

INFLUENCE OF LOCATION-RELATED FACTORS ON THE FOREIGN INVESTORS' MARKET-ENTRY STRATEGIES: THE CASE OF SERBIA

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Abstract The most important strategic issues in foreign investment decision process are which country-specific strategy and which mode of entry should MNC pursue when it enters into specific country/market? In the sense of the Dunning's eclectic paradigm, foreign direct investment can be explained by three groups of factors: the ownership advantage of the investor (O), by location factors (L), and by internalization of activities (I). Because most of foreign investors that expand their production/activities internationally have some ownership and internalization advantages, the key determinant in decision-making process is the location advantage of the host country. There is a bulk of location determinants, and among them authors especially stress institutional factors, which derive from the FDI policy regime of the country. The authors deal with dilemma is it possible to influence foreign enterprises' decision process in term of mode of market entry, and what are the incentives and location-specific resources which increase bargaining power of host country. After termination of privatization of socially-owned and state enterprises, the most attractive mode of foreign companies entry for Serbia are Greenfield investments. In this paper we will try to answer what are the possibilities for Serbia to attract more this investment by well-established measures of so-called location marketing.

Key words: foreign investment, market-entry strategy, location factors, financial incentives, and location marketing.

1 Introduction

One of the most important strategic issues regarding foreign direct investment is the choice of the entrance mode of MNC at particular country or market. Entry mode represents the means of internationalization of the firm and determines the level of exposure, and use of local assets and management in MNC activity overseas [9, p.577]. Well-known forms of entry mode are export, licensing, and franchising, but they are modes of low commitment of MNC human capital (such as knowledge, expertise, skills, time), and other resources, so we are not going to pay special attention to them in this paper. We will deal with modes of entry of higher commitment, and they, generally, can be split off in two broader groups: 1) wholly owned modes of entry, and 2) collaborative ones. They differ by ownership structure and mode of establishment as Somlev and Hoshino noticed [9, p.578].

The wholly owned ventures usually take the form of Greenfield or Brownfield investments or acquisitions. Greenfield investment or start-up entry mode occurs when a foreign enterprise starts out on a completely new place, which demands constructing new objects and obtaining new technology. Although this type of investment enables foreign investor the highest level of protecting its intellectual property (especially new technology and know-how), and possibility to fulfill its own specific requirements, it needs time, so represents gradual market entry [2, p.10]. Brownfield investment represents an acquisition with deep restructuring, planned at a very rapid pace, which allows the market entry advantages of acquisition due to the quick entry and immediate access to local resources [5]. Hence, Brownfield venture represents investment where a foreign enterprise starts working in a building or a place used previously for production or other business, and where exists certain infrastructure. Consequently, certain advantages of Brownfield ventures derives, which include [2, p.10]: 1) the entry mode can overcome obstacles of limited availability of certain assets, 2) the investor has a wider choice of potential target firms since radical restructuring is planned, and as Meyer & Estrin stressed [5], 3) this wholly owned entry mode allows for complete control over many of the primary business functions. Acquisition of existing firm represents the fastest and less risky way of entrance in market regarding control of assets and protecting technology/intellectual property.

Collaborative modes of entry represent the use of strategic alliances or joint ventures with foreign companies as the primary vehicle for entering foreign markets. Joint ventures, strategic alliances, and other cooperative agreements (such as business cooperation contracts-BCC) with foreign partners are a favorite means for entering a foreign market in the contemporary world. In the past, as Thompson and Strickland noticed [14, p.214], export firms in industrialized nations sought alliances with firms in less developed countries as vehicle to import

and market their products locally in conditions where such agreements were necessary to win approval from the host country's government to enter this market. The number of strategic alliances, joint ventures, and other collaborative efforts has increased for the past few decades, and these cooperative agreements between domestic and foreign companies appear for a variety of reasons, besides gaining wider access to attractive country markets.

The importance of different modes of entry potentially varies when it comes to foreign investment from developed to less developed countries. The role of Greenfield investment is greater than one of the acquisition, because after acquisition of domestic enterprise foreign investor can decide to divest some units or activities, and exit from certain business [16, p.135]. But generally, acquisition of domestic firms by MNC or other private investors can increase production and export, as well as efficiency of domestic business. This is especially important in the condition of globalization, because it is difficult for domestic firms to go alone to world market for, at least, two reasons: first, there are substantial costs of entry to global market, and second, there is severe competitiveness of world-class brands on global market, and to achieve competitive advantage of local product/services, domestic firms have to invest heavily in marketing activities [11, p.89].

Although wholly owned modes of entry (especially Greenfield investment) allow, as we already mentioned, the highest level of control of investment, and the lowest level of technological risk, they demand significant resources. This is the reason why MNCs take them in consideration when the risks of investment at certain market/country are generally low, i.e. in stable economies [7, p.159]. However, the most common mode of FDI in transition countries was joint venture, as a form of cooperation of foreign and domestic enterprises, where foreign investor has a considerable share in newly founded business. This is the most popular mode of entry of strategic partner interested in obtaining resources or market share at host country. Foreign partner is interested in joint venture when technology, which it brings, is not its core resource, and when it does not have enough knowledge and information to effectively and efficiently perform operations in that market [10, p.110-112].

