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List of Abbreviations

AIK - Agency for Investments and Competitiveness

BiH - Bosnia and Herzegovina

CBBIH - Central Bank of Bosnia and Herzegovina

CEFTA - Central European Free Trade Agreement

EU - European Union

FDI - Foreign Direct Investments

FIPA - Foreign Investment Promotion Agency of Bosnia and Herzegovina

GDP - Gross Domestic Product

HAMAG INVEST - Croatian Agency for SMEs and Investment

HNB - Croatian National Bank

HRK - Croatian Kuna

IFRS - International Financial Reporting Standards

K - Thousand

KM - Convertible Mark

M&A - Merger & Acquisition

M - Million

MNEs - Multinational Enterprises

OECD - Organization for Economic Co-operation and Development

R&D - Research & Development

SFR - Socialist Federative Republic

SIEPA - Agency for Foreign Investments and Export Promotion of the Republic of Serbia

SMEs - Small and Medium Enterprises

UNCTAD - United Nations Conference on Trade and Development

WTO - World Trade Organization

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1. Introduction

International business, globalization of markets and economic development are today very strongly connected with one another. More precisely, international business activity occurs simultaneously with the all-embracing phenomenon of globalization of markets, which refers to the continuous economic integration and increasing interdependency of countries worldwide. Just a couple of decades ago this was not the case and everything was done in a more complex way.

Globalization itself simplifies and assists the firm's attempts to expand abroad and at the same time it is rather obvious that internationalization has become easier. One of the most important proofs of the globalization phenomena could be demonstrated through the financial crisis that began in the United States in 2008. The global economy is integrated and all of the problems spread like a disease from one country to another causing a severe recession of global scale proportions.

International trade and international investment are considered to be the most important tools of international business. As a definition, international trade is "the exchange of products and services across borders, characteristically done through importing or exporting, whereas international investment stands for the transfer of capital / assets from an investor country to a foreign country or the acquisition of assets in that country."

The assets mentioned in the definition of international investment comprise technology, infrastructure, capital etc. and there are two fundamental types of investments. The first type is international portfolio investment, which can be defined as" passive ownership of foreign securities with the purpose of creating financial gains" and the second type - Foreign Direct Investment (from now on FDI), which involves an "internationalization strategy where the home firm creates a physical presence through the acquisition of production factors such as capital, technology, labor, land, plant and equipment in the host country."[1]

Of the above two classifications of investment we concentrate primarily on FDI in this thesis, and more precisely Greenfield FDI and the importance of the Greenfield investments for transition countries in South-East Europe.

[1] Cavusgil et al. 2012, p. 40-43

2. FDI Theory

The dispersion of capital and ownership across borders is one of the most remarkable aspects of globalization. Here are some definitions of FDI:

"FDI can be defined as an internationalizations strategy in which the firm establishes physical presence through acquisition of productive assets such as capital, technology, labor, land, plant and equipment[2], or as the process whereby residents of one country (the source country) acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country (the host country)."[3]

"According to Madura and Fox, FDI is an investment in real assets (such as land, buildings, or even existing plants) in foreign countries and engagement in joint ventures with foreign firms or acquiring of foreign firms."[4]

Consistent with the Balance of Payments Textbook FDI is considered to be an international investment in which the direct investor acquires a long lasting interest in an enterprise in a foreign country. Further characteristics of direct investment are the long-term relationship between the investor and the home country, as well as certain level of control and influence by the direct investor. FDI incorporate the initial transaction between above mentioned parties, which are usually followed by further investment, transactions and relations with new affiliated enterprises in the home country.[5]

"A similar definition given by the Organization for Economic Co-operation and Development specifies a constitution of controlling interest and states that FDI are a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor."[6]

The expression "long lasting relationship" could also be used to differentiate FDI from portfolio investment, which is delineated by its short term nature and involvement of high turnover of securities. One other accepted feature lies in terms like "control" and "controlling interest". Through these terms the difference between FDI and portfolio investment is

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[2] Cavusgil et al. 2012, p. 434
[3] Moosa, 2002, p.1
[4] Madura / Fox. 2011, p.442
[5] Balance of Payments Textbook,1996, p. 107, http://www.imf.org/external/np/sta/bop/boptex.pdf, 04.05.13
[6] Glossary of Foreign Direct Investment Terms and Definitions, p. 7, http://www.oecd.org/daf/inv/investment-policy/2487495.pdf, 05.05.13

identified, since portfolio investors do not look for control or a lasting interest. Consequently the distinctive characteristic of FDI, compared with other forms of international investment, is the element of control over management policy and decisions.[7]

2.1 Classification of FDI

There are three possibilities to classify FDI. They can be differentiated on one hand from the perspective of the investor country and on the other hand from the perspective of the host country. A third classification involves considering the preferences of the investor country.

2.1.1 Investor country perspective

From the perspective of the investor country there is a differentiation between:

- Horizontal FDI
- Vertical FDI
- Conglomerate FDI

Horizontal FDI: this type of FDI is important if the company has intentions to utilize some monopolistic or oligopolistic advantages, such as patents or differentiated products, especially if expansion in the home country would be interfering with anti-trust laws.[8] Horizontal FDI is used for production of the same or similar products within the corporate organization at several domestic and foreign locations. According to Pfaffermayer horizontal FDI could also be used as a strategy to minimize exchange rate risk. Risks averse companies will shift their production partially to the host country and in this way reduce the exchange rate risk.[9]

Vertical FDI: is divided into backward vertical FDI and forward vertical FDI. This FDI is used "for the purpose of exploiting raw materials (backward FDI) or to be close to the consumers through the acquisition of distribution outlets (forward FDI)."[10] Forward vertical FDI in downstream production stages avoids transaction-specific investments for the erection

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[7] Moosa, 2002, p.1
[8] Moosa, 2002, p.4
[9] Pfaffermayr, 1996, p.15-16
[10] Moosa, 2002, p.4

of distribution facilities and service facilities abroad and related bilateral monopolies (small number condition) and allows the use of "economies of scale and scope".[11]

Conglomerate FDI: is used if FDI abroad has a purpose to manufacture goods and products which are not manufactured in the home country.[12] Consistent with Moosa, conglomerate FDI involves horizontal as well as vertical FDI.

2.1.2 Host country perspective

From the perspective of the host country there is a differentiation between:

- Import-substituting FDI
- Export-increasing FDI
- Government-initiated FDI

Import-substituting FDI: In this case goods are previously imported by the host country and production follows afterwards. As a consequence imports in the host country as well as exports in the investor country will decline. Three aspects determine this type of FDI and these are: the size of the market in host country, transportation cost and trade barriers.

Export-increasing FDI: investors undertake this type of FDI to seek new sources of input which are raw materials and intermediate goods. This particular type of FDI increases exports in such a way that the host country increases its exports of raw materials and intermediate products in the first instance to the investing country and also to other countries where the investing countries have their subsidiaries, which increases exports overall for the host country.

Government-initiated FDI: are in most cases imposed by governments themselves when there is a balance of payments deficit. Governments offer incentives to foreign investors and in this way hope to achieve their goal, which is a minimization of the deficit.[13]

2.1.3 Preferences of investor countries

With respect to the preferences of the investor countries there is a diversification into an expansionary type and a defensive type of FDI. In the case of expansionary FDI the investors want to exploit firm-specific advantages in the host country while defensive FDI

[11] Pfaffermayr, 1996, p.17
[12] Shenkar, 2007, p.61, http://www.sagepub.com/upm-data/18594_Chapter_3.pdf, 06.05.13
[13] Moosa, 2002, p.5

looks for a cheap workforce in the host country in order to reduce the costs of production. Expansionary FDI is considered to be an internationalization strategy because investor companies use foreign markets to expand sales and secure resources in order to maintain their growth. Defensive FDI help companies which undertake them to control their costs in the home country market (competitive advantage in the home market).[14]

2.2 Current explanatory theories on FDI

2.2.1 Product life-cycle theory

This specific theory was developed by Raymond Vernon and it helps explain why investor countries prefer FDI to exporting. According to Vernon, the investor gains a monopolistic advantage from product innovation in its own country. At first, production is concentrated in the home country, but when the product becomes standardized in its growth stage, there is an incentive to relocate to a country where it is possible to exploit lower production costs. Usually the investment will take place in a country that can support economies of scale in local production (this implies that a host country is still at growth stage). In the mature product stage the competition among producers and imitating foreign firms is at its peak. As a result the investor country could shift the production from the previous country to a new lower-cost country and instead of the old product at the end of its life-cycle (decline stage) the investor may initiate the production of the new standardized product from its own market in its subsidiary. Product life-cycle theory is more relevant for the countries which engage for the first time into foreign markets, than to companies (MNEs-Multinational Enterprises) that already conducted FDI.[15]

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[14] Chen, Ku, 2000, p.154
[15] Shenkar, 2007, p.68, http://www.sagepub.com/upm-data/18594_Chapter_3.pdf, 07.05.13

2.2.2 Monopolistic advantage theory

A monopolistic advantage is present if a company possesses resources or capabilities that only a small number of other firms or no firms at all can demonstrate and through this advantage it generates profits and other returns. The theory states that firms which use FDI as an internationalization strategy possess certain resources and capabilities not easily available to opponents. As a result these firms gain certain degree of monopoly power over local firms in foreign markets. Usually this kind of monopolistic advantage should be specific to the investing firm (for this reason they are also called firm-specific or ownership-specific advantages).[16]

According to Shenkar the aforementioned advantages come from two sources. The first is superior knowledge and involves production technologies, managerial skills, industrial organization and knowledge of the product. The second determinant is the possibility to achieve economies of scale, which can occur through horizontal FDI (i.e. an increase in production leads to a reduction of unit costs of services such as financing, marketing and technological research), or vertical FDI (i.e. company benefits from lower local production costs and through this advantage achieves economies of scale in the production of single components).[17]

This theory also argues that at least two conditions should be considered for a company to target a foreign market rather than its home market. Firstly, the company should be able to gain returns that are higher than those in its home market (this is at the same moment the initial motivation to undertake the foreign investment, because the company can take advantage of its monopoly power). Secondly, a company should also obtain higher returns compared to its competitors in the foreign market. This is one further incentive to invest, because the investor can use the monopoly profits which, at the beginning, cannot be imitated (earned) by the foreign firms.[18]

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[16] Cavusgil et al. 2012, p. 195
[17] Shenkar, 2007, p.69, http://www.sagepub.com/upm-data/18594_Chapter_3.pdf, 07.05.13
[18] Cavusgil et al. 2012, p. 196

2.2.3 Internalization theory

Internalizations theory is considered relevant when the market the company operates in (usually internal and external market) is for some reason not able to accommodate an effective environment in which it is possible to use and benefit from own technology and production resources. For this reason the company creates an international market through investments in foreign countries with the goal to fulfill its short and long-term objectives.[19]

Cavusgil reflects on the internalization theory as the process used by companies to acquire or retain parts of the value-chain activities inside the company. If the investor company successfully obtains specific parts of the value-chain operations it can severely minimize disadvantages in doing business with partners in host country. This action allows greater control over foreign business. One more important reason why companies acquire certain value-chain functions in foreign markets is to optimally control proprietary knowledge important for the development, production and sale of company's products.[20]

"According to Shenkar the internalization advantages include:

- avoiding search and negotiating costs
- avoiding costs of moral hazard (moral hazard refers to unknown harmful action by suppliers, buyers, and joint venture partners)
- avoiding costs of not kept contracts and subsequent litigation
- capturing benefits of interdependent activities
- avoiding government intervention (e.g., quotas, tariffs, price controls)
- controlling supplies and conditions of sale of inputs (including technology)
- controling purchasers
- applying cross-subsidization, aggressive pricing, and transfer pricing"[21]

2.2.4 Eclectic paradigm

This theory was proposed by Professor John Dunning as a frame for deciding the dimension of foreign investment and a pattern of the value-chain operations that companies

[19] Shenkar, 2007, http://www.sagepub.com/upm-data/18594_Chapter_3.pdf, p.69, 08.05.13
[20] Cavusgil et al. 2012, p. 197-199
[21] Shenkar, 2007, http://www.sagepub.com/upm-data/18594_Chapter_3.pdf, p.70, 08.05.13

carry out abroad in order to optimally conduct investment projects. It is often understood as the most comprehensive and widespread of FDI theories. The eclectic paradigm theory offers a general plan that explains how a company should produce internationally. There are three conditions assigned to this theory that determine whether a company will internationalize via FDI and these are:

- Ownership-specific advantages
- Location-specific advantages
- Internalization advantages

The first condition explains that if a company wants to enter and conduct business in a foreign market it should possess ownership-specific advantages compared to other firms already doing business in that market. These specific advantages are knowledge, skills, capabilities, key relationships, and other assets necessary for effective competition in foreign markets. For international success it is of great importance that the advantages are significant enough to counterbalance the costs that occurred while engagement in foreign operations took place. Additionally these advantages should be specific to the investor company and not alienable by other companies (proprietary technology, managerial skills, trademarks and brands, economies of scale etc.). Strong and valuable ownership-specific advantages lead to a higher possibility for engaging in FDI.

The second condition is the presence of location-specific advantages, which are described as the comparative advantages available in individual foreign countries (natural resources, skilled labor, low-cost labor, inexpensive capital etc.).

The third and last condition is the presence of above mentioned internalization advantages. These are the benefits a company obtains from internalizing foreign based manufacturing, distribution, or other stages in its value chain. As soon as the company makes profit it could transfers its ownership-specific advantages across national borders. Advantages are meant to be secured within the own organization instead of giving them to foreign companies.

In this case the decision to invest depends on the option between internalization and utilization of external partners. Internalization advantages include the ability to control production and marketing of products, the ability to prevent unintended dispersion of the proprietary knowledge, as well as the ability to decrease buyer confusions about the value of products that the company offers.[22]

3. FDI by mode of entry

There are several possible market entry forms of investors and the four most important modes of FDI entry are: Greenfield investment, Brownfield investment, M&A and Joint ventures.

Greenfield investment "occurs every time a firm invests to build new manufacturing, marketing or administrative facilities. The investment in this case implies that a company purchases an empty plot of land in a foreign country and builds a production plant, marketing subsidiary or some other facility for the exclusive purpose of this investment." Host country governments usually encourage MNEs to conduct Greenfield investment because it creates new jobs and production capacities, facilitates technology and know-how transfers to local companies through spillover effects and improves connections with the global market. Often governments offer incentives to encourage Greenfield investments, because of the advantages they could bring with them. These advantages are important because in particular cases they represent crucial decision incentives which may be sufficient to countervail some of the advantages of M&A mode of entry has over Greenfield mode of entry.[23]

Brownfield investment is the second mode of FDI entry and includes the purchase of existing buildings, warehouses and office space by foreign investors. Abandoned and derelict sites and buildings in urban areas are interesting for investors. Due to the non-use, the urban land creates ecological, social and aesthetic problems of the city, and thus should stimulate investors to enable them by investing and transforming the existing facilities into infrastructure they can use for their own purposes. In transition countries, this form of investment is common, rather than Greenfield investments, with the main reason for this being that in these countries there is a lot of unused capacity in the form of large companies from the socialist period, which are waiting for the process of privatization or bankruptcy.[24]

The third mode of FDI entry is **M&A**. Acquisitions take place when a company purchases (acquires) a company or facility in a host country and during this process a change

[22] Cavusgil et al. 2012, p. 199-200
[23] Cavusgil et al. 2012, p. 444-445
[24] Karadjic , 2011, p. 65

in control of the company occurs. Through the acquisition the company gains asset ownership and access to existing suppliers and customers and in this way ensures an immediate stream of revenues, an outcome in contrast to Greenfield investment. If two companies join to form new (possibly larger) firms they are said to have merged. Mergers are special types of acquisition. They are commonly used between companies of similar size since they are able to incorporate their operations on the same level. Mergers in foreign countries often must deal with cultural differences, competition polices abroad, corporate values and operating methods in order to achieve success (detailed planning, commitment and advance research are also important aspects).

