



ISSN 1409-7893  
e-ISSN 1857-7741  
UDK -338

# **Economic Development**

**JOURNAL OF THE INSTITUTE OF ECONOMICS - SKOPJE**

**Year. 16 No.1-2/ 2014**

---

**Skopje, May, 2014**



## **Economic Development**

### **Published by:**

Institute of Economics- Skopje, University "Ss.Cyril and Methodius",  
Republic of Macedonia

### **Editor in chief:**

Biljana Angelova, Ph.D. (Institute of Economics- Skopje, Macedonia)

### **Editorial Board:**

Biljana Angelova, Ph.D. (Institute of Economics- Skopje, Macedonia)

Vasile Dinu, Ph.D. (Academy of Economic Studies, Bucharest, Romania)

Verica Janeska, Ph.D. (Institute of Economics- Skopje, Macedonia)

Angelo Manaresi, Ph.D. (Alma Mater Studiorum-University of Bologna, Italy)

Maja Micevska Scharf, Ph.D. (Netherlands Interdisciplinary Demographic  
Institute, The Hague, Netherlands)

Goran Penev, M.Sc. (Institute of Social Sciences, Belgrade, Serbia)

Tatjana B. Petkovska, Ph.D. (Institute of Economics- Skopje, Macedonia)

Ivan Tchalakov, Ph.D. (University of Plovdiv, Bulgaria)

**Secretary of editorial board:** Sretanka Gjorgjievska

**English language editor:** Jovanka Jovanchevska-Milenkoska

**Cover design:** Koco Fidanovski

**Computer preparation and printing:** VIDEKS-Skopje

**UDK -CIP** Catalogue record from National and University Library  
"St.Kliment Ohridski"- Skopje

### **Address:**

Institute of Economics-Skopje

Prolet 1

1000 Skopje

Republic of Macedonia

phone : +389 2 3115 076

fax : +389 2 3226 350

E-mail: [eis@ek-inst.ukim.edu.mk](mailto:eis@ek-inst.ukim.edu.mk)

Published **three times per year**

Available on the websites: [www.ek-inst.ukim.edu.mk](http://www.ek-inst.ukim.edu.mk)

Abstracted/ indexed in: **EBSCO** Publishing Database,

Central and Eastern European Online Library (**CEEOL**)

Circulation: 200

Price: 300 MK Denars; 10 EUR

*The Ministry of Education and Science of the Republic of Macedonia has financially participated in printing the journal. In accordance with the decision No.07-3266/20 as of 11 July 1999 by the Ministry of Finance of the Republic of Macedonia, a reduced tax rate has been paid for publishing "Economic Development".*



## CONTENTS

<b>Neda Petroska Angelovska, Marija Ackovska, Biljana Angelova</b> THEORETICAL AND PRACTICAL ASPECTS OF VALUE ADDED TAX IN THE REPUBLIC OF MACEDONIA (Original scientific paper).....	(1-10)
<b>Tatjana Petkovska Mirchevska, German Filkov</b> THE ROLE OF THE MARKETING MIX IN TELEVISION MEDIA AND THE CONCEPT OF “CONSUMER AUDIENCE” (Original scientific paper).....	(11-29)
<b>Vasil Popovski, Sanja Nikolik</b> THE SIGNIFICANCE OF THE ORGANIZATIONAL KNOWLEDGE FOR ACQUIRING COMPETITIVE ADVANTAGE ON THE TELECOMMUNICATION MARKET IN THE REPUBLIC OF MACEDONIA (Original scientific paper).....	(31-47)
<b>Natasha Daniloska</b> MODEL OF KNOWLEDGE SYSTEM FOR ORGANIC AGRICULTURE IN THE REPUBLIC OF MACEDONIA (Original scientific paper).....	(49-65)
<b>Diana Boskovska, Elena Gligorova</b> EFFECTS OF THE FINANCIAL CRISIS ON THE LENDING ACTIVITY OF BANKS IN THE REPUBLIC OF MACEDONIA (Original scientific paper).....	(67-76)
<b>Zoran Janevski, Marin Velkovski</b> ENTREPRENEURIAL OPPORTUNITIES FROM OFFSHORING (Original scientific paper).....	(77-90)
<b>Dejan Mojsoski</b> LIBERALIZATION OF THE INTERNATIONAL AIR TRANSPORT: ITS ROLE IN THE GROWTH OF THE AIR TRAVEL AND THE ECONOMIC EFFECTS (Original scientific paper).....	(91-106)

<b>Tatjana Nestorovska</b>	
COMPARATIVE ANALYSES OF THE INFLUENCE OF SMALL AND MEDIUM ENTERPRISES TO THE ECONOMY	
(Original scientific paper).....	(107-119)
<b>Jelena Tast</b>	
FOREIGN DIRECT INVESTMENT AND INTERNATIONAL TRADE IN GLOBALIZATION	
(Original scientific paper).....	(121-135)
<b>Marko Andonov, Zoran Mihajloski, Elena Davitkovska, Vesna Goceva</b>	
LEGAL ESSENCE OF THE MANAGEMENT CONTRACT WITH THE SPECIFICS OF THE MACEDONIAN LEGISLATION	
(Professional paper).....	(137-150)
<b>Neda Kaleshovska</b>	
ADOPTING PROJECT MANAGEMENT OFFICES TO EXPLOIT THE TRUE BENEFITS OF PROJECT MANAGEMENT	
(Professional paper).....	(151-165)
<b>Kristina Kovacevik</b>	
FOREIGN DIRECT INVESTMENTS IN REPUBLIC OF MACEDONIA: AN OPPORTUNITY FOR DOMESTIC ENTERPRISES TO PARTICIPATE IN GLOBAL SUPPLY CHAINS	
(Professional paper).....	(167-180)
<b>Maja Ristova</b>	
THE ADVANTAGE OF SOCIAL MEDIA	
(Professional paper).....	(181-191)
<b>Guidelines for authors</b> .....	(193-195)

**Dear reader,**

"Economic Development", published by the Institute of Economics – Skopje, is an academic journal in the field of economic development and has been an important medium for 14 years. The main goal of "Economic Development" is to provide intellectual platform to the wider academic and professional publics, and promote the development of economic thought in the country and the world. The interest and need for publishing of the journal were continuously increased all these years.

On the path of development of the economic thought and building a wide network of research and professional cooperation with other countries in the world, we set new goals, criteria and challenges in order to improve the journal's quality. In this regard, during 2010 and 2011, significant changes have been made in editorial policy, design and its availability to broader academic and professional public in the region and worldwide. As result of all this changes, starting from no.3/2010 "Economic Development" will shift into international journal, will be published in English language and will be distributed in all countries of the region and worldwide.

This academic journal covers theoretical and empirical researches in the field of economic and social development, demography, education, corporate governance, international economics, international management, administrative management, corporate and public finance, economics and tourism management, agricultural policy and agricultural management, marketing and marketing management, entrepreneurial management and other areas in the field of social sciences.

The journal "Economic development" has an open approach in accepting and publishing the papers reviewed by an international editorial board consisting of three domestic and five foreign experts. The journal is available in print and online form, through the database of academic papers published by the Institute.

Skopje, May 2013

*prof. Biljana Angelova, PhD*  
*Editor-in-chief*



UDC 336.226.322.01(497.7)  
Original scientific paper

Neda PETROSKA-ANGELOVSKA<sup>\*)</sup>  
Marija ACKOVSKA<sup>\*\*)</sup>  
Biljana ANGELOVA<sup>\*\*\*)</sup>

## THEORETICAL AND PRACTICAL ASPECTS OF VALUE ADDED TAX IN THE REPUBLIC OF MACEDONIA

### Abstract

The meaning of taxes for the state and the state budget has never lost its importance despite many political and socio-economic changes that have occurred throughout history since the beginning of taxation. Taxes in a state play a very important role in its existence and operation, whereby the phenomenon itself is an important research topic. National tax systems and tax policies of countries covering a range of taxes and other revenues that fill the state budget are a necessary element of the process of existence, growth and progress of the state. Undoubtedly, scholars and practitioners are unanimous about the importance of sales tax or value added tax as an invaluable element of the process of the circular movement of income tax and charging the public treasury.

Macedonia has a well-developed system and tax policy on VAT which includes primary and secondary legislation, relevant professional institutions and mechanism that facilitates its recovery, which reduces the possibility of tax evasion. Republic of Macedonia has had successful tax reforms in terms of value added tax on its way to European integration, and has implemented a model that is fully compatible with the pattern of VAT in the European Union. Macedonia has a policy of lower tax rate of VAT compared to rates in surrounding countries, making it a favorable

---

<sup>\*)</sup> PhD, Institute of Economic-Skopje at the University Ss Cyril and Methodius,  
E-mail: neda@ek-inst.ukim.edu.mk

<sup>\*\*)</sup> PhD, Institute of Economic-Skopje at the University, Ss Cyril and Methodius,  
E-mail: marija@ek-inst.ukim.edu.mk

<sup>\*\*\*)</sup> PhD, Institute of Economic-Skopje at the University, Ss Cyril and Methodius,  
E-mail: angelova@ek-inst.ukim.edu.mk

country for foreign investments. In the remaining part of this work there is a more detailed elaboration on the basic features of VAT in the country as a suitable basis for further comparison with VAT in the surrounding countries and the European Union.

**Keywords:** tax system, tax policy, tax, value-added tax rate, Republic of Macedonia

**JEL classification:** H; H2

### **Introduction**

Taxes are a historical category that has frequently changed across all socio-economic formations, in almost all periods. The contents of taxes have changed in parallel with changes in the political, socio-economic and other relations. However, the importance of taxes for the state and the state budget has never lost its validity, and today many of the modern state financial theorists use the term "tax state". Taxes are no longer seen as a classic vehicle with the state's goal to provide funds to cover public spending; they have some broader economic and social functions in national economies.

In the modern world, VAT is the most widespread form of general consumption taxes. That kind of tax expands in developing countries and countries in transition. The share of value added tax in today's systems can be explained by its advantage over other forms of sales taxation. Value Added Tax - VAT<sup>1</sup> is not a new type of tax, but net sales tax at all phases. The consumption tax is charged at each stage of the busy cycle, so it affects the value at that stage which is added by the taxpayer. Crossing from stage to stage, goods are always taxed with the value that is added so that excludes previously paid taxes. The added value is that value which the manufacturer, a person who provides a service, a retailer and wholesaler of raw materials add to the inputs (idle) before they sell the improved or new product or perform a service<sup>2</sup>.

After independence, the Republic of Macedonia was faced with the challenge to build its own economic system as well as introduce its

---

<sup>1</sup> Value Added Tax - VAT, Impôt sur la Valeur Ajoutée - IVA

<sup>2</sup> Arsovski D., Nenovski M., Smiljkovski I. (2012), "Javni finansii" [*Public finances*], Ohrid: Faculty of Tourism, University St. Kliment Ohridski. p. 105

own fiscal system, based on the principles of market economy, private property and economic independence of the entities. The major reform of the taxation system of the Republic of Macedonia is considered the introduction of Value Added Tax in 2000 as a replacement for the previous sales tax on products and services. This in Macedonia was an important step ahead in the process of European integration as a prerequisite for majority of reforms by the European Union.

Today, the Republic of Macedonia has a tax system that is fully compliant with the taxation model system of the European Union and its Member States, which is especially true for the VAT system.

### **1. Theoretical aspects of the fundamentals of value added tax in the Republic of Macedonia**

In the tax and fiscal system of Macedonia especially important place is reserved for the value added tax, which as a replacement of the sales tax on products and services entered into force in 2000. Value Added Tax (VAT) is the most important tax in the tax system of the Republic of Macedonia from the group of indirect taxes, i.e. the taxes which are calculated and levied on the turnover of goods and services. Value Added Tax is a consumption tax which is calculated and payable at all stages of production and trade, and the whole service sector, unless otherwise prescribed by law. The basic principles on which VAT rests are:<sup>3</sup>

- VAT is net tax charged at all phases. Subject to tax is only the value added at all stages, from supply of goods and services, through the manufacturer or service agent, to the final consumer ,actually the final user;
- Regardless of the number of phases, i.e. the number of participants in trade, the final price of the product determines the amount of tax. All participants in the chain "are cleaned" from the previous tax, but the entire burden falls on the final consumer, because this tax is called a general consumption tax;
- In general, all procurement activities carried out by taxpayers are subject to taxation. If purchases are made by registered taxpayers, there is always the VAT.

---

<sup>3</sup> Arsovski D., Nenovski , Smiljkovski I. (2012), "Javni finansii" [Public finances], Ohrid: Faculty of Tourism, University St. Kliment Ohridski, p. 234

- In the Law on Value Added Tax the obligatory expression of particular value in the invoice is emphasized. This separate expression of tax is due to the need for easier and simpler recording and controlling taxes, mostly because of the need for its proper and accurate calculation;

The invoice or bill is a fundamental document in the VAT system. The nature of this tax requires that no one keeps the bill in a drawer because it brings benefits in the form of reduced tax payments. This means that the invoice is not issued light-heartedly, because the issued invoice or bill creates an obligation to pay VAT, which is difficult to avoid.

Value added tax as a tax on general consumption is extremely important in the broadest framework for budgeting and functioning of the state. Although legal entities appear as payers of this tax when trading with goods and services, this tax does not burden them, but the income is borne by the final consumer. As sales tax at all stages, VAT is charged at each stage of the busy cycle and affects the value at one stage which is added by the taxpayer.

## **2. Tax rates of VAT and VAT revenues in the Republic of Macedonia**

The Republic of Macedonia in terms of rates of value added tax introduced model of two rates that include general and preferential tax rate<sup>4</sup>.

With the introduction of value added tax in 2000 as a replacement of the then general sales tax, the general rate sales tax on products (goods) and services decreased from 25% to 19%, and any subsequent amendments to the VAT Act from 2003, that rate additionally declined to 18% and a preferential tax rate of 5%. The application and the amount of these rates are in accordance with the rates applicable in the EU, pursuant to the Sixth Directive, which prescribes general rate not lower than 15% and preferential rates not lower than 5%. However, Member States apply a general rate ranging from 15% to 27% and reduced preferential rate ranging from 5% to 15%. From the member states of the EU, Cyprus has

---

<sup>4</sup> Atanasovski, Zh. (2004), "Javni finansii" [*Public finances*], Skopje: Faculty of Economy, University Ss Cyril and Methodius, p. 114

the lowest rate of 15% and while Hungary has the highest of 27%, followed by the Scandinavian countries Sweden and Denmark with 25% rate.<sup>5</sup>

The general tax rate of 18% applies to all turnover and imports, except for the turnover and imports taxed with preferential tax rate. Preferential tax rate of 5% is applied to turnover and import of shortlisted goods and services, and imports of goods that are extremely important for the living standards of the population. In the current socio-economic conditions the existence of this reduced rate is quite justified, because should it be revoked, it would increase the price range of vital goods and services, thus reducing the already low living standard and encouraging and strengthening of social tensions. With the amendments to the Law on Value Added Tax of 2011, the rates were decreased, i.e. preferential tax rate of VAT was introduced in the field of construction, hotel keeping and food industry<sup>6</sup>.

Official statistics of the Public Revenue Office in the capacity of institution responsible for supervision and control of VAT, for this purpose used sufficiently reliable indicators for identifying the conditions of payment of value added tax in the country for five years (2008-2012).

**Table 1: Revenues from value-added tax**

Year	*million MKDenars
2008	36,174
2009	35,178
2010	37,694
2011	42,223
2012	38,468

Source:

<http://ujp.gov.mk/mk/naplata/category/453>, <http://ujp.gov.mk/mk/naplata/category/634>,

<http://ujp.gov.mk/mk/naplata/category/777>, <http://ujp.gov.mk/mk/naplata/category/850>, <http://ujp.gov.mk/mk/naplata/category/937>.

---

<sup>5</sup>[http://ec.europa.eu/taxation\\_customs/taxation/vat/how\\_vat\\_works/rates/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/rates/index_en.htm)

<sup>6</sup> Amendments and supplements to VAT Law, Official Gazette of RM, no. 135/11

For the specified period, there are increased revenues from the value added tax from year to year, with significant growth statistics recorded in 2010 compared to 2009, and in 2011 compared to 2012. The increase in revenue in this respect is the result of enhanced fiscal surveillance by the authorities, and the tax increase awareness in the country in the past several years. Especially when it comes to value added tax, the introduction of the obligation for registration of cash payments and cash registers turnover of goods and services are recorded significantly better in terms of application and payment of value added tax.

### **3. Comparative analysis of VAT in some European countries**

Amid the global economic crisis many governments around the world decided to supplement the lack of necessary funds in their budgets with tax increases. On the contrary of these practices, the tax policy in Macedonia remained the same, which means that despite the crisis in our country, taxes did not change. Macedonia lowered the tax rates at the beginning of 2008 and they have remained intact to this day, during a period in which most of the far wealthier European countries raised their tax rates. Macedonia has the lowest taxes in comparison with the member states of the European Union and the neighboring countries, and is one of the few states that does not plan to raise taxes in the midst of an economic crisis in the Eurozone. There are similar tax rates in Albania, Serbia and Bulgaria, but still they are either higher or planned to be increased by a certain percentage.

**Table 2: Tax rates of VAT in the region (in %)**

Country	Tax rates
Macedonia	18
Bulgaria	20
Albania	20
Serbia	20
Croatia	25
Slovenia	20
Greece	23

Source: <http://grid.mk/86432988/947574/>

The VAT rate in Bulgaria and Albania in 2009 was 20%, and at the end of 2012, Serbia increased the VAT from 18% to 20%. Croatia increased the VAT rate by 2 percent and reached 25% in March, 2012, and the rate of VAT in Greece in 2011 was 23%. VAT in Slovenia remained the same at 20%<sup>7</sup>.

Low taxes are one of the highlights of our country for attracting foreign investments.

Foreign investors, as one of the key factors they decide to invest in Macedonia among others, cite low taxes. As for the EU, although the earlier Directives regarding the amount of VAT tax rates were fully within the competence of Member States, the Sixth Directive includes provisions partially governing the VAT amount. First it was decided that from 1 January 2006 to 31 December 2010 the standard rate must not be lower than 15%, which later in 2007 changed "from 1 January 2011 to 31 December 2015 the standard rate must be less than 15%. States may apply one or two reduced rates. The list of goods which are taxed at a reduced rate are given in the Annex to the Sixth Directive (foodstuffs, water, drugs, medical equipment, books, newspapers, utilities, etc.) and should not be lower than 5%.

Today the following is applied:<sup>8</sup>:

- Application of minimum general rate must not be lower than 15%;
- Application of goods and services listed in Annex X of Directive 2006/112/EC at a reduced rate which shall not be less than 5%;
- Ability to apply lowest rate (super reduced rate), which is lower than 5% for the goods and services within Annex X;
- Ability to apply the so-called zero rate;
- Ability to apply the parking rate (transition rate) for goods and services not listed in Annex X, which is lower than 12%.

The geographic rate, which is reduced general rate, is applied by some countries to encourage economic activities in specific areas, such as tourist regions, islands, free trade zones, etc. In order to deal with the debt crisis, the conservative government of Spain in the second half of 2012 decided to cash additional ten billion by increasing the tax rate of value added tax. From 1 September 2012 the new VAT rate came into

---

<sup>7</sup>[<http://grid.mk/read/news/86432988/947574/vo-srbija-od-deneska-ddv-zgolemeno-na-20-otsto>] (Nov, 2013)

<sup>8</sup>[[http://ec.europa.eu/taxation\\_customs/taxation/vat/how\\_vat\\_works/rates/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/rates/index_en.htm)]

force, which rose from 18% to 21%<sup>9</sup>. This measure was part of the Spanish government saving's package which increased the prices of products and in turn reduced the purchasing power of the citizens of this "European" country.

Increased taxes happened in almost all European countries. Italy, which was hit hard by the debt crisis in September 2012 raised VAT by one percent to 21%, and had a plan for another increase of 23%, which should come into force in January 2013. The Netherlands decided to increase VAT by 2%, to 21%, which should come into force by the end of 2013. Spain recently approved increase in VAT by 3% to 21%. Low VAT rate of 8% has Switzerland, which in 2011 raised this rate by 1.4%. France is preparing a plan to raise VAT. Lower rate of VAT than Macedonia have only Cyprus (17%) and Norway (15%), which in July 2009 raised the rate for 2% or 1%.<sup>10</sup>

### **Conclusion**

Taxes have never lost their importance for the state and no tax is seen as a classic vehicle to cover public expenditure, but as the foundation for keeping healthy and solid fiscal, economic and social policies in the economy.

Macedonia has a well-developed tax system and policy particularly with regard to VAT which is covered by the appropriate primary and secondary legislation, the relevant professional institutions and mechanism that facilitates its recovery and reduces the possibility of tax evasion.

Republic of Macedonia implemented successful tax reforms regarding value added tax, and the implemented VAT model is fully compatible with the VAT model in the European Union.

---

9

[[http://ec.europa.eu/taxation\\_customs/taxation/vat/how\\_vat\\_works/rates/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/rates/index_en.htm)]

<sup>10</sup>European Union - Tax policy p.50 These include several groups of products and services such as: food, pharmaceuticals, medical equipment, transportation of passengers, supplying water, books, newspapers, services in the field of culture, social services, health and dental services. Super low rate applied France (2.1%), Greece (4%), Ireland (4.4%), Italy (4%) , Luxembourg (3%), Spain (4%) and Poland (%). Zero rate applies, for example, for the purchase of food, supply of pharmaceutical products, supplying assistance to disabled persons and so on. A Metodijev.

Comparative analysis shows that Macedonia has a policy of lower tax rate of VAT compared to rates in surrounding countries, making it a favorable country for foreign investments.

### **References:**

1. Arsovski D., Nenovski ., Smiljkovski I. (2012), “*Javni finansii*“ [*Public finances*], Ohrid: Faculty of Tourism, University St. Kliment Ohridski.
2. Atanasovski, Zh. (2004), “*Javni finansii*“ [*Public finances*], Skopje: Faculty of Economy, University Ss Cyril and Methodius.
3. Bogoev, K., Atanasovski Zh. (1992), “Konceptija za nov danochen system na Republika Makedonija” [Concept for new taxation system in the Republic of Macedonia], Skopje: MF.
4. Baldwin, Richard and Wyplosz, Charles. (2004), “*The Economics of European Integration*”, UK: Mc Graw-Hill education.
5. European Commission Directorate – General Taxation and Customs Union: Structures of the Taxation Systems in the European Union;
6. First Council Directive 67/227/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes;
7. Historical events: The establishment of the EEC and Euratom, European Navigator (ENA);
8. Hitiris, Theo. (2003), “*European Union Economics*”, England: Pearson Education.
9. L.Sweating. (2004), “Tax evasion”, Presentation at the seminar for preventing financial crime, Skopje, March 2004.
10. Pejkovski, ., „Evropski monetaren system i monetarna politika“ [European Monetary System and Monetary Policies], Shtip: Faculty of Economy, University Goce Delchev.
11. Pockova, I. (2013), “Modelot na DDV vo Evropskata unija i sistemot na DDV vo Republika Makedonija – komparativen pristap” [VAT models in the EU and Macedonia – comparative approach], MA thesis, Shtip: Faculty of Economy, University Goce Delchev.
12. Rulebook on issuing document – receipt for reversed transaction, as well as functional and technical features of fiscal machines and

- the integrated automatic management system (“Official Gazette of RM”, no. 55/01, 57/01, 99/01, 91/04, 61/05, 03/08 25/08;
13. Simovic H. (2005), “Fiscal policy in the EU and the Stability Pact and growth“, *Journal of Economics Faculty in Zagreb*, 3.
  14. Sixth Council Directive 77/388/EC of 17 May 1977 on the harmonization of the laws of the member States relating to turnover taxes - Common system of value added tax, uniform basis of assessment;
  15. Stakac B. (2009), “*Public finance*“, Belgrade.
  16. VAT Law, Official Gazette of RM, no. 44/99, 59/99, 86/99, 11/00, 8/01, 21/03, 19/04, 33/06, 45/06, 101/06, 114/07, Constitutional Court no. 93/00, 17/04, 103/08, 114/2009, 133/2009, 95/2010, 102/2010, 24/2011, 135/2011 155/2012;
  17. <http://ec.europa.eu>
  18. <http://ujp.gov.mk/mk>

**UDC 658.8:654.197**  
**Original scientific paper**

**Tatjana PETKOVSKA MIRCHEVSKA<sup>\*</sup>**  
**German FILKOV<sup>\*\*</sup>**

**THE ROLE OF THE MARKETING MIX IN TELEVISION  
MEDIA AND THE CONCEPT OF “CONSUMER AUDIENCE”**

**Abstract**

This paper analyses the application of the basic principles of the marketing mix in one of the most important mass medias – the television, in the direction of satisfying the needs of consumers, as well as maximizing the financial results: product (television program and the audience), price (at which `produced` viewers are sold to the advertisers), promotion (of one's own TV program) and the distribution (programming).

The paper is based on the basic theoretical and practical knowledge of the marketing concept and leads to its practical application in television as mass media. With an increasing number of viewing options and changes in different fields of business, living and various viewing habits of the public, the need for a more consistent adoption of the marketing concept in media, especially television increases as well. At the same time, appropriate changes and adjustments in this direction are necessary on the side of the advertisers.

In a world of fiercer media competition and everyday audience fragmentation, an urgent compliance of the marketing strategies and tactics will be necessary in order to `produce` a sufficient size and composition of `known` audience suitable to be sold to the advertisers.

**Key words:** marketing mix, media, television, television audience advertising, public

**JEL classification:** M3, M31, M37, M39

---

<sup>\*</sup>) Ph.D, full professor, Institute of Economics, University St Cyril and Methodius, Skopje, Republic of Macedonia, E-mail: tatjana@ek-inst.ukim.edu.mk

<sup>\*\*</sup>) Ph.D, researcher, Center for civil communications, Skopje, Republic of Macedonia, E-mail: gfilkov@ccc.org.mk

## **Introduction**

Each year, companies spend millions of Euros on television advertising. How much of this money will be spent efficiently mostly depends on the choices that will be made by the television viewers: when and which television program they will choose to watch. Therefore, it is essential for companies that do advertising to better understand and perform research on the audiences (television viewers), which in this case have a dual role of being both viewers and consumers of the products and services being advertised. It is therefore especially important to know exactly when and in which number the targeted consumers of the products or services of a company watch television.

In order for televisions to “reach” their consumers (audience), they need to apply the marketing concept, i.e., they need to apply the instruments of the marketing mix in their functioning.

The product consists of a program that is initially produced or purchased by the television, which is then broadcast, drawing the audience it has created with the program, and is later sold to the advertisers. This means that first of all, television creates a program that is sold to certain viewers at a certain period of time, and secondly from these viewers it creates a quantum of audience that is “sold” to the advertisers.

When speaking of television, price as one of the elements of the marketing mix, just like the product, has its own features. From the perspective of televisions, what they actually sell is time for advertising. Besides the attribute itself that this “commodity” carries, another feature is that it is a very limited commodity. More specifically, the amount of time televisions can sell to advertisers for airing their commercial messages is limited not only by law, but also by viewers’ patience.

From the distribution perspective, the appropriate setting of a program schedule is crucial to any television station, as it is exactly this program, more specifically, the types of programs that will be offered in each time period of the day which will determine the number of viewers that will be attracted to each program, the number of commercials and the price at which the advertising space will be sold.

Contemporary marketing has long viewed promotion, which is one of the four elements of the marketing mix, beyond its basic meaning. Promotion is increasingly more often seen as a communication, i.e. an integrated marketing communication. However, promotion in electronic

media significantly differs from promotion of other products and services. The main difference stems from the fact that other products resemble each other, whereas each television program is different from the other and should thereby be promoted separately.

Knowing the viewers and their habits is not only important for companies that are advertising, but also for televisions, as this will help them design their programs (shows) and distribute them (program schedule) so as to attract and satisfy more viewers from a given segment, thus contributing to higher viewer ratings, which will enable the attraction of even more commercials and the realization of higher revenues.

### **1. “Consumer Audience” Concept and Viewer Behavior**

Media and marketing researchers are increasingly speaking about consumption of media products instead of receiving or interpretation of media content. This clearly indicates that media content is seen as a product that is sold to the consumer audience. Wernick<sup>1</sup> is among the first that considers this merging of the concepts of audience and consumer target group to be part of the phenomenon called commercialization. Since then, understanding the process of the so-called media consumption has become a central part of significant scientific research grouped around two opposing opinions<sup>2</sup>. The first assumes that the audience is passive and powerless, while the second puts media consumption as an active process in the center of the focus.

A general conclusion amongst experts in this field is that the need for measuring, segmenting and targeting the audience emerges from commercialization.

However, some scientists strongly criticize such views because of the loss of personal identity of the individual viewer and the conversion of viewers into a number, and consider that the audience is being addressed much more as a consumer than it is as a citizen.<sup>3</sup>

---

<sup>1</sup> Wernick, A. (1991), “*Promotional culture: Advertising, Ideology and Symbolic Expression*”, London: Sage Publications. p.181

<sup>2</sup> Puustinen, L. (2006), “The Age of Consumer-Audience, Conceptualizing reception in media studies, marketing, and media organizations”, *Working Paper*, 5/2006 Department of Communication, University of Helsinki.

<sup>3</sup>Puustinen, 2006:1

According to one approach, “television programs are closely linked to the wider promotional culture and we have accepted them in large numbers and with little resistance. We are not in the position anymore to make a clear distinction between our roles as consumers and as citizens. We are not just one of these two social phenomena anymore, but are often both at the same time. In contemporary television, the promotional market culture is inseparable from the setting of program schedules according to lifestyle. Likewise, in our lives, it is quite difficult to define ourselves outside the lifestyle that the market offers us”<sup>4</sup>.

In 1977 the economist Dallas Smiti was the first to reveal the idea of “commercial media economics”, which is based on the concept of selling audiences to advertisers, whereby the audience in that sense is bought and sold based on its viewing habits and consumer capacities<sup>5</sup>.

In regards to the audiences seen as consumers, critics (Ang, Carpenter, Lury and Warde, 2006) mainly speak from a constructionist perspective and view the consumer-audience relationship as a “discursive constructs produced by media and advertising organisations”. According to them, the issue refers to an “imaginary groupings of people that advertising agencies sell to goods producers”. Lury and Warde (1997) represent the idea that all this is actually a product of the companies that are advertising, more specifically, that the whole concept of creating an audience and then selling it as a commodity to the advertisers is actually not created to help consumers in easing their access to products and services, but rather to help companies to “reduce their anxiety and lack of knowledge and imagination”.<sup>6</sup>

Puustinen concludes that the daily life of the consumer audience is not predetermined by the media and commercial world, but that the audience and consumers still have the power and space to act within the structures of economy and culture. Nevertheless, she suggests that both consumption and communication should be seen together by all three aspects: their structure, process and agency.<sup>7</sup>

---

<sup>4</sup> Miles, S. ed. (2002), “*Changing Consumer: Markets and Meanings*”, Florence, KY: Routledge, p.71

<sup>5</sup> Miles, S. ed. (2002), “*Changing Consumer: Markets and Meanings*”, Florence, KY: Routledge, p.12

<sup>6</sup> Lury, C. and Warde, A. (1997) “Investments in the Imaginary Consumer: Conjectures Regarding Power, Knowledge and Advertising”, in Mica Nava, Andrew Blake, Iain MacRury and Barry Richards (eds) “*Buy This Book: Studies in Advertising and Consumption*”, London: Routledge, 87-102.

<sup>7</sup> Puustinen, Liina (2006:17-18)

According to one approach “if television viewing were habitual, the estimation of future advertising audiences would be much easier”.<sup>8</sup> The high fluctuations in the viewership of television series are the clearest indication of selective viewing, which causes television stations to terminate broadcasting certain series and to replace them with new ones because of audience decline.<sup>9</sup> Consumer behavior is most closely related to the media, and within this framework to television as well, as the factors that motivate consumers in making a purchase decision determines how to define the groups of people who will continue to be targeted with commercial messages. The study of consumer behavior helps advertisers in designing effective campaigns. Because of this, there are increased talks about the so-called consumer audience and despite the opposing views a general conclusion among analysts dealing with this issue is that the need for measuring, segmenting and targeting the audience has emerged exactly from commercialization.

MacBeth<sup>10</sup> poses a dilemma on the various influences television has on different viewers, proving that two viewers sitting next to each other and watching the same television program will have different impressions, recollections and understandings of that program. It is believed that during such different impacts one program has on different viewers, there are cases when the characteristics of the viewer prevail and others when the characteristics of the message or content prevail.

In this context, the same author states the conclusion made by Langer and Piper in that “*how* one person views television is much more important than *what* that person is viewing”. Thus, television in this sense is considered to provide the ability to control the viewer in choosing which program to watch, whereas the predictability of “what the viewer will watch”, which is enabled by certain characteristics of the viewer or the program, is an important part of that control. In this respect, studies have shown that it is very important if the viewer is watching the program with attention or absence (MacBeth, 1996:5)

Analysts in the field of the behavior of media audiences as consumers are in general divided into two opposing groups. The first, led by liberals, sees consumers as “heroes” of the market economy, while the

---

<sup>8</sup> Kasari, Heikki J. (1985) “Patterns of Television Viewing in Finland”, Doctoral Dissertation, Helsinki: University of Helsinki.

<sup>9</sup> Puustinen, Liina (2006:17-18)

<sup>10</sup> MacBeth, T. M. (1996) “*Tuning into young viewers: social science perspectives on television*”, London: Sage

second, represented in social studies, seeks to view consumers as “culturally mislead persons” manipulated by commercials and media.<sup>11</sup>

Aside from the opposing views, members of the media audiences as consumers have gone in full depth in all media related studies and about 70% of all media studies are performed for the purpose of assessing the audience as consumers in the process of purchasing.

The role of media is very important in this process from various aspects. Television advertising is frequently used to create or enhance awareness, or to inform people on the qualities of a particular brand and what that brand can offer. In this way (e.g., ranking of automobiles based on awards received, comparing a product with the same type of products from other manufacturers etc.), the consumer may develop certain buying preferences. Furthermore, television commercials can help reach consumers in search of certain brands. Sometimes, advertisers offer such things as better warranty and other terms so as to help or encourage consumers in choosing exactly their product. On the other hand, all these specific offers allow advertisers to measure the results of advertising more easily.<sup>12</sup>

Vollmer and Precourt highlight the need for a change in the behavior of marketers through continual experimentation, innovation and shifts in strategy so as to be more confident they have connected effectively and are communicating with consumers. In this sense, instead of being satisfied with knowing how many people are exposed to their messages, marketers should strive in determining how well their messages are received, whether they caused a consumer response and exactly what those responses are. This means that it is not important how many people are watching, but whether they pay attention and respond.<sup>13</sup>

---

<sup>11</sup> Slater, Don, (1997) “Consumer Culture and Modernity”, Cambridge: Polity Press, pp. 33-34.

<sup>12</sup> Katz, Helen E. (2003) “*The Media Handbook: A Complete Guide to Advertising Media Selection, Planning, Research, and Buying*”, Mahwah, NJ: Lawrence Erlbaum Associates, p. 41.

<sup>13</sup> Vollmer, C. and Precourt, G. (2008), “*Always On: Advertising Marketing, and Media in an Era of Consumer Control*”, New York: McGraw-Hill Companies, Inc.

## **2. The Meaning of the Marketing Mix Concept in Television Advertising**

### **2.1. Product attributes from the perspective of television as media**

The television program or the content that is broadcast by television is only one half of the so-called dual product in television, which is one of the most significant features of television. On one hand, it creates a program that is sold to certain viewers in a certain period of time, and afterwards, on the other hand, “sells” those viewers in the form of an audience to the advertisers. Hence, the decision on what type of program to create is one of the most important decisions in the functioning of any television, because the overall functioning depends on that decision.

In general, televisions of the so-called general format broadcast programs that are diverse in genre and feature contents such as documentaries, informative, children’s and sports events programs, as well as other entertainment/music programs. Part of this content is produced by the televisions themselves (news, contact/entertainment programs, etc.), while the greater part is purchased from other producers, i.e. production houses (films, series, documentary programs, sports events, etc.).

For televisions it is much more cost-effective to buy a certain series than to produce it. The minimum cost for production of one half-hour inexpensive series is at least 30,000 dollars. If 13 such episodes were to be recorded, the total cost for the television would be nearly 400,000 dollars, and these episodes would cover only half an hour per week over a three month period.<sup>14</sup> On the other hand, the television does not stand a chance in earning 30,000 dollars from selling advertising space during the airing of each episode. Therefore, it is much more efficient for the television to buy the series from another producer at a cost not greater than 5,000 dollars per episode, or about 65,000 dollars in total, a sum which will be much easier to obtain from the sale of advertising time during the broadcasting of the series. As for the production houses that are producing these series, their effectiveness is

---

<sup>14</sup> Blumenthal, H. and Goodenough, O. (2006) “*This Business of Television*”, New York: Billboard Books, pp.112-116

provided by selling the series to several other television stations, and later releasing them on DVD.

The program that is purchased and produced by the television station itself is divided on several bases. Primarily, it is divided by genre, by time of day when it is broadcast, as well as by the audience it is intended for. Thus, overall, the program is divided into several types of shows, which in economic terms are actually types of products in the television industry (Blumenthal and Goodenough, 2006:112-116).

## **2.2. Price attributes from the perspective of television as a media**

Price, as one of the elements of the marketing mix, just as the product, has its own characteristics when speaking in terms of television. One of the attributes of price, as an element of the marketing mix, is that some consider it to be expressed through the time that has been spent watching television.

Another attribute of price, though perhaps most important, is that television viewers who do not pay to watch television programs, still do pay in a later stage, in the process of buying products and services, prompted by watching a certain program or commercials that were broadcast during that program. This is actually the entire “philosophy” in terms of price and television viewers. Television remains to be one of the few industries where there is no direct exchange of value for products and services. In television, the price is not paid by those for whom it is intended or watched by, i.e., the viewers, but it is paid indirectly by advertisers who advertise commercials during programs that are watched by viewers so as to attract them later into buying their products or services. This way the price is paid indirectly for watching television.

To make the calculation of the price more simple, or to ease the method of estimating the price to be paid, a rational mechanism for calculating the cost for advertising has been developed among advertisers and it is expressed as cost per thousand viewers (or CPM which is an abbreviation of cost-per-media). From the perspective of the one who pays the price i.e. the advertiser, it is expected for the cost to reach 1,000 viewers. The formula for calculation is as follows:<sup>15</sup>

---

<sup>15</sup> Webster, J.G., Phalen, P.F. and Lichty, L.W. (2000), “*Rating Analysis: The Theory and Practice of Audience Research*”, New Jersey: Lawrence Erlbaum Associates, Publishers, Mahwah, p.212

$$\text{CPM} = \frac{\text{Cost of an advertising spot}}{\text{Projected target audience}} \times 1,000$$

The cost of the advertisement spot is expressed in monetary value, and the projected target audience is expressed in a whole number. The resulting number once again represents a monetary value. The projected target audience is obtained in the following way<sup>16</sup>:

Projected target audience = Rating (in %) × number of people in that audience.

If necessary, when a certain advertiser advertises more than one commercial, it is best to calculate the average cost times 1,000 or the average CPM in the following manner:<sup>17</sup>

$$\text{Average} = \frac{\text{Cost of schedule} \times 1,000}{\text{Target gross impressions}}$$

However, the most applied method of calculating the costs of advertising in electronic media is the so-called Cost per Point, where rating points are used as a unit of measurement instead of per thousand viewers:<sup>18</sup>

$$= \frac{\text{Costs for advertising spot}}{\text{Target audience rating}}$$

An alternative method for calculating this cost can be applied here as well, when there is a large number of spots that are being broadcast and when the average cost per rating point is a better measure for the efficiency of each spot. This is called Cost per Gross Rating point and is calculated as follows:<sup>19</sup>

---

<sup>16</sup> Webster, Phalen, and Lichty (2000:212)

<sup>17</sup> Webster, Phalen, and Lichty (2000:212)

<sup>18</sup> Webster, Phalen, and Lichty (2000:212)

<sup>19</sup> Webster, Phalen, and Lichty (2000:213)

$$\text{CPGRP} = \frac{\text{Costs of schedule}}{\text{Gross rating points}}$$

Ratings are actually the chief currency for planning the costs of advertisers and the revenues of television (Katz, 2003:111). Because it is quite difficult to measure the actual viewership of advertisement spots, both advertisers and televisions have to rely on a kind of surrogate indicator, i.e. the number of viewers who watched the program airing the advertising message.

This commodity is also subject to “loss”, in other words, the period of time foreseen for airing a certain advertisement is irreversible, so if an advertisement does not air during this exact time than it will not air at all. In some countries there are predetermined time-lengths for broadcasting advertising spots. For example: 30 seconds, 15 seconds, 10 seconds. In some places air time is simply sold per second, no matter how many seconds the advertisement is. The commercial value of an advertising spot depends on the number and type of viewers, the time of day when it is broadcast, the demand, competition, season etc.

The selling of advertisement time is usually performed by the television sales department.

Webster, Phalen and Lichty (2000:65) indicate that the monitoring of the financial performance of a television requires constant analysis by the television, not only of its revenue from advertising, but also of its so-called market power or power of the television. This power is determined by comparing the revenues earned from the advertisements with the potential revenues available in the market. Furthermore, since revenues mostly depend on audience size and composition, they should reflect the share of audience. For this purpose, it is recommended that a comparison is made between the earned revenues of the television and the size of its viewers. Statistically this is called a “power ratio” and is calculated as follows:

$$\text{Power Ratio} = \frac{\text{Share of market revenue}}{\text{Share of audience}}$$

It estimates the percent of the so-called total advertising portion a television receives for each percent acquired from the audience share.

In principle, this ratio should be calculated separately by each television because in many countries it is extremely difficult to obtain the exact data on the share of the advertising revenue of each television in the total available advertising revenues.

