follow the trend. The objective of this method is to perceive the main course of the phenomenon and enable the price direction trend review, according to which the current rapid price fluctuations are “conformed” with. Moving averages (MA) is calculated as a price average at a certain period (for a certain number of days) defined in advance. The term “moving” is used because for each calculation the last unknown quantity of a price - x , within certain period of time, is taken. For example, a simple fifty-day long moving average (MA 50) is calculated in the following way: all the prices realized within the last fifty days are added and the total of it is divided by 50 (a number of days within the period). The calculation is repeated for each day so the last price is added to the above mentioned total and the one of 51 day ago is subtracted from it. The moving average calculated in this way is called the simple one, because each price within the observed period is given an equal significance in the process of calculation. Apart from the simple one a pondering and exponential moving averages, that place more weight on recent prices, are applied, as well.

The length of a period for which the moving average is calculated depends upon the time period of investment. A short-term period is the one that lasts for 10 or 20 days, an intermediate one is the one that most often lasts for 50 days and a long-term period lasts for 100 or 200 days. Shorter moving averages are usually more sensitive ones and provide early signals, due to which they are applied to a shorter period of investment. Longer moving averages are less sensitive to short-term price changes, due to which they are applied to long-term analysis. The author of the paper uses daily moving averages analysis in the paper due to the Belgrade stock market trading data availability.

Moving averages are applied to identify a signal of a trend ending or the beginning of another trend establishment. Moving averages do not predict a trend but only confirm the market direction.

There are three ways of a trend direction determination. *The first way* is to determine a trend based upon the moving average direction. If the moving average increases the trend is considered to be an ascending one. If the moving average decreases the trend is considered to be a descending one. *The second way* is based upon the mutual price in relation to the moving average. In an ascending trend a price is above the moving average while in a descending one a price is below the moving average. *The third way* uses the ratio of a short and long moving average. If the short moving average is

above the longer one, the trend is considered to be an ascending one, and if it is below the one, the trend is considered to be a descending one.

Moving averages provide signals for investment decisions. They represent the levels of resistance or support, regarding to whether the market trend is an ascending or descending one. A moving average price crossover, i.e. breaking through the resistance or support is considered to be the signal for buying or selling. A crossover of the two moving averages at different time periods provides rather strong signals for an investment. When a short moving average crosses over a longer one, in an upward direction, the buy signal arises. In the case of a short moving average crossing over of the longer one, in a downward direction, the sell signal arises. A change of a moving average direction indicates the qualitative changes in the mood of an investor.

BELEXline Moving Average Index Analysis

A common share index of the Belgrade stock market – *BELEXline* (abbreviated), is the main “benchmark” index of the Belgrade stock market (BSM). It has been established with an objective to represent the movement of share prices, traded in the BSM in the most real and precise way. The *BELEXline* has been turned into account since 30th September, 2004 with a base index value of 1000. Originally, the methodology of index calculation was based upon the total market capitalization, and then the index calculation has been improved by the pondering market capitalization of the shares that are in the free circulation (free float). In that way the accuracy of market processes description has been improved, the quality of an index itself as well as the availability of the information to the public investors. The *BELEXline* index is designed in a way that describes the overall market movements in the most faithful way that can also be the basis for the structural products and their derivatives creation in a domestic as well as foreign market. The structure of an index basket includes the shares of 100 companies that are traded with in the Belgrade stock market.

Date	Belexline	index change	% of a change
01.03.2006.	2062,59		
03.05.2007.	5007,34	+ 2944,75	+ 142,8
31.03.2009.	844,36	- 4162,99	- 83,3

Figure 4. BELEXline index values [9]

Serbian Stock Market Trend Analysis from 1st March, 2006 to 31st March, 2009

The BELEXline index value on 1st March, 2006 amounted to 2062,59 and on 31st March, 2009 it was 844,36. The maximum index value of 5007,34 was reached on 3rd May, 2007 which indicates that the observed period was extremely volatile at the time.

In Figure 5, a diagram of BELEXline index value is shown and simple moving averages of BELEXline index for an intermediate period of 50 days (MA 50) and a long-term period of 100 days (MA 100) in the period from 1st March, 2006 to 31st March, 2009. It is noticed that in the first period until 3rd May, 2007 the market was in a strong ascending trend when on 3rd May, 2007 a maximum index value of 5007,34 points was reached. Until 16th August, 2007, during the above mentioned period, the index value was above its MA 100, which means that the market was in its long-term ascending trend. Starting from 20th July, 2006 to 4th June, 2007 the value of the index was above its intermediate moving average period of 50 days.