2 Theoretical framework

2.1 The choice of market entry strategy

The important strategic issue in foreign investment decision process is which country-specific strategy (in addition to corporate-specific strategy) should MNC pursue when it enters into specific market/country? Many researchers have noticed

that in the process of internationalization of their activities firms were motivated by different strategies for different foreign countries. But, there are not so many studies about relationship between country-specific strategy that firm pursues and chosen entrance mode. These country-specific strategies are market-seeking, resource-seeking, and efficiency-seeking strategies (the latest also related to assets-seeking strategies). There are also few other strategies mentioned in the business literature, such as client-following, competitor-following strategies, etc.

Hence, some authors have tried to hypothesize and test [2] how these strategies influence the choice between two distinct structures of mode of entry – joint ventures and wholly owned subsidiaries. This choice can be introspect within resource-based, transaction cost, bargaining power or even, recently, behavioral approach framework, as Somlev and Hoshino stressed in their study [9, pp.577-598].

Market-seeking strategy is performed by MNCs that are interested to enter a new and potentially large market. As previous researches stipulated, the strategic objective of those MNCs is to create sales or market share by seeking new customers in foreign markets. This was especially enforced strategy by Western firms pursuing consumer and industrial markets in CEE, SEE countries, and so-called emerging markets. As Gil et al. cites [2, p.3] those Western firms were seeking market share and steady growth, and in the most aggressive cases, they were seeking market domination.

Resource-seeking strategy is employed by MNCs that are interested in exploiting abundant or scarce resources. For resource-seeking multinational corporations, access to a secure supply of natural resources (like oil or gas) is a key determinant for investing in a particular country [13, p.505]. Tarzi cites an example of Japanese transnational corporations, which have increasingly relocated their production operations to be close to the source of raw materials. The type of the strategy is when MNC pursues some strategic important resources such as new technologies, or highly educated workforce or specialists in R&D, also known as an asset-seeking strategy.

Efficiency-seeking strategy is enforced by those MNCs which primary motive is to lower the costs of raw material, land and labor [13, p.504]. Owing to these cost savings, as Tarzi points out, those MNCs can capture economies of scale and rationalize operations, and consequently, maximize the rate of return through efficiency-seeking measures.

Client-following strategy is pursued by MNCs who are interested in providing services/products to other Western firms, which were already had entered to new emerging and growing market [2, p.3]. Following the first wave of Western companies who had entered CEE and SEE markets, other supplier organizations got into these markets. Those Western firms required and preferred services/products supplied by other Western firms because often they couldn't get

these products or services from the local suppliers or they were not of desired quality or quantity.

2.2 Factors determination of foreign investment and market-entry strategy

There are three groups of factors cited in a relevant literature, which need to be considered and analyzed in relation to decision-making about entry. Those are: 1) country-specific factors, 2) industry-specific factors, and 3) venture-specific factors [15, pp.441-463]. Country-specific factors refer to country risk and cultural distance of the host country.

Industry-specific factors are concerned with characteristics of the industry in which foreign firm (MNC) operates. This refers to ability of MNC to provide differentiated products through its own brand name. Another of these factors is competitive intensity related to the number of firms in the market.

Venture-specific factors are investment amount, duration of investment, partner alignment, etc. Venture-specific factors are associated, also, with normal business or commercial risks, such as change in economic costs or demand, change in competition in the market, or risk of new products/services introduction [6, p.768].

The so-called eclectic paradigm of J.H. Dunning [1, pp.173-190], known also as the OLI model, is the most influential framework for empirical investigation of FDI determinants for decades. The paradigm offers a holistic framework to take into consideration all of important factors that influence the decision of a MNC about going internationally in production and other operations, which will drive its growth. As some authors accurately noticed [12, p.351], the model is context-specific, and its configuration will depend a lot on type of the firm, region or country, industry or value-added activity in which firm operates.

In the sense of the Dunning's eclectic paradigm Stoian and Filippaios [12, p.351] point out that the returns to FDI and FDI itself, can be explained by three groups of factors: the ownership advantages of firms (O), which indicating what are the competitive advantages of the firm which is going to do its business internationally; by location factors (L), which explain where MNC is going to produce or do its business; and by internalization factor (I), which explains why MNC is going to engage in FDI rather to sell license to foreign firm or to contract a franchising arrangement.

There are, in contemporary literature, some extensions of the OLI model in attempt to fully develop conceptual framework and to explain other consideration of MNC during foreign investment decision-making process. The well-known are extensions made by Guisinger [3] in his "evolved eclectic paradigm". His model has often been cited as the OLMA model. There are two distinctions in re-

lation to the OLI model. First, Guisinger replaces the “I” group of factors with “M” factors, which stands for the mode of entry. Involving this group of factors in analytical framework allows researches to explain how different determinants affect decision about mode of entry in different context of factors’ influence that exist in different countries. That presumption is pretty much related to the topic of this paper also. The “A” in the model stands for adaptation of the firm’s operation to the international business environment that is based on the institutional theory. Because most of foreign investors that expand their production/activities internationally have some ownership and internalization advantages, the key remaining determinant are the location advantages of the host country.