Webster, Phalen and Lichty (2000:67) suggest that the power ratio can also be calculated separately for each segment which is relevant to a particular television. Hence, if a certain television targets men between 18 and 49 then it can calculate this ratio only for the share of audience of this age group. Also, the ratio can be calculated for the share of audience for a certain time period of the day as well. Nevertheless, the authors emphasize that the data itself on the ratio does not offer much information and that it is much more important to follow historical data on the trends in the movement of the ratio, especially if it is calculated for certain segments or parts of the day. In this way, a conclusion can easily be made whether the increase or decrease in the share of the total advertising revenue is the result of an increase or decrease in the share of audience of the given segment or period of day. Based on the results more righteous decisions can be made accordingly.

### **2.3. Attributes of distribution from the perspective of television as a media**

A television program is divided into program segments, which represent parts of the day in which a particular program is broadcast, and they differ according to the type and content of the program, as well as the type and number of viewers, and hence according to the price for advertising within these segments. According to these segments, each television prepares a program schedule, more specifically, a fixed schedule of shows and programs that are to be broadcast during an entire day, i.e. television programming. Program schedules on weekdays differ from program schedules during the days of the weekend, primarily due to the different living routines viewers have on weekdays and weekends. There are differences between the program schedules during autumn, winter and spring and summer.

The proper setting of a program schedule is crucial to any television station, as the size of viewers that will be attracted to each program, the number of commercials as well as the price at which the

advertising space will be sold all depend on the type of program that will be offered at each specific time period of the day. Therefore, those responsible for programming must choose such a program at a given time of the day that will attract the audience, by size and type, which the advertisers want to target. The more successful television stations are in doing this, the better results they will achieve in their work. One of the most significant authors in the world studying this issue, Eastman and Ferguson (2001:4) consider that „...the primary goal in creating a program schedule is to maximize the size of the audience targeted by those who are advertising, and the only way to achieve this is to satisfy the needs and wishes of that audience.“

A very important issue in the context of the creation of a program schedule is the cost of that program. It is exactly the high costs of producing television shows and buying rights to broadcast certain programs (series and motion pictures, sports and music events etc.) that pose the greatest obstacle in setting the type of program schedule that would attract the desired number of viewers (according to size and type), and would satisfy the needs of the viewers and television and those who advertise. Thus, in some countries major national televisions annually spend about 5 billion dollars just for purchasing the rights to their programs, of which about 3 billion dollars go for programs that are aired during the so-called prime time between 20:00 and 23:00, whereas the costs of producing just one episode of the most popular series broadcast in prime time range between 0.5 and 1.5 million dollars.<sup>20</sup>

Hence, when creating the program schedule, television stations find themselves pressed between the demands of the viewers, their own interests, the interests and demands of the clients (those who are advertising) and the high prices of the programs. While every television station would like to continuously increase the number of those viewing their shows, they are faced with the demands of their clients, which on one hand want the same thing – many viewers, but on the other hand “many viewers” for them does not mean “any which viewers”. They want the “many viewers” of a particular program to be interested in buying their product and having the money to do it. The more such viewers a television creates for its programs, the more success it will

---

<sup>20</sup> Scheduling strategies, Oswego State University,  
[<http://www.oswego.edu/commstdy/condra/powerpoint/brc320/netwkprime-schedulingstrategies.ppt>] (30.07.2011)

have. Contrary to popular belief, it is not the task of televisions to create programs, but rather to build an audience of interest to advertisers.

In order to achieve this, television stations, in turn, perform viewer segmenting and targeting: to examine which part of the audience and in which part of the day they are most likely to watch a particular program. Further attention should be given as to ensure for that segment of viewers to also be the potential buyer of the products of those who advertise during these programs, while taking into consideration the cost of the program and its cost-effectiveness.

The process of programming is performed primarily by selecting programs that are considered to meet the wishes and needs of the viewers, organizing these programs in a certain schedule and advertising these programs in front of the appropriate audience. Certainly, at the end the results need to be evaluated and if deemed necessary, to take corrective action, if possible.

The immensity of the importance of properly setting the program schedule can be shown through a research that was conducted in 2010, according to which 90% of the entire program viewed on television was viewed via traditional broadcast television, with linear television programming (based on a predetermined program schedule)<sup>21</sup>. Only 10% of the viewed television program was viewed through digital video recorders, pay-per-view options, on-demand television, online services, podcasts etc.

Anticipations are that the consumption of a television program broadcast according to a predetermined program schedule will grow in the coming years due to several reasons, mainly due to the still insufficient development of other viewing options (despite their initial rapid development), as well as the charging of fees for so-called nonlinear services (pay-per-view, on-demand television etc.). Therefore, it is estimated that watching linear television will dominate in the next period as well.

This further increases the importance of setting up such program schedules which will best suit the desires, needs, living and working schedules of people so that they can continue to spend, if not more, at least 40% of their waking hours watching television.

---

<sup>21</sup> Media Predictions (2010), Deloitte Touche Tohmatsu Global Technology, Media and Telecommunications Industry Group, p. 4-5

## 2.4. Attributes of promotion from the perspective of television as a media

Promotion, especially when understood in its broader sense as an integrated marketing communication process, includes many other activities. "All activities undertaken by one entity with the purpose of making its products or services known to the market, or for the purpose of selling them".<sup>22</sup>

It seems as if this definition of promotion best suits the nature and specifics of the promotion of a television program, which, on one hand, should become known to the audience through this promotion, and on the other, should be sold, i.e., to acquire or maintain a certain size of audience and to sell that audience to the advertisers.

However, promotion in electronic media is significantly different from the promotion of other products and services. The main difference stems from the fact that other products such as, for example, toothpaste, resemble each other, whereas each television program is different from the other. Therefore, in order to be effective, each show and even each individual episode of a series should be promoted separately. This is what mostly distinguishes the promotion of television products from the promotion of other products and services.<sup>23</sup>

Five major development changes contribute to the increased importance of television promotion:<sup>24</sup>

1. Rising costs for production of a television program;
2. Increased number of television channels;
3. Rapid growth of online media;
4. State deregulation of media and
5. Impact of the application of new technologies.

For televisions the promotion of their programs is so important to them that each year they give up huge potential revenue that could be realized if instead of broadcasting promotional material for their shows, televisions used this time to broadcast commercials. In addition, televisions also pay other media and companies to run advertising for their programs (such as in billboards, newspapers, magazines etc.). In

---

<sup>22</sup> Sekulovska, N. (2005), "*Promocija*" [Promotion], Skopje: Faculty of Economy.

<sup>23</sup> Eastman, S.T., Ferguson, D.A. and Klein, R.A., eds., (2006), "Media Promotion and Marketing for Broadcasting, Cable and Internet", Burlington, MA: Focal Press, p.1

<sup>24</sup> Eastman, Ferguson and Klein (2006:5)

recent years, television websites devote an increasingly significant space for the promotion of their programs, which also means losing certain anticipated incomes that could be realized if commercial messages were to be broadcast instead of promotional contents. These practices speak of the indispensable role that promotion of television programs has in television marketing in the direction of retaining the existing and attracting new viewers.<sup>25</sup>

Eastman, Ferguson and Klein go so far as to equate the identity promotion in media with product branding, and believe that promotion is an effort to establish an identity for the pay television network distinct from all other entertainment and information services.<sup>26</sup>

Promotion of the television program has the following three main functions:

- To retain existing viewers,
- To extend their viewing time, and
- To attract new viewers.

This means that promotion is intended for the existing, but also for new and potential viewers. Without a doubt, existing viewers can be best targeted during the viewing of a particular show. New or future potential viewers can be targeted by promoting a particular show in other shows that are watched by viewers we would like to watch the particular show that is being promoted. New viewers can also be targeted by promoting the program through other media and means such as billboards, flyers, daily and special editions of newspapers and magazines, the internet etc.

“...Promotion is the way the audience hears about new and ongoing programs, and it influences audience size. The best program in the world will have no audience unless, somehow, people hear about it and learn when and where to hear/see it. Promotion is about that ‘somehow’ “<sup>27</sup>

In order for viewers to watch a particular show, movie or any other television content they must first be informed about it. The main way of finding out is through the promotion of the program. Research shows that 90% of viewers find out what’s new on television and two-thirds list television as their most important source about what to watch on TV (Eggerton, 2004). Therefore, the number of viewers and the length

---

<sup>25</sup> Eastman, Ferguson and Klein (2006:1-2)

<sup>26</sup> Eastman, Ferguson and Klein (2006:3)

<sup>27</sup> Eastman, Ferguson and Klein (2006:5)

of time spent watching shows directly depend on the successful promotion.<sup>28</sup>

### **Conclusion**

In order for televisions to survive and achieve the highest possible revenue, they need to adopt and implement the marketing concept, in other words, they need to optimize all the marketing instruments in their strategy: product, price, distribution and promotion. Televisions will be able to maximize the effects of their work only through the full satisfaction of its consumers, who in this specific case have a dual role of being viewers and advertisers.

In terms of the product, as one of the instruments of the marketing mix, here it has a so-called dual role – which is one of the most important features of television. Therefore, from a marketing perspective it is very important to satisfy the needs of the viewers as this further on determines the overall functioning of television, of advertisers (for whom it is very important to reach out to as many of their potential consumers as possible) and of the entire economy.

Price as an instrument of marketing has several features in terms of television as media. One of its features refers to the price at which televisions sell their product to the audience and advertisers (those who advertise). Another feature is expressed through the time that is spent in watching television. Also, another specific is that television viewers who do not pay to watch television programs (as they do by buying newspapers, for example), still do pay later in the process of purchasing products and services, prompted by seeing a particular program or commercial that aired during the program. This is actually the entire “philosophy” regarding price and television viewers.

Distribution as a marketing mix that is applied in televisions refers to the practice of placing shows in a specific broadcasting time slot, i.e., so – called program schedules (in accordance to the needs and viewing habits of viewers). A television program is divided into program segments that represent parts of the day in which a particular program is broadcast, which segments differ according to the type and content of the program, as well as according to the type and number of viewers, and hence in terms of the price for advertising within these segments.

---

<sup>28</sup> Eastman, Ferguson and Klein (2006:168)

According to these segments, each television prepares a program schedule, more specifically, a fixed schedule of shows and programs to be broadcast during an entire day. Program schedules on weekdays differ from program schedules during the days of the weekend, primarily due to the different living routines viewers have on weekdays and weekends. There are also differences between the program schedules during autumn, winter and spring and summer. This means that the people responsible for programming need to choose such program in an exact time of day that will attract the audience, by size and type, which the advertisers wish to target. The more successful television stations are in doing this, the better results they will achieve in their work.

Promotion as a marketing instrument is promoting the product (in this case the program) to an audience with the purpose of increasing the number of viewers, as well as promoting the audience to the advertisers. For televisions the promotion of their programs is so important to them that each year they give up huge potential revenue that could be realized if instead of broadcasting promotional material for their shows, televisions used this time to broadcast commercials. In addition, televisions also pay other media and companies to run advertising for their programs (such as billboards, newspapers, magazines and etc.). In recent years, television websites devote an increasingly significant space for the promotion of their programs, which also means losing certain anticipated income that could be realized if commercial messages were to be broadcast instead of promotional contents.

As to the research on media audiences as consumers, there are numerous views that dominate in regards to the relation consumer-audience in marketing. Knowing the audience and their behavior is considered one of the most difficult tasks in television marketing, just as knowing the consumers is considered as one of the most difficult tasks in marketing in general.

This task becomes even more complicated if one considers the results of research showing that television viewing is not only based on habits, but rather it is a selective activity. In this respect, the role of television marketing mix is of extreme importance.

**References:**

1. Blumenthal, H. and Goodenough, O. (2006) *"This Business of Television"*, New York: Billboard Books.
2. Eastman, Susan T. and Ferguson, Douglas A. (2001), "Broadcast/Cable/Web Programming", *Strategies and Practices*, Sixth Ed., Wadsworth.
3. Eastman, S.T., Ferguson, D.A. and Klein, R.A., eds., (2006), "Media Promotion and Marketing for Broadcasting, Cable and Internet", Burlington, MA: Focal Press.
4. Eastman, S.T. (2000), *"Research in Media Promotion"*, NJ: Lawrence Erlbaum Associates.
5. Eggerton, J. (2004), *"IPG surfing Is Next Big Wave"*, Broadcasting and Cable, 25 June.
6. Kasari, Heikki J. (1985) "Patterns of Television Viewing in Finland", Doctoral Dissertation, Helsinki: University of Helsinki.
7. Katz, Helen E. (2003) *"The Media Handbook: A Complete Guide to Advertising Media Selection, Planning, Research, and Buying"*, Mahwah, NJ: Lawrence Erlbaum Associates.
8. Lury, C. and Warde, A. (1997) "Investments in the Imaginary Consumer: Conjectures Regarding Power, Knowledge and Advertising", in Mica Nava, Andrew Blake, Iain MacRury and Barry Richards (eds) *"Buy This Book: Studies in Advertising and Consumption"*, London: Routledge, 87-102.
9. MacBeth, T. M. (1996) *"Tuning into young viewers: social science perspectives on television"*, London: Sage.
10. Media Predictions (2010), Deloitte Touche Tohmatsu Global Technology, Media and Telecommunications Industry Group, p. 4-5.
11. Miles, S. ed. (2002), *"Changing Consumer: Markets and Meanings"*, Florence, KY: Routledge.
12. Puustinen, L. (2006), "The Age of Consumer-Audience, Conceptualizing reception in media studies, marketing, and media organizations", *Working Paper*, 5/2006 Department of Communication, University of Helsinki.
13. Scheduling strategies, Oswego State University, [<http://www.oswego.edu/commstdy/condra/powerpoint/brc320/netwkprime-schedulingstrategies.ppt>] (30.07.2011)

14. Sekulovska, N. (2005), “*Promocija*” [Promotion], Skopje: Faculty of Economy.
15. Slater, Don, (1997) “Consumer Culture and Modernity”, Cambridge: Polity Press.
16. Vollmer, C. and Precourt, G. (2008), “*Always On: Advertising Marketing, and Media in an Era of Consumer Control*”, New York: McGraw-Hill Companies, Inc.
17. Wernick, A. (1991), “*Promotional culture: Advertising, Ideology and Symbolic Expression*”, London: Sage Publications.
18. Webster, J.G., Phalen, P.F. and Lichty, L.W. (2000), “*Rating Analysis: The Theory and Practice of Audience Research*”, New Jersey: Lawrence Erlbaum Associates, Publishers, Mahwah.



UDC 621.39:339.137.2]:005.94(497.7)  
Original scientific paper

Vasil POPOVSKI\*)  
Sanja NIKOLIC\*\*)

**THE SIGNIFICANCE OF THE ORGANIZATIONAL  
KNOWLEDGE FOR ACQUIRING COMPETITIVE ADVANTAGE  
ON THE TELECOMMUNICATION MARKET IN THE  
REPUBLIC OF MACEDONIA**

**Abstract**

The era of knowledge brings new changes, evident in the rapid advance and development of science, engineering, and technology, which in turn entails changes in society, as well as on the market, creating new “rules of the game” to which organizations would have to respond. At a time of sharp competition and open markets, the success of a modern organization cannot be measured only by the acquired material property. The organizational knowledge represents a new economic category that comprises the overall knowledge of the employees and determines the competitive advantage of the organization. During the transition from industrial economy to knowledge economy, the effective use of knowledge becomes one of the decisive factors in the competitive battle among companies in the Republic of Macedonia. In conditions of changing and unpredictable modern business, and in the struggle for conquering competitive advantage, companies are intensely focusing on the knowledge they possess. Developing the necessary knowledge within the organization requires a focused combination of the knowledge and the abilities of all the participants in the management process – human resources, technologies and processes.

---

\*) PhD, Institute of Economics – Skopje, E-mail: vasil@ek-inst.ukim.edu.mk

\*\*\*) PhD, MIT University, Faculty of Management – Skopje,  
E-mail: nik\_sanja@hotmail.com

**Key words:** knowledge economy, organizational knowledge, human resources, competitive advantage, telecommunication

**JEL Classification:** L96; O15; O34

## **1. Knowledge economy in context of increasing competition**

The era of knowledge brings new changes that are seen in the rapid advance and development of science, engineering and technology, which in turn entails changes in society, as well as on the market, creating new “rules of the game” to which organizations would have to respond. These changes are especially visible in the last ten years, and the following can be distinguished in brief:<sup>1</sup>

- Knowledge is crucial factor for the success of the organization. Competitive advantage is built through managing and connecting staff that possess specific knowledge and skills.
- The time for decision making is significantly shortened. The dynamic environment and the changes occurring in it do not leave space to the organization for long consideration. Timely, quick reactions that will follow current changes are needed.
- Relations among employees are becoming very complex. The new conditions of work emphasize the importance of independence, communication skills, and the ability to build and maintain good relations with the employees in the organization. Virtual organizations are a common occurrence, which reduces the need for physical contact of the employees.
- The information and communication technologies are increasingly being incorporated into the interactions among people, as well as into business transactions. People have become dependent on technology to such an extent that literacy is no longer reading and writing, but work on computers.

Under the influence of the technological and social changes, the era of knowledge also brings forward changes in the consumers’ buying

---

<sup>1</sup> Slavkovi , M. (2006), “Upravljanje znanjem i menadžerske kompetencije, *"Korporativno upravljanje u tranziciji – vlasništvo, kontrola, menadžerske kompetencije"* [Corporate Governance in Transition - ownership, control, managerial competence], Kragujevac: Faculty of Economy, pp.180-199

habits. Consumers are well-informed on the products, and the needs are complex and sophisticated. It no longer represents a challenge for the organization to satisfy the current consumers' needs, but to foresee future needs. This requires continuous investment in equipment – modern production technology, as well as education and training of employees so that they can meet the changing demands on the market. Consumers' needs, which are changing under the influence of the abovementioned conditions, have shortened the product life cycle, and have also imposed new higher quality standards which would have to be respected by the organizations in the process of production.

The competitive advantage of the organization can result in expertise in product design, product features, creative marketing, relations with clients, collaborators, suppliers, competitors. The organizations in the era of knowledge are forced to long life learning. Competitors on the market “never sleep”. Knowledge can be quickly taken over, copied. Therefore, the organization must learn faster and better than its competitors.<sup>2</sup>

## **2. The organizational knowledge as precondition for acquiring competitive advantage**

In the era of knowledge, the focus of an organization's activities is placed upon the most appropriate use of resources. The resources and the skills, which are unique, rare, and create value, bring competitive advantage to the organization. It is thought that the production of competitive products and services requires appropriate resources. During that, knowledge is stated as a key resource in the organization. If the organization possesses knowledge, it will be able to produce and offer competitive products and services on the market. In this era, the traditional factors of production – capital, land and labor force lose their importance in relation to the importance that knowledge acquires as a crucial strategic resource. The optimal use of the traditional factors of production depends on the level of knowledge in the organization.

At a time of sharp competition and open markets, the success of a modern organization cannot be measured only by the acquired material property. In these conditions, the organization's ability to create newly-

---

<sup>2</sup> Slavkovi , 2006

added value is increasingly gaining importance.<sup>3</sup> Hence, it can be said that the success of the modern organization depends on its ability to manage material property and the organizational knowledge.

The interest in the organizational knowledge begins to surge at the very moment when managers realize that the accounting reports do not present the real image of the actual value of the organization, and that they cannot reflect the organization's ability for creating new value.

The organizational knowledge is a new and relatively complex economic category that includes all the subjects of operation within the organization, which cannot be explicitly expressed in the traditional accounting reports. These subjects are particularly important for the organization because they create new, added value, and thus, they also influence the long-term profitability and competitive ability of the organization.

The organizational knowledge represents the overall knowledge of the employees, a specific property of the organization, above all due to its intangibility, which is not the case with buildings, land, equipment, etc. It constitutes the knowledge of the employees – the human resources. The knowledge of the employees, their skills and abilities determine the way in which the organization operates.

A number of organizations today do not pay enough attention to this resource because they see it as a cost to the organization, instead of as an investment.<sup>4</sup> As an addition to this is also the inability to measure or follow the organizational knowledge in the book of accounts.

The organizational knowledge is in fact creating value through practical application of knowledge – to turn knowledge into products, services or processes which will bring new value to the organization.

---

<sup>3</sup> Sunda D., Švast N. (2009), "Intelektualni kapital - temeljni imbenik konkurentnosti poduzeća" [Intellectual capital - a fundamental factor in the competitiveness of enterprises], Zagreb: Ministry of Economy, Labour and Entrepreneurship, p.34

<sup>4</sup> (Sunda and Švast, 2009: 34)

### **3. The organizational knowledge on the telecommunication market in the Republic of Macedonia**

In the period of transition, Macedonian enterprises faced with the processes of restructuring, where changes of the capital ownership took place. The results from this process in the Republic of Macedonia were far from the expected. In the struggle for survival, only a part of the enterprises managed to position on the market. In this process, there were also newly-established enterprises trying to answer the current conditions through developing capacities for successful performance and persistence in the market. The primary objective of the enterprises was achieving competitive advantage within the frameworks of the national economy.

The processes of EU integration created a global competition. This meant a constant adaptation according to external factors and development of internal capabilities of the organizations.

In their efforts to accept the paradigms of the developed and successful companies, Macedonian enterprises should not disregard the fact that the modern knowledge-based economy sets the organizational knowledge as a key imperative and the factor of productivity and efficiency. If it is known that human capital is a source of organizational knowledge, then the great importance of the management of human resources will also be perceived and employees will be considered an investment instead of an expense of the enterprise.<sup>5</sup>

In order to examine the role and the importance of the organizational knowledge, a research survey was conducted in the Republic of Macedonia. The research refers to companies from the telecommunications sector. The telecommunication market is dynamic and the technological changes create a complex environment. The legal regulations aimed at opening of the market and stimulate the competition.

The research was conducted in 10 companies, to a sample of 100 respondents. The majority of respondents are between 26 and 36 years old, immediately followed by respondents who are between 36 and 45 years old with 25%. 7% of the respondents who answered the questionnaire are aged up to 25 years, and only 3% of the respondents are between 46 and 55 years old, which indicates a relatively young

---

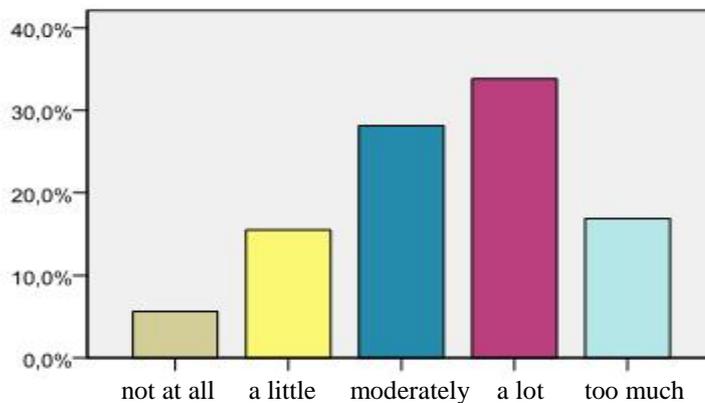
<sup>5</sup> Catleska, Z., V. (2007), "Globalniot pazar i konkurentnosta: integriranje na biznis strategiiite I coveckite resursi" [Global market and competitiveness: integration of business strategies and human resources], Skopje: Politicka misla.

population working in the organizations that are the subject of this research.

Regarding the qualification of the workforce, the majority of the respondents are highly educated – 63%, and the percentage of those who have completed their master studies as well, is also high – 30% of the respondents. Only 7% of the respondents have completed their secondary school education.

The survey results indicate that the impact of the process of globalization has intensified the competition on the telecommunication market in the Republic of Macedonia. The majority of respondents or 51% answered that the globalization has greatly intensified the competition on the market, while 27% of the respondents answered that the globalization has moderately intensified the competition. Only 7% of the respondents believe that the competition on the market is not intensified at all. This indicates the fact that the majority employees are aware of the changes taking place on the market, as a result of the processes of globalization.

**Chart 1: The impact of the process of globalization on the telecommunication market competition in the Republic of Macedonia**

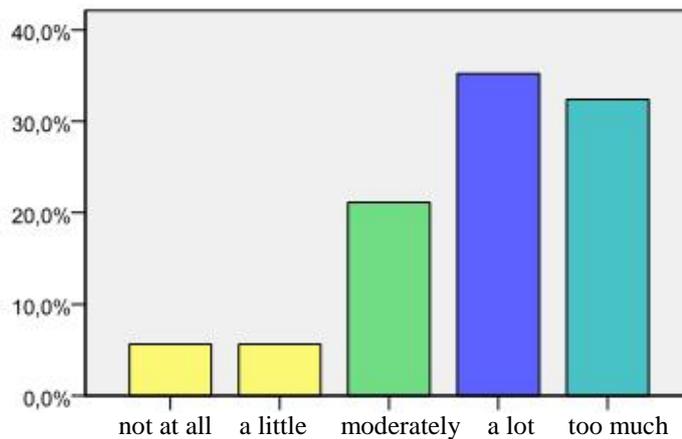


Source: research by the authors

Regarding the organizational knowledge, as an important factor for acquiring competitive advantage on the telecommunications market in the Republic of Macedonia, the two-thirds of the respondents answered that an adequate organizational knowledge is especially important for acquiring competitive advantage. 22% of the respondents

believe that the organizational knowledge has a moderate influences, while 6% of the respondents answered that the influence is insignificant. The results indicate the importance of organizational knowledge in order to acquire competitive advantage.

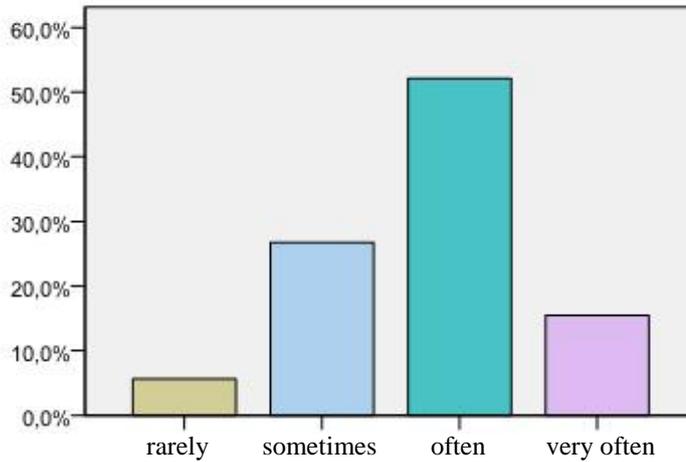
**Chart 2: Organizational knowledge as an important factor for acquiring competitive advantage in the Republic of Macedonia**



Source: research by the authors

The application of the organizational knowledge depends on the activities undertaken by human resources managers in the organizations. In this respect, it is investigated whether the human resources management undertakes activities in the direction of improvement of the knowledge and the professional skills of the employees regarding the dynamic changes on the telecommunication market. The results show that 52% of the respondents believe that the human resources management in their organization “often” undertakes activities for improvement of their knowledge and professional skills, and 15% of the respondents answered “very often”. Only 5% of the respondents answered that the managers “rarely” undertake activities aimed at improvement of the knowledge and the skills of the employees. The majority of the respondents confirmed that the human resources management undertakes activities for the improvement of their knowledge.

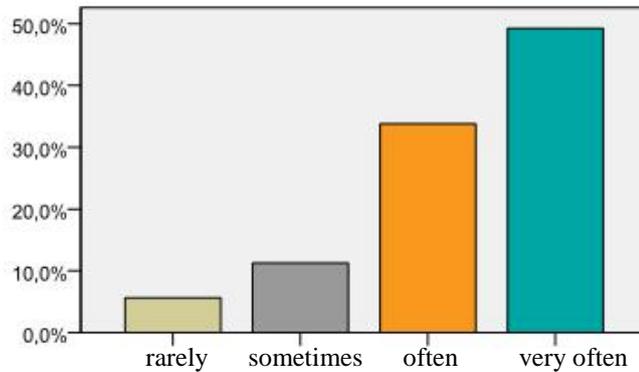
**Chart 3: Human resources management and the application of the organizational knowledge**



Source: research by the authors

Regarding the attitude of the employees and their need to constantly upgrade and improve their knowledge, as a result of the intensified competition on the telecommunication market, 49% of the respondents answered that “very often” they feel the need to improve the knowledge in their area of work and 34% of the respondents answered “often”. 12% answered “sometimes”, and only 5% of the respondents answered “rarely”. The results show that the majority of the employees are aware of the need to constantly improve and upgrade their personal knowledge, which positively adds to the activities undertaken by managers in this direction.

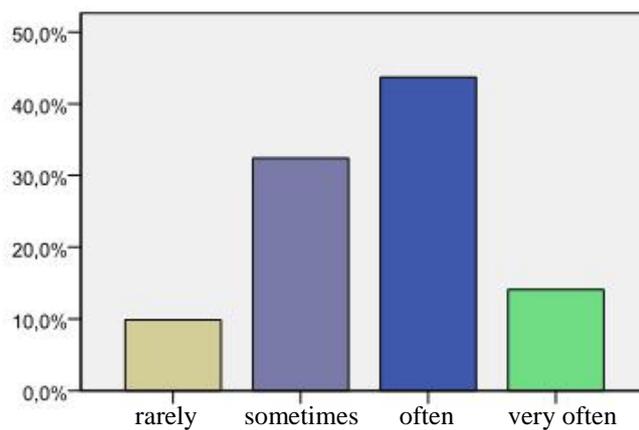
**Chart 4: The intensified competition on the telecommunication market and the attitude of the employees**



Source: research by the authors

In the purpose of knowledge improvement and upgrade, it was examined whether the employees attend trainings in the domain of their profession. The results show that the two-thirds of the respondents answered that they attend training in the domain of their profession (44% answered that they “often” attend training in the domain of their profession and 14% answered “very often”). 32% of the respondents answered “sometimes” and 10% - “rarely”. The results confirm the interest of the employees for improvement and upgrade of their personal knowledge.

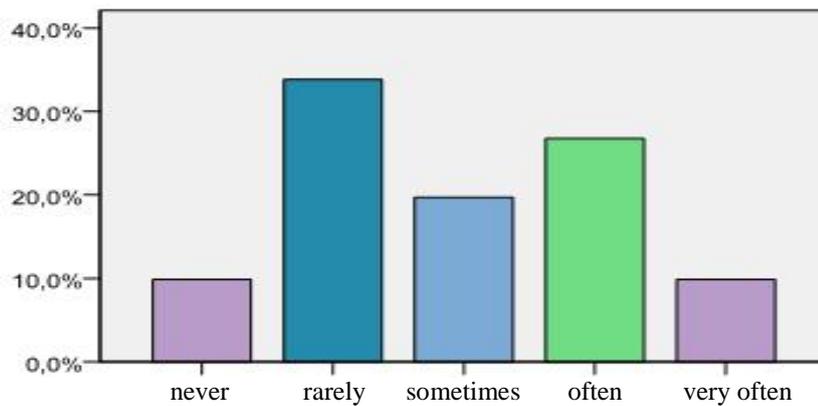
**Chart 5: Trainings in the purpose of improvement the organizational knowledge**



Source: research by the authors

Due to the conditions imposed by the open market, the interest of the employees to attend training outside the domain of their profession was examined. 26% of the respondents answered that they “often” attend such training and 10% answered “very often”. 20% of the respondents answered “sometimes”, 34% of the respondents answered that they “rarely” attend training outside the domain of their profession and 10% of the respondents answered “never”. This indicates that the employees do not recognize the need for personal improvement of skills and knowledge outside the domain of their profession.

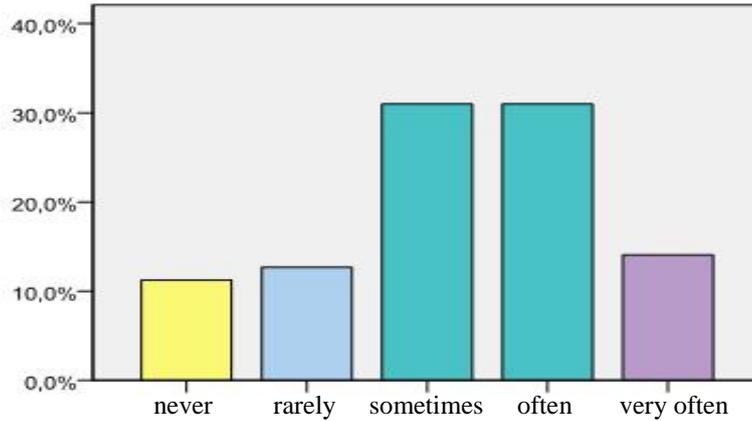
**Chart 6: The interest of the employees to attend training outside the domain of their profession**



Source: research by the authors

Regarding the activities undertaken by managers related to the organization of adequate employee training, 15% of the respondents answered that the managers organize training “very often” and 30% answered “often”. 30% answered that managers organize training “sometimes”. This indicates the initiative of the management towards development and improvement of the knowledge and the skills of the employees by sending them to training.

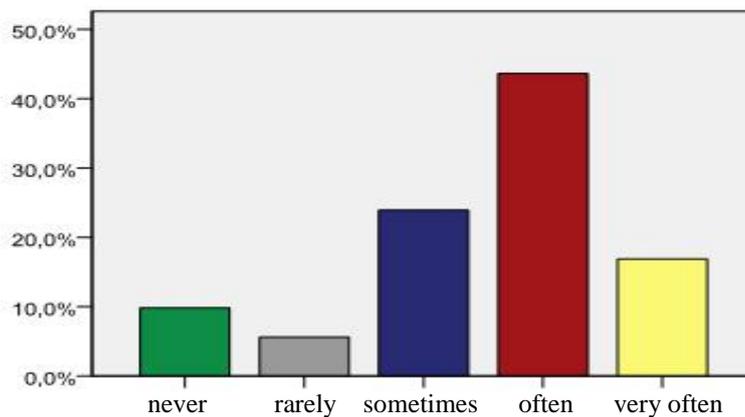
**Chart 7: The activities undertaken by managers related to the organization of adequate employee training**



Source: research by the authors

On the other hand, the employees themselves show initiative for attending training. The majority of the respondents (43% answered “often” and 15% answered “very often”) answered that they attend training at their own initiative. 26% of the respondents answered “sometimes” and only 6% of the respondents “rarely” attend training at their own initiative. 10% of the respondents do not attend training at their own initiative at all. The self-initiative of the employees in the direction of their personal professional improvement is especially positive.

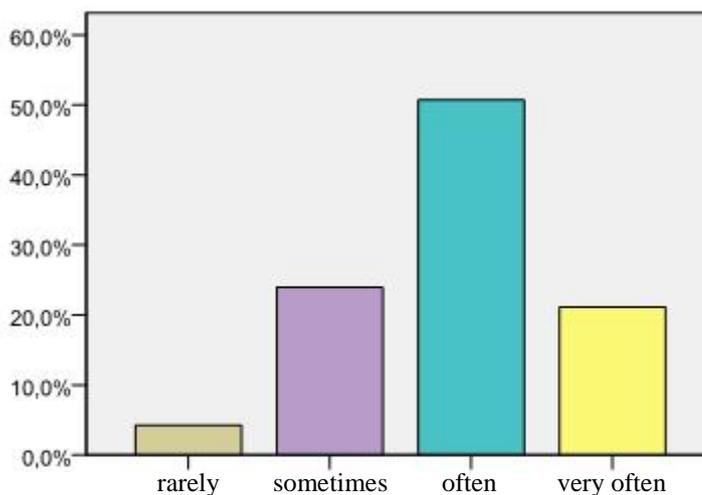
**Chart 8: The self-initiative of the employees in the direction of their personal professional improvement**



Source: research by the authors

The effects of the application of the organizational knowledge were examined through the use of the acquired knowledge from the training in the process of decision making in the everyday work. In this respect, even 50% of the respondents stated that the acquired knowledge “often” helps them in everyday decision making and 20% of the respondents answered that the knowledge acquired from the training “very often” helps them in decision making. 25% answered “sometimes” and only 5% of the respondents answered that the acquired knowledge is “rarely” applied in the decision making. The results show that the effect of the application of the organizational knowledge is positive, or that the knowledge acquired from training helps the employees in the process of decision making.

**Chart 9: The effects of the application of the organizational knowledge in process of decision making**

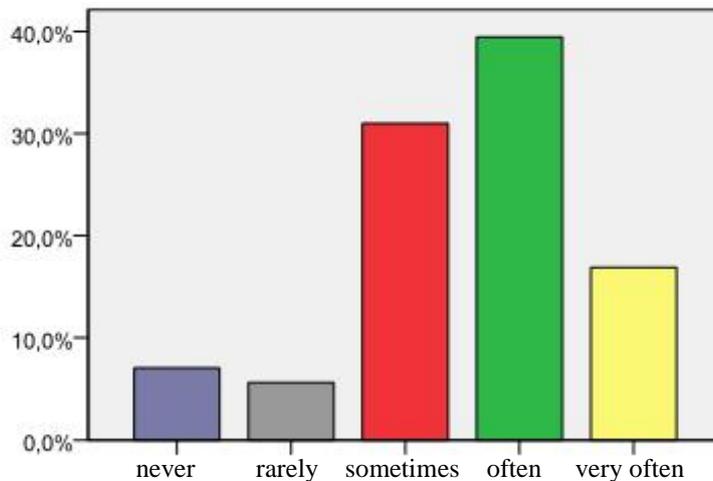


Source: research by the authors

Regarding the activities of the management in the direction of motivating the employees for continuous personal improvement through an adequate system of rewards in the organization, one half of the respondents answered that the system of rewards motivates them to upgrade their knowledge (38% answered “often” motivates them and 16% of the employees answered “very often”). 32% of the respondents answered that the system of rewards “sometimes” motivates them for personal improvement, 6% answered “rarely”, and 8% answered that

they are “never” motivated to improve. Since the majority of the respondents believe that the system of rewards is adequate, or it motivates them for personal improvement, it can be concluded that the system of rewards is an important factor in the application of the organizational knowledge.

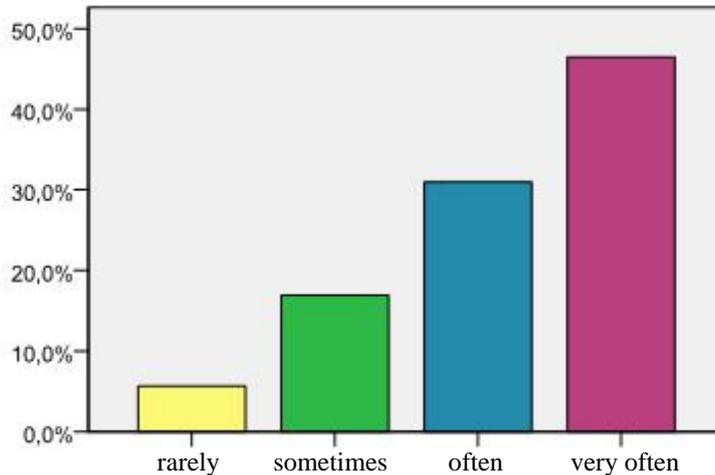
**Chart 10: The activities of the management in the direction of motivating the employees for continuous personal improvement**



Source: research by the authors

Regarding the attitude of the employees about their contribution to acquiring competitive advantage in the organizations where they work, the majority of the respondents – even 78%, answered that with their knowledge they can contribute to acquiring competitive advantage. 17% answered “sometimes”, and only 5% answered that they can “rarely” contribute to acquiring competitive advantage with their knowledge. These results indicate the awareness of the employees of the importance of their knowledge and the contribution they can make for acquiring competitive advantage in the organizations where they are employed.

**Chart 11: The attitude of the employees about their contribution to acquiring competitive advantage in the organizations**



Source: research by the authors

The results obtained from the survey show the significance of the organizational knowledge in the organizations on the telecommunication market in the Republic of Macedonia. Managers undertake a number of activities in this direction such as, organizing training for the improvement of the knowledge and the skills of the employees, creating an adequate system of rewards that should motivate the employees for professional improvement, and on the other hand, the employees show interest and awareness for the need of constant improvement of their personal knowledge and skills, which is imposed by the open market. Such need of continuous investment in the professional improvement is especially emphasized on the telecommunications market due to the connection of telecommunication with high technology, as well as the legal regulations in this area.

### **Conclusion**

The process of globalization imposed the need of modification of the management processes. Namely, because of the free market and the dynamic market factors, which are in constant development – change, organizational knowledge is new tool for achieving goals and successful work of the organization. This resulted from the fact that the value and

the resources are no longer perceived in the same way as in the “traditional” economy, not only from the aspect of organizations, but also from the aspect of countries, regions, industries. The way of creating value for the consumers, which is the fundamental criterion for successful functioning of the organization, significantly differs from how it was in the past – from the way of creating value in the “traditional” economy. The new way of creating value requires a new management approach, or a new way of work.

The technological changes and a complex environment are extremely notable at the telecommunication market. Also the legal regulations opened the market and stimulate the competition. The process of globalization has intensified the competition on the telecommunication market in the Republic of Macedonia.

Regarding the dynamic changes on the telecommunication market, organizational knowledge becomes important factor for acquiring competitive advantage. The use of the organizational knowledge depends on the activities undertaken by human resources managers in the organizations. Managers have to take activities in order to improve the organizational knowledge and professional skills of the employees.

The system of rewards is a crucial factor of motivation to upgrade employees’ professional knowledge. Also the activities undertaken by managers are related to the organization of adequate employee training which indicates the initiative of the management towards development and improvement of the knowledge and the skills of the employees by sending them to training.

The effects of the application of the organizational knowledge were examined through the use of the acquired knowledge from the training in the process of decision making in the everyday work and the results show that the effect is positive, so the knowledge acquired from training helps the employees in the process of decision making.

The employees as well are aware of the need to constantly improve an upgrade their knowledge. They are interested in attending trainings in purpose of improving their knowledge. The results show that the employees are interested in improving their knowledge in the domain of their profession, but they don’t recognize the need to upgrade knowledge outside the domain of their profession. Having in mind that, managers should motivate the employees to improve their knowledge and skills outside of their professional specializations.