The last mode of entry is **Joint venture**. Investors undertake this mode of entry either with a host country company, another foreign investor company or with government institutions. Primarily the companies (MNEs) are interested in contributing assets, participating in ownership to some degree (majority, minority or 50:50 share) and sharing the ongoing common risks. In most cases Joint ventures, like mergers, generate certain positive outcomes and these are: inter-partner-learning and resource sharing, increased economies of scale, cost efficiency by avoiding of same activities, a broader range of products and services and most important, achieving greater market power.[25]

3.1 Greenfield vs. M&A

It is observable from figure 1 that cross-border M&A and Greenfield investments have displayed diverging trends over the past couple of years. On the one hand, M&A decrease until 2009 and since then have been increasing, and on the other hand, Greenfield projects have shown a small decline, and generally stagnated in the same period (although the value of Greenfield investments is still significantly higher than M&A).

In 2011 the value of cross-border M&A increased to about $526 billion because most of the projects which started in 2010 were realized. This fact also increased the value of assets on stock markets and gave further incentives for future buyers to carry out such operations. The total value of M&A deals in developed and transition countries was over $3 billion.

Compared to M&A, Greenfield investment projects didn´t experience big changes in value terms (approximately $904 billion) even though in 2008 these projects accounted for the highest value in general. The stagnation can be explained by the global economic crisis which

[25] Cavusgil et al. 2012, p. 444-445

started 2008. The crisis spread out very quickly and financial consequences were noticeable in almost all of European countries. One further reason was the financial crisis within EU members which began in Greece in 2010 and spread out to other financially endangered countries like Spain, Portugal, Italy and Ireland. FDI in general decreased significantly for the same reasons till 2009. Afterwards there was a slight increase in world inward FDI until 2011 followed with another decrease in 2012.[26]

Greenfield projects in developing and transition economies worldwide rose to a small extent in 2011 as the economy started to slightly recover, accounting for more than two thirds of the total value of such projects.

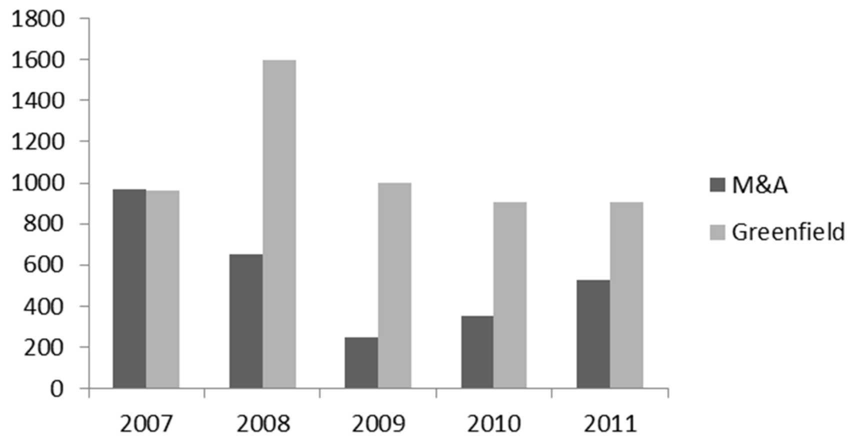

Figure 1: Value of cross-border M&A
and Greenfield FDI projects worldwide, 2007–2011 in billion Dollars[27]

The main differences between Greenfield investment and M&A are in their impacts on host economies, especially before the investment (assessment, planning) and in the initial stages of investment. M&A don´t have the same development benefits as Greenfield investment projects if considered in the long run. There is a distinction between the two entry modes in terms of the creation of new productive capacity, additional value added, employment etc. The effect of M&A on, for example, host country employment can even be negative (for examples in cases of restructuring companies). In special circumstances M&A can bring short-term benefits similar to Greenfield investments and vice versa.

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[26] http://unctadstat.unctad.org/TableViewer/chartView.aspx, 10.07.13
[27] World Investment Report, 2012, http://www.unctad-docs.org/files/UNCTAD-WIR2012-Full-en.pdf, p.6, 11.05.13

Over longer periods M&A are often followed by other sequential investments creating similar benefits to Greenfield investments. In other investment impact fields, such as employment and technology transfer, the differentiated effects of the two entry modes disappear over time.[28]

4. Motives for FDI

Conditions and benefits from pursuing FDI in various countries change over time. Some countries become more attractive targets, while other loese their "appeal". The choice of target countries for FDI presumes different motivations.

Revenue-related motives	Cost-related motives
Attract new sources of demand	Fully benefit from economies of scale
Enter profitable markets	Use foreign factor of production
Exploit monopolistic advantages	Use foreign raw materials
React to trade restrictions	Use foreign technology
Diversify internationally	Use foreign factor of production

Table 1: Motives for FDI[29]

According to the division shown in table 1 there are **revenue-related motives** which are undertaken to enhance revenues:

Attract new sources of demand - Investors often reach a phase when growth is not possible in their country and one of the most often cited reasons for that is strong competition. There is also a possibility that the company´s market share in its home country may be near to the potential high point. These are the main reasons for engaging in FDI in markets abroad where there is potential demand that could play a role in the further growth of the company. (Many developing / transition South East Europe countries are up to date perceived as attractive sources of new demand).

[28] World Investment Report, 2012, http://www.unctad-docs.org/files/UNCTAD-WIR2012-Full-en.pdf, p. 6-8, 11.05.13

[29] Own representation based on Madura / Fox. 2011, p.443-445

Enter profitable markets - If the investors realize that higher earnings can be achieved in other markets, they may as well decide to compete in those markets. The plan would be to offer lower prices and in this way undercut excessively high prices from competitors, but the traditional sellers in a new market could interfere with this by lowering their prices and by doing so, they would obstruct the new market participants in their attempt to take a part of the market share. Some local competitors can still offer lower prices even after the foreign companies made the FDI (this is mostly the case in initial Phase of Greenfield investments and when negative effects such as insufficient bureaucracy quality occur).

Exploit monopolistic advantages - As already mentioned, companies which possess resources or capabilities not available to competing firms in foreign countries tend to become internationalized. One of the examples we addressed, is that firms which are for example more technologically advanced in their own markets, usually have noticeable advantages in countries with less developed technology, which gives them the competitive edge over local firms.

React to trade restrictions - FDI can be used as a defensive or an aggressive strategy and in some specific cases companies use FDI rather as a defensive strategy to achieve their goals. This is ordinarily done to bypass trade barriers set up on the part of some governments. If a company anticipates that their exports to a particular market would be threatened or prohibited by more strict trade barriers, it is very likely for the company to pursue FDI to avoid the barriers, thus avoiding undesired revenue losses.

Diversify internationally – The economies of countries are not perfectly tuned and could vary over time. As a result net cash flows from sales of products spread across a number of countries should be more balanced than those from similar sales in a single country. Through international production and sales diversification investors can make their net cash flows less variable and inconsistent, which eventually leads to a smaller possibility of liquidity deficiency. From a MNEs point of view there is a lower cost of capital because shareholders and creditors recognize the much lower risk and as a result benefit from stable cash flows.

<u>Cost-related motives</u> shown in table 1 are pursued in an attempt to eliminate costs as much as possible:

Fully benefit from economies of scale - some companies are able to increase their earnings and shareholder wealth due to economies of scale (lower average cost per unit resulting from increased production). These are in most cases firms which use much more machinery in the production process then other assets and they are most likely to benefit from economies of scale. For example, the removal of trade barriers within the European Union announced through one single Act gave MNEs in Europe a competitive advantage over some Non-European MNEs. Lower taxes enabled a climate suitable for gaining a competitive edge and eventually MNEs were able to fully benefit from the economies of scale.

Use foreign factors of production – due to some market deficiency such as incomplete information, relocation transaction costs and barriers to industry entry labor costs are not generally equal among markets. Labor as well as land costs may vary from country to country and for this reason investors try to position and assemble production sites in locations where land and the labor force are more cost efficient. As a consequence MNEs scan markets in a continuous process to determine whether they can benefit from lower costs in foreign markets.

Use foreign raw materials – There are several reasons why investors choose not to import raw materials from a given country but instead develop production capacity in the country where the raw materials are located. The two most important (for such decision) are transportation costs and unique location of the resources. Transportation costs increase the price of the products and reduce the ability to compete in own and foreign markets, while the unique location of raw materials presupposes that these particular raw materials are only accessible (available) in one or only few countries.

Use Foreign Technology – In almost every case investors transfer their technology to foreign countries, but on the other hand MNEs are also establishing or acquiring their subsidiaries in foreign countries with the purpose of learning new technologies of the MNEs in foreign countries. This technology is then used to improve their own production processes and increase production efficiency in home facilities and in all subsidiaries around the world, which helps them to gain local and global competitive advantages.

React to exchange rate movements – Through surveys, investors may perceive that foreign currency is undervalued which gives them the incentive to use this circumstance for investing in a country. This is done because investment would be cost efficient compared to other countries. The initial cash flows should be relatively low which is very important in the case of Greenfield investment where the initial costs are often large. On the other hand exchange rate movements can be used to counterbalance changing demand for a company´s exports due to exchange rate fluctuations.[30]

5. FDI effects in host countries

FDI has played an important role in restoring the economy and solving unemployment in all countries that have passed the so-called transitional economy. Central and South-Eastern Europe has recognized the benefits of FDI and tries to achieve the maximum benefit from the presence of foreign capital in their economies. These transition economies have launched a series of political and promotional activities and stressed the importance of organization of its legislation system by offering fiscal incentives, in order to continue attracting foreign investment.

FDI ultimately contributes to general economic growth. However, in addition to the economic effects of foreign capital, foreign investments carry a variety of social, political and technological influences. The presence and intensity of the effects of certain foreign investments depends on types of FDI, as well as on the openness of the country for the admission of foreign capital. Advantages of attracting foreign direct investment are of high importance, especially when it comes to transition countries, which are characterized by chronic lack of investment capital necessary to finance the economy.[31]

Host countries expect that FDI increases economic growth, which is usually achieved through capital accumulation, but at the same time the stock of knowledge and factor productivity (achieved by distribution of knowledge) are also supposed to increase. FDI

[30] Madura / Fox. 2011, p.443-445
[31] Jevtic et al. 2011, p. 228-229

effects on the host country´s economic growth can be positive or negative. The difference in outcomes depends on the mechanisms through which potential economic growth could be influenced.

As Table 2 asserts, the effects of FDI on the host country economy are in almost every case bipolar and the previously mentioned mechanisms, which influence economic growth can set off positive as well as negative effects.

FDI effects	**Impact Positive / Negative**	
Transfer of new technologies and know-how	X	X
Formation of the human resources	X	X
Integration into the global economy	X	X
Increased competition in the host country	X	X
Firms development and restructuring	X	
Difficulty of implementing economic policies		X
Host country wages	X	
Host country´s economic growth	X	

Table 2: Factors explaining the impact of FDI on host country economic growth[32]

5.1 Transfer of new technologies and know-how

Investors, or more accurately MNEs are in most cases the importers of new, more advanced technologies, which can improve host country´s economic performance. FDI is a very important way of transferring technology in transition countries. The reason for this improvement is the fact that on the one hand MNEs are regarded as more technologically developed and they are a major source of technology diffusion across the world, and on the other hand these companies invest a great deal of money into Research and Development (R&D).

New technologies bring forward gains that cannot be otherwise obtained through financial investments or the acquisition of goods. Normally, this transfer implies a R&D cost reduction in the host companies and this eventually leads to firms becoming more competitive

[32]Own presentation based on: Moura, Forte, 2010, p. 4 / Lipsey, 2002, p. 19-58

in their own market. Some of the new technologies transferred are in the form of training, technical assistance, important information, new facilities, specific products, unique production processes and, in some cases raw materials and intermediate goods. MNEs establish connections with local research entities (public institutes and universities) in order to secure continuous technology and know-how transfer.

Technology as well as know-how transfer can also be accompanied by negative effects. Damijan et al. found in their research no or even negative knowledge and technology spillovers to the host country.[33] Investor company could for some particular reason have contrary reaction to host country´s R&D, because it doesn´t want to lose certain parts of its technological advantage. It is likely that the company could even transfer not entirely applicable technologies for the same reason. Finally there is a high possibility for a host country to become dependent on new technologies brought in by investors, which can with time lead to decrease in R&D investments by local firms. As a result there will be continuous need for new technologies, mostly submitted from the investor.[34]

5.2 Formation of the human resources

The labor force is also an essential factor for every investor, and this factor exerts an influence on host countries as a source of economic growth. One of the main reasons is that with know-how and implemented new technology MNEs seek out highly skilled workers. Advancement of the labor force directly leads to an increase in company´s productive capacity. Training of personnel can occur in two ways, formal and informal training and workers undergo this phase during the initial period of new operations. The training offered by MNEs impacts on the foreign company, the host country´s economy and through this the host country itself, because local companies in all likelihood employ these newly educated workers. It is also very likely that trained employees could form their own company and use the previously transferred knowledge to run it successfully (emergence of new competitors). MNEs are not only responsible for the training, but they also use it as a demonstration tool to point out the demand for skilled workers to the local government.

[33] Damijan et al. 2001, p.19
[34] Moura, Forte, 2010, p. 4-5

There are also negative effects in host countries from FDI inflows in relation to the labor force. In some cases the use of advanced technology by investor companies may lead to a decrease in the demand for labor. These companies will use fewer workers than comparable local firms, thus increasing the unemployment. Furthermore there is a threat that the local regime could reduce public spending in areas such as some levels of education in the host country. The main reason for this is because governments perceive MNEs as a source of training and improving in observed areas. Finally there is a possibility that highly educated workers may leave the host country because there are no R&D activities they can be involved in.[35]

5.3 Integration into global economy

FDI helps in the host country´s economy integration into the global economy through financial inflows received from investor countries and diverse case studies point out direct linkages between FDI and increased global trade. Under certain assumptions the economic growth increases with the openness of the host country. One of the reasons for this is because local firms copy (attain) and use knowledge from MNEs such as expertise in marketing, establishment of plants, assembly of distribution network and the creation and formation of international lobbies. Most MNEs have already gone through a similar process and can be of great help for the local firms with their previously gathered experience. Usually local firms operate as MNEs subcontractors and use the same supply chains of brands recognized in the international market MNEs are engaged in. This leads eventually to developing of own brands and export of products into other markets that are independent from MNEs operations.

Local firms may incorporate (adjust) themselves into the MNEs strategy and follow them into other markets or even substitute other suppliers in MNEs subsidiaries. In some cases the local authorities create, as a response to MNEs request, infrastructure (additional production facilities and transportation infrastructure for distribution of raw materials) that contributes to international trade and host country´s internationalization.

The negative side is that FDI has a greater impact on imports than exports (a negative influence on balance of payments) because MNEs have a great demand for goods and raw materials and some host countries cannot provide them in the desired quantity or quality. The

[35] Moura, Forte, 2010, p. 6

other case is that investment made by MNEs is meant to supply the local market and does not involve exports. FDI may also spread problems initiated in the home country and in this case the improvement in the balance of payments cannot be accomplished even in the long run. Negative impacts on exports, and through this on internationalization, can also occur if the investor obtains credit in the host country.[36]

5.4 Increased competition in the host country

FDI contributes to manufacturing and the concentration of capital in the host country to some extent by inducing competition. Local firms are challenged after MNEs entry in their market and in most cases, in order to keep their market share, they increase productivity, while prices are reduced as much as possible. Further on, they engage in a more efficient allocation of resources. As already mentioned, increased competition leads to investment in R&D, but it also leads to investment in equipment and employees. From a general point of view, FDI increases the competition more in closed economies.

According to Damijan "the competition effects of foreign owned firms to domestic firms outweigh the positive spillovers generated through trade."[37] Due to the increased competition some of the smaller companies will most probably close their facilities, and this could lead to clustering in the region or a country (this can occur also as a response of small companies to MNEs pressure), which again decreases competition. Income in the home country is not divided equally between all participants. This unequal division of capital and income can be one further reason for the disappearance of smaller firms. Human capital is also seriously influenced at the expense of small enterprises because MNEs tend to attract skilled workers through their carrier possibilities or better financial offers.