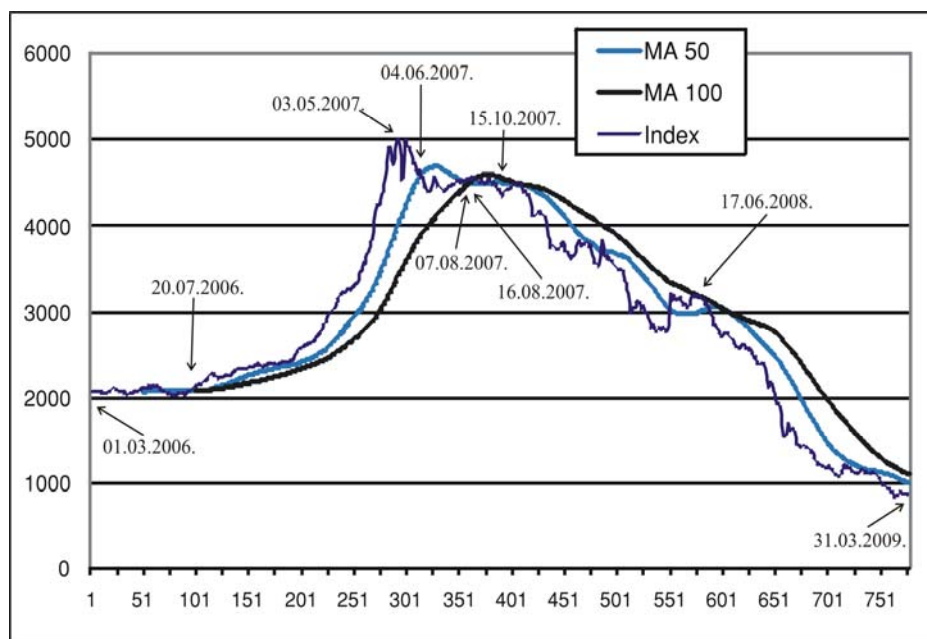


Figure 5. BELEXline MA 50 and MA 100 from 1st March, 2006 to 31st March, 2009³⁶

³⁶ Private graph created in Excel Worksheet on the basis of the BELEXline index value, taken from the Belgrade stock market website and calculated moving averages values for the periods of 50 and 100 days.

Since the beginning of December, 2006 a sudden and rather significant increase of both moving averages MA 50 and MA 100 slopes can be noticed, which is typical for the ascending trend final phase during which an excessive optimism dominates the market.

The first index crossover with its MA 50 occurred on 4th June, 2007 and it amounted to 4569 at the *BELEXline* index value. The crossover occurred under an acute angle which first pointed out the first stoppage of a former long-term ascending trend and then indicated a possible change of a long term trend even. After that the index approached its MA 50 and started oscillating around it. The above mentioned oscillation is also typical for the periods after the maximum index value reaching in the market. On 7th August, 2007 a moving average MA 50 cut across the moving average MA 100 which can be explained by the change and a descending trend establishment that followed.

A long-term trend is established on the basis of the index value mutual position in relation to its long-term moving average. The establishment of a new descending long-term trend is the crossover of the *BELEXline* index value with its moving average MA 100 which amounted to 4543 at the *BELEXline* index value on 16th August, 2007. The above mentioned crossover lasted for 7 days only after the crossover of the two moving averages MA 50 and MA 100. The crossovers in the short period of time indicated the long-term descending trend establishment.

From 16th August, 2007 to 31st March, 2009, since the crossover of a long-term MA 100 line, the *BELEXline* index was below the long-term trend line. It means that within that period the market was in the long-term descending trend all the time. However, during that same period certain intermediate corrections occur i.e. the periodical recovery and index increase occurred, as well. The first correction occurred already on 15th October, 2007 when the index “rebounded” from its MA 100 again, which was also typical and which represented the “testing” of the resistance line after which a long-term and sharp fall followed. The next testing and rebounding from the MA 100 trend line, that represented a resistance one, occurred on 17th June, 2008. After that further index fall came forth, again.

On 31st March, 2009 a relative *BELEXline* index value position of 844,36, in relation to its intermediate moving average MA 50 of 994 and a long-term moving average MA 100 of 1100 indicated that the market was still in a descending long-term trend.

Moving Average Convergence/Divergence – MACD

Moving Average Convergence and Divergence or MACD (when abbreviated), represents a trend following indicator. It is calculated as a difference between a shorter and longer exponential moving average of 12 and 26 days.

MACD is drawn on a separate graph that is being analyzed together with another graph in which the basic value (an index value in our case) with its moving averages are being presented. The MACD values oscillate around the “zero” line which gives them the features of an oscillator. When the shorter moving average of 12 days is above the longer one of 26 days, the MACD has positive values i.e. it is above the “zero” line. On the other hand, when the shorter moving average is below the longer one i.e. when it is below the “zero” line, the MACD has negative values. A mutual ratio of the shorter and longer moving average indicates the trend direction of movement which is an ascending one if the MACD is positive i.e. a descending one if the MACD is negative. The MACD measures the moving averages speed of change due to which it has the characteristics of a momentum indicator.

In the MACD graph, a moving average of 9 days is represented, as well. It is a signal line that is used as a "trigger" line. The crossing of the MACD line with the "trigger" line denotes the purchase ("buy") or selling ("sell") signal. The "buy" signal has a stronger significance if the MACD line cuts through the signal line in an upward direction, while both lines are far away, below the "zero" line. The "sell" signal has a stronger significance if the MACD line cuts through the signal line in a downward direction while both lines are far away above the "zero" line.