Both the managers and the employees show interest and awareness for the need of improvement of personal knowledge which is imposed by the open market. The employees are aware of the importance of their knowledge and the contribution they can make for acquiring competitive advantage in the organization.

Managerial revolution points out the need and the importance of organizational knowledge as a condition for successful work and for achieving the competitive advantage of the organization. The traditional means of production have lost the decisive role in acquiring competitive advantage. If the success of an organization in the traditional economy was measured by the quantity of produced and sold products, today the success of an organization is measured by the knowledge, skills and abilities that an organization owns. In conditions of changing and unpredictable modern business, and in the struggle for conquering competitive advantage, companies are intensely focusing on the knowledge they possess. Developing the necessary knowledge within the organization, requires a focused combination of the knowledge and the abilities of all the participants in the management process – people, technologies and processes.

Organizational knowledge became a key resource for the success of the organization. Today, world economy is facing a new challenge. The production and the technological revolution are already in the past. The stage is entered by the managerial revolution – the era of knowledge. In knowledge economy, which is on the horizon, organizations will compete at which one owns better organizational knowledge and at finding a better way to develop the human resources in the organization. Implementing systematic and continuous learning in the entire organization becomes one of the most important forms of human resources development.

### **References:**

1. Argote, L., B. McEvily, R. Reagans. (2003), “Managing Knowledge in Organizations: An Integrative Framework and Review of Emerging Themes”, *Management Science, Special Issue on Managing Knowledge in Organizations: Creating, Retaining and Transferring Knowledge*, 49(4).

2. Catleska, Z., V. (2007), "Globalniot pazar i konkurentnosta: integriranje na biznis strategiite I coveckite resursi" [Global market and competitiveness: integration of business strategies and human resources], Skopje: Politicka misla.
3. Hansen, M.T., N. Nohria., T.Tierney. (1999), "What s Your Strategy for Managing Knowledge", *Harvard Business Review*, March/April.
4. Jennex, M.E. (2005), "What is KM?", *International Journal of Knowledge Management*, 1(4), I-IV.
5. Malhotra, Y. (1997), "Knowledge Management in Inquiring Organizations", Proceeding of 2RD Americas Conference of Information System (Philosophy or Information Systems – in Track), Indianapolis.
6. Skyrme, D.J. (1999), "*Knowledge Networking: creating the Collaborative Enterprise*", Butterworth Neinemann.
7. Slavkovi , M. (2006), "Upravljanje znanjem i menadžerske kompetencije, "*Korporativno upravljanje u tranziciji – vlasništvo, kontrola, menadžerske kompetencije*" [Corporate Governance in Transition - ownership, control, managerial competence], Kragujevac: Faculty of Economy.
8. Sunda D., Švast N. (2009), "Intelektualni kapital - temeljni imbenik konkurentnosti poduze a" [Intellectual capital - a fundamental factor in the competitiveness of enterprises], Zagreb: Ministry of Economy, Labour and Entrepreneurship.



UDC 005.94:631.147(497.7)  
Original scientific paper

Natasha DANILOSKA\*)

## MODEL OF KNOWLEDGE SYSTEM FOR ORGANIC AGRICULTURE IN THE REPUBLIC OF MACEDONIA

### Abstract

Organic agriculture is one of the fastest growing agricultural production systems in Macedonia, each year recruiting more producers and accumulating more knowledge. Its development stage enters a critical point where exchange of ideas, information and knowledge must take place. Therefore, main purpose of this paper is to research and explain the need for establishing organic agriculture knowledge system in Macedonia.

An integral part of the paper is explanation of key processes within organic agriculture knowledge systems. At the beginning, the current situation in the Macedonian organic production will be presented and analyzed. Discussion on actors of the organic agriculture knowledge system and their possible implications, as well as the most important knowledge devices, will follow. The last part will describe a possible model for creation of organic agriculture knowledge system in Macedonia.

Research methodology is based on literature review, as well as secondary statistical data and comparative analysis. Results will show that only systematic approach will enable easier access to information and will help farmers in implementing the complete organic product process.

**Keywords:** organic agriculture, knowledge system, knowledge actors, knowledge devices, farmer networks

**JEL classification:** Q01, Q12, Q19

---

\*) PhD, Associate professor at the Institute of economics, University Ss Cyril and Methodius, Skopje, Republic of Macedonia, natasha.daniloska@ek-inst.ukim.edu.mk

## **Introduction**

Thanks to its original concept, organic agriculture brings radical change and innovation based on new values of economically viable, environmentally sound and socially fair agriculture. This certainly contributes to the continuing development of organic agriculture all over the world, which proves that mankind is awarded the need for transition to sustainable agro-food model. Its genuine attributes and development potentials makes organic agriculture a land use system that can help in addressing several challenges Macedonian society faces poverty, loss of biodiversity and water pollution. This particular land, or even better, nature use system involves not only substantially distinct production technologies, but also new approach to farm management, farmers' collective organisation and market strategies. As an outcome of these interactions, it builds on a new knowledge base and proposes alternative knowledge processes to those of conventional agricultural system. Research confirmed that most of organic agriculture knowledge has not been developed through the formal education system or by conventional science (Sumner, 2008). Namely, organic agriculture emerged as informal movement started by farmers and environmentalists, unlike many other agricultural innovations which are mostly result of science and technology development and delivered to farmers as comparatively standardised, ready to use knowledge. Under these circumstances, the most substantial contribution of organic agriculture has probably been knowledge of production and its dissemination through social learning and other knowledge devices (information flow, farmers' experiments, networks, innovations and technology transfer).

Benefits of organic agriculture are only possible if based upon an innovative knowledge system that links a diversity of actors along the food chain across sectors, disciplines, professions, regions and borders. Therefore, transition to this sustainable agriculture model depends on establishing new efficient knowledge and learning system, that is not a set of general technical practices to be implemented everywhere. Organic agriculture is an ongoing and complex context-specific adaptation of its practices by local actors, where production processes are strongly connected with the local environment and knowledge, preserved by one generation of farmers and passed on to the next generation. The learning process on organic agriculture is tightly linked to a process of trial-and-error by organic farmers and consumers, and it is the outcome

of their inventions and innovations. This is most certainly true for the creation, accumulation and dissemination of organic agriculture knowledge in Macedonia, where major knowledge base has been created, developed, tested, protected, passed down and expanded upon by practitioners in the field. Exchange of all gained knowledge is mostly through only one communication model – organic farmers communicating with other organic farmers, which in many cases are also family related.

Although in its bear essence organic agriculture shares the use of naturally occurring biological processes with ancestor methods, it must be pointed out that it has the capacity to absorb as much technological and science advancements, as conventional agriculture (Ingram, 2007). In fact, in order to meet sustainability goal, technological and scientific innovations are more than needed in the domain of improving soil fertility, using natural regulation and diversity to prevent pests and diseases in crops and livestock, using little additives in processing (Niggli et al, 2008:17). Additionally, the need to strengthen organic farmers' positions among other farmers, policy makers and other food system agents represent another broad opportunity for science-based solutions. In this sense, the organic agriculture knowledge system includes many actors, its institutions and organizations and is therefore a result of an intensive social learning process.

## **1. Organic agriculture in the Republic of Macedonia**

Development of organic agriculture in Macedonia is dating back from the late 1990s, started as an initiative of several farmers, supported by foreign donors. Although the historical development of organic agriculture in the country is short, as will be shown, it is also very dynamic and encouraging.

In 1999 initial expertise has been provided for drafting the legal bases for organic production, and by the end of 2000 the first draft law on organic production was completed. In 2001, the Government adopted the draft Law on Organic Production and launched the project “Local initiatives to organic farming”, as part of a program to support environmental NGOs. Finally, in 2004 the Law on Organic Production<sup>1</sup> was passed and an obligation was taken to complete national legislation

---

<sup>1</sup>Official Gazette No. 16/2004

with 12 other necessary by-laws. The first by-law was adopted in December 2004 and was concerned with establishment of an Advisory Coordination Commission on organic agriculture. The second by-law, was adopted in March 2005. Three by-laws regulating the production standards in organic agriculture (plant production, animal production and processing) were adopted in June 2006.<sup>2</sup> Same year, the National Federation of Associations of Producers of Organic Products “Biosan” was registered. In 2007 the National strategy with Action plan for development of organic agriculture for the period 2008-2011 was adopted.<sup>3</sup> In 2009, the first Macedonian certification body was accredited. The same year, in December, some changes were made in order to harmonize national legislative with the Council Regulation (EC) No. 834/2007 and Commission Regulation (EC) No. 889/2008, which resulted with a new Law on Organic Agriculture,<sup>4</sup> entered in force in 2010. By the end of 2010, all remaining by-laws were adopted.<sup>5</sup>

Along with adaptation of the national legislation, in 2007 the Macedonian Government launched a program to financially support the development of organic agriculture. Measures of this program provide increased financial support of 30% for organic production compared to regular production, as well as additional support for the processing and trade of organic products, followed by coverage of 50% of the cost of certification.

---

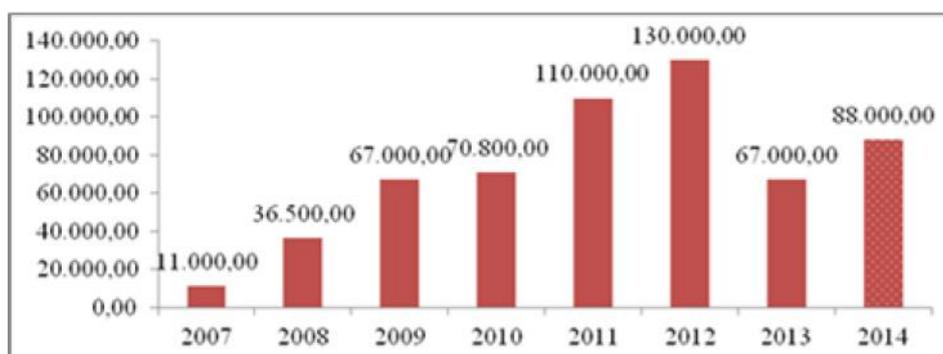
<sup>2</sup>Official Gazette No. 60/2006

<sup>3</sup>Ministry of agriculture, forestry and water economy of the Republic of Macedonia: National strategy with Action plan for development of organic agriculture for the period 2008-2011, Skopje, august 2007.

<sup>4</sup>Official Gazette No. 146/2009

<sup>5</sup>Official Gazette No. 162/2010 and 163

**Chart 1: Financial support for organic agriculture in the Republic of Macedonia for the period 2007-2014, (in MKD)**



Source: Ministry of agriculture, forestry and water economy of the Republic of Macedonia: Report on development of agriculture and rural development for 2013, Skopje, February 2014, p. 63.

As can be seen in Chart 1, in the period between 2007 and 2012, from year to year, Government was practically doubling the amount of financial support for Macedonian organic producers, reaching its record amount of 130.000,000 Macedonian denars (MKD) in 2012. Presented data reveals that the financial support was reduced to 67.000,00 MKD in 2013, while the projected support for 2014 is 88.000,00 MKD.

In terms of certified production area under organic agriculture and number of organic agricultural producers in Macedonia, from modest 4-5 producers in 1998, up to 2007 there were 50 organic farmers and 266 ha. certified organic production area. Macedonian organic agriculture reaches its peak in 2011, with maximal 780 certified organic producers and 6.580,92 ha. under organic production. In the years to follow, we can notice a declining trend, settled by 400 certified organic farmers, cultivating 3.167,85 ha. of certified production area in the Republic of Macedonia in 2013. As shown in Chart 2, organic agriculture in the Republic of Macedonia up until 2011 has positive trend, both regarding certified production area and number of operators.

**Chart 2: Number of certified organic operators and area under organic agriculture in the Republic of Macedonia (ha) in 2007-2013**



Source: Organic production capacities [<http://www.mzsv.gov.mk/?q=node/220>]

As seen from the structure of the Macedonian organic sector presented in Table 1, the most significant increase in the area under organic agricultural products is shown in cereals (from 668 ha. in 2009 to 3,670 ha. 2011), and organic fruit production (from 211 ha. in 2009 to 971 ha. in 2011). There is also substantial progress in the development of organic livestock production. The number of organic cattle breed increased from 377 heads in 2009 to 5,221 heads in 2011, the number of sheep heads increased from 22,052 in 2009 to 113,904 heads in 2011, and the number of goats increased from 1,039 heads in 2009 to 5,133 heads 2011. In the analyzed period, organic honey and production of bee products have unstable development.

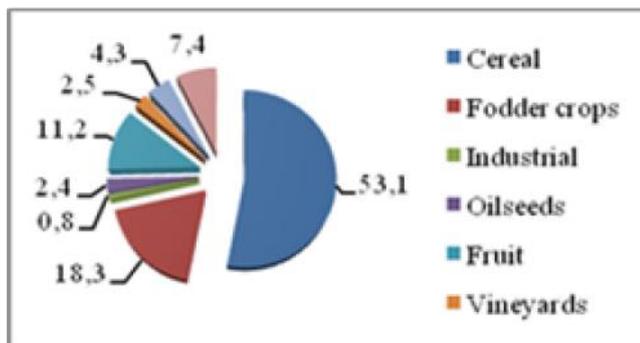
**Table 1: Organic production in the Republic of Macedonia for the period 2009-2013**

	2009				2010				2011				2012				2013			
	In conversion	organic	total	In conversion	organic	total	In conversion	organic	total	In conversion	organic	total	In conversion	organic	total	In conversion	organic	total		
Cereal	502	166	668	2.724	276	3.000	3.292	378	3.670	1.345	899	2.244	770	788	1.558					
Fodder crops	101	82	183	849	146	995	724	261	985	436	552	988	315	376	691					
Industrial	12	41	53	32	/	32	33	5	38	17	15	32	33	1	34					
Oilseeds	64	0	64	41	7	48	150	9	159	86	73	159	40	33	73					
Fruit	137	74	211	166	168	334	764	207	971	424	79	503	239	82	321					
Vineyards	46	14	60	224	21	245	11	30	41	80	46	126	11	31	42					
Pruning	84	59	143	164	36	200	193	70	263	112	46	158	50	71	121					
Fallow	/	/	65	306	66	272	406	47	453	316	135	451	125	179	304					
<b>Total number of organic livestock production (in conversion and certified organic production)</b>																				
Bovines	180	197	377	2.522	37	2.559	3.810	1.411	5.221	712	1.981	2.693	1.213	1.523	2.736					
Ships	21.844	208	22.052	92.523	6.275	98.798	63.670	50.234	113.904	28.160	45.551	73.711	27.254	37.047	64.301					
Goats	791	248	1.039	2.470	578	3.048	2.084	3.049	5.133	412	2.605	3.017	248	2.698	2.946					
<b>Total number of organic honey and production of bee products (in conversion and certified organic production)</b>																				
Bee hives	/	/	/	4.443	9.444	13.887	4.404	8.777	13.581	2.938	6.065	9.033	1.238	5.121	6.363					

Source: Organic production capacities [<http://www.mzsv.gov.mk/?q=node/220>]

Regarding production structure (Chart 3.) in the analyzed five year period, the biggest share in organic plant production in Macedonia, nearly 53.1% goes to cereals, followed by fodder crops with 18.3%. Significant share have fruits, represented with 11.2%, and fallows with 7.4%. Vineyards, pruning, oilseed crops and industrial crops accounts for approximately 1-4% of the total organic plant production in Macedonia in the period 2009-2013.

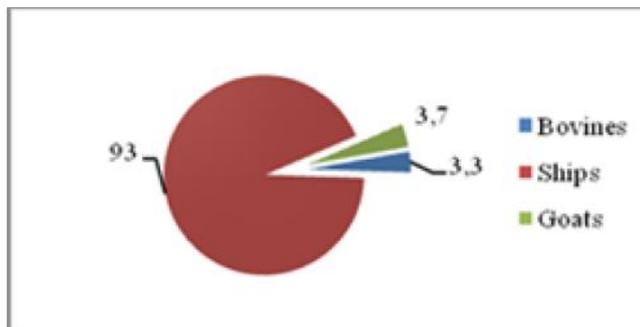
**Chart 3: Structure of organic plant production in the Republic of Macedonia in the period 2009-2015 (in %)**



Source: Organic production capacities [<http://www.mzsv.gov.mk/?q=node/220>]

Regarding animal organic production, in Chart 4 we can see that in the Republic of Macedonia, in the period 2009-2013, absolutely dominant is organic cattle breeding, represented with lion share of 93%.

**Chart 4: Structure of organic animal production in the Republic of Macedonia in the period 2009-2015 (in %)**



Source: Organic production capacities [<http://www.mzsv.gov.mk/?q=node/220>]

From all the presented data regarding development of organic agriculture in Macedonia, we can say that it is following the trend of the governmental financial support. This acknowledgment is rather unfortunate since the financial support is an integral part of the national agricultural policy, which is in direct connection with the budget capacity and can be subject to changes. Additionally, on the part of agricultural producers, such situation is suggesting lack of commitment and inability to accept organic production a “modus vivendi”, rather than temporary or part-time activity. Regarding the structure, it is evident that it is not well diversified, since both in organic plant and animal production in the Republic of Macedonia, we have one dominant representative (cereals and cattle), while other types of production show little, or no progress.

All things said, we can say that the development stage of Macedonian organic agriculture enters a critical point, where exchange of ideas, information and knowledge must take place. Therefore, we are confident that it is necessary to establish organic agriculture knowledge system in Macedonia.

## **2. Actors in organic agriculture knowledge system**

Organic agriculture knowledge system has five main actors with an interest in developing organic agriculture.<sup>6</sup>

- Organic farmer
- Research
- Extension services
- Education and training
- Support systems.

Although all elements of one system are equally important, in the case of organic agriculture knowledge system, we must give biggest credit to the farmers themselves. Namely, in the agriculture the major interface between humans and the environment happen, thus deeming the role of the farmer crucial. By engaging themselves in organic production, organic farmers are constantly experimenting new techniques, followed by investing efforts in different management of labor, time and space,

---

<sup>6</sup> Dockès, A, T. Tisenkopfs and B. Bock. (2011), “WP1 Reflection paper on AKIS”, *Collaborative Working Group Agricultural Knowledge and Innovation Systems*. Frankfurt/Main (DE): Institute for Rural Development Research at Johann Wolfgang Goethe University, p.25.

adapting and refining solutions to change, comparing different options with farmers that work in similar conditions, and making the right choices. This on-farm research component generates new knowledge that will benefit all farmers, thus, it needs to be circulated. The establishment of knowledge system is instrumental in helping farmers to exchange generated knowledge and become stronger and more independent. In addition, knowledge-exchange provides a critical mass and sets an end to the isolation, stimulating various forms of cooperation and information exchange between organic farmers. Strong argument that justifies farmers' central role is the fact that the organic sector, especially in developing countries, is represented by small (individual) farmers. The major reason they converted to organic production in most cases is because it does not require drastic change in their farming practice, and offers options for risk reduction, especially regarding market risks. This implies that they are still not very educated or informed and that any help is more than welcomed.

Regarding other elements-research, extension and educational organizations, as actors of the knowledge system, are relatively stable and static. Differences between countries occur in the structure of the system, its organization and governance (e.g. under a public or private structure), as does in the level of centralization or decentralization. Particularity of the organic agriculture knowledge system are the support systems, as they can be highly fragmented and subject to a dynamic process of emerging new structures and actors. Among actors in organic agriculture knowledge system, we must mention local NGOs and the private sector, characterized with personal motivation and expertise and in many cases initiators of most pioneering organic projects. Local NGOs can achieve a lot on their own, but sooner or later they realize that it is desirable to forge links with the local and national government, which is of crucial importance for the strait of the knowledge system.

Other actors in the organic agriculture support system are the organic entrepreneurs and SMEs that are among the major drivers of innovation, because they have to adapt their internal organization and technologies to comply with the rules and standards of organic production. Together with cooperatives and organic farmers' associations are the actors that often provide input, input-related technical advice as well as advice related to products.

Very valuable and supportive actors in the system are the media and the journalists (professional journals and, increasingly, web-sites).

Mass media in general shapes food discourses in society at a large scale and mobilizes consumers' attitudes in terms of food quality and safety, values, alternative food networks and environment protection.

Among actors in organic agriculture knowledge system need to be mentioned all commercial service providers, like veterinarians, plant and soil laboratories, brokers in the land market, providers of farm management software and especially (fiscal) accountants and banks. They contribute to the knowledge system with providing sources for know-how on certain aspects of the organic agriculture, especially related to knowledge and innovation.

Other than the above mentioned actors, the ones who probably will be intensely interested in the development of organic food and farming systems are future generations, who clearly do not have a voice yet. To meet future generations' needs for healthy food they have to be educated about the need to maintain healthy soil and a food chain which enables fair distribution of food.

Last, but not least, we must bear in mind that there are other „silent actors” in the organic knowledge system. They are represented by a number of species of plants and animals, that have moral right to survive and exist and not be destroyed and eradicated.<sup>7</sup>

### **3. Devices involved in organic agriculture knowledge system**

In the knowledge system of organic agriculture there are many so-called knowledge devices that initiate the process of knowledge creation and exchange. Among those that are closely related with the specific adaptation of practices by local actors is social learning, information flow, farming networks, innovation, experimentation and technology transfer.

Social learning, as process of conformation, has already established and there are socially accepted roles and practices, where new knowledge is generated within and facilitated by a social structure. It is a creative process in which the collective is engaged in concerted action, which leads to considering active learning process that is defined, structured, flexible, which seeks improvement and change in the existing state.

---

<sup>7</sup> Vilkka, L. (1997), "The intrinsic value of Nature". *Value Inquiry Book Series No. 59*. Helsinki: University of Helsinki.

Information flow is a key input into organic agriculture systems, but only if transmitted information is relevant, is increasing or changing farmer's knowledge and if it is improving farmer's situation. Additionally, such information has added value when used in combination with previous experience to enhance knowledge. Information flow to organic farmers can be done via seminars, discussion, field days, workshops, newsletters or mass media such as internet.<sup>8</sup>

Facilitation of innovation and knowledge in terms of social links, exchange and sharing is done through farming networks. Thanks to networks, innovation and knowledge is disseminated and reaches legitimization in broader society, new markets and policy field. The network is multidimensional and it is a collective process with wide range of actors involved such as scientific staff, agricultural adviser, management adviser, cooperative, etc. Studies in various parts of the world confirm the role of farmer networks in the growth of organic agriculture.<sup>9</sup>

Innovation is one of the key competences of organic farmers and it helps to build flexible knowledge system. Innovation doesn't take place independently from technical innovation but is precondition, concomitant or consequence of technical innovation. In organic agriculture knowledge system innovation is needed in sense of institutional innovations that will require organization and institutionalization of organic knowledge. In the context of organic agriculture, innovation is mostly result of experimentation. Experiment can be provoked by external change and emerging problem, they can be stimulate by personal interest and curiosity, or can be deliberate trials to effect desired future change.<sup>10</sup>

Technology transfer involves the transfer of research findings to farmers and the aim is to encourage innovation and improve profitability of the system. An early model was the Linear Diffusion model in which scientists developed technology which is transferred to managers by

---

<sup>8</sup> Petersen K. and Hurley E. (2003), "Information needs of organic farmers", Institute of Natural Resources, College of Sciences, Massey University, p.3.

<sup>9</sup> Assouline, G. and F. Just. eds. (2000), "Making agriculture sustainable: The role of farmers' networking and institutional strategies". *Final report*. European Research Project DG XII Environment and Climate Program.

<sup>10</sup> Kummer S., Aigelsperger L., Milestad R., Chowdhury A., Vogl C., (2010), "Knowledge systems, innovation and social learning in organic farming - an overview". *European IFSA Symposium, 4-7 July 2010, Vienna (Austria)*, p.38.

extension agents.<sup>11</sup> The new technology is first adopted by innovative farmers and growers and later by the broader farmer community.

#### **4. The Model for organic agriculture knowledge system in the Republic of Macedonia**

We believe that organic agriculture knowledge system in Macedonia should be integral part of the national agricultural knowledge system (AKS) and its extension services, as its modus operandi and as supplement to the financial support. We propose organic agriculture to be introduced as “system innovation”, with participatory, or “side by side” network approach towards all the actors and knowledge devices. The expected result is to have a set of organic agriculture actors and/or persons, as well as links and interactions between them, engaged in the generation, transformation, transmission, storage, retrieval, integration, diffusion and utilization of organic agriculture knowledge and information, with the purpose of working synergistically to support decision making, problem solving and innovation in organic agriculture<sup>12</sup>. This approach should also enable existing AKS to propose and develop practical ideas to support innovation, knowledge transfer and information exchange between actors in organic agriculture. Incorporation of organic agriculture into existing AKS as a “system innovation” will introduce operational techniques that will reflect the manner in which development and innovation in organic agriculture actually occurs today: often through diffuse networks of actors who are not necessarily focused on traditional research and development. This will enable the AKS to encompass and influence the complexity of knowledge and innovation processes in the organic agriculture sphere and will help organic farmers to become more compatible with broader sustainability goals.

In this model the four sets of actors act upon the knowledge of organic producers and generate innovations in response to problems and opportunities, desired outcomes, system drivers and regulative policies and institutions (Figure 1.). However, as the left-hand side of Figure 1

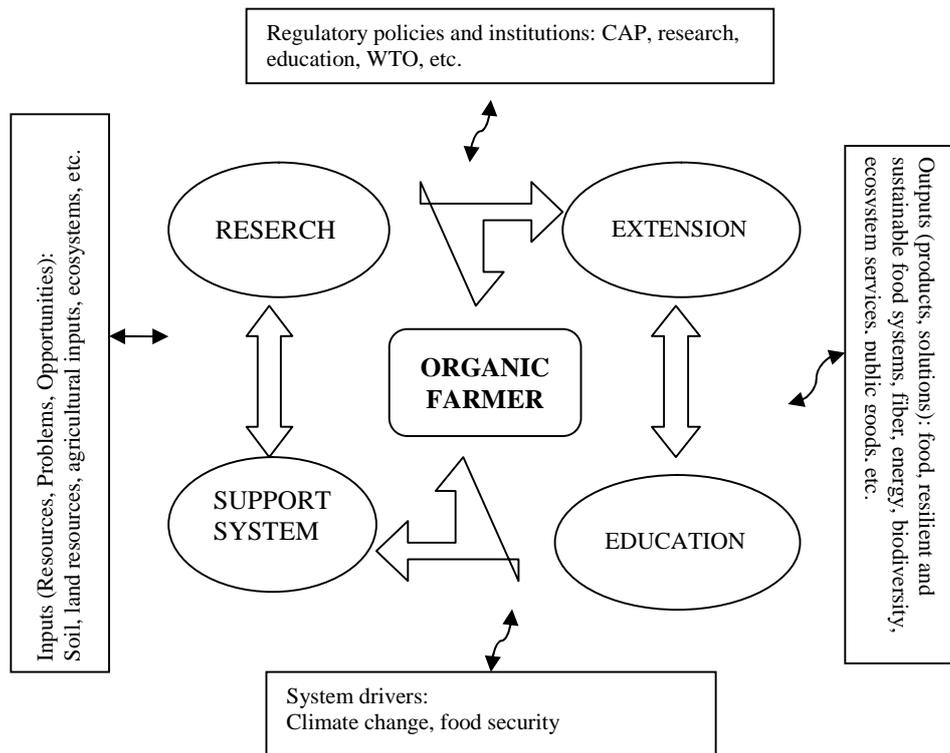
---

<sup>11</sup> Rogers, E. M. (2003), “*Diffusion of innovations*“, 5<sup>th</sup> ed., New York: Free Press. p.57.

<sup>12</sup> Rölöng, N. G. and Engel, P. G. H. (1991), “IT from a knowledge system perspective: concepts and issues”, paper presented at *European Seminar on Knowledge Management and Information Technology*, Wageningen.

shows, problems are not simply given by the context. Rather, they are framed in different ways by specific paradigms. The same is true of material inputs and knowledge, which are also shaped by paradigms. Such differences are important in framing research priorities, societal choices and public accountability.

**Figure 1: A model of organic agriculture knowledge system**



Source: Adapted by Dockès et al., 2005:37.

The emphasis in this AKS is introducing organic agriculture both as economic, social and environmental innovations into the model, being influenced by paradigm shifts (that parallel those that are occurring in research and innovation policies) towards network driven multi-actor innovations and even a step further-towards Life Long Learning.

## Conclusion

Organic agriculture in the Republic of Macedonia is one of the fastest growing agricultural sectors, with double-digit annual growth in land under organic cultivation, value of organic products and number of organic farmers. Most of the success has been achieved through the vision and enterprise of individuals and local farming groups operating with great support of the Government, both in terms of subsidies and legal framework.

The problem with governmental support is that the integrity and motivation of a purely government-driven initiative can attract criticism and the concentration of too much influence in the hands of politicians and civil servants, which in democratic societies is perceived as undesirable. Nevertheless, state support for organic agriculture in Macedonia is significant and therefore the organic agriculture knowledge system must be built within the national agricultural knowledge system. Accepting organic agriculture as “system innovation” will transform existing Macedonian agricultural knowledge system towards more participatory model of functioning.

We firmly believe that the proposed model for organic agriculture knowledge system in the Republic of Macedonia will gather tacit and local knowledge and will establish organic farmers as more autonomous “knowing agents” both at farm and food-chain and at the same time will induce a process of transdisciplinary co-production of knowledge among farmers and all other actors of the knowledge system.

## References:

1. Assouline, G. and F. Just. eds. (2000), “Making agriculture sustainable: The role of farmers’ networking and institutional strategies”. *Final report*. European Research Project DG XII Environment and Climate Program.
2. Blanc, J. (2009), “Family farmers and major retail chains in the Brazilian organic sector: Assessing new development pathways. A case study in a peri-urban district of Sao Paulo”. *Journal of Rural Studies* 25(3): 322-332.
3. Dockès, A, T. Tisenkopfs and B. Bock. (2011), “WP1 Reflection paper on AKIS”, *Collaborative Working Group Agricultural*

- Knowledge and Innovation Systems*. Frankfurt/Main (DE): Institute for Rural Development Research at Johann Wolfgang Goethe University.
4. Ingram, M. (2007), "Biology and beyond: The science of 'back to nature' farming in the United States", *Annals of the Association of American Geographers*, 97(2), 298-312.
  5. Kummer S., Aigelsperger L., Milestad R., Chowdhury A., Vogl C., (2010), "Knowledge systems, innovation and social learning in organic farming - an overview". *European IFSA Symposium, 4-7 July 2010, Vienna (Austria)*.
  6. Ministry of agriculture, forestry and water economy of the Republic of Macedonia: National strategy with Action plan for development of organic agriculture for the period 2008-2011, Skopje, August 2007.
  7. Ministry of agriculture, forestry and water economy of the Republic of Macedonia: Report on development of agriculture and rural development for 2013, Skopje, February 2014.
  8. Niggli, U., A. Slabe, O. Schmid, N. Halberg and M. Schlüter. (2008), "Vision for an Organic Food and Farming. Research Agenda to 2025. Organic Knowledge for the Future". *Technology platform ORGANICS, IFOAM Regional Group European Union (IFOAM EU Group)*.
  9. Official Gazette of RM, No. 16/2004; 60/2006; 146/2009; 162/2010 and 163/2010.
  10. Petersen K. and Hurley E. (2003), "Information needs of organic farmers", Institute of Natural Resources, College of Sciences, Massey University.
  11. Rogers, E. M. (2003), "*Diffusion of innovations*", 5<sup>th</sup> ed., New York: Free Press.
  12. Röling, N. G. and Engel, P. G. H. (1991), "IT from a knowledge system perspective: concepts and issues", paper presented at *European Seminar on Knowledge Management and Information Technology*, Wageningen.
  13. Sumner, J. (2008), "Protecting and promoting indigenous knowledge: environmental adult education and organic agriculture", *Studies in the Education of Adults*, 40(2), 207-223.
  14. Vilkkka, L. (1997), "The intrinsic value of Nature". *Value Inquiry Book Series No. 59*. Helsinki: University of Helsinki.

15. Walker, B. and D. Salt. (2006), "Resilience thinking. Sustaining ecosystems and people in a changing world". Washington DC: Island Press.
16. Organic production capacities of RM, Ministry of Agriculture, Forestry and Water Economy,  
[[www.mzsv.gov.mk/?q=node/220](http://www.mzsv.gov.mk/?q=node/220)]



**UDC 336.71:336.717.5(497.7)**  
**Original scientific paper**

**Diana BOSKOVSKA<sup>\*)</sup>**  
**Elena GLIGOROVA<sup>\*\*)</sup>**

**EFFECTS OF THE FINANCIAL CRISIS ON THE LENDING  
ACTIVITY OF BANKS IN THE REPUBLIC OF MACEDONIA**

**Abstract**

Macedonian banking is basically traditional banking, therefore loans are the main sources of the banks for provision of funds. Given that the analysis of lending is very complex, the paper makes reference only to certain aspects of the lending activity of banks in the past: structure of assets in the banking sector, dynamics of lending activity and lending structure by sectors (corporate and household sector).

The analysis based on all previously mentioned aspects is done for the period before and after the global financial crisis in order to see the effects of its impact on the credit activity of banks. There is an evident fact that slowing economic activity in the real sector, and tightening credit conditions by banks after 2008 conditions the existence of downward trend in the lending activity, which is evident through the reduction of the share of loans in the assets of the banking sector, the rate of growth of gross loans, and the rate of growth of loans in the corporate and household sector.

**Keywords:** lending activity, bank's assets, gross credit, credit growth rate, corporate sector, household sector.

**JEL classification: G21**

---

<sup>\*)</sup> PhD, associate professor at the Institute of Economics - Skopje, University Ss Cyril and Methodius - Skopje, E-mail:diana@ek-inst.ukim.edu.mk

<sup>\*\*)</sup> MSc., NLB Tutunska Banka AD Skopje, E-mail: e.gligorova@gmail.com

## **Introduction**

Credit activity is an important segment of the economy of a country, which significantly affects the country's economic development. Credit activities are the dominant banking activities in most banks and in the total portfolio of the bank. Thus banks expect from these activities to achieve the biggest income. However, on the other hand it depends on the the timely repayment of the credits. A bank's credit portfolio management is important and they tend to retain control over their claims and to avoid or reduce losses of workload that may have a direct impact on the prosperity and survival of the bank, as well as on the stability of the overall economy of the country .

The Macedonian banking sector, although indirectly exposed to the impact of the global financial crisis, set a new challenge - to maintain a high level of liquidity and to maintain the confidence of depositors. The deteriorating economic situation in the past, which resulted in reduced purchasing power, thus restrained consumption of the real sector and the citizens, affects the increase of credit exposure of banks at risk. This, in turn, contributed to reduction in the credit activity of banks after 2008. Credit activity and its dynamics before and after the financial crisis is studied in this paper.

### **1. Analysis of the structure of banks' assets**

The banking system in Macedonia consists of seventeen banks and eight saving houses. In terms of credit activity<sup>1</sup>, the general conclusion is that the concentration is in the group of large banks<sup>2</sup>, because they participated with 48.3% of the total lending activity starting in 2003, and 66.3% in 2012.<sup>3</sup> In the recent period the group of large banks have strengthened the position on the banking market and they are major drivers for annual growth of the gross loans (the share in 2007 rose

---

<sup>1</sup>The paper focuses only on the credit activity of banks because savings account for an insignificant percentage, or 1% of total assets and 1.4% of total loans.

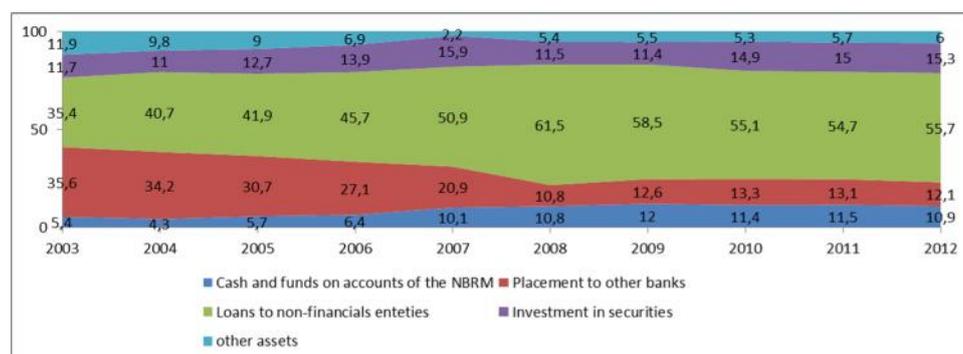
<sup>2</sup>In order to do more adequate analysis, NBRM divides banks into three groups (according to the size criterion of total assets). So, today, the group of large banks includes three banks, a number that has remained unchanged since 2003, while the number of banks in the group of medium-sized and small banks ranged from 6 to 8 medium-sized banks and from 7 to 13 small banks.

<sup>3</sup>Report on the banking system of the Republic of Macedonia in 2003, 2012, NBRM.

up to 70.3%<sup>4</sup>). In the period after 2006 and 2007, there is a significant trend of strengthening the position of the group of medium banks, first by increasing the deposit base and then by increasing and strengthening the market share in total assets.

Loaning bank activities could be considered from more aspects. One aspect of the analysis is the recognition of the share of loans in the total assets of the banking sector. The change in the share of individual assets in the assets in the period of ten years indicates the activity of banks performed in that period. The structure of the assets of the entire banking system is shown in the Figure 1, where you can clearly see that the situation stems from 31.12.2003, when the banks had a strategy of targeting deposit placements in the first-class banks in the world, instead of lending in the country itself. The share of the placements to other banks and the category of loans to non-financial entities of over 70% by 2010 indicates prevailing exposure of the banking system to credit risk.

**Figure 1: Asset structure of the banking system for 2003-2012**



Source: Own calculations according to Annual reports of NBRM for period 2003- 2012 year

The displayed graph 1 shows that since 2009, there is slowdown of credit activity and reduction of its share in the total assets (under 60% compared to 2008, when participation is the highest - 61.5%) as a result of the stricter conditions of lending by banks due to deteriorating economic conditions. The expense of this slowdown has increased the share of placements in banks and the share of funds in the accounts with

<sup>4</sup>Report on the banking system of the Republic of Macedonia in 2007, NBRM.

NBRM<sup>5</sup>, as well as increased investments of banks in securities (from 11,7% in 2003 to 15.3% in 2012), primarily due to the positive assessment of the connection between return and risk of that investments, but also due to improving the liquidity of banks. In this period there was increased participation of investment of banks in low-risk securities, which also shows that banks are still wary of increasing lending activity.<sup>6</sup>

Generally speaking, that conditions largely increase the activities of banks, and thus the bank's assets are the deposits, because all these years they have a role of the dominant source of funding for the banking activities. Deposits show continued growth starting from 2003 to 2007, which led to an increase in the assets of banks and credit growth and their share in assets. But starting from 2008, when there was stagnation of deposits as well as tightening of the conditions for external borrowing, until 2012, deposit growth was slowing down due to slowing economic growth and uncertainty from the debt crisis. What is remarkable in this period is greater reduction of deposits in the corporate sector, primarily due to reduced liquidity of operations and need for cash.

## **2. Analysis of the dynamics of credit market**

Under the impact of the global financial crisis, banks in the country have felt the slowdown in total assets. The reasons for this were multiple: psychological pressure created by domestic entities, reduced propensity for saving because of future uncertainty about the effects of the financial crisis, and declining trust in the banking system (which had the most reaction by household sector). This in turn affects the tightening of credit conditions for approval of loans by the banks.

Also, slowing the dynamics of lending is a result of certain legislative measures brought forth by NBRM. In June 2008 the Decision for mandatory deposit<sup>7</sup> was brought, which conditioned banks to allocate required deposits to the NBRM accounts monthly, if they exceed the maximum limit for approval of loans to the household sector, in order to discourage and slowdown the rapid growth of loading activities in the

---

<sup>5</sup>This change is due because of tight monetary policy of the NBRM, namely made increasing rates of reserve requirements for liabilities denominated in the currency.

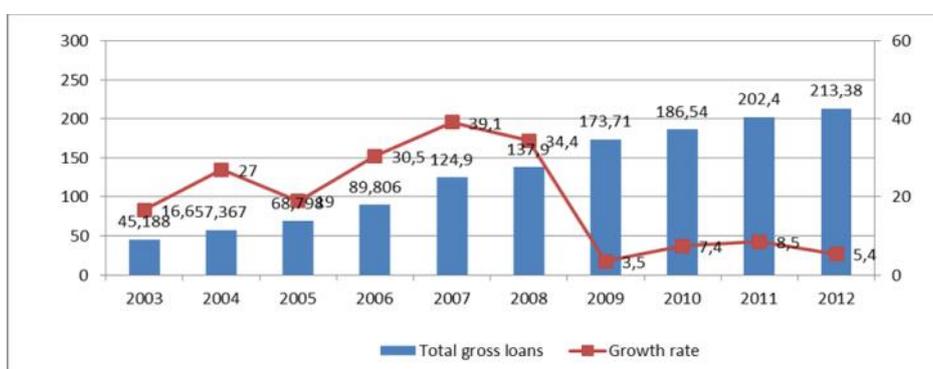
<sup>6</sup>Report on the banking system and banking supervision in the Republic of Macedonia in 2009, NBRM, p. 25.

<sup>7</sup>Decision for mandatory deposit Official gazette, Republic of Macedonia, no. 163, 26 december 2008 year, Skopje.

population sector, which in the years before 2008 reached up to 56%. Also, with the adoption of the Decision to amend the Decision for methodology for determining the adequacy of capital<sup>8</sup> and the introduction of higher risk weight for claims arising from approved and used overdrafts on transaction accounts and credit cards, there is certain contribution to the reduction in the credit activity of banks in the household sector. Then, the change in the Decision for mandatory reserve increased the rates of reserve for liabilities with currency component (increased rates for foreign currency liabilities from 10% to 13% and liabilities in foreign currency clause from 10% to 20%). This increase in the reserve was intended to increase the liquidity of banks, but also meant reducing the amount of available funds that banks can use for lending.