Among location advantages, which are primarily economic determinants, and bring certain benefits to foreign investors, the most important are: cheap labor and other natural resources, market size and openness of the market, rapidly growing economy, macro-economic environment and its stability, as well as some additional economic factors.

Although plentiful cheap labor enabling Western firms to reduce production costs and achieve economic of scale, it is not by itself a factor to expand foreign investment. Otherwise, the majority of total FDI in the world would inflow to less-developed countries where labor is much cheaper. Lower wages or cheaper other natural resources are easy to copy by other less-developed countries, and do not bring sustainable competitive advantage to the host country. Singularity that makes labor strategically important is whether this labor is well educated and trained in industrial skills.

On the other hand, market-seeking investors are attracted by market size as a predominant factor. The larger the size of domestic market, measured by gross domestic product (GDP) per capita, the more attractive it would be for foreign investors hence the greater market potential to sell their products/services in such a big market. Furthermore, as Stoian and Filippaios argue [12, p.356] that larger host market means that economics of scale is more likely to be achieved by potential investors in local production. However, besides market size that will increase the probability of investing in a host country, other important determinant is openness of the economy, influencing competitiveness position of the country in terms of international trade and exposure.

Competitiveness of the country refers to the country’s ability to achieve sustained high rate of growth per capita real income, measured by GDP per capita in constant prices, and it is given by the overall competitiveness index (CI).

Among other key economic location variables, the rate of the economy growth is especially stressed in the literature [13, p.507]. A sustainable moderate-to-high rate of growth makes the host country particularly attractive for foreign investment because it reflects through GDP growth and accordingly higher market potential. Macroeconomic stability, which is reflected through a relatively stable exchange rate, low rates of inflation, etc., attracts foreign investors and improves

competitive position of a host country. The additional factor that stands as a critical location factor is infrastructure of the host country.

But we also have to stress the importance of political, especially institutional environment investigation as important variable in decision-making process of MNCs' investment abroad. Generally, high level of macro-political and micro-political risks deters foreign investment. Macro-political risk refers to the general political stability in the country, which is important because FDI tends to be more long-term commitment of capital investment through international production compared to portfolio investment, for example. The micro-political risk is expressed in restrictions to free flow of the capital, treatment of foreign investment by law, as well as FDI policy regime.

Under the contemporary conditions of global economy institutional determinants become more and more important in attracting foreign investment. That expanding of location determinants comes from institutional theory. The institutional environment can attract or deter foreign investment inflows as well as force MNCs towards modes of entry, which are basically non-equity structures or, on the other hand, which represents wholly-owned ownership structure. Among those institutional determinants the most important are: rule of law, regulation on private property rights and property of intellectual capital, quality of bureaucracy, expropriation risk, level of corruption, and also ethnic tension in a host country. In transition countries during the first stage of transition to market economy the resolution of basic institutional rules, such as property rights and the rule of law increase environment uncertainty for foreign investors. Corruption, in terms of illegal payments that can appear in the form of bribes, for example, and connected with licenses permits, tax assessment, etc., negatively affects the decision to invest in a country. Higher level of corruption implies higher transaction costs when entering a new economy and reduces probability of investment [12, p.361]. Also, in the initial phase of transition, economic reforms have a large impact on FDI inflows, and important determinants are liberalization and stabilization of economy.

In decision-making process regarding FDI, lower ratings are also given to countries where expropriation of private foreign investment is more likely to happen. Finally, ethnic tension is a determinant that refers to degree of tension within a country connected with racial or nationality conflicts among people. Lower ratings are given to countries where these tensions and conflicts are high, because of possible problems that can result from them.

In the second phase of transition, some factors of so-called "location marketing" can be effective in attracting FDI inflows. This makes an emphasis on different incentive schemes including corporate taxation and tax holidays, other financial incentives, strategic incentives negotiated with individual investors, and development of Special Economic Zones and industrial parks, within which the incentives are offered to foreign investors. Although there are no strong evidence about direct relation between these incentives that less-developed countries offer

to foreign investors and real FDI growth, many transition and developing countries rely on such a policy of FDI regime. Regardless of different opinions in economics literature about the real incentives impact on FDI and growth, foreign investors actually expect such incentives under the contemporary conditions of business. That indicates the example of the Czech Republic where only 10% of new Greenfield investors enter the market in 2001 without receiving such incentives [4, p.889].

The third phase by Jensen opinion starts with the EU enlargement, when the most of new member countries expect that EU accession will have a positive impact on further FDI inflows. But some of the incentives implemented during the first two phases are not to be allowed after EU accession, so the new member country must be prepared to involve in severe competition for new foreign investment along much developed countries of the EU.

3 Location factors: the case of Serbia

Over the past few years of extensive political and economic reforms, Serbia has developed into a stable democratic country with a fast growing market economy. The ongoing significant legislative reforms contributed to bringing the legal framework in line with the EU legislation. International companies in Serbia are guaranteed equal legal treatment as local ones. They are allowed to invest in any industry (except in the field of production and trade in armaments, or in certain other areas defined as restricted by law), and freely transfer all financial and assets, including profits and dividends.

Investment may be made by founding a new company, or by expanding the capital of an existing domestic company. The acquisition of shares in the initial capital of a company, or any other property right through which a business interest in Serbia is realized, is considered foreign investment, as well.

