

# Research of multinational companies operating in serbia



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The current research has been realized by combining of the theoretical knowledge through the revision of the literature relevant for the existence, operations and growth of multinational companies and different spillover effects they create, as well as practical research realized in the field on five multinational companies operating in Serbia.

The first part of the literature review concentrated on various theoretical approaches concentrating on the existence, growth and business activities of multinational companies, among which the focus remains on the Dunning's eclectic paradigm and its relevance to the multinational operations.

At this point, the author would like to recall the eclectic paradigm formulated by Dunning. Dunning (1977, 1981, 1988, 1993a, 1995a, 1995b) and his eclectic paradigm attempt to explain the ability and willingness of companies to serve markets across national borders. The eclectic paradigm tends to explain why companies choose to exploit any available advantages through foreign production instead of using domestic production, exports or portfolio resource flows. Furthermore, Dunning hypothesized that a company will go for international production or engage in foreign direct investment in the case it owns net ownership advantages (mostly in the form of intangible assets) vis-à-vis firms of other nationalities in serving particular markets, and that these ownership advantages, accompanied by internalization and location possibilities, will enable a company to benefit when using or "internalizing" a particular foreign market itself, instead of selling, renting or leasing them to foreign companies (OLI advantages).

Location possibility in the context of Dunning`s paradigm means locating a multinational firm`s production activity in a foreign country that possesses competitive advantages in terms of factor endowments. According to Dunning, if these three conditions (ownership, location and internalization) are not present, the firm can instead serve its local market through domestic production and expand it to serve foreign markets through international trade. The bigger the ownership advantages of multinational companies, the more incentive they have to use these themselves. The more the economics of production and marketing favor a foreign location, the more they are likely to engage in foreign direct investment. The propensity of a particular country to engage in international production is then dependent of the extent to which its enterprises possess these advantages and the location attractions of its endowments compared with those offered by other countries (Dunning 1981: 79).

Dunning refers to his paradigm as “ the dominant paradigm of international production”. The eclectic paradigm presumes ownership specific advantages as endogenous variables, i. e. to be a determinant of foreign production. This means that the paradigm is not only involved with answering the question of why firms go for FDI, in preference to other modes of cross-border transactions. It is also concerned with why these firms possess unique resources and competencies – relative to their competitors or other nationalities – and why they choose to use at least some of these advantages together with portfolio of foreign-based immobile assets. This makes it different from the internalization model, which regards ownership advantages as exogenous variables (Dunning, 1993a: 252).

As perceived by Dunning, the eclectic paradigm is meant to capture all approaches to the study of international production. In his opinion the model represents a good starting point to discover the global explanation of MNE`s existence and growth since it synthesizes the explanations of the existence and nature of international production. Modern economic explanations of cross-border production activities of multinational firms are mostly reflected in the configuration of ownership, internalization and location advantages. Dunning has incorporated those three fractions under the wing of his eclectic paradigm, but his primary objective in doing so is still to find eclectic explanations to the phenomenon of international production.

Furthermore, Dunning states that his eclectic paradigm can give an adequate analytical framework which provides comprehension for all kinds of foreign production in services. Stressing the interdependence between services and goods industries, he asserts that “ it makes no sense to try to develop a new paradigm to explain the “ transnationality” of the service sector” (Dunning 1993a: 248-284). In his scholarly research, Dunning was assertive to find all possible explanations of the existence of multinational enterprise in his eclectic paradigm. As the years went by, he tried to expand knowledge in the framework of his eclectic paradigm by attempting to accommodate possible additional explanations to multinational production activity that come to his knowledge.

As an example, for instance, he points out that the advent of collaborative alliances among multinational firms does not lead to the development of a new multinational theory. Therefore, he has incorporated alliance capitalism in his eclectic model. In his renewed version of the eclectic paradigm in the <https://assignbuster.com/research-of-multinational-companies-operating-in-serbia/>

light of alliance capitalism, Dunning(1995a) states that inter-firm alliances (with clear reference to American multinational companies!) in innovation-led production systems, are appearing as dominant forms of market-based capitalism, and are overtaking the global influence over hierarchical capitalism. At this point, the author would like to point out that Dunning has focused on the narrow view of the value-adding activity of innovation-led capitalism, and has considered other joint ventures as insignificant. However, other authors point out to the fact that all forms of existing alliance capitalism, not wholly owned production operations, dominate the multinational enterprise involvement in less developed countries (Vaupel and Curhan 1973).