There is a threat that host authorities could save in terms of public expenditure to invest more in attracting FDI. This decrease in public expenditure will eventually affect local firms that are subsidized by the government, which will make them over dependent and constrained in their future considerations. Finally because of the decrease in public expenditures it is highly probable that this kind of government behavior could indirectly lead to the closure of smaller firms.

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[36] Moura, Forte, 2010, p. 7-8
[37] Damijan et al. 2001, p. 19

MNEs are sometimes partially financed by the host countries (investment incentives or other contractual agreements) and this could reduce the host country ability to grant loans to local firms. The chain reaction leads to the loss of domestic savings which makes it even harder to obtain loans, which are for a significant number of small firms in every country possibly the only way of financing.[38]

5.5 Firms development and restructuring

FDI, among many other consequences for the host country, constitutes better economic conditions and ambience, which plays a significant role in overall economic growth. MNEs are capable of overcoming high entry barriers and after entering the market they can reduce and even eliminate monopolies in given sectors of an economy. In M&A (takeover or privatization in transition countries), but also in other types of entry, MNEs can force or persuade local companies to adopt their policies and procedures which is usually followed by the incorporation of workers from other MNEs subsidiaries. As a result the structure of local firms changes, because the local companies imitate the more efficient MNEs structures and because the business environment has evolved through the initial changes introduced to the governments by MNEs.

5.6 Difficulty of implementing economic policies

Implementing policies regarding FDI can in some cases influence only the given sectors but commonly it is the whole host country´s economy that is affected. FDI inflows might be a source of imbalance and very difficult to predict. When this is the case, it could destabilize the host country´s economy and affect negatively the fulfillment of economic policies. If the inflows of capital in the form of FDI are unforeseeable and extreme, they could at the same time increase inflation in proportion to the inflows.

Additionally, as explained in the previous section, MNEs FDI inflows could challenge host country´s government authority. Basically the MNEs are able to manipulate political and economic decisions of local regimes through their control over assets and employment (financial power). MNEs are also known to put pressure on authorities through lobbying and in this way fulfill objectives that are not complementary to host country economic growth.

[38] Moura, Forte, 2010, p. 9-10

MNEs use their size, importance and influence and in this manner impact upon the economy in the host country which brings out these severe changes. The resulting changes are in a large number of cases independent of the local authority's decisions and not in favor of the host country´s policies.[39]

5.7 Host country wages

According to Görg, Holger and Strobl, "host country may benefit from the presence of foreign owned firms, particularly if they encourage them to train their workers." Training of the workers directly increases the wages employed by MNEs and country´s level of absorptive capacity. Indirectly there are positive productivity spillovers (which eventually increase the wages) generated through movement of trained workers from foreign to domestic firms.[40] Certain studies have presented evidence that investor companies pay higher wages than host firms and at the same time also higher wages than the average wage in the host country. There are several reasons for this:

- MNEs from foreign countries have different standards and higher average wage in their home country. Even the minimum wage from some investor countries is considered to be a high wage in the investing economy.
- MNEs employ a certain number of skilled employees or employees with demanded qualifications, and there is always an emphasis on capital and product flow, and also on the size of investor firms. These employees are generally properly compensated for their work and in most cases the payment is higher than average in the country.
- There is a possibility of MNEs being put under pressure by host country government. In this case the investor must comply with the regulation as well as legislation framework.
- Foreign firms are trying to maintain good public relations.
- MNEs avoid the loss of their proprietary knowledge by giving higher wages to workers and in this way giving them an incentive not to migrate to domestic owned firms.

There are only a few studies which acknowledge the fact that FDI in the host country increase average levels of wage, however this is not the case in transition countries where

[39] Moura, Forte, 2010, p. 10-11
[40] Görg et al. 2002, p. 20

there has been demonstrated that the relation between foreign capital inflows and higher wages exhibits positive effects. Never-the-less the residency of large MNEs might still affect wages in the home market. One way to explain this spillover effect could be through an increase in the demand for labor (both high and ordinarily skilled workers) and the other is the competition between MNEs and home country firms in the same labor market, where domestic firms have to pay higher wages to attract workers.[41]

FDI and MNEs positively influence the wage levels in the host country, but there are still some small companies, which may be forced out of the market. From the MNEs perspective the liquidation of these firms is one further way to rearrange capital in the host country´s market (this could also be considered as a negative effect and a reason for some host countries to not be in favor of FDI). Ultimately even the negative effects (negative productivity spillovers from MNEs), considering wages, couldn’t be so large to offset the positive effects, which result from FDI in the host country in the long run.[42]

5.8 Host country´s economic growth

The examination of all effects influencing the host country´s economy is finally used for the purpose of providing evidence for economic growth in the country receiving FDI. Borensztein states “that the effect of FDI on economic growth is dependent on the level of human capital available in the host country and gives empirical evidence that FDI has positive effects on economic growth when the level of education is higher than a given threshold.” It is possible to differentiate further effects of FDI on economic growth. On the one hand FDI increases the overall level of investment and on the other hand FDI enhances productivity as a result of interaction with human capital.[43] But growth alone is not to be considered solely, because other, further observations (as well as explanations) must be taken into account.

Some authors explain these facts through a possible “gap” in knowledge or ideas and not the lack of physical capital. So in order to reduce and close these “gaps” authorities and other responsible participants should find a compromise solution which would induce economic growth. The easiest way in this context would be to stimulate economic growth by giving MNEs proper incentives for this task. And the most common way for MNEs to achieve

[41] Görg,Greenway 2003, p. 12
[42] Lipsey, 2002, p. 19-21
[43] Borensztein et al. 1995, p. 21

this, is to create an economic environment that is attractive to other foreign investors capable of bringing necessary resources.

Certain studies note that the size of inward FDI, relative to GDP, is not related in any consistent way to rates of growth, nevertheless this is not the case in all subsets of the world´s countries where inward FDI has been shown to have a positive effect. For example in Central and Eastern Europe as well as in former Soviet transition countries FDI is a deciding and very important (one might say crucial) explanatory variable for economic growth. Most of these countries are industrialized and have well educated and capable labor forces. Studies from transition countries in almost all cases confirm a positive effect of FDI on growth but the results are also not universal across periods which can be explained through global financial and political crisis.

Growth effects are as mentioned related to incentives offered by host country´s trade policy, which means that "efficiency of FDI in promoting growth would be increased by an export promotion policy and decreased by an import substitution policy."

The existence and breadth of local financial markets are a very important variable which determines how FDI affects economic growth. In weak markets (or abstractedly markets) the advantages and knowledge local firms gained from foreign companies do not come to fruition, thus the growth effect is muted.[44]

[44] Lipsey, 2002, p. 19-58

6. Basic risks

As asserted, countries around the world take an active part in the globalization process, thus becoming more dependent and connected to each other. An important role in this context belongs to MNEs and especially their investments in foreign countries. International investments are affected to a large extent by country risk. Sudden business environment changes represent for the decision makers lower profitability of investment, or reduced asset value of MNEs in host countries. Aggravation of the business environment leads to the possible cancellation of planned investments.

Environment Changes	Simple	Complex
Stable	Simple + stable = **Small uncertainity**	Complex + stable = **Medium small uncertainty**
	Small number of environment elements; elements are alike	Great number of environment elements; elements are different
	Elements do not change or they do change but very slowly	Elements do not change or they do change but very slowly
Unstable	Simple + unstable = **Medium great uncertainty**	Complex + unstable = **Great uncertainity**
	Small number of environment elements; elements are alike	Great number of environment elements ; elements are different
	Elements change often and unpredictably	Elements change often and unpredictably

Environment complexitiy

Table 3: Framework for the environment uncertainty evaluation[45]

Table 3 shows the influence of environmental complexity and its dynamism in the global market. The shift from the upper left quadrant to the lower right quadrant represents the uncertainty throughout the framework for the uncertainty evaluation (shift from simple

45 Petrovic, Stankovic, 2009, p. 10

and stable environment offering an adequate business environment towards complex and unstable environment).[46]

While some countries attract a great deal of FDI, other countries are not as efficient. There is a variety of reasons for this, but one of the most important reasons is the risk of failure. A bad business environment as shown in table 3 (lower right quadrant) is represented by the country´s risk in a host economy. This risk consists of political and financial risks.

Political risk may be interpreted as the possibility of endangering the quality of the institutional environment, or more precisely, it is the risk that an investing country could experience a decrease in the return on investment due to low institutional quality and high political instability. There are two important aspects which make investors highly sensitive when considering political risks and these are sunk costs (the cost of acquiring information to overcome the lack of knowledge and familiarity in the host country) and operating costs (the costs of running foreign business). In the case of sunk costs, institutions should provide a predictable framework for the interaction between investors and their country to lower the risk premium and through this also political risk. On the other hand, operating costs, which are for example: hold-offs in obtaining permits, corruption, special protection, tax assessments etc., are also the results of inefficient institutions. Political risk comprises 12 subcomponents covering both political and social attributes and these are:

Government Stability	Military in Politics
Socioeconomic Conditions	Religious Tensions
Investment Profile	Law and Order
Internal Conflict	Ethnic Tensions
External Conflict	Democratic Accountability
Corruption	Bureaucracy Quality

Table 4: Subcomponents of political risk[47]

All of the subcomponents are closely associated with FDI flows. In particular, socioeconomic conditions, democratic accountability, ethnic tensions, religious tensions and

[46] Petrovic, Stankovic, 2009, p. 9-10
[47] Own representation based on Hayakawa et al. 2011, p. 6

corruption need to be under control (even a form of continuous supervision) in order to attract FDI.

Financial risk implies that a host country will not be able to pay back its foreign financial commitments. FDI in contrast to a bank loans or portfolio investments for example, cannot be as easily withdrawn and for this reason investors are sensitive to financial risk in the host country (MNEs consider countries with high foreign debt less attractive for investments and are very careful in their assessment studies).

High financial risk consequently leads to crisis. A chronic deficit in the budget balance, exchange rate instability (increases uncertainty for the MNEs business decisions) and inflation (in the case of high inflation, already invested assets, future returns as well as home country´s currency may become less worth) contribute to the host country´s increase in foreign debt, thus increasing financial risk. There are 8 subcomponents involved in financial risk:

Foreign Debt as a percentage of GDP	Exchange Rate Stability
Foreign Debt Service as a Percentage of Exports of Goods and Services	Current Account as a Percentage of Exports of Goods and Services
Net international Liquidity as Months of Import Cover	Annual Inflation Rate
Budget Balance as a Percentage of GDP	Current Account as a Percentage of GDP

Table 5: Subcomponents of financial risk[48]

Compared with political risk a higher financial risk of host countries doesn´t exhibit such a strong opposite effect on FDI inflows, which means that if a host country wants to attract FDI in greater number and value, it should primarily reduce political risk, because the benefit from this is more notable than from reducing financial risk.[49]

[48] Own representation based on Hayakawa et al. 2011, p. 7
[49] Hayakawa et al. 2011, p 4-16

7. Evolution and movement of FDI

International trade and FDI throughout history were the energetic forces for economic growth and development in the world. Never-the-less, the significance of FDI has been disputable since the 1960s. There have always been different beliefs regarding the FDI. Some claim that FDI induces development and increase in productivity in a host country and in this way "contributes to differences in economic growth and development performances" across the world. Others however emphasize the risk of FDI ruining "local capabilities and using up natural resources without sufficiently reimbursing host countries". The importance of FDI across the world has changed and varied over time and economies.

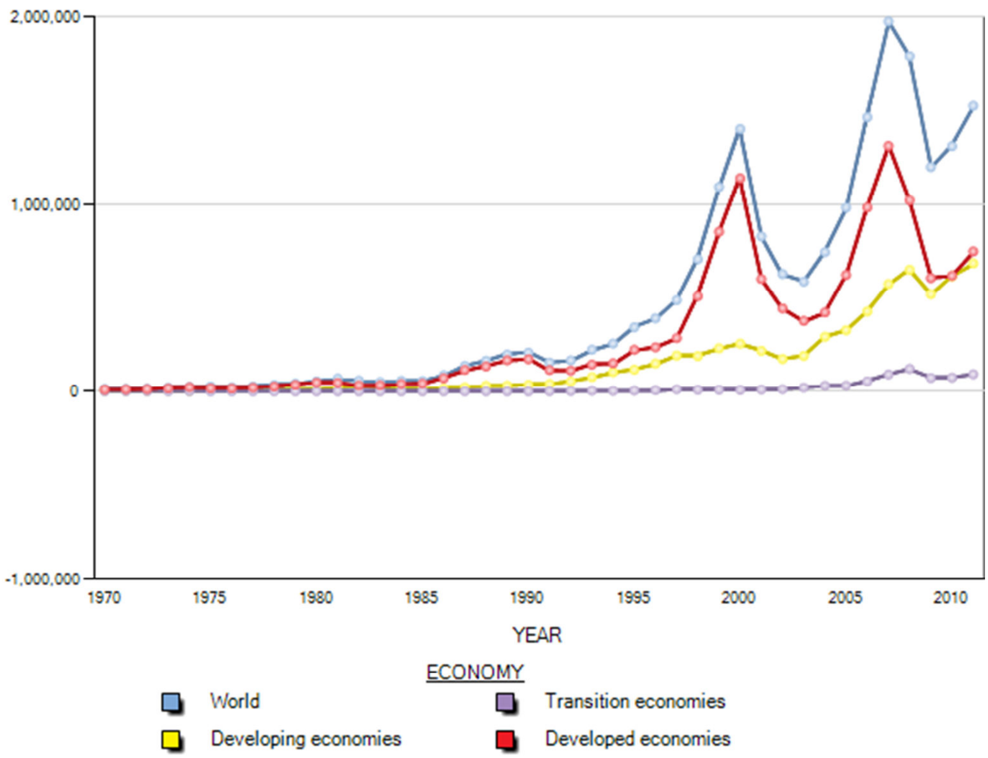

Figure 2: Inward and outward FDI flows in millions US Dollars, annual, 1970-2011[50]

As shown in figure 2 a great degree of importance and influence was assigned to FDI at the beginning of the 20th century (with the influence decreasing in the middle and then rising again at the end). Especially in the last decade FDI worldwide and in developing / transition countries manifested differences across regions and countries.

[50] http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx, 03.05.13

Growth induced by FDI and at the same time the determinants of FDI have adapted step by step. Policy boundaries to invest have affected the attraction of FDI worldwide for certain periods of time. A constant need for fresh capital as well as a perpetual need for stable economic fundamentals (such as market size and growth), skilled workforce, good infrastructure, and advanced local technological capabilities has shown the immense encouragement for conducting FDI globally. As a result of a significant change in the last few decades, regimes have become more open to FDI. They have liberalized and optimized their policies to properly benefit from FDI.

Over the last two decades, FDI was used as a tool for increasing GDP growth and productivity by providing capital, technology, knows how etc. There has even been a tendency for competition for FDI. As the governments became more liberal, they more and more realized the positive as well as the negative aspects of. Gradually it became clear that the effects should not be taken for granted and that they depend not only on the type of FDI but also on company characteristic, economic environment and country legislation.

As asserted, even though FDI brings capital inflows and new technologies this doesn't automatically mean that there will be positive effects (spillover effects) for the local economy. In this context governments should specify a legal framework and improve the investment climate in order to make FDI work for economic development. It is also very important to adjust the capacity to absorb the FDI and its positive spillover from the investor countries (infrastructure, targeted human resource development, linking into supply chain of local firms).

Altogether, a noticeable transition toward a relaxation of the FDI regime has been made, and demand for FDI is considered to be significantly higher today than for example a couple of decades ago. In addition governments have realized how important it is to attract FDI and that their policies can influence the effects of FDI on economic growth as well as development.[51]

[51] Willem te Velde 2006, p.2

8. The Situation in Yugoslavia and preconditions for FDI

Many countries have experienced difficulties and failure in their history. The case of Socialist Federal Republic of Yugoslavia is unique, because the fall of the communist ideology as the main binding element of the economy disintegrated not only the state, but also the society. Germany was devastated and divided in 1945 with dissolved government, but the society managed to preserve and very quickly, with the help of the West, reorganized, gained economic power, strengthened political their political institutions, which eventually led to reunification and changed geo-strategic circumstances.

