THE INFLUENCE OF THE BUSINESS CLIMATE ON THE STRATEGIC DECISION-MAKING PROCESS OF THE FOREIGN COMPANIES OPERATING IN MONTENEGRO

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Abstract

The Balkan market has been proving to be, for some years, one of the most dynamic and active ones - thanks to the reforms implemented by local governments, aimed at opening up to foreign companies in order to acquire the technology and know-how needed to comply with Western development standards, in view of a future entry into the EU.

In particular, among the countries in this area, Montenegro is now playing an important role, due to the high degree of attractiveness achieved by improving the business climate, which is increasingly directing Foreign Direct Investment (FDI) towards this country.

Following a brief analysis of the main forms of Foreign Direct Investment, the present work is aimed at examining what fields have experienced an improvement in the business climate in Montenegro and how this has influenced the development strategies of foreign companies (particularly Italian ones), thus yielding an economic benefit to corporate investors as well as to the country itself.

To this end, an analysis was carried out using the data collected from interviews with the managers of the companies located in Montenegro, based on ten indicators: Starting a Business, Dealing with Construction Permits, Employing Workers, Registering Property, Getting Credit, Protecting Investors, Paying Taxes, Trading Across Borders, Enforcing Contracts, Closing a Business. The final results were then compared with those obtained, on average, in the Balkans.

JEL Classification: F43, L26, M13.

Key Words: Growth; Business Climate; Entrepreneurship; Strategies; Montenegro

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1. Introduction

The increasing globalization of the world economy has made the business decision-making process much more complex than before, because of the number of variables coming into play which the top management of a company must carefully weigh up to avoid unfortunate business choices.

The growing need for internationalization, involving the search for strategies (direct or indirect export, partnerships with local investors, or foreign direct investments) allowing competitive advantages, leads entrepreneurs wishing to choose the most attractive market, to analyze such factors as: the extent of the market itself, the economic and political stability of the country, the existing skills and know-how in the area, the existence of skilled human resources, labour costs, the quality of transport and logistic infrastructures, contained energy costs, a favourable tax and regulatory framework.

The Montenegrin market seems to be the most interesting one in the Balkan area, because of the numerous reforms implemented, aimed at improving the business climate, in order to attract those foreign investors who, thanks to their technologies and know-how, are able to accelerate the process of harmonization of the country with Western standards, in view of a forthcoming entry into the EU.

Thus, the process of liberalization of the country, starting with the privatization of large local companies such as Niksic steelworks, Telekom Montenegro, Podgoricka Bank, Montenegrin Railways, Montenegro Airlines, represents just the beginning of an ambitious project that, following the Government intention, aims at making the country play the role of the new “Balkan Switzerland”.

Therefore, starting from an analysis of the reforms implemented and of the main indicators dealt with, the present work aims at assessing, first, whether those reforms have brought about a real benefit in the business climate of the country; secondly, at evaluating their economic, social and strategic impact on businesses and finally, at examining the impact that such reforms have had on the Italian presence in the country as well as how the latter has strategically changed from a sectoral perspective.

In order to carry out the present study, the starting point for the methodology adopted was the survey carried out by the World Bank and elaborated in the annual report drawn up by the Doing Business team in collaboration with experts from academia and involving 183 countries.

The report has been drawn up by interviewing more than 8,000 local experts (lawyers, accountants, business consultants, government officials, shippers) who answered questions about legal and tax issues, either in writing or in interviews (analysing the legal status of the businesses, their size, their market position and the nature of the operations carried out); the final results, properly revised, have the advantage of being compared, over time, between the countries as well.
Ten indicators,\(^1\) considered as valid for all countries, were selected for the survey but, in particular, five of them, those being mainly the object of reforms by the Government, will be taken into consideration by the present study, namely: Starting a Business, Employing Workers, Getting Credit, Protecting Investors, Paying Taxes.

For each indicator selected, the main reforms implemented and their impact on businesses were treated briefly, comparing the above-mentioned indicators with the average data collected from the area which the country belongs to.\(^2\)

For the sake of informational accuracy, it has to be specified, that a major requirement for the methodology adopted is that the company is aware of any information needed about how to operate and how to complete the procedures, that the statistics relate to the most economically important towns in the country and concern limited liability companies (or similar); in addition, the standard case analysed only considers some specific issues and not all the problems affecting a company and the indicators issued represent the average of the various answers by the interviewees.\(^3\)

2. Reforms

As already noted in the introduction, the Montenegrin Government is distinguishing itself for the reforms implemented, aimed at improving the business climate in the country, in order to attract foreign investors.

- Following the analysis of the indicators which were the object of reforms in recent years, the first indicator examined is related to starting a business (Starting a business).

  In this context, the Government has taken important steps to attract foreign investors, offering them the same treatment as local companies, reducing the time and costs of starting a business, allowing investors to transfer or reinvest profits if they comply with the Revenue system, and abolishing tax on the profits gained by the companies.

