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THE IMPORTANCE OF ASIAN CONGLOMERATE BUSINESS MODELS IN INTERNATIONAL MANAGEMENT

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Abstract: *This paper analyzes the prominent Asian conglomerate business models in terms of contemporary international management. The paper examines their specific characteristics and contribution to increasing the competitiveness and export performance. It also reviews current and future importance of business networking in practice, with special reference to the conditions of discontinuity. The emphasis is on the significance of the implications of the Asian management in the development of conglomerates and independent business entities within them. It has been shown that important business models in the Asian market with its existence shape the conditions of profit making and the course of regional integrations. The paper displays the results of studies of Asian management and its importance for the improvement of the position of Asian conglomerates in the global market. The innovativeness of Asian management is also important as it contributes to companies' success in international business with its specific knowledge and methods. The focus is on the management of international activities and prospects of the global success of Asian business groups. Practical examples provide insight into the most important advantages that characterize the Asian conglomerate business models in the context of comparative management.*

Key words: *Asian conglomerate business models, International management, Business groups, Export*, *Competitiveness*.

1. INTRODUCTION

The complex business environment in Asia requires timely optimal business decision making in order to achieve planned economic results of operations. The current environment demands a flexible adaptation to new international markets, due to the existence of different quality and quantity of important resources, such as knowledge, capital and technology. Management of these resources is the key to the future and sustainable development of Asian companies. Bearing in mind that the given conditions are followed by increasing fluctuations within the aggregate supply and demand, and the different needs of consumers, Asian markets require a modified approach to the creation of the business model. Based on this, it can be concluded that the modelling of business ventures has to be founded primarilly on innovation. New business models in Asia can be viewed as parts of the business system, consisting of a series of interdependent links, thus creating an advantage and making competitive business viable (Mayo & Brown, 1999).

Models of modern business networking in Asia realistically reflect the growing economic prosperity of the Asian economies. The use of business opportunities to create value for consumers is visible in applying specific management skills in practice. There is a trend of business process improvement, with the aim of generating profits with the help of synergistic effects of knowledge, capital and information.

The analysis of specific characteristics of conglomerates and business groups in Asia requires exploration of the entire social and economic environment of enterprises, which is reflected in the decision making processes of managers. The impact of cultural heritage and its consequences for the management structure provide a broader picture of the reasons for the creation of innovative approaches to business. A distinctive holistic approach is featuring along with the connections with traditional values of society on the one hand and focus on future business success at the international level on the other. Multidisciplinary nature points to the continuous need of Asian management for improvement and enhancement of business processes, while achieving efficiency and developing knowledge management. The existence of business groups contributes to the success of regional integrations and acts as an important factor of achieved macroeconomic performance and enhanced competitiveness.

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2. CHARACTERISTICS OF ASIAN CONGLOMERATE BUSINESS MODELS

Business groups in Asia start from a competitive performance in the market, with the development of strong business relationships with multinational corporations abroad. Their essential characteristics are diversification of production and centralized control. In the modern international management, they are associated with the specifics of the Asian management and the centuries-old tradition of culture that ultimately resulted in the formation of hierarchical structures largely based on the age and experience of managers.

Some authors (Almeida & Wolfenzon, 2006) emphasize the family management of firms in business groups as a major difference compared to other conglomerate companies in the world. Business groups are characterized by the operation of separate business entities that are under the same ownership and work with the unique control. The high degree of independence and domestic market imperfections promote economies of scale and incremental growth of innovation, contributing to long-term success in international business.

The achieved results are largely attributed to specific managerial skills, unique, original business models and development of new methods of management. For our analysis, especially important business groups in terms of the specifics of doing business in the modern practice of international management are *chaebol* groups in the Republic of Korea, conglomerate companies *qiye jituan* in the People's Republic of China, the *business houses* in India and *keiretsu* in Japan.

The sales of *chaebol* business groups are equal to about 75% of Korea's GDP (gross domestic product) (Colpan, Hikino, & Lincoln, 2010). These groups are the main drivers of innovation in Korea, significant in terms of international competitiveness, as well as a great strength of the economic prosperity of the state. Their characteristics are management of companies in accordance with paternalism, and in some cases a lack of transparency of information. Development of *chaebol* groups has a crucial impact on total exports and future course of economic development of Korea. Continuous changes in the external business environment impose detailed analyses of the functioning of the *chaebol*, as a factor of shaping the social, economic, cultural, and technological components of the entire Korean society. The challenge of testing the responsibility delegation functions and the creation of new management processes in the business of *chaebol* consists of defining the modified business paradigm that will serve the next generation of managers as a basis for decision making.

By applying the reformed regulations and rules, transparent operations and increasing the number of specific skills, the management of *chaebol* calls for the harmonization of the existing system and the new model of international business. The mechanism of the high degree of state intervention, present since 1950s of the twentieth century, involves a hybrid form of close cooperation between the public and private sectors in the Republic of Korea. The impact of modern business models of companies in *chaebol* groups depends precisely on the market deregulation and mutual cooperation with major international corporations. The liberalization of markets, the increased level of competitiveness of enterprises and generating new business strategies affect the need for a smaller share of the instruments of state action, with an increasing emphasis on the sustainability of the business model of *chaebol*. Sustainable management integration has increased by 25% over the period of 2007-2012, as a result of a better distribution of responsibilities, increased investment in research & development and investments in sustainable business opportunities (Solability, 2013). Internal management strategy called New Venture Units (NVU) focuses on the replication ideas of start-ups business model in context of existing firms (Kim, Bae, & Bruton, 2012). The growing interest of *chaebol* managers for innovative solutions arising from the internal business environment makes NVU a new foothold of innovation development, as the main reason for the huge success of these business groups in international business.

According to the (International Chamber of Commerce, 2013**)**, based on the Open Markets Index, the Republic of Korea is ranked at the 45th place out of 75 countries, with a score of 3.6 (on a scale of 1 to 6). Notwithstanding its rank, according to the market openness, among the G20 countries, the intensity of local competition, according to which the Republic of Korea takes the eighth place out of 189 countries, indicates the negotiating power of the *chaebol* management and competitive strength they possess and in foreign markets (Schwab & World Economic Forum, 2013). Outsourcing in the stage of interorganizational actions of the company has an increased participation, where *chaebol* groups position their production processes in the countries of the region. Capital capabilities and effective human resources management provide an impressive level of absorptive capacity of the *chaebol* in the case of the global economic crisis. Continuous improvement of cohesive business policy, which respects the principles of successful corporate governance, contributes to the preservation of the economic power of *chaebol* in global terms.