The Yugoslav case shows that even during the former communist regime the entire key binding aggregates underlying the state: economics, ideology, institutional mechanisms for solving conflicts and preventing decay were seriously damaged. Of all the binding elements that held the community and in this way the economy, emotional remains were the only ones that gave some kind of hope even though they weren't strong enough to provide a new, positive integration in the future. The process of destruction was emerging and the only pillar still holding everything together and intact was Tito´s personal authority.[52] It was obvious at the time, as soon as the authority would be gone, the road to disintegration would be wide open.[53]

Economic inefficiency and the misfortune of missed opportunities by former socialist countries in SFR Yugoslavia together with a very complicated mix of various factors at the time led to the collapse of the socialist system and to the transition from the earlier command (planned) economy, to a market economy. The above mentioned changes were followed by multi-layered imbalances, such as discrepancies between industry, agriculture and infrastructure activities, forced industrialization that has imposed the construction of steel, and the foreign trade imbalance which simultaneously caused the shortage and excess of supply and demand. The solution for this situation was sought by the inflow of foreign capital.[54]

In transition countries FDI was considered until the 1990s almost exclusively a phenomenon of the so-called developed world, but just at this time a major change took place and put FDI as the principal source for funding for developing countries. These countries

[52] http://go.galegroup.com/ps/i.do?id=GALE%7CA20400942&v=2.1&u=43wien&it=r&p=LitRC&sw=w http://komunist.free.fr/tito/bio.html, 04.05.13
[53] Zec M. 2012, p.698
[54] Bogdan Z. 2009, p.4

were trying even more, with the liberalization of their markets, to attract large amounts of capital necessary to stimulate the economy.

Foreign private capital of a long-term nature comes in the country mostly through two basic forms: Greenfield FDI (launching brand new manufacturing assets) and Mergers & Acquisition (from now on M&A) as purchases and acquisition of existing business and facilities plus taking control of these facilities with the aim of more efficient management.[55] Greenfield FDI and M&A differ in the process of implementation and also in impact they have on the economy of the host country, especially in the initial phase of an investment.

Transition countries have in recent years become a record FDI recipient, and the whole region in general is becoming more and more competitive. A noticeable trend is the creation of two sub-groups within the transition countries. The members of the first group are Croatia, Serbia, Romania and Bulgaria, and second Bosnia and Herzegovina Former Yugoslav Republic of Macedonia, Montenegro and Albania, with large differences in the number of realized FDI, especially Greenfield FDI. The first group was more successful by attracting and realization of investment because these countries were faster in implementing political and economic changes.

The experience of successful transition countries indicates a smaller number and value of Greenfield FDI in the beginning of transition, primarily because most countries chose large-scale privatization in which M&A play a more important role. But it is important to stress that these privatizations are not driven by market forces, but rather a result of diverse political games. The very specific value to the social and economic circumstances prevailing in the above group of countries requires the need for Greenfield FDI, which unlike other forms of FDI, implies unquestionable increases in physical capital and employment, the transfer of modern technology and knowledge, and an improvement in the competitiveness and economic environment of the host country.[56]

[55] Bogdan Z. 2009, p.5-6
[56] Begovic et al. 2008, p.17

9. Austrian Greenfield FDI

According to UNCTAD (and as shown in figure 3), Austrian global FDI rose in 2011 such that it exceeded the pre-crisis average, but it was still 22% below the maximum value in 2007. Austrian outward FDI in 2011 had the second highest value ever recorded ($ 30,450 M) which is more than three times as much as in the previous year ($ 7,731 M).[57]

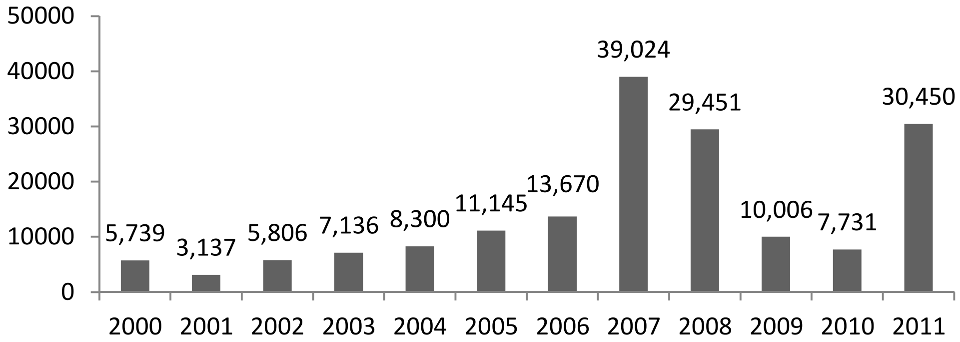

Figure 3: Austrian FDI worldwide (outward) in millions of US Dollars, 2000-2011[58]

In 2012 FDI in Austria declined to $ 22,137 M, which is 27.3% less than in 2011. The most important target regions were other EU countries (50.3%), East Europe (13.4%), Luxemburg (35.1%), Turkey (13%) and Switzerland (11.9%). Austria is the third largest investor in EU newcomer countries following the Netherlands and Germany, but is the largest in South East Europe, especially in Bosnia and Herzegovina, Croatia and Serbia.[59]

In the period from 2003 till 2010 Austria made 275 investments in BiH and more than a half of these were Greenfield investments. The total value of investment in this period was € 5,758 M, € 4,245 M was the value of M&A, € 1,436 M was Greenfield investment and € 77 M was the value of unknown modes of entry or loans. Considerable differences are observable in generated profit and employed persons. There were 27.99 thousand (K) persons employed through M&A and 9.76 K through Greenfield investments (giving a total of 37.75 K), while the annual profit in the same period made through M&A amounted to € 206 M and through Greenfield there was a loss of € 8 M (giving a total of € 199 M).

[57] http://www.en.bmwfj.gv.at/ExternalTrade/ForeignTradeData/Documents/Direktinvestitionen_%C3%96sterreichs.pdf, p. 1, Retrieved: 29.05.13
[58] http://unctadstat.unctad.org/TableViewer/chartView.aspx, 29.05.13
[59] http://www.bmwfj.gv.at/Aussenwirtschaft/oesterreichswirtschaftsbeziehungen/DatenundFakten/Documents/%C3%96sterreichs_Aussenwirtschaft_2012_rev2.pdf, p. 11, 29.05.13

The number of investment projects by Austria in Croatia (2003-2010) was almost 5 times higher than in BiH (total of € 1,182 M). Greenfield investments accounted for € 531 M and the rest were M&A (€ 651 M). The total value generated was € 33,404 M and the value of Greenfield investment accounted for € 11,891 M (The rest were M&A/unknown modes of entry € 20,899 M / € 614 M). A noteworthy difference was in the annual profits in Croatia. The total of € 2,570 M, which was almost 13 times more than in BiH, was evenly divided between Greenfield (€ 1,307 M) and M&A (€ 1,261 M) investments. Whereas Greenfield investments in this period generated more profit, M&A investments helped employ more workers (104.85 K of a total 171.60 K).

Serbia received 533 investment projects from Austria between 2003 and 2010. There were 299 Greenfield and 234 M&A investments. Overall the number exceeded the one in BiH, but was still significantly lower than the number of investments in Croatia. Total value of € 10,235 M consisted of € 4,298 M in M&A, € 5,743 M in Greenfield investments and € 193 M in unknown modes of entry. In the observed period Serbia was also one of the three transition countries to put an emphasis on Greenfield investment. Generated annual profits were higher in the case of Greenfield investments than M&A (€ 285 M compared to € 114 M giving a total of € 399 M). As a result there were 99.68 K persons employed till 2010 (through M&A 55.66 K and through Greenfield 44.12 K).[60]

10. FDI in Bosnia and Herzegovina

10.1 Basic information

Bosnia and Herzegovina is a country situated in South East of Europe (in the western part of the Balkan Peninsula) with a population of 3,752,228 (in 2011). The capital and largest city of the country is Sarajevo. The country borders Serbia to the east, Montenegro to the southeast and Croatia to the north, west and southwest, as well as about 20 miles from the city of Neum to the Mediterranean Sea. Since the Dayton Agreement (1995) the county consists of two entities and one district, the Federation of Bosnia and Herzegovina, the Republic of Srpska and the Brcko District, which is special administrative region. [61]

[60] Source: Österreichische Nationalbank, Statistik Hotline, prepared by Mr. Kurt Eisenhuber, BA
[61] http://de.wikipedia.org/wiki/Bosnien_und_Herzegowina, 31.05.13

BiH is a middle income country that has achieved a lot after the post-war situation in the mid-1990s. Currently, Bosnia and Herzegovina is a potential candidate for the EU. There is a great effort to reorganize and meet EU demands. The country depends on financial and political help from the EU countries. In the period 1998-2008, BiH experienced strong growth, with GDP per capita almost 4 times higher than in previous years. Simultaneously poverty rates decreased from close to 20% to about 14%.

The beginning of the global financial crisis in late 2008 had a permanent negative impact on the economy of Bosnia and Herzegovina. BiH is even now in the middle of a recession struggling with the various factors causing even more problems (not only financial but also of political nature). In 2011 the economy recovered and grew by 1% after the deep recession in 2009. GDP declined by 2.9% before the country went back into a recession in 2012. Inflation in 2011 was partly caused by higher international food prices and weak domestic demand. For the upcoming period is anticipated gradual economic growth with expected 3.5% in 2015.

In an attempt to overcome the difficulties, the country has focused on new models that encourage exports and FDI (the main reasons for this decision were the slow economic growth and escalating volatility in Europe). In this way, BiH was able to upgrade its physical infrastructure, improve the business environment and to upgrade the necessary human capital (Greenfield investments were the best way to achieve all three factors at once) with the aim of becoming more competitive in the EU region as well as in the rest of South East Europe. The country still relies heavily on Western Europe for investment, trade and credit. In recent years there has been an increase in the government deficit as a result of the expansion of an import policy and consequent reduction of exports (even though exports have expanded in recent years, particularly in base metals and electricity industries).[62]

10.2 Legal Framework for FDI

The most important legislation relevant to FDI include the law on FDI Policy (1998), Commercial Code, Securities Law, the Law on Enterprise, Law on Privatization of Banks, Law on Banks, Law on Expropriation of Foreign Investment and the Law on Free Trade

[62] http://www.worldbank.org/en/country/bosniaandherzegovina/overview, 31.05.13

Zone. Even though BiH consists of two Entities, the legal framework across the country is fully harmonized and facilitates FDI in both entities as well as in District Brcko.

Essentially there are no prohibitions concerning the investments fields except for the following: fields of armaments, public information, radio and TV broad casting (excluding cable), electronic media (excluding Internet), newspapers and other publications produced in the local market. In these cases, foreign investment may not exceed 49%. All investment in BiH is subject to public order, health and environmental concerns. Usually the investors receive national treatment when conducting FDI.

There is a compulsory registration which must comply with laws within the entity. A review of the application for an investment is administered by an authorized body which eventually gives its consent. Investment may be carried out through the incorporation of a new business enterprise or expansion (increasing control) of already existing ones. There is a variety of possible corporate structures BiH offers and these are: Unlimited Joint Liability Company, Limited Liability Company, Limited Partnership, and a Joint Stock Company.

Considering the exceptions that were previously stated (where foreign ownership is limited to 49%), there are no further limitations for foreign investors on how to run their business. The lower limit for foreign control is 10% (in capital or voting rights). Foreign investors may gain ownership on land in the Federation of BiH if they are already running a business there. As a consequence a foreign investor is allowed to own: office buildings, office premises, apartments and apartment houses and industrial land with mentioned facilities.

There are no explicit demands on foreign investors in the form of local content, obligatory involvement of nationals, exports or conditions in terms of geographical circumstances. Every business operation is required to accept several inspections in accordance with the national treatment clause of Foreign Exchange Controls. Free currency flows are not prohibited in any way for foreign investors, as well as transfers and recirculation of profits, and other cash-flows. Foreign companies are allowed to hold accounts in commercial banks of their choice on the territory of BiH in desired currency.

All Entities in BiH should aim to establish favorable conditions for FDI. This means that custom duties for investors should be waived, but at the same time this should apply also to home investors. Investment capital is not taxable and corporate income tax, at the rate of 30% in the Federation part of BiH, can be deducted if firm´s exports exceed 30% of total income. According to the Federation law on Corporate Income tax there should also be a tax reduction for a period of 5 years equal to the percentage of foreign capital invested in the assets of the company (in case the foreign capital is greater than 20% of total capital). This incentive counts only in companies with 100% foreign capital investment.

When considering the second entity, all foreigners with a permanent residence and non-resident foreigners earning income in the Republic of Srpska are required to pay a 10% personal income tax on revenues from farming, property and property rights, authorship, patents and technical improvements, capital gains, and other activities.[63] [64]

10.3 Promotion agency

The Foreign Investment Promotion Agency (FIPA) of Bosnia and Herzegovina (BiH) is a State Agency founded with the mission to:

- attract the number and value of FDI inflows in to BiH
- motivate existing investors to reinvest in BiH
- assist the interplay between public and private sectors, and directly improve the business environment for FDI
- advertise a positive image of BiH as a potential investment destination

The Council of Ministers of BiH gave authorization to the FIPA to promote FDI. The agency helps investors to directly negotiate with the government and participates actively in improving the legal framework for foreign investments. FIPA directly and indirectly assists investors in developing contacts with the public as well as the private sector. In addition, it cooperates with embassies and diplomatic missions in BiH and in this way (through their channels) expand investment possibilities in BiH.

FIPA provides the information, analysis and advice for potential investors through the inclusion of:

- following economic and business trends
- legislation for FDI
- expanding incentives for potential investors

[63] http://unctad.org/Sections/dite_fdistat/docs/wid_cp_ba_en.pdf, p. 8-9, 31.05.13
[64] http://www.fipa.gov.ba/publikacije_materijali/zakoni/default.aspx?id=315&langTag=en-US, 31.05.13

- the network between government and non-government organizations in the country[65]

10.4 BiH and Greenfield Investments

When it comes to the regional distribution of FDI, it is considered to be a favorable situation if the influx of FDI comes from several countries because this minimizes the negative effects of investor country´s markets in the host country. BiH has registered inward FDI from 91 countries around the world. European countries are the most important investors in BiH and are estimated to have invested about 90% of the total.

According to data from the Central Bank, countries that have invested the most in BiH are: Austria with a recorded (Convertible Mark-KM) KM 2,336 M (M 1,194 €), or with a share of 22.4% in the total amount of FDI, followed by Serbia with 1,834 M KM (M 938 €), or share of 17.4% and Croatia with KM 1,328 M (M 679 €), or a share of 12.6%. The most important investor countries are presented in the following chart.