\(^1\) The indicators analysed are the following: Starting a Business, Dealing with Construction Permits, Employing Workers, Registering Property, Getting Credit, Protecting Investors, Paying Taxes, Trading Across Borders, Enforcing Contracts, Closing a Business.

\(^2\) The country is part of Eastern Europe and Central Asia area involving the CEFTA member countries (Albania, Bosnia and Herzegovina, Croatia, Kosovo, Macedonia, Moldova, and Serbia) and the EU members (Bulgaria, Slovenia, Romania and Poland), the Baltic Republics (Estonia, Lithuania, Latvia) as well as another 12 countries belonging to the area: Armenia, Azerbaijan, Belarus, Cyprus, Georgia, Kazakhstan, Kyrgyz Republic, Russian Federation, Tajikistan, Turkey, Ukraine, Uzbekistan. For further information see: http://www.doingbusiness.org/EconomyRankings/?regionid=2

\(^3\) For further information about the methodology adopted see: World Bank, 2010, http://www.doingbusiness.org/MethodologySurveys/MethodologyNote.aspx
In this respect, start-up firms (limited companies or joint-stock companies, partnerships with local investors, as well as local branches or representative offices) will be exempted from paying tax on the profits gained: for a year, in the case of commercial, financial as well as insurance investments; for three years, in the case of new firms engaged in other activities; for five years, in the case of either companies located in deprived areas or those firms involving total foreign investment or investment exceeding 50% of the capital; for ten years, in the case of those companies located in duty free zones (such as the Port of Bar).

These regulations will not apply to those companies which stopped carrying out an activity similar to the new one, during the three years preceding the starting up of the new company.4

Analysing the data relating to this indicator, it can be seen that the development of new businesses has been encouraged by the streamlining of bureaucratic procedures (Time, days) in terms of number of days needed to complete them, that, compared to 2008, has been practically halved, namely 13 days against 24, turning out to be lower than the average of the area by 17.4 days in 2009; despite this, the procedures number (Procedures, number) (the main ones being the decision of starting up a business, filling a form and a statutory declaration)5 still remains high, being twice the number of the procedures needed in the other countries belonging to the eastern Europe and Central Asia area, i.e. 12 procedures against an average of 6.7.

Another factor favouring business starting up in the country is represented by the low initial costs to be borne by the partners (Cost, % of income per capita) which are about 1/3 of the average costs in the area (2.6% of income per capita against 8.3%).

In addition, the minimum capital needed to start up limited companies (Min. capital, % of income per capita) is, actually, symbolic, (1 Euro), while, on the other hand, the percentage of the minimum capital that previously had to be compulsorily paid in advance, before the establishment and registration of the company, was abolished.

Such reforms have led the country to progress in the rankings, in respect of this indicator, from 107th, in 2009, to 85th, in 2010, out of the 183 economies examined (World Bank 2010).

- The second indicator considered, was the one relating to hiring workers (Employing workers), for which the Government object was to make work as flexible as possible, compared to the past, with both open-ended contracts and time contracts whose length

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ranges from a minimum of 6 up to a maximum of 10 years, involving 3 kinds of contracts (general, sectoral and individual).  

Moreover, in order to promote employment, 50% reductions of the taxable base were provided for, in the case of those companies employing local temporary staff, as well as tax exemption on corporate profits, according to the number of people in need hired by the companies and calculated by considering the total staff of the companies themselves. The positive results of such reforms are supported by indexes. In fact, as an example, considering the rigidity of employment index (Rigidity of employment index)\(^ \text{7} \) ranging from 0 (maximum flexibility) to 100 (indicating the maximum rigidity of regulation), it scores just 13 points (i.e. less than half the average in the countries of the area scoring 29.2 points), confirming the high flexibility of work in the country.

Finally, as to dismissal costs, calculated according to the number of weeks to be paid to the dismissed employee (Redundancy costs, weeks of salary), they amount to 28 weeks, in line with the 27.8 weeks average of the countries of the area (World Bank, 2010).

Thanks to such positive indexes, this indicator got the best annual performance among the 10 indicators examined, so that to make the country progress again from 93\(^ {\text{rd}} \), in 2009, to 46\(^ {\text{th}} \), in 2010, allowing it to rise 47 positions in the rankings and to rank 2\(^ {\text{nd}} \), following after Macedonia alone, among the CEFTA (Central European Free Trade Agreement) member countries.

- The indicator relating to getting credit (Getting credit) records very good results as well, thanks to the reforms implemented.

In fact, the introduction of the Euro, the Law on banks and on the Central Bank as well as that regulating bankruptcy, liquidation and the protection of deposits are just some of the most significant reforms.

More recently, a new credit public registry has been established, providing detailed information on the amount of loans granted both to individuals and businesses, as well as the first guarantee fund for SMEs in the country, namely the

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6. The general contract is made between the employers' associations and trade unions, the sector one is valid for certain industries and the individual one is stipulated between the union representatives of the employer and of the manager.