The impact of all these factors led to a slowdown of credit activity after 2008. In Figure 2 the movement of the rate of growth of loans starting in 2003 until 2012 can be observed through the movement of the rate of growth of gross loans.

**Figure 2: Total amount of gross credits and the growth rate for period 2003-2012 year**



Source: Own calculations according to Annual reports of NBRM for period 2003- 2012 year

From the data shown, it can be seen that the growth rate in 2009 was only 3.5%, while in previous years it is over 30%.

But, as it can be seen from Figure 2, since 2010 there has been a revival of credit activity and the growth rate of gross loans is increased.

<sup>8</sup>Decision to amend the Decision for methodology for determining the adequacy of capital, Official gazette, Republic of Macedonia, no. 32, 7 march 2008 year, Skopje.

The revival of credit activity is due to the more stable environment and the gradual recovery and revival of the domestic economy and expanding deposit base, most in the household sector (growth rate of deposits is three times higher than the previous year<sup>9</sup>). The growth in this period is a result of the increased lending to the corporate sector, the export sector, and growing consumption of population. This moderate increased growth in loans is followed by a continuous downward trend in interest rates (and largely influenced by changes in the Law on Obligations in 2010<sup>10</sup> when the maximum contractual interest is prescribed).

But the general impression is that in the period after 2008 there has seen great caution on banks and their focus on maintaining a quality loan portfolio, primarily due to the risks of the environment, and the difficult recovery of existing loans.

### **3. Analysis of the credit portfolio of non-financial sectors**

When analyzing the sectoral structure of the credit portfolio, the fact that loans in the corporate sector are dominant in comparison with loans to the household sector is quite evident. Lending to the population sectors almost did not exist before 2003. However, 2003 witnessed significant growth and interest in banks because of the fact that these loans carried high rates of return and were less risky since there was a possibility for diversification of risk.

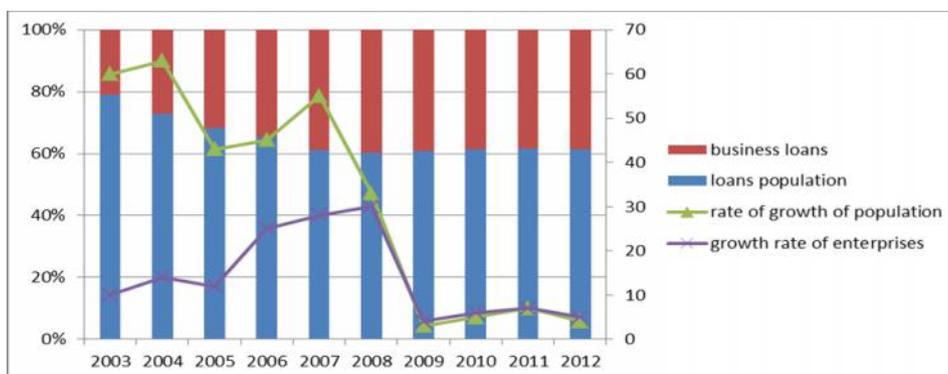
The participation of the corporate and household sector in the credit portfolio and the dynamics of lending activity of these two sectors is shown in Figure 3. For the entire analyzed period there was greater participation of the corporate sector in the structure of the credit portfolio in relation to the household sector.

---

<sup>9</sup>Report on the banking system and banking supervision in the Republic of Macedonia in 2010, NBRM, p.3.

<sup>10</sup>Law for change the Law of obligations, Official gazette no. 81, 30 june2009, Skopje.

**Figure 3: The participation of the corporate and the household sector and growth rate for period 2003-2012 year**



Source: Own calculations according to Annual reports of NBRM for period 2003- 2012

The data in Figure 3 shows that the decline in lending from 2008 until 2012 was present in both sectors. The impact of the financial crisis on banks' credit activity led to a reduction in the credit growth rate in both sectors.

Starting in 2008 the population sector appeared significantly reduced credit growth over the previous year (from 56.2% in 2007 to 37.4% in 2008) because of the effect of the previously mentioned measures taken by NBRM and the strained terms of banks for loan approval. From 2009 to 2011 the population sector realized lower growth rate than the corporate sector. This significant slowdown of credit activity as previously stated is due to increased fear and risk of banks' inability to realize the security and perceptions of worsening for this kind of credit<sup>11</sup>. Credit growth of the population sector in 2010 had even lower rate than the corporate sector. It was due to "slower growth in disposable income, and lower demand for loans in order to achieve greater caution with the population and the slow adjustment of expectations to the uncertainty"<sup>12</sup>. It means that in terms of the uncertainty on the labor market, the population still refrains from consumption and is more inclined towards saving.

In 2011, banks gradually changed their views on the riskiness of this sector according to the perception of future favorable expectations in

<sup>11</sup>Survey of credit activity, april 2009, NBRM.

<sup>12</sup>Report for financial stability of Republic of Macedonia for 2010, NBRM, p. 87.

the improved economic environment and thus increase the growth rate of this portfolio. During this year for the first time there was bigger growth in the household sector than in the corporate sector, thereby increasing their share in the absolute increase in gross loans. This change occurred after three years of constant reduction of the household sector in the growth of gross loans, which happened because of the greater caution of this sector in lending and the banks' perception of increased risk of this loan portfolio due to less conservative approach of the banks in their lending in pre-crisis period.

In the corporate sector from 2003 to 2008 there was a permanent decline in gross loans, but despite this dynamic this sector had a dominant share in the total gross loans (from 60% in 2008, with greater contribution to the increase of total credits, 57.9%, see Figure 3).

In 2009 under the impact of the financial crisis there were noticeable changes in credit growth. The low growth rate of loans to this sector by 4.4% (compared to 32.8% in 2008) due to reduced demand for loans because of restraint in consumption and reduced tendency for new borrowing in an unpredictable future income. Certain impact on slowing demand for loans decreased foreign trade in this period, which is direct result of the world economic and financial crisis. However, in 2010 the number of approved applications, according to the Survey of lending activity of banks in 2010<sup>13</sup> increased in this sector due to the adaptation of the bank to the new economic conditions caused by the crisis, interruption of the "restraint" of lending and beginning of the phase of supporting lending in terms of stable domestic and global economic environment. These positive trends in the economy also suggest that there is a connection between the growth of credit activity among enterprises and the economic cycle of the country. In 2011 and 2012 the demand for loans in the corporate sector increased, but with less intensity due to a moderate tightening of conditions for lending to this sector by requesting to provide collateral of possible credit risk (risk of non-payment of credit claims).

---

<sup>13</sup>Survey of credit activity, February 2010, NBRM.

## **Conclusion**

Credits play an important role in the bank, because they make up 50% to 80% of the total assets in bank assets.

From the analysis in the paper it can be concluded that unlike the pre-crisis period when banks were the main goal-increasing market share and increased the loan portfolio, the orientation of the banks in the last four years has been more with restraint of the bank lending, retention stability of banks and keeping quality of the loan portfolio.

The positive trend of growth of gross loans in the period 2003 to 2007 was due to: the dynamic role of the banks to increase lending activity particularly in the household sector, increased lending in foreign currency, targeting to long-term lending and reducing exposure to credit risk or improving the quality of its credit portfolio. The credit portfolio during this period is of high quality because of its "immaturity"; a portfolio which should be carefully followed in the later stage of its "payback".

The financial crisis in 2008 led to the restraint of the corporate and household sector from investing and spending, and abstinence from lending because of the tightening of credit conditions by banks, which resulted in a decline in credit growth. The decline was felt in both sectors. The trend of improvement in the loan portfolio was discontinued in 2008 due to "payback" portfolio of population and the appearance of the first signs of deterioration from world financial crises, which resulted in reducing the export of enterprises, restructuring of loans in recent years, write-offs of outstanding loans and taking over the outstanding claims by banks.

## **References:**

1. Annual report of NBRM from 2003 to 2012 year
2. Decision for mandatory reserve, Official gazzete no.163, from 26.12.2008, Skopje.
3. Decision to change Decision for methodology of determining the capital adequacy, Official gazzete no.32, from 7 march 2008, Skopje.
4. Law for change the Law of Obligations, Official Gazette, no.81, 30 June 2009, Skopje

5. Report for financial stability of Republic of Macedonia for 2010, NBRM.
6. Report for banking system and banking supervision in Republic of Macedonia in 2003, 2007, 2010, 2012, NBRM.
7. Survey of lending activity, 2009, 2010, NBRM.

**UDC 334.722:005.591.43**  
**Original scientific paper**

**Zoran JANEVSKI\*)**  
**Marin VELKOVSKI\*\*)**

## **ENTREPRENEURIAL OPPORTUNITIES FROM OFFSHORING**

### **Abstract**

This paper focuses on the impact which offshoring has on entrepreneurial activities and how specific factors influence certain individuals to follow their incentives and build international business model throughout offshore operations. What is the meaning of offshore financial centers? Which are the steps that entrepreneurs should undertake? Together with advantages and disadvantages of this kind of investment, these are the main topics elaborated in this paper. Outsourcing is an important part in this international venture as well, so they play a huge role in moving capital and human labor from one point of the world to another.

Offshore financial centers along with outsourcing activities offer a variety of services and products, which can be beneficial for today's entrepreneurs. Entrepreneurial start-ups based on this kind of business models can gain competitive advantages, penetrate new markets, reach new customers and ultimately increase profits.

Today, offshoring and outsourcing operations have deep impact on strategic decisions made by the management of the companies; they can influence whole economies and regions, improve corporate profits and decrease risk operations. According to most recent research, offshore financial centers have vast amount of money on their balances – they are very attractive to the majority of investors, and also to entrepreneurs as a way for starting a new venture.

**Keywords:** entrepreneurship, offshoring, offshore finance centers, outsourcing, investments

**JEL Classification: L26, F2, H25**

---

\*) PhD, Institute of Economics – Skopje, E-mail: zoran.janevski@ek-inst.ukim.edu.mk

\*\*\*) MSc, Anakom Dooel Skopje, E-mail: marinvelkovski@yahoo.com

## Introduction

Entrepreneurship presents a vital, flexible and dynamic component of the economy and is considered to be the "cradle" of creating new job opportunities. Entrepreneurship has a great impact on the economy and society as a whole, influencing the performances of major companies. It acts as a generator and instigator of reforms. Entrepreneurship and the SME sector can exist and develop only in a specific economic environment and are driven by elements of global trading. One of the most important elements in recent decades concerning the global economy are represented via the offshore operations and outsourcing. The term *offshore finance centers* appeared in the 1980s, being defined as jurisdictions that provide commercial and corporate finance services to non-resident corporations (Andrew and Alex, 2012: 2) and contribute to higher economic activity by improving the profitability of business operations between legal entities. Offshoring and outsourcing forms of financial performance are very similar, but their roles in international operations are drastically different. Outsourcing is the process when it comes to cooperation agreement with an entity outside the company – another company. The company that enters into a contract for outsourcing can be in the same country or abroad. The practice of outsourcing is as old as business itself. What to subcontract is a question of a strategic choice. In the past, outsourcing contracts were made only for a small part of companies' operations. Today, companies keep only the core of their business in-house, and everything that is cheaper and more effective to be done abroad is sent almost anywhere in the world.

Offshoring, however, means moving work and jobs outside the country where a company is based (Bhagwati and Blinder, 2009: 20). For example, if Apple starts its own laboratory in London, instead the one in Palo Alto, that would be offshoring. But if they decide to make an agreement with another company in the US or abroad for their R&D operations, in that case it would be outsourcing.

There are many advantages and disadvantages regarding these kinds of international investments. Entrepreneurs should realize that in order to maintain and increase their business activities, and to become more competitive and achieve higher incomes, they should always be open to considering outsourcing and offshoring as possible ways of starting or expanding their business ventures. Using modern methods of collaboration and continuously investing in human capital are necessary

for the future of the companies. Therefore, entrepreneurs have obligation and responsibility to decide which of the core activities from the value chain could be best carried out abroad. In recent decades launching hundreds of millions of jobs in developing countries was a direct result of outsourcing and offshoring (Contractor, Kumar, Kundu, Pedersen, 2011: 2). At the same time, many people in developed countries have lost their jobs because companies where they previously worked were able to find cheaper alternatives. Although there are some disadvantages, the benefits offered by offshoring and outsourcing are greater for all parties involved. In countries with a huge supply of cheap labor this provides an opportunity for job creation, which will lead to higher living standard. Thus, companies involved in offshoring and outsourcing will have lower labor costs, and generate higher profits. Moving the businesses from West to East from the very beginnings of this phenomenon has contributed to the loss of jobs in rich countries, especially for the less skilled workers. In the last few years offshoring and outsourcing became one of the most powerful aspects of globalization (Contractor, Kumar, Kundu, Pedersen, 2011: 2). But some new phenomena have been happening in many industries in the world. By the end of 2013, after moving almost entire IT and mobile phones industries in Asia, especially in China, a new production line has been established to make personal computers on America's soil again. But, in this case the new manufacturing facility is built by Lenovo, the Chinese company, not by a company from the US (Wall Street Journal, December 2013). Many companies realized that they move too much work abroad and start to bring some of it back home (such as Google, General Electric, Ford Motors in the last few years), and other companies from emerging countries choose their location for production on European and US soil, thus commencing the process known as "reshoring". These crucial changes that have taken place over the last 5-10 years have opened new opportunities for entrepreneurs to widen their possibilities how to make their startups more competitive and strategically valuable.

### **1. Concept and role of offshore finance centers**

In modern literature offshore finance centers are often identified as "tax heavens" (Hampton and Abbott, 1999; Palan, Murphy and Chavagneux, 2013; Morriss, 2010). In fact they represent jurisdictions

that are separate from the main regulatory bodies (states) and have their own autonomy. This can be a physical separation as a separate territorial unit – an island, or remain within a city like London or New York. Offshore jurisdictions are lands that have a large number of financial institutions engaged in the business of non-residents (Cobb, 2009: 335). However, other institutions classify this offshoring centers as centers for management services with high profits. The most widely accepted term for these centers is "offshore finance center", which is used by global and regional regulatory and supervisory bodies (Maurer, 2007: 155). Offshore finance centers are promoted as places with low taxes, places which protect the anonymity of data, with a wide range of appropriate financial expertise for business and individual assets (Hampton, 2010: 6). According to Henry (2012), a significant fraction of global private financial wealth, at least \$21 to \$32 trillion as of 2010, has been invested virtually tax-free through the world's still-expanding black hole of more than 80 offshore secrecy jurisdictions. And this is just financial wealth. A big share of the real estate, yachts, buildings, properties, jewelry, arts and other non-financial-wealth are also owned via various offshore structures. OECD (1998) characterizes offshore finance centers through a combination of the following parameters:

- Minimal or zero tax
- Preferential tax regimes
- Lack of transparency
- Lack of effective exchange of information.

In fact, offshore finance centers are a symbiosis of all these features. The most typical service performed in these centers are banking operations, but current services also include fund management, insurance, accounting services, tax planning, intellectual property registration, company registration on a yacht, brokerage and consulting services, etc. (Orion, 2014). From the beginning of offshoring and outsourcing, international finance centers became the cradle for establishment of anonymous accounts of wealthy individuals, and therefore there is a general suspicion that they are actually centers typically used for tax evasion. These are attractive locations for investment for the global tycoons, especially for those from the post-socialist transition countries. The mere existence of differences in the manner and form of a national tax policies and practice gives incentive for individuals to reflect on reallocation of their equity. One of the biggest advantages of offshore centers is that they offer lower costs,

higher quality of service, price stability, more potential business partners, and a possible access to a great number of investment funds. On the other hand, certain features, such as tax erosions, banking secrecy and many others are the reasons for which these financial centers are under a high level of monitoring by international institutions, international financial controllers, and international funds. International finance centers in general and offshore finance centers in particular contribute largely to the functioning of the economies in the world. According to Hines (2009: 12-13), their most typical five roles are:

- To stimulate foreign direct investment in countries with high income. Companies are more likely to invest in international finance centers due to the rapid growth of profits in relation to countries that impose high taxes.
- To discipline financial markets. Low tax rates that are offered in international finance centers, limit the extent to which banks and other large institutions can take advantage of local monopolies to the detriment of individuals and businesses.
- To promote good governance and a lot of benefits that can accrue from democratic accountability.
- To have an impact on tax collection and tax competition between major countries. The availability of low taxes allows governments to maintain healthy domestic tax bases without causing tax competition from neighboring countries.
- To influence on the global economy. In the past 25 years they have experienced rapid growth, partly reflecting their growing importance of the financial sector of modern economies. The ability of international finance centers to finance other sectors of the domestic economy adds additional value and economic activity worldwide.

Offshore finance centers serve a number of legitimate, and some less than legitimate purposes. In the past their success was characterized by their ability to minimize tax burdens only for the non-resident corporations, but other methods of evaluation have become more useful since offshore finance centers have started providing some other value-added services, as well.

## **2. Distribution and importance of offshore finance centers**

During the 1960s and 1970s in Europe some instruments in the banking sector appeared, which started changing things on global level. The imposition of reserve requirements, higher interest rates, restrictions on financial products, controls over capital flow, and high rates of taxation in many OECD countries were one of the most frequent measures, which were probably the main reasons for change of the financial players on the global stage (Hines, 2009: 33). Attractive services that were offered by offshore finance centers have started to attract international investors. In Europe, Luxembourg began attracting investors from Germany, France and Belgium in the early 1970s of the last century because of introducing low tax-rates. In the Middle East, Bahrain began to serve as a center for collecting excess oil from the region. In the Western Hemisphere, Bahamas and the Cayman Islands were in a similar position. Promoting investment opportunities for the major world economies, which ultimately supported the creation of jobs and increased their economic growth, were one of their major advantages. These offshore finance centers started implementing their development strategies mainly through various tax-exemptions schemes, thus offering a competitive advantage for the entrepreneurs around the world. Because of this, they are often subjected to criticism from international institutions for outstanding issues involving tax evasion, money laundering or financial frauds. There are many examples of funds that originate from the activities involving dealing drugs, prostitution or gambling, which have been invested back into national economies as legal investments through the entrepreneurial activities initiated by the offshore established companies. (Cobb, 2009: 343). But, their real importance is much greater. There is a misunderstanding in the community about their real functions. Burns and McConvill (2012) stress that their importance is particularly evident because they are used for different reasons:

- Joint venture companies. – Offshore companies are often used as a form of joint ventures when investors from different countries are joining together to fund a project.
- Costs and ease of use. – The minimum fees, low costs for establishing a company and ease of use of services are the main reasons why most offshore entities choose to invest offshore.

- Relationship with, and access to regulatory bodies. – A key feature of the leading offshore finance centers is the fact that they are relatively small countries, with little population working together as a close community. This is an attractive feature of financial centers because it means that the regulatory bodies are much more accessible and easier to reach. They are more open-minded and proactive, unlike their colleagues in countries which impose higher taxes.
- Access to financial markets. – If entrepreneurial venture is established in one of the offshore finance centers, there will be many more funding opportunities.
- Equity. – Offshore finance centers are quite significant for investment funds. Investment funds with large assets owned by investors around the world can attract a number of successful businesses in these financial centers.

In the past most of the attractive offshore destinations were mainly on the islands, especially those in the Pacific Ocean. Today, many countries, including developed ones, have realized the power of attracting non-resident entrepreneurs to invest and start their own business on their grounds, under their jurisdiction. Even US has introduced many offshore initiatives in order to attract offshore fund and entrepreneurial ventures especially in industries like: software development, nano-tech, green-tech, e-commerce, web design and web hosting, online consulting and management (Globes America, 2014).

### **3. Establishment and development of offshore companies**

The phenomenon of outsourcing and offshoring gives way to a series of issues which companies must tackle before they begin to focus on this kind of operations (Contractor, Kumar, Kundu, Pedersen, 2011: 37):

- The company needs a diversification into the company's value chain.
- The company should have appropriate interfaces between organizational and spatial features, and
- The company should stay focused on minimizing the outsourcing costs and minimizing the overhead costs of running the company.

Establishing an offshore company is legitimate and legal. Actually, it is a practice of a huge number of entrepreneurs and companies who see their opportunities at offshore destinations. The company management, i.e. the entrepreneur, and the accredited mediation agency should work together in order to determine what is the most ideal place for establishment of the offshore company, in accordance with the laws of the particular jurisdiction. Creation of offshore company is the part where the entrepreneur actually sets the pillars of functioning of the company at an offshore destination. They usually appoint local managers in the country where the offshore company is located, in many cases without any real business role and power, just declaratively to represent the company. One of the many specifics of these financial centers is that the process of establishing an offshore company costs minimal fees, and the incorporation process could contain a big portion of secrecy. If the entrepreneur, the owner of the newly established offshore company wishes to keep his identity secret to the public, then no single authority should be able to trace their involvement into the company's activities. Special intermediary agencies with expertise in offshoring within the particular jurisdiction usually help this process run smoothly and without any legal obstacles. They may provide full support and consulting to ensure effective functioning of the overall operation of the company at a relatively low cost. In recent years, global giants from various industries increasingly use offshoring and outsourcing, even for the most complex work, such as research and development, programming, insurance underwriting, medical prescriptions and more (Contractor, Kumar, Kundu, Pedersen, 2011: 327).

#### **4. Advantages and disadvantages of offshoring**

Offshoring is a possible option even for the already existing businesses; it is not a case only for the entrepreneurial startups. Offshoring certain parts of the company - certain functions of the value chain, meaning reallocating these operations to locations abroad, such as production or handling and distribution. A lot of the companies still retain their core competencies near their corporate headquarters. But, in recent years, companies have even started to reallocate their core competencies, such as design, marketing, research and development and

to shift towards offshoring centers. In fact, more and more functions and activities are considered to bring competitive advantage if they become part of the offshoring or outsourcing process. Depending on the offshore destination, companies benefit from the offshore center's infrastructure, as well as from lower tax rates. Entrepreneurs who invest offshore also gain benefits from using the services of offshore banking. Offshore banking provides greater protection for active investments, along with improved capability in the fund management of the international business. The benefits are significantly greater. Offshore centers generate income from financial activities of their new clients, as well as from the existing ones, which leads to higher economic growth in the offshore country. Economic stability and employment rate growth are factors that also affect the development of a country (the offshore destination). One positive aspect of offshore territories is gaining funds in their state budgets from the payment of minimal fees for the operations of the registered offshore companies, as well as the new company's registration and renewal of licenses. Additional benefits exist for the local workforce due to creating new jobs. Some economies, like the Cayman Islands, Virgin Islands and many others rely exclusively on offshore activities as a major source of government revenue and economic activity. One of the advantages of these small economies is minimum formalities for the establishment of offshore companies. Another advantage is the short distance to major economies, which is often the case and benefit for small offshore jurisdictions.

On the other hand, disadvantages of offshore operations are research topics of international finance institutions, which constantly monitor their development. Restructuring through outsourcing and offshoring of companies from developed countries have a number of negative implications, in which the most explicit are (Bhagwati and Blinder, 2009: 51):

- Slower growth in average productivity - US and other rich countries often shift production to countries like China and India, which increases the growth rates in these economies and in this way, performs the redistribution process of international convergence.
- US vs. Europe. - The constant competition between US and Europe imposed pace of continuous technological innovation, which in some cases gives the advantage to the United States and in other to Europe.

- China or India - US residents and citizens of other English speaking countries in the future should not be concerned by competition from China, which is largely in the manufacturing sector of consumer goods. They should be more focused on competition from India, which is mainly in the service sector. Knowledge of English language is an important source of comparative advantage.
- Inequality in wages and salaries - Differences in financial contributions between educated and uneducated workforce are becoming more prominent around the world. This phenomenon is largely a consequence of technical progress, which will, as it is obvious, continue to grow.
- Job satisfaction – Recently modern economic living imposed alienation and isolation due to excessive professional obligations. It is estimated that the industry of personal services will become dominant in the future, which could lead to an increase of social activities between people and their greater satisfaction with their careers and professional development.

Governments around the World often express concerns about the negative impact of offshoring destinations on their own economies. The biggest risk detected is tax evasion, which is often said to be the main reason why companies conduct their businesses offshore. According to Hines (2009) there is always a possibility for the income earned in countries with higher taxes to be filed as if earned in offshore destinations for the purposes of smaller taxes. It is a public secret that some of the incentives for offshore operations are inspired by possibilities for dissembling and investments into criminal activities in other countries, including activities related to terrorism and drugs. This type of operations are forbidden in almost all countries in the world and are sanctioned and rigorously controlled by all governments. Financial and economic strength of offshore destinations largely depend on their ability to attract global financial business, thus competition between them is really strong. This competition is beneficial as it contributes to innovations in financial instruments and products and reduces the cost of financial services in the world. However, it can also cause concern if the lower cost of financial services is achieved by reducing the regulatory and supervisory standards. Because of the reason that offshore finance centers provide financial services primarily for non-residents, the

authorities in the countries of their origin are interested in the impact to their national economies caused by the offshore operations. Many renowned economists in the world consider that offshore and outsourcing operations need to have effective consolidated supervision. It would allow national supervisors to have access to information of the modern banking system, which will lead to consolidated supervision that could be effective only when cross-border cooperation and exchange of information is efficient (Darbar, Johnston, Zephirin, 2003). Anonymity of financial transactions in the operation of offshore companies undermines the reputation of these financial centers, which leads to deterrence of potential investors. Even more, certain supervisory standards are inadequate and more comprehensive risk analysis is impossible due to lack of reliable data on activities in offshore finance centers. At policy level there are strong concerns that financial regulatory loopholes could undermine the stability of the global financial system. There is a need for unique solution, by providing conditions in which offshore finance centers would operate under the internationally accepted standards. In that sense there are the recent developments in the European Union, where ministers of finance of the member countries have started negotiation to strengthen cooperation between Member States and certain offshore destinations, thus raising the level of transparency for banking information exchange, which would lead to strengthening the fight against tax evasion (<http://faktor.mk/archives/47612>).

### **Conclusion**

Entrepreneurship is the main generator of new jobs. It is a stimulator of well-being within national economies and provides incentives for new capital investment and continuously sustainable democratic society. New businesses are inspired by new ideas, which are the main instigator of building competitive advantages over other companies. New ideas are not always related to products or services; some of the most innovative people try to extend the range of ideas and have decided to start their businesses offshore. Offshore finance centers represent jurisdictions with special tax and regulatory policies that have specific favorable terms for foreign investment. Despite their size, country of origin or industry, companies often use offshoring and

outsourcing. Going offshore could be an opportunity to pursue an entrepreneurial venture with maximum effective and efficient operations, efficient allocation of resources, which would bring best possible financial results. A large number of limitations in the financial and business sector stemming from the 1970s contributed to the development of this type of offshore finance centers. The establishment of an offshore company in the right jurisdiction effectively protects entrepreneur's investments and offers bigger and wider perspectives and opportunities. The entrepreneur is required to have a vision and information to manage the whole offshoring process. There are benefits from the offshoring and outsourcing process for both the entrepreneurs and the domestic offshore jurisdiction. The economic growth in offshore country, economic stability and employment are beneficiary factors influenced by offshore finance centers. Many of the most attractive offshore destinations keep focus exclusively on offshore activities, which are the main source of government revenue and economic growth and activity.

On the other hand, inconsistent tax structure and easy changing policies on offshore territories are the basis for further speculation about what happens with the money earned in these centers. National tax authorities have serious problems in detecting offshore tax evasion. International finance authorities are seeking systematic approach to this global phenomenon, which will lead to final solution of this problem.

### **References:**

1. Andrew, T., and F. Alex. (2012), "A Teaching Note on Offshore Financial Centers", *Journal of Advancement in Business Education*, 1-2012.
2. Bhagwati Agdish, and Alan S. Blinder. (2009), "*Offshoring of American jobs: What response from U.S. Economic Policy*", Massachusetts London, England: The MIT Press Cambridge.
3. Burns, J. M., and McConvill J. (2012), "Offshore financial centers: An unstoppable force for good", *Cayman Financial Review*,  
[<http://www.compasscayman.com/cfr/2012/07/18/Offshore-financial-centres--An-unstoppable-force-for-good>] (12.01.2014).
4. Cobb Sharon C. (2009), "Redefining "Offshore" in Latin America", *Growth and Change*, 40(2), June 2009.

5. Contractor Farok J., Vikas Kumar, Sumit K. Kundu, Torben Pedersen. (2011), “*Global Outsourcing and Offshoring, An Integrated Approach to Theory and Corporate Strategy*”, New York: Cambridge University Press.
6. Darbar Salim M., R. Barry Johnston, and Mary G. Zephirin. (2003), “Assessing Offshore, Filling a gap in global surveillance”, *Finance & Development*.
7. Globes America (2014), “Bank Account for Non-US-Residents/Non-US-Citizens”,  
[<http://globesamerica.com/US-Bank-Account-for-Non-US-Resident-Non-US-Citizen.htm>] (12.02.2014).
8. Hampton, P. Mark, and Jason P. Abbott. (1999), “*Offshore Finance Centers and Tax Havens: The Rise of Global Capital*”, Purdue: Purdue University Press.
9. Hampton M. (2010), “*Small Island Economies: Exploring Alternative Development Strategies to Hosting Offshore Finance*”, UK: University of Kent.
10. Henry, S. James. (2012), “The Price of Offshore Revisited: New Estimates for “Missing” Global Private Wealth, Income, Inequality, and Lost Taxes”, *Tax Justice Network*.
11. Hines, R. J. (2009), “International Financial Centers and the World Economy”, *Society of Trust and Estate Practitioners (STEP)*,  
[<http://www.step.org/sites/default/files/Comms/reports/InternationalFinanceCentres.pdf>] (21.01.2014).
12. Morriss, A.P. (2010), “*Offshore Financial Centers and Regulatory Competition*”, Government Institutes.
13. Maurer B. (2007), “*Re-Regulating Offshore Finance*”, Irvine: Department of Anthropology, University of California.
14. OECD (1998), “Harmful Tax Competition: An Emerging Global Issue,”  
[<http://www.oecd.org/dataoecd/33/1/1904184.pdf>] (14.02.2014).
15. Orion (2014). “Orion Offshore Services”, Orion Corporate & Trust Services Ltd.  
[<http://www.orionibc.com/our-offshore-services.aspx>] (10.02.2014).
16. Palan, R., Murphy R., and Chavagneux C. (2013), “*Tax Havens: How Globalization Really Works*”, Cornell University Press.

17. The Wall Street Journal. “Lenovo Opens State-of-the-Art 200,000m(2) R&D, Sales Operations & Production Facility”, December 19, 2013,  
[<http://online.wsj.com/article/PR-CO-20131219-907414.html>]  
(24.02.2013).
18. [<http://www.offshoringtimes.com/AdvantagesOfOutSourcing.html>]  
(03.01.2014)
19. [[http://upload.wikimedia.org/wikipedia/en/thumb/a/a9/Offshore\\_financial\\_centers.png/500px-Offshore\\_financial\\_centers.png](http://upload.wikimedia.org/wikipedia/en/thumb/a/a9/Offshore_financial_centers.png/500px-Offshore_financial_centers.png)]  
(14.02.2014)
20. [<https://webpace.utexas.edu/dtt56/Offshore-Company.html>]  
(22.02.2014)
21. [<http://faktor.mk/archives/47612>] (15.01.2014)

**UDC 656.7:339.13.012.42**  
**Original scientific paper**

**Dejan MOJSOSKI<sup>\*</sup>)**

**LIBERALIZATION OF THE INTERNATIONAL AIR  
TRANSPORT: ITS ROLE IN THE GROWTH OF THE AIR  
TRAVEL AND THE ECONOMIC EFFECTS**

**Abstract**

Since its very beginning the international air transport sector was characterized as a heavy economically regulated sector, based on the reciprocity and control by the governments. With the increase of the importance of this transport modality, the need for growth and the elimination of this kind of limitations arose in order to satisfy the needs of the economy and society.

The alteration of the economic regulation in the international air transport began with deregulation of the USA air transport sector and continued with the European Union air transport three-packet liberalization. This process further continued in other parts of the world.

The comparative approach has been used to express the characteristic of the liberalization of air transport. The main result of the liberalization is the introduction of the Low-Cost Carriers in the air transport market with the continuous increase of their capacity in the share of total seats. The Low-Cost carriers had a share of 35% of the capacity share of total seats on the market in Europe in 2010, compared to the 5% in 2001. In the North America this number amounted to 29% in 2010, compared to the 18% in 2001. In addition, the liberalization of the air transport enabled creation of three global alliances which have strengthened the world-wide aviation network and have stimulated planetary growth of the air transport.

In conclusion, as a result of the liberalization, the air transport came to a continuous growth which supported the economic activities,

---

<sup>\*</sup>) Ph.D, Director General of the Civil Aviation Agency of the Republic of Macedonia, Dame Gruev 1, 1000 Skopje, Republic of Macedonia,  
e-mail: dmojsoski@CAA.gov.mk; d\_mojso@yahoo.com

and in narrower sense it influenced the macroeconomic components, the gross domestic product and the employment. The liberalization of the air transport enabled the support of the economy through increase of the economic activities and support of the employment.

**Keywords:** air transport, liberalisation, low-cost carriers, alliance, economic regulation

**JEL Classification:** L93, F3,

### **Introduction**

The international air transport is regulated on a bilateral basis in accordance with the International Convention on Civil Aviation signed on December 7<sup>th</sup>, 1944.<sup>1</sup> In general, this Convention, also known as the Chicago Convention, imposed the rules of the economic regulation of the air transport on the principle of reciprocity, limitation and control in the hands of the state seventy years after its signing.

The economic activities of the air transport are set within the frames of the structure or the rules of the game as agreements and memoranda, laws and regulation that govern the economic regulation. The economic regulation of the air transport set in the frames of the Convention led to a limitation where governments had a main role in the strategies of limitation and allowing new routes and destinations, creating prices and ownership of the airlines putting the sovereignty and the national identity first. Realizing these conditions the creators of the legal frame for liberalization of the air transport used the competition as a powerful tool for the changes in this sector in order facilitating the international rules which gave significant results.

The concept of liberalization of the air transport which outstripped the limits of the Convention started in the seventies in the USA and continued in the nineties in the EU. Worldwide, this process continued in Latin America and the Caribbean and Asia/Pacific.

The liberalization enabled the entrance of the Low-Cost Carriers in the air transport market as well as replacement of the state control and subsidizing with air companies that operate on a market basis. Today, the

---

<sup>1</sup> ICAO (International Civil Aviation Organisation) (2006), Convention on International Civil Aviation Doc. 7300/9, 2006, Montreal: ICAO  
[[http://www.icao.int/publications/Documents/7300\\_cons.pdf](http://www.icao.int/publications/Documents/7300_cons.pdf)]

participation of these Low-Cost Carriers in the capacity share of total seats is in almost all regions of the world is increased in comparison with the period of the beginning of 2000s. Additionally significant phenomenon on the global air transport is the formation of three alliances which are a response of the market logic.

Along with the increase of the portion of the Low-Cost Carriers in the air transport market and creation of alliance, important characteristic of the liberalization is the quantitative growth of the air transport as an important indicator, evidenced through the growth of the number of transported air passengers.

In the Republic of Macedonia the basis for liberalization of the air transport is established with the signing of the Multilateral Agreement on the Establishment of the European Common Aviation Area in 2006 and its ratification in 2007<sup>2</sup>, the National Air Transport Strategies of the Government<sup>3</sup>, the change in the rules for flight approvals by changing the Regulation on Flight Approvals by the Government.<sup>4</sup>

These experiences and practices contributed to the increase in the air transport in the Republic of Macedonia from 8.7% in terms of the

---

<sup>2</sup> Multilateral Agreement between the European Community and its Member States, the Republic of Albania, Bosnia and Herzegovina, the Republic of Bulgaria, the Republic of Croatia, the former Yugoslav Republic of Macedonia, the Republic of Iceland, the Republic of Montenegro, the Kingdom of Norway, Romania, the Republic of Serbia and the United Nations Interim Administration Mission in Kosovo on the establishment of a European Common Aviation Area - Annexes – Annexes (Official Journal of the Republic of Macedonia No.27/2007 and No.98/2009)

[[http://www.caa.mk/Upload/Document/MK/Zakoni/27\\_07\\_mkd\\_eng.pdf](http://www.caa.mk/Upload/Document/MK/Zakoni/27_07_mkd_eng.pdf)]

and the Agreement between the Republic of Macedonia and the European Community on certain aspects of air services and its ratification in 2006 (Official Journal of the Republic of Macedonia no.127/2006),

[[http://www.caa.mk/Upload/Document/MK/Zakoni/127\\_06\\_mkd\\_eng.pdf](http://www.caa.mk/Upload/Document/MK/Zakoni/127_06_mkd_eng.pdf)]

<sup>3</sup> Government of the Republic of Macedonia, National Programme for the adoption of the EU Law Revision 2012, [<http://www.pravda.gov.mk/documents/NPAA2012.pdf>]  
Ministry of Transportation and Communication, National Strategy for the development of aviation in the Republic of Macedonia, Skopje, 2007

[<http://www.caa.gov.mk/Upload/Document/EN/Regulativa/National%20Strategy%20for%20development%20of%20aviation%20in%20the%20Republic%20of%20Macedonia.pdf>] (26.07.2007),

Ministry of Transportation and Communication, National Transport Strategy 2007-2017 [[http://www.seetoint.org/wp-content/uploads/downloads/2014/01/FYRM\\_Transport-Strategy-2007-2017.pdf](http://www.seetoint.org/wp-content/uploads/downloads/2014/01/FYRM_Transport-Strategy-2007-2017.pdf)]

<sup>4</sup> Government of the Republic of Macedonia, Regulation for the Specific requirement, the manner and the procedure for the receiving of the flight permits (Official Gazette of the Republic of Macedonia No.142/2010)

passengers volume in 2011<sup>5</sup> to 16,8 % in 2013<sup>6</sup> in terms of passengers volume and enabled the entrance of Low-Cost Carriers and this share on the market.

### **1. Economic regulation of the air transport**

The regulation of the International Air Transport Market is based on the Convention on International Civil Aviation. With this Convention the countries accepted a system in which the governments determine the conditions for entrance on the market. The development of these events during the Chicago Convention limited the commercial approach to the air transport and led to the establishment of hard regulated market and government control known by the name point-to-point, which was the basic cell on the air transport market.

ICAO defined the air transport market between any two places as current and potential transport of people and goods that are transported or can be transported between those places with commercial air services<sup>7</sup>. The markets for international air transport are divided in four categories: market of two cities; second category is the market of two countries which contains all routes that connect the cities of these countries; third category is connection of the markets of two regions and includes all routes that connect the two regions and the fourth category is the global market which includes all points in the world included in the industry of the air companies.

The rapid growth of the air transport and the potential of the market was a primary factor that influenced the development of the market structure. That enabled the evolution of the structure of the aviation market to move slowly from hard economically regulated toward

---

<sup>5</sup> TAV Macedonia. Traffic data for the airports: Skopje Alexander the Great and Ohrid St. Paul the Apostle Compared 2010/2011 for the period January-December, Traffic Statistics Report 2010-2011 for Skopje and Ohrid Airports (from 13.01.2012, with No.09-66/3), Passangers volume. Skopje, 2012

<sup>6</sup> TAV Macedonia. Traffic data for the airports: Skopje Alexander the Great and Ohrid St. Paul the Apostle Compared 2012/2013 for the period January-December, Traffic Statistics Report 2012-2013 for Skopje and Ohrid Airports (from 09.01.2014 with No. 09-24/1), Passangers volume. Skopje, 2014

<sup>7</sup> ICAO (International Civil Aviation Organisation), *Manual on the Regulation of Internatioanl Air Transport , Second Edition-2004* Doc 9626, Montreal, ICAO: 2004, p. 4.1-1

liberalized air transport market. The creation of the markets (“hub – and - spoke”) is characteristic for the two greatest world markets, USA and EU. The conception of this model appeared in the middle of the 1970s, led by the air companies in the USA for the delivery of packages by creating its own company node. Very soon other companies in Europe accepted this model and developed their own nodes and wires giving natural superiority to this system for fast package delivery.

The economic regulation set in the Convention, represents the commercial air transport as scheduled air transport conducted by aircrafts for public transport of passengers, mail and goods for a compensation or lease<sup>8</sup>. According to the terminology used by ICAO, the term air transport is much more specified and it relates to aspects connected with transport by air. As a term, the aviation is much more general and it encompasses more areas as the military, state and private flights, production of aircrafts, air navigation, non – commercial transport and specialized air transport<sup>9</sup>. The services in the commercial air transport, in the broadest sense, include the services dedicated to public transport and performed by the aircrafts on a Schedule or Non-schedule basis. According to the classification of ICAO, the activities for civil aviation have wider scope.<sup>10</sup> The services of the commercial air transport further divide the unscheduled air transport in charter transport, other unscheduled transport and transport on demand. These activities together with the airport services in aviation navigation, the producers in civil aviation, aviation trainings, maintenance, reparations and repairs, the regulatory functions and other activities generate significant economic benefits.

The main principle for liberalization of the air transport express by IATA refers to the fair competition and deals with three fundamental freedoms i.e. freedom of access to global capital, market access and price service in line with market conditions.<sup>11</sup>

---

<sup>8</sup> Article 96(a) regular air transport conducted by aircrafts for public transport for passengers, mail and goods

<sup>9</sup> ICAO (International Civil Aviation Organisation), *Manual on the Regulation of International Air Transport*, Second Edition-2004 Doc 9626, Montreal, ICAO: 2004, p.iv

<sup>10</sup> ICAO (International Civil Aviation Organisation), *Global and Regional 20-year Forecasts*, Doc 9956, Montreal, 2013:ICAO, p.7

<sup>11</sup> IATA (International Aviation Transport Association) (2011), *Words of Change: Collection of Speeches by Giovanni Bisignani*, 2011:IATA, p.128

As the international airlines started to develop a world node and wire system in order to connect the international market, the complexity and the mutual dependency of the system increased and the need for creation of global networks appeared, which would bring greater quality and quantity of the routes by which the companies will acquire greater access to all markets and enable greater flow of passengers from any part of their systems. The liberalization of the air transport is the main process that will enable corporate collaboration on a liberal global basis.