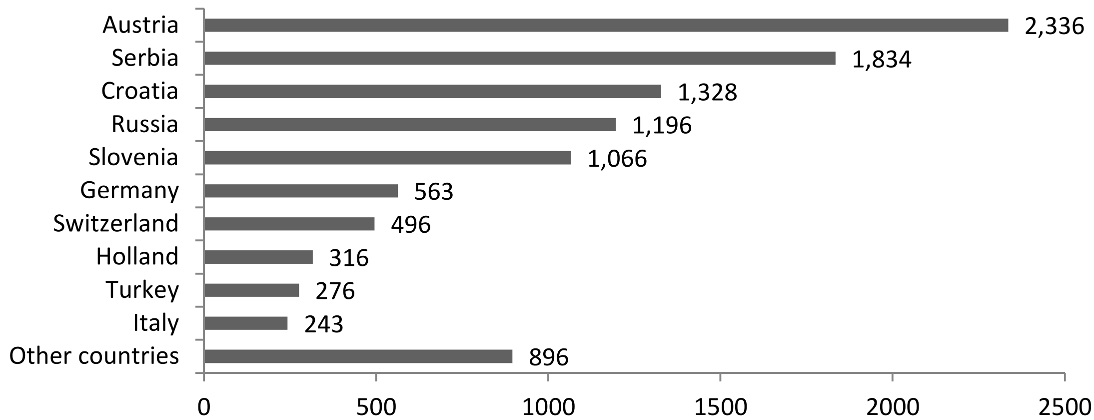

Figure 4: Most important investors by country in BiH - Total amount 10.5 billion KM, 1994-2011, Millions of KM[66]

The aftercare program was initiated in 2006 to strengthen cooperation between FIPA and companies in the field. The aim of these activities is to get into direct contact with investors, receive information about the problems they encounter in the course of the business establishment and intentions regarding further investment. The information collected indicate the reasons why investors choose to invest in Bosnia and Herzegovina, an opinion on the business environment, as well as suggestions for improving the business climate in order to attract reinvestment and new investment.

[65] http://www.fipa.gov.ba/o_fipa/misija/default.aspx?id=210&langTag=en-US , 02.06.13
[66] Source: Central Bank of Bosnia and Herzegovina (CBBH)

Since 2007, the representatives of FIPA (from all three offices - Sarajevo, Mostar and Banja Luka) made 260 visits to companies across BiH. There were 238 observed companies (some companies were visited more than once during the aftercare program). Although this is not a real basis for a comprehensive analysis of foreign investment in BiH, the aftercare program research can serve as an indicator according to certain parameters. The total invested capital in 238 companies was €3.1 billion (or KM 6 billion) and employment was 39,835 workers. In addition, with this amount of invested capital, 189 companies, or 79.4% of observed companies, intended to continue investing in their capacity as well as enhancing and expanding it. The expected value of planned reinvestment in these companies is € 1.7 billion (KM 3.3 billion) or 55.3% of the realized investments. The results from the aftercare program can be summarized in the following charts.

Viewed by type of investment (entry mode), the largest number of visited companies conducted Greenfield investment is 42% of the total of 238 companies.

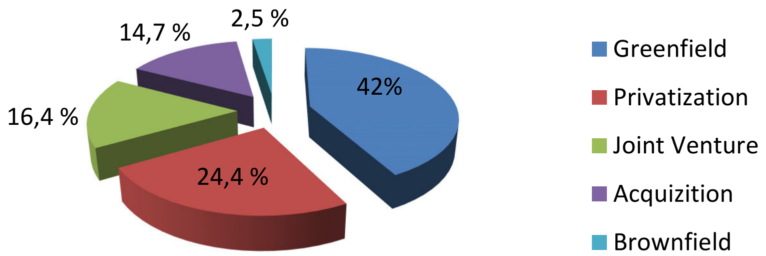

Figure 5: Types of investments according to entry mode (238 companies) 2007-2012[67]

Although most of the investments are Greenfield, privatization is the most important mode of entry by value of investment, comprising 45.7% of the total invested capital in all of the visited companies (€ 3.1 billion).

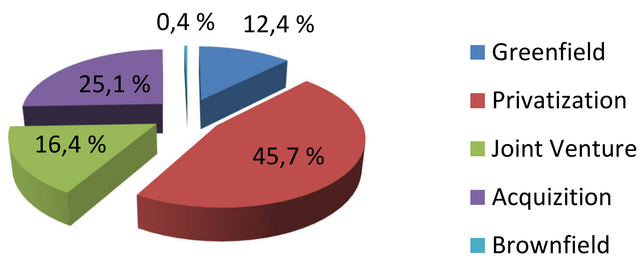

Figure 6: Value of investment (total capital 3.1 billion euros)[68]

[67] Source: FIPA, Aftercare program 2007-2012, prepared by Mrs. Dusanka Brkic and the Analysis department of the FIPA office

[68] Source: FIPA, Aftercare program 2007-2012, prepared by Mrs. Dusanka Brkic and the Analysis department of the FIPA office

When analyzed by sector in which the investment took place, from all observed companies, the largest number is in the manufacturing sector followed by telecommunication sector, banking and other financial services.

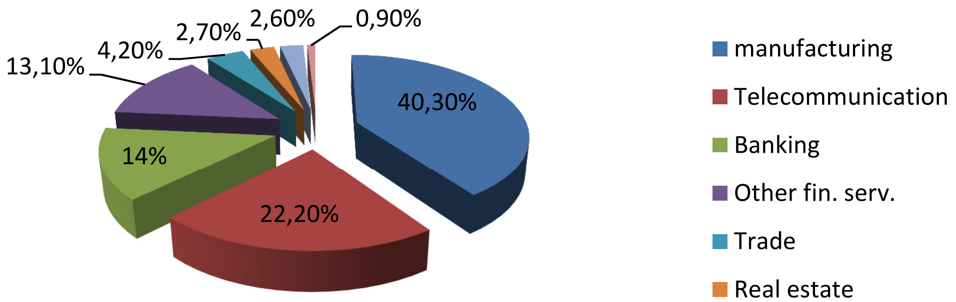

Figure 7: Sectors by participation in total invested capital (3.1 billion euros)[69]

According to UNCTAD the total amount of Greenfield projects in BiH between 2003 and 2011 was 217 and the total value of these investments added up to $ 11,903 M. The value of Greenfield investments per year has declined since 2007 due to political and financial crises. In 2011 there was an increase in the value of Greenfield investment (almost 4.5 times as large as in 2010). A steady increase was noted in the first quarter of 2012. Figure 8 shows the number and value of Greenfield projects from 2003 till 2011.

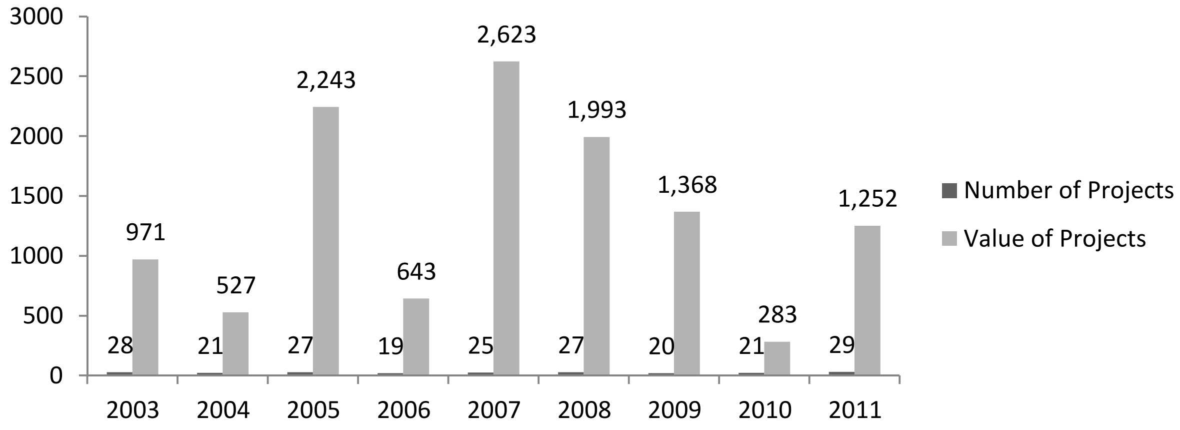

Figure 8: Number and Value of Greenfield FDI projects in BiH, 2003-2011, Millions of dollars[70]

[69] FIPA, Aftercare program 2007-2012, prepared by Mrs. Dusanka Brkic and the Analysis department of the FIPA office
[70] Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com). Note: Data refer to estimated amounts of capital investment.

10.5 STUDEN – AGRANA Case study

"At AGRANA, we all share one vision - to be the world quality leader in refining agricultural raw materials into sugar, starch and processed fruits. Our passion for quality and efficiency makes AGRANA the natural choice of food companies and for technical applications worldwide". (AGRANA's Corporate Vision)

AGRANA is an Austrian company with international signature, which produces a wide range of industrial products using diverse agricultural raw materials. The company employs around 8,500 people and it has headquarters in 56 manufacturing plants located throughout the world. In 2012 AGRANA generated consolidated revenues of roughly € 3.1 billion. The company has been listed in the Prime Market segment of the Vienna Stock Exchange since 1991.

AGRANA is a dominant supplier in its all three business (sugar, starch and fruit) and its essential customers are local manufacturers as well as international partners (particularly those in the food industry) in Central, Eastern and South-Eastern Europe. In the sugar division (the strongest of all three), AGRANA´s leading products are sold under the brand "Wiener Zucker". The company is also considered as a supreme bioethanol and starch-products manufacturer in Europe, as well as the leader in fruit processing business.

The Group participates in the value chain from the start by purchasing agricultural raw materials to the production and sale of the final products (end products are sold to a large extent in sugar division). Strategic knowledge, know-how and common collaborations with agricultural growers are very important to achieve company´s vision goals. Because all of the divisions are very similar, AGRANA can use this to exploit its specific firm specific advantages and market position relative to the competition in the three markets.

An international growth strategy, with respect to local market opportunities is AGRANA´s long run objective, as well as to maintain steady relationship with customers and suppliers in their way of doing business. The overall objective is to offer top product quality globally and regionally, with best possible service and innovative ideas. In 2006 AGRANA started the negotiations in order to open a raw sugar refinery in Brcko, Bosnia Herzegovina jointly with the Bosnian-Austrian company SCO Studen & Co Holding, Vienna as 50% partner.[71]

Brcko, 6 June 2008 - The opening of the STUDENT-AGRANA raw sugar refinery in Brcko represented the completion of one of the largest food manufacturing plants in recent years in Bosnia and Herzegovina, in which AGRANA and her longtime distributor in the Western Balkan region, Student Holding Wien, each held 50%.

The total investment in Bosnia-Herzegovina and the first new raw sugar Refinery was approximately € 40 M, creating 160 jobs. The production capacity of the new refinery was 150,000 tons of white sugar per year (produced mainly from imported raw sugar). In March 2008, the project was handed the Best Foreign Greenfield Investment Award 2007 on behalf of the BiH Foreign Investment Promotion Agency.

Johann Marihart, CEO of AGRANA at the time, explained the investment decision as follows: "The Western Balkans has always been an important export destination for AGRANA. Due to the reform of the EU sugar regime, the WTO panel ruling on EU carbon sugar exports settings and the fact that Bosnia-Herzegovina is exclusively dependent on sugar imports, we decided to outsource our sugar production activities to BiH."

Ilija Studen, CEO Student Holding, emphasized the importance of the refinery for the region. "Our recently established sales joint venture will further strengthen our cooperation and help our market share in the Western Balkans region by 2010 to expand."

Student Holding is a company specialized in the trade of white and raw sugar, oilseeds and edible oils in South Eastern Europe. In the past fiscal year, the company sold approximately 130,000 tons of white sugar in the Western Balkan region.

At the time the Greenfield investment took place, AGRANA was the leading sugar and starch producer in Central and Eastern Europe and the global leader in fruit preparations and one of the world's largest producers of fruit juice concentrates. In the financial year 2007/ 08, AGRANA generated revenues of € 1.9 billion. In the Sugar segment, the Group operated a total of nine production sites in Austria, Hungary, the Czech Republic, Slovakia, Romania and

[71] http://www.agrana.com/, 03.06.13

Bosnia-Herzegovina. In Bulgaria, AGRANA operated a packaging and distribution joint venture with Zaharni Zavodi AD, Sofia.[72]

According to information received from Mr. Patocka, AGRANA´s regional director for the West Balkans, there wasn´t a significant change in the number of people working in AGRANA-STUDEN facilities in Brcko; an additional 10 Workers were employed till 2012 and production capacity increased to 170,000 tons per year.[73] Raw sugar was still imported into BiH which in the end had some negative effects on the host country´s balance of payments.

As a part of the incentives packages offered for this investment AGRANA-STUDEN didn't pay profit taxes initially, but this was not an exception, because every foreign investor enjoyed these privileges in BiH. Even though the company enjoyed only a small proportion of fiscal advantages, it had an almost oligopolistic position in the BiH market with only a few domestic competitors. In spite of this the large companies from abroad represented continuous threat because of the low barriers to entry and the not so effective security measures for the company and its FDI in BiH (as already stated, sugar was mainly imported into the country and not produced).

According to information obtained from Mr. Patocka, technologies transferred in BiH were also used in Austria but the know-how transfer was not providing expected results. Still, after an implementation period, even some new processes for sugar refinement were introduced and used in the new plant. Workers were mainly recruited from the local area, but small problems occurred with particular accounting tasks. It was difficult to find IFRS experts suited for the needs of the company, so that the company brought these experts from abroad and after a short period of time (approximately 1-3 years) they would be substituted with native workers who learned from them and gathered the desired experience in this transition sequence.

Generally STUDEN-AGRANA paid higher wages to its employees than the local competitors. Wages were also significantly higher when compared to the average wage level in the country. In addition skillful employees were given higher wage as an incentive for improvement and to forestall other local firms (competitors) in luring these highly qualified

[72] Source: AGRANA Investor Relations, provided and prepared by Mr. Hannes Haider, Corporate Communications/ Investor Relations

[73] BiH, Serbia, Russia, Turkey and Ukraine had 6 plants operating (1 Sugar and 5 fruit), generated € 168.4 M revenues and employed 917 workers.

workers away. The company had positive spillover effects on other employers in the industry as well in the region (after some time STUDEN-AGRANA became a trendsetter on a country level). They gradually brought out some new norms in: technology that was used in production and raffination processes, as well as the wages paid in the region. Spillover effects induced the increase in the competition between the smaller firms which ultimately led to an increase in productivity and investments in own R&D (competition needed to keep up as STUDEN-AGRANA was not the only competitor threatening to overtake their market share).

Furthermore, Mr. Patocka stressed some concerns and threats that were considered at the time of this particular FDI implementation. Some of them are present to this date, and they even caused a close-down of the factory for a short period of time (for a couple of months at the beginning of operations). The most important threats, from the AGRANA-STUDEN point of view are:

- General political situation in the country
- Uncertainty of legislation
- Protection of investors and their investments
- Clarity / Transparency
- Authority hurdles / Bureaucratic problems
- Corruption

Nevertheless, most of the hurdles were overcome and the company succeeded in its intentions of conducting this direct investment, while keeping its mission in focus, which was to offer cost efficient products, international standards, fulfillment of the given tasks / objectives and continuous development of the products.[74]

[74] Source: interview with Mr. Johann Patocka, AGRANA´s regional director for West Balkan, 29.05.13

11. FDI in Croatia

11.1 Basic information

Croatia is a country in South Europe with a population of 4,403,000. Its territory lies east of the Adriatic Sea and in the southwest part of the Pannonia Plain. Slovenia lies to the northwest, Hungary to the north, Serbia to the northeast, BiH to the east and Montenegro to the southeast border. The capital city of Croatia, Zagreb, is situated near to the Slovenian boarder. The territory of Dubrovnik has no direct land connection to the rest of the country. A few kilometers wide access to the sea of Bosnia and Herzegovina (Neum) in between, made the area around Dubrovnik the only enclave of the country.[75]

The main priority of Croatia is to join the EU on 1 July 2013, as the 28th state member. The economy is recovered and the institutions ready to meet the requirements of membership in the EU. The government should also raise the competitiveness of Croatian firms, so that they would be ready to participate in the large EU market and maximize the opportunities membership will bring, especially a large number of financial funds that the EU has to offer.

Shortly before the 2008-09 crisis, the Croatian economy grew annually at a steady 4-5%. The country´s revenues have doubled, and as the result the economic and social environment has significantly advanced. The extended crisis has made it much more difficult for Croatia to achieve higher (planned) economic growth. The country has been in a recession for the last five years, with the loss of almost 11% of its production.