Paternalistic, authoritarian management style is associated with a high degree of nepotism in the *chaebol*, which proved to be economically efficient, given the presented work ethic, with respecting traditional and family values. The family is the initial reason for the existence of these groups, which is suggested by the term *chaebol*, which is a specific combination of two words "wealth (*chae*) and family (*bol*)." In the long run, vertical integration and operation within the internal market reduces transaction costs and promotes a more efficient allocation of resources between two associated enterprises (Murillo & Sung, 2013). The emphasis is on the synergy of specific knowledge, diversification of investment and attitude to business risk.

"Top 30" *chaebol* groups have an obvious role of a leading force in the economy of the Republic of Korea. (Moskalev & Park, 2010). Sustainability of business with own financial and technical resources contributes to *chaebol* groups competitiveness in international business. Solutions for global challenges faced by top management are found in the redistribution of equity, more efficient monitoring by the banks, a greater share of external markets in their business, with the aim of greater placement of the final products (Choe & Pattnaik, 2007). Equal distribution of wealth and the internationalization of business of small *chaebol* group members (*kyeyol* companies) are cited as key future strategic orientation, due to the increased geographic dispersion of distribution, growth of foreign competition and the importance of price competitiveness.

Internal monitoring and operation on the principle of holding companies is gradually adapting to the growing demands for a holistic, institutional management system in accordance with moral norms and beliefs of individuals. Reorientation of business towards technologically advanced products strengthens the interaction between managers and communication, given that the top management has the authority but not all of the relevant information, while the middle and lower management has the necessary information, but not the authority to implement them. The emphasis is on improving the management through changes of the existing business model in order to achieve the desired success and future economic prosperity of the Republic of Korea (Park, Shin, & Suh, 2008).

Building on the model of the future challenges of *chaebol* business groups, comparable to them are the basic principles of management of *qiye jituan* conglomerate companies in the People's Republic of China, that in the mid-1990s became an important form of doing business. *Jituan* business groups emerged from many state regulations and laws adapted to the creation of new conglomerates, which was expected to comprehensively incite the whole Chinese economy. Business ventures of Chinese *jituan* are mainly centralized, primarily stemming from the parent company to the subsidiary companies ("children" companies), in which the mother company owns a majority share in the property (Lu & Yao, 2006). With this multilayered management structure *jituan* is able to control a large number of partner companies, which is why diversification is a popular strategy aiming to achieve progressive development. Specific approach to managing complex *jituan* groups stems from deep-rooted Chinese cultural norms, based on which the business associations are achieved primarily through a personal relationship of managers (*guanxi management*). According to Chinese business customs, security of basic resources necessary for existence should be consolidated with a large network of *renqing* (exchange of private services among employees, manager empathy) and *mianzi* (face, reputation and honor of the individual) (Su, Mitchell, & Sirgy, 2007). The given principles are largely responsible for the extensive system of loans within the Chinese business groups, which continue to operate externally and shape other economic activities in the country. Quantitative analyses showed that the higher the interaction of managers within *guanxi*, the greater the rate of profitability and productivity of a company (Keister, 2000). On the downside, it is noted that the connections between *guanxi* managements hinders the implementation of acquisitions and spin-off of the business group members.

Intervention of the authorities and direct participation in decision-making arises, due to the implementation of the objectives of international management, the need for the division of Chinese business groups in terms of public and private property, in order to choose an adequate strategic approach to business. These two groups of companies primarily differ in the degree of diversification in the later stages of the life cycle of the company, where private Chinese business group are highly diversified, thus becoming a key factor in organizational mosaic of management in East Asia (Carney & Gedajlovic, 2003). The size of conglomerate Chinese companies gives them an advantage in the process of financing, and there are common examples of business groups establishing their own financial institutions, similar to those around which the processes are organized in the Japanese *keiretsu* groups (He, Mao, Rui, & Zha, 2013). National business groups in China are particularly effective in the sector of control of the group capital and distributing the final products. Increasingly present and incremental is the transformation into hybrid forms of business of conglomerates, connecting public and private sector and taking advantage of bilateral dependence in terms of economic transition (Nee, 1992). Inefficiency can arise in case of frequent attempts of the state to use microinterventions to affect the decision-making of the management (Nee, 1992).

There is a tendency to reduce the influence of the state over *jituan* to a less extensive administration and partial control of the parent company of the conglomerate, which is considered to be a major step towards market economy and liberalization of trade in goods and services. According to (Keister, 2000), special attention should be directed towards analysis of the interdependence of government regulations and economic performance of conglomerate companies in China.

Dynamic collectivism, as a consequence of the philosophical values of Confucianism, contributes to the accumulation of firm specific knowledge within the Chinese business groups. Power of the Chinese management, resulting from the egalitarian collectivism and consensus-based decision-making, makes the model of business groups in China adequate for fast-changing markets in Eastern Asia. Vertical collectivism, as a still prevalent form of governance, shows a degree of inefficiency, which is indicated by the ranking of the People's Republic of China at the 60th position out of 189 countries included in the analysis, according to the willingness to delegate authority (Schwab & World Economic Forum, 2013). However, in the long run, both horizontal and vertical collectivism create a relationship of trust between companies and customers (Romar, 2004) and form the basis for moral reasoning of managers. Rule of law (*fa zhi*) serves as a framework for the design of structural change of groups and their strategic orientation of business relationships (Wang, Wang, Ruona, & Rojewski, 2005). Competitiveness of member companies of Chinese *jituan* pertains to the specific management initiatives, creativity and interpersonal cooperation of which improve the model of Chinese business groups. In the context of sustainable development in contemporary Chinese management, special attention is paid to corporate social responsibility (Milicevic, Lovric, & Markovic, 2012).