7. This index is the result obtained from the average of 3 sub-indexes: the index of difficulty in recruiting staff (Difficulty of hiring index) examining the existence of fixed-term contracts, even for permanent work, and their expiration, the rigidity of hours index (Rigidity of hours index), checking the existence, in the contract, of work at night or at weekends as well as the number of weekly hours of work and finally the one measuring the degree of difficulty in dismissing employees (Difficulty of redundancy index) signalling whether or not the dismissal of an employee or a group of nine employees, needs a public body to be informed and to issue authorization for it. See: World Bank, 2010, http://www.doingbusiness.org/ExploreEconomies/?economyid=210
Montenegro “Confidi”, both of which allowing the country to rank 43rd in the
general list (World Bank, 2010).

In particular, among the most significant indexes, two are worth noticing. The
first one describes the effectiveness of security and bankruptcy laws that would
facilitate getting loans (Strength of legal rights index), showing an optimal value
equal to 9 on a scale of values of 0 to 10, well above the average of 6.6 of the
countries in the area; the second relates to the percentage of businesses and pri-

tate individuals surveyed in the public registry (Public registry coverage, % of
adults) providing data on unpaid debts or credits in the last 5 years; the above
index reaches a value of 27.6% of the adult population (aged over 15 years), three
times the average of the countries in the area, i.e. 9.7%.

However, no private credit registry (Private bureau coverage, % of adults)
exists in the country yet; on the other hand, the index relating to the degree of ac-

cessibility and quality of information about credit (Depth of credit information in-
ex), that can be found in private or public registries, is to be improved, showing
a value which is equal to 2, on a scale of 0 to 6, thus lower than the area average
of 4 (World Bank, 2010).

Another indicator that benefited from the reforms implemented is the one relating to
protecting investors (Protecting investors).

The government has in fact, finally, guaranteed that the investor has the cer-
tainty of his right of ownership, which will be lost only in case of public security,
upon a compensation, however, equalling the value of the expropriated property;
in addition, the investor will get interest at the LIBOR rate, calculated according
to the time between expropriation and compensation; moreover, the proportional
rates fixed by the Government range from 0.08% and 0.80% and can be applied
to various kinds of property.9

Thanks to these reforms, the investor protection index (Strength of investor
protection index)10 scores 6.3 points, on a scale of 0 to 10, and is higher than the


8. The “Confidi” will have an authorized capital of 5 million Euros. See: Balkans and Caucasus

canicauscaso.org/ita/Cooperazione/Dalle-regioni/Montenegro-Primo-fondo-di-garanzia-per-il-
paese

9. The rates apply to property, as well as to inheritance and donations and to real estate market,
while as regards payment, this may include not only ownership and usufruct, but also the right
of user and of occupancy, the right of long-term lease as well as ownership of shares held
within the company.

10. This index is the result obtained from the average of 3 sub-indexes: the one concerning trans-
parency and disclosure of information (Extent of disclosure index), the one involving the
degree of directors’ responsibility for abuses on the company’s property (Extent of director
average value of 5.5 in the area, thus ranking the country 27th in the list, in 2010, (the best position reached by the country among the ten indicators examined) and 3rd, following Albania and Macedonia alone, among the CEFTA countries (World Bank, 2010).

Even the indicator measuring the payment of taxes (Paying taxes) benefited, in some way, from the reforms implemented, in order to give greater impetus to foreign investment.

In fact, the “Agreement against Double Taxation” signed by Montenegrin authorities with some countries, including Italy, is very important for foreign investors, as it aims at fixing the rate of tax payment in relation to the real financial potentials of the tax-payer, favouring stability and economic growth in the country, creating suitable conditions for compatibility with other tax systems as well as equal conditions for tax-payers operating within the same market, through the free movement of goods, services, people, and capital.

As to tax rates, the most important changes concern the following: the personal income tax amounting to 15% in 2007, was reduced, first, to 12% in 2009, equalling the corporate income tax in 2010, then reaching 9%,11 VAT amounting to 17% both for products and services and to 7% in order to promote tourism, the abolition of customs duties on 95% of goods that, thanks to this, can circulate freely.12

In fact, looking at the indexes, it can be noticed that the reforms implemented led to a real reduction in the tax pressure in the country, as the profit tax (Profit tax) represents 8.3% of the profits themselves and is lower than the average value of 10.9% of the countries of the area; similarly, other taxes (Other taxes) have an impact on profits only of 1.8%, compared to the average value of 9.4%.

Even welfare contributions (Labour tax and contributions) are kept below the average value of 18.8% against 23.1% and help keep tax percentage acceptable, compared to gross profit equalling 28.9% against the average value of 43.4%.