A divergence is a phenomenon where the two curve lines represented in the graph move in the opposite directions. The above mentioned phenomenon of divergence represents a very important signal in the technical analysis. It is observed between the graphic representation of the price (index) and some of the indicators, the MACD line, in this case. It can be positive or negative one. For instance, if the MACD line starts to rise while the prices are still declining then it is the positive divergence and the fall of the prices is expected to end soon. A negative divergence occurs when the MACD line begins to decline while the price still increases. Then the growth of the prices is expected to end soon. A divergence phenomenon appearance is not so common, however, in the technical analysis it is considered to be one of the most reliable signals that precede the higher growth or decline of the prices.

**The MACD Belexline Analysis from
1st March, 2006 to 31st March, 2009**

The MACD values have been calculated on the basis of the Belexline index value from 1st March, 2006 to 31st March, 2009 [9], and its moving averages of 12 and 26 days. The MACD analysis has been complementary to the two moving averages one. The MACD oscillation in the current trend, at the time, indicated the slowing down i.e. weakening of the trend or its acceleration and strengthening of the one, even. Its signals represent the first signals and warnings that were yet to be confirmed by the trend signals which are considered to be more important ones. The MACD and signal (trigger) lines diagram is represented in Figure 6.

From 17th July, 2006 to 23rd May, 2007 the MACD had a positive value which confirms that the market was in an ascending trend. In Figure 6 it can be noticed that the MACD line reached its extreme value, realized on 23rd April, 2007, when the Belexline index had a value of 4812,9. The extreme value of the MACD indicated that the market was "overheated" i.e. that the optimism was in its prime, after which the trend stagnation followed. The crossing of the MACD line with the signal line with its index volume of 4714,09, that occurred on 25th April, 2007, represented a serious signal of the growth stoppage. It is known that the MACD signal is more significant if it is more, far away from the "zero" line. The second signal is the crossing of the MACD and the "zero" line, that occurred on 23rd May, 2007, when the index value was 4761,81. It is the moment that indicates the occurrence of the 12 and 26 day moving average lines cross-section and the change of their relative positions after that.

After 23rd May, 2007 the MACD had dominantly negative values which indicated a descending, downward trend. As the time passed, it was also noticed that its bottoms had more and more negative values which gave basic grounds for the assumption of the established downward trend continuation. Occasional MACD positive values that were occurring in much shorter periods of time, pointed out shorter periods of consolidation within the downward trend. The MACD signals preceded the signals based upon the crossing over of the trend line. For instance, on 27th May, 2008 the MACD reached its maximum value after which it changed its direction sharply i.e. moving into a downward direction. The change of the MACD direction of movement pointed out the correction weakening and indicated that the MA 100 long-term trend line would represent a strong resistance line. A rebound of the index from his MA 100 followed on 17th June, 2008 after which the downward trend was continued.

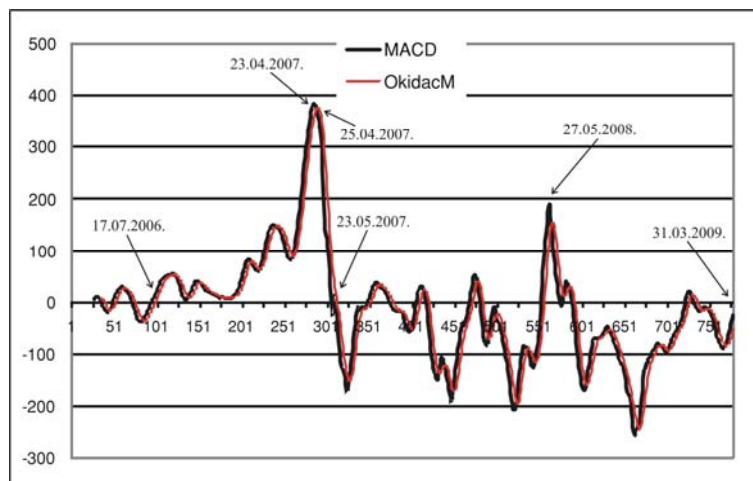


Figure 6. The MACD and its trigger from 1st March, 2006 to 31st March, 2009³⁷

A negative MACD value that occurred on 31st March, 2009, pointed out that the market was still in a decline and its positive slope indicated that the descending trend would come to its slowing down.

Research Results Analysis

By the analysis of the *BELEXline*, the Belgrade stock market common share index trend, its intermediate MA 50 and a long-term MA 100 moving averages and MACD indicator, the signals of the long-term trend weakening and its change have been noticed. In the graph of the Figure 7 the characteristic signals given by MACD, index value and moving averages cross-sections as well as the cross-sections of MA 50 and MA 100 lines are presented in the chronological order of their appearance. In the above mentioned graph, a date of each signal origin is listed along, then a number of day delays in regard to the previous signal, then the *BELEXline* index value on the day of the signal occurrence. The *BELEXline* index decline dynamics is expressed by the absolute index change (*BELEXline* difference) between the current and the previous index value. A corresponding proportional index value reduction is expressed in regard to the corresponding previous signal index value. It is noticed that the MACD signals preceded the signals that were crossing over the trend lines. It is also noticed that the fall index percentage is significantly higher in the first signals in regard to the fall index percentage of the subsequent signals.