The emergence of complex business systems in India called *business houses*, as insufficiently tested models in the practice of international management, implies the importance of business networking in Asia. The diversity of the business portfolio and focus of financial resources to conglomerate core business support the expansion of the *business houses* in the restrictive business environment of India (Manikutty, 2000). Structure of business houses model, in a way similar to *chaebol* groups in the Republic of Korea, can set conceptual obstacles in improving management and timely implementation of business plans and make it difficult to allocate industry-specific resources, mainly inflexible and nonfungible (Colpan, Hikino, & Lincoln, 2010).

“Persons Acting in Concert” (PACs) represents individuals, companies or other legal entities through which the controlling shareholders may indirectly control affiliate companies (Colpan, Hikino, & Lincoln, 2010). The importance of the PACs for business is visible in the fact that the direct ownership of the family members of the owner of the *business houses* in India is very small, so in the company Reliance Industries it is only 0.75%, while in the Tata group it is not registered (Colpan, Hikino, & Lincoln, 2010).

Some authors (Khanna & Palepu, 2000) find that *business houses* in India by focusing on the strategy of unrelated diversification can fill institutional gaps and use their own capacity to play a key role in business ventures. However, while unrelated diversification would be an adequate response of optimal development in regulated market conditions, the Indian market deregulation allows groups to choose a route based on the use of the current opportunities, with the help of the core competences. When the capacities limit is reached, *business houses* expand their activities by signing license agreements with companies from industrial sectors that are not related to their primary group business (Nayyar, 2008). In the period after the implementation of the so-called "Second Wave" reforms, investments of Indian *business houses* largely turned to developed countries, promoting global competitiveness by geographical refocusing and changing the sector composition. Due to the saturation of demand and globalization of business trends, *business houses* are more concentrated on the production of technologically advanced products and marketing opportunities, with the possible neglect of generic resources within the group (Guillen, 2000). Effective management of international activities and turning towards capital-intensive industries make Indian business houses important global competitors. They also become a leader among developing countries in the number of mergers and acquisitions executed annually (Nayyar, 2008).

A comparative analysis conducted in 2006 shows that the company, members of business groups in India, were six times larger in terms of sales profits than stand-alone firms, and four times larger in terms of their overall assets (Colpan, Hikino, & Lincoln, 2010). Data analysis suggests taking advantage of economies of scale. Efficiency is reflected in the high turnover ratio of stocks, lower production costs and a higher rate of return, giving a strong negotiating power to management in India. Managers of business houses have a parental role, for which the Indian term is *mai- baap* (mother - father) business management (Goyal, 2012).

Thus, the top management also has a high reputation in international activities, where it implements important decisions based on competence and social equality of employees, which is particularly highlighted in the Indian conglomerate. A pragmatic approach to solving problems gives them the freedom resulting from the control of the business processes of the group, thus initiating the growth and indirectly influencing the improvement of the market mechanism.

Japanese *keiretsu* conglomerate groups consist of technologically superior companies in the Asian market. Business-oriented and financially concentrated around the major Japanese banks, *keiretsu* use the advantage of the positioning of its production facilities in the markets of neighboring countries, as indicated by the fact that they accounted for about 40% of all foreign direct investment of Japan in Asia (Peng, Lee, & Tan, 2001). *Keiretsu* systems are divided into horizontal and vertical, suggesting great heterogeneity of the organizational structure of Japanese conglomerates. Vertical *keiretsu* consists mainly of manufacturing companies and their subcontractors, where upstream suppliers and downstream distributors share the total costs of joint ventures (Lin, 2005). Common equity and close relationships among suppliers reduce transaction costs, promote better coordination and create long-term relationships of cooperation (Matsuura, Pollitt, Takada, & Tanaka, 2003). The combination of autocracy at the conglomerate level and a high degree of autonomy within the company strengthens the ability to create information and transition efficiency of the vertical *keiretsu* in the planning process and reciprocal monitoring of companies, during business internationalization process (Aoki, 1990). Intra-group information spillovers enhance innovation in member companies, and thereby enhance their business success (Lincoln, 2009).

Horizontal *keiretsu*, on the other hand, is based on a lesser degree of hierarchical structures, frequent informal bottom-up management interactions and the formation of the business core, generally of a bank or trading company, which provides financial support to conglomerate (Peng, Lee, & Tan, 2001). It is composed of companies from various industrial sectors, whose management makes independent decisions and shapes the policies *keiretsu* by equal rights (Lai, 1999).

The management of *keiretsu* conglomerates is characterized by the decision to establish long-term, flexible contracts with employees, frequent communication, reducing information asymmetry and specialized investments. The main source of competitiveness of *keiretsu* is its capability to generate extremely high profit margins through joint contributions of the member companies individually specialized for a particular business segment in the chain of production (McGuire & Dow, 2009). The power of *keiretsu* groups establishes the basis for secure business environment, promotes research and development and prevents destabilization of the economic development of the country, resulting in the generation of technological fusion in the Japanese market. Significant competitive advantage derives from the possession of rare, valuable and hard to imitate assets, which have the power to create great added value for the company during the initial stages of entering the foreign market (Peng, Lee, & Tan, 2001). The prominent internal control of *keiretsu* companies, one of the main features of their management, significantly increases productivity by using specific mechanisms and skills, which in practice proved to be very successful (Lai, 1999).

Total commitment to achieving the goal of reducing inventory costs and operating in accordance with the principle of zero inventory is what makes business management techniques of *keiretsu* one of the most efficient in the framework of international management. Special attention is devoted to teamwork, lateral communication and cyclic distribution of labor, according to which employees are trained to perform several different tasks (Wireman, 2004). *Anshin* management concept, which is literally translated as "peace of mind", is based on the establishment of trust between suppliers and manufacturers and a large investment of time and effort in establishing long-term business partnerships (Aoki & Lennerfors, 2013). Applying homogenization of management activities and promoting cooperation between companies, *keiretsu* groups skillfully combine traditional business values and the demanding requirements of the international aspects of business, thus positioning itself as a leader in cost- efficiency and productivity in the Asian market. Impact of the success of *keiretsu* companies in the Japanese economy is unambiguous. Thus, according to (International Chamber of Commerce, 2013), Japan is ranked as number 1 in the enhancement of production processes and the intensity of local competition, in the analysis that included 189 countries.