However, what consigns the country only to 145th place in the rankings, in 2010, and that the Government should aim at improving is, on one side, the reduction in payments number per year (Payments number, per year), amounting to

liability index) and the one measuring the company’s members ability to sue directors for corporate mismanagement (Ease of shareholder suits index). See: World Bank, 2010, http://www.doingbusiness.org/ExploreEconomies/?economyid =210


12. Only a package of agricultural products are excluded from liberalization, which are considered as strategic for the country and for which Montenegro reserves the right to agree upon special tariff rates.
89, almost double the average value of 46.3 concerning the countries of the area, and on the other one, the streamlining of payment-related bureaucratic procedures (Time, hours per year), equalling 372 hours per year, well above the average of 336.3 hours (World Bank, 2010).

The analysis of both the indicators and the indexes examined, clearly shows that Montenegro has undoubtedly become one of the most active countries, not only in the Balkan region, but worldwide. The policy aimed at improving the business climate, to attract foreign investors, was greatly appreciated by both the European Union and several international bodies, such as the World Bank and the International Monetary Fund (IMF). The reason for their appreciation is that, despite the current international financial crisis, the country can boast a high GDP (that is estimated at + 0.5% at the end of 2010)\(^{13}\) as well as a consolidation of the market economy and an increased flow of foreign investment into the country itself, although some unsolved problems, such as corruption, still exist.

However, the country has progressed remarkably in the world rankings drawn up by the Doing Business team, from 77\(^{th}\) to 71\(^{st}\), in 2009 and 2010 respectively, out of the 183 economies examined, placing it above an industrialized country like Italy, ranking 78\(^{th}\) (World Bank, 2010).

### 3. Economic and social impact of reforms on businesses

In the light of the apparent improvement of the business climate, the impact of reforms on businesses will be checked from an economic, social and strategic point of view.

First of all, it turns out that the streamlining of bureaucratic procedures and the reduction in costs of starting up new businesses, not only increased their number but also improved their performances, compared to the past, due to both a reduction in entry costs and an increase in productivity per employee.\(^{14}\)


\(^{14}\) In fact, the study indicates that, on a sample of 97 countries included in the Doing Business rankings, a cost reduction of 80% of per capita income has increased the total productivity of businesses of about 22%. In addition, following an analysis made on 157 countries, the same reduction in entry costs results in an increase of approximately 29% of productivity per employee. See: Barseghyan, L., 2008, “Entry Costs and Cross-Country Differences in Productivity and Output”, *Journal of Economic Growth*, 13 (2): 145-67.

From a strategic point of view, this result is explained as a consequence of abolishing barriers to entry, resulting in increased competition, thus leading to, as is the case in Mexico (a developing country like Montenegro), a reduction in prices of approximately 1%, which corresponds to a reduction in the income of the existing businesses amounting to about 3.5%; a situ-
Another consideration, in this respect, is that relating to the movement of labour and capital from one sector to another, which greatly increases at times of financial crisis like the present one, due to the streamlining of formal procedures and reduced costs associated with starting up a business (Ciccone and Papaioannou, 2007).

Strategically, in fact, when the fixed costs of starting up a business are high, it is more difficult for entrepreneurs to work a transformation of the firm’s range of activity from one sector to another offering, at that moment, better prospects of opening up to foreign markets, reducing, as a matter of fact, the interest of the firm in entering a new market (World Bank, 2009).

As to the hiring of workers, it can be stated that, a labour legislation making work more flexible than the present one, will undoubtedly allow further benefits in terms of increasing commerce and industrial production as well as of reduction in the unemployment rate.\(^{15}\)

The creation of the public registry on credit was very important as well, for businesses that, now, have access, particularly in transition countries, twice as fast as large firms (Brown and Zehnder, 2007), due to the increased number of loans repaid by entrepreneurs to their financial backers, compared to the past.\(^{16}\)

\(^{15}\) This consideration is supported by the results of an investigation carried out on 1948 retail businesses in Indian metropolises, according to which legislation making work more flexible would lead to 22\% increase in trading activities. See: Almeida, R. and Carneiro, P., 2008, Forthcoming. “Enforcement of Labor Regulation and Firm Size”, Journal of Comparative Economics.

In fact, evidence of what is stated above is supplied by another investigation, carried out in Brazil, showing a reduction in employment due to high rigidity of labour legislation.

In addition, further benefit, brought about by work flexibility, is represented by 15\% increase in industrial production as well as by the reduction in unemployment in Indian towns, while, on the other hand, 20\% decrease in production is witnessed in western Bengal, because of high rigidity in the country. See: Philippe, A., Burgess, R., Redding, S. and Zilibotti, F., 2008, Forthcoming. “The Unequal Effects of Liberalization: Evidence from Dismantling the License Raj in India”, American Economic Review, 94 (4): 1397-1412.

\(^{16}\) Generally, there was an increase in the use of credit equal to 4.2\%, mainly due to a higher percentage, compared to the past, of loans repaid by entrepreneurs to their financial backers (about 80\% in developing countries like Montenegro), because of advertising, on the register, about their degree of solvency that, if negative, would prevent them from being granted new loans, in the future. See: Brown, M., Jappelli, T. and Pagano, M., 2008, “Information Sharing and Credit: Firm-Level Evidence from Transition Countries”. Finance Working Paper 201, European Corporate Governance Institute, Brussels.
In addition, it is to be noted that the reform highlighted, among other things, makes it harder for some businesses to manage illegal income, due to a more careful monitoring than before (Claessens and Perotti, 2007).