³⁷ Private graph representation created in Excel Worksheet on the basis of the calculated MACD index value

	MACD and trigger cross- section	Max. index value	MACD and "zero" cross- section	Index and MA50 cross- section	MA50 and MA100 cross- section	Index and MA 100 cross- section
Date	25.04.07	3.05.07	23.05.07	4.06.07	7.08.07	16.08.07.
Difference of the day		6	15	9	47	7
Index [9]	4714,09	5000,34	4761,82	4569,34	4551,35	4543,04
BELEXline difference			238,52	192,48	17,99	8,31
% differ.			4,8	4,0	0,4	0,2

Figure 7. A chronological display of the signal weakening and trend changes and their delay with the corresponding BELEXline index values

Conclusion

This paper has demonstrated the trend analysis applicability in the stock market in Serbia in the last three years. A moving averages method uses rather simple and homogeneous rules that are easily applied in the conditions of an existing trend. By the trend analysis the investors can accumulate their profit withing an ascending trend and sell the shares when the stoppage or change of the trend occurs. A prompt identification of early weakening signals as well as the ones that confirm the change of a trend enables the investors to be quite successful while making decisions upon their investments. When the market is not in a trend, i.e. when it is in a horizontal one, the above mentioned moving average method is not possible to apply.

The trend concept analysis and the BELEXline indexes of the two moving averages method from 1st March, 2006 to 31st March, 2009 pointed out that the stock market in Serbia had two distinctive long-term trends at the above mentioned observed period of time. At first it had an ascending and after that a descending trend. In the first three months of 2009, the BELEXline index kept moving downward in the long-term descending trend. The paper confirmed that the signals of the moving averages method are late, which has been a common feature of the trend based methods.

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**ANALIZA TRENDA NA TRŽIŠTU KAPITALA U SRBIJI
U PERIODU 1.03.2006.- 31.03.2009.**

Rezime: U radu se istražuje mogućnost primene metode analize trenda na tržištu kapitala u Srbiji. Izložene su osnovne postavke tehničke analize i koncept trenda. U analizi trenda primenjena je metoda dva pokretna proseka i pokretni prosek odstupanja i podudaranja (MACD). Trend je smer kretanja posmatrane veličine. Pokretni proseki su metod kojim se uočava tok pojave i prikazuje smer njenog kretanja. Oni indentifikuju uspostavljanje, zaustavljanje postojećeg, promenu i uspostavljanje novog trenda. Jedan od pokazatelja koji potvrđuje smer i daje prve signale slabljenja trenda je MACD indikator. Autor je analizirao dinamiku kretanja vrednosti opšteg indeksa akcija Beogradske berze, Belexline, u periodu 1.03.2006. – 31.03.2009. godine, primenom metode dva pokretna proseka: srednjoročnog od 50 dana i dugoročnog od 100 dana na tržištu kapitala u Srbiji.

Ključne reči: tržište kapitala, korporacija, predviđanje, Belexline, trend, pokretni prosek, MACD.



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EMPLOYEE TURNOVER: CAUSES, CONSEQUENCES AND MANAGEMENT

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Abstract: *Companies continually monitor and control employee turnover rate in order to predict and control the replacement costs of employees leaving organization. Employee turnover rate higher than the average rate in industry sector in which organization dominantly operates presents a serious warning. A high employee turnover rate shows that there are some problems within organizations, which require to be solved. Therefore it is necessary for companies to continuously and systematically manage employee turnover. The goal is to decrease dysfunctional turnover rather than to decrease the employee turnover at any cost.*

Key words: *employee turnover, voluntary turnover, employee turnover costs, optimal employee turnover rate, strategic management of employee turnover.*

1. Introduction

Employee turnover shows the number of employees who leave the organization for various reasons. Organizational exit may be defined as the termination of the employee's membership in an organization [33] and may be the consequence of the initiative of the employee – voluntary turnover (for example, resignation, retirement), or of the initiative of the employer – involuntary turnover (for example, termination for cause, layoffs, etc.). In certain cases the employees may leave the organization regardless of their will or the employer's will, as the consequence of the legal reinforcement, as it is the case with permanent loss of working ability, etc.

Human resource management (HRM) literature for almost fifty years is engaged with the research of turnover as an essential aspect of the employment (according to Holtom *et al*, 2008, there are more than 1,500

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published articles). In recent years, with growing competition, economic recession, global financial crisis, organizational restructuring and fast technological changes, many organizations have faced with the need to systematically manage the employee turnover. On the other hand, there has been a growing mobility of individuals in the labor market who are searching for more challenging jobs, higher salaries and better benefits, which additionally strengthened the need for taking a more concentrated focus on the employee turnover.