3. ASIAN CONGLOMERATES IN CONTEMPORARY INTERNATIONAL MANAGEMENT

Haier Group, a Chinese conglomerate group *jituan*, succeeded in a relatively short period of time since its establishment in 1984 to create a reputation of a highly efficient manufacturer of quality consumer electronics and home appliances. The strategy of internationalization of Haier Group is comprised primarily of the operation on the principle of Uppsala model, by successive greater physic distance and expansion of products range in the early stage of export of products in developing countries, by forming a joint venture with local business partners. The goal of the management is to market the products whose brand is recognized worldwide, but with adaptation to the specific needs of consumers. In the markets of developed countries, business is started with low-end items by applying extender strategy of penetration pricing and then, by gradually building trust with users, the aim is to ensure competitiveness in the high-end consumer products sector (Duysters, Jacob, Lemmens, & Jintian, 2009). By emplying Dodger strategy of transfer of international competitive assets back to the domestic market, Haier Group avoids direct confrontation with immediate competitors and establishes technology alliances with the competition, as well as with global conglomerates in other industrial sectors. By "rural" and "green" strategies Haier Group has developed a large network of energy-efficient operations in rural areas of China, becoming a leader in this field since 2009 till today, which is a great foundation for testing different market segments (Chan, 2011).

Samsung Group, a globally renowned Korean conglomerate group, consists of more than 60 affiliate companies, the largest being Samsung Engineering, Samsung Heavy Industries, Samsung Medical Center and Samsung Electronics. Parental role of Samsung's headquarters is very present. An example of a particularly successful company within this conglomerate group is Samsung Electronics, which has made great progress in manufacturing technology components, which to them are cash-cow products (Rim, 2007). The strategy of expansion by extensions of partnerships and conquest of peripheral markets has allowed Samsung to become the leader in the memory chip industry, already after the first 10 years of operation (Mathews, 2006). Investment in research and development as a key to achieving sustainable competitiveness are substantial. The Samsung Advanced Institute of Technology as Samsung Group's R&D Hub has been established.

LG Group is characterized by an extremely complex network of business and dominance in emerging markets such as India, Indonesia and Brazil. Fields of activity of this conglomerate are primarily electronic industry (LG Electronics), chemical industry (LG Chem) and telecommunication industry (LG Uplus). Out of the total investment, significant funds are allocated to research & development, which is the main reason for its rising dominance in the sector of LED (Light- emiting diode) technology as a key innovation in the group. By increasing production capacity as a survival strategy, LG Group maximize economies of scale. Applying the tactic of aggressive internationalization through mergers and joint ventures, LG has become one of the world's most competitive business groups. By increasing the quality of the final product, LG becomes the best "value for money" competitor (Choe & Pattnaik, 2007). "Top - tier" strategy of sustainable competitive advantages enables LG Group to set the market standards in understanding what really needs to be done in order to create a balance between cost-efficiency and meeting the specific needs of the user (Choe & Pattnaik, 2007).

Reliance Industries Limited business house is the second company by income level in India. Business model of this business group gives a realistic picture of the advantages of the complex structure of a company and the benefits of intra - industry trade in goods, reducing transportation costs and inventory turnover ratio, as two important factors in the business sector of the petroleum industry. By backward vertical integrated management strategy of procurement of raw materials within the group, Reliance reduces costs for the amount of import duties and creates a sustainable business model, which is indicated by the fact that 2012 export of this business house had a share of even 14% of the overall exports of India (Reliance Industries Limited, 2013). The resiliance of the business model in the period of uncertainty and rapid changes results from the leadership in innovation and turning towards renewable energy sources, especially *jatropha curcas* biofuel production model, including sources of competitiveness, such as reducing greenhouse gas emissions and longer productive life of installed production plants (Pandey, Singh, Singh, Kumar, Singh, & Singh, 2012).

Tata Group has a long business tradition. Today, this renowned Indian business house is operating with more than 100 global affiliate companies in various sectors, including the sector of information and communication technologies, engineering, energy, automotive, chemical and other industries. Large companies that make up the Tata Group are: Tata Steel, Tata Motors, Tata Consultancy Services, Tata Power, Tata Chemicals, Tata Communications and Tata Beverages. The impetus of creative ideas and innovative solutions has resulted in the emergence of Business Excellence Model, where Tata Group views each subsidiary as a center of excellence, which decentralizes responsibility and accelerates the process of generating new business plans (Tata Group, 2013). Managerial competence within the group requires the formation of teams of experts, who continue to manage demanding operations abroad. Purchasing luxury brands such as Jaguar and Land Rover, Tata Group acquires significant market share in developed countries and know-how. A large part of its business activities is turned to the internationalization of business, with a strong focus on branding all product lines. Orientation towards business philanthropy is prominent.

An example of a successful horizontal *keiretsu* is a Mitsubishi Group, a part of which is also one of the six major banks of Japan, The Bank of Tokyo - Mitsubishi UFJ, Ltd., around which the operations of many other *keiretsu* groups are centred. Mitsubishi Group operates on the principle of management without a parental company, applying flexible strategy of high degree of unrelated diversification. Code of conduct and review of the development of individual management skills arising from collectivism puts the work ethic to the forefront of management. Respect for cultural heritage and a specific business model contributed to the international competitiveness of the Mitsubishi Group. The *"Shoki Hoko"* concept of corporate social responsibility, *"Shoji Komei"* concept of integrity and honesty, *"Ritsugyo Boeki"* the concept of expanding the business internationally represent the three basic principles of business philosophy that are the mainstay of integrated business chain of continuous customer satisfaction (Mitsubishi Corporation, 2012).

4. CONCLUSION

Analysis indicated the specificity of Asian conglomerate business models and confirmed the importance of effective management in terms of increasing competitiveness of the conglomerates in global business, the actions of which reflect the macroeconomic situation of individual countries. A prominent feature is the strategic orientation to stable operation and long-term development, with the implementation of sustainable growth components. Results and achievements on the level of business groups are reflected in the further development of the Asian economies. The conglomerates are expected to continue in the future to improve competitiveness at the global level through effective implementation of specific management models and techniques, as distinguishing features of Asian management.