## **2. The air transport market in the context of liberalisation**

The liberalization of the air transport is an important trend and process contributing to the modification of the regulating and functioning of the air transport and strengthening of its role in the development of the national and world-wide economy. From an economic aspect the role of the liberalization in the development of the air transport is a process that participates in the evolution and the change in structure of the air transport market itself. This process influenced the development of the global liberal air transport market at the same time. The initiative for deregulation of the air transport was initiated by the USA with its first implementation in the domestic transport. The positive experience of making Open Skies Agreements with 100 signing countries since 2010<sup>12</sup> was a recognizable indicator about the competition which led to an increase in the air transport of passengers, the quality of the services and a decrease in the prices. In the early 1970s, generally a condition existed where governments should regulate the air transport market with various regulations, directives and interventions. The new processes represented the attitude that the condition of an unregulated market will lead to an increase of the competition, greater productivity, greater efficiency which, in turn, will lead to a decrease in the prices. The Airline Deregulation Act will remain remembered in history as one of the first examples of deregulation in USA which enabled the reintroduction of the market forces in a strongly regulated environment of commercial airlines. The integration in Europe and the development on the Community level was the main fluid, which led to the establishment of a unique air transport market. The legal case “Nouvelles Frontières” from April 1984,

---

<sup>12</sup> ICAO (International Civil Aviation Organisation) (2013), Global Air Transport Outlook to 2030 and trends to 2040 Cir 333, AT/190, Montreal, 2013:ICAO, p.25

the entrance into force of the Single European Act and the action undertaken by the Directorate for Competition of the European Commission against the contracts for alliance of the airlines led the process of air transport liberalization through three regulatory packages. These events were a result of a higher level of development of the European Community and its ability of multilateral regulation in the frames of the European Union.

The concept of the European Union enabled free flow of people, services, goods and capital which resulted in a major expansion of the transport in all its modes. EU introduced policies that relied on a Single Market and raising the trade. This included the competition policy which provides lower prices and encouragement measures for cross-border collaboration between the firms and businesses.

The final stage in the process of liberalization and opening the air transport market in the European Union was conducted and was subject of the third package. In the third package the European airlines gained full right on transport in the European Union and creation of a Single Aviation Market in EU. The liberalization measures of the European Commission basically removed all commercial controls in the sector of air transport in EU-15 including Island, Norway and Switzerland which adopted these measures without entering the European Union. These measures, adopted in 1992 and applied from January 1993 introduced the freedom of giving services in the frames of the European Union gradually and in April 1997 the freedom of giving sabotage, which is the right of airlines from one country to operate the routes of another member-state.

The “Third Package” of EU air transport liberalization measures came into effect on January 1 1993 and have substantially reduced the restrictions on interstate flight operations.<sup>13</sup> The main measures of the third package were conducted through the frame legislation, or the economic regulations for the inner air transport market. These economic regulations opened the market for all airlines that own a Community Air Carrier Licence. The Regulation on Freedom of the Approach on the

---

<sup>13</sup> Hewings, Geoffrey; Wiedemann, Randal A. Reynolds-Feighan, Aisling. (2000) Economic evaluation of the impact of air service on small metropolitan and rural communities: final report , United States Department of Transportation. Office of Aviation Analysis, June 2000, p.30  
[<http://researchrepository.ucd.ie/bitstream/handle/10197/2914/REAL%20US%20DoT%20Study%20July%202000.pdf?sequence=1>] (20.06.2000)

Market opens all international air routes in the European Union for all air companies that own a Community Certificate without any restrictions.<sup>14</sup> Since April 1997 an unconditional approach to all domestic markets was approved to all airlines in the European Union. Maybe one of the most significant freedoms was the freedom of establishing by which the citizens of the EU can established Air Carrier in any EU member-state. A significant impact of the 1992 package was the stimulus it gave to the development of low-cost airline services.<sup>15</sup>

The ruling of the European Court of Justice from November 2002, against the Open Skies Agreements of the EU Member States and the USA initiated new dynamic negotiation for making agreements for air transport. In June 2002 the Council of the European Union gave mandate to the European Commission for negotiations on behalf of all Member States with USA for making agreements in the air transport, or in the creation of Open Aviation Area between the two territories.

All these processes, inevitably, had a significant influence on the growth and development of the air transport on a global level. The challenge of the air transport liberalization was present on the other continents as well. The process of air transport liberalization in Latin America started with the elimination of the air companies owned by the states and the governmental assistance in this sector. Several regional initiatives and a multilateral legal frame for liberalization and Open Skies Agreements enabled this process to make significant contributions for the growth of the air transport. The process itself started in 1979 when Chile adopted the Law on Commercial Civil Aviation and in 1991 supranational decision for adoption of intersubregional policy of open skies was approved and it included Venezuela, Columbia, Ecuador, Peru and Bolivia.<sup>16</sup>

---

<sup>14</sup> Council Regulation (EEC) No 2409/92 of 23 July 1992 on access for Community air carries to intra-Community air routes; Official Journal L 240, 24/08/1992 P. 0008-0014

<sup>15</sup> InraVISTAS-ga Inc, *The Economic Impact of Air Services Liberalization*, p. 16  
[[http://www.iata.org/whatwedo/Documents/economics/liberalization\\_air\\_transport\\_study\\_30may06.pdf](http://www.iata.org/whatwedo/Documents/economics/liberalization_air_transport_study_30may06.pdf)]

<sup>16</sup> ATConf/6-IP/6 5/3/13DEVELOPMENTS IN THE LIBERALIZATION OF INTERNATIONAL AIR TRANSPORT SERVICES IN THE LATIN AMERICAN REGION (Presented by 22 Member States, members of the Latin American Civil Aviation Commission (LACAC)), year 2013, Montreal-Canada  
[[http://www.icao.int/Meetings/atconf6/Documents/WorkingPapers/ATConf6-ip006\\_en.pdf](http://www.icao.int/Meetings/atconf6/Documents/WorkingPapers/ATConf6-ip006_en.pdf), p. 2]

### **3. The economic effects of the air transport market liberalisation**

The liberalization of the air transport enabled the appearance of cheap air ticket of the Low-Cost Carriers. They became significant players in the global civil aviation in a relatively short period. In the period from 2001 to 2010 in all world continents came to an increase in the share of the Low-Cost Carriers in the total seats. The greatest percentage of the share was noticed in Europe and in 2010 it amounted to 35%.<sup>17</sup>

The liberalization of the air transport increased the flights in the European Union dramatically which stimulated the development of services by the cheap airlines. The access to the great airlines market was without any law limitations and encouraged the investment in new services and aircrafts necessary for their fulfilment.<sup>18</sup>

The liberalization enabled significant increase in the share of the Low-Cost carriers on the air transport market. In Europe the capacity of the division of the total seats in 2010 amounted to striking 35%, compared with the 5% in 2001<sup>19</sup>. The increase in the air transport is mostly due to the successful process of liberalization of the air transport. By opening the national markets for competition it is allowed to the airlines to operate with their routes outside their countries. The competition between the airlines is increased, but still they successfully faced the solution to the economic problems and financial limitations.

The development of the air transport is a significant indicator of the economic activities and the transport trends reflect the long-term development of the economy and reflect the short-term problems of the serious and instant influences connected with the national security and the increase in the fuel price which was especially noticed in the air transport. According to the data of 51% of the inbound passengers travelled by air, 41% on road, 6% used water and 2% the rails in the

---

<sup>17</sup> ICAO (International Civil Aviation Organisation) (2013), *Global Air Transport Outlook to 2030 and trends to 2040* Cir 333, AT/190, Montreal, 2013:ICAO, p. 28

<sup>18</sup> InraVISTAS-ga Inc, *The Economic Impact of Air Services Liberalization*, Sine Loco, InraVISTAS-ga Inc, 2006, p. 16

[[http://www.iata.org/whatwedo/Documents/economics/liberalization\\_air\\_transport\\_study\\_30may06.pdf](http://www.iata.org/whatwedo/Documents/economics/liberalization_air_transport_study_30may06.pdf)]

<sup>19</sup> ICAO (International Civil Aviation Organisation), *Global and Regional 20-year Forecasts*, Doc 9956, Montreal, 2013:ICAO, p. 28

2010.<sup>20</sup> This proportion of international air transport is a clear indicator of the improved economic, social and cultural connection and improvement in the quality of life.

The Single Aviation Market in Europe in the years after the liberalization generated an increase of 44 million passengers or more than 33% compared with the growth of the internal market of the EU which amounted between 4 and 6% annually. The additional transport demanded additional 681 round flights daily.<sup>21</sup> This in accordance with statistics create growth with average annual rate of 7,3% led to an increase of the air transport of passengers between the EU and other countries to 176 million passengers compared to 123,4 million passengers in 1993. The routes toward the countries that accessed and the countries candidates noticed a growth by 5,2% after 1992. The intercontinental routes increased with a slower rate of 2,6% starting with 709 in 1992 and reaching 942 in 2003. The greatest increase is noticed in 2000 when the intercontinental flights were realized on 983 routes.<sup>22</sup>

In Europe, the Low-Cost carriers had a share of 35% of the capacity share of total seats on the market in 2010 compared to the 5% in 2001. In the North America this number amounted to 29% in 2010, compared to the 18% in 2001. The liberalization, also, led to significant geostrategic changes in the air transport in the world and to the appearance of the three air companies from the Arabian Gulf which created a new aviation force in the world and a significant competition to the regular airlines.<sup>23</sup> The process of liberalization of the air transport created conditions and a possibility for opening new destination and entrance of the Low-Cost Carriers on the market.

In the Latin America and the Caribbean, It is especially significant to be emphasized that in the period 2001 – 2010 the share of passengers of the Low-Cost Carrier increased significantly, i.e. from 3%

---

<sup>20</sup> ICAO (International Civil Aviation Organisation) (2013), *Global Air Transport Outlook to 2030 and trends to 2040* Cir 333, AT/190, Montreal, 2013:ICAO, p.18

<sup>21</sup> InraVISTAS-ga Inc, *The Economic Impact of Air Services Liberalization*, Sine Loco, InraVISTAS-ga Inc, 2006, p. 17  
[[http://www.iata.org/whatwedo/Documents/economics/liberalization\\_air\\_transport\\_study\\_30may06.pdf](http://www.iata.org/whatwedo/Documents/economics/liberalization_air_transport_study_30may06.pdf)]

<sup>22</sup> European Commission, DG TREN, *Analysis of the European Air Transport Industry 2003-Final Report*, Bruxelles, Office for the Official Publications, 2005 p.47

<sup>23</sup> ICAO (International Civil Aviation Organisation) (2013), *Global Air Transport Outlook to 2030 and trends to 2040* , Cir 333, AT/190, Montreal, 2013:ICAO, p.28-30

in 2001 to 30% in 2010.<sup>24</sup> Driven by those experiences and practices, the main step for the following regional air transport liberalization in Latin America came with the initiative for Multilateral Open Skies Agreement based on the text adopted on the Fifth Worldwide Air Transport Conference.<sup>25</sup>

By 2005, Australia-New Zealand traffic was fully 56 percent higher than it would have been in the absence of any liberalization and increased total traffic by over 1.7 million passengers per year.<sup>26</sup>

The statistics effects are publish by the airports show growth in the air transport and provides the entrance of the Low-Cost carriers on the market. In the compared 2011/2012 period, traffic data for the airports Skopje and Ohrid shows increase for 8.7% in terms of the passengers volume.<sup>27</sup> Concerning the compared 2012/2013 period, the air transport grew on the two international airports Skopje and Ohrid increased by 16,8% in terms of passengers volume and in 2013 overcome the long expected number of more than one million (terminal and transit) passengers.<sup>28</sup>

Another benefits of the liberalization of the air transport is the agreements for multinational collaboration which led to the formation of global alliances, A significant evolution of the structure of the air transport market and the most significant change led by the liberalization is the formation of global alliances, i.e. global market for the international alliances.<sup>29</sup> They adopted different strategies for the

---

<sup>24</sup> ICAO (International Civil Aviation Organisation) (2013), *Global Air Transport Outlook to 2030 and trends to 2040* Cir 333, AT/190, Montreal, 2013:ICAO, p. 29

<sup>25</sup> ECAC. ECAC News Number 49. Focus on Air Transprrt Liberalisation. Latin America and Air Transport Liberalization p.27

<sup>26</sup> InraVISTAS-ga Inc, *The Economic Impact of Air Services Liberalization*, Sine Loco, InraVISTAS-ga Inc, 2006, p. 20  
[[http://www.iata.org/whatwedo/Documents/economics/liberalization\\_air\\_transport\\_study\\_30may06.pdf](http://www.iata.org/whatwedo/Documents/economics/liberalization_air_transport_study_30may06.pdf)]

<sup>27</sup> TAV Macedonia. Traffic data for the airports: Skopje Alexander the Great and Ohrid St. Paul the Apostle Compared 2010/2011 for the period January-December, Traffic Statistics Report 2010-2011 for Skopje and Ohrid Airports (from 13.01. 2012, with No.09-66/3), Passangers volume. Skopje, 2012 p.2

<sup>28</sup> TAV Macedonia. Traffic data for the airports: Skopje Alexander the Great and Ohrid St. Paul the Apostle Compared 2012/2013 for the period January-December, Traffic Statistics Report 2012-2013 for Skopje and Ohrid Airports, Passangers volume (from 09 01.2014 with No. 09-24/1). Skopje, 2014 p. 2

<sup>29</sup> Daniel Yergin, et al, *Fettered Flight: Globalisation and the Airline Industry*, Cambridge Energy Research Associates, Inc., 2000), p. 21

innovative cooperative contracts and the formation of alliances was the answer of the air companies to the process of liberalization.

The rationalization of the operation and the more effective market coverage together with the regulatory barriers of the restrictive bilateral contracts developed the global phenomenon in the industry of the air companies which enabled the creation of “nets”, or a global market for the international alliances, especially in the 1990s. The creation of the alliances, actually, reflects the efforts by the air companies for the creation of global networks on the air transport market based on a natural commercial basis which would lower the economic costs in the globalized and competitive environment and would lose the shins of the government limitations. The appearance of global alliances, as Star Alliance, Oneworld and Sky Team, "mega-alliances, grouping of alliances on geographically allocated big and medium air companies with widely combined global networks” changed the structure of the air transport market dramatically.

### **Conclusion**

During the late 1970s and 1980s the trend of liberalization of the air transport expanded from the domestic USA market to the international markets. The liberal bilateral agreements incarnated in Open Skies Agreements signed in 1978 between the USA and several European countries. In Europe, the Netherlands and the United Kingdom were the first to effectively deregulate the air transport in 1984/85 by adopting the ultraliberal bilateral agreement. Later these countries gradually started to sign relatively liberalized bilateral agreements with other European countries. These liberal bilateral agreements were a precursor to the first air transport liberalization package in the Community which started in 1988.

Inspired by the deregulation of the domestic transport in USA in 1978, as well as with the decision of the European Court of Justice in the case *Nouvelles Frontières* from April 1984, the entrance into force of the Single European Act and the action undertaken by the Directorate for Competition at the European Commission against the agreements for alliances of the air companies which were a kind of catalyst for the events that followed, the Council of EU brought the decision for the first air transport liberalization package.

The Regional Liberalization of the Air Transport in the European Union (The Three Packages of EU) is the process of liberalization started in December 1987 with the first package of measures and it lasted nearly three years. It led to lowering of the capacity limitation, increase in the routes and creation of zones with greater flexibility in the prices. The measures limited the right of the governments to the introduction of new prices. Flexibility was allowed and the air companies were enabled to split the capacity of seats in two countries that had signed a bilateral agreement.

These experiences and practices has contributed to the increase in the air transport of the passengers' volume in the Republic of Macedonia from 8.7% in 2011 to 16.8% in 2013. The process of liberalization of the air transport in the Republic of Macedonia is closely connected with the process of European integration and acceptance of the European practices and experiences. The first step starts with creation of and the Establishment of a European Common Aviation Areas, with further steps as amendments in the Government Regulation, signing Memoranda on Understanding based on the implementation of the above mention Multilateral Agreement which led to a change from a restrictive to a liberal regime of the economic regulation.

The liberalization of the air transport and the growth in traffic are a reaction of the removed legal barriers for flight approvals and the increase in the demand for air trips because of the convenient offer and the wider choice of destinations. As a result of the liberalization the air transport came to a continuous growth which supported the economic activities, and in narrower sense it influenced the macroeconomic components, the gross domestic product and the employment. The liberalization of the air transport enabled the support of the economy through the increase of the economic activities and the support of the employment. This role has a long-term influence which acts on the improvement of all its economic capacities with the improvement of the mobility, availability, the choice of modality and the possibility to travel, inter - trade exchange and availability of the European and world destinations to all its citizens whether for vacation or recreation, family or friend visits etc.

The integration of the air transport of the Republic of Macedonia in the Single Market of the European Community influenced the growth of the air transport and as a main chain for supporting the employment and the growth of the GDP taking into consideration the multiplier effect

as a normally expressed as a factor showing how much the direct economic impact of the airport is increased by the indirect and induced economic effect of airport activities.<sup>30</sup> In addition, with the catalyst effect, the air transport significantly support the tourism. The new Low-Cost Carriers brought a significant benefit for the integration in the European and world-wide networks and markets, support for the working posts, enabler of the mobility, and they improve the public opinion and perception about the civil aviation.

### **References:**

1. Agreement between the Republic of Macedonia and the European Community on certain aspects of air services and its ratification in 2006, Official Journal of the Republic of Macedonia no.127/2006, [[http://www.caa.mk/Upload/Document/MK/Zakoni/127\\_06\\_mkd\\_eng.pdf](http://www.caa.mk/Upload/Document/MK/Zakoni/127_06_mkd_eng.pdf)]
2. ATConf/6-IP/6 5/3/13 DEVELOPMENTS IN THE LIBERALIZATION OF INTERNATIONAL AIR TRANSPORT SERVICES IN THE LATIN AMERICAN REGION, Presented by 22 Member States, members of the Latin American Civil Aviation Commission (LACAC)), 2013, Montreal-Canada, [[http://www.icao.int/Meetings/atconf6/Documents/WorkingPapers/ATConf6\\_ip006\\_en.pdf](http://www.icao.int/Meetings/atconf6/Documents/WorkingPapers/ATConf6_ip006_en.pdf)]
3. Council Regulation (EEC) No 2409/92 of 23 July 1992 on access for Community air carries to intra-Community air routes, Official Journal L 240, 24/08/1992 P. 0008-0014
4. Daniel Yergin, et al. (2000), "*Fettered Flight: Globalisation and the Airline Industry*", Cambridge Energy Research Associates, Inc.
5. ECAC (European Civil Aviation Conference) (2013), "ECAC News Number 49. Focus on Air Transport Liberalisation", Neuilly/Seine: ECAC.
6. European Commission, DG TREN, (2005), "Analysis of the European Air Transport Industry 2003 - Final Report", Brussels: Office for the Official Publications of the European Union.

---

<sup>30</sup> ICAO. (International Civil Aviation Organisation) (2013), *Airport Economic Manuel Doc 9562, Thirth Edition-2013*, Montreal, 2013: ICAO p. (xv)

7. European Commission (2004). “*Key fact and figure about the European Union*”, Luxembourg, Office for Official Publication of the European Communities.
8. Hewings, G., Wiedemann, R., A. Reynolds-Feighan, A. (2000), Economic evaluation of the impact of air service on small metropolitan and rural communities: final report , United States Department of Transportation. Office of Aviation Analysis, June 2000, p.30.  
[<http://researchrepository.ucd.ie/bitstream/handle/10197/2914/REAL%20US%20DoT%20Study%20July%202000.pdf?sequence=1>]  
(20.06.2000)
9. IATA (International Aviation Transport Association) (2011), Words of Change: Collection of Speeches by Giovanni Bisignani , IATA.
10. ICAO (International Civil Aviation Organisation) (2013), Airport Economic Manuel , Doc 9562, 13 ed., Montreal: ICAO.
11. ICAO (International Civil Aviation Organisation) (2013), Global Air Transport Outlook to 2030 and trends to 2040 , Cir 333, AT/190, Montreal :ICAO.
12. ICAO (International Civil Aviation Organisation) (2004), Manual on the Regulation of International Air Transport , Doc 9626, 2 ed., Montreal: ICAO.
13. ICAO (International Civil Aviation Organisation) (2013), Global Air Transport Outlook to 2030 and trends to 2040 Cir 333, AT/190, Montreal, 2013:ICAO
14. ICAO (International Civil Aviation Organisation) (2006), Convention on International Civil Aviation , Doc.7300/9, Montreal: ICAO.
15. InraVISTAS-ga Inc, *The Economic Impact of Air Services Liberalization*,  
[[http://www.iata.org/whatwedo/Documents/economics/liberalization\\_air\\_transport\\_study\\_30may06.pdf](http://www.iata.org/whatwedo/Documents/economics/liberalization_air_transport_study_30may06.pdf)]
16. KC, Pukar. (2012), "Modeling the Effects of Air Transport Liberalization on the Airline Industry", *Economics Honors Papers*. [<http://digitalcommons.conncoll.edu/econhp/7>]
17. Ministry of Transportation and Communication, National Transport Strategy 2007-2017  
[[http://www.seetoint.org/wp-content/uploads/downloads/2014/01/FYRM\\_Transport-Strategy-2007-2017.pdf](http://www.seetoint.org/wp-content/uploads/downloads/2014/01/FYRM_Transport-Strategy-2007-2017.pdf)]

18. Multilateral Agreement between the European Community and its Member States, the Republic of Albania, Bosnia and Herzegovina, the Republic of Bulgaria, the Republic of Croatia, the former Yugoslav Republic of Macedonia, the Republic of Iceland, the Republic of Montenegro, the Kingdom of Norway, Romania, the Republic of Serbia and the United Nations Interim Administration Mission in Kosovo on the establishment of a European Common Aviation Area - Annexes – Annexes, Official Journal of the Republic of Macedonia No.27/2007 and No.98/2009,  
[[http://www.caa.mk/Upload/Document/MK/Zakoni/27\\_07\\_mkd\\_eng.pdf](http://www.caa.mk/Upload/Document/MK/Zakoni/27_07_mkd_eng.pdf)]
19. National Programme for the adoption of the EU Law Revision 2012, Government of the Republic of Macedonia,  
[<http://www.pravda.gov.mk/documents/NPAA2012.pdf>]
20. National Strategy for the development of aviation in the Republic of Macedonia (2007), Ministry of Transportation and Communication, Skopje.  
[<http://www.caa.gov.mk/Upload/Document/EN/Regulativa/National%20Strategy%20for%20development%20of%20aviation%20in%20the%20Republic%20of%20Macedonia.pdf>] (26.07.2007).
21. Regulation for the Specific requirement, the manner and the procedure for the receiving of the flight permits, Skopje, Government of the Republic of Macedonia, Official Gazette of the Republic of Macedonia No.142/2010.
22. TAV Macedonia. (2012), “Traffic data for the airports: Skopje Alexander the Great and Ohrid St. Paul the Apostle Compared 2010/2011 for the period January-December”, *Traffic Statistics Report 2010-2011 for Skopje and Ohrid Airports (from 13.01.2012, with No.09-66/3), Passangers volume*, Skopje.
23. TAV Macedonia. (2014), “Traffic data for the airports: Skopje Alexander the Great and Ohrid St. Paul the Apostle Compared 2012/2013 for the period January-December”, *Traffic Statistics Report 2012-2013 for Skopje and Ohrid Airports (from 09.01.2014 with No. 09-24/1), Passangers volume*. Skopje.

UDC 338:334.722.012.63/.64].022/.023(497.7)

Original scientific paper

Tatjana NESTOROVSKA\*)

## COMPARATIVE ANALYSES OF THE INFLUENCE OF SMALL AND MEDIUM ENTERPRISES TO THE ECONOMY

### Abstract

Several decades backwards small and medium enterprises have been in the focus of the attention of the world economy.

The examinations of the modern economic science and the world experiences undoubtedly confirm that there is no stable and qualitative economic development without more significant presence of the small and medium enterprises (SME) in the economic structure of each country.

Beside that they represent an important segment of the economic structure of all developed countries and they also represent one of the key factors of pre-structure in the countries which are in transition.

**The subject** of this paper is the influence of SME on the development of the economy together with comparative statistic display of their condition in R. Macedonia and Europe. **The aim** of this paper based on the presented and analyzed foreign experiences, which refer to the influence of SME on the economy, is to give evaluation on the place and role of SME on the economy of R. Macedonia.

At the same time in order to achieve the aim of the research, **the methods** of synthesis of systematic analyses, comparison, as well as combination of qualitative and quantitative analyses of the results have been used.

**Key words:** *small, medium, enterprises, growth of gross domestic product, employment*

**JEL classification: O12**

---

\*) PhD, Bitola, University St Clement Ohridski HMS Bitola  
E-mail: tnestorovksa@yahoo.com

## **Introduction**

Each developed economy is inevitably influenced by small and medium enterprises, companies and their working support, general economic growth of the country which are stimulated to improve and promote their business in many ways.

Small and medium enterprises have multiple advantages. They are becoming one of the most prosperous aims of national policies for economic development in the world. This is achieved through numerous economic features, especially in the area of creation of new posts, they have great contribution in the increase of employment, i.e. contribute to the use of knowledge, skills and entrepreneurial abilities of thousands of people, but also contribute to stronger competition on the market.

The history of the small and medium enterprises is very long and their development was marked by the increase in economic growth. The largest growth SME had was at the beginning of the 1970s.

The importance of the development of SME for the development of R. Macedonia is immense, considering the long term tradition in the development of the private sector in the field of craftwork, which represents challenge for our research. The motive stems from the necessary steps which are to be taken in order to enable emerging precise national economic policy for the development of small and medium enterprises as part of the overall long-term strategy for economic development of Macedonia in the future.

### **1. Qualification of the characteristics of SME**

In the definition of the term small company different views have appeared conditioned by the necessities and tasks of macroeconomic policy. The classification of micro, small, medium and large enterprises is made on the basis of larger number of criteria<sup>1</sup>; employment, financial result, value of the assets, turnover etc. Difficulties in the definition and classification mostly appear due to the fact that the sole objective or statistic measure does not correspond to the aim.

---

<sup>1</sup> Shuklev, B. (2001), "*Management of small business. Skopje: Faculty of Economics*", p.57

In the definition by EU, the basic criterion is the number of employees, however, the most corresponding definition SME can be seen in comparative terms, as shown in the following table:

**Table 1: Qualification of enterprises**

	EU Definition of enterprises	Law on Commercial Enterprises (2004)	Accounting Law (1992), last amended in 2002
In the first year of working it is necessary to satisfy two of the following criteria			
Micro	to 10 employees	t 10 employees	
	Annual turnover <sup>1/A</sup> 2 million Euros	Annual turnover < 50,000 uros	
	Value of the assets <sup>1/A</sup> 2 million Euros	maximum 80% of the gross income to be earned by one client	
Small	to 50 employees	to 50 employees	to 50 employees
	Annual turnover <sup>1/A</sup> 10 million Euros	Total turnover < 2 million Euros	Annual turnover < 8,000 MKD average monthly salaries per worker
	Value of the balance of state <sup>1/A</sup> 10 million Euros	Value of the assets < 2 million Euros	Value of the assets < 6,000 MKD average monthly gross salaries per worker
Medium	to 250 employees	to 250 employees	to 250 employees
	Annual turnover <sup>1/A</sup> 50 million Euros	Annual turnover < 10 million Euros	Annual income < 40,000 MKD average monthly salaries per worker
	Value of the balance of state <sup>1/A</sup> 43 million Euros	Value of the assets < 11 million Euros	Value of the assets < 30,000 MKD average monthly salaries per worker

Source: Agency for Entrepreneurship Support of RM, report for MPS Skopje, 2004:24

The previous table represents how the European Union classifies enterprises, and what classification of enterprises is given in Macedonia's legislation. We can conclude that the classification of the companies in the Law on Commercial Companies was made pursuant to the definition used by EU and regarding the number of employees, the same classification has been adopted. But, regarding the overall turnover and values of the balance of state, that is not the case. Just several enterprises in RM can correspondingly merge within European classification. In order to solve this problem, the authorities accepted the values of EU with reduced ratios of 1/4 or 1/5 for the turnover and the balance of state.

Consequently, a small company in R. Macedonia is considered to be an economic subject which in each of the last two years has fulfilled at least two of the following three criteria:

- Average number of employees on basis of working hours up to 50
- Annual income lower than 8,000 MKD average gross salaries per worker in the RM economy
- Average value of the assets lower than 6,000 MKD average monthly gross salaries in the economy of RM

All other enterprises are considered as large.

## **2. Small and medium enterprises in the economy of the European Union**

In order to show the importance of small and medium enterprises in the EU economy, the simplest way is to illustrate the representatives and the contribution that they make to the common milestones for economic wellbeing such as employment and the incomes.

The largest number of enterprises which have been registered on the territory of the European Union are small and medium enterprises. As much as 99,8% of the enterprises are SMEs. 92,8% of SMEs are the smallest ones, so called micro enterprises, which have up to ten employees<sup>2</sup>; 6,7% are small and 1,1% are medium enterprises. In Table 2, the number of micro SMEs in EU<sup>3</sup> is shown. The statistic data received by Eurostat present reduction of the number of micro SMEs in

---

<sup>2</sup> Ožegovi , L. Pavlovi , N. (2012), "Menadžment malih i srednjih preduze a nosilac razvoja privrede", Škola biznisa, p.77

<sup>3</sup> Eurobarometer Team of the European Commission, *Observatory of European SMEs, Flash Eurobarometer*, No. 196, Budapest: European Comission, 2007:7

2013, which is primarily due to the economic crises of 2009, whose consequences are felt even today.

**Table 2: Number of small and medium enterprises (in millions) for 2000, 2008 and 2013**

	2000 ( U-19)	2008 ( U-27)	2013 ( U-27)
icro	19	19.3	18.8
Small	1.2	1.4	1.3
Medium	0.16	0.2	0.2
SME (total)	20	21	20.3
Large	0.0	0.0	0.04

Source: Eurostat, National Statistical Offices DIW DIW econ, London Economic (<http://epp.eurostat.ec.europa> checked on 2503.2014)

In 2012 in EU 27% out of 130.601.730 employees WERE employed, out of which 66,5% employed in SMEs (table 3).

**Table 3: Number of employed in EU -27 for 2012**

icro	Small	Medium	SME	Large	Total
37,494,458	26,704,352	22,615,906	96,814,717	43,787,013	130,601,730
28.7%	20.5%	17.3%	66.5%	33.5%	100%

Source: Eurostat, National Statistical Offices, DIW, DIW econ, London Economics (<http://epp.eurostat.ec.europa.eu> checked on 25.02.2014)

In EU industry, 2,130,000 people have been employed - 1,701,570 in micro and small enterprises, i.e. in the class from 0-9 and 10-19 employees. The number of employees in SMEs in the industry in the class from 50-250 employees is 72,000 people<sup>4</sup>.

Referring to the capital turnover, the majority is generated by commercial SMEs – in 2012, the average annual turnover was 2,658,000 Euros, followed by the industrial SMEs from 2,070,000 Euros. The average number of SME employees in the Union was 7,1 which is the biggest number in the industrial sector.

<sup>4</sup> <http://appsso.eurostat.ec.europa.eu/nui/setupModifyTableLayout.do>

**Table 4: The economic power of SME in the European Union 2012**

Section	Average annual turnover (000) Euros	Average number of employees	Average annual turnover per employee in (000) Euros
Industry	2070	10	166
Commerce	2658	6	405
Real estate and consulting	1163	6	180
Total	5891	7,1	749

Source: <http://appsso.eurostat.ec.europa.eu/nui/setupModifyTableLayout.do>

From Table 4, it can be concluded that the largest number of SMEs are from the commercial sector, and they produce an average annual turnover of 2,658,000 Euros, then followed by the industrial SMEs with 2,070,000 Euros turnover in 2012. The production sector of the EU industry had a total of 2,070,500 SMEs involved out of a total of 2,130,000 companies<sup>5</sup>. Expressed in percentages, 97.2% of the total number of companies are SMEs.

Existence of larger number of SME is of special importance for the economy of each country from a reason that they support the innovations, support and increase, the competition, offer possibilities for new employment which represent significant factor of fortune.66% of the total number of employees in the European Union work in small and medium enterprises, presented in table 5

**Table 5: Total number of employees in SMEs in EU**

Year	Total number of employees (million)	
	Total	SME
2008	135,8	90,6
2012	130,6	96,8

Source:

[http://epp.eurostat.ec.europa.eu/cache/ITY\\_OFFPUB/KS-ET-11-001/EN/KS-ET-11-001-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-ET-11-001/EN/KS-ET-11-001-EN.PDF)

<sup>5</sup> <http://appsso.eurostat.ec.europa.eu/nui/setupModifyTableLayout.do>

From the table it can be seen that in 2008 in the EU there were a total of 135.8 million employees, out of whom 90.6 million employed in SMEs. 39.3 million (24%) are employed in micro enterprises, 27.9 million (20.5%) in small enterprises and 23.4 million (17.2%) in medium enterprises. Regarding 2012, beside the fact that the overall number of employees in EU significantly decreased, the number of employees in SMEs increased, so that 66.5% of the employees in EU work in SMEs. As for the 65% of the turnover of the capital, it goes to SMEs, a fact which obliges to serious analyses, discussions, observations and creation of adequate policies of long-term development support in this significant part of the economic structure.<sup>6</sup>

### **3. Small and medium enterprises in the economy of R. Macedonia**

Opposite to the era of industrialization (in regard of the previous social system in Macedonia as part of the former Yugoslavia), where the most crucial question was the development of industrial activities in the era of post-industrialism (computer society), one of the most actual questions is the development of small and medium enterprises. Factors which primarily determine the development of small and medium enterprises are development of Information Technology, other technologies (telecommunications, transport means, bio-engineering and genetic engineering) as well as globalization of world economy, which implies new modern forms of business working, new knowledge application, new technology and business cooperation in the interest of supplying competitive production and services on the global market of goods and services.<sup>7</sup>

Strategy for development in our conditions are based on the determination for micro, small and medium enterprises to become the propulsion force of the future economic development, filling the existing vacuum created by the total collapse of large enterprises. The continuous strengthening of the SME sector after 2000 is a result of improvement of general conditions for entrepreneurship, supporting, measurements and

---

<sup>6</sup> Potevska-Zarenzakova, M. (2000), *“The Perspectives of Small Economy”*. Skopje: Neol-Risto Ltd., p.25

<sup>7</sup> Miteva, E. “Technological development of small and medium enterprises in RM through programs for cooperation with foreign partners”, page. 2

activities in the state but also on the local level of government. Special attention was dedicated to the stimulating surrounding for work and the security of financial support for the development of the SME sector and entrepreneurship.

The importance of SMEs in Macedonia is represented by the basic indicators - the enterprises from 2004, and until now, have participated with 99% of the total number of active enterprises for the current year, i.e. from 2004 to 2007 their number was 50000, and then it started to increase<sup>8</sup>.

**Table 6: Number of small and medium enterprises in R.Macedonia**

Employees	2008	2009	2010	2011	2012	2013
0-9	58,476	65,641	70,032	67,294	61,053	60,599
10-19	2,047	2,223	2,483	2,754	2,937	2,989
20-49	1,304	1,483	1,568	1,698	1,795	1,787
50-250	1,177	1,159	1,211	1,187	1,280	1,291
250+	189	201	203	185	201	209
Total	63,193	70,710	75,497	73,118	74,421	71,290

Source: [www.stat.gov.mk](http://www.stat.gov.mk)

The largest percentage comprise enterprises which belong to the group from 0-9 employees – more than 90%. Regarding their number in the years up to 2010, there was an upward tendency, but in 2011 there appeared to be downward tendency of the number of micro enterprises, which, on the other hand, was result of decrease in the total number of enterprises.

In the next table 7, the turnover according to the number of employees is presented, as well as the added value by factor of expense according to the number of employees in SMEs (micro, small and medium), meaning all SMEs which have from 0-250 employees are divided by sections.

---

<sup>8</sup> [www.stat.gov.mk](http://www.stat.gov.mk)

**Table 7: The economic power of SMEs in Macedonia (2012) in million MKD**

Section	Turnover according to the number of employees in million MKD		Total number of employees		Added value by factor of expense according to the number of employees	
	Total	0-250	Total	0-250	Total	0-250
Industry	251,561	110,365	101,453	73,828	50,380	29,978
Commerce	389,591	333,189	93,392	81,103	45,652	41,292
Real estate and consulting	37,583	33,661	33,248	23,879	17,670	14,394
total	940,561	477,215	228,093	178,810	113,702	85,664

Source: <http://www.stat.gov.mk/pdf/2013/6.1.13.98.pdf>

From table 7 it can be noticed that from the total number of employees in three largest sections: industry, commerce and real estate with consulting (228,093; 178,810) or 78,4% are employed in SMEs. The largest percentage 86,8% of employees in SMEs work in commerce. Regarding the turnover, and according to the number of employees in 2012, the largest is the participation of enterprises in commerce, retail and whole sale, where each enterprise has employed up to 250 people. In these enterprises, 333,189 employees are working, and there is a turnover of 389,591 million MKD – regarding the added value by factor of expense it is the largest in the industry.

In table 8 the development flow of the increase in the number of SMEs from 2008 to 2012 is depicted

**Table 8: Total number of employees in R. Macedonia and number of employees in SMEs**

Year	Total number of employees	
	Total	SME
2008	609,215	437,475
2009	629,901	453,031
2010	659,557	494,793
2011	642,748	476,572
2012	657,849	493,260

Source: [www.stat.gov.mk](http://www.stat.gov.mk)

It is interesting to mention that the overall number of employees in small enterprises is constantly growing with high speed compared to the increase of the overall number of employees. That is to say, in 2008 71% of the total number of employees were employed in SMEs and in 2013 that percentage was 75%. Opposite to this, the number of employees in large enterprises is decreased, which appears to be due to firing of workers from large companies. As they are unemployed, part of them get employed or found small companies and in that way the number of the small enterprises has increased. Also, the number of small enterprises has increased, so that the large enterprises suffered reconstruction and were divided into smaller units. The number of employees in the small enterprises is in continuous growth. And opposite of 2004, when it was 56, 11% of the total number of the employees today is 75%.

The Republic of Macedonia, for a longer period of time made low rates of growth of the Gross Domestic Product (GDP). After the independence in 1991 until 1995 the rates of growth were negative. In 1995, GDP was 80% of the GDP in 1990. In the period from 1996 to 2000, the growth rate of GDP was moving in positive direction within 1, 2% to 4, 5%<sup>9</sup> or 2, 3% annually on average.<sup>10</sup>

The conflict in 2001 negatively influenced the growth rate – the GDP was -4, 5%.

In 2002, there was a positive growth of GDP of 0,9%, which in 2003 was 2, 3% and from 2004 to 2008 the growth rates of GDP were on the level above 4% (4,1%; 4,1%; 4,0%; 5,9%; 4,9%).

According to the indicators of GDP growth, the level of GDP from 1990 in 2007 reached the level where it can be compared to the processes in other countries in transition. The highest rate of GDP was 6,1% in 2007.

Similar tendency was happening in 2008, when there was an economic growth of 5% and the economy entered the recession with -0,9%. The increasing of the growth rate started in 2010 with 1,8% and

---

<sup>9</sup> Nanevski, B., Stojanova, V. and Josifovska, A. (1997), *“The Development of small and medium enterprises and the reduction of the unemployment in R.Macedonia”*, Skopje: Foundation “Frederick Ebert”, office Skopje, p. 90

<sup>10</sup> Mishkovska-Kajevska, Lj., Kusakov, H., Petroski, A., Petkoska, T., Pendev, D., Petkovska-Mirchevska, T., Angelova, B., Stoshik, L., Ackovska, M., Adzi Mitrevska-Lazarevska, P., Petroska, N. and Pecevka, Z. (2002), *“The small enterprises in the development of the economy of Republic of Macedonia”*, Skopje: Institute of Economics, p. 59

the tendency of growth continued throughout 2011, when it reached 2,8%.

As Macedonia has low development rate, the growth rate should be a double digit or from 10% and above, so as to influence the overall economy. Surely, it is important for the increased rates to be in continuity for at least three years in order to have positive effect.<sup>11</sup>

According to the previous analyses that the economic crises left mark on the economic growth and besides the fact that entrepreneurship activities in 2009 were very current, still there was decreasing of the growth rate of GDP. According to many research activities, the small and medium enterprises are more immune to the strikes of the world economic crises, it can still be felt, and taking into consideration the fact that SMEs represent 99% of the overall number of enterprises in 2013 there was still a decrease in the number of micro enterprises (0-9 employees) in R. Macedonia.

So there is a question posing: Is the entrepreneurship reason or consequence of economic growth?

### **Conclusion**

When we talk about the influence of SMEs in the economy and the economic growth of a country, it is worth to mention the fact that they represent the engine of the economic development of a country. They increase the level and extent of using new resources in the economy with high level of flexibility and adaptability the other new market conditions They promote the private ownership and the entrepreneurship capabilities. They are the engine of the development in countries with market economy and developing countries, as well. The development of SMEs enables increase in the social product, increase of economic subjects, creation of new posts, rising of the living standard, substitution of the export and larger export competition of domestic economy.

The section of small and medium enterprises shows that the future belongs to the entrepreneurship of personal initiatives and creativity in working, therefore it is necessary to give special emphasis to the private sector so as to get corresponding place in the priority developing aims.