Economic growth in the first half of 2013 has been weak (1.5% increase in GDP), considering the dependence of the Croatian economy on EU financial support, and not ideal business climate in their own country. 50% of Croatian trade is in the Euro area, particularly with Germany and Italy, and the EU is the source of about 75% of FDI flows into the country. There is a very high concentration of European banks in Croatia whose ownership indirectly opens the Croatian economy to opportunities and to the financial problems after joining the EU.

[75] http://de.wikipedia.org/wiki/Kroatien , 05.06.13

At the end of 2012 unemployment in the country is still among the highest in Region as well as in Europe (over 14%). At the end of 2012 employment lost approximately 115,000 people (mostly in manufacturing, construction and trade) as the result of the global and local financial crisis. Inconstant demand for Croatian tourism products and services combined with limited entry of foreign capital has led to a crisis of poverty, which has increased from 10% to 14%. It is observable that the profile of the poor changed (in most cases educated and younger people, who live in a more urban areas were more affected then the rest of population).

Croatia consumes about 7.8% of GDP on health, though because of the population structure that will change in the next 50 years. A great increase in the elderly population is anticipated and for this reason investments in health services must also be adjusted to satisfy future demand.

The agricultural sector employs 14% of the workforce with 42% of the country's population living in rural areas. Agriculture is an important source of income and Croatia secures 4% of GDP aside for this purposes. Protecting the rural environment is of paramount importance for the EU Common Agricultural Policy.

Croatia is located along the three pan-European transport corridors between the EU and South East Europe. The location itself is of great importance to the economic relationship between the above mentioned. Croatian authorities have invested massively in the development of its transportation network mostly through public funding, focusing mainly on roads, highways and ports (roughly € 40 billion). Croatian Railways are still in need of massive investment if they are to be integrated within the EU network.

From an ecological standpoint, the Croatian territory is one of the most well-preserved in Europe, with 47% of its land and 39% of its sea proclaimed as specially protected areas and conservation areas. Natural heritage attracts millions of tourists annually, with revenues from tourism amounting to about 15% of the country's GDP.

Croatia has acceded to the Kyoto Protocol in 2007, and in 2009 they set goals and associated strategies for their fulfillment. The objectives are in line with EU 20-20-20 agreement (reducing carbon dioxide emissions by 20%, increasing the share of renewable energy in the energy mix to 20%, and improve energy efficiency by 20%, all by 2020).[76]

11.2 Legal framework for FDI

An act on investment promotion and development of the investment climate has been in effect since 2000. The main target group consists of domestic companies and foreign investors. The basic important guidelines can be summarized in a few points:

Incentive measures are regulated by the Act, and relate to projects of investment and boosting competitiveness in: production and processing activities, development (innovation) activities, business support activities and activities involved in services with high added value.

Incentive measures also accommodate environmentally safe entrepreneurial activities and the goal is to provide:

- entry of new equipment and modern technologies
- higher employment and training of employees
- development of products and services of higher added value
- increase in business competitiveness
- balanced regional development in Croatia

Tax incentives are entitled when:

- The investment does not exceed € 1 M. For the recipient of incentive measures, income tax is reduced by 50% of the statutory income tax rates for a period up to 10 years from the start of the investment, provided that a minimum of five new jobs are created as a result of the investment
- The investment is equivalent to the amount of HRK 1-3 M, income tax is reduced to 75% of the statutory income tax rates for a period up to 10 years from the start of the investment, and in this case a minimum of 10 new jobs should be associated with the investment.

[76] http://www.worldbank.org/en/country/croatia/overview , 05.06.13

- The investment exceeds HRK 3 M, the beneficiary of incentive measures benefits from an income tax reduction by 100% of the statutory income tax rates for a period up to 10 years from the start of the investment (minimum of 15 new jobs).

Applicants of incentives may be granted tax incentives also without creating new jobs on the condition that they modernize technological processes and existing production lines or plants. The applicant has the obligation, during the entire period of use of incentives, to keep the same number of jobs he had at the time of filing the application, and not less than three years from the beginning of the use of incentives.

There are also incentive measures preconditioned through generation of new employment in unprivileged regions:

- For investment in regions with unemployment rates up to 10% a non-repayable grant to cover eligible costs of job creation associated with an investment to the value of up to 10% of eligible costs for new employment shall be granted (the maximum amount of € 3,000 euros per job is not to be exceeded).
- In region with an unemployment rate between 10% and 20% the same principle is applied, only that here it is 20% of the eligible costs of job creation associated with an investment up to a maximum amount of € 6,000 per created job.
- For regions exceeding a 20% unemployment rate grants will amount to 30% of the previously mentioned cost (a maximum amount equivalent to € 9,000 per job).

Finally there is a differentiation between capital and labor-intensive investment projects:

- Capital investment projects represent an investment in fixed assets Holders of the incentives should invest at least € 5 M, provided that a minimum of 50 new jobs related to the investment project will be created within a period of three years after the investment.
- On the other hand labor-intensive investment projects represent an investment in fixed assets of holders who receive the incentive measure. This investment should provide a minimum of 100 new jobs related to the investment project within a period of three years after the investment.[77]

[77] http://www.minpo.hr/default.aspx?id=267 , 09.06.13

11.3 Promotion agency

In Croatia operate two main and a large number of small regional promotion agencies. All of them are connected both with the government and with each other. The two main agencies are the Agency for Investments and Competitiveness and the Croatian Agency for SMEs and Investment. AIK is an agency appointed by the government. Its mission is to help investor countries to execute their projects. AIK achieves this by differentiating by sectors and regions, concentrating competition in the regions and simplifying operations in Croatia. The three most important objectives are to attract more projects, create new employment and improve the investment climate.[78]

HAMAG was founded in 2002 as a state agency. It focused on promoting the development of SMEs and increasing their share in the overall Croatian economy. Key activities of the Croatian Agency for SMEs were developing an effective support infrastructure at the national, regional and local level, creating a supportive environment, enabling the use of grants based on the needs expressed in the financing, development and application of technology, improving quality, enhancing competitiveness, as well as networking among local and foreign firms.[79]

In order to improve the investment climate in Croatia AIK and HAMAG INVEST coordinate activities for the realization of investment projects in partnership with investors and relevant government bodies, local and regional governments, and with other legal entities involved on Croatian territory.

AIK and HAMAG INVEST, in collaboration with regional development agencies provide active support to investors at all stages of the investment project. They also coordinate activities that affect the performance and time limit for the realization of projects in the Republic of Croatia.

The Croatian government has the determining role at the end of this process. The final step is the acceptance of the quarterly report which contains information about the state of implementation of the investment projects and the information about administrative barriers in the investment environment which prevent realization of projects. With the aim of improving

[78] http://www.aik-invest.hr/o-nama/ ,09.06.13
[79] http://www.hamaginvest.hr/o-nama/osnivanje/ , 09.06.13

the investment climate agencies propose solutions which have the task to remove administrative and all other barriers.[80]

11.4 Greenfield investments in Croatia

The involvement of foreign investors in Croatia has increased significantly after the political changes at the end of 1999 took place. As figure 9 shows at the beginning of 2005 FDI already exceeded the limit of € 10 billion, representing a value of more than 30% of GDP. The acceleration of the reforms in the following years increased Croatia`s attractiveness for foreign investors considerably.

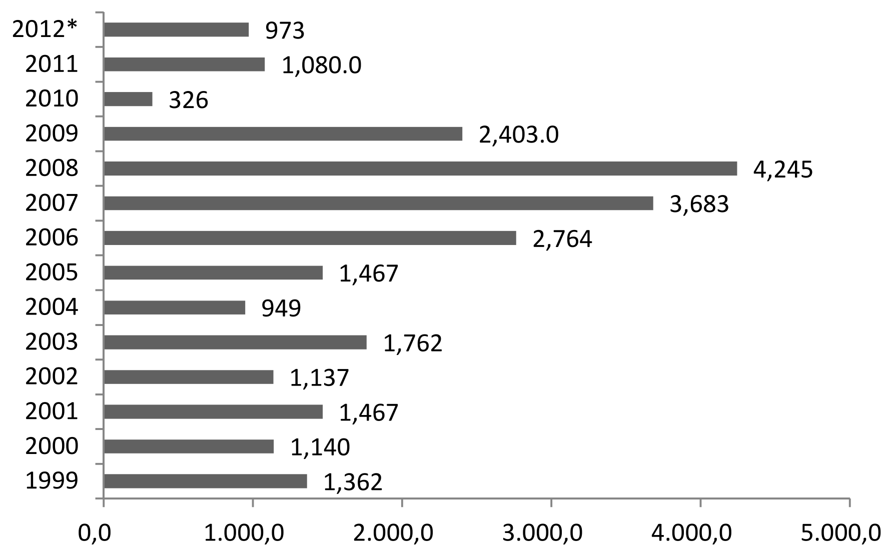

Figure 9: FDI in Croatia by years, 1999-2012, Millions of €, Total amount € 24,766.1 M[81]

According to data from the Croatian National Bank (HNB), countries that have invested the most in Croatia are Austria (€ 6,976.1 M), the Netherlands (€ 4,055.5 M), Germany (€ 3,055 M), and Hungary (€ 2,360.8 M). Not surprisingly Austria is the major investor in Croatia (or as we already mentioned in all three countries). Largely this is because of investments in banking, telecommunications, wholesale, manufacturing sector and because there are almost 750 Austrian subsidiaries in Croatia (these are only the subsidiaries, which allowed the release of their information).[82]

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[80] http://narodne-novine.nn.hr/clanci/sluzbeni/2012_10_111_2391.html , 09.06.13
[81] Source: http://www.hnb.hr/statistika/estatistika.htm , 10.06.13
[82] Source: WKO Subsidiary in Zagreb, information provided by Mrs. Mag. Katharina Haslauer

The largest share of FDI inflow comes from Austria and represents approximately 28% from the total amount of FDI Croatia received over the years. Roughly three-quarters of the overall capital inflow (FDI), come from EU countries. The most important investors by country are reviewed in the following figure.

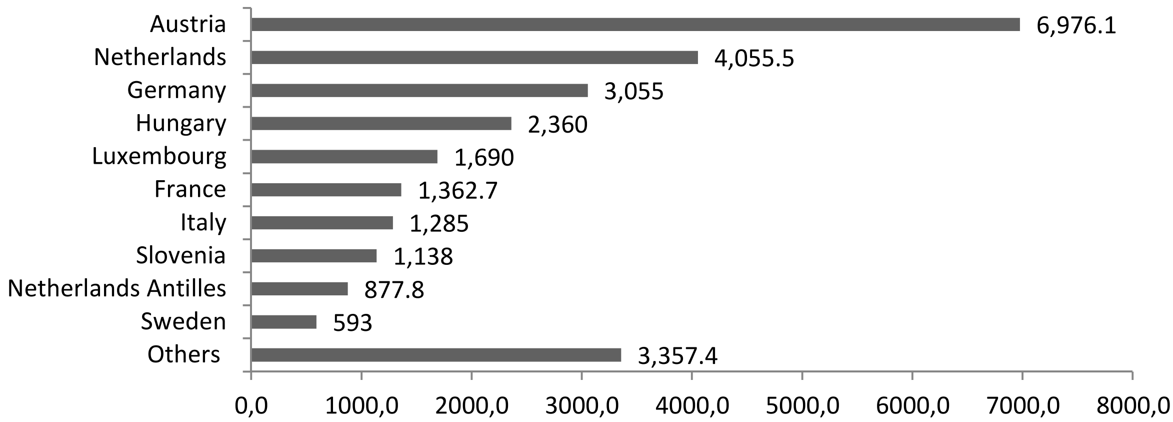

Figure 10: Most important investors in Croatia by country, 1993-2012, Millions of Euro[83]

According to data received from the Statistic Department of the HNB the total amount of Greenfield investments over the period 2001-2012 was € 7,417.5 M.

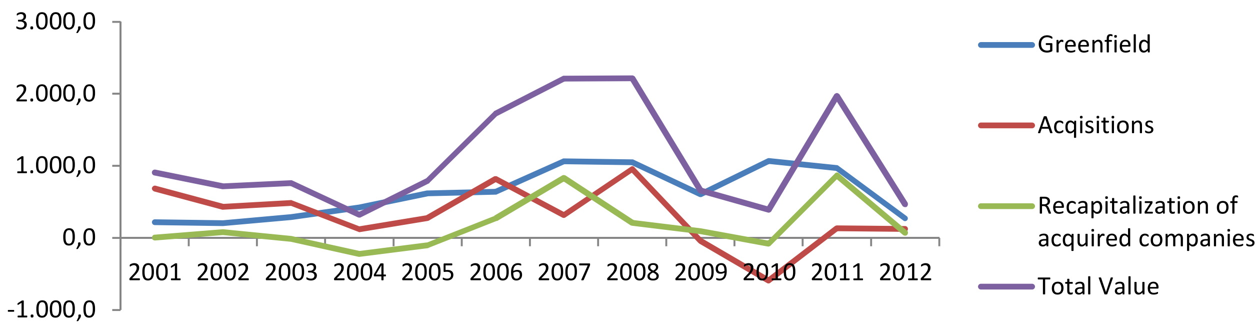

Figure 11: FDI in Croatia, according to the type of investment (2001-2012) in millions of euro[84]

Compared to other modes of entry Greenfield investments were predominant in terms of value, twice as large as acquisitions (€ 3,710.9 M) and almost four times larger than recapitalization of acquired companies (€ 2,004.7 M). FDI inflows (not only Greenfield, but also other modes of entry) were at their peak from 2006 till the end of 2008. Greenfield

[83] Source: http://www.hnb.hr/statistika/estatistika.htm , 11.06.13
[84] Source: Croatian National Bank (HNB), prepared by Mrs. Ivona Sliskovic, Statistic Department.

investment, observed in the same period, decreased nearly 50%. Compared with other modes of entry there was an increase of Greenfield FDI in 2011 before finally decreasing to the minimum in 2012 (€ 271.3 M).

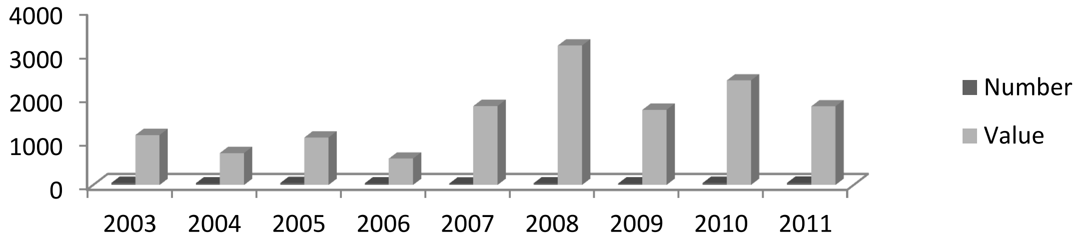

Figure 12: Number and Value of Greenfield FDI projects in Croatia, 2003-2011, Millions of dollars[85]

The data acording to UNACTAD doesn´t comply entirely with informations recieved from HNB. The reason for these differencies, according to Mrs. Sliskovic, could be the estimation method , as well as the fact that UNCTAD also took under consideration the Greenfield projects which were planned, but not yet realized at the time of data entry.

11.5 Calzedonia Case Study

As stated, there are two major agencies which promote FDI in Croatia. They coordinate their efforts with smaller regional investment promotion agencies. On the regional level, the free business zones are adopting the role of FDI promoter and facilitator. Currently twenty business zones are more or less evenly distributed across Croatia.[86] As a definition "a free zone is a part of the territory in the Republic of Croatia, specially fenced and marked where economic activities are undertaken under special conditions (Article 2 Free Zones Act and Article 172 Customs Act)."[87] Mostly it is the case that free zones receive customs benefits as well as benefits for the taxation of income and profit according to the economic situation of the region (number of unemployed, infrastructure conditions etc.).