Both in theory or in practice, internalizing a foreign market and going for a joint venture alliance with a foreign partner are just two possible options that a multinational company can choose in international business activities. Therefore, alliance as a strategy can be the dependent variable, just like international production, that needs further explanations. Explanations to joint ventures overseas could also include ownership, location and internalization considerations. Border lines between the three levels of economic analysis – microeconomic, mesoeconomic and macroeconomic – have to be neglected in order to synthesize the various economic approaches to the research of multinationals.

This current research showed that multinational theories and paradigms which have been described in the literature review chapter and which include extensive individual and group researches are, at best, still in the developing phase. It could be concluded that not one of these theories, <https://assignbuster.com/research-of-multinational-companies-operating-in-serbia/>

including the Dunning`s eclectic paradigm of international production, has captured the true nature of multinational companies, as well as their existence, growth and operations. Contemporary theories on multinational companies, elaborated in detail by a number of scholars, are generally meaningful for the business operations of multinational companies in Western Europe, North America and some other parts of the world. Furthermore, as discussed in the literature review, the advantages of strategic alliance capitalism have been recognized in the literature on international business recently. On the other hand, it is evident that some scholars take it for granted and support the position that it does not require the development of the new multinational theory. For example, Dunning (1993, 1995a) has tried to include alliance capitalism into his eclectic paradigm of international production. He has attempted to integrate all major multinational theories and he has insisted on making foreign production as the dependent variable. In fact, Dunning has realized that the phenomenon of alliance capitalism is now overtaking the global impact over hierarchical capitalism. However, he has minimized the scope of alliance capitalism only to American - sponsored inter - company strategic alliances in innovation - led production systems. His tendency to perceive other forms of joint - ventures as less significant, contradicts the nature and scope of international operations in the developing countries. How can then one explain the growing trend of and dominance of multinational joint ventures in developing countries?

Asides from the joint venture, international trade represents another segment which is not clearly captured by contemporary theories on

multinational companies. According to the theoretical body, companies opt for international production following the criteria of ownership – specific advantages, location – specific advantages and internalization incentives, followed by imperfections of the markets. It could be noticed that a common position of the majority of international business scholars exist that market imperfections, for example tariffs and barriers, prevent efficient operations of international trade, and consequently the operations of multinational companies. To be more precise, internalization theory presumes that multinational companies appear due to the market failures which present an obstacle for efficient activities of international trade. However, when a company becomes multinational by having, for example, two or more stages of production processes located in at least two countries, this does not mean that international trade and other modes of business activities have vanished. Furthermore, once a company internalizes a market by setting up, for instance, a wholly owned subsidiary in a foreign country, transactional imperfections still remain present, although at a lower level than before the internalization. There is no dilemma that external transaction imperfections are present for as long as the internal market has to interact with the external open market system, having in mind the links of its supply chain to the customer ends. Therefore, as long as multinational companies interact with external markets, due to their need to supply markets with their products and services, international trade will exist and grow. In addition, it is not a surprise that multinational companies represent a significant share of international trade volume and growth, according to the reports of the United Nations. Even in extreme situation of the fully integrated vertical companies, these companies have to interact with regular, external markets

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not only for the purpose of marketing their products, but also for the marketing their excess of raw materials and intermediates.

It should be highlighted that when a company has intension of expanding its business activities to other foreign countries, a number of considerations will be taken into account, asides from ownership – specific advantages, location – specific advantages and internalization incentives. For instance, a question which arises is whether the government of the targeted host country supports the setting up of manufacturing branches without any national equity. In the case of Serbia, foreign investors are shown significant support if there is an active local participation. Furthermore, multinational companies may not decide to set up a wholly owned manufacturing subsidiary, in spite of the support of the government. It could happen that investment terms, regulations and conditions are discouraging for multinational companies. When market imperfections represent an obstacle for the efficient mode of export (due to trade barriers or tariffs), multinational company can choose another form of available modality which is in accordance with its strategic objectives and interests. Consequently, an MNE can decide to set up a fully owned subsidiary in case its objective is to have complete ownership, independency and decision – making. In cases this is not allowed by the host country, another option for a multinational company is to enter into a joint venture agreement with a local company, which would also mean a divided ownership structure, as well as control. However, both of these options represent a part of cross – border units and form and added value to a multinational system. Generally speaking, all other possibilities are to be explored by a multinational company before foreign investor makes the



decision about the modality of entry to the market of the foreign country.

The chosen modality is supposed to maximize the multinational value chain.

The basic difference between wholly owned subsidiaries and joint ventures is in the ownership, control and decision making process.