Reform and harmonization of the decision making process with international trends represent a challenge and an opportunity for Asian conglomerates to expand their operations in highly developed countries, starting with the benefits of development of production processes in technologically advanced economies of Asia. The close connection between business, social and economic environment in Asia foregrounds the importance of strategic management decisions. The degree of government intervention, control and financial support must be seen from the aspect of increasing the business performance of networked companies.

Business trends in the global environment show that the business of conglomerates has a positive effect on the course of development of the Asian economies. In the international management particularly prominent are the achievements of the presented Asian companies in many sectors. Future role of Asian conglomerates is important from the perspective of sustainable competitiveness in a global context.

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FOREIGN DIRECT INVESTMENTS AND ECONOMIC GROWTH: THE CASE OF SERBIA

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Abstract: *In the global economy there are movements of capital from one to other countries. For the countries which carry out economic reforms, inflows of foreign direct investments (FDI) are important for achieving better economic performances. There are various research papers about the influence of FDI on the economic growth. The aim of this paper is to analyze the influence of FDI on gross domestic product (GDP), exports and unemployment in the Republic of Serbia from 2000 to 2012. The method used is linear regression applied on the World Bank data and the Statistical Office of the Republic of Serbia data. For the period of 2000-2012, the results show that there is no linear correlation between FDI and GDP per capita, exports and unemployment. The economic crisis has worsened the already poor economic situation in Serbia. For the period before the global economic crisis (2000-2007) the obtained results show that there is a strong positive correlation between FDI and GDP per capita, FDI and exports, FDI and unemployment.*

Keywords*: foreign direct investments, economic growth, gross domestic product, exports, unemployment, the Republic of Serbia*

1. INTRODUCTION

When trends of capital exports are analyzed, it is necessary to take into consideration the global economy, global markets and global competition. Exportation of capital from one to another country represents the investment of capital into the economic development of another country. The process of exportation of capital is carried out in order to realize higher profits from such investments than the profits gained from investing into domestic market. The capital moves to the regions where higher profits are expected. Investors invest in lucrative opportunities and possibilities for avoiding risks. Natural resources, large domestic markets and lower production costs are a few attractive factors for investment. The movements of capital from one country to another could be observed from various aspects. The main and the most important classification implies two forms of capital exports: investments and loans. When deciding on investment of capital according to the above given classification, the basic criteria is the difference in profits or dividends if the capital is used for investing, i.e. the amount of interest if the capital is used for giving loans.

Of all types of capital flows, foreign direct investment is generally considered to be the most desirable. Capital inflows such as bank loans and bond funds tend to crowd out domestic investment; however FDI tends to increase the national investment in the equal amount. In today's globally competitive environment, attracting foreign direct investments is one of the top issues for most countries, and especially for the countries which carry out economic reforms. FDI has the potential to generate employment, raise productivity, transfer technology, increase exports and contribute to the overall economic development. Due to that fact, all countries try to improve many factors and policies that have influence on attracting foreign investors. There are different studies that show FDI has a positive effect on the economy (Borensztein et al., 1998; Campos and Kinoshita, 2002; Makki and Somwaru, 2004; Alguacil et al., 2011; Giroud et al., 2012) while also there are researches whose standpoint is that FDI has a negative effect on the economic growth and other economic variables (Hermes and Lensink, 2003; Stanisic, 2008; Doytch and Uctum, 2011).

The aim of this paper is to analyze the impact of foreign direct investment on the economic growth of the Republic of Serbia. The research has been conducted as an analysis of the influence of FDI on GDP, exports and unemployment in Serbia from 2000 to 2012. The method which was used is linear correlation conducted on the World Bank data and the Statistical Office of the Republic of Serbia data.

The paper is structured in five chapters. After the introduction, the second chapter offers an overview of the Serbian economy. The third chapter delivers applied methodology which describes the influence of FDI on the economic growth in the Republic the Serbia from 2000 to 2012. The next chapter gives an overview of the research results, while the last chapter reserved for the conclusion.

2. OVERVIEW OF THE SERBIAN ECONOMY (2000-2012)

Year 2000 is determined as the real beginning of economic reforms in Serbia and at the very start economic growth was present. Production growth in Serbia has been explained by the following factors: a) before 2000 Serbia already had a market-based economy, b) there was macroeconomic stability present, which improved business environment and helped achieve economic growth, c) the country received foreign support and donations (at the end of October 2000), and d) the UN sanctions had been lifted (Begovic et al., 2005). The reforms were implemented quickly. The expansionary fiscal policy and tight monetary policy were the main tools for developing better economic environment. A large number of enterprise privatizations was performed. The banking system, as a sector with a large inflow of foreign capital, was reformed as well. In addition, Serbia received numerous foreign grants and aid. The lack of savings and domestic capital slowed down further reforms and the ability to finance consumption and investment. In that situation, the solution was the inflow of foreign capital, especially foreign direct investments. Foreign capital had a role in achieving Serbian economic growth. Since then, FDI is considered an essential factor in starting production and realizing economic growth.

According to the Development Report of Serbia 2010 (2011), the economic growth of Serbia is based on domestic demand, import and the need for foreign funds. In the period 2001-2008 the average rate of economic growth was 4.9%. The achieved economic growth was a consequence of the process of undergoing economic and social policy changes, institutional reforms and the favorable environment in the international capital market (Đorđević and Veselinović, 2010). However, Serbia established a new model of growth. The new growth model was changed to pro-investment strategy and export-oriented economic growth. The new growth is based on the reform of the public sector, restructuring and infrastructure development. The main objectives of this model are correlated with the EU's goals – decrease of unemployment, human capital improvement, investing in knowledge and technology, export-based growth, rational energy use and poverty reduction. Accomplishing such objectives depends on – fixed investment increase, reducing the share of public consumption in GDP, raising the share of exports in GDP and reducing the current account deficit (Jednak et al., 2013). Although Serbia implemented the new model of economic growth, the rise in production output was not achieved. The possible reasons could be the lack of domestic capital, less foreign investments in comparison with the 2000s due to the global economic crisis, previous unstable political and business environment, insufficiently developed institutions, small domestic market or the distance from investing countries (Erstin and Uvalic, 2013). Further on, the exports are not high enough because the most investments are made the service sector which does not have a large share in the Serbian exports. During the time period 2000 – 2012, the FDI in Serbia had a different volume and trend. The most inflows of FDI were through the privatization and acquisitions in the banking sector, while the greenfield investments were very low.