One of the best examples and the largest export oriented Greenfield zone in Croatia is the Varazdin Free Zone. It was founded in 2001 and situated in the northern part of the country. The location was well suited for trade between EU countries (close to Hungary,

[85] Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com). Note: Data refer to estimated amounts of capital investment.
[86] http://zone.mingorp.hr/index.htm , 11.06.13
[87] http://www.slobodna-zona.hr/index.php?option=com_content&view=article&id=4&Itemid=8&lang=en , 11.06.1.3

Slovenia and Austria) and its main focus is on the production of merchandise for later export. Some of the companies involved in the zone are suppliers for car parts, medical devices, CNC aluminum, machinery, and textiles products. 17 companies (the majority is from Germany and Austria) are active in the Varazdin free zone and they employ 3,200 workers. In the previous year this free zone had more than HRK 2.5 billion (€ 334.5 M) in annual revenue and was the second largest exporter in the country.[88]

Calzedonia Group, which manufactures a huge range of products, was founded in 1986 in Verona, Italy and has roughly 20,000 employees worldwide. Calzedonia has several firms which operate on Croatian soil (more precisely in the Varazdin Free Zone) and simultaneously is one of the largest Greenfield investors in the country as well as in the region.

There are 3,000 stores distributed in 30 different countries over the world under the brands Calzedonia, Intimissimi, Tezenis and Falconer. In the Balkan Region Calzedonia is present in almost every country which was a member of SFR Yugoslavia. It has representatives in Croatia, Serbia, Slovenia, Macedonia and Montenegro (only BiH is excluded). Besides in Italy and the already mentioned countries of the former SFR Yugoslavia, the group expanded its business activities across Europe, namely in Austria, Czech Republic, Greece, Hungary, Poland, Portugal, Spain and Romania. The company portfolio states that about 90% of total income in 2011 was achieved by exports, and for 2013 the volume is projected to exceed € 100 M. According to officials the main factor of the Groups achievements is the perfectly competitive quality-price ratio combined with capabilities in franchising networks (positioning in core zones of the most important cities) and sophisticated advertising.[89]

Calzedonia has so far invested a total of HRK 805 M (€ 106.5 M) in Croatia in newly built factories for the production of socks, bathing assortment and underwear (lingerie), and to a lesser extent in its own retail network. Following this initial investment expansion, the company continues to invest € 100 M in the construction of a new logistics center for the brand Calzedonia in the industrial zone Jalzabet near Varazdin. On a plot of 250,000 square meters the company is going to build a distribution center from which Calzedonia products will be delivered worldwide. This investment is going to provide employment for an

[88] Best Practices in Investment for development, p.83, http://unctad.org/en/Docs/diaepcb200915_en.pdf , 12.06.13
[89] http://www.calzedonia.it/en/corporate/history , 12.06.13

additional 200-250 workers and the land for its realization will be provided by the government (as an incentive). The overall number of Croatian workers in the production facilities is 2,118 and there are another 600 workers employed through cooperation with the Group´s partners.

The Calzedonia Group in Croatia is present in seven technological, organizational and entrepreneurial affiliated companies. In 2010 the established company Calzedonia Croatia is the holder of all retail activities and the company Ducal, launched in 2011, is responsible for the construction and development of the aforementioned logistics center.

Positive effects of this investment were not only noticeable in Croatia, but also in Serbia, its immediate neighbor. Shortly after the investment in Croatia the officials in the Group decided to invest € 20 M in the construction of a new factory in Subotica, which will employ a thousand workers. This is the second investment by an Italian company in Serbia, which already has a factory for the production of underwear in Sombor.[90]

Mr. Branko Grcic, deputy prime minister and minister of regional development and EU funds, asserted that the politics of the Croatian government is to remove any obstacles in the field as soon as possible in order to achieve such valuable investments. Grcic also stated that the obstacles to the realization of such projects are sometimes banal and illogical, and the commitment of the government to eliminate all the problems that hinder investment will help to decrease the cost and increase the competitiveness of Croatian companies. As a remark to these statements Mr. Dubravko Hoic, a member of the management board of Calzedonia Croatia, mentioned that they as investors encountered a lot of minor difficulties during the realization of the investments, but the biggest threat was in the form of problems with land acquisition.

Never-the-less they both agreed that the Calzedonia Group is an example of a very successful Greenfield investment and that this investment is exactly what the Croatian economy needed at this time. They additionally highlighted the figure of more than 3,000 employees in the group, more than a billion HRK in revenue and nearly 90 % of production exported. New technology and know-how will eventually increase the competitiveness in

[90] http://www.poslovni.hr/strane-kompanije/calzedonia-siri-poslovanje-u-regiji-191712 , 12.06.13

Croatia and Calzedonia´s brands are one of the best ways of integrating into the global economy (after all it is a company active in 30 countries all over the world).[91]

12. FDI in Serbia

12.1 Basic information

The Republic of Serbia is a landlocked country in South Eastern Europe with a population of 7,120,666. The country is located in the center of the Balkan Peninsula, and the capital city is Belgrade. Hungary and Romania are situated on the north and north-east border with Bulgaria to the east. To the south, it borders to Macedonia, Kosovo and Montenegro. BiH and Croatia are situated on the east side.[92]

Serbia found itself in a crisis situation for many years after the fall of the SFR Yugoslavia as well as Croatia and BiH. In order to return to the path of prosperity and progress the country needed to experience severe changes and to totally alter the mindset of the legislative responsible politicians. In 2008 a new EU oriented government stood up to the challenge and faced the politically sensitive issue of Kosovo's unilateral declaration of independence and the financial (global) crisis. This included efforts to undertake significant improvements, which will eventually deal with the above stated problems.

The European Commission has at the end of 2011 recommended Serbia to receive "candidate" status for becoming a member of EU. These are positive signs which indicate that the country is making the right decisions. Serbia exhibits sustained fiscal discipline (even though it has the highest inflation in the region, 11.1%) and it doesn´t hesitate to implement difficult measures like wage and pension freezes to help overcome the crisis.

The government succeeded in the battle against organized crime and also arrested and extradited war criminals responsible for war crimes in BiH and Croatia. The biggest challenge, Kosovo's unilateral declaration, was also effectively resolved with the help of EU and to the mutual satisfaction of both countries. Serbia has accomplished a lot and still is on its way to reinstate its place in the international community.

[91] http://www.poslovni.hr/domace-kompanije/ovo-je-po-grcicu-primjer-uspjesne-greenfield-investicije-229841 , 12.06.13

[92] http://de.wikipedia.org/wiki/Serbien , 13.06.13

Serbia suffered from the international crisis in 2009, which led to an unemployment rate of 28% in 2012 and a poverty rate of almost 10% in 2012 (the increase from 2008-2012 was approximately 4%). GDP is estimated to grow by 2% till the end of 2013. The largest problem for the country was to translate economic recovery into employment and to become more competitive. Serbia is a country with a lot of highly qualified workers and sufficient quality infrastructure. It requires new technologies in order to create an efficient business environment as well as capable institutions (beside government proclaimed institutions) to facilitate foreign investments.

Serbian exports intended for non EU countries (CEFTA countries not included) amount to 35% and for EU countries to 55%. The rest is exported to the CEFTA members (10%). The major export industries are the steel industry, the food sector, chemicals, transport equipment and automotive industry.[93]

12.2 Legal framework for FDI

According to the Chamber of Commerce and Industry of Serbia and Foreign Investment Law ("Official Gazette", no. 3/2002 and 5/2003) a foreign investor can be a foreign legal person residing abroad, foreign individual and local citizen with permanent or temporary residence abroad for more than a year.

Foreign investors (foreign legal and natural persons) may:

- establish a new company (up to 100% ownership)
- purchase the shares of an existing company
- obtain a permit (concession) for the use of natural resources
- obtain approval to build, operate and transfer a facility or plant
- acquire any other property rights of foreign investors by which he realizes his business interests

Investment may be in the form of: foreign convertible currency, goods, intellectual property rights, securities and other property rights, the conversion of receivables in shares and debtor shares. Non-Monetary Contributions must be expressed in money.

[93] http://www.worldbank.org/en/country/serbia/overview , 13.06.13

The rights of foreign investors include: the freedom of foreign investment, national treatment, legal certainty, conversion and freedom of payments, the right to conduct business books in accordance with internationally accepted accounting and auditing standards, the right to transfer profits and property. Foreign investors enjoy full legal security and legal protection in respect of rights acquired by investment, which cannot be narrowed by subsequent amendments to laws and regulations.

Foreign investors can not alone or with other foreign investors set up a company in the production and trade of weapons, as well as the area that is in accordance with the law designated as a restricted area. The exception to this is if investors form a company with a domestic legal subject (still gives him no right of the majority to participate in the management without permission of authorities responsible for defense).

Imports of things that represent investment are free, provided that these imports meet the regulations governing the protection of the environment. Imports of equipment, except passenger vehicles and gambling machines, are exempt from customs duties and other import duties.

In order to increase the inflow of FDI that has a great influence on the creation of new jobs, the transfer of new knowledge and technologies and to restore regional development the state provides a range of financial incentives (funds are awarded, depending on the sector and place for investment) for:

- investment in the manufacturing sector of which the minimum value of investment is at least one million euro and which provides at least 50 new jobs
- investment in the manufacturing sector in devastated areas and areas of special interest with minimum value investment of 500,000 euros and which provides at least 50 new jobs
- investment in the service sector, which may be the subject of international trade (minimum value of investment 500,000 euros) and which provide at least 10 new jobs
- investment in strategic projects in the field of tourism (minimum value of investment € 5 M) and which create at least 50 new jobs

- large investment projects, provided that at least 20% of the investment value wouldn´t be realized later than the expiration of one year from the date of signing the contact[94]

12.3 Promotion agency

The Agency for Foreign Investment and Export Promotion of the Republic of Serbia (SIEPA) was founded in 2001 by the country authorities. The agency fulfills two main purposes. The first one is to promote investment opportunities and help foreign and domestic investors in their intentions in Serbia. Secondly, it directly and indirectly contributes to the creation of new jobs, domestic growth, technology transfer and skills (knowledge) transfers.

Further objectives are to increase competitiveness of home companies by demonstrating their performance at the most prestigious international fairs, establishing business contacts and getting familiar with current trends in various industries.

Support for foreign investors is reflected in assistance to foreign investors to start or expand existing business in Serbia. Companies which want to invest or reinvest in Serbia are usually offered the following services:

- finding greenfield and brownfield sites – the agency provides data about construction sites and free capacities owned and offered by individuals and legal entities to potential and existing investors.
- assistance in administrative procedures at all levels – there is an active contribution to the implementation of investment through providing economic, legal and other types of information, as well as counseling regarding multiple administrative aspects for doing business in Serbia
- mediation in communication with relevant authorities at the national and local level - organizing visits and meetings with ministries, agencies, local governments and other relevant institutions in order to achieve effective implementation of projects and solve specific problems.
- connections with local suppliers - supplier database contains information on the production line, quality standards and production capacity of domestic enterprises, as well as their contact details

[94] http://www.pks.rs/PoslovnoOkruzenje.aspx?id=808&p=1&idjezik=1 , 13.06.13

Last but not least, SIEPA conducts Aftercare Service mostly intended for companies which realized their investment projects. The purpose of this service is to maintain regular contact with investors in case of need for support in business activities, with a focus on potential expanding.[95]

12.4 Greenfield investments in Serbia

Serbia is one of the most interesting investment locations in South East Europe. In the period from 2000 till 2012 the country attracted nearly € 21 billion in inward FDI. Some globally recognized MNEs such as FIAT, Microsoft, Gazprom, Siemens and others, found Serbia to be a perfect fit for their investment. Greenfield projects in particular were acknowledged through an award from the OECD as the largest investment of this mode of entry in South East Europe (2004-2006).

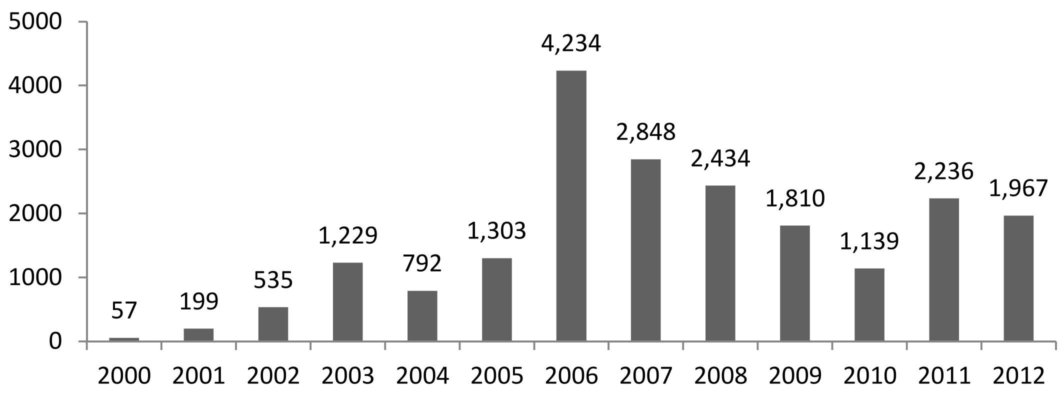

Figure 13: Inward FDI in Serbia, (2000-2012), in millions of euro[96]

Figure 13 once more confirms these facts. There was a strong increase in inward FDI in 2006 followed by a gradual reduction up to 2010. The global financial crisis had a significant impact on the Serbian economy in this period, consequently in the same period the value of investments went down (this was for example not the case in Croatia where the inflow of investments increased at the time). As the economy recovered and important political issues came to be resolved the inflow of FDI also began to increase, apart from the small draw back in 2012. In 2013 Serbia noted a total amount of € 3,296 M in inward FDI, which was on the way to the peak from 2006 (€ 4,234 M).

[95] http://siepa.gov.rs/sr/index/o-nama/siepa.html , 14.06.13
[96] http://siepa.gov.rs/en/index-en/invest-in-serbia/strong-fdi-figures.html , 16.06.13

In general the top investors in Serbia are countries from the EU. Austria is top investor as in BiH and Croatia, followed by Norway, Luxembourg, Germany and Italy, while major investor countries also include Greece, the Netherlands, the Russian Federation, Slovenia, Switzerland and France.

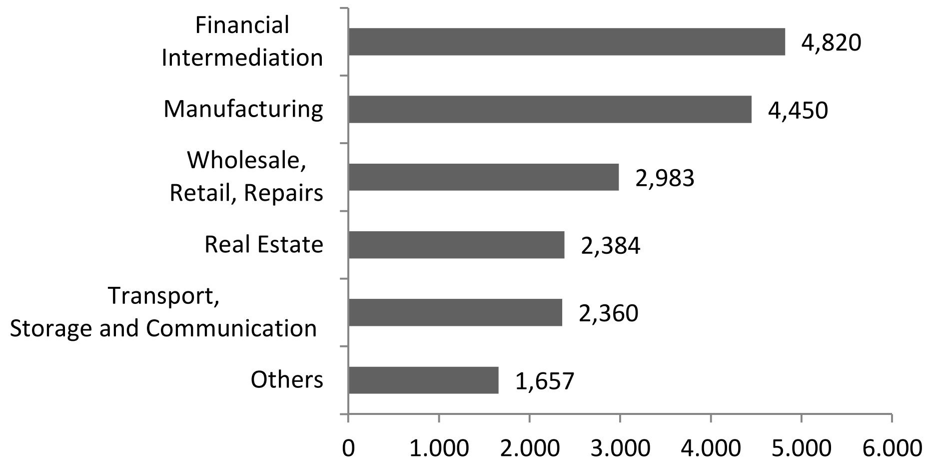

Figure 14: Inward FDI in Serbia, by industry, (2000-2012), in millions of dollars[97]

Banks and insurance companies in Serbia are the sector which registered the highest value, considering FDI inflow ($ 4,820 M). The second most important industry was manufacturing with $ 4,450 M. Wholesale, Retail and Repairs, Real Estate and Transport, Storage and Telecommunication captured $ 7,727 M, while other industries made $ 1,657 M in the period 2000 - 2012.

With regard to data received from UNCTAD in the period between 2003 and 2011 there were 651 Greenfield investments in Serbia and the value generated by these investments amounted to $ 31,220 M. As figure 15 shows, there was a steady increase in Greenfield investment from 2003 until 2007. Most of the investment was executed in 2008 (116), creating a value of $ 9,197 M. In 2009 the value decreased by more than a half to $ 4,095 M and remain almost unchanged until 2011 (a slight increase in value, as well as in the number of Greenfield investments was noted).