Significant part of the current research has been dedicated to the spillover effects which multinational companies produce, and their verification through the analyzed case studies. According to the revised literature, the local companies benefit from the transfer of knowledge from MNEs, only in the case when they have adequately trained human capital. This argument has been explained by the theoretical concept of absorptive capacity - referring to the fact that a local firm has the ability to recognize new knowledge, understand it, integrate it into the firm and use it productively (Cohen and Levinthal 1990, Zahra and George, 2002). The degree of spillover effects, very much depends of the host country, in the first place of the local companies and their absorption power. It is essential that the gap between foreign direct investors and local enterprises is not too large, otherwise, spillover effects can be neglected. Workforce of the country is the issue which is crucial for the absorption power. As the labor market becomes more flexible and workforce more educated the tendency towards greater absorption power increases. Data elaborated in Chapter 4 of this thesis show that Serbia has the highest English speaking proficiency in Eastern Europe. Furthermore, 42% of the total population has basic knowledge in English, followed by German and French language. Serbia offers a wide availability of highly qualified staff. The number of engineers and managers is sufficient to meet the growing demand of international companies in the country. Labor

supply is comprised of about 1.9 million employed and 750,000 unemployed, while increasing by app. 27,000 university and 2-year college graduates and 75,000 high school graduates yearly. Also, the conducted research on the four multinational companies showed that, for example in the case of Hypo Group that 78% of the employees belong to the age category of 20 – 39 years old, and that 47% of all employees have university education. Additionally, the current research determined that the Serbian work force is quite loyal to the employer and shifting jobs is much less frequent than in some Eastern European countries. Therefore, the present research is in compliance with the above stated claim revised in the literature, since it was determined that labor force in Serbia is not a cheap resource. The thing which was crucial for the penetration of FDI to Serbia is the flexibility of its labor force and its ability to learn quickly. Consequently, the absorption capacity elaborated in the literature exists in the case of Serbia and therefore, spillover effects cannot be neglected.

When it comes to the issue on the vertical spillovers, the revised literature states that they do not rely on externalities but are a part of consumer and producer surplus by market transactions. Foreign companies often purchase intermediate goods from domestic suppliers, which can create spillovers through several mechanisms (Lall 1978, Smarzynska, 2002): MNEs can improve indigenous local companies by setting higher business standards for them, based on their supply relationship, for example they introduce just in time deliveries, and they provide incentives to improve productivity processes and the quality of products. At the same time, FDI can positively affect the demand for intermediate goods, which helps local companies

achieve economy of scale. The results of the analyzed case studies in this research comply with the above stated having in mind that this analysis determined that all of the analyzed multinational companies have very strong vertical downward connections with the local enterprises. For example, Telenor realizes construction works through local suppliers in a modern way to which these enterprises are not used to. Also, the company purchases software from the local software program suppliers, meaning that local enterprises are hired to create the software components, which are specific for the Serbian market. In the case of the Hypo Bank, long-term relations with local software suppliers have been developed for the creation of specific banking software. When it comes to vertical upward relations, Holcim and Kraft Foods have engaged local trucking companies for transport and distribution of their products. The process of loading products is entirely regulated according to the standards of these companies and every transporter is required to purchase GPS system which enables Holcim and Kraft to have an insight to where the products are located in every moment. Also, for the distribution and retail sale of Telenor`s products, the company hired local enterprises. These local companies have been trained by the Telenor staff in the field of procedures which are standardized on the corporate level. In this way, new corporate standard improved the effect of local distributors.

During the present research close attention was dedicated to entry strategies of the analyzed multinational companies and their strategic objectives which motivate them in Serbia. Subsidiaries play many different roles within MNEs and differ in their interactions with the local environment

and the spillovers they create. On the other hand, the literature on MNEs impact to the host country has paid little attention to the diversity of business strategies that influence the type and extent of spillovers. Therefore, international business literature on entry strategies (Anderson and Gatignon, 1986; Hennart and Park, 1993; Estrin and Meyer, 2004) and subsidiary roles (Galunic and Eisenhardt, 1996; Birkinshaw, 2000) provided the theoretical knowledge and the opportunity to analyze links between FDI strategies and their potential impact in Serbia. Furthermore, the literature on the countries in transition (Djankov, and Murrel, 2002, Estrin, 2002), offered a comprehensive approach of the privatization concept in Serbia, confirming that in the case of Serbia, as well as in the countries of Central and Eastern Europe foreign ownership has improved productivity and profitability of these countries in the first years after the privatization. Authors in favor of the process argue that investors foreign investors are often well positioned to help and restructure a firm in crisis, which can, in the short term, mean the loss of work places for a number of employees, but alternative may be even more drastic, meaning that foreign investors are actually saving jobs by providing crucial resources and with this, ensuring the survival of the company. This point has been confirmed through the case study on Holcim Srbija a. d. cement factory, which at the time of the take over had 2500 employees. Through a carefully deigned privatization program, which included attractive redundancy packages for employees who volunteered to leave willingly, this number was consequently reduced 470 employees. In this way, a competitive market oriented company, with a realistic number of work places was created and continued to conduct its business activities with success.