The importance of implementing a reform protecting investors has certainly helped attract foreign investors that, with their technologies and know-how, can help reduce the existing gap between a developing country like Montenegro and industrialized countries.  

With regard to tax cuts, the introduction of both personal income tax and corporate income tax, amounting to 9% (among the lowest in Europe), has allowed, finally, expedited bureaucracy and greater respect for the law and transparency in enterprise accounting, thus giving new impetus to private investment and to the development of new businesses in the country.

In fact, it was noted that a lower internal revenue often makes the procedures for payment of taxes easier (Diankov, Ganser, McLiesh, Ramalho and Shleifer, 2008).

4. The new strategic trend of businesses in Montenegro

In the light of the impact of the reforms on business strategies, it can be noted that, in recent years, entrepreneurs have oriented their choice towards a direct presence on the territory, under various forms (trade and production subsidiaries, equity joint-ventures between Italian and local entrepreneurs, agreements on technology and know-how transfer, etc.).

This consideration is supported by observing the growth in FDI (Foreign Direct Investment), rising, in recent years, from 10.6 million Euros, in 2001, to 895.2 million Euros, in 2009 (ICE, 2010).

Going deeper into the analysis, the question is whether this increase is due to inflow or out flow FDI.  

The analysed data about the unemployment rate in the country, showing a remarkable decrease between 2001, equalling 31.5%, and January 2010, equalling 11.4%,


make us understand that FDI can be considered as inflow, which is typical of an open economy, able to attract foreign investment into the country (ICE, 2010).

As to their evolution over time, a distinction has to be made. Until 2007, they were mostly of the brownfield kind, due to privatization of the main sectors in the country, while the greenfield ones played, mostly, a secondary role, being mainly made by local investors having limited capital. In recent years, thanks to the improvement of the business climate, new activities have experienced growth, carried out by foreign investors, even in the form of SMEs (Small and Medium Enterprises), mainly of the limited liability kind, needing just a symbolic authorized capital (1 Euro) to be started up.

It is worth noticing that entrepreneurs consider this kind of investment as less risky than acquisition because of the possibility of deferring the investment over time and of operating gradually in the foreign country, (starting, for example, with a sales department, then followed by a warehouse and a first phase of assembly, up to completing the whole production process) as well as of benefiting from the competitive advantages of the parent company and from their cultural homogeneity.

As to the strategic orientation adopted by companies, it can be inferred, supported by the data available, that it is mostly oriented towards the global one, specifically favouring greenfield investment, rather than the multidomestic one.

The global strategic orientation is indeed realized, when local authorities stimulate the entry of foreign companies, if the latter have sophisticated technology secured by patents or the know-how of the company owner, in the presence of significant economies of scale and if they have plants producing beyond the absorption capacity of the country, as well as a high value-added transport of goods which is considered not to be economically disadvantageous for the company.

Considering the data supplied from a strategic point of view, various reasons account for the development of FDI in the country.

A first motivation is accounted for by a better adaptability of the product to the specific needs of the local market, because of easier collection of information and better contact with customers.

It was noted, in fact, how companies (the Italian ones, for example) that can achieve a cost advantage resulting from their own resources (in such sectors as fashion and food where better technology and know-how than the developing countries are available), tend to outsource the research and development function as well as the commercial one, leaving their business in the country of origin if the cost of transport particularly affects the total cost.

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20. The empirical investigation was carried out on 287 subsidiary companies working in 22 countries and related to 104 international companies. See: Bertoli, G. and Valdani, E., 2006, International Markets and Marketing. Egea, Milano.
A second reason is due to the need, especially for the industrial sector, to provide a high quality pre- and post-sale service, that not only allows customers to interface directly with the manufacturer, but also allows the latter to avoid the bull whip effect\(^{21}\) by eliminating the stocks-in-trade which are typical of indirect export involving a broker.

Another important reason is getting around barriers concerning tariffs or other items through operating directly abroad. It must be said, however, that those barriers were abolished for 95\%, in Montenegro.

In addition, SMEs are often driven by the opportunity of achieving a better control of the market niche in which they operate that, mostly through a direct presence in the territory, allows them to be more efficient in a given sector.

A motivation affecting the choice of some entrepreneurs to invest abroad is, surely, that of being able to influence the buyers psychologically, by the mere fact of belonging to a leading country in a specific field (as is the case with the Made in Italy label in the field of fashion, food, etc.).

Therefore, the main customer of a company often decides to internationalize, compelling, in fact, the supplier as well to follow, in order to operate in a just-in-time perspective involving continuous flows of goods between the forward firm and its suppliers, so as to reduce the waiting downtime and leftover stocks in the warehouse.