[97] http://www.nbs.rs/internet/latinica/80/platni_bilans.html , 16.06.13

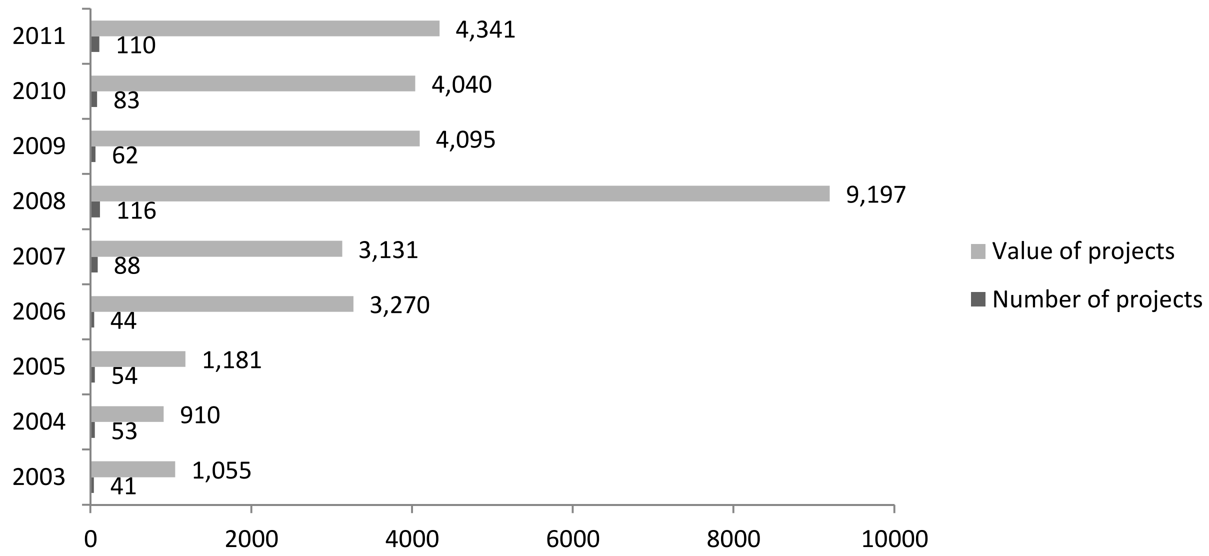

Figure 15: Number and Value of Greenfield FDI projects in Serbia, 2003-2011, Millions of dollars[98]

According to information provided by Mr. Jankovic Bojan,chief advisor by SIEPA, the 30 largest Greenfield investments in Serbia had a value of € 3,502 M and simultaneously, besides this capital inflow, these investments opened 21,626 new jobs.

Some of the most important investors are: Merkator (Slovenia; 5,000 employees), Coca Cola HBC (Greece; 1,500 employees), OMV Srbija (Austria; 1,500 employees), Metro Cash & Carry (Germany; 1,600 employees), Hellenic Petroleum EKO SERBIA (Greece; 700 employees), Schneider Electric (France; 1,000 employees), Vienna Insurance Group(Austria; 864 employees), Benetton Serbia (Italy; 2,700 employees), BOSCH (Germany; 620 employees), Hypo Alpe Adria Bank (Austria; 833 employees), Nexe Grupa (Croatia; 857 employees), Carlsberg Pivara (Denmark; 505 employees) and MOL (Hungary; 560 employees).[99]

[98] Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com). Note: Data refer to estimated amounts of capital investment.
[99] Source: SIEPA, prepared by Mr. Bojan Jankovic, Chief Advisor, (due to the lack of official data on individual investments, the data are based on the SIEPA research, and include both finished and planned (announced) investments).

12.5 Case study Yura Corporation

Free Zones, already mentioned in Croatia, are also present in Serbia. They stand for a physically fenced and marked part of the territory of the Republic of Serbia, with equipped infrastructure (or possibility of facility construction), where the companies can carry out production and service activities with certain incentive benefits.

Free Zones in Serbia are: Pirot, Subotica, Zrenjanin Novi Sad, Kragujevac, Šabac, Užice, Jug, Smederevo, Kruševac and Svilajnac. Serbia is at the door of the European Union and the intersection of Corridor 10 and Corridor 7 on the Balkan Peninsula, which represents the link between eastern and western, northern and southern Europe. This allows the companies, which operate in the free zones, easy and relatively fast access to the EU market.

Investors in Serbia, who conduct their business in Free zones, receive special incentives and a preferential tax regime (exclusion from VAT and duties on imports of raw materials, production of goods for export, machinery, equipment and building materials).

Imports and exports of goods into the zone are unlimited. Goods that are imported from the zone to the domestic market are subject to the import regime for foreign goods. Employers doing business in a free zone are granted to lease business premises, workshops and warehouses under favorable conditions. In addition, companies can transfer their earnings made within the zone to any country (also Serbia) without prior (and sometimes delayed) approvals. Investors are unburdened of tax payments, duties and fees.[100]

The city of Nis and Free Zone Jug, (Donje Medjurovo / Raca) were the chosen location of a South Korean Company, Yura. This Free Zone is located on the south of Serbia and it is very near to the border with Kosovo. There are 257,867 citizens in municipality of Nis and 173,151 are potential employees. The unemployment rate in 2013 reached 36.4%, with average wages (net) being € 317.[101]

The south of Serbia had experienced until 2009 problems similar to some parts of the former SFR Yugoslavia before 1992. A mostly centralized economic system absorbed the majority of resources, which in a very large part went to the capital city of Belgrade (it was the capital city of SFR Yugoslavia as well). Circumstances of a political and financial nature had led to the fact that investors from across the world recognized the potential benefits by

[100] http://siepa.gov.rs/sr/index/investirajte/slobodne-zone.html , 17.06.13
[101] http://serbia-locations.rs/municipalities-srb/municipality.php?ID=105 , 17.06.13

making their investments in one of the Free Zones and especially Free Zone Jug (south). One of the examples is the Yura Corporation.

Yura is a South Korean corporation that manufactures electronic components for the automotive industry, which are primarily cable installation, automotive spark plugs, coils and proprietary cables. Yura Corporation is divided into three divisions: Yura Harness (cable installation), Yura Eltec (cables and components installation) and Yura Tech (spark and coils).The largest of the three divisions is Yura Harness and this particular division has plants in Serbia.

The corporation was established in 1992 as a first hand supplier for Hynadai and KIA motors and covers approximately 60% of demand for these manufacturers. Yura is a family owned enterprise (family Ohm) which employs worldwide 50,000 employees and generates revenues more than € 700 M. Yura Corporation owns: one research center, four distribution centers and seven factories in South Korea, eight factories in China, a factory in Vietnam, five factories in Slovakia, one factory in Russia, one factory in Tunisia and the four factories in Serbia.

Investments in Serbia:

The Corporation bought Zastava Elektro in Raca (April 2010). The total value of the investment was € 8 M. Yura received a grant of € 4.5 M (4,500 € per workplace for 1,000 employees) from the programme for the encouragement of FDI, which conducts SIEPA. The funds are fully paid out.

Yura Corporation has built a Greenfield factory in Nis, which was officially opened on 13.6.2011. The value of the investment was € 15 M (18,600 m2 in size). Nis provided for this project free land of about 4 hectares on site on Donje Medjurovo. Because of the strategic importance of the city of Nis for regional development, this project was awarded grants of 7,000 euros per new workplace (1,500 workers), for a total subsidy of € 10.5 M.

Yura Eltec a second division of Yura in Nis also chose the location of Donje Medjurovo and built there a factory for the production of wire (Shinwon). The value of the investment was € 8 M. This is more capital-intensive type of production and with this factory Serbia became a central hub of Yura Corporation for Europe, which is why a subsidy of 10,000 euros per job location (for 300 people) was proposed. A supplier of copper cables for

Yura Eltec is the Serbian company RTB Bor. Shinwon Ltd. was officially opened on 17.10.2011.

On 08.07.2011 Yura Corporation in Serbia signed a Memorandum of Understanding to build a fourth factory in Leskovac. The purpose of this plant is to produce cable installations for KIA and Hyundai, and it was scheduled to employ 1,500 workers. The total value of the investment was € 13 M and the factory will be the largest factory in Nis.

The city authorities made an agreement with the company "Nevena" Leskovac on handover of the plot of about 4 hectares, which has not been used. This plot was attributed to Yura with the purpose to build the factory (exclusively this purpose). Because of the magnitude of investment the city shown particular interest for this project and granted the subsidy of 7,000 euros per new workplace (1,500 workers), making a total of € 10.5 M.

Based on information received from representatives of the company, the number of employees in all Serbian facilities is: Yura Corporation Ltd., Raca 1366 workers; Yura Corporation Ltd., Nis 1,946 workers, Shinwon Nis 451 worker; Yura Corporation Ltd., Leskovac, 605 workers (total of 4,368 employees). [102]

[102] SIEPA, prepared by Mrs. Sladjana Pavlovic and provided by Mr. Bojan jankovic, Chief Advisor

13. Conclusion

When it comes to transition countries, the inflow of foreign capital in the form of FDI, after the extremely low value in the 1990s, was significantly increased in 2000 and the following years. Bearing in mind the situation in the BiH, Croatian and Serbian economy, the need for further growth of this inflow remains. The business climate in all three countries improved, but not fast enough to stimulate rapid development of the corporate sector and of small and medium enterprises.

The situation determined by the high level of unemployment, chronic lack of financial resources and limited alternative sources of foreign exchange funds narrowed the possibility to choose high-quality foreign direct investment that best suited the needs of the economy. It is increasingly important to stimulate investors from the EU and neighboring countries, in order to ensure satisfactory dynamics of FDI flows in the coming years.

States accept FDI as a source of capital and as a mean to promote competition and economic efficiency. There are ambiguous results concerning the effects of Greenfield FDI on the host country, but when it comes to transition countries they are mainly positive. Consumers benefit from better quality, wider choice and lower prices of goods and services they purchase. New technologies are introduced and there are indisputable positive spillovers in know-how and increases in average wages as well as a gradual integration into the global market.

Greenfield FDI strongly contributes to the development of the host country. The impact of this FDI on companies and the economy in general is different depending on the sectors in which FDI takes place, the size and openness of the market and the quality of the environment that is created through economic policies.

However there are still serious problems (risks) that foreign investors face by deciding to realize investment projects in transition countries. The main limitations on increased inflows of FDI are still the present level of political and economic risk in the countries. The transition process has made relatively slow progress, while business costs continue to remain high, which to some extent explains the economic risks. Political risks however, although reduced through the democratization of the country, remained a very influential factor.

Corruption, insufficient infrastructure and a too complex administration are in addition to (or as a part of) political risk very serious and expensive obstacles for attracting Greenfield

FDI. In order to make changes, authorities must take a course of action to remove these flaws. Corruption increases the cost of business immensely and it is a problem that is widespread across South East Europe. With regard to infrastructure, only Croatia made (till now) significant improvements in investment.

A particular problem for foreign investors that remains is a too complicated administration, inherited from the previous period. Advancements in the form of positive examples provided by the FDI promotion agencies (FIPA, SIEPA, AIK and HAMAG) are quite visible, but the smaller regional promotion bureaus still do not cooperate efficiently. FDI is in some cases very time and cost consuming and the government should, together with state and regional agencies, improve the entire process. Optimally, from the investor´s perspective would be to obtain all permits in one institution as soon as it would be possible.

Even though there were some predictions of a global recovery in FDI during 2012, these did not come true. In fact the number of FDI projects decreased worldwide 16% and in Europe by more than 20%. Only a small number of countries experienced a rise in FDI, but this rise couldn't be compared to the pre-recession peaks.

Reduced economic growth across international markets in 2013, a lower World GDP than in 2012, and financial and political crisis in some European countries are likely to negatively influence important decision makers, when it comes to FDI. For this reason there is a possibility that Greenfield FDI will decline until the end of 2013.

Favorable FDI destinations, including the transition countries will have to compete to maintain their Greenfield FDI level from previous years. Some of the promising growth sectors for investments would be renewable energy, software and IT services, metal and the automotive industry. In order to accomplish sustained growth in Greenfield and overall FDI the financial crisis in Europe must be resolved and political stability reinstated. After these readjustments have been implemented, the FDI market is expected to grow again in 2014 at the earliest.

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15. Appendix

15.1 Abstract

The first part of this paper is conceived as a short introduction and explanation of developments in Foreign Direct Investment across in the world as well as a theoretical overview of FDI classification, explanatory theories, modes of entry and motives for FDI.

The second part considers the effects of FDI inflows on a number of transition countries in South East Europe and explores the basic risks which most likely occur when investors decide to realize their intended objectives.

In the third part a short outline of Austrian Investment (overall and Greenfield) in BiH, Croatia and Serbia is given. In this context, basic information, legislation, important promotion agencies and an overview of important Greenfield FDI for every country in particular is summarized with information from a case study at the end of each section.

The FDI literature exhibits ambiguous results concerning the effects of Greenfield FDI on the host country, but when it comes to transition countries the results indicate that the relationship between FDI inflows and previously mentioned factors is mainly positive with small exceptions over different periods. Finally, the conclusion includes a general forecast and suggestions on how to overcome the investment crisis and attract new inflows of the required and essential Greenfield FDI.

15.2 Zusammenfassung

Der erste Teil dieser Arbeit ist konzipiert als kurze Einführung und Erläuterung der ausländischen Direktinvestitionen Geschichte in der Welt sowie als eine theoretische Übersicht von FDI Klassifikation, FDI erklärenden Theorien, Formen der Eingang und Motive für FDI.

Zweiter Teil spezifiziert die Auswirkungen der FDI-Zuflüsse auf große Anzahl von Transitionsländern in Süd-Ost-Europa und erforscht die grundlegenden Risiken, die wahrscheinlich auftreten, wenn Investoren entscheiden die angestrebten Ziele zu verwirklichen.

Im dritten Teil wird ein kurzer Abriss der österreichischen Investitionen (insgesamt und Greenfield) in Bosnien und Herzegowina, Kroatien und Serbien gegeben. In diesem Zusammenhang werden grundlegende Informationen, Gesetze, wichtige Promotion-Agenturen und Übersicht über wichtige Greenfield FDI für jedes Land einzeln mit praktischen Fallstudie am Ende jedes Abschnitts zusammengefasst.

Die FDI Literatur weist mehrdeutige Ergebnisse, wenn man Auswirkungen von Greenfield FDI auf das Gastland bedenkt, aber wenn es um den Transitions- Ländern handelt, die Ergebnisse zeigen, dass das Verhältnis zwischen ausländischen Direktinvestitionen überwiegend positiv mit kleinen Ausnahmen über verschiedene Zeiträume ist. Schließlich enthält die Schlussfolgerung allgemeine Prognose und Vorschläge, wie die Investition Krise überwinden werde könnte während neue Züflusse von erforderlichen und wesentlichen Greenfield FDI herangezogen werden.

15.3 Curriculum Vitae

Profile

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Education

2011 - Today	Master of Business and Administration at University of Vienna, Focus on Operation Research and Energy and Environment Management
13/10/2009	Degree: Bachelor of Arts
2005 - 2009	Business Administration; University of Applied Sciences Mainz; Mainz, Germany
2003 - 2004	German language course; Johannes Gutenberg University, Germany
2001 - 2003	Economics; University of Sarajevo; Sarajevo, Bosnia and Herzegovina
1997 - 2001	Gymnasium; Capljina, Bosnia and Herzegovina

Languages

Serbo-Croatian	Mother tongue
German	Fluent in spoken and written (certificate)
English	Fluent in spoken and written (diploma)
Bulgarian	Basic knowledge

Software Knowledge

Windows OS	Excellent knowledge
MS Office	Excellent knowledge
Adobe	Solid knowledge
MS Project	Solid knowledge