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According to the analyzed literature, policymakers often prefer export-orientated FDI projects, which are expected to transfer knowledge on operating production and to enhance the trade balance by selling to the foreign markets. But some export processing operations in enclaves with few linkages to the local economy (Meyer, 2004). Other FDI provide local markets with new product and services, with or without local processing. This type of FDI transfer operational and marketing knowledge and contribute to the local economy by providing better quality products. This also impacts local competition, while export orientated does not. Both types of FDI potentially transfer resources that may lead to spillovers but their nature differs significantly. It has been acknowledged through the analyzed case studies that Serbia has more market oriented FDI than efficiency oriented FDI, with only one efficiency oriented FDI (Ball Packaging). Majority of the FDI in Serbia are market oriented and fall under the non – exchangeable goods sector. However, these investments are incredibly important for the purpose of improving the overall business climate in Serbia: the telecommunications sector (Telenor, VIP), investments in banking, insurance and retail. They not only increase competitiveness, but they also create a surrounding which can then become attractive for other efficiency oriented FDI, which is crucial for the economic stability of the country.

One of the major concerns in the revised literature on multinational companies is the labor standards in MNEs affiliates and subcontractors in emerging economies. The literature treats this issue from two sides: on one hand, concern with global standardization and the firm's reputation induces many MNE affiliates to pay higher wages and to apply high labor standards

with respect to working hours, sick leave, child labor, unionization etc.

(Caves, 1996: 228, Moran, 2002). Generally speaking, MNEs wish to keep their qualified staff and therefore they offer incentives to keep them satisfied, unless when they are employing unskilled labor with few outside job opportunities. On the other hand, lower wages and lower labor standards represent opportunities to reduce production costs. This type of concern is present in certain industries like textile, footwear and assembly of electronics. (Cerny, 1994; Scherer and Smid, 2000). Apart from firms' engagement in activities related to the wellbeing of their workforce, a rather new phenomenon is corporate social engagement via companies' participation in private and/or public-private governance schemes at the national and transnational levels (Falkner 2003; Mattli 2003; Gulbrandsen 2004). Corporate Codes of Conduct (CoCs), represent a set of rules many MNEs have adopted in areas ranging from labor practices to environmental standards. Some CoCs have been developed by individual MNEs that try to implement them not only across their global network of subsidiaries but also along their chain of suppliers. In the case of the present research, the analyzed case studies showed that multinational companies in Serbia have implemented higher labor standards concerning working hours and conditions, together with the implementation of their codes of conduct. Telenor, Holcim, Hypo Group and Kraft Foods have implemented their codes of conduct not only on their own companies in Serbia, but have also passed these set of rules to their suppliers and subcontractors.

It should also be mentioned that foreign investors influence institutional development, but at the same time they adjust to local institutions. The

literature analyses these issues separately. Authors who belong to the group of strategy scholars like Peng, Henisz and Meyer analyze how FDI strategies are adjusted to the local contexts and institutions in particular, whereas development scholars investigate how FDI influence local context. It is obvious that FDI strategies and the local environment are interdependent in emerging economies. Governments changing regulations in order to attract FDI can influence both informal and formal institutions. However, institutional framework influences the choice of MNE`s entry strategy to host region.

Moreover, according to Meyer, institutions moderate many of the relationships discussed above between foreign and local firms (Meyer, 2004):

Labor market institutions moderate the mobility of people between local and FDI firms, and thus the diffusion of knowledge, but also local firms' loss of employees to foreign competitors. Labor laws and their enforcement regulate minimum wages and working conditions.

Capital market institutions moderate the ease of local sourcing of capital, but also the possible crowding out of local investment.

Environmental regulation and enforcement influence the potential negative effects on the local environment.

Competition and industry regulation influence foreign investors' ability to extract

monopoly rents or otherwise benefit from market power.

Education systems enhance the availability of skilled labour and the absorptive capacity

Special economic zones may attract more FDI, but at the same time they limit the interaction with indigenous industry and thus spillovers.