Finally, the opportunity, for a firm, to benefit from international contracts providing for the transfer of technology and know-how, acquiring a stake, though a minority interest, in the developed country company (as is the case for Montenegro), can represent a good opportunity for investment.

In fact, that transaction has two advantages for the buyer company.

On the one hand, it has not to pay the full amount for the transferred technology (which is paid proportionally) and, on the other, the company secures itself the necessary support, by the other party, to start up and operate the new plant.

5. The influence of the business climate on the Italian presence in Montenegro and future prospects

In 2009, Italy became the main partner of Montenegro, for FDI, outdoing Serbia. As to the trade balance, in 2008, it was, for the first time, favourable to Italy, approaching 19 million Euros, a trend that rose, in 2009, to almost 55 million Euros, with exports representing 6.73\% of the total (ICE, 2010) and that was confirmed in the first six months of 2010 recording 32.1 million Euros.

\(^{21}\) By this term, we mean the deviation of demand in logistics. See: Mariotti, S. and Mutinelli, M., 2003, International Growth for SMEs, Il Sole 24Ore, Milano.
The improved business climate led to increased Italian businesses’ investment in Montenegro due to a number of factors that we shall now examine.

A) First of all, a stable macroeconomic policy as well as an economic system that is open to foreign investment, witnessing an increase of 5.4 points in the economic freedom index in 2009 as compared to 2008 due to improving 7 economic freedoms out of 10; which led Italian operators to consider the country as an excellent launching pad for investment in the Mediterranean and the Balkan areas.

It so happens that the foreign investor, that has the same rights and duties as a local one, is allowed either to own 100% of the company shares or to be a minority shareholder, to buy real estate, to transfer without limit and promptly the profits coming from investment as well as to carry out any kind of investment, namely from privatization to the acquisition of assets, to joint-ventures, etc., from duty-free new equipment investment to relief from double taxation.

It is clear that what is described above has favourably influenced Italian entrepreneurs, who invested being confident that they would safeguard the following: the company’s governance, the profits earned in case of political unrest in the country, the value of transactions thanks to the use of the euro currency, the rush for companies in financial difficulties, the participation in public auctions or public bids for the privatization of some strategic sectors in the country’s economy, etc.

B) The Montenegro membership of the WTO (World Trade Organization) implied the implementation of the TRIPS agreements (Trade-Related Aspects of Intellectual Property Rights), which led, in 2008, to establishing a public office for intellectual property, namely IPO (Intellectual Property Office) that is in charge of accepting and processing the applications for national trademark registration; in addition to this, the Extension and Cooperation Agreement which came into force in March 2010, provides that, as from that date, the applications for European and international patents shall be automatically extended to Montenegro.

The adoption of these regulations weighed heavily on the Italian investors’ choice of operating in the Balkan area, since they protect the useful Italian know-how exported into the country to favour the economic and social growth of the population.

C) The enforcement of some laws concerning the taxation and welfare systems represents an unquestionable advantage for Italian companies that are thus allowed to reduce the costs of bureaucratic and welfare procedures, not to mention those relating to the payment of taxes, given that Italian tax rates are, unfortunately, the highest in the Old Continent.

Such laws can be described as follows: the corporate profit tax, expediting the bureaucratic procedures associated to the payment of taxes, limiting the costs to
set up a joint-stock company to only 10 Euros and the documents to be sent in to just 3, a reduced personal income tax equalling 9% (the lowest in Europe), as well as the payment of social security contributions amounting to 20.5% providing for an increased contributory burden on the employee, namely from 12% to 15% and a contraction in the contributions to be charged to the employer, namely from 8.5% to 5%.

D) The harmonization of the energy sector with the UE regulations on the subject, through laws regulating the use of energy sources and energy efficiency; which, in line with the strategy for energy development in Montenegro planned until 2025, has boosted the sector favouring the settling of important Italian investors in the area, namely A2A, Terna, Enel, Duferco. In particular, the above-mentioned strategy has implemented the construction plans of the hydroelectric power plant on the Moraca river, of wind power plants as well as of electric transmission networks covering the 2008-2012 four-year period.

E) The passage of the law about the quality of infrastructures as well as about intellectual property together with the issuing of an announcement of competition for the year 2010, to grant unsecured financing and subsidies to those companies that are involved in checking and safeguarding the quality of the infrastructures themselves, have helped in settling Italian companies in the country aiming at developing interesting business thanks to the privatization process involving transport.

F) Another factor that led Italian operators to invest in Montenegro was represented by the activities planned by the Government within the “Strategy of development of small and medium-sized enterprises 2007-2010” as well as the “Small Business Act”. Among these, the following are worth mentioning: the institutional support for the development of SMEs (Small and Medium Enterprises), through promoting the regional and local business centre now available in Plav and Kolasin carrying out pilot schemes aimed at developing industrial clusters; improved information networks for the companies thanks to better services for entrepreneurs, by operating a “Market information centre,” as well as the entrepreneurial management, marketing and communication promotion.