Merlevede and Schoors (2009) analyzed the FDI inflow in 10 transitional economies and found that the FDI inflow in those countries is primarily affected by the used models of enterprise privatization. The study demonstrated that the countries which mainly used models of internal privatization and free distribution of stock to their citizens, attracted significantly less investments than the countries whose privatization was largely based on the external model.

The highest inflows of FDI were at the beginning of the analyzed period and in 2006 (mostly due to FDI in the telecommunications sector), while the declines of FDI were in 2004, 2008 and 2009. Total net FDI during the entire period amounted to about €15.1 billion (2001-2011). Foreign investors invested in Serbia in the following sectors - services sector (trade, banking, telecommunications, distribution of petroleum products, tourism) and production sector (beer, beverage, tobacco, food and metal and non-metals industry). The highest inflows of FDI came from Austria, Norway, Germany, Luxemburg, Greece, the Netherlands, Italy, Russia, Slovenia and Hungary. The highest foreign investments in Serbia (2001-2011) are Telenor (€ 1602 EUR mil), Gazprom Neft – NIS (€ 947 mil), Fiat Serbia (€940 mil), Delhaize (€933 mil), Philip Morris DIN (€733 mil), Stada – Hemofarm (€650 mil), Mobilkom – VIP Mobile (€633 mil), Agrokor (€614 mil), Banca Intesa (€508 mil), Salford Investment Fund (€500 mil), Eurobank EFG (€500 mil), Raiffeisen bank (€500 mil), Mercator (€500 mil) and StarBev – Apatin Brewery (€487 mil) (Business info group, 2012). Even though the inflows of foreign capital have been present in Serbia, the country's economy has not always had good economic performance. FDI had a direct and an indirect impact on economic activities in Serbia. Moreover, various investments had a different time of realization and influence on the output increase. Due to this fact, there is some difference between FDI and GDP. Based on this overview, the correlations between FDI and GDP, exports and unemployment will be analyzed in the following sections of the paper.

3. METHODOLOGY AND DATA

This paper is based on applied methodology and research carried out in the previous period in the Republic of Serbia (Šabić et al., 2012; Jaćimović et al., 2013). A survey conducted in 2012 (Šabić et al., 2012) found a high correlation between FDI inflows and GDP and between GDP inflows and exports, while the linear correlation between FDI inflows and the unemployment rate was very low for the time period of 2000 to 2010.

Jaćimović et al. (2013) conducted a linear regression analysis of the dependence of imports and exports of goods and services and the growth of GDP per capita from FDI inflows. Time period taken into consideration by this research is from 1995 and ends with 2011. The inflow of FDI was the independent variable, while the dependent variables were the import and export of goods and services and GDP per capita. This study led to several conclusions: 1) There is a strong linear correlation between these variables; 2) Albania has the highest influence of FDI on the dependent variables; 3) Bosnia and Herzegovina has the lowest degree of correlation between variables; 4) The impact of FDI inflow on GDP per capita is the lowest in Macedonia. However, the shortcoming of the research lies in the low statistical reliability of the used method. This is due to the fact that the only reliable correlation between the variables is identified in the case of Albania, where we can see that €1 million of FDI inflow leads to an increase in exports of €3.56 million, the growth of imports of €5.73 million and the growth of GDP per capita by $4.3. In all other cases, R^2 is lower than 0.5 which makes it impossible to analyze the remaining SEE countries. The authors distance themselves from the results and suggest different effects of the global economic crisis on the analyzed countries as the reason for these results.

In this paper, the Inward FDI Performance Index was calculated for the period from 2000 to 2012. Subsequently, the linear correlation between FDI inflow and GDP per capita, FDI inflow and exports of goods and services and FDI inflow and the unemployment rate for the same time period were analyzed.

Inward FDI Performance Index ranks countries according to FDI inflows based on their economic strength (measured by GDP level). The index is calculated using Equation 1:

where FDI_i represents the FDI inflow for the observed country, FDI_w represents the total amount of FDI in the world, GDP_i represents the GDP of the country observed and GDP_w the total world GDP.

If the index value is greater than one, it indicates that the country attracted more FDI than it contributed to the total global production (measured by GDP) and vice versa in the case when the index is lower than one. The Inward FDI Performance Index measures the country's attractiveness for foreign direct investment according to its market size, while other factors are considered to be of equal importance. Other factors may be various: political and economic stability, the presence of natural resources, development of infrastructure, business environment, opportunities for participation within the privatization process and similar (Bandura, 2005).

Pearson's coefficient of simple linear correlation will be used for measuring the degree of concurrence between: (1) FDI (x) and GDP per capita (y); (2) FDI (x) and exports of goods and services (y), and (3) FDI (x) and the unemployment rate (y) in Serbia for the time period 2000-2012. The standard formula for calculating Pearson's coefficient is used:

To simplify the interpretation, the coefficient of determination R^2, which represents the squared value of Pearson's coefficient, will also be used. The determination coefficient measures the degree of the variance of the two variables which is common, in other words, we examine the common part of the FDI variance and a) GDP per capita, b) exports of goods and services, and c) the unemployment rate in Serbia for the observed period of 2000-2012.

Data on FDI and unemployment rates are downloaded from the database of the World Bank, while data on GDP, GDP per capita and exports of goods and services was obtained from the sources of the Statistical Office of the Republic of Serbia. The data was analyzed using statistical software package IBM SPSS

Statistics 22. It was used to calculate the previously explained Pearson's coefficient of linear dependence. The Inward FDI Performance Index for Serbia for the period 2000-2012 was calculated based on the data obtained from the World Bank.

4. RESULTS AND DISCUSSION

The Inward FDI Performance Index for the observed period demonstrates different values by years (Table 1), so it can't be claimed that a trend in FDI inflows exists. The index has the minimum value in the first (2000), as well as in the last analyzed year (2012). The index value is also lower than 1 in 2001. In all other observed years, the index exceeds the value 1, indicating that Serbia attracted more FDI in relation to its economic strength in global terms, measured by domestic GDP share in world GDP. The highest value of the index is realized in 2006 (5,00) and 2003 (4,78).