The authors' attempt is to present a relevant location factors in Serbia in relation to market entry strategy and mode of entry. For the foreign companies that implement resource/asset-seeking strategies the relevant factors in decision-making process to invest in Serbia are: geographic location, infrastructure, land and construction, abundant labor and intellectual capital, natural resources, non-polluted nature.

As for the strategic geographic location concerned, Serbia is located in South East Europe in the central part of the Balkan Peninsula. Bordering Hungary in the north, Romania in the northeast, Bulgaria in the east, Serbia is in the neighborhood of the European Union. Because Serbia geographic position is at the intersection of Pan European Corridors No. 10, and No. 7, Serbia links Western Europe with South Europe and the Middle East via these strategic transportation

corridors. Therefore, Western companies can effectively serve their European and Middle Eastern customers from Serbia. In this way they can fully benefit from having production outside of the European Union, while enjoying the possibility of easily accessing the EU market, and provide services and transport goods in projected and also flexible timetable. That makes Serbia a perfect place for MNCs to locate their operations in terms of logistics. Also, because of its position Serbia offers a great transport potential and has an extraordinary potential to become the logistic hub of the Southeastern Europe.

As the labor as a resource is concerned, Serbia can offer abundant and relatively cheap workforce. On the supply side of the labor market the number of unemployed people has reached 916,257 out of which 3.6% have university degree. When we take into consideration that 33,546 unemployed people have two-year college graduate diploma, the share of unemployment graduates reaches 7.3% of total unemployment. The official unemployment rate amounted to 20.9% in 2006 and 18,1 in 2007 [24]. The age structure of unemployed people shows that almost 32% of them are under 30 years of age, while approximately 57% are aged 40 or less.

Serbian labor is regarded as high-quality, skill-set, but yet low-cost workforce, and therefore it is a strong business performance driver. The quality of Serbian intellectual capital originates from educational system, which is generating well-educated, skilled, fast-learning, multilingual people, who are technically and IT literate. On behalf of that there is the fact that more than 40% of population have knowledge of English language (almost double the percent than in Poland and the Czech Republic, and almost three times more than in Bulgaria and Hungary), and that almost 1/3 of all students graduate from technical universities. Also, unlike most transition countries in CEE and SEE, Serbia has been experiencing extensive business relationships with Western economies and companies for decades. Throughout years of business cooperation Serbian workers have received specific manufacturing and management knowledge and know-how, knowledge of new technologies, industrial skills, and standards. Therefore, local workforce needs minimum training and education to adopt advanced technologies and processes. The skill level of local workforce is reflected in increasing of industrial productivity over the past five years at the rate of 11.4% [18]. As a part of the employment support strategy and in order to attract investors, the National Employment Service provides attractive incentives for potential employers. The financial incentives range from subsidies for new employment in underdeveloped regions and for certain population categories to sharing retraining costs.

In addition to abundant, well-educated and yet cheap labor, Serbia also has to offer other resources as its location advantage. There are, at the first place, unpolluted nature (land, water, forests), ore, mineral water and natural beauties as a base for tourism development, infrastructure facilitation, etc.

Because of unresolved question about acquiring Construction Land, and to simplify the construction procedure, Urban and Building Permits have been replaced with a Construction Approval. The issues of state ownership on Construction Land, but also of restitution of private ownership of land, which was expropriated after World War II by the state, need to be solved because these unresolved questions deter foreign direct investments in Serbia.

As for the intellectual property (assets) protection is concerned, foreign companies enjoy equal rights as domestic ones with regard to registration and protection of their trade marks, industrial design, patents, and other forms of industrial property.

For the foreign companies that implement market-seeking strategies relevant determinants in decision-making process to invest in Serbia are: big potential market, the rise of living standard, growth of GDP and GDP per capita, liberalization and increasing of foreign trade, membership in international organizations, Bilateral Treaty Agreements (Free Trade Agreements), customs agreements with many countries, etc.

With the population of 7.5 million people, Serbian market itself is among the largest in the Central- and South-East Europe. In addition to that a number of Free Trade Agreements [19] contributed to booming market potential. Namely, Serbia is the only country outside of the Commonwealth of Independent States that enjoys a Free Trade Agreement with Russia, which makes Serbia particularly attractive to foreign investors. That agreement means that goods produced in Serbia with prevailing value added in Serbia are considered of Serbian origin, thus free of customs when entering Russian market of close to 150 million people.

Also, Serbia is a member of the Central European Free Trade Agreement (CEFTA), which encircles free trade area where companies have possibility to place their goods customs free to 25-30 million people. Also, the Agreement stipulates accumulation of products origin, meaning that products exported from Serbia are considered of Serbian origin if integrated materials are originating from any other CEFTA country, European Community, Iceland, Norway, Switzerland (including Liechtenstein) or Turkey, provided that such products have undergone sufficient processing in Serbia.