It is clear that such activities allow the new entrepreneurs to be known on the local markets, by using distribution networks to place products and suitable promotion campaigns bearing costs that are definitely lower than those to be borne by Italian companies when using the “do it yourself” system.

G) Another factor attracting foreign capital was the suppression of the double taxation that allowed the implementation of TPP (Passive Improvement Trade).

The main recipients of what can be considered as a real sub-supply of the production phase are the companies working in the textile-clothing and footwear sectors, that greatly reduce their production costs thanks to the higher specialization of the sub-supplier company.
Briefly, this operation consists in the export of either raw material or a semi-manufactured product by an industrialized country to a country that is geographically close by, like Montenegro, where the labour cost is particularly low (in 2009, the average monthly wage of an Italian-speaking worker reached 463 Euros, about 1/3 of the Italian one).

At this point, such semi-manufactured products are transformed into raw finished products and are transferred again into the country of origin to be finished off and then sold.

According to the EU regulation, when goods are re-imported they are partially taxed, the amount due being equal to the difference between the customs duties applying to re-imported goods and those paid on the goods that are temporarily exported.

From what is described above, it can be shown that, at a sectorial level, the innovation put forward by the Montenegrin Government in order to improve the business climate in the country has boosted Italian FDI in the country itself, concerning mostly Made in Italy production.

In fact, as compared to 2009 and after its collapse in 2008, the clothing industry (including leather goods) recorded an upswing along the first six months of 2010 (+7%), amounting to 5,751,000 Euros, a result that, though being slightly positive in terms of percentage, bears a higher value considering the current international recession and as a matter of fact, it ranks the clothing industry first, in terms of value, among Italian investments in the country.

Another sector, namely the food industry, whose value is internationally acknowledged, ranks second, recording a significant change in the first six months of 2010 as compared to 2009 (+17.3%) thus reaching 3,885,000 Euros, followed by the furniture industry recording a positive variation (+19.2) equalling 2,678,000 Euros in the same period.

The development of the above sectors was due to the fact that, being purely labour-intensive they benefited, mainly, from such advantages as cutting expenses, due to low labour costs in Montenegro and customs-duty exemption thanks to the use of TPP (Passive Improvement Trade) in addition to the export of the Italian know-how that, in such sectors, is a world leader.

Their success was favoured by increased purchasing power of the average consumer who has started to focus his attention on quality products that are acknowledged worldwide.

However, besides the Made in Italy development, Italian companies are leading the way in such highly technological sectors as energy, infrastructure, building as well as tourism.

As compared to the past, such innovations were mainly encouraged by the above-mentioned legislation focusing on the development of alternative energy
sources and on energy efficiency, as well as on the quality of infrastructures and on intellectual property.

In the energy sector, Italian groups (A2A, TERNA, Duferco and Enel) are worth noticing, with important investments.

In particular, the A2A electrical energy group has acquired, for 436 million Euros, 43.7% of the EPCG State-owned public service generator, thus becoming, at present, a very important strategic partner, with the prospect of acquiring, in the future, a majority stake in the firm, thanks to the agreements made with the Montenegrin Government.

“TERNA” Italian company has made a collaboration agreement with EPCG, concerning the project of a 1000 MW high voltage submarine cable allowing interconnection between the electro-energy Italian system (Pescara) and the Montenegrin one (Tivat).

Enel is going to develop a coal plant yielding a power of 800 to 1200 MW.

Finally, the Duferco company is going to build an incinerator for urban waste, yielding 85 MW of power.

As to infrastructures, interesting business opportunities are likely to be developed thanks to the Government’s desire to privatize the Zeljeznice Crne Gore railway system and the Port of Bar.

Concerning the development of the railway system, the Montenegrin Government was granted loans by the EIB and the EU for a total amount of 40 million Euros, reaching a trilateral agreement between Italy, Montenegro and Serbia to build the railway line Bar-Belgrade allowing Serbia to have direct access to the port of Bar and playing a primary strategic role within Corridor 10, starting from Salzburg, crossing Belgrade and stopping at Salonika (ICE, 2010).

With regard to this, the technical feasibility study, aimed at building the railway system, that is worth 1.4 million Euros (of which 1 million Euros to be charged to Italy and 400,000 Euros to the Serbian and Montenegrin Governments) was let out on contract to the Italferr company that is the world leader in the design and construction of railway systems (ICE, 2010).

In particular, as regards engineering, the Gatti firm has purchased the Livnica Foundry in Niksic.