Table 1: Inward FDI Performance Index for the Republic of Serbia (2000-2012)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Inward FDI Performance Index	0.06	0.70	2.02	4.78	2.58	2.72	5.00	2.01	1.77	2.42	1.69	2.54	0.60

Based on the data, Pearson's correlation coefficient was calculated and the results are shown in Table 2.

Table 2: Correlations between FDI net inflow and exports of goods and services, GDP per capita, unemployment rate (2000-2012)

		FDI net inflow	Exports of goods and services	GDP per capita	Unemployment rate
FDI net inflow	Pearson Correlation	1	.446	.492	.488
	Sig. (2-tailed)		.127	.088	.091
	N	13	13	13	13

Based on the obtained results, it can be concluded that there is no statistically significant correlation between FDI and exports of goods and services (R^2=0,199); FDI and GDP per capita (R^2=0,242) and FDI and the unemployment rate (R^2=0,238). These results imply that there is no influence of FDI on the basic macroeconomic indicators and the economic growth in Serbia. The reasons for this can be found in the impact of the global economic crisis on the Serbian economy and the significant decline of all macroeconomic indicators.

To comprehend whether the global economic crisis had an impact on the relationship between FDI and economic growth in Serbia, the analyzed period of 2000-2012 was divided into two sub-periods: the period before the global economic crisis from 2000 to 2007 and the period after the global economic crisis from 2008 to 2012.

The obtained results for the first sub-period are shown in Table 3. The results are considerably different from the results for the whole given period.

Table 3: Correlations between FDI net inflow and exports of goods and services, GDP per capita and unemployment rate (2000-2007)

		FDI net inflow 2000-2007	Exports of goods and services 2000-	GDP per capita 2000-	Unemployment rate 2000-2007
FDI net inflow 2000-2007	Pearson Correlation	1	.870**	.743*	.792*
	Sig. (2-tailed)		.005	.035	.019
	N	8	8	8	8

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

The correlation between FDI and exports of goods and services is statistically significant at $p<0.01$, while the linear correlation between FDI and GDP per capita and FDI and the unemployment rate is statistically significant at $p<0.05$. At the same time, FDI and exports of goods and services share 75,69% common variance (R^2=0,757); FDI and GDP per capita share 55,20% common variance (R^2=0,552) and FDI and the unemployment rate share 62,73 of explained common variance (R^2=0,627). It is evident that in the period of 2000 to 2007, the highest linear correlation is present between FDI and exports of goods and services, which may indicate that the FDI were mainly export-oriented.

However, there is a positive correlation between FDI and the unemployment rate, which confirms that the increase in FDI inflow raises the unemployment rate. This can be explained by the fact that FDI were mainly the result of the privatization process, which implied rationalization of business operations, which in this way found a new owner.

The obtained results for the sub-period of 2008 to 2012 are presented in Table 4.

Table 4: Correlations between FDI net inflow and exports of goods and services, GDP per capita and unemployment rate (2008-2012)

		FDI net inflow 2008-2012	Exports of goods and services 2008-2012	GDP per capita 2008-2012	Unemployment rate 2008-2012
FDI net inflow 2008-2012	Pearson Correlation	1	.090	.862	-.666
	Sig. (2-tailed)		.885	.060	.220
	N	5	5	5	5

It is visible that there is no linear correlation between FDI and exports of goods and services. Pearson's correlation coefficient for the relationship between FDI and GDP per capita is 0.862, while the coefficient of determination is 0.743, which indicates a strong connection between FDI and GDP per capita for the period of 2008-2012. However, due to the shortcoming of Pearson's coefficient and its sensitivity to the size of the sample, this relationship is not statistically significant, i.e. it can't be confirmed with how much trust the obtained results can be accepted. There is a moderate inverse linear correlation between FDI and the unemployment rate (Pearson's coefficient equals -0.666), while R^2 equals 0.444, which confirms that there isn't a statistically significant correlation between these variables. The inverse correlation between FDI and the unemployment rate can be explained by the creation of new jobs by the inflow of investments by slowing down the privatization process in the period of 2008 to 2012.

4. CONCLUSION

Based on the analysis of the economic state of the transition countries which carry out economic reforms, it can be concluded that the macroeconomic stability, economic growth and development, political climate, legal certainty, tax policy and other factors have the biggest influence on FDI inflows. The development of a market based economy, opening of the economies to the world, strengthening of the private sector, stability, and above all political stability, legal system reforms and its adaptation to the European legislation, as well as the consistent implementation of adopted laws and tax harmonization with the ones existing primarily in the European Union, are the internal factors which directly influence the decisions of foreign investors to put their money into the developing countries. Some of those factors have a negative impact on a potentially higher FDI in the SEE region. First of all, this refers to the slow implementation of legal system reforms, the slow economic restructuring, the problems in the privatization process, slow and weak growth of the private sector, as well as the unstable political situation in the recent years that had its culmination in war activities.

For the developing countries, the transition economies and the countries which carry out economic reforms, foreign direct investments are the key factor for achieving better economic performances. Those countries have a lack of domestic capital. Thus, their model of the economic growth is based on the foreign capital. However, some of the countries could not obtain output increase. Various research explore correlation between foreign direct investment and GDP. Some of the studies show a positive correlation between those two variables (Borensztein et al., 1998; Campos and Kinoshita, 2002; Makki and Somwaru, 2004; Alguacil et al., 2011; Giroud et al., 2012), while others show a negative correlation (Hermes and Lensink, 2003; Stanisic, 2008; Doytch and Uctum, 2011).