Added to this are duty-free exports to the European Union and the United States for most product and services. Within European Union's Stabilization and Accession Process Serbia has been awarded exceptional trade measures, enabling export of all product originating from Serbia without customs and other fees, with exception of wine and baby beef. This agreement abolished customs duties and quantitative limitations for import of Serbian textile products and guarantees that in the future. Using this strategy the Serbian export of mentioned products will become entirely free. Also, the trade with US is pursued under Generalized System of Preferences (GSP). The GSP program currently provides preferential duty-free entry for more than 4,650 products, including most manufactured and intermediate

goods and selected agricultural and primary industrial products (except most textile products, leather goods and footwear).

In summary MNCs, which doing business in Serbia, have the opportunity to export their goods and services to almost one billion people market without paying any customs duties.

Serbia is not only a full member of many international organizations (IMF, WB, EBRD, EIB, the Council of Europe, the Partnership for Peace), and in negotiations for full membership in the World Trade Organization, but also has signed number of Bilateral Investment Treaties (with 34 other countries, including the USA, UK, Germany, France, Austria, Italy, and Greece) in order to further safeguard foreign capital.

Increasing market potential is evident due to the macroeconomic indicators of GDP growth rate, GDP per capita, average net monthly salary, inflation rate, foreign currency reserves, and foreign trade. Serbia has one of the fastest growing economies in Europe for the past few years, with the GDP growth rate of 5.8% in 2006, and estimated rate of 7.5% (by the Statistical Office of Serbia) for the year 2007 [20]. GDP per capita has reached 4,207 US\$ in 2006 and 5,641 in 2007 while the average net monthly salary amounted to 258 euro in 2006 [20]. By the same source, the sectors with major growth are telecommunications, construction, and transport, while industrial production lagging with an increase of 4.4%. Also, gain in retail trade amounting to 6.5% shows a rising purchasing power of Serbian people. An increase of real net average salaries in 2006 was by 11.4% against the previous year, and along with household credit expansion contributed to rise of purchasing power of local population. The stabilization of local economy is also viable through decline of inflation rate, which was 6.6% at the end of 2006, and 10.1% at the end of 2007, and obviously has a tendency to return to single digits.

The key macroeconomic indicators that determine market potential for foreign direct investment are shown in Table 1 [20].

Table 1 Key macroeconomic indicators as drivers for FDI

| Key macroeconomic indicators | 2002 | 2003 | 2004 | 2005 | 2006 |
|-------------------------------------|-------------|-------------|-------------|-------------|-------------|
| GDP, USD mln | 15,841 | 20,345 | 24,517 | 26,231 | 31,630 |
| GDP per capita, USD | 2,112 | 2,720 | 3,285 | 3,525 | 4,199 |
| GDP real growth rate | 4.2% | 2.5% | 8.4% | 6.2% | 5.8% |
| Inflation rate, year average | 19.5% | 11.7% | 10.1% | 16.5% | 12.7% |
| Employment, year average, 000 | 2,067 | 2,040 | 2,051 | 2,069 | 2,029 |
| Unemployed, end of year, 000 | 904.4 | 944.9 | 969.9 | 990.7 | 1,011.1 |
| Registered unemployment | 24.5% | 26.1% | 23.9% | 24.9% | 25.9% |

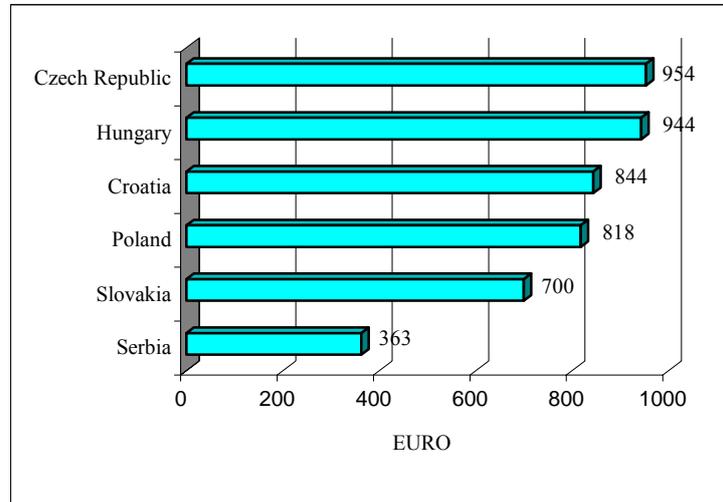
| rate | | | | | |
|----------------------------------------|--------|--------|--------|--------|--------|
| Unemployment rate (ILO) | 13.3% | 13.6% | 10.1% | 6.4% | 11.4% |
| Foreign Currency Reserves, USD mln | 3,063 | 4,436 | 5,147 | 6,541 | 12,637 |
| Export of goods and services, USD mln | 2,961 | 3,958 | 5,181 | 6,264 | 8,593 |
| Import of goods and services, USD mln | 6,059 | 8,054 | 11,637 | 11,810 | 14,885 |
| Balance of goods and services, USD mln | -3,098 | -4,096 | -6,456 | -5,456 | -6,292 |

Source: Data from Statistical Office of Republic of Serbia, National Bank of Serbia, Ministry of Finance contributed by SIEPA (adapted by the authors)

For the foreign companies that implement efficiency-seeking strategies among the most important factors in decision-making process to invest in Serbia are: low operating costs (especially labor costs), low other costs of performing operations, low taxes and social contributions, which all give rise to operations efficiency, as well as local regulations which determine easy start-up for foreign companies. Also, some measures within FDI policy regime, such as tax and financial incentives made by local government (in the scope of so-called “marketing of location”) can contribute to attraction of foreign investment and choice of mode of entry of foreign enterprise.