As to the tourist industry, it is contributing 15% of GDP (Angelici, 2009), thanks to the efforts made by the Montenegrin Ministry, that is privatizing the largest beach in the country (Velika Plaza for which from 5 to 10 billion Euros are expected to be cashed) (Finotello, 2009) and promoting the natural and artistic beauties of the country; however, the sector needs redeveloping as regards its hotel facilities and the related services (with greenfield investments), in order to ensure high quality standards as well as developing alternative forms of tourism, for which demand is increasingly growing, as it is for farm holidays.
6. Conclusions

The present work showed that Montenegro is one of the Balkan countries that implemented the highest number of reforms in recent years, aiming at attracting those foreign investors that are needed to harmonize the country with the standards of the most industrialised European countries, in view of a forthcoming entry into the EU.

In particular, such reforms, aimed at promoting business start-ups, favouring workers’ employment, improving information about credit, strengthening investors protection and reducing taxation, would lead the country to an improved business climate, so as to rank it 71st in the world list, out of the 183 economies involved in the survey.

This improvement would be favoured, among other things, by the reduced rates of income tax (9% for both personal and corporate income tax) and customs (95% of the industrial products exchanged with the EU), as well as by the symbolic authorized capital (1 Euro) needed to start up limited companies, tax exemption on profits from 1 to 10 years according to the situation, streamlining bureaucratic procedures, a higher flexibility of work, greater banking transparency, a new public registry on credit, a guarantee fund for SMEs and by a real protection of the investments made.

The main benefits of the reforms, having an impact on the development of the economy in the country, would be as follows: the starting up of new businesses in a shorter time, greater productivity of the existing ones as well as of the employees within the companies, increased employment and movement of labour and capital, increased use of credit, greater protection of minority shareholders, lower internal revenues and visibility of corporate shadow income.

At this point, the aim of the present work was to determine whether this regulatory change would affect business strategies, apart from its beneficial effect from an economic and social point of view.

The answer is positive, since the most widely used mode of internationalization seems to be that of FDI, rising from 10.6 million Euros in 2001, to 895.2 million Euros in 2009.

These investments would be mainly inflow, which are typical of an open economy, allowing foreign investment into the country, mainly due to a reduction in the unemployment rate from 31.5%, in 2001, to 11.4% in January 2010.

In addition, as regards the evolution of FDI, according to the research carried out, the greenfield kind, once used only by local investors, is now the one preferred also by SMEs investing abroad as it is considered to be less risky than the brownfield kind, thus driving firms to develop their internationalization process through a global strategic approach rather than a multi-domestic one.

The reasons why entrepreneurs would opt for FDI could be explained as follows: the opportunity to have access to export markets reducing either costs of transport or communication time (market seekers businesses), the acquisition of inputs (i.e.
labour) at a lower cost than those available in the Internal Market (resource seekers), ease of access to information and strategic knowledge to innovate products and processes (strategic seekers), or the opportunity to centralize dispersed activities in terms of space, in the presence of economies of scale and scope (efficiency seekers).

The benefits brought about by the development of FDI in the country, would be identified in an increased level of expertise and training of human resources, the transfer of innovative technologies in the territory, the country’s integration in the global economy and international trade as well as in creating the right conditions for higher competitiveness, thus allowing business development.

However, FDI also shows a negative side whose effects could be detected in the following: the worsening of the balance of payments in the country, in case of the profits coming back into the country of origin, a change in the social fabric affecting mainly the developing countries, due to trade globalization as well as a reduced political sovereignty of the community to benefit multinationals.

The last point of the research was meant to analyze whether the evolution of the business climate in Montenegro had weakened or strengthened the position of Italy as a main investor in the country.

In this case as well, the answer is positive, considering that Italy has become the main partner of the country for FDI and that foreign trade with the country was on the credit side, for the first time in 2008, approaching 19 million Euros with further growth in 2009 up to about 55 million Euros, that was confirmed in the first six months of 2010 with 32.1 million Euros.

The high local entrepreneurial dynamism is being mainly addressed to the high-technology sectors (telecommunications, electrical energy, information technology, infrastructures etc.), such sectors in which Italy is not historically in the forefront.

As a consequence, as clearly shown by the sectorial analysis, Italian companies are increasingly focusing their strategic orientation towards high technology sectors (telecommunications, electrical energy, information technology, infrastructures) in order either to keep or to increase their market share.

Looking forward, major employment opportunities for Italian companies could be those related to large infrastructure projects such as those for the tenders supplying the Port of Bar, AD Marina Bar, AD “Montecargo Podgorica” as well as to the privatization of the State Railways (Zeljeznice Crne Gore), of Tobacco industry “Duvanski Kombinat, of “Plantaze” alcoholic wines producer and of Velika Plaza Beach (ICE, 2009).

From the scenario shown, it can be assumed that the winning strategy for start-up companies, in the future, will be to enter first into these highly technological sectors that bear, as well, a high potential of growth, by using for their huge initial investment, not only conventional financing but also the Venture Capital and Business Angels in particular (EBAN, 2006).
The local government, on its side, is expected to continue the process of reforms aimed at improving the business climate as well as to solve such problems as corruption, in order to allow the country to be increasingly involved in the global flows of investment and to make the ambitious dream of becoming the “Balkan Monte Carlo” come true.

References