Furthermore, a good understanding of the role of MNEs in a particular country is crucial for discussing policy in relation to MNEs. If estimation exists that the impact of MNEs is positive, an argument could be made for policy intervention to encourage FDI (Blomstrom and Kokko, 2003). However, the present research discovered an important finding of the regarding the host country: it is not possible to accurately measure the spillover effects and then express them in the currency amount, because methodological obstacles are simply too large. Therefore, it should be recommended that countries should not subsidize FDI. Some will find justification for such subsidizations in the fact that investors can not appropriate the spillover effects that create, and therefore compensation should be made to them. Such compensation is not feasible without precise measurement, not to mention the potential harm it could cause, once private interests master the country. These dangers are quite important referring to the state policies relating to the greenfield FDI in Serbia.

One of the conclusions which was drawn from this research is that multinational companies may have various modes of their cross - border activities other than international production. Therefore, identifying multinational companies with international production, as seen in the literature, is not meaningful for the setting of their operations in Serbia. As it



has been seen in the case studies, multinational companies in Serbia operate through different modalities of international production, strategic alliances, licensing and many more.

This research, as its contribution to knowledge, has identified core and auxiliary roles of multinational companies. Furthermore, their auxiliary roles have been analyzed in detail during this research, which refers to their transfer of the managerial, technical and marketing skills, research and development activities, employment, industrial and economic growth, human resource development, consumer welfare, environment protection, cultural understanding and preservation. Furthermore, it is expected that multinational companies which possess understanding of the Serbian culture are expected to have a competitive advantage in the Serbian market in comparison to companies that don't.

Majority of research on FDI in the past decade that have analyzed the net assessment " of the impact of FDI in some 30 countries over the past 15 years, adopted the " apparent positive influence on the economic welfare the host country". Similarly, the macroeconomic research of the countries has generally acknowledged the existence of the positive impact of FDI. The challenge which remains for the host country to achieve is to create the environment competitive enough to attract the best investors, thus increasing the economic growth, employment, and export possibilities of the country to the maximum.

Another useful conclusion of the research is that peaceful and stabile environment is crucial for the operations of multinational companies, in order

for them to achieve and maintain their business objectives. Therefore, political and economic reforms which have been conducted in Serbia after 2000 and are still in progress have been rated positively, as perceived by the multinational managers.

The findings of this doctoral research point to the high responsiveness of the interviewed multinational managers for the cultural aspect of the Serbian population. Namely, this perception is very much in accordance with the analyzed literature, which emphasizes the need of multinational companies to understand the culture of the surrounding where they conduct their business operations, in order to achieve and maintain competitive advantage. Moreover, the respondents generally viewed Serbian language as very important for the business activities of multinational companies in Serbia. Therefore, multinational companies operating in Serbia are expected to employ enough number of Serbian employees and Serbian speaking staff, in order to conduct their daily business activities without any problems.

Additionally, conclusion which could be drawn from this research is that analyzed multinational companies, besides from their understanding for cultural issues of their staff, also include them in the process of strategic planning and long - term decision - making. Multinational companies which want to operate successfully in the market need to respect the local commercial regulations, along with cultural and ethical considerations, in order to avoid problems with the government and citizens of the host country. This research showed that all of the analyzed companies operate successfully and this fact is positively related to their local responsiveness

and cultural awareness. This is very important for the long – term success of multinational companies in Serbia.

## **7. 2. Bias and limitations of the case study approach**

Having in mind that the methodology of this doctoral research lays upon the case studz methodology, some limitations of this method should be pointed out. For example, the authors who deal with this type of research, such as Yin (1984), Tellis, Stake and Simons identified three different types of arguments against the case study research.

Firstly, case studies are often criticized to have the lack of rigor. Yin (1984: 21) states that “ too many times, the case study investigator has been sloppy, and has allowed equivocal evidence or biased views to influence the direction of the findings and conclusions”.

Secondly, since the case studies involve a small number of analyzed subjects, in some cases even only one subject, they offer very little basis for scientific generalization,. The question which is often raised is “ How can you generalize from a single case?” (Yin, 1984: 21).

Thirdly, not rarely, case studies are marked as being too long, difficult to handle and produce and require a massive amount of documentation (Yin, 1984). This is particularly the case when it comes to case studies of ethnographic or longitudinal nature, which could extract a great deal of data over a period of time. In case the data are not organized in a proper manner and systematically, it could cause problems for the researcher.

The usual criticism of the case study method is its dependency on a single case exploration making it difficult to reach a generalizing conclusion (Tellis, 1997). Yin (1993) found case methodology “microscopic” because of the limited sampling cases. To Hamel et al. (1993) and Yin (1994), however, setting of research parameters and objectives are far more important in case study method than a big sample size.

It could be concluded that despite the above stated limitations, researchers continue to use this type of methodology, especially in the research works where real – life situations govern social issues and problems. Also, it should be emphasized that case studies are very present in the literature in various disciplines and domains.

In the case of the present research, the author based the analysis on multinational com