In this paper the special attention is given to the employee turnover, which represents an important aspect of the employment in all organizations. The paper deals with the causes and consequences of the voluntary turnover, optimal turnover rate and the ways of managing employee turnover strategically. Finally, the paper suggests the practical implications for the managers how to approach turnover if they want to reach the optimal turnover rate in long term and consequently to decrease human resource management costs.

2. Voluntary turnover: process and causes

To manage employee turnover efficiently and control turnover costs in long term it is important to analyze voluntary turnover, when employees willingly leave the organization. Although the involuntary turnover is an important aspect of the total employee turnover, frequently it is not included within different turnover research frameworks. Voluntary turnover is of special importance for the organizations because the employees who perform better are believed to have more external employment opportunities, and, thus, are more likely to leave [45], and therefore high rates of voluntary turnover may have harmful effects on organizational performance [12].

For a long time voluntary turnover has been attracted the attention of large number of human resource management researchers, in their attempt to identify the process through which the people who leave the organization are passing through as well as to analyze the reasons and motives which lead one employee to make the decision to leave the organization. Major reason behind frequent interests for voluntary turnover is the fact that the voluntary turnover represents the cost for the organization, and therefore the rate of voluntary turnover should be kept at the lower possible level.

Until the mid of 1980s a vast number of different models were developed with an intent to explain the process of turnover at the individual level of analysis, through which the individuals who decide to leave the organization are passing through [20; 34; 25; 27; 36; 37; 44; 15]. For example, March and Simon (1958) suggest that two factors, perceived

Employee Turnover: Causes, Consequences and Management

desirability and perceived ease of leaving the organization influence an employee's motivation to leave the organization, whereas individual differences related to abilities and bio data (such as gender, age, tenure) directly influence perceived easiness of leaving the organization. Porter and Steers (1973) introduced a turnover model in which the employees' met expectations were the driving factor that influences the turnover decisions. One of perhaps the most prominent turnover models is the Mobley's turnover model [25; 26] which is based on the assumption that the individual who is dissatisfied with his current job makes the decision to quit at an early stage. The individual begins to think about leaving the organization, evaluates the costs of leaving the old job and the costs of searching for a new job. Consequently, the individual begins to search for an alternative employment, compares its costs and benefits against the present job, makes the decision to quit and finally he quits. Following the Mobley's process model, Hom et al. (1984) introduced an alternative model that describes the behavior of the individual after he started to think about quitting and to evaluate probable utility of leaving the organization. According to this model the employee will either search for a new job or he will resign immediately. One alternative turnover theory – The Catastrophe Model - was proposed by Sheridan & Abelson's (1983). According to this model [41] decision to quit is the consequence of an extremely small change in the job satisfaction and the stress that the employee feels. In a case when the employee feels dissatisfaction with his job or with his organization but is not seriously considering quitting, even minor problem, conflict or other unpleasant job experience may be the cause for him to bring the decision to leave the organization.

Conclusions which can be drawn from the process voluntary turnover models on the individual level of analysis are the following: (a) an important factor of turnover decision is the fact whether or not the person has the alternative job offer; (b) some employees plan in advance to leave the organization and behave appropriately with such a plan; (c) some employees have a plan to leave the organization which are dependant on some future uncertain events; (d) some employees impulsively make turnover decision, so their decision process is extremely short [19].

Later research, until the mid of 1990s, were mainly focused on contextual variables (on the organizational and group level of analysis) which may influence voluntary turnover, such as: organizational culture [2], group cohesion [30], reward system, gender structure, and demography, the person–organization fit [31; 18], mentoring [47; 32], embeddedness of an individual within social networks [23]. Finally, many researchers were

investigated the consequences of turnover for the individual [29] and for the organization [28; 35].

During the last decade the turnover research has been further expanded and focused on the following issues: (1) investigation of individual differences between the employees in predicting the voluntary turnover; (2) examination of stress- and change-related attitudes of the employees; (3) empirical research of the existing turnover models; (4) an increased focus on the contextual analysis with an emphasis on interpersonal relationships; (5) examination of the factors which positively influence the individual's decision to stay with his organization (such as, for example, organizational commitment); (6) modeling of turnover processes in time [14].

Whether one employee will leave the organization or will not depends on his perception about ease of leaving one job for another one. The employee's perception about the ease of leaving his organization is influenced by various factors. One group of factors which influence the employee's perception about the ease of leaving his organization represents the organizational and environmental factors outside of the organization related to the characteristics of labor market, such as the presence and the strength of trade unions, the unemployment rate, the relation between supply and demand for specific employee profile, etc. [7]. In developed countries characterized by low unemployment rate it is logical that voluntary turnover tend to be lower, since alternative employment is offered to the employees who decide to leave the organization in a greater extent. The employee's perception about the ease of leaving the organization would be mostly influenced his perception about the supply and demand for his type of competence on the labor market, and the availability of different alternative jobs for him. Some studies suggest that even in a case when conditions on the labor market are mostly harmful, if the individual who is thinking to leave the organization gets the job offer, the influence of this development significantly prevails the weight of high unemployment and negative trends on the labor market [43; 11].