---

<sup>11</sup> [http://faktor.mk/archives/34132?utm\\_source=daily.mk](http://faktor.mk/archives/34132?utm_source=daily.mk)

SMEs represent the most vital part of Macedonian economy and in that section, large number of individuals have been employed, who produce the largest part of gross domestic product of the country. The balanced regional development of R. Macedonia depends a lot on the number of successful SMEs and their balanced location in all parts of the country, which on the other hand influences an eruption of the rate of unemployment on local level.

Through comparative analyses of simple statistic data from EU and R. Macedonia, the extent of domination of SMEs in EU and R. Macedonia has been presented, as well as the influence on the economy with multiple positive effects. In many European states among which is R. Macedonia the participation of SMEs was 95-99% regarding the total number of all companies. In the last several years over 60% - 70% of the overall employment belongs to that section and here over 50% of the value added tax was realized. If these data are not neglected in certain analyses, it will be very clear what is the part and the importance of SMEs in the development of the economy in R. Macedonia.

#### **References:**

1. Deakins, D., et al. (1996), "*Entrepreneurship and small firms*".  
aidnehead: McGraw-Hill.
2. Eurobarometer Team of the European Commission, Observatory  
of European SMEs, Flash Eurobarometer, No. 196, Budapest:  
European Comission, 2007
3. Joji , R. (1988), "*Preduzetništvo dileme i zablude jugoslovenske  
teorije i prakse upravljanja*", Belgrade: Privredni pregled.
4. Lazarevska, T. (2009), "*Entrepreneurship in Macedonia: part of  
the global research of the entrepreneurship*", Skopje:  
Macedonian Development Foundation of Enterpresis.
5. Mishkovska-Kajevska, Lj., Kusakatov, H., Petroski, A., Petkoska,  
T., Pendev, D., Petkovska-Mirchevska, T., Angelova, B., Stoshik,  
L., Ackovska, M., Adzi Mitrevska-Lazarevska, P., Petroska, N.  
and Pecevska, Z. (2002), "*The small enterprises in the  
development of the economy of Republic of Macedonia*", Skopje:  
Institute of Economics.

6. Miteva, E. "Technological development of small and medium enterprises in RM through programs for cooperation with foreign partners", page. 2
7. Nanevski, B., Stojanova, V. and Josifovska, A. (1997), "*The Development of small and medium enterprises and the reduction of the unemployment in R.Macedonia*", Skopje: Foundation "Frederick Ebert", office Skopje.
8. Ožegovi, L. Pavlovi, N. (2012), "*Menadžment malih i srednjih preduze a nosilac razvoja privrede*", Škola biznisa.
9. Potevska-Zarenzakova, M. (2000), "*The Perspectives of Small Economy*". Skopje: Neol-Risto Ltd.
10. Shuklev, B. (2001), "*Management of small business. Skopje: Faculty of Economics*", p.57
11. Story D. J. (1994), "*Understanding the Small Firm Sector*". London: Routledge.
12. <http://appsso.eurostat.ec.europa.eu/nui/setupModifyTableLayout.do>
13. [http://faktor.mk/archives/34132?utm\\_source=daily.mk](http://faktor.mk/archives/34132?utm_source=daily.mk)
14. <http://www.gemconsortium.org>
15. <http://arhiva.sojuzkomori.org.mk/Uploads/Nacionalna%20strategija%20za%20mali%20isredni%20pretprijetija.pdf>
16. [www.sbs.gov.uk](http://www.sbs.gov.uk)
17. [russianlics.sstu.ru/globalics.../%20\(English\).doc](http://russianlics.sstu.ru/globalics.../%20(English).doc)
18. <http://www.economics.uci.edu/~dneumark/REStat%20small%20businesses.pdf>
19. <http://ec.europa.eu/enterprise/policies/sme/> n line available
20. <http://econintersect.com/b2evolution/blog1.php/2013/02/24/eu-deeper-recession-forecast>  
[www.stat.gov.mk](http://www.stat.gov.mk)



Jelena TAST\*)

## FOREIGN DIRECT INVESTMENT AND INTERNATIONAL TRADE IN GLOBALIZATION

### Abstract

The increased foreign direct investment (FDI) worldwide and the influence of transnational corporations (TNCs) in international economy are main characteristics of a new world economy. In the era of globalization TNCs, as main driving forces of international flow of capital in the form of FDI, become a major factor in international trade.

The objective of research in the paper is the relationship between FDI and international trade. The paper starts with a brief history of theoretical approach to FDI. During the 1990s, new trade theories incorporated FDI as an important factor in the international trade. Horizontal FDI suggests that FDI and trade are substitutes whereas vertical FDI suggests a complementary relationship. Selected indicators of FDI and international production in the paper show the importance of TNCs in the international economy.

One of the contributions of FDI is to increase the host-country exports. Comparing FDI's inflow and outflow by groups of countries and their import and export of goods and services, the paper researches the relation between FDI and international trade in the host-country. In this context, the impact of FDI on the host-country export will defer, depending on its motives, whether it is efficiency-seeking, market-seeking, resource-seeking or strategic-assets-seeking.

**Keywords:** foreign direct investment, transnational corporations, international trade, globalization, economic development

**JEL classification:** F02, 21, 23

---

\*) PhD candidate, Faculty of Management, MIT University-Skopje, Republic of Macedonia, E-mail: jelena.stajik@hotmail.com

## **Introduction**

The end of the 20<sup>th</sup> century opened a new era of internationalization of production and capital-era of globalization.

The increased FDI worldwide and the influence of TNCs in international economy were main characteristics of a new world economy.

Economic literature argues about the relationship between the FDI and international trade, whether they are substitute or complementary. During the 1990s, new trade theories incorporated FDI as an important factor in the international trade. The distinction between vertical and horizontal FDI can be related to the relationship between FDI and trade. Horizontal FDI suggests that FDI and trade are substitutes whereas vertical FDI suggests a complementary relationship.

In the era of globalization FDI growth is faster than the growth of world trade. TNCs, as the main driving forces of international flow of capital, become a major factor in the international trade. More than a half of international trade is through TNCs.

One of the contributions of FDI is to increase the host-country exports. The impact of FDI on host-country international trade will defer, depending on its motives, whether it is efficiency-seeking, market-seeking, resource-seeking or strategic assets-seeking. Until the 80's, market-seeking and resource-seeking FDI were dominant, but in recent years, globalization induced changes in efficiency-seeking FDI.

### **1. Theoretical approach to FDI**

The economic literature related to FDI is very extensive. Early publications are based on classical theory of international trade. In 1909, Alfred Weber in his work "The theory of location advantages" first attempted to explain the motives for FDI.

Stephen H. Hymer with the work "International operations of national companies" in 1976 is considered to be the founder of studying the TNCs' motives and exports of capital in the form of FDI.

Considering the motives for internationalization of capital, economic theories are classified into two groups of theories: theories whose approach is based on the general theory of industrial organization (Caves 1971, Kindleberger 1969, Hyrmer 1976) and theories that focus

on the process of internalization (Rugman 1981, Hennart 1982, Teece 1986).

The first group of theories focus on the imperfection of the markets' and TNCs' motives to achieve monopol position. The first systematic presentation was made by Stephen H. Hymer.<sup>1</sup> Previously, teething theoretical views did Kindelberger in 1969 and Caves in 1971.

The second group of theories are based on transaction costs and provide an explanation why TNCs prefer FDI rather than export or licence. Founders of the Theory of Internalization are the economists P.J. Barcly and M.C.Casson with the work "The Future of multinational companies" in 1976.<sup>2</sup>

Beyond this classification, in the economic literature can also be found many other papers that focus on factors that affect FDI.

OLI-Paradigm by John H. Dunning (Dunning, 1977, 1981), as a modern conception which explains the motives for export of capital in the form of FDI, synthesizes the previously mentioned theories.<sup>3</sup>

### **1.1. OLI-paradigm**

According to the OLI-Paradigm, FDIs are determined by three groups of advantages:

- Ownership advantages - O;
- Location advantages - L;
- Internalization advantages - I.

Ownership advantages include advantages that are specific to the company, such as management skills, technological capacities or product innovations. Ownership advantage allows TNCs greater competitive advantage over domestic firms.

Location advantages include specific location features of alternative countries or regions such as: low input prices, skilled labor force, developed infrastructure, national policies to attracting FDIs etc.

Internalization advantages include reduction of transaction costs, uncertainty and risk, market control, etc. Market failure is the main argument of the Internalization advantages.

---

<sup>1</sup> Hymer, S.H. (1976), "International Operation of National Firms: A study of Foreign Direct Investmen", Cambridge: MIT Press, pp.18.

<sup>2</sup> Barcly, P.J. and Casson, M.C. (1976)," *The Future of Multintational Enterprise*", Macmillan, London, pp.23

<sup>3</sup> Dunning, J.H. (1993), "Multinational Enterprises and the Global Economy", Wokingham, England: Addison-Wesley Publishing Company Inc, pp.12

If the company utilizes only the ownership advantages, then the best is to place their products by licence. If the company has certain internalization advantages then export will be the best way to approach foreign markets. But if apart from ownership and internalization advantages the company also has ownership advantages then it is the best for company to internationalize their products through opening foreign affiliates.

The basic hypothesis of the OLI-Paradigm is that the company will engage in FDI if and when they realize all three groups of advantages The Paradigm points out that the combination of Ownership, Location and Internalization advantages and their exact configuration defines which companies become TNCs, where to locate their production and how they are involved in international production. In explaining the paradigm Dunning considers that "...in the formulation of operational hypotheses about the relationship between individual variables and OLI-level and pattern of international production, it is important to determine the context in which the relation is researched".<sup>4</sup>

According to Dunning there are four basic motives for FDI:

- Resource-seeking FDI
- Market-seeking FDI
- Efficiency-seeking FDI
- Assets-seeking FDI.

Output resulting from efficiency-seeking FDI is typically intended for exports, and therefore the impact of such FDI is likely to be an increase in exports from the host country. If local firms supply inputs to affiliates producing goods for exports, the local content of value added export would be that much greater. In cases where intermediate goods are imported from outside the host economy, efficiency seeking FDI will increase exports as well. In the case of market-seeking FDI the impact on export will defer, whether they are oriented primarily to the host-country market or to the regional market. Resource-seeking FDI refers to the labor market and natural resources of the country, and by definition, it increases the host-country export. In the case of asset-seeking FDI, the impact of the trade will depend on the nature of acquired assets.

---

<sup>4</sup> Dunning, J.H., (2001), "The Eclectic (OLI) Paradigm of International Production: Past, Present and Future", *The Journal of the Economics of Business*, 8(2), 173-190.

## **1.2. FDI and the new trade theory**

The new trade theory developed in response to the failure of classical trade theories to incorporate concepts observed in actual flows of international trade such as intra-industry trade. The contribution of the new trade theory was that it allowed the construction of general equilibrium trade models which could include increasing returns to scale, imperfect competition and product differentiation.<sup>5</sup>

A weakness of the early contributions to the new trade theory was that they failed to incorporate FDI. During the 1980s and 1990s, new trade models incorporated FDI as an important factor in the international trade.

There are two primary forms of FDI, horizontal and vertical. Horizontal FDI means that a TNC replicates the same activities in several different geographical locations, whereas vertical FDI implies that a TNC locates production stages according to factor costs.<sup>6</sup>

Horizontal FDI occurs when the motive is primarily market-seeking and the firm wants to satisfy foreign market demand by local production, whereas vertical FDI has primarily an efficiency-seeking motive.

The distinction between vertical and horizontal FDI can be related to the relationship between FDI and trade. Horizontal FDI suggests that FDI and trade are substitutes whereas vertical FDI suggests a complementary relationship. In 1991, Porter, first states that for company to be successful in the international economy, it should use two parallel streams: export of goods as well as services and FDI.<sup>7</sup>

## **2. The role of Transnational Corporations in the international economy**

In the era of Globalization, TNCs are the main driving force in the international economy and the major factor of Internationalization of capital in the form of FDI.

---

<sup>5</sup> Helpman, E. and Krugman, P.R. (1985), *“Market Structure and Foreign Trade”*, Cambridge, Mass: MIT Press, pp.21.

<sup>6</sup> Markusen, J.R. (1995), “The Boundaries of Multinational Enterprises and the Theory of International trade”, *Journal of Economics Perspectives*, p.169-189

<sup>7</sup> Porter, M. (1990), *“The Competitive Advantage of Nations”*, Free Press, New York, pp.15

In the last decade the number of TNCs is growing very fast. By the 90s the number of TNCs was 37,000 with 170,000 foreign affiliates. At the beginning of the 21<sup>st</sup> century there were 82,000 TNCs worldwide with 810,000 foreign affiliates.<sup>8</sup>

Future selected indicators of FDI and international production show the importance of TNCs in the international economy (Table 1).

Until 1990 the value of sales through foreign affiliates was similar to the value of world exports. Since 1990 sales through affiliates abroad grow faster than the world exports. In 1990 the total sales by foreign affiliates was about \$6 billion, while world exports were \$4.4 billion, or sales through affiliates abroad exceeded world exports by 36%. Since 2000 sales by foreign affiliates are twice as the world exports. In 2010 sales by foreign affiliates were around \$33 billion, while world exports were \$18,7 billion, i.e. sales through affiliates abroad almost twice exceeded world exports.

Growth of sales through foreign affiliates in terms of world exports indicates that the production of the home-country FDI replaces the production of TNCs, which actually substitute the classical exports of products and services.

The role of TNCs in international trade show participation of foreign affiliate exports in world exports. At the beginning of the 21<sup>st</sup> century foreign affiliate exports accounted for one third of total world exports. In 2011 exports of affiliates abroad were \$6,2 billion while world exports were \$18,7 billion, i.e. foreign affiliates accounted for one third of total world exports.

Given the high share of exports of foreign affiliates in world exports, TNCs appear as major actors who control the international trade of certain products. In the early 80s, international trade of primary products was under control of only a few TNCs. Although in recent years FDI in the primary sector declines, TNCs continue to control international trade of the products. In the primary sector a small number TNCs controlled about 90% of total production.

The most of world trade takes place between foreign affiliates of TNCs. In 1990, 1/3 of world exports took place between TNCs and their

---

<sup>8</sup> UNCTAD, (2010), “*World Investment Report, Investment in a Low-carbon Economies*”, United Nation, New York and Geneva, pp.34

affiliates abroad.<sup>9</sup> In the same period, TNCs exports to other companies were more than 30% of world exports.

This means that in 1990, more than 60% of total world exports were through TNCs. Since 2000, about 40% of world trade has taken place between foreign affiliates.<sup>10</sup> If we add in exports of TNCs to other companies, it means that more than a half of world trade was handled through TNCs.

Intrafirm trade does not mean real trade. It is a trade without a competition. Thus, TNCs, not competition, determine prices in each stage of production. Intrafirm trade is initiated by “transfer prices”, a way of extracting part of the income generated in the host-country.

---

<sup>9</sup> UNCTAD, (2002), “*World Investment Report, Transnational Corporations and Export Competitiveness*”, United Nation, New York and Geneva, pp.141

<sup>10</sup> UNCTAD, (2002), “*World Investment Report, Transnational Corporations and Export Competitiveness*”, United Nation, New York and Geneva, p.143

**Table 1: Selected indicators of FDI and International production, 1990-2011, (in billions dollars)**

	1990	2000	2005	2005-2007	2008	2009	2010	2011
<b>FDI inflow</b>	208	1,271	986	1,472	1,771	1,114	1,244	1,524
<b>FDI outflow</b>	241	1,150	893	1,487	1,929	1,101	1,323	1,692
<b>Sales of foreign affiliates</b>	6,026	15,680	21,721	21,293	31,069	29,298	32,960	27,877
<b>Grosse product of foreign affiliates</b>	1,477	3,167	4,327	3,570	6,163	5,812	6,636	7,187
<b>Total assets of foreign affiliates</b>	5,938	21,102	49,252	43,324	71,694	77,057	56,998	82,131
<b>Exports of foreign affiliates</b>	1,498	3,572	4,319	5,003	6,663	5,186	6,239	7,358
<b>Employees in foreign affiliates</b>	24,476	45,587	57,799	55,001	78,957	79,825	68,218	69,065
<b>GDP</b>	22,121	31,895	45,273	50,338	60,766	55,005	62,909	69,660
<b>GFCF</b>	5,099	6,466	9,833	11,208	13,822	12,404	13,940	15,777
<b>Exports of goods and services</b>	4,414	7,036	12,954	15,008	19,986	15,716	18,713	22,096

Source: UNCTAD, [[www.unctad.org/stat](http://www.unctad.org/stat)]

### **3. FDI and international trade: are they substitute or complementary**

This part contains analyses of the global FDI, presenting panel data of FDI inflow and outflow by groups of countries since the 90's to 2011. By comparing FDI inflow and outflow by groups of countries and their import and export of goods and services, we analyze the relationship between FDI and international trade in the host-country (Table 2).

Since the end of the 20<sup>th</sup> century FDIs are growing intensively. FDI growth is faster than the growth of world trade and world economy. For instance in the period 1992-2004, the total FDI increased by about 260%, while the world trade growth by about 100%, and the world economy by 32%.<sup>11</sup>

Despite long-term trend of growth until 2000, during the period of 2000-2003 FDI declined about 50%.

In 2004, FDI increased for the first time in three years for about \$648 billion. In the period of 2004-2007, FDI were growing again. In 2007 FDI inflow reached record historical levels of \$1,979 billion. In 2008, economic and financial crisis was reflected on FDI worldwide. After continuous growth in the period 2004-2007, global FDI inflow in 2008 fell by 14% compared to 2007. In 2010 and 2011 FDI inflow increased, but it is still 15% lower than the level before the crisis.<sup>12</sup>

Developed countries are major recipients and largest source of FDI worldwide.

Until 2000 they accounted for about 80% of the world FDI inflow and 90% of the world FDI outflow. After this period the share of developed countries in the world FDI inflow and FDI outflow decline primarily due to increase in the share of developing countries total FDI. The decline in the share of developed countries in the world FDI inflow is greater than in the world FDI outflow. In 2011 developed countries have a share of 50% in total FDI inflow and 70% in total FDI outflow in the world.

The largest source of FDI is the United States, and it retained its position during the crisis in 2008. Other major sources of FDI are Great

---

<sup>11</sup> Hill, Charles W.L.(2007), "*International Business: Competing in the Global Market*", 6<sup>th</sup> edition, New York: McGraw-Hill/Irwin, pp.121

<sup>12</sup> UNCTAD, (2011), "*World Investment Report, Non-Equity Modes of International Productions and Development*", United Nation, New York and Geneva, pp.134

Britain, France, Germany and Japan. In the period 1998-2007 these countries account for about 60% of the world FDI outflow.

In recent years, particularly after the global financial and economic crisis, FDI in developing countries and countries in transition is growing. In 2010, for the first time, developing countries and countries in transition together attracted more than half of world FDI inflow. Indeed, the growth of FDI worldwide is due to the growth of foreign investment in developing countries.

In 2011, developing countries accounted for about 50% of the FDI inflow and 25% of the FDI outflow worldwide. Participation of countries in transition in the world FDI flow is low, at about 5%. Transition economies are still excluded from the international flow of capital, despite the liberalization of conditions for foreign investments in the last few decades. Among the developing and transition countries the most important sources of FDI are China and the Russian Federation.

If we compare the FDI inflow and outflow by groups of countries and their import and export of goods and services, we can see that there are differences among them (Table 3).

In developed countries' import of goods and services is greater than the inflow of FDI. In 2011 developed countries' share in world FDI inflow was 49%, while their share in world imports was 60%.

In developing countries and transition economies the FDI inflow is greater compared to import of goods and services. In 2011 the share of developing countries in the world FDI inflow was around 46%, while their share in the world import was 37%.

**Table 2: DI inflow and outflow by regions, 1992-2011**

	Participation in total FDI inflow (%)			Participation in total FDI outflow (%)		
	Developed countries	Developing countries	Countries in transition* World	Developed countries	Developing countries	Countries in transition* World
<b>1992-1997</b>	58.2	38.1	3.7 100	92.2	7.6	0.2 100
<b>1998</b>	68.4	28.1	3.5 100	91.9	7.8	0.3 100
<b>1999</b>	76.2	21.3	2.5 100	92.9	6.9	0.2 100
<b>2000</b>	79.8	18.2	2 100	91.4	8.3	0.3 100
<b>2001</b>	69.9	26.9	3.2 100	91.2	8.3	0.5 100
<b>2002</b>	72.2	23.2	4.6 100	91.8	7.4	0.8 100
<b>2003</b>	65.5	30.7	3.8 100	93	5.8	1.2 100
<b>2004</b>	55.7	36.2	5.6 (3.7 CIS, 1.9 SEE) 100	84.4	13.9	1.7 (1.69 CIS, 0.01 SEE) 100
<b>2005</b>	59.1	36.5	4.4 (3 CIS, 1.4 SEE) 100	83	15	2 (1.8 CIS, 0.2 SEE) 100
<b>2006</b>	66.7	29.4	3.9 (3.1 CIS, 0.8 SEE) 100	82.2	16.1	1.7 (1.6 CIS, 0.1 SEE) 100
<b>2007</b>	66.3	29.1	4.6 (4 CIS, 0.6 SEE) 100	84.1	13.5	2.4 (2 CIS, 0.4 SEE) 100
<b>2008</b>	55.3	37.7	7 (6.2 CIS, 0.8 SEE) 100	80.7	16.1	3.2 (3 CIS, 0.2 SEE) 100
<b>2009</b>	51	43.1	5.9 (5.4 CIS, 0.5 SEE) 100	72.7	23.1	4.2 (4.1 CIS, 0.1 SEE) 100
<b>2010</b>	48.4	46.1	5.5 (5.2 CIS, 0.3 SEE) 100	70.7	24.7	4.6 (4.59 CIS, 0.01 SEE) 100
<b>2011</b>	48.9	45.2	5.9 (6.4 CIE, 0.3 SEE) 100	70.9	24.2	4.9 (4.8 CIS, 0.1 SEE) 100

Sources: UNCTAD [[www.unctad.org/stat](http://www.unctad.org/stat)], own calculations

In transition economies FDI inflow is also greater compared to the import of goods and services. But, its share in the world FDI inflow and in the world import is relatively low, around 6% and 3%, respectively.

If we compare the export of goods and services and the FDI outflow, the situation is different.

In developed countries FDI outflow is greater than the export of goods and services. In 2011 the share of developed countries in the world FDI outflow was around 71%, while their share in the world export was around 57%.

In developing countries the export of goods and services is greater than the FDI outflow. In 2011 share of developing countries in the world FDI outflow was around 24%, while their share in the world export was 40%.

In transition economies, as in developed countries, FDI outflow is greater than the export of goods and services but their share in the world FDI outflow and in the world export is relatively low and without major difference between them, around 5% and 3.5%, respectively.

**Table 3: FDI and import and export of goods and services by regions in 2011 (%)**

	<b>Developed countries</b>	<b>Developing countries</b>	<b>Transition economies</b>
<b>Import of goods and services</b>	60	37.1	2.9
<b>FDI inflow</b>	48.9	45.2	5.9
<b>Export of goods and services</b>	56.6	39.9	3.5
<b>FDI outflow</b>	70.9	24.2	4.9

Source: WTO, (2011), International Trade Statistics, and UNCTAD, (2011), “*World Investment Report, Non-Equity Modes of International Productions and Development*”, UN, New York and Geneva, own calculations

One of the effects of FDI is to increase the export in host-country. In this context we analyze the share of foreign affiliates in total export of host-country FDI by the group of countries.

In developed countries the share of exports of foreign affiliates in total export is much higher than in less developed countries (developing countries and countries in transition).

Since 2000, twenty economies account for over three quarters of the value of world trade. The list is dominated by developed countries, led by United States, Germany and Japan. From developing countries China is a leading country according to the share in world export.<sup>13</sup>

Developing countries, traditionally, are the major exporters of primary products. In 2000, developing countries had share of 56% in world trade of primary products.<sup>14</sup> In recent years, the share of primary products in world trade is declining. But, for many developing countries, the availability of natural resources is their only comparative advantage.

The effects of FDI on host-country in international trade will defer, depending on its motives – whether they are efficiency-seeking, market-seeking, resource-seeking or strategic-assets-seeking.

Output resulting from efficiency-seeking FDI is typically intended for export. In developing countries the efficiency-seeking motive is less important. Market-seeking FDI which is oriented towards the regional market rather than the host-country market increases exports of the host-country. In less developed countries most of FDI is oriented primarily to the host-country market. The impact of resource seeking FDI in developing country in oil and gas industry is noteworthy, but resource-seeking FDI depends much on the access of the host-country to technology.

## **Conclusion**

The increase of FDI worldwide and the influence of TNCs in the international economy are main characteristics of a new world economy, with consequences on development.

In the era of globalization TNCs have a strong influence on the pattern of international economy. More than a half of world trade was through TNCs. As a result, TNCs may determinate the scope and structure of international trade.

---

<sup>13</sup> UNCTAD, (2002), “*World Investment Report, Transnational Corporations and Export Competitiveness*”, United Nation, New York and Geneva, pp.114

<sup>14</sup> UNCTAD, (2002), “*World Investment Report, Transnational Corporations and Export Competitiveness*”, United Nation, New York and Geneva, pp.121

Growth of sales through foreign affiliates in terms of the world exports indicates that production of the home-country FDI replaces the production of TNCs, which actually substitutes the classical exports of products and services.

Given the high share of exports of foreign affiliates in the world exports, TNCs appear as major actors who control the international trade of certain products.

Developed countries are major recipients and largest source of FDI worldwide.

At the same time, in developed countries the share of exports of foreign affiliates in total export is much higher than in less developed countries (developing countries and countries in transition).

In recent years, particularly after the global financial and economic crisis in 2008, FDI in developing countries and countries in transition is growing.

Developing countries, traditionally, are the major exporters of primary products. In recent years, the share of primary products in the world trade is declining, but for many developing countries, the availability of natural resources is their only comparative advantage.

Economic literature suggests that the effects of FDI on host-country international trade will defer, depending on its motives. Globalization induced changes to efficiency-seeking FDI are directly related to the host-country export but require economies with a certain level of economic development.

### **References:**

1. Barcly, P.J. and Casson, M.C. (1976), "The Future of Multintational Enterprise", London: Macmillan.
2. Dicken, P. (1999), "*Global Shift: Transforming the World Economy*", London: Paul Chapman Publishing Ltd.
3. Dunning, J.H.(1993), "*Multinational Enterprises and the Global Economy*", Wokingham, England: Addison-Wesley Publishing Company Inc.
4. Dunning, J.H. (2001), "The Eclectic (OLI) Paradigm of International Production: Past, Present and Future", *The Journal of the Economics of Business*, 8(2).

5. Helpman, E. and Krugman, P.R. (1985), "*Market Structure and Foreign Trade*", Cambridge, Mass: MIT Press.
6. Hill, Charles W.L. (2007), "*International Business: Competing in the Global Market*", 6<sup>th</sup> ed., New York: McGraw-Hill/Irwin.
7. Hymer, S.H. (1976), "*International Operation of National Firms: A study of Foreign Direct Investment*", Cambridge: MIT Press.
8. Markusen, J.R. (1995), "The Boundaries of Multinational Enterprises and the Theory of International trade", *Journal of Economic Perspectives*, p.169-189;
9. Porter, M. (1990), "*The Competitive Advantage of Nations*", New York: Free Press.
10. Stiglitz, E.J. (2002), "*Development policies in a world of Globalization*", Columbia University.
11. UNCTAD, (2002), "World Investment Report, Transnational Corporations and Export Competitiveness", United Nation, New York and Geneva;
12. UNCTAD, (2010), "World Investment Report, Investment in a Low-carbon Economies", United Nation, New York and Geneva;
13. UNCTAD, (2011), "World Investment Report, Non-Equity Modes of International Productions and Development", United Nation, New York and Geneva.
14. WTO, (2011), International Trade Statistics, [[http://www.wto.org/english/res\\_e/statis\\_e/its2011\\_e/its11\\_toc\\_e.htm](http://www.wto.org/english/res_e/statis_e/its2011_e/its11_toc_e.htm)]
15. World Bank. (2002), "*Globalization, Growth, and Poverty: Building an Inclusive World Economy*", Washington DC: World Bank and New York: Oxford University Press.



**UDC 005.95-051:347.44(497.7)**  
**Professional paper**

**Marko ANDONOV<sup>\*</sup>)**  
**Zoran MIHAJLOSKI<sup>\*\*</sup>)**  
**Elena DAVITKOVSKA<sup>\*\*\*</sup>)**  
**Vesna GOCEVA<sup>\*\*\*\*</sup>)**

## **LEGAL ESSENCE OF THE MANAGEMENT CONTRACT WITH THE SPECIFICS OF THE MACEDONIAN LEGISLATION**

### **Abstract**

Management contracts are a kind of business statute that delegate specific rights, obligations and responsibilities to the managers. In their essence, they are synthesis of management and governing power. The success and realization of the corporative goals as a motivational part correlate with the both types of power greatly. At the same time, they encourage the negotiation process and the conclusion of the management contract. The key role of the managers as carriers of occupational risk is to create professionally based coalition of interests among those who are involved in the realization of corporative goals and the business policy of the company, thus providing growth and development.

One of the main aims of this paper is to determine the legal nature and essence of the management contract, as a crucial step in establishing managers' status and position. Special attention will be paid to the characteristics of these contracts, having in mind certain comparative observations in this sense. It is very important to emphasize that management contracts are not substitution of employment contracts. The form and legal frame of manager's individual engagement may differ, but

---

<sup>\*</sup>) PhD, Assistant Professor at the School of Law within the University American College – Skopje, e-mail: andonov@uacs.edu.mk

<sup>\*\*</sup>) PhD, Assistant Professor at the School of Law within the University American College – Skopje, e-mail: mihajloski@uacs.edu.mk

<sup>\*\*\*</sup>) PhD, Assistant Professor at the Institute of Economics – Skopje, University Ss. Cyril and Methodius e-mail: elena@ek-inst.ukim.edu.mk

<sup>\*\*\*\*</sup>) LLM, Civil servant, Ministry of Local Self Government – Bureau for Regional Development, e-mail: vesnagoceva@hotmail.com

a well-defined contract must provide several basic preferences, which will be analyzed in this paper.

However, the main emphasis will be given to the actual normative (as well as practical) structure of the subject matter in Republic of Macedonia, where we will express our hope that through this paper we will be able to clarify certain dilemmas within the scientific and professional circles regarding this issue.

**Keywords:** company, managers, management contract

**JEL classification number:** K20

### **Introduction**

The essence of the contract that regulates the relations between the managers and the company contains certain specifics. This contract must meet certain standards regarding form and include specific answers to all questions pertaining to the status, business and legal powers, compensation and evaluation of the operation results, solving disputes and determining the responsibility of managers in the company. Therefore, this contract should be looked at as a kind of a business statute which delegates specific rights, obligations and responsibilities to managers, so that they are mutually connected with the determined business venture or running of the company. These contracts represent the mutual relation between the holders of the entrepreneurial risk (investors, owners) and the managers as carriers of the occupational risk. In their essence, the management contracts represent a synthesis of the power of management and power of leadership. The contract is a type of a document that is based on partnership between those who have a business vision and willingness to invest funds, and managers who accept the professional challenge, to implement the business vision in life.

#### **1. Regulation of relations between the company and the managers**

As a rule, the relations between the company and the members of the management body are settled on status base and contractual base.

### **1.1. Regulation of relations on status base**

The position of a member of the managing body is acquired pursuant to a law, and the authorized body issues an act on behalf of the company for the acquired position. The act which confers the status of a member of the managing body is a corporate act by its nature. The members of the board of directors or the members of the supervisory board acquire the position on the base of the decision of the assembly, whereas the members of the managing board acquire their position on the base of the decision of company's supervisory board. All these decisions are simple, and the reason for this is that they are made on the base of the powers outlined in the law. At the time of election, i.e. appointment for the managing body, and, thus, acquisition of the position of a member of the body, the set of rights and obligations provided for by law arises out. The rights and obligations acquired by a member of the board of directors or members of the supervisory or management board, as well as by an executive member of the board of directors, have been identified and defined by law.

The decision for election of the board of directors or supervisory board, i.e. their member, shall enter into force from the date of adoption<sup>1</sup>. However, as an exception, some of the rights and obligations provided for by law can be arranged differently, if this is foreseen by law. Such is the case when individual members of the managing board of the company are deprived from the right to represent the company: a right that belongs to a member according to law, but, by a decision of the managing board and in accordance with the supervisory board, the advocacy right may be granted only to some members of the board. Also, the board of directors appoints the executive members - managers of the board of directors with an act which is a corporate act by nature.

### **1.2. Settlement of relations on contractual base**

The settlement of relations between the company and business entities can be established on a contractual base. Despite the fact that they are established on a status base, the Macedonian Company Law does not exclude the possibility to establish these relations on a

---

<sup>1</sup> Company Law, article 344 paragraph 1. (Official Gazette of the Republic of Macedonia, no. 28/2004, 84/2005, 25/2007, 87/2008, 42/2010, 48/2010, 24/2011, 166/2012, 70/2013, 119/2013, 120/2013, 187/2013, 38/2014, 41/2014)

contractual base. The relations on a contractual base are not established with all members of the company's managing body; only some of the members of these bodies have the privilege to establish contractual relations in order to regulate the issues related to the position of a member in the company's body<sup>2</sup>. Upon regulating the rights and obligations of the members of the company's bodies, the Macedonian Company Law stipulates that the agreement on the regulation of relations between the company and a member of the company's body may be concluded only by the executive members of the board of directors and the members of the managing board of the company<sup>3</sup>. The possibility for the company to conclude such a contract with a non-executive member of the board of directors and members of the supervisory board of the company is excluded.

## **2. The legal nature of the management contract**

The character of the position of the executive member of the board of directors, i.e. a member of the managing board, may be obtained only on status base, with a corporate act adopted by the competent body of the company. The financial and material position of the executive member of the board of directors, i.e. the member of the managing board is of significant importance in establishing relations on a contractual base.

### **2.1. The management contract as a legal instrument**

Albeit, management contracts are not only legal instruments or a formality for settlement of salaries, benefits, rights and obligations in relation to the operations of the company and other details of the bilateral relations among contracting parties; the management contract is a key document which depends essentially on the success of a concrete work. For this reason, the Macedonian Company Law includes an express prohibition for an executive member of the board of directors or member

---

<sup>2</sup> Nedkov, D-r. Milan. (2005), "Managing with a shareholding company, An advise for corporative management, Skopje.

<sup>3</sup> Company Law, article 350 (Official Gazette of the Republic of Macedonia, no. 28/2004, 84/2005, 25/2007, 87/2008, 42/2010, 48/2010, 24/2011, 166/2012, 70/2013, 119/2013, 120/2013, 187/2013, 38/2014, 41/2014)

of the managing board to sign an employment contract. The contract that regulates the relations between the company and an executive member of the board of directors, member of the managing board or manager, can also regulate and determine the salary or monthly fee, the right to life insurance and other types of insurance, the entitlement for reimbursement for travel and other expenses, the right to participate in the annual profit and other rights. The signing of the management contract imposes certain obligations that are established by law and refer to exercising of powers by the executive member of the board of directors, a member of the managing board, or the manager in favor of the company (managerial responsibilities), attention to the orderly and conscientious merchant, business confidentiality during the mandate and after the termination of the mandate, prohibition of competition and liability for disclosure of conflict of interests and dealings with stakeholders.

## **2.2. Management contract as contract of autonomous right**

By their legal nature, the management contracts are contracts of autonomous right. It is a special *sui generis* legal institute provided for in the Macedonian Company Law. By their form and content, management contracts reflect the imperative mandate, i.e. the business and legal relations of the company and management, rather than clearly qualified and measurable propositions of cooperation on the basis of which the established corporate goals, mutual rights, powers and responsibilities, including remuneration of managers, are founded. The executive member of the board of directors, managing board member or manager elected for a determined period of time, may perform its function by establishing employment relations and without establishing employment relations. In cases when the function is performed by establishing employment relations, the labor rights are exercised under the conditions laid down in the contract for arranging the relations between the executive member of the board of directors, the managing board member or manager of the company, in accordance with the Macedonian Company Law. The provisions of the Law that are related to an executive member of the board of directors and member of the managing board, shall also apply to the manager of all other forms of trade companies. The contract determines the manner and conditions under which the provisions are implemented in the company, unless the function is performed without establishing employment relations. On the other hand, according to the

Macedonian Company Law, the provisions of the labor agreements, as well as the provisions of the law on employment relations in regard with establishing and termination of employment relations, disciplinary responsibility, salary, benefits and protection of worker's rights, do not apply to the executive member of the board of directors, member of the managing board, i.e. manager of managing persons. These persons can exercise their rights in the manner and under the conditions laid down in the contract.

### **3. Characteristics of a management contract**

The main characteristic of a management contract is its autonomy, expressed by particular specifics that give the *sui generis* nature to the agreement. These contracts are not substitutes to the employment contract by which employment relations are established. Management contract shall specify the role of the manager and the mutual rights, powers, duties and responsibilities on a contractual basis. At first glance, although it seems that it is less important question in regard with the form of the entrusted mandate, the managers contract represents a binding legal framework of the will of the company and the manager. As set in that manner, and even in the negotiation phase, the management contract requires the necessity to harmonize the views on the labor-legal and material conditions upon taking the office.

#### **3.1. Legal framework of a management contract**

The form and the legal framework of individual hiring of managers varies from case to case, but any well-defined management contract must provide some basic parameters in its content, such as: responsibilities, powers and responsibilities of the manager, labor-legal status of the manager, manner of communication and monitoring of the performance of business policy objectives, motivation and remuneration for the results achieved, business - ethical rules, insurance against business risks and the issue on compensation for damages, compensation for the manager and the method of interpretation of changes and termination of the management contract .

Due to the fact that most of the answers to these questions are addressed and defined by legislation, the experience shows that it is

much better, and, in any case, it is more proper to incorporate the specifics and agreed positions for cooperation in the content of each particular management contract. The individual character of the management contract requires that the presented recommendation should find their place, because, unlike the experiences of the countries of the European Union, as a rule, there are no developed standards of corporate governance or ethical codes, so room is left for arbitrary interpretation of external regulations and the content of the internal agreements.

### **3.2. Form of management contracts**

The Macedonian Company Law does not provide a solution on the form in which the contract will be concluded; however, starting from the essence and characteristics of this contract, it is necessary to be concluded in a written form. It could primarily have a particular benefit from the experiences arising out of the Anglo-Saxon practice in regard with the methodology that is going to be used in development of management contracts. In terms of their form, the management contracts in the Anglo-Saxon law are identical with the letters of intent, i.e. they are quite specific as a result of the substantial terms of office of the manager<sup>4</sup>. In their content, there is just a little bit of an unnecessary text in terms of professional duties and powers, as this is basically presupposed, because they are covered by the legislation, or worked out in details with the corporate laws of the company. However, the contracts precisely define the issues in terms of corporate objectives, powers, obligations, deadlines, basic salary, the conditions for exercising awards, various fees associated with the work, anti-competitive clauses and so on. By contrast, the structure of the content of most of the management contracts in the Republic of Macedonia is predominantly made of paraphrasing quotes of the legal provisions or styling of general rights, powers and responsibilities of the parties to the contract.

---

<sup>4</sup> Public discussion was held among the business community of the Republic of Croatia during 2002, in regard with the model of a management contract proposed by “HUM-CROMA” – Croatian association of managers and entrepreneurs – with the aim to find a national standard of a management contract, led by their intention and as associate member of the European Conference of Managers (SES), within the process of harmonization of professional standards of the managing structure with the standards used in the area of the European Union.

#### **4. Contracting parties in the management contract**

Upon determining of the status of the managers in the company, the introduction in the management contract should clearly state the act on the basis of which decisions are based on selection and appointment of managers or members of the managing body, details and authorization of the person that represents the company, determining the status position of the manager in the company, the contracting authorities and limitations in the legal representation of the company, as well as the general and special acts that determine the rights, obligations and responsibilities of managers who are not covered by the management contract.

The rights and obligations of the executive members of the board of directors, managing board members, or the manager, in addition to the rights and obligations stipulated by law, can be determined by a contract on regulation of the relations between the company and an executive member of the board of directors, managing board member or manager<sup>5</sup>. Macedonian Company Law determines the parties entered into the management contract. The contract with an executive member of the board of directors may be concluded by the non-executive members of the board of directors, and it shall be signed by the president of the board of directors on behalf of the company<sup>6</sup>. In a company with a two-level management system, the contract shall be concluded between the members of the managing board or managers and the members of the managing board on behalf of the company and it should be signed by the president of the supervisory board. The board of directors, in accordance with its powers, shall submit an application for registration of executive members that are authorized to represent the company, in the commercial register of the executive members authorized to represent the company. The representative of the company is a natural person that, by law, is determined to represent the company.

The regulations for settlement of relations between companies and business people is highly harmonized with the EU regulations for

---

<sup>5</sup> Company Law, article 350 (Official Gazette of the Republic of Macedonia, no. 28/2004, 84/2005, 25/2007, 87/2008, 42/2010, 48/2010, 24/2011, 166/2012, 70/2013, 119/2013, 120/2013, 187/2013, 38/2014, 41/2014)

<sup>6</sup> Company Law, article 350 (Official Gazette of the Republic of Macedonia, no. 28/2004, 84/2005, 25/2007, 87/2008, 42/2010, 48/2010, 24/2011, 166/2012, 70/2013, 119/2013, 120/2013, 187/2013, 38/2014, 41/2014)

this area, and the principles of corporate governance adopted in the wider international arena are incorporated in them.

In various legislations, the issues related to the legal framework for regulating the relations between the management and the company is mainly regulated by the laws that govern the rights of companies. For example, in the Serbian legislation, managerial contracts are covered by The law on trade companies, The labor law, The law on mandatory social insurance contributions and The law on pension and disability insurance fund and other laws.

Similarly to the Serbian legislation, the Croatian legislation regulates this issue in the Law on trade companies and other regulations governing the framework of the powers and responsibilities of managers in legal action.