Average salaries in Serbia are lower in comparison to some other countries in the region, thus ensuring cost-effective production for foreign enterprises operating here. Even though they are slightly higher than in neighboring countries, such as Romania and Bulgaria, total costs for employers do not exceed the level of 40% of the level in EU countries from Eastern Europe. Competitiveness of Serbia’s labor costs compared to select Eastern European countries can be established from the data in Figure 1 [21].

Figure 1 Total monthly labor costs in 2005 (EUR)



Source: EUROSTAT, Statistical Office of Republic of Serbia (contributed by SIEPA)

Labor costs are particularly low in some processing industries where average salaries are below 300 euro. Production of furniture, apparel, footwear, textile, leather products, as well as some service industries, such as hotels and restaurants, fall within this category, while few industries, such as tobacco and oil processing, and financial services have significantly higher salaries. Also, salary tax and social insurance contributions are already among the lowest among CEE and SEE countries, and with only modest real salary growth in the coming years forecasted at around 5%, cost competitiveness of Serbia's labor force is going to enhance. In addition, low utility costs, possibility of accelerated depreciation of fixed assets at rates of up to 25% above the prescribes ones for fixed assets that are used for ecological purposes, energy savings, scientific research and education (computer hardware) are important factor in reaching high profit margins for foreign companies operating in Serbia. Besides, productivity in Serbia has steadily risen in recent years, and in 2006 the growth of industrial productivity compares to preliminary year was 13.5%. Industries with the largest FDI inflow, such as tobacco, food and beverages, and chemicals were among the leaders in productivity improvement.

Low taxes and social contributions bear share in substantial cost-competitiveness of Serbian industry also. Besides low salary tax and social insurance contributions mentioned above, other taxes such as Corporate Profit Tax, Value Added Tax (VAT), Property Tax, Personal Income Tax are among lowest in Europe, even compared to CEE and SEE countries. Comparison of those tax rates and social security contribution in Serbia and selected CEE countries is presented in Table 2 (table made by the authors from the data presented by SIEPA) [22].

Table 2 Taxes and Social Security Contributions rates – Serbia to selected CEE countries

| Country | Corporate Profit Tax Rate | Standard VAT Rate | Salary Tax Rate | Social Security Contributions Rate | | |
|----------------|---------------------------|-------------------|-----------------|------------------------------------|---------------|---------------|
| | | | | Employee | Employer | Total |
| Serbia | 10% | 18% | 12% | 17.9 | 17.9 | 35.8 |
| Poland | 19% | 22% | na | 18.71 | 17.23 - 20.12 | 35.94 - 38.83 |
| Bulgaria | 10% | 20% | 12% - 24% | 12.43 | 23.98 - 24.68 | 36.41 - 37.11 |
| Croatia | 20% | 22% | 15%-45% | 20.0 | 17.2 | 37.2 |
| Slovenia | na | na | na | 22.1 | 16.1 | 38.2 |
| Hungary | 16% | 20% | na | 13.5 | 33.5 | 47.0 |
| Czech Republic | 24% | 19% | na | 12.5 | 35.0 | 47.5 |
| Slovakia | 19% | 19% | 19% | 13.4 | 34.4 | 47.8 |
| Romania | 16% | 19% | 16% | na | na | na |

Source: PricewaterhouseCoopers (data presented by SIEPA)

As a measure within FDI policy regime, Serbian government announced substantial financial and tax incentives and holidays for foreign investors [22]. Among financial incentives further state grants for Greenfield projects are available for investors: in production – from 2,000 up to 5,000 euro of state grants per new job created; in services – from 2,000 up to 10,000 euro; and in R&D – from 5,000 up to 10,000 euro of state grants per new job created.

Among tax incentives the most attractive are:

- A ten-years corporate profit tax holiday for investment over 7.5 million of euro and 100 new employees;
- Corporate profit tax credits up to 80% of the fixed assets investment;
- Carrying forward of losses over a period up to 10 years;
- A five-year corporate profit tax holiday for concessions;
- Salary tax exemptions for employees under 30 and over 45 years;
- Annual income tax deductions up to 50% of the taxable income;
- Customs-free imports of equipment based on foreign investment.

Regarding tax credits, the amount of tax due can be reduced by 20% of the amount invested in fixed assets for the respective tax period. This reduction cannot exceed 50% of the total tax liability. A number of sectors (agriculture, fishing, production of textile yarn and fabrics, garments, leather, base metals, standard metal products, machines, office machines, electrical machines, radio, TV and

communication equipment, medical instruments, motor vehicles, recycling and video production) are entitled to receive a tax credit in the amount of 80% of investment made in fixed assets. For small companies, a tax credit is also granted for fixed assets in the amount of 40% of the investment made in the current year. The credit may not exceed 70% of the tax due. Also, the taxpayer generating profit in a newly established unit in an underdeveloped region will receive a tax credit for a period of 2 years in an amount proportionate to the profit of that unit in the total profit of the company [22].