Apart from mentioned factors, the individual's perceptions about the ease of leaving the organization have also been influenced by the job itself, that is individual's perceptions about the job he is performing, his salary, the level of stress he is exposed to, as well as about his internal job satisfaction. The employee will easier decide to leave the organization if the level of his general satisfaction is lower, the stress he is exposed to higher, if he performs monotonic job which is high horizontally specialized and if the extent of his dissatisfaction with the salary is high. His perception about the ease of leaving the organization will be also influenced by the following

Employee Turnover: Causes, Consequences and Management

factors: the length of tenure, degree and type of education, marital status, age, the number of supported family members, economic position of his family, ease of finding the first employment, rationality of his expectations with regards to the job, his job commitment, etc. [7].

3. Costs of turnover

Organizations continuously monitor and seek to control the turnover rate in order to predict and control the costs of replacing the job leavers. Although there are significant differences between countries, the analysis of turnover costs as well as labor shortages in critical industries world-wide point out the importance of retaining key resources for successful organizations. Therefore, as the response, managers apply human resource management policies and practices aiming at actively reducing undesirable turnover [9; 16; 17; 24]. Some studies show that voluntary turnover is an important factor which influences the organizational performances [39; 46]. Many argue that the turnover represents the key link between organizational strategy and behavior. Some studies indicate that even 30% of the market value of companies is attributable to intangible factors, such as managerial credibility and experience, ability to attract and maintain talents, compensation strategy etc. [4].

While in some professions the turnover rate is high, in some other professions it is low. A number of scholars suggest extremely high turnover rates among information engineers (nearly 20%) and high costs associated with their replacement, which accounts in average 33.000 USD per employee [10], as well among food service employees – even 50% and low turnover rates in the educational services sector – nearly 10% [14]. Using an example from the health care industry, Cascio (2000) calculated that the cost of replacing 288 employees per year (in a hospital with 200 beds employing 1,200 persons with a turnover rate of 2% per month) was 2,888,295.52 USD when all sources of costs were analyzed. Yet across firms in the same industry, turnover rates vary widely. Differences in turnover exist among different parts of the world. Some data shows that Europeans are half as likely to change jobs as Americans in a given year [14].

The turnover rate higher than the average rate in the industry where the organization carries out its business is a sign of serious warning, and should be understood as a symptom of problems within the organization. High voluntary turnover rate may be a quite expensive organizational strategy, since it may harm the organizational reputation as the employer and to reduce opportunities for successful recruitment of qualified candidates [21; 42].

Costs of voluntary turnover depend on the actual situation. When the organization is planning to permanently terminate the job position left by the job leaver, voluntary turnover of the employee(s) may have some positive effects. On the other hand, in a situation when the organization is pressed to replace the employees who voluntarily leave the organization to continue with its regular operation, the costs increase significantly. Replacement costs include several groups of costs such as: the separation costs, the recruitment costs, the selection costs, and the training costs [8; 13].

First group of costs which the organization experiences when the employee decides to leave the organization are so-called separation costs, which are associated with voluntary turnover regardless of both the reasons behind the turnover and the fact whether the job leavers will be replaced or not. The highest proportion of these costs includes salary, specifically severance pay (usually several monthly salaries of the employee), health insurance pay in a certain period of time. The organizations may have additional cost, for example in the U.S., through increased tax if the former employees in a greater extent draw benefits from the unemployment fund. Finally, an essential component of the total cost includes the administrative costs such as costs of exit interviews, costs associated with job search assistance, etc.

Replacing the employees who voluntarily leave the organization begins with the recruitment of new prospective candidates for a certain job position. Recruitment costs include all costs associated with application of various often external recruitment methods among which the following have been considered as the most popular: advertisement, use of state and private employment agencies, recruitment through schools and universities. If one organization does not employ a recruitment specialist within its HR department, it must use the services of external providers for the recruitment purpose. As the vacant position is higher in the hierarchical ladder and the employee's competences is more difficult to find in the labor market, the higher is probability that the organization would contract a specialized headhunting agency which standard fee for these services, apart from the costs of finding the candidate, accounts even to 30% of the annual salary offered for the vacant position. Besides, the fact that this method of recruiting prospective candidates, apart from extremely high costs, is characterized by low rate of success in finding appropriate candidates should also be taken into account. The recruitment costs for new hires are additionally increased either in a case that the new entrant again leaves the organization in short run or in a case that he does not deliver good performance on his job.