The Polish legislation, however, governs the relations of the company management in a very detailed manner, by two main regulations: Code of trade companies and the Labour Code. Also, in part of this matter, and the remuneration of managers in particular, significant place is taken by the Polish Civil Code.

It should be taken into consideration that other European countries regulate these relations in a similar manner, by using relevant European directives as their basis; this particular topic will also be discussed in this paper.

In the United States, the judicial thinking regarding management contracts is concentrated on the question of the autonomy of deciding of companies on their own. Whether their management contract is considered valid, depends on the extent of the delegation of managerial functions. The Board may give authority to act, but it can not delegate its managing function<sup>7</sup>. Thus, the management does not have a legal authority to take the place of the managing board of the company. In this context, the courts consider the criteria such as: the duration of the contract and who has the authority to decide in a final degree, in relation to the business policy of the company<sup>8</sup>. The principle of non-delegation<sup>9</sup>

---

<sup>7</sup> *Kennerson v. Burbank Amusement Co*, 120 Cal.App.2d 157, 260 P.2d. 823, 832-833 (1953); *Manson v. Curtis* 171 A.D. 954 (1915), aff. 223 N.Y. 313 (1918); *McQuade v. Stoneham* 263 N.Y. 323, 189 N.E. 234 (1934); *Clark v. Dodge* 269 N.Y. 410, 199 N.E. 641 (1936); *Long Park Inc. v. Trenton-New Brunswick Theatres Co et al* 297 N.Y. 174 77 N.E 2d 633 (1948); see also *infra* p. 28.

<sup>8</sup> *Sherman & Ellis Inc. v. Indiana Mutual Casualty Co* 41 F 2d 588 (7 Cir. 1930).

<sup>9</sup> *Hansmann, H.* (2004), "Corporation and Contract", Center for Law, Economics and Public Policy, Research Paper, No. 300

is applied even if the shareholders of the company have already approved the management contract<sup>10</sup>.

In France and UK, the management contracts are also eligible but only to a limited extent<sup>11</sup>. Because of the fact that they are rarely mentioned in the relevant literature, such agreements seem to have no practical significance. Also, it should be added that the Macedonian experience moves in these frameworks, when discussing about the establishment of the legal framework for governing of management contracts; mainly, more or less, it regulates this issue in a similar manner.

## **5. Employment-legal status of managers**

An executive member of the board of directors, managing board member or manager elected for a specific period of time, may perform its function by establishing an employment relation or without it<sup>12</sup>. When the function is performed by established employment relation, the labor rights are exercised under the conditions laid down in the contract for arranging the relations between the executive member of the board of directors, managing board member or manager of the company, in accordance with the Macedonian Company Law.

### **5.1. Rights and responsibilities of managers arising out of the employment relations**

The rights and obligations of the employment relations that are established by a contract and are obtained by an executive member of the board of directors, managing board member or manager, who, before the election, was employed in the company, will now be put at rest (standstill). The standstill starts from the date of election of that person<sup>13</sup>. A person may be an executive member of the board of directors or a managing board member only in one shareholding company.

---

<sup>10</sup> Hansmann, H. (2004)

<sup>11</sup> Pagano Marco and Paul Volpin, (2004) "Managers, Workers and Corporate Governance Control" ECGI (European Corporate Governance Institute), Law Working Paper No. 01/2004

<sup>12</sup> Company Law, article 366 paragraph 2 (Official Gazette of the Republic of Macedonia, no. 28/2004, 84/2005, 25/2007, 87/2008, 42/2010, 48/2010, 24/2011, 166/2012, 70/2013, 119/2013, 120/2013, 187/2013, 38/2014, 41/2014)

<sup>13</sup> Company Law, article 366 paragraph 1.

According to the Macedonian Company Law, the executive members – in order to carry out its powers stipulated by law - may appoint managers who perform day-to-day running of the company in accordance with the decisions, directions and orders of the executive members of the board of directors<sup>14</sup>. In order to execute the powers established by law, the managing board may also appoint managers who perform day-to-day running of the company in accordance with the decisions, directions and orders of the managing board<sup>15</sup>. These persons shall exercise the rights and obligations arising out of the employment relation, under the terms stipulated in the contract for settlement of the relations between the managing body and the managing officer - contract for settlement of relations with the managing officer. This contract regulates the salary, compensations (benefits), the participation in the profit, compensation costs, compensation for life insurance and other kinds of insurance and other employment rights. The manner of determining of the type and scope of total income and other rights and obligations that arise out of the employment relation of the managing officer is appropriate to the type and scope of assigned duties and responsibilities to the managing officer, as well as to his personal contribution to the success of the company. The contract with the managing officer is signed by the president of the managing body, on behalf of the managing body.<sup>16</sup>

According to Article 366, paragraph 4 of the Macedonian Company Law, the provisions of collective agreements, and the provisions of the Labour Law related to the process of establishing and termination of employment, disciplinary responsibility, salary, fees and safety at work are not applied for managers. These persons realize the rights that arise out of these provisions of the Labour Law in a manner and under the conditions laid down in the contract for arranging the relations with the managing officer.

The rights and obligations of the nominated persons that were acquired before the election, especially those who were employed in the company and were determined by a contract, will be put on standstill upon their nomination to be persons with special responsibilities

---

<sup>14</sup> Company Law, article 371 paragraph 5.

<sup>15</sup> Company Law, article 375 paragraph 3.

<sup>16</sup> Company Law, article 366 paragraph 4 (Official Gazette of the Republic of Macedonia, no. 28/2004, 84/2005, 25/2007, 87/2008, 42/2010, 48/2010, 24/2011, 166/2012, 70/2013, 119/2013, 120/2013, 187/2013, 38/2014, 41/2014)

(managers) by a decision of the managing body. The standstill starts from the date of election of that person.

## **5.2. Aspects of judicial practice**

In our practice, following the period of transition of the society and development of the economy based on the principles of the market economy, the most widespread model of management contract concluded between the contracting parties is the contract on employment relations (employment contract), with full-time working hours and for a determined period. This model and manner of organizing the employment and legal relations of managers in companies is resulting of a kind of inertia, due to the fact that during the process of privatization of state owned enterprises, the most number of members in the managing bodies and those who were running the business in the companies, were recruited from the prevailing economy leaders. This circumstance gives the managers managers a relatively greater security for employment, because in the sense of employment-legal matters, they conclude an employment relation for a period that is stipulated in the contract. The fact that certain professional risks have previously been compensated by a higher level of job security can be taken as an advantage, because it is assumed that managers, after the expiration of the term or upon termination of the contract, will be offered a job within the company, a post that matches with their qualifications. This benefit encourages the professionals inside the companies to accept the challenge that is offered with the managerial post and to get out of its main occupation for a determined period of time. Also, in this manner, the owners of companies are enabled to more easily make combinations with the available human resources and potentials within the company.

The management contract is a separate legal instrument, i.e. a corporate act which legally shapes the will between the company and the manager. The statement defined by the Macedonian Company Law: "unless the function is performed without concluding employment relations" could refer only to an exception when it is determined that the executive member of the board of directors and member of the managing board may not be elected executive member of the board of directors, i.e. member of the managing board in other shareholding companies in the Republic of Macedonia, except in banks, insurance companies and other companies if it is so stipulated by law. This exception is also

applied in regard of the manager of a company. From the above, it follows that only in exceptional cases, a member of the board of directors and executive board member may hold office without employment, when the rights and duties are performed in more than one company. This exception is applied in relation to the manager of the company.

In corporate and legal sense, the exercising of the post of an office manager in the company with an employment-based legal relation is treated as performing job on a working post with special powers and responsibilities, and the management contract determines and defines the given powers to conduct the work of the company in accordance with the principles set in the corporate objectives.

### **Conclusion**

The managers are the most important capital and resource investment of each company, but at the same time it has to be kept in mind that to create a good management structure major investments are required, a lot of time and synchronized mutual relations. Upon discovering the management potential and upon its development, the professional and business characteristics should be recognized, such as: initiative, communicability, creativity, knowledge in methods of management, etc.

The creation and termination of contracts that regulate the relations of an executive member of the board of directors or managing board member are connected with the moment of acquisition of the position of a member of the board of directors or managing board member. This contract is not a contract based on who receives the capacity as an executive member of the board of directors or managing board member – it governs those rights and obligations which are not regulated by law. At the end, it can be concluded that this paper highlighted the key aspects related to the legal nature of managerial contracts, placing special emphasis on legislation and practices in the Republic Macedonia.

**References:**

1. Company Law (Official Gazette of the Republic of Macedonia, no. 28/2004, 84/2005, 25/2007, 87/2008, 42/2010, 48/2010, 24/2011, 166/2012, 70/2013, 119/2013, 120/2013, 187/2013, 38/2014, 41/2014).
2. Donnelly, H.J., Gibson, I.J., and Ivanchevich, M.J. (1998), *“Fundamentals of management”*, McGraw-Hill.
3. Drucker F. P. (2003), *“The Practice of Management”*, *Wall Street Journal*.
4. Gordon N, J. (2005), *“Executive Compensation: If There’s a Problem, What’s the Remedy? - The Case for “Compensation and Analysis”*, *Columbia Law and Economics Research Paper, 273*, Columbia Law School;
5. Gordon N, J. (2005), *“Boards and the Mechanisms of Director Independence”*, Draft prepared for the Stanford Law and Economics workshop.
6. Hansmann H. (2004), *“Corporation and Contract”* Center for Law, Economics and Public Policy, Research Paper, No. 300;
7. Hertig Gerand. (2007), *“On-Going Board Reforms: One Size-Fits-All and Regulatory Capture”*, ECGI (European Corporate Governance Institute), Law Working Paper No. 25/2007;
8. Kralev, T. (2001). *“Principles of Management. Center for International Management”*, 2<sup>nd</sup> Ed, Skopje.
9. Nedkov, Dr. Milan. (2005), *“Managing with a shareholding company” - An advise for corporative management*, USAID, Skopje.
10. Pagano Marco and Paul Volpin. (2004), *“Managers, Workers and Corporate Governance Control”*, ECGI (*European Corporate Governance Institute*), Law Working Paper No. 01/2004.

Neda KALESHOVSKA\*)

## ADOPTING PROJECT MANAGEMENT OFFICES TO EXPLOIT THE TRUE BENEFITS OF PROJECT MANAGEMENT

### Abstract

In today's highly competitive business environment, organizations need to stay alert and act in a fast and efficient manner. Many organizations have discovered project management as a valuable asset for successful organization, enabling them to respond timely to the changes in the environment and to plan and organize resources to achieve the envisaged outcome. Given the need for a consistent project methodology many organizations have deployed a focused Project Management Office (PMO) as coordination body of the project management flow and advocate for project management.

The goal of this paper is to demonstrate that adopting PMOs would ensure true guidance and support in the project management roadmap and true utilization of the benefits of project management. In this regard, this paper makes a direct correlation between the success criteria identified for projects and the contribution of the PMOs. Furthermore, it exploits the responsibilities of PMOs and how these responsibilities support the projects' successful execution. Finally, giving insight into PMOs as a trending practice among the organizations nowadays, this paper attempts to examine the strategic possibilities as well as the benefits these organizations have witnessed from adopting PMOs as a precondition for successful project execution.

**Keywords:** *project, project management, project management office, PMO, project methodology, project management benefits*

**JEL classification:** L29, M00

---

\*) MSc. in economics "University Ss. Cyril and Methodius University – Skopje", Faculty of Economics, Project Office Specialist at Vip Operator, E-Mail: n.kaleshovska@vipoperator.mk

## **Introduction**

Working today has proven that everything changes and everything changes really fast. In that manner, successful organizations are those that think proactively, anticipate changes and adjust their strategies on the new conditions. Every organization that wants to attain a sustainable competitive advantage on the market must pay special attention to the advances in the technology and introduce innovations in their work.

Many organizations have discovered project management as a practice for conducting work in the organization, innovations and/or changes such as new or revised products, new or modified premises, new or adapted technology etc. In these regards, projects try to deliver work initiatives on time, within budget and to an agreed level of quality as they are being defined within the triangle of scope, time and budget.

However, project success rates have been diverse. This paper, by exploring the concept of project management and by viewing and analyzing reasons for project success as well as project failure, tries to demonstrate that adopting PMOs would ensure true guidance and support in the project management roadmap and true utilization of the benefits of project management as a contributor of project success.

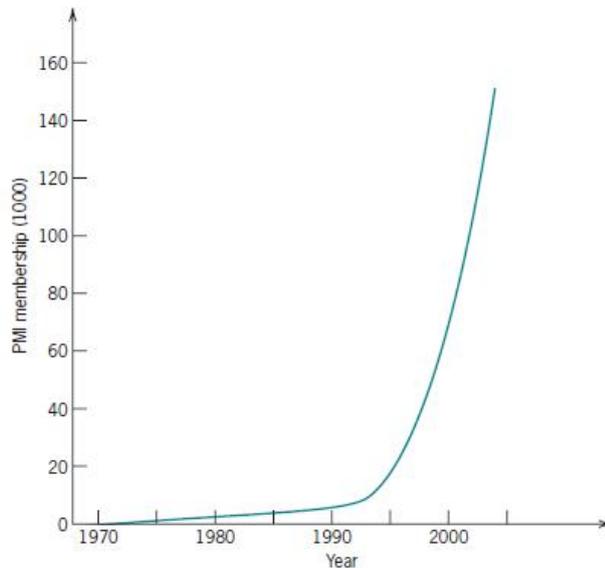
In that manner this paper also extracts the benefits of an implemented PMO and makes a direct correlation between the success criteria identified for projects and the contribution of the PMOs both as an enhancer of the success factors in projects as well as a coordination body that helps diminish the reasons for project failure.

### **1. Projects and project management**

Projects have been around for long time. Building of the pyramids, building of the Eifel tower, sending astronaut Neil Armstrong on the moon as well as many other monumental buildings and moments of the past have the characteristics of projects and project management. However, from those times, organizations have come to realize that many of the work they do is indeed project oriented. In last decade project management has been rather formalized into a professional approach for achieving the undertaken tasks and planned work initiatives.

One of the major international organizations dedicated to this professionalization is the Project Management Institute<sup>1</sup>, established in 1969. By 1990, the PMI had gained 7,500 members. Five years later, it had grown to over 17,000, and by the end of 2007 it had exploded to over 260,000 members in more than 171 countries. This growth is demonstrated in Figure 1.

**Figure 1: PMI growth**



Source: Meredith J.R. and Mantel S. J. Jr. (2009): “Project Management, A Managerial Approach”, 7th edition, John Wiley and Sons, Inc. USA, p.5

### **1.1. Definitions of project and project management**

The PMI has defined a project as a “temporary endeavor undertaken to create a unique product or service”<sup>2</sup>. According to Haynes M.E., a project is an „undertaking that has a beginning and an end, and is carried out to meet established goals within cost, schedule and quality objectives“. He defines project management as a „management approach that brings together and optimazies the resources necessary to

---

<sup>1</sup> PMI, at [www.pmi.org](http://www.pmi.org), (07.02.2013)

<sup>2</sup> PMI (Project Management Institute) (2004), “A Guide to the Project Management Body of Knowledge”, 3<sup>rd</sup> ed., PA: Newtown Square. p.5

successfully complete the project, with resources including skills, talents, and cooperative efforts of a team of people, facilities, tools and equipment, information systems, techniques and money“.<sup>3</sup> Also, Richman L. defines project management as „combination of the knoweldge, skills, methods, techniques and tools used to plan and manage project work establishing a sound basis for effective planning, scheduling, resourcing, decision making, management and plan revision“.<sup>4</sup>

From this, it can be concluded that projects are temporary activities. They are goal oriented, complex, risky and dynamic. Projects are always defined within the triangle of scope, time and budget. Having defined the projects, project management is about the application of knoweldge, skills, tools and techniques to project activities to meet the project requirements.

## 1.2. Project success rate

One of the most commonly used reports regarding project failure was the CHAOS Report<sup>5</sup>. The results from this report take into consideration 365 companies with a total of 8380 Information System applications under development. The results from the report conclude:

“*Project Success*” – Projects completed on time and on budget with all features and functions as specified. Only 16.2% of projects were classified under this category.

“*Project Challenged*” – Projects completed, but either over cost, over time and/or lacking some of the features and functions originally specified. 52.7% of projects were classified under this category.

“*Project Impaired/Failed*” – Projects that were abandoned or canceled at some point. 31.1 % of the projects were classified under this category.

However, project success has improved significantly. According to Johnson the success rate in projects has increased since the CHAOS Report. According to this report, the overall project success rate has

---

<sup>3</sup> Haynes, M.E. (2002), “*Project Management, practical tool for success*”, 3<sup>rd</sup> ed., Menlo Park: Crisp Publications, Inc., p.3

<sup>4</sup> Richman, L. (2011), “*Successful Project Management*”, 3<sup>rd</sup> ed., USA, NY: American Management Association., p.2

<sup>5</sup> The CHAOS Report (1994), The Standish Group, [http://www.standishgroup.com/sample\_research/chaos\_1994\_1.php] (05.01.2013).

increased from 16% in 1994 to 28% in 2000<sup>6</sup>. The final statistics for project success rate from the PMI's survey - the Standard for Portfolio Management - shows that 64% of projects successfully met their original goals and business intent in 2011<sup>7</sup>. That leaves one third of the organizations in the category of unsuccessful projects. The trend of the surveys demonstrated a positive increase in the percentage of successful projects, from 16.2 % in 1994, through 28 % in 2001, to 64 % in 2011. Regardless of measurement semantics, the core of the issue is to determine the reasons for improvements in the project success rate as well as to determine the reasons for project failure and how it can be avoided.

### 1.3. Reasons for project success

Many writers have listed various reasons for failure in projects. Field has acknowledged how projects fail too often because the project scope is not fully appreciated and/or the user needs are not fully understood<sup>8</sup>. Hoffman believes that it is the project managers and their losing of the big picture view that drives project failure; in that manner he says how project managers too often act as process cops and report compilers and lose sight of what they are supposed to be doing – to make sure projects are running effectively<sup>9</sup>.

The results of the research paper by Anil and Thomasson<sup>10</sup>, states that the project success is inferred in the following three variables that have the greatest impact on the performance of project:

1. *Good planning* – detailed forward planning of the implementation stages, task timelines as well as re-planning as

---

<sup>6</sup> Johnson, J. (2001), "*Collaborating on Project Success*"

[<http://www.suttonsoft.com/documents/70percentfailure.pdf>] (22.10.2013).

<sup>7</sup> PMI (Project Management Institute) (2011), "*The Standard for Portfolio Management*", 2<sup>nd</sup> ed., USA: PMI Publications.

<sup>8</sup> Field, T. (1997), "When bad things happen to good projects", CIO magazine, 11(2), 54-60.

<sup>9</sup> Hoffman, Th. "*Value of Project Management Offices Questioned*", Computerworld, July 21, 2003, [<http://www.computerworld.com/printthis/2003.0,4814,82345,00.html>] (11.7.2013).

<sup>10</sup> Anil, I. and Thomasson, D. (1991), "An Empirical Investigation of the use of Content Analysis to Define the Variables Most Prevalent in Project Successes and Failures", Proceedings of the 1991 PMI Annual Seminar/Symposium.

an iterative process that requires agile rethinking according to the changes imposed.

2. *Clear responsibility and accountability* – clear understanding of the team members of their roles and duties in a project.
3. *Schedule control* – continual monitoring and measurement of time, milestones, people and equipment schedule.

A more recent survey on this topic, the survey conducted by the PMI, Pulse of the profession<sup>11</sup>, found the most critical project success factors to include:

- > *Talent*: Staffing the team with appropriate skilled people.
- > *Project Management Basics*: Taking the time to create a realistic implementation plan.
- > *Executive Sponsorship*: Ensuring top-level management support for the project.
- > *Focus on benefits*: Clearly defining the expected benefits from the project.
- > *Change Management*: Effectively managing change associated with the project.

All these claims are true and correct and this paper uses both lists of indicators for project success intended as an input for the correlation between success factors in projects and PMO in regards that the PMO can directly impact these success factors and thus contribute to an increase in the percentage of project success. In the next section these reasons are seen through the perspective of PMOs and how their involvement contributes to successful project execution.

## 2. Adoption of the concept Project Management Office

As project management has evolved and received a widespread recognition and adoption so has the need for an organizational entity that will support the project management process and the project managers in their project activities, and will coordinate all the projects towards the organization's strategy roadmap. Such organization body is the Project Management Office (PMO), which performs in a capacity that achieves project management oversight, control and support.

---

<sup>11</sup> PMI (Project Management Institute) (2012), "*Pulse of the Profession*", [http://www.pmi.org/~media/PDF/Research/2012\_Pulse\_of\_the\_profession.ashx] (22.10.2013).

In this regards, Hill acknowledges how the PMO helps both the project manager and the relevant organization to understand and apply professional practices of project management and adapt and integrate business interests into the project management efforts which it is associated with<sup>12</sup>.

PMOs trace their origins back to the Project Support Offices (PSOs) that cropped up in the 1960's to help large, complex aerospace and construction projects. As automated support tools such as the original Artemis scheduling application started to appear and become more widespread, the direction of PMOs changed to include tools support to project managers. The emphasis changed again during the 1990s to include coordination among multiple projects to ensure consistency in PM practices and quantitative portfolio management. While individual projects may have specific PSOs depending on the project's size and complexity, more often now the enterprise's PMO provides support across a variety of projects that the organization is involved in<sup>13</sup>.

### **2.1. Definition and forms of Project Management Offices (PMOs)**

The PMO can be defined as an organization that can maximize the value of project management by standardizing the practices and consolidating the initiatives across the enterprise<sup>14</sup>. Another definition expresses PMO as an organizational body or entity assigned to various responsibilities related to the centralized and coordinated management of those projects under its domain. The responsibilities of a PMO can range from providing project management support functions to actually being responsible for the direct management of a project<sup>15</sup>.

As every organization is different, there can be different structures of a PMOs according to the requirements as well as the current settlement of the organization. Therefore, matching the right project office structure with the individuality of the organization is critical for success.

---

<sup>12</sup> Hill, G.M., 2007, *"The Complete PMO handbook"*, Auebach Publications, p. vii.

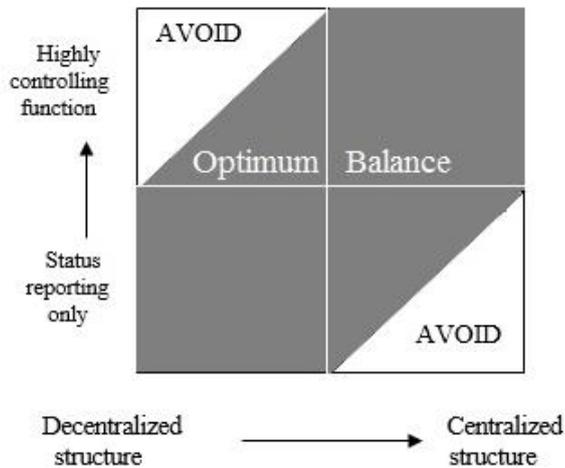
<sup>13</sup> Parth, F.R. (2012), *"Implementing a PMO within Toyota Financial Services"*, USA [http://www.projectauditors.com/Papers/Singapore/ToyotaPMO.html] (12.02.2013).

<sup>14</sup> Maghraby, R.A. (2011), "How to establish a PMO", *PM World Today*, 13(10), 1-5.

<sup>15</sup> PMI (Project Management Institute) (2008), *"A Guide to the Project Management Body of Knowledge"*, PMBOK Guide, 4<sup>th</sup> ed, ANSI: 2008:1.

Figure 2 shows the spectrum of options for a PMO from a decentralized to a centralized structure and from a PMO only for status reporting to a PMO with highly controlling function.

**Figure 2: PMO Structure**



Source: Colegiate Project, 2007

Hence, in a decentralized structure, the PMO provides a valuable reporting service for project status data. Mainly in a decentralized structure the PMOs have the advisory role for project management methodology standards and for project issue resolution. Furthermore, this structure is lower cost solution with fewer impacts on the institutional structure. However, as a downside, under this type of structure the institutions move more slowly to a complete project management methodology adoption and do not gain the full benefits of a project office.

On the other hand, a centralized PMO structure has bigger control. Here, the PMO has the authority to set and enforce standards. The centralized structure allows institutions to more rapidly adopt project management methodologies. Also, issue resolution is more simplified as there is a single escalation path to the top decision maker. Furthermore, with this structure the PMO provides a single source for data and a complete picture of the portfolio of projects. However, as a downside the

PMO can get a “project police” reputation due the high control and demand of data.

There is no right design of a PMO. Depending on the specific needs of the organization, the characteristics of the institution as well as the expectations on the success, the PMOs can be organized into a form as needed. However, as shown in the figure two structures should be avoided: a decentralized structure with highly controlling functions and a centralized structure with responsibility only for status reporting. Instead the structure should be somewhere in the Optimum Balance field.

## **2.2. Responsibilities of Project Management Offices**

In order to understand the benefits derived from implementing and adopting PMOs, first it has to be understood what their responsibilities are so as to understand the areas of their work and how they contribute to the project management flow.

A good description of the responsibilities of the PMOs is provided by Block, who specifies the following activities under the responsibility of the PMO<sup>16</sup>:

- > Enterprise-wide project coordination and consistency;
- > Set standards and methodologies for all projects in the enterprise;
- > Do quality audits of the projects;
- > Help the management and executive teams select projects that support strategic goals;
- > Help the executive team track the entire portfolio of projects in work by developing metrics and measuring all projects against those metrics;
- > Identify the resources that are available to work on upcoming projects;
- > Support the project managers and project teams with training, mentoring and career development;
- > Collect and archive the documents from completed projects and analyze them for trends;
- > Provide a knowledge management system that gathers all project-related information and makes it available in a readily-accessible, useful format.

---

<sup>16</sup> Block, T.R. (1999), “The Seven Secrets of a Successful Project Office”, *PM Network*, April, 1999:43-48.

### **2.3. Correlation between success criteria for projects and the contribution of the PMOs**

According to the success factors for projects identified in sub-section 2.3, this sub-section demonstrates the correlation between those success factors and the contribution of the PMOs for successful project execution.

*Good planning.* Key for successful project execution is a good forward plan that will take into consideration what the scope of the project is, project goals, deliverables, milestones, resources, work activities, KPIs, possible risks, budget needed etc. The PMO has the knowledge of all the aspects that need planning in a project as well as the experience of a well-executed plan and can support project managers in preparing a well-defined project plan.

*Clear responsibility and accountability.* One of the basic responsibilities of a PMO is to mentor and coach all project stakeholders in that they are all knowledgeable of the project management process and their responsibilities. Furthermore, PMOs support kick off meetings and can support and ensure that there is a clear understanding of the responsibilities of all parties.

*Schedule control.* Controlling the status of the projects is also the responsibility of a well-established and working PMOs as they have a general overview of all the project's progress and continually monitor and measure their advancement. Furthermore, PMOs can use software and tools to help measure the projects' progress and generate or make reports for all the projects from the portfolio that further supports project status tracking.

*Talent.* PMOs ensure project management knowledge sharing among all interested parties in the organization. Thus, the employees are mentored into the process of project management, the project management techniques and methods. Furthermore, the PMOs have the repository and database of all projects' data, including project resources and can support staffing the projects with the most appropriate skilled people.

*Project Management Basics.* The fundamental purpose of a PMO is to help both the project manager and the relevant organization to understand and apply professional practices of project management. By setting the standards for project management, by doing regular trainings the PMO provides project-related information which are accessible as

well as practical and usable to the project managers, allowing them to successfully execute projects.

*Executive Sponsorship.* As PMOs are coordination bodies, they are also communication points between the project sponsors, which mainly are the executive top-level management as well as the project managers and project members. Project sponsors and their support is an essential precondition for project success and adoption of a PMO would move the organization into accepting the responsibility and power of project sponsorship and guiding the executive top level management into their tasks and responsibilities to they support the project manager through their connection, knowledge and power into successful bottleneck resolution and thus successful project execution.

*Focus on benefits.* Clearly defining what the project should deliver is essential in avoiding project scope creep, the phenomenon when the scope of the project is not properly defined, documented or controlled and continuous to grow and change. As this is one of the reasons for project failure, such negative occurrences are to be avoided with organizations that have an established PMO.

*Change Management.* Projects evolve and projects change as they evolve. Change management is a common practice in project management and an important precondition for successful project execution. The role of the PMO is to guide projects into valid reasons for change request approval and approach towards change management. Furthermore, as not all changes are approved – such as delays due to improper planning, insufficient engagement of the project owner to secure resources and internal visibility or missing escalations, the PMOs support both project managers to avoid such mistakes and steer to make rightful project decisions.

In addition to such direct correlation between the success factors in projects and the support of the PMOs in each, a correlation between the PMOs and the success rates in projects has also been recognized in the CHAOS Report, by the Meta Group, estimating that deploying a Project Management Office can reduce project failures by up to 80%<sup>17</sup>. Furthermore, according to the PMI's report Pulse of the Profession (2012) it has also been recognized that a strong PMO can reinforce the value that project management brings, in that organizations that have a PMO have a success rate of 65%.

---

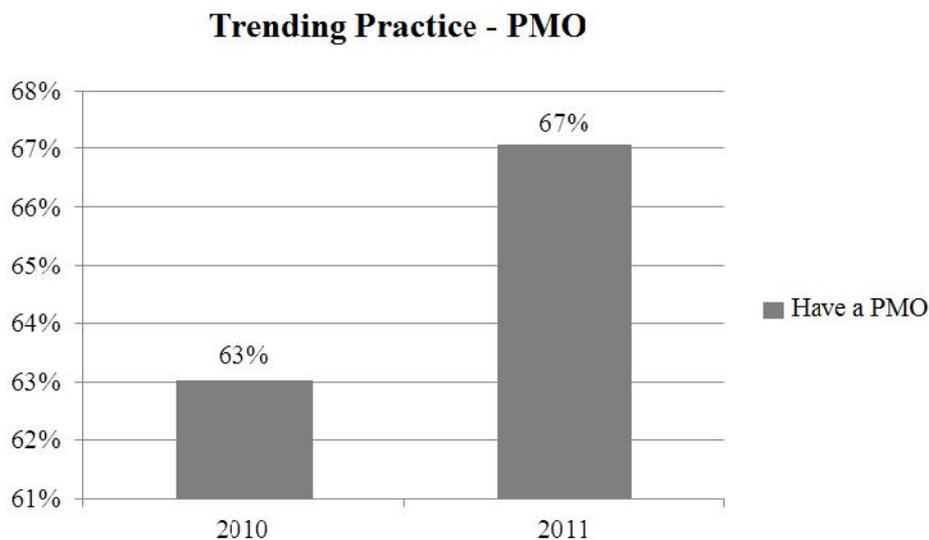
<sup>17</sup> The CHAOS Report (1994), The Standish Group,  
[[http://www.standishgroup.com/sample\\_research/chaos\\_1994\\_1.php](http://www.standishgroup.com/sample_research/chaos_1994_1.php)] (05.01.2013)

## 2.4. Adoption of Project Management Offices by organizations and their benefits

Many organizations worldwide are adopting project management and PMOs as a way of work due to the many benefits that organized and controlled project management provides, such as efficient and timely execution of initiatives, organized structure of work, budget control etc.

According to the survey on PMI's Pulse of the Profession organizations are increasingly using PMOs. This survey takes into account feedback from over 1000 practitioners of project management and leaders. The figure below demonstrates increase in a percentage in the organizations that have a PMO, now standing just above the two-thirds mark (67%) demonstrating standardization in the project management practices across organizations that are practicing project management.

**Figure 3: Practice of PMO, 2010-2011**



Source: PMI Survey, Pulse of the Profession, 2012

Furthermore, in the same survey, regarding success factors in projects, having a PMO was established as one of the most critical success factors.

According to Rathore<sup>18</sup> some of the benefits of having a PMO are:

- > More projects delivered on time and within budget;
- > Better strategic alignment between business objectives and the projects initiated;
- > Money spent on right things;
- > Greater leadership buy-in for department level projects and therefore greater chance of project succeeding and getting support when needed;
- > Better enterprise wide utilization of resources;
- > Lesser or no overlap of effort between departments. Lesser or no duplication of work undertaken by different departments;
- > Better communication across the organization and therefore quicker and better decision making;
- > Better collaboration and coordination across departments;
- > Better visibility of initiatives across the enterprise;
- > Greater returns of the projects implemented;
- > More efficient delivery of projects and therefore faster time to market;
- > Better risk mitigation and structured risk resolution.

### **Conclusion and Future Work**

In this paper the benefits of adopting PMOs as an essential element and factor for successful projects were presented and these benefits, as success factors critical for projects, were connected with the direct contribution and involvement of PMOs. By understanding the responsibilities of PMOs, by following the experiences of the organizations that have a PMO, by following the growing trend of organizations that have implemented PMOs and by following the surveys conducted in these regards it can be concluded that adopting PMO supports the most important aspects of successful project execution.

More projects delivered on time and within budget, better strategic alignment between business objectives and the projects initiated,

---

<sup>18</sup> Rathore, A. (2010), “*The growing importance of EPMO (Enterprise Project Management Office) in today’s Organizations*”, Wipro Technologies, p.13. [<http://www.projectsmart.co.uk/docs/the-growing-importance-of-epmo-in-todays-organisations.pdf>] (12.01.2013)

better enterprise wide utilization of resources, better communication, better collaboration and coordination across the organization etc. enable efficient delivery of projects and improved success rate. Demonstrating the benefits of PMOs and the demands of working in this day and age, the need to rapidly evolve and improve the time to market and deliver projects demands working by the principles of a coordinated and well established project management, guided by a coordination body such as a PMO as an effective and efficient way of implementing new ideas and strategies, as well as new projects.

However, there are many options for future improvements as technology advances. The new opportunities enabled by the enhanced capacities of the automated tools can open new doors for PMOs in helping them to better track and coordinate the projects they support. Hence, this paper hopes to unlock frontiers for additional research in order to further development in the PMOs capabilities as enablers of successful project management execution and work.

#### **References:**

1. Anil, I. and Thomasson, D. (1991), "An Empirical Investigation of the use of Content Analysis to Define the Variables Most Prevalent in Project Successes and Failures", Proceedings of the 1991 PMI Annual Seminar/Symposium.
2. Block, T.R. (1999), "The Seven Secrets of a Successful Project Office", PM Network, April, 1999:43-48.
3. Collegiate Project, (2007),
4. [<http://www.collegiateproject.com/articles/PMO.pdf>] (20.02.2013).
5. Field, T. (1997), "When bad things happen to good projects", CIO magazine, 11(2), 54-60.
6. Johnson, J. (2001), "Collaborating on Project Success" [<http://www.suttonsoft.com/documents/70percentfailure.pdf>] (22.10.2013).
7. Haynes, M.E. (2002), "Project Management, practical tool for success", 3rd ed., Menlo Park: Crisp Publications, Inc.
8. Hill, G.M., 2007, "The Complete PMO handbook", Auebach Publications.

9. Hoffman, Th. "Value of Project Management Offices Questioned", Computerworld, July 21, 2003, [<http://www.computerworld.com/printthis/2003.0,4814,82345,00.html>] (11.7.2013).
10. Maghraby, R.A. (2011), "How to establish a PMO", PM World Today, 13(10), 1-5.
11. Meredith, J.R. and Mantel S. J. Jr. (2009), "Project Management, A Managerial Approach", 7th ed., USA: John Wiley and Sons.
12. Parth, F.R. (2012), "Implementing a PMO within Toyota Financial Services", USA [<http://www.projectauditors.com/Papers/Singapore/ToyotaPMO.html>] (12.02.2013).
13. PMI (Project Management Institute) (2004), "A Guide to the Project Management Body of Knowledge", 3rd ed., PA: Newtown Square.
14. PMI (Project Management Institute) (2008), "A Guide to the Project Management Body of Knowledge", PMBOK Guide, 4th ed, ANSI: 2008.
15. PMI (Project Management Institute) (2011), "The Standard for Portfolio Management", 2nd ed., USA: PMI Publications.
16. PMI (Project Management Institute) (2012), "Pulse of the Profession", [[http://www.pmi.org/~media/PDF/Research/2012\\_Pulse\\_of\\_the\\_profession.ashx](http://www.pmi.org/~media/PDF/Research/2012_Pulse_of_the_profession.ashx)] (22.10.2013).
17. PMI (Project Management Institute), [[www.pmi.org](http://www.pmi.org)] (22.10.2013).
18. Richman, L. (2011), "Successful Project Management", 3rd ed., USA, NY: American Management Association.
19. Rathore, A. (2010), "The growing importance of EPMO (Enterprise Project Management Office) in today's Organizations", Wipro Technologies [<http://www.projectsart.co.uk/docs/the-growing-importance-of-epmo-in-todays-organisations.pdf>] (12.01.2013).
20. The CHAOS Report (1994), The Standish Group, [[http://www.standishgroup.com/sample\\_research/chaos\\_1994\\_1.php](http://www.standishgroup.com/sample_research/chaos_1994_1.php)] (05.01.2013).



**UDC 658.86/.87:334.72(497.7):339.727.22**  
**Professional paper**

**Kristina KOVACEVIK<sup>\*</sup>)**

**FOREIGN DIRECT INVESTMENTS IN REPUBLIC OF  
MACEDONIA: AN OPPORTUNITY FOR DOMESTIC  
ENTERPRISES TO PARTICIPATE IN GLOBAL SUPPLY  
CHAINS**

**Abstract**

The attraction of foreign direct investments and international cooperation are considered to be important priorities for small economies. They are desirable because of the positive effects in terms of increased employment and inflow of capital, technology, skills and knowledge in host countries. Especially important are the opportunities for building deeper, long-term relationships of cooperation and partnerships between domestic enterprises and foreign investors. Through this cooperation domestic enterprises can participate in global supply chains and ensure stable sale and market share for their products in form of materials and semi-finished products for foreign investors.

The purpose of the research is to identify the opportunity for involvement of domestic enterprises in global supply chains, through cooperation with foreign direct investors. The subject is to explain theoretically the category of foreign direct investments and their implications on domestic economy, to explain the current situation with foreign direct investments in Macedonia and to provide recommendations about their attraction and intensified involvement of domestic enterprises in global supply chains. The research is based on qualitative approach, using the methods of analysis and synthesis, induction, deduction and comparison.

The research shows that foreign direct investments are important for the development of Macedonian economy, but it is necessary to take

---

<sup>\*</sup>) MSc Younger assistant, University "Goce Delcev" Stip, Faculty of Tourism and Business logistics, "Krstev Misirkov" b.b., Stip, Macedonia  
e-mail:kristina.kovacevik@ugd.edu.mk

several measures to increase them and intensify the cooperation with domestic enterprises in order to exploit the full potential they offer. In this regard, the Government, the Macedonian Bank for Development Promotion, as well as the domestic enterprises play a critical role.

**Key words:** diffusion, knowledge, technology, capital, cooperation

**JEL classification:** F21, L26.

### **1. Foreign direct investments: concept, positive and negative implications for domestic enterprises**

Foreign direct investments play a key role in the process of international economic integration. They are creators of direct, stable and long-term relationships between the economies of the affected countries, encourage transfer of technology and knowledge between them and can be a significant generator of economic growth.

Foreign direct investments are cross-border investments by residents in foreign economy with the objective of obtaining a lasting interest in enterprises residents in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the enterprise.<sup>1</sup> According to the National Bank of the Republic of Macedonia direct investments are cross-border investments made to obtain a lasting interest in an enterprise resident in an economy other than of the investor, and to gain influence on the business strategy of that enterprise.<sup>2</sup> They allow transfer of management and technical skills and diffusion of knowledge or entrepreneurship in form of research and development, production technology, marketing knowledge and managerial skills.<sup>3</sup>

The effects they generate are subject to fierce and often contradictory debate between researches and politicians. Politicians and

---

<sup>1</sup> OECD Factbook 2013: Economic, Environmental and Social Statistics, [<http://www.oecd-ilibrary.org/sites/factbook-2013-en/04/02/01/index.html?itemId=/content/chapter/factbook-2013-34-en>]

<sup>2</sup> National Bank of the Republic of Macedonia [<http://www.nbrm.mk/?ItemID=79D1B7E53FF9B74FA7DA40C529AAB550>]

<sup>3</sup> Dunning J., (1992), “*Multinational Enterprise and Global Economy*”, Addison Wesley Publishing, 55-56;

economists in countries that export capital are concerned about the capital leaving their country, unlike those in countries in which the capital is invested, which are concerned about the impact this capital has on domestic enterprises. However, in transition countries, as well as in developing countries, foreign direct investments are desired and welcomed because of the positive effects associated with multinational investments in capital, technology and expertise. They are an important factor for national economy development and have long-term implications over its competitiveness.

Positive externalities in the literature usually arise from the assumption that foreign investors possess more advanced technology compared with domestic enterprises resulting in processes of diffusion of knowledge and technology between foreign investors and domestic enterprises.<sup>4</sup> The foreign investors have advantages arising from the possession of specific resources; advantages that are commonly achieved through high levels of investments made in innovative activities.<sup>5</sup>

The advantage arising from the possession of specific resources combined with the advantages provided by the host country, in terms of access to cheaper and plentiful resources and raw materials, is the most frequent and important stimulus behind the decision to displace the production capacity to another country.<sup>6</sup> Once foreign enterprises enter the domestic market, diffusion of ideas and technologies takes place in the respective and related industries.<sup>7</sup>

Knowledge diffusion is usually generated through demonstration effects that can be identified horizontally in enterprises from the same industry. For example, demonstration effects are generated when local enterprises modernize their technology, develop new products and processes or implement similar organizational practices with those presented by foreign investors. The cooperation with foreign investors and the possible imitation of their innovation by local enterprises can help local enterprises to increase their productivity.

---

<sup>4</sup> Caves, R. (1996), "*Multinational enterprise and economic analysis*", Cambridge, England: Cambridge University Press.

<sup>5</sup> Guadalupe, M., Kuzmina, O. and Thomas, C. (2012), "Innovation and foreign ownership". *American Economic Review*, 102(7), 3594-3627.