This paper analyzes the Serbian economy and the role and impact of FDI on the economic performances - GDP, exports and unemployment for the period of 2000-2012. The results show that in the analyzed period of 2000-2012, there was no statistically significant correlation between FDI and macroeconomic indicators (GDP per capita, exports of goods and services, and the unemployment rate). Surely that the global economic crisis affected the economy of Serbia and made the already bad economic situation even worse. In order to comprehend the effects of the economic crisis, the analysis was divided into two sub-periods: the period before the economic crisis, from 2000 to 2007 and the period after the financial crisis, from 2008 to 2012. In the first sub-period, the results showed that there is a strong linear connection between FDI inflows and macroeconomic indicators. The most important is the relationship between FDI inflows and the exports of goods and services. This may indicate that investments increase the export potential of Serbia, which is very important given the constant balance of trade deficit. There is also a high correlation between FDI and the unemployment rate, which is primarily the consequence of the fact that FDI was attracted through the privatization process, which included restructuring and downsizing in order to increase efficiency and a small number of greenfield investments. The period of 2008-2012 was characterized by a high correlation between FDI inflows and the exports of goods and services, while there is no significant linear correlation between FDI inflows and GDP per capita and FDI inflow and the unemployment rate. The results for the second sub-period can be explained by the effects of the global crisis on the Serbian economy and the deterioration of all macroeconomic indicators in the given period.

Based on the research on the impact of FDI in the process of transforming the economies of numerous world countries, and especially the former Eastern Bloc, into the modern market economies, attracting foreign capital has become the priority of the economic policy of the Republic of Serbia. Given the fact that Serbia is one of the last European countries to enter the transition process, it has the advantage of the experiences of other countries at its disposal in terms of FDI inflow.

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INTERNATIONAL COMPETITIVENESS AS A RESULT OF ENTREPRENEURIAL INITIATIVES IN CONTEMPORARY BUSINESS

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Abstract: *Paper presents analysis of international competitiveness as a result of entrepreneurial initiatives. Business model is introduced as a tool suitable for such analysis and details of contemporary business model theory are presented in order to build a solid basis for analyzing competitiveness of companies. Another conceptual prerequisite for such analysis is considered in form of tools needed to grapple with competitiveness concept. Building on these an analysis is provided where the individual traits of the entrepreneur are pinpointed as an element of utmost importance for international competitiveness of entrepreneurial activities in contemporary business. The paper also presents the variety of entrepreneurial initiatives in the international environment.*

Keywords: *International Competitiveness, Business Model, Entrepreneurial Initiatives, International Business, Internet, Born Global Entrepreneurs.*

1. INTRODUCTION

The analysis of international competitiveness, so highly important for planning the new business venture or any other kind of international entrepreneurial business activity, is almost impossible without looking at the business model proposed for such an activity. Recent discussions and dilemmas regarding the business models related to some of the biggest entrepreneurial activities in ICT (Information and communication technologies) area such as IPOs (Initial Public Offering) of Twitter and Facebook companies and acquisition of WhatsApp firm illustrate this issue very clearly. To achieve international competitiveness is an ultimate business aim for any entrepreneur in a globalized and highly dynamic contemporary business environment. In order to achieve this clear cut business vision is needed along with the first class leadership skills. Although entrepreneurship by its definition involves risk taking and involving with activities regardless of resources on hand one must consider thorough planning when embarking on international business venture. Therefore the core importance of analyzing business plan related to it.

2. INTERNATIONAL PERSPECTIVES OF BUSINESS MODEL

There are many preconditions for the success of international entrepreneurial activity. Sometimes these fail in spite of the existence of resources and opportunities and many times the failure is due to inadequacy of the underlying business model. In order to avoid such failures, business model needs to be examined, looked at in detail and planned carefully in advance of an international entrepreneurial activity. Difficulty of this task is partly due to unexacting consensus on definition or the nature of business model concept among scholars and practitioners. Therefore we will have to look at different approaches in order to present more clearly this concept that bears such an importance for international entrepreneurial activities.

Dilemmas regarding the conceptualization of the business model are best illustrated by variety of synonyms used in place of the word model such as design, pattern, architecture or plan. Often we find in both practitioners notes and scientific papers instead of business model terms such as business concept, economic model or revenue model describing various aspects or the unity of the same phenomena. As business model describes very different aspects of an organization at different levels of comprehension of the inner workings of an organization such as economic, strategic and operational levels at which an organization functions. In order to bridge this gap an integrative definition of a business model has been proposed as: a concise representation of how an interrelated set of decision variables in the areas of venture strategy, architecture, and economics are addressed to create sustainable competitive advantage (Morris,

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Schindehutte & Allen, 2005). Entrepreneurs need to consider six groups of factors related to their business activities in order to get a hold on overall picture of business perspective in a certain market that is best described and defined by the business model.

The first group of factors relate to the offering of the organization, its primary product or service, the way in which the product or service can be accessed by customers, the means of production or provision of services. Business model often fits into business deliberations of technology based spin-off companies and one such example is coming from Xerox company breeding grounds and the success they achieved based on the differences in their respective business models and pondering entrepreneurs did when envisioning the offerings of these spin-offs (Chesbrough & Rosenbaum, 2002).

The second group of factors defines market elements and the intended user groups defining those for whom the product or service has been planned for. Organization driving the entrepreneurial business may be B2B or B2C oriented and the intended market may be local or national or international. Also position of the customers in the value chain needs to be defined. The analysis and planning of the approach to user groups when defining the business model is of high importance, especially in the entrepreneurial activates related to ICT where the long tail principle drives most of the contemporary markets (Gordijn & Akkermans, 2001).

The third group of factors deals with internal capabilities of an organization and the factors driving it. These factors include all elements of the business from production and selling to R&D and supply chain management. According to (Viscio & Pasternack, 1996) the core competences of a company are of crucial importance for the business model and it is of utmost importance how this competence or competences if there are more then one in play fall in with other elements of the business model. If their importance is underplayed, then the organization most likely won’t be able to exploit the full capacity it can derive from such a competence. On the other hand, if it is a sole object of the business model and if other elements are ignored and removed from the business planning process, then there is a danger of sudden and astonishing market or other occurrences disrupting entrepreneurial business activities.

The fourth group of factors important for a business model of entrepreneurial venture deals with competitive strategy issues such as innovation leadership, customer relationships, product quality and its features, overall operational excellence and dependability. It is often that a business model represents the design of content, structure, and governance and allow for creation of value through the exploitation of business opportunities (Amit & Zott, 2001). All the described elements playing into competitive strategy of an organization constitute important factors within the business model concept and that entrepreneur with intentions towards the international activities have to consider these important factors within the business model framework.

The fifth group of factors involves those relating to economic