Employee Turnover: Causes, Consequences and Management

After recruitment of candidates the organization must undertake selection among the candidates which submitted their applications. Selection costs will depend on the size of costs associated with the use of various selection methods, such as instruments for collecting bio data (application form, CV), instruments for collecting data on personnel characteristics, abilities and preferences (written tests, personality test, assessment centre, job sample, etc.), interview with candidates, medicine and physical tests, etc. Selection costs depend also on the availability of recruitment specialists within the organization who are able to perform proficient selection or it would be necessary to contract external specialized agency for that purpose. The costs would also include the time that the line managers, outside the HR department, dedicate to interviewing the candidates. Sometimes the total costs should increase if employing one candidate implies payments of the following costs: renting or buying a flat and moving the members of the candidate's family. Total selection costs may be additionally increased by making the selection mistakes, i.e. if the organization selects inappropriate candidate or, in a reverse case, if the organization fails to notice an excellent candidate.

The process of employment of the chosen candidate has not been finished by his selection, but rather by his socialization which includes his orientation and job oriented instructions. The HR department is responsible for the new comer's orientation that is his acquaintance with the organization, whereas the immediate supervisor is responsible to instruct the new comer with his job. The socialization costs for new comers represent the part of the overall training costs associated with the replacement of the employees who voluntary leave the organization. If the organization recruits the non-experienced candidate who needs a long-lasting training, the training costs may be additionally enlarged for both the costs of trainer and the lost productivity during the training process.

Although voluntary turnover often has negative connotation for the organization, the departure of job leavers does not necessarily cause high costs barely, but it may have several positive effects on the organization, such as: decrease of labor costs through employing the young candidates with lower salaries; creation of a setting for replacing the employees with unacceptable performance; the entrance of new employees to the organization may increase the diversification and innovativeness; enhancement of organizational climate through upgrade of interpersonal relations in organization, etc.

4. Optimal turnover rate

Turnover, as already mentioned, shows the number of employees who leave the organization for the number of reasons. Turnover rate is calculated as the ratio of the number of employees who leave the organization during one year and the average number of employees in the organization. The turnover rate of 25% is considered to be quite normal and acceptable for large organizations. The replacement costs for organizations which have higher turnover rates are much higher compared with the organizations with acceptable turnover rates, which devastate the competitiveness of the former type of organizations on the market. In order to improve its competitiveness on the market and to control the costs of voluntary turnover any organization needs to determine its optimal turnover rate, i.e. the turnover rate where the turnover related costs are equal to the retention costs [3, p. 333], that is where the total costs are lowest. For some companies, such as for example *Mc Donalds*, *Burger King*, *Pizza Hat* etc., which do have extremely high turnover rates due to poor working conditions and low wages, it would be more expensive to decrease the turnover rate through double or triple increase of salaries, than to have high turnover rates.

The analysis of total turnover in an organization may direct us to make absolutely incorrect conclusions; it does not give much information for the planning, such as: which job positions and which organizational units suffer from high turnover rates, what is the average age of job leavers, what is the length of tenure of job leavers, etc. To get information which does have higher utility for the planning and management of turnover, it is desired to disaggregate the general turnover rate. Voluntary turnover is far more complex issue to be well resolved by the organizational general turnover rate. To get data with higher utility for the process of managing voluntary turnover the additional indicator may be used that is the Employee Stability Index [5], which shows which proportion of the total employment stays in the organization. The Employee Stability Index is calculated as the ratio of the number of employees staying in organization more than one year and the number of employees in the previous year [5]. Furthermore, for the analysis needed for more effective management of voluntary turnover the additional indicator may be used, that is tenure of the employees who voluntarily leave the organization. Type of jobs performed by job leavers could also be analyzed. Some researchers tried to investigate whether the employees with outstanding or with poor performances are eager to leave the organization, though they did not provide precise answer to that question. [22]. The employees with unacceptable performances are sometimes are likely to leave the organization though, on the other hand, they may stay in organization

Employee Turnover: Causes, Consequences and Management

due to insufficient alternative employments; the employees with excellent performances are sometimes showing more readiness to leave the organization because other employers offer them significantly higher salaries. Therefore, the conclusion that the organizations are more efficient without job leavers may be incorrect.

5. Managing voluntary turnover strategically

In the process of managing voluntary turnover first it is necessary to evaluate at what extent the turnover is desirable or undesirable for the organization. The Martin-Bartol's Performance Replaceability Strategy Matrix (Martin, Bartol, 1985) can be used for that purpose. According to the Matrix, desirability or undesirability of turnover depends on both the performances and the replaceability of job leavers.

Turnover is highly dysfunctional for the organization when the employees with excellent performances and low and uncertain replaceability on the market leave the organization. In this case it may be better (and cheaper) solution for the organization to try, by all means, to retain the employee through elimination of the sources of his dissatisfaction, i.e. the reasons behind his decision to leave the organization. Dysfunctional turnover for an organization may also be the turnover of either the employees with average performances and low replaceability on the labor market or the employees with high performances and high replaceability on the labor market. In short run, even turnover of employees with low performances and low replaceability may also be dysfunctional for an organization. Since it is difficult to replace the job leavers, it is better solution to seek the measures directed to increase their effort and performance on the job.