In order to make easier start-up business for investors, Serbian government took a measure to faster registration and starting of operations. The registration procedure takes a maximum of 18 days, and in the near future will be on-line. According to the World Bank's Doing Business Report for 2009 [25], Serbia scores upcoming indicators in comparison with countries in the region (in average) for issuing licenses, getting credit, paying taxes, trading across borders and closing a business. Also, Difficulty of Hiring and Firing Index, for example, are 67.0 and 30.0, while in region are 36.4 and 32.4, respectively. Rigidity of employment index is almost the same as in the region: 39 in Serbia and 38.9 in region, but the firing costs are lower.

Since the economic reforms are introduced in 2001, Serbia has grown into one of the most attractive emerging investment locations in CEE and SEE. To the middle of 2008, FDI inflow in the country has exceeded 16.5 billions of US\$, while in the past three years alone, Serbia attracted over US\$ 12 billion of inward foreign direct investment. Based on the data from Economic Review of the National Bank of Serbia [23] net FDI inflows in Serbia from 2000 to 2008 were: 2000 – 50,252 US\$ millions, 2001 – 165,338 US\$ millions, 2002 – 475,454 US\$ millions, 2003 – 1,360 US\$ billion, 2004 – 965,690 US\$ millions, 2005 – 1,515 US\$ billion, 2006 – 4,264 US\$ billions, 2007 – 2,295 US\$ billions, and 2008 (January-July) – 2,321 US\$ billions. The list of leading foreign investors topped by world-class companies and banks mostly coming from financial sector (3,850 US\$ billions), telecommunications and transport (2,284 US\$ billions), while manufacturing sectors ranking 3rd with 2,111 US\$ billions mostly in tobacco industry, metal processing industry, food and beverages industry, automotive industry, wood and furniture industry, footwear and textile industry, and pharmaceutical industry. The industries which also exceeded one billion US\$ net FDI are wholesale, retail, repairs with 1,455 billion of US\$, and real estate and renting with 1,255 billion of US\$. These were the most attractive industries for foreign investment in other transition countries also, because profit potential of these businesses exceeded the one of other industries. But indirect effects of the FDI in these sectors are expected from diversification of investments such as the case of automotive industry where significant investments in automotive components industries, i.e. the business of automotive supplier, are to be expected (related to client-following strategy of market entry).

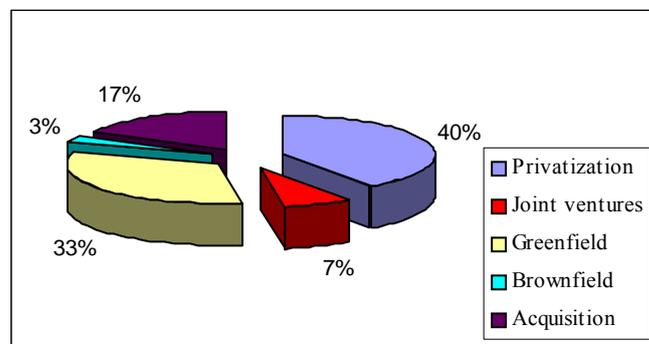
The data about leading companies-investors in Serbia as well as investment type (mode of entry), and investment amount are given in Table 3 (based on presentation of Serbia Chamber of Commerce) [17] and in Figure 2.

Table 3 Leading companies investors in Serbia and their mode of entry

| Company | Country | Industry | Investment type | Investment amount (EUR mln) |
|-------------------------------|----------------|--------------------|-----------------|-----------------------------|
| Telenor | Norway | Telecommunications | Privatization | 1,602 |
| Fiat | Italy | Auto Industry | Joint Venture | 700 |
| Philip Morris-DIN | USA | Tobacco | Privatization | 611 |
| Mobilkom | Austria | Telecommunications | Greenfield | 570 |
| Banca Intesa | Italy | Banking | Acquisition | 508 |
| Plaza Centres | Israel | Real Estate | Greenfield | 500 |
| Stada | Germany | Pharmaceutical | Acquisition | 475 |
| Embassy group | India | Real Estate | Greenfield | 428 |
| Interbrew | Belgium | Food/Drinks | Acquisition | 427 |
| NBG – National Bank of Greece | Greece | Banking | Privatization | 425 |
| Biotech Energy | USA/Hungary | Oil industry | Greenfield | 380 |
| U.S Steel | USA | Metal industry | Brownfield | 250 |
| Mercator | Slovenia | Retail | Greenfield | 240 |
| Fondiarria SAI | Italy | Insurance | Privatization | 220 |
| Lukoil | Russia | Oil industry | Privatization | 210 |
| Airport City | Israel | Real Estate | Greenfield | 200 |
| Block 67 Associates | Austria/Serbia | Real Estate | Greenfield | 180 |
| Holcim | Switzerland | Construction | Privatization | 170 |
| OTP Bank | Hungary | Banking | Privatization | 166 |
| Engel group | Israel | Real Estate | Greenfield | 160 |
| Alpha Bank | Greece | Banking | Privatization | 152 |
| Metro Cash & Carry | Germany | Wholesale | Greenfield | 150 |
| OMV | Austria | Gas stations | Greenfield | 150 |
| Coca Cola | USA | Soft drinks | Acquisition | 142 |
| Lafarge | France | Construction | Privatization | 126 |
| San Paolo IMI | Italy | Banking | Acquisition | 122 |
| CIMOS | Slovenia | Auto industry | Privatization | 100 |
| JTI | Japan | Tobacco industry | Privatization | 100 |
| Droga Kolinska | Slovenia | Food/Drinks | Greenfield | 100 |
| Carlsberg | Denmark | Food/Drinks | Greenfield | 100 |