<sup>6</sup> Rugman, A. (1981), "Inside the multi-national: The economics of internal markets". New York; Columbia University Press.

<sup>7</sup> Javorcik, B.S. (2004), "Does foreign investment increase the productivity of domestic firms? In search of spillovers through backward linkages", *American Economic Review*, 94(3), 605-627.

Another way by which diffusion of technology, skills and knowledge can be generated is through labor mobility.<sup>8</sup> Normally, when foreign enterprises hire local workers they organize trainings through which the workers acquire new skills in correlation with the strategies, operations and processes implemented by the enterprise. Trained local workers can terminate the employment contract with the foreign enterprise and start working in domestic enterprise or start their own business. Also, the knowledge accumulated as a result of the international experience of foreign enterprises can have influence on domestic enterprises' export decisions.<sup>9</sup> In some circumstances, this knowledge can become a stimulus for establishment of new enterprises and exploitation of export opportunities identified by domestic enterprises.

Although, this kind of knowledge diffusion usually takes place within one industry, still there is an opportunity for diffusion of knowledge between different industries, a process that is associated with the national economy development. This kind of knowledge transfer is generated when foreign enterprises develop cooperation relationships with local enterprises. If foreign enterprises set quality standards on higher level, the local suppliers usually would have to ask for technical support in order to improve their production, organizational and managerial skills.<sup>10</sup> Ultimately, this would result with increased productivity of those domestic enterprises that cooperate with the foreign ones. Additionally, being part of a global supply chain can mean creation of advantage from economies of scale, as well as stimulation of new domestic enterprises entry in the industry. Labor mobility between vertically related industries can foster improved performances of local enterprises. However, the degree of diffusion will depend on the degree of cooperation between foreign and domestic enterprises and whether and how much foreign enterprises use locally produced inputs. If foreign enterprises work solely with foreign associates and use only foreign sources, in that case cooperation opportunities with domestic enterprises are limited and modest.

---

<sup>8</sup> Fosfuri, A., Motta, M. and Ronde, T. (2001), "Foreign direct investment and spillovers through labor mobility", *Journal of International Economics*, 53(1), 205-222.

<sup>9</sup> Kneller, R. and Pisu, M. (2007), "Industrial linkages and export spillovers from FDI", *The World Economy*, 30(1), 105-134.

<sup>10</sup> Burstein, A.T. and Monge-Naranjo, A. (2009), "Foreign know-how, firm control, and the income of developing countries", *Quarterly Journal of Economics*, 124(1), 149-195.

On the other hand, foreign direct investments are perceived as creators of negative externalities for the domestic economy. The entry of foreign enterprises increases the competitive pressure on domestic enterprises, which may drive less efficient local firms out of the market.<sup>11</sup> Increased competitive pressure often leads to prices reduction, which ultimately results in displacement of local companies from the market, which although inefficient in the international boundaries, still can contribute to increased employment and income on a local level. The effect of stealing the market share from foreign enterprises occurs because their entry decreases the productivity of domestic enterprises as a result of the pressure to lower the production quantities.<sup>12</sup> This effect can easily be identified in the context of a single industry, when foreign and domestic enterprises compete directly as suppliers of other upstream foreign enterprises. The efforts for cost reduction by foreign enterprises can be a reason for international instead of local procurement of intermediate goods. Ultimately, in order to meet the global standards local sourcing can be replaced with international one.

Also, negative externality can be seen on the factor market. The foreign enterprises have the necessary resources and perspective opportunities to attract the most productive domestic resources and this is particularly true for labor. They have the power to provide better working conditions and higher wages as opposed to domestic enterprises, and that's why they'll attract the most talented and capable domestic workers. In regards with potential impacts on entrepreneurship, foreign direct investments may lower the rate of establishment of new domestic enterprises by altering the payoffs to potential entrepreneurs with those from wage employment.<sup>13</sup> In this context, a research concludes that under particular circumstances the monetary return for entrepreneurs is valued less compared with the risk-free salary earned from employment in foreign enterprise.<sup>14</sup> However, the crowding out of domestic enterprises in terms of products, labor or suppliers doesn't always mean deterioration

---

<sup>11</sup> Djankov, S. and Hoekman, B. (2000), "Foreign investment and productivity growth in Czech enterprises", *World Bank Economic Review*, 14(1), 49-64.

<sup>12</sup> Aitken, B. J. and Harrison, A.E. (1999), "Do domestic firms benefit from direct foreign investment? Evidence from Venezuela", *American Economic Review*, 89(3), 605-618.

<sup>13</sup> De Backer, K. and Sleuwaegen, L. (2003), "Does foreign direct investment crowd out domestic entrepreneurship?", *Review of Industrial Organization*, 22(1), 67-84.

<sup>14</sup> Hall, R.E. and Woodward S.E. (2010), "The burden of the non-diversifiable risk of entrepreneurship", *American Economic Review*, 100(3), 1163-1194.

of economic welfare. Indeed, the increased competition imposed by the foreign direct investments can induce more efficient use of local resources and subsequent increase of welfare.

## **2. Foreign direct investments in Republic of Macedonia, 2007-2012**

The promotion of international cooperation and the attraction of foreign direct investments are considered to be one of the five strategic areas of action for achieving the vision of the Macedonian industrial policy.<sup>15</sup> In this direction the country makes efforts to attract a larger share of foreign capital through foreign direct investments. In regards with the investment climate particularly important are the economic and legal activities taken in the last years. In the recent years we have witnessed the reforms in the tax system (proportional corporate and personal income tax rate of 10% and 0% tax on reinvested profit, investors operating in the technological industrial zones use tax relives for ten years), reforms to improve the credibility and the services provided by the public institutions and cut the bureaucratic procedures (easy firms' registration, easier processes for obtaining planning permissions), better protection of property rights and contracts execution (legal protection), etc. Also, marketing campaigns and activities are continuously launched in order to promote Macedonia as a desired investment destination, with more sectors promoted in front of foreign investors. Regional forums are organized, councilors and local promoters are hired, potential investors are contacted and so on.

Meanwhile, the macroeconomic stability was maintained through stabile fiscal and monetary policy, low inflation, balanced public finances with low budget deficits and low public debt. Besides the national macroeconomic stability, the Government's actions and policies are considered to be an important factor that influences the level of foreign direct investments. In this regard, the attraction of foreign direct investments is an important priority for the Government and represents

---

<sup>15</sup> Industriska politika na Republika Makedonija 2009-2020 [Industrial Policy of Republic of Macedonia 2009-2020], Ministerstvo za ekonomija na Republika Makedonija, 2009, 29-30.

an important category in the Government program 2011-2015.<sup>16</sup> Related with this is the Program of the Ministry of Economy for investment incentives, 2011-2014<sup>17</sup> aimed at developing policies and implementing reforms that will lead to more dynamic economic growth and development, in correlation with the strategic objectives of the Government program. The following table presents the levels of foreign direct investments in Republic of Macedonia from 2007 to 2012. The highest level is recorded in 2007, when the country attracted foreign direct investments worth 505,97 millions of euros, as a result of which it reached GDP growth of 5%. In 2008 the level dropped to 399.89 million of euros and GDP growth remained around 5 per cent. In 2009 as a result of the global crisis, the level of foreign direct investments was 144,97 millions of euros. In 2010, 160,02 millions of euros were attracted. The lowest level was recorded in 2012, when the level dropped to 104,77 millions of euros.

**Table 1: Foreign direct investments in Republic of Macedonia, 2007-2012**

Year	Foreign direct investments (in millions of euros)
2007	505,97
2008	399,89
2009	144,97
2010	160,02
2011	336,79
2012	104.77

Source: Adapted from data of the Narodna Banka na Republika Makedonia

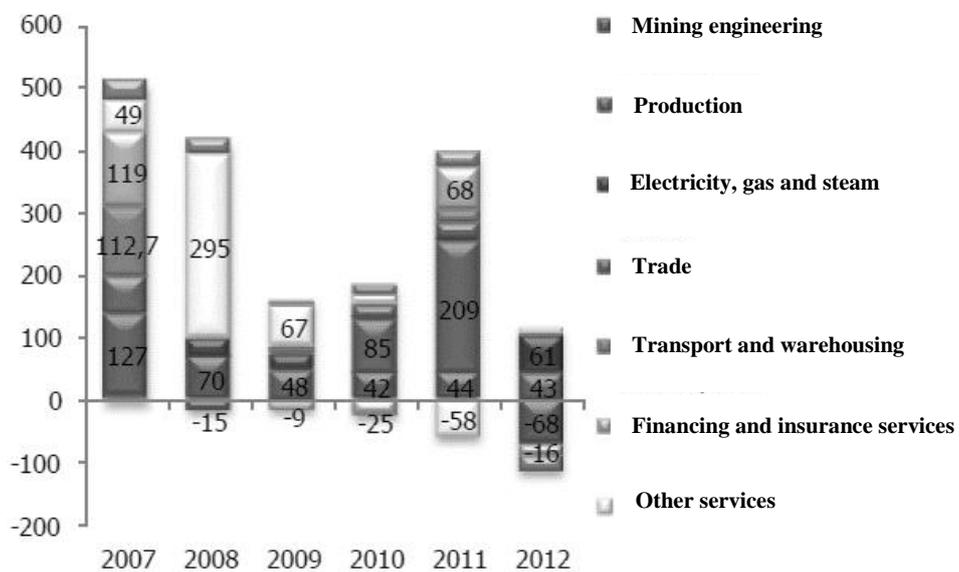
---

<sup>16</sup> Programa na Vladata, 2011-2015 [Government Program 2011-2015], Government of the Republic of Macedonia, [<http://vlada.mk/node/262?language=en-gb>]

<sup>17</sup> Programa za pottiknuvanje na investicii, 2011-2014 [Program for Investment Support 2011-2014], Ministry of Economy of Republic of Macedonia, [[http://economy.gov.mk/ministerstvo/sektori\\_vo\\_ministerstvo/sektor\\_za\\_pottiknuvawe\\_investicii/3388.html](http://economy.gov.mk/ministerstvo/sektori_vo_ministerstvo/sektor_za_pottiknuvawe_investicii/3388.html)]

The next figure provides a graphical representation of foreign direct investments by sector in millions of euros in the period of 2007 to 2012. In terms of sector distribution, foreign direct investments are mainly concentrated in manufacturing and services, with the largest share invested in manufacturing in 2011 and the least in 2008. Most of the production refers to the production of automotive parts and electronics.

**Picture 1: Foreign direct investments by sector (in millions of euros)**



Source: Godisen izvestaj na rabotenjeto na NBRM vo 2012 godina, (2013), Narodna banka na Republika Makedonija;

Compared with other transition economies, in 2012 Macedonia had the lowest inflow of foreign direct investments from all transition countries. Lower level compared with the politically and safety unstable Bosnia and Herzegovina, also Albania and Montenegro have far higher levels. The next table shows the inflow of foreign direct investments in transition countries in South-East Europe in millions of dollars.

**Table 2: Inflow of foreign direct investments in transition countries in South-East Europe (millions of dollars)**

Inflow of foreign direct investments						
Region / economy	2007	2008	2009	2010	2011	2012
<b>Transition economies</b>	93 371	121 429	72 750	75 056	96 290	87 382
SE Europe	13 187	13 257	8 577	4 592	7 202	4 235
Albania	659	974	996	1 051	1 036	957
BiH	1 818	1 025	149	324	380	633
Croatia	5 041	6 220	3 339	432	1 502	1 251
Serbia	3 439	2 955	1 959	1 329	2 709	352
Montenegro	934	960	1 527	760	558	610
Macedonia	693	586	201	212	468	135

Source: UNCTAD, FDI – TNC – GVC Information system, FDI database, (2013) [[http://unctad.org/en/PublicationChapters/wir2013References-Annexes\\_en.pdf](http://unctad.org/en/PublicationChapters/wir2013References-Annexes_en.pdf)]

The inflows of foreign direct investments in other European countries are much higher than these levels. That's why comparison with them isn't even worth making.

### **3. Opportunities and recommendations for attracting foreign direct investments and domestic companies' participation in global supply chains**

Macedonian economy is one of the smallest in Europe therefore internationalization is a necessity for the functioning of the economy. The development of market economy and economic reforms, along with the stable macroeconomic policy, are important factors for development of the investment climate in Macedonia and for the perception that foreign investors have about the investment opportunities offered by the country. The favorable geo-strategic position is an important comparative advantage that creates the potential for the country to become a regional center for facilitating trade and developing competences in supply chain management. Unfortunately, the underdeveloped, old and expensive infrastructure prevents the complete utilization of this potential. Low

labor costs are particularly important for labor-intensive industries (such as textile and automotive industry), but they are not sufficient by themselves to attract foreign investors. Regarding the workforce qualification, although the statistical figures are favorable, yet the actual market situation is different and less desirable. The country is still highly rated in terms of corruption<sup>18</sup> and this continues to be a serious problem and destructive obstacle to economy development. According to this characteristics of the national economy, actions that would increase the inflow of foreign direct investment in the country are:

- Better protection of property rights and ensured effective execution of contracts through effective and independent judiciary;
- Consistency and stability in terms of the tax system and the established legal framework;
- Serious investments in building and modernizing of infrastructure;
- Increased quality of services provided by the public administration;
- Research the actual needs of the labor market and make adjustments into the education strategy (secondary and higher education) according to the market's real needs;
- The eventual EU and NATO entry would mean reduced risk and increased national safety and security, as well as increased confidence of investors to invest their capital in the country.

We have noted earlier that foreign direct investments create opportunities for huge development implications over the domestic economy, especially in cases when it comes to industries that weren't included in the business structure of the country previously and in which there are no domestic manufacturers that operate. In this way direct competition between domestic and foreign enterprises for taking bigger market share is avoided as well as the subsequent displacement of the less efficient enterprises from the market (usually the domestic ones). In terms of the negative impact on the labor market, i.e. the attraction of the few talented and skilled workers and the reduction of the formation rate of new local enterprises, the propensity of the prospective entrepreneurs to take risk and start their own business plays an important role.

---

<sup>18</sup> Corruption Perceptions Index 2013, Transparency international, [http://cpi.transparency.org/cpi2013/results/#myAnchor1]

Thus, foreign direct investments in Macedonian case can be creators of significant positive externalities, especially through the opportunities for participation of domestic enterprises in global supply chains and absorption of knowledge, technology and skills. However, in order to be part of global supply chains, Macedonian enterprises would have to make their contribution in increasing the overall value of supply chains and thus to participate in the creation of the competitive advantage of the chain. Also, the Government can have a great influence in deepening the cooperation by obliging foreign direct investors to use a certain minimum percentage of locally produced raw materials and semi-finished materials, providing export to third markets or joint participation on some other projects, in exchange of the benefits provided by the host country.

Of course, in this case from domestic manufacturers it is expected to redesign their operations and to increase the technology, management, research and development levels at the required level, i.e. to provide internationally competitive prices and way of working.

The following activities are recommendations for successful development of domestic enterprises by achieving and maintaining long-term cooperation with foreign enterprises:

- Increase of quality and productivity levels through implementation of reliable methods for productivity improvement, quality standards, increased research and development and introduction of new, more efficient technologies;
- Make production orientation modifications and focus on prospective industries and strategic markets where foreign investors operate or potentially will;
- Take more aggressive and proactive approach in terms of searching information about the needs and production programs of foreign investors, the cooperation rules and the global market trends;
- Attend trainings and seminars to keep up with technological changes and +participate in trade shows in order to present the capacities of the enterprise. Also, business meetings should be organized more frequently, where foreign investors as well as domestic enterprises could present their capacities and needs. These business meetings should be organized and managed by the Government.

Additionally, the Macedonian Bank for Development Promotion, as the only development bank in the country, whose main objective is to support and encourage the development of the Macedonian economy by providing investment credits to small and medium enterprises and export companies, should facilitate the access to cheaper credit lines for domestic enterprises that have or seek to build a deeper cooperation with foreign investors. In regards of providing the necessary institutional support, it is important to establish a public institution whose main purpose will be promotion and facilitation of cooperation between domestic enterprises and foreign investors, which will distribute timely and relevant informations to local enterprises and will provide the necessary services for international operation and cooperation.

Of course, further entrance of high-quality foreign direct investments, which will bring new technologies, knowledge, investments and new employments and will be willing to cooperate with domestic enterprises and utilize local materials and semi-finished products, will open up new opportunities for collaboration and vertical integration across supply chains.

### **Conclusion**

In the process of international economic integration, foreign direct investments play a key role. They are creators of direct, stable, long-term relationships between the economies of the countries, encourage transfer of technology and knowledge and can be an important generator of economic growth. Positive externalities are usually referred to the assumption that foreign investors possess more advanced technology than domestic enterprises resulting with processes of knowledge and technology diffusion. Negative externalities, however, are associated with the claim that the entry of foreign enterprises increases the competitive pressure on domestic enterprises, which can displace the less efficient domestic enterprises from the market.

Foreign direct investments in the case of Macedonia can be creators of significant positive externalities, especially through the opportunities for participation of domestic enterprises in global supply chains and absorption of knowledge, technology and skills. In recent years the country has increased inflow of foreign direct investments (except in 2012), but yet they are the lowest in the region and under the

desired level. Activities such as making changes in the judicial system, maintaining consistency and stability in the tax system, building new and modernizing the existing infrastructure, increasing the quality of public administration's services, as well as adjustment of the education system according to the needs of the labor market can have positive influence on foreign direct investments inflow. On the other hand, in order to deepen the cooperation between domestic and foreign enterprises it is necessary that domestic enterprises redesign their operations and increase the technology, management, research and development levels at the required level, i.e. provide internationally competitive prices and way of working. Also, the Government and the Macedonian Bank for Development Promotion must actively provide the needed support to domestic enterprises in this process.

### **References:**

1. Aitken, B. J. and Harrison, A.E. (1999), "Do domestic firms benefit from direct foreign investment? Evidence from Venezuela", *American Economic Review*, 89(3).
2. Barry, F., Görg, H. and Strobl, E. (2003), "Foreign direct investment, agglomerations, and demonstration effects: An empirical investigation", *Review of World Economics*, 139(4).
3. Burstein, A.T. and Monge-Naranjo, A. (2009), "Foreign know-how, firm control, and the income of developing countries", *Quarterly Journal of Economics*, 124(1).
4. Caves, R. (1996), "*Multinational enterprise and economic analysis*". Cambridge, England: Cambridge University Press.
5. Corruption Perceptions Index 2013, Transparency international, [<http://cpi.transparency.org/cpi2013/results/#myAnchor1>].
6. De Backer, K. and Sleuwaegen, L. (2003), "Does foreign direct investment crowd out domestic entrepreneurship? Review of Industrial Organization", 22(1).
7. Djankov, S. and Hoekman, B. (2000), "Foreign investment and productivity growth in Czech enterprises". *World Bank Economic Review*, 14(1).
8. Dunning J., (1992), "*Multinational Enterprise and Global Economy*", Addison Wesley Publishing.

9. Fosfuri, A., Motta, M. and Ronde, T. (2001), "Foreign direct investment and spillovers through labor mobility". *Journal of International Economics*, 53(1).
10. Guadalupe, M., Kuzmina, O. and Thomas, C. (2012), "Innovation and foreign ownership", *American Economic Review*, 102(7).
11. Hall, R.E. and Woodward S.E. (2010), "The burden of the non-diversifiable risk of entrepreneurship", *American Economic Review*, 100(3).
12. Haskel, J., Pereira, S and Slaughter, M. (2007), "Does inward foreign direct investment boost the productivity of domestic firms?", *Review of Economics and Statistics*, 89(3).
13. Industriska politika na Republika Makedonija 2009-2020 [Industrial Policy of Republic of Macedonia], (2009), Ministry of Economy of Republic of Macedonia.
14. Javorcik, B.S. (2004), "Does foreign investment increase the productivity of domestic firms? In search of spillovers through backward linkages", *American Economic Review*, 94(3).
15. Kneller, R. and Pisu, M. (2007), "Industrial linkages and export spillovers from FDI", *The World Economy*, 30(1).
16. Narodna banka na Republika Makedonija, [National Bank of Republic of Macedonia] [<http://www.nbrm.mk>]
17. OECD Factbook 2013: Economic, Environmental and Social Statistics, [<http://www.oecd-ilibrary.org/sites/factbook-2013-en/04/02/01/index.html?itemId=/content/chapter/factbook-2013-34-en>]
18. Programa na Vladata [Government Program], 2011-2015, Government of the Republic of Macedonia, [<http://vlada.mk/node/262?language=en-gb>]
19. Programa za pottiknuvanje na investicii [Program for Investment Support], 2011-2014, Ministry of Economy of Republic of Macedonia. [[http://economy.gov.mk/ministerstvo/sektori\\_vo\\_ministerstvo/sek\\_tor\\_za\\_pottiknuvawe\\_investicii/3388.html](http://economy.gov.mk/ministerstvo/sektori_vo_ministerstvo/sek_tor_za_pottiknuvawe_investicii/3388.html)]
20. Rugman, A. (1981), "*Inside the multi-national: The economics of internal markets*", New York: Columbia University Press.
21. UNCTAD, FDI – TNC – GVC Information system, FDI database, (2013) [[http://unctad.org/en/PublicationChapters/wir2013References-Annexes\\_en.pdf](http://unctad.org/en/PublicationChapters/wir2013References-Annexes_en.pdf)]

Maja RISTOVA \*)

## THE ADVANTAGE OF SOCIAL MEDIA

### Abstract

Many companies use social media to promote and sell their products and services. Through the most popular social media outlets such as Facebook, Twitter, LinkedIn, blogs and forums, companies can reach potential clients who are in need of their products or services.

With the development of the global network, the Internet has the potential to reach a greater number of customers than television and newspaper advertisements. In fact, most readers choose the Internet as a way of finding out about events in their country and the world because they can access a greater amount of information in a shorter period of time.

As a communication tool, the Internet allows users easy access to a vast amount of information about the products which companies offer on the market throughout the country and the world.

This professional paper will analyse the most popular social media outlets through which companies can sell and promote their products or services: Facebook, Twitter, LinkedIn forums and blogs. This paper will also argue that social media have a major impact, both positive and negative, on everyday life, and that companies can provide information about their products or services in a relatively short time through social media. Social media also allow companies to resolve problems with dissatisfied customers more swiftly through interactive communication.

**Key words:** social media, Facebook, LinkedIn, Twitter, blogs, promotion

**JEL classification:** M31, M37

---

\*) MSc., Social Media and Marketing Coordinator, Fridge Check DOO, Skopje  
E-mail: ristova.maja@gmail.com

## **Introduction**

Companies can use the Internet to quickly survey customers and obtain evidence regarding customer satisfaction with the products they have purchased. Through constant monitoring of the behaviour, wishes and needs of customers, companies can adapt their products to market requirements.

The Internet is also a powerful communication tool through which users can exchange information and ideas about certain products and services. In addition, the Internet allows Social Media Managers to easily get in touch with their companies' current customers, as well as to attract new potential customers.

Modern life requires a modern way of working. In the past, companies needed Marketing Managers to market and advertise the company in traditional ways such as through television and newspapers. Today, most of the marketing performed by these same Marketing Managers is implemented through social media.

In the business sector, a company's professional 'Social Media and Marketing Manager' is responsible for all online promotions through social media – promoting the company's products or services, placing ads, monitoring public opinion and replying to requests or complaints posted by users on the company's social media pages.

Social Media Managers should be in constant online interaction with customers. Social media platforms are online communities of people who share common interests or activities. Social networks help companies to promote their products and business in new and innovative ways. Users use online sources, including social networks, to reach opinions about the characteristics of certain products and services. Social sites are a modern tool used in companies that allocate a significant amount of funds to promote the products or services.

### **1. The advantage of Facebook**

In the last few years, social media has become the most popular communication platform on the Internet. Kaplan and Haenlein (2010) define social media as: "a group of Internet-based applications that build on the ideological and technological foundations of Web 2.0 and that allow the creation and exchange of User Generated Content."

The popularity of social media sites is based on the mediums of video, microblogging or virtual reality.

**Table 1: Facebook Statistics**

<b>Facebook Demographics</b>	<b>Data</b>
Percentage of 18–34-year-olds who check Facebook when they wake up	48 %
Average number of friends per Facebook user	130
Average number of pages, groups and events a user is connected to	80
Average number of photos uploaded per day	205
Number of fake Facebook profiles	81,000,000
<b>Global Facebook Reach Statistics</b>	
Number of languages available on the Facebook site	70
<b>Facebook Platform Statistics</b>	
Average number of apps installed on Facebook each day	20 million
Total number of apps and websites integrated with Facebook	7 million
<b>Every 20 Minutes on Facebook</b>	
Links shared	1 million
Friends requested	2 million
Messages sent	3 million
<b>Facebook Company Statistics</b>	
<b>Data</b>	
Total number of Facebook employees	4,619
Total 2012 Facebook revenue	\$5,090,000,000
Total 2013 Facebook revenue	\$6,150,000,000

Source: Facebook statistics [<http://www.statisticbrain.com/facebook-statistics/>]  
(18.02.2014)

The statistics presented in Table 1 show the popularity of Facebook and the extent of engagement on the part of users. Half of all Facebook users are constantly logged in, and users spent a total of over 700 million minutes a month on Facebook in 2011. The situation is similar for other social networking sites. According to eMarketer's 2009 study of students at American colleges, Cohort analysis of women make up the majority (60%) of users of social network sites, while men make up 40% of social network users.<sup>1</sup>

Facebook provides users with an online profile page where people can post things they are interested in and discuss topical events. Profile Pages are a personal place where people share comments, videos and pictures, etc.

The nature and functionality of Facebook groups differ in several ways from those of Facebook pages (profiles of brand pages). Facebook groups allow space for small groups of users who share common interests or opinions to post photos and join discussions, etc. Groups can also be secret or private in order to limit which members have access to the group and to group posts (this is also called a “closed set”).

There are also open or public groups in which all posts are public and available for everyone on Facebook to see, and these posts can even be found through search engines like Google. The creator of a Facebook group can make the group public so that anyone can join, or they can require users to request approval to join or send invitations to users to join. Group administrators can send mass messages directly to members in private messages.<sup>2</sup>

Any user of Facebook can connect to a company's Facebook page simply by clicking the Like button, thus enabling them to interact with the brands, companies, organizations and celebrities they like. For social media marketing managers, Facebook provides an opportunity to examine the attitudes and opinions of online consumers about certain products or services. Managers are able to obtain opinions from people from different cultures all over the world by performing online surveys of users on any given topic. Thanks to Facebook and the statistical

---

<sup>1</sup> Boyd, D. M., and Nicole B. E. (2007), “Social Network Sites: Definition, History, and Scholarship”, *Journal of Computer-Mediated Communication*, p. 13.

<sup>3</sup> Chu S. (2011), “Viral advertising in social media: participation in Facebook groups and responses among college-aged users”, *Journal of Interactive Advertising*, American Academy of Advertising, 12(1), 30–43.

information it provides, managers can get detailed information about users' engagement activity on Facebook.

## **2. The advantage of Twitter**

Twitter is a more recently created social media tool that offers a microblogging service to its users – newer concept than that of Facebook. Twitter was launched in 2006, and by June 2009 it already had 41 million users. Twitter allows users to write 140-character posts, called 'tweets'. Twitter users can follow other users, allowing them to read their posts. Twitter users can only see the posts of other users that they follow.

Many companies use Twitter and Facebook as a way of promoting the products or services they offer.

Tweets and replies do not mean much to anyone unfamiliar with a company. Companies should thus be sure to provide sufficient information on their Twitter profile page about who they are and the goods and services they offer. A company's Twitter name should also be the same name they use on other social networks and forums.

In practice, Twitter follows the opinions of individual tweeters. The company should post about itself, and they can use their logo, though they do not have to use an avatar.<sup>3</sup>

Profile information is important. Companies should not include promotional information in their user profiles. To follow someone on Twitter is not necessarily an avowal of friendship, but nonetheless affords interaction and conversation – at least in short bursts.

The following terms and abbreviations native to Twitter are essential for understanding the network (abbreviations are given in parentheses):

**Tweet:** A 140-character message.

**Retweet (RT):** Re-sharing or giving credit to someone else's tweet.

**Feed:** The stream of tweets one sees on their homepage. This stream comprises updates from the users they follow.

**Mention (@):** A way to reference another user by their username in a tweet (e.g. @mashable). Users are notified when @mentioned. This is a way of conducting discussions with other users in a public realm.

---

<sup>3</sup> "Kako koristiti Twitter u poslovnom okruženje"

[[http://www.economy.rs/biznis-mali/46/saveti/online-drustvene-mreze/Kako\\_koristiti-Twitter-u-poslovnom-okruzenju.html](http://www.economy.rs/biznis-mali/46/saveti/online-drustvene-mreze/Kako_koristiti-Twitter-u-poslovnom-okruzenju.html)] (20.02.2014)

**Direct Message (DM):** A private 140-character message between two people. One can decide whether to accept a Direct Message from any Twitter user, or only from users they are following, which means a Direct Message can only be sent to a user who follows them back.

**Hashtag (#):** A way to denote a topic of conversation or participate in a larger linked discussion (e.g. #AmericanIdol, #Obama). A hashtag is a discovery tool that allows others to find tweets according to topics. One can also click on a hashtag to see all the tweets that mention the topic in real time - even from people they don't follow.<sup>4</sup>

With regard to design, a company's Twitter account should be branded in accordance with the theme and colours of the company's website, including blogs, logos, pictures and etc. Once a company's profile is personalized, the user can start tweeting. Companies can search the website 'search.twitter.com' to find topics of interest to the company's target customers.<sup>5</sup>

It is important to follow the most active users in the Twitter community and to pay attention to what kind of content they post, as well as to refer to their followers. Following potential clients, colleagues and experts in the business environment is also a way of showing them that you care about their opinions as end-users.

Following Twitter users is another way of motivating online users to follow you back so they will see tweets of company products, providing an opportunity for end-users to contact the company. Twitter users can also contact the companies they follow through a private direct message.<sup>6</sup>

Opportunities for marketing and business on Twitter include:<sup>7</sup>

- Fast access to information
- Rich access to potential clients, associates and other contacts
- The opportunity to create a personal and/or company brand free-of-charge
- Free traffic to the official company website
- Free promotion of events and other public relations

<sup>4</sup> [http://mashable.com/2012/06/05/twitter-for-beginners] (18.02.2014)

<sup>5</sup> "Kako koristiti Twitter u poslovnom okruzenje"

[http://www.economy.rs/biznis-mali/46/saveti/online-drustvene-mreze/Kako\_koristiti-Twitter-u-poslovnom-okruzenju.html] (20.02.2014)

<sup>6</sup> Koloska, K. (2011), "Menadziranje so socijalni mrezi za ostvarivanje na biznis celi", [Managing social networks for fulfilling business goals", Skopje, p. 102.

<sup>7</sup> Twitter (2014), "Twitter za biznis" [Twitter for Business], ed. 1.0, [www.internetmarketing.com.mk] (22.02.2014)

- The simplest channel for receiving feedback
- Employment opportunities
- Excellent service for creating a database of useful links, information and observations

Twitter is an additional tool that companies can use to promote their products and also to follow the opinions of users and maintain constant communication, allowing the company to improve the quality of products or services offered.

The advantage of social media is that it enables the swift gathering of information about the opinions of the public and individual users regarding the products offered by the company. This is an improvement on the classical marketing approach which required marketing managers to make personal presentations or to contact customers directly through phone calls or face-to-face surveys to find out their opinions about the quality of the products or services of a company.

### **3. The advantage of LinkedIn**

LinkedIn is an online resume that was created as an online business network. It is not the same type of social network as Facebook and Twitter since LinkedIn serves to connect people for business purposes rather than for the purpose of commenting or talking to one another. It is an important part of the social network package for company leaders and employees.

The LinkedIn platform is a social utility which, together with Facebook and Twitter, makes up a complete set of tools through which companies can represent their businesses in the digital world.

LinkedIn is a social network used by many experts throughout the world, covering 170 industries and 200 countries. The website was launched on 5 May 2003, when the five founders invited 300 of their most important contacts to join the network. A year later, LinkedIn had more than 4,500 online users.

A LinkedIn profile allows an individual to find and meet potential customers, experts in a particular area. LinkedIn enables new business opportunity collaborations, allows companies to find new employees, and

enables employees to find new jobs in corporations that will help them achieve their career goals.<sup>8</sup>

On LinkedIn, companies can create profiles in order to present their work to a wider audience. Connecting to companies or people is performed in a similar way to the Facebook platform. Today companies use LinkedIn to connect with those candidates who are best qualified to work for them.

#### **4. The advantage of Forums and Blogs**

The modern way of seeking out ideal candidates for a certain job is to search through online communications and to conduct online interviews with candidates in order to save time and money. From this we can observe that LinkedIn is an important additional platform to Facebook, since it offers time-saving technology and gives opportunity to present the company with activities and to review potential job seekers.

Blogs are another way in which users can share and exchange opinions about certain topics. Blog discussions are typically longer than those on other social networks. Blogs are places where people can write and promote their own work.

In Company Blogs, companies share details and features about the products they offer on the market, and they can open discussions about what changes the company needs to make to their products. This means companies review the products of other companies.

In Customer Blogs, companies follow the opinions of users to gain customer feedback on the positive and negative aspects of the products they offer on the market. Blogs and forums created by administrators companies establish topics and open discussions related to the particular products or services they offer. Through these blogs, potential customers receive information about the quality of companies' products and services.

The advantage of blogs and forums is that they get information. They are also an additional place for companies to advertise online, creating opportunities for companies to broaden the range of their online advertising.

---

<sup>8</sup> Damnjanovic, Vesna, Vladimir Matovic, Slavica Cicvaric Kostic, Milan Okanovic. (2012), *"The Role of the LinkedIn Social Media in Building the Personal Image Faculty of Organizational Sciences"*, Belgrade: University of Belgrade.

## **Conclusion**

Many companies are increasingly advertising online. With the development of technology and new ways of working in companies, businesses are increasingly turning to the virtual world, also called 'e-business'.

Our goal in this paper is to clarify the advantages of social media in terms of promoting products and services online. Through social media, companies can reach potential clients faster than through standard advertising practices. Companies can send individual or group messages and promote their brands, saving time and resources.

From this we can conclude that:

- Social media has a major impact on everyday life.
- People can easily and quickly get the information they need.
- Companies can cheaply and easily promote themselves and their products and services online.
- Companies can access much larger audiences.
- Companies can easily obtain feedback on certain products and services.
- Social media offers online advertising.
- Social media represent the easiest-to-use communications tool available.
- Social media save time and resources.
- Companies can use social media to obtain a positive online reputation.
- Social media enable the conduct of online surveys.
- Social media allow for the creation of a Personal brand.
- Social media facilitate easy exchange of knowledge.
- Companies can gain public attention and popularity through social media.
- Social media enable individual and group interaction

Some companies also offer their managers online certification through exams relevant to their profession. These courses run by managers are responsible for leading the company's social networks and online advertising. Social media has a major impact in the promotion of companies online. Through Facebook, Twitter, LinkedIn, blogs and forums, companies can follow users' engagement and interaction.

Social media is a social virtual community where people can exchange knowledge and opinions. The advantages of social media are based on:

- Functions between companies and users.
- Information exchange between companies and users.
- To improve accessing, organizing and communication information's.
- To improve the interactivity and perceptual experience.
- To gather information about customers via surveys and contests for new product development.
- Relationship building.
- Improve sales.
- To rich bigger customer audience.

This does not mean that traditional methods of advertising will die out altogether, but the company's marketing is managed in a modern way. Online ads can be set up very simply on social networks. Companies can put online banners, pictures and buttons allowing potential customers to gain access with one click to detailed information about the products and services they offer.

### **References:**

1. Boyd, D. M., and Nicole B. E. (2007), "Social Network Sites: Definition, History, and Scholarship", *Journal of Computer-Mediated Communication*.
2. Chu S. (2011), "Viral advertising in social media: participation in Facebook groups and responses among college-aged users", *Journal of Interactive Advertising*, 12(1),30-43, in *American Academy of Advertising*, 30-43.
3. Damnjanovic, Vesna, Vladimir Matovic, Slavica Cicvaric Kostic, Milan Okanovc. (2012), "*The Role of the LinkedIn Social Media in Building the Personal Image Faculty of Organizational Sciences*", Belgrade: University of Belgrade.
4. Facebook Statistics (2014),  
[<http://www.statisticbrain.com/facebook-statistics>] (18.02.2014)

5. Koloska, K. (2011), “*Menadziranje so socijalni mrezi za ostvarivanje na biznis celi*”, [Managing social networks for fulfilling business goals], Skopje.
6. Kwak H., Lee C., Park H., and Moon S. (2010), “What is twitter, a social network or a news media?”, Department of Computer Science, KAIST.
7. Twitter (2014), “Kako koristiti Twitter u poslovnom okruzenje“ [How to use Twitter in social environment], [http://www.economy.rs/biznis-mali/46/saveti/online-drustvene-mreze/Kako\_koristiti-Twitter-u-poslovnom-okruzenju.html] (20.02.2014)
8. Twitter (2014), “Twitter za biznis” [Twitter for Business], ed. 1.0, [www.internetmarketing.com.mk] (22.02.2014)

**Interner resources:**

1. Facebook Statistics: (2014) available at: <http://www.statisticbrain.com/facebook-statistics/> 18.02.2014
2. Twitter (2014) available at: [http://www.economy.rs/biznis-mali/46/saveti/online-drustvene-mreze/Kako\\_koristiti-Twitter-u-poslovnom-okruzenju.html](http://www.economy.rs/biznis-mali/46/saveti/online-drustvene-mreze/Kako_koristiti-Twitter-u-poslovnom-okruzenju.html) “Kako koristiti Twitter u poslovnom okruzenje“ (20.02.2014)
3. Twitter (2014) available at: [www.internetmarketing.com.mk](http://www.internetmarketing.com.mk)  
Twitter - edition 1.0, 22.02.2014



## Guidelines for Authors

*Economic Development* is an international journal publishing scientific and professional papers of economic theory and practice in broader sense, referring to different scientific fields (economics, management, demography, etc.) and scientific areas, as well as interdisciplinary papers. The journal also publishes other articles of scientific and professional interest: essays, professional papers, reviews and book reports, notes on scientific meetings, and alike. The journal is looking forward to cooperation with researchers from the country and abroad.

The journal publishes papers written in English language however, papers in other languages can also be published with a special decision by the editorial board.

The journal will accept only those manuscripts that have not been published or accepted for publication, nor are being considered for publication elsewhere. The authors guarantee that the paper accepted for publishing has not been published before in other publication.

The papers are subject to review and scientific categorization. Based on that, the paper can be categorized as: 1) original scientific paper; 2) notes; 3) preliminary communications; 4) reviews; 5) conference papers; or 6) professional paper.

The paper should be written in *MS Word*, font *Times New Roman*, font size 12, line spacing 1. The articles should not exceed 4000 words, while other manuscripts (essays, professional papers, reviews and book reports, notes on scientific meetings) should not exceed 2000 words.

The manuscript should be arranged in the following order: *authors' names, title of the article, abstract, text* (structured in several sections), *conclusion*, and *references*. The *abstract* (in 100-200 words) should contain concise overview of subject of the paper, methodological approach, main results and conclusions. Five **key words**, and **JEL** classification number should be written under the abstract.

The papers are submitted to the editorial board of the journal by electronic mail. The first page should include author's name, academic title (if any), affiliation(s), complete mailing address (including e-mail, telephone and fax numbers). Submitted paper should be written in English language (professionally edited and grammatically correct).

**Quotations and notes** should be elaborated as footnotes and marked successively with Arabic numbers. The scope of quotations and notes should be limited to 15 lines.

**References** in the text should be cited as follows:

(Rosenbloom, 2004: 56-70)

Abbreviations such as "ibid", "op. cit" are not used.

**Tables, graphs, pictures** and other illustrations should be presented in Arabic consecutive numbers. The references or data sources of the tables and graphs should be cited below, preceded by any additional comments or explanations. Tables, graphs, pictures and other illustrations are prepared in black and white techniques presented appropriately in the text. All graphs and illustrations and diagrams should be additionally submitted in their original electronic form (jpg, gif, xls, and alike). If presented data have been previously published, it is the authors' responsibility to obtain any required permissions prior to submission.

### **References**

References should be listed in alphabetical order at the end of the article, in the following manner:

#### Books:

Rosenbloom, B. (2004), "*Marketing channels: a management view*", Mason: Thomson South -Western

#### Articles in journals:

Helpman, E., Melitz, M. & Yeaple, S. (2004), "Exports versus FDI with heterogeneous firms", *American Economic Review*, 94(1), 300-316.

#### Internet source:

Cassarino, J.P. (2009), "*EU Mobility Partnership: Expression of a New Compromise*" in: Migration Policy Institute-Migration Information Source, September 2009,

[<http://www.migrationinformation.org/Feature/display.cfm?ID=741>]

(28.11.2009)

Corporate source:

OECD (Organisation for Economic Cooperation and Development) (2003), “*National accounts of OECD countries*”, Vol.1, 1990-2001, Paris: OECD

If there are more papers cited from one author and published in the same year, letters are added to the year. e.g. (2010a), (2010b), etc.

Upon submission of manuscripts the editorial board 1) sends the paper to a researcher-reviewer 2) informs the author about possible suggestions or comments on the manuscript that need to be revised or 3) informs the author that the paper has been rejected. Only positively reviewed manuscripts are published in the journal. Provided the manuscript is refused, (the editor is not obligated to present reasons for refusal), the author may submit the paper elsewhere. Submitted manuscripts will not be returned to the author. Once the manuscript is accepted for publication, the author must not publish the paper in other journal without consent of the editorial board.

The papers should be sent in electronic form to the editorial board of the journal on the following e-mail address:  
E-mail: [eis@ek-inst.ukim.edu.mk](mailto:eis@ek-inst.ukim.edu.mk)