On the other hand, voluntary turnover may be functional for an organization in a case when the employees with low performances and high replaceability on the labor market decide to leave the organization. The turnover of employees with average performances and high replaceability may be desirable for an organization, though its desirability depends on the size of total costs. Functionality of this type of turnover is also influenced by the probability that the new hire would deliver higher performances than the job leaver.

Analysis of the desirability of some type of voluntary turnover is needed for efficient management of turnover, because it gives information to the organization or to the HR department about both when the departure of one employee should be accepted and when they should try to retain the job leaver.

6. Conclusions and implications for management

The previous analysis suggests that organizations need to continuously manage employment turnover, while it is worthy to note that voluntary turnover may and frequently have extremely damaging consequences for the organization. The goal of the organization should not necessarily be reducing turnover at any cost, but rather reaching the optimal turnover. Optimal turnover is the point where the turnover related costs are equal to the retention costs. Furthermore, efficient management of turnover assumes decrease of dysfunctional or undesirable rather than total turnover in an organization. The analysis has shown that the most dysfunctional turnover for an organization is when the employees with high performances and low and expensive replaceability are leaving the organization. On the other hand, in cases when poor performers neither improve their performance nor show intent to leave the organization, the organization should encourage them to leave in this way increasing functional turnover. Many suggest that both goals are achieved through implementation of the pay-for-performance, because they differentiate between good and poor performances and thus motivate the best performers to stay and the poor ones to leave the organization.

Nevertheless, it is impossible to expect that any organization may fully controls voluntary turnover [1]. There are a number of people who leave organizations for reasons which are not associated with the organization: moving family, sickness, return to school, etc. If the majority of employees leave the organization for these reasons, than it is bad alternative for the organization to retain these employees by costly retention strategies, since invested money present obvious loss. Therefore it is often recommended that the analysis of all indicators providing detail information about the characteristics and personnel motives of job leavers should be done first, before application of any instrument aimed at turnover decrease. In this way it becomes possible to calculate actual turnover costs and then to compare them with the costs of alternative solutions in order to make an appropriate decision. In addition, it is necessary to organize the exit interviews with employees who leave the organization in order to gather the information about the turnover causes, regardless of the approach in managing turnover the organization selects. In this way, turnover management process takes a long-term perspective, i.e. initiative to optimize the turnover in long term.

With regards to the future directions of turnover research, current studies suggest that there are several crucial themes which will dominate the relevant literature, and they include: (1) further investigation of

Employee Turnover: Causes, Consequences and Management

interpersonal, social and team dynamics providing for a deeper understanding of the decision process to leave the organization [38]; (2) empirical research in many more countries, since the previous research was mainly focused on USA, and in a lower degree, on Australia and Great Britain; (3) further re-examination of the time in the turnover process; (4) further investigation of causes and paths of decision making process to leave the organization among new comers; (5) continuation of the research about the relationship between voluntary turnover and organizational performance [14].

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FLUKTUACIJA ZAPOSLENIH: UZROCI, POSLEDICE I KONTROLA

Rezime: Kompanije kontinuirano prate i nastoje da kontrolišu stopu fluktuacije kako bi predvideli i stavili pod kontrolu troškove zamene zaposlenih koji odlaze iz organizacije. Stopa fluktuacije koja je viša od prosečne u industrijskoj grani u kojoj organizacija obavlja svoju dominantnu delatnost treba i mora da bude ozbiljno upozorenje. Visoka stopa voljne fluktuacije je jednostavno simptom da postoje određeni problemi unutar same organizacije. Zato je neophodno da kompanije kontinuirano i sistematski upravljaju fluktuacijom. Cilj ne treba da bude smanjenje fluktuacije zaposlenih po svaku cenu, već smanjenje samo štetne fluktuacije.

Ključne reči: fluktuacija zaposlenih, troškovi fluktuacije zaposlenih, optimalna stopa fluktuacije zaposlenih, strategijska matrica upravljanja fluktuacijom zaposlenih

Guideline for writing papers for ECONOMIC THEMES:

1. The paper should be introduced at 12-15 pages. **Page format:** *File - Page Setup - Margins* - Top, Bottom: 5.5 cm, left, right - 4.5 cm, header, footer - 4.8 cm; *Paper size:* A4; **Font:** Times New Roman - 11 pt. **Spacing:** *Format - Paragraph - Indents and spacing:* Indentation: Left, Right 0; Special: First line 1.27; Spacing: Before 6pt, After 0pt; Line spacing: Single; **Tables** and **formulas** write in program Word for Windows, and **pictures** in program Corel Draw.
2. Paper should have: Title in English (bold, all caps, 12pt, center); Scientific degree, author's name (bold, small caps, 12pt, center); Footnote: institution (10pt); Abstract and key words in English (italic, 10pt); Subtitles (bold, small caps, 11 pt, center); Introduction, elaboration and conclusion (11pt); Literature (10pt, example: Rayport J. F., Jaworski B. J., Introduction to E-commerce, McGraw-Hill, International Edition, 2003.; in paper use number from literature, example: [1, page x]); Title, abstract and key words in Serbian (10pt).
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