Source: SIEPA

Figure 2 Share of different foreign investment's mode of entry in Serbia



Source: our owned calculation based on data from table above

Until recently, the greatest inflow of FDI in Serbia has originated from privatization of socially-owned and state enterprises. Foreign investors mostly took part in the privatization of domestic firms in the mode of tender, and less in the mode of auction. Until the end of 2005 extremely low FDI inflow in Serbia came through Greenfield investment, and by that year they never exceeded the amount of 150 millions of US\$ annually [see more in 11]. Situation has changed during past three years, and greater inflow of FDI by Greenfield investment are now-days present in Serbia. Estimates by the National Bank of Serbia in relation to Greenfield investment in 2006 showed that they reached one billion US\$ and increasing. As a result, the Organization for Economic Co-operation and Development (OECD) awarded Greenfield projects in Serbia as the largest Greenfield investment in South East Europe for the year 2006. However, the inflow of Greenfield investment is still very low considering development needs of Serbia, and tendencies of decreasing inflow of investment duty execution from privatization process, after initial privatization of most attractive socially-owned and state enterprises has finished. After termination of privatization of remaining state-owned enterprises new investments will depend exclusively on FDI, especially in the mode of Greenfield and joint venture mode of investment. It is not surprising that during the first phase of transition, as in the other CEE countries, the role of privatization exceeded other type of investment, because this was a period of stabilization and establishment of market economy institutions as well as liberalization of trade and restitution of rule of law. The insignificant inflow of foreign investment through Greenfield mode of entry is obvious, when we take into consideration pretty unfavorable environment for investment especially before 2006 in terms of inflation rate, unemployment rate, negative balance of good and services exchange, negative current account balance, etc. Greenfield investment needs stable environment, intellectual property protection (technology, know-how, patents), and rule of law. Serbian government still has to do serious work on the improvement of all economy performances and creation of favorable and stable environment in order to attract more Greenfield investment.

4 Conclusion

Some of the clearly recognized weaknesses of Serbia, which impose bad image of Serbia and diminish attractiveness of local environment for foreign investments are [8]: telecommunication infrastructure, transport and logistics infrastructure, quality of life, transparency and political stability, social climate, availability and quality of research and development. This is also proven by the data from World Economic Forum, according to which Serbia ranks 85 among 134 countries by Global Competitiveness Index [26] for 2008-2009. For Basic requirements rank is 88, and in detail: Institutions – 108; Infrastructure – 102; Macroeconomic stability – 86; Health and primary education – 46. When Efficiency enhancers are concern the rank is 78, and in detail: Higher education and training – 70; Goods market efficiency – 115; Labor market efficiency – 66; Financial market sophistication – 89; Technological readiness – 61; Market size – 65. When Innovation and sophistication factors are concern the ranks are for Business sophistication 100, and for Innovation - 70. According to WEF the most problematic factors for doing business in Serbia are: Policy instability (17.0% of responses); Corruption (12.2%); Inefficient government bureaucracy (10.5%); Inadequate supply of infrastructure (7.0%); Crime and theft (6.9%); Access to financing (6.6%); Tax regulations (6.3%); Inflation (6.3%); Tax rates (6.1%); Poor work ethics in national labor force (5.9%); Inadequately educated workforce (5.4%); Government instability/coups (5.2% of all responses).

On the other hand, there are clear advantages of Serbia as investment destination such as lower labor costs, especially for qualified and trained workers, skilled, educated workers with knowledge of English language, industrial tradition, geo-strategic position in South East Europe, a number of free trade agreements, natural resources for production in agriculture, process industry and tourism, better investment climate, numerous tax and financial incentives for foreign investors, etc., which we tried to emphasize in this paper.

It is surprising that government has not take initiative to attract more investments in the mode of joint ventures, when we take into consideration that other emerging economies (example of China is most effective) initially took advantage of this form of investment. There is only one big investment in the form of joint venture (the case of joint venture between Fiat-Italy and Zastava) in the automobile industry, as well as few minor. There is an announcement that Serbian enterprise Srbijagas will form joint venture with Russia's Gazprom in order to build Serbia's 400 km segment of pipeline, which is going to be one of biggest joint venture investment besides the Fiat's. Government can (and has to) stimulate this mode of MNCs entry through financial or tax incentives, especially because it

is a mode where substantial spillover effects (in the form of technology, know-how, management and marketing skills spillovers) are to be expected.

One of the paper's limitations is lack of empirical results based on research on sample of foreign firms operating in Serbia about actual motives of those foreign firms entry to Serbian market. In the future research authors should explain if there are influence/correlation between location-specific factors and choice of pursuant strategy and mode of foreign firms entry mode to Serbian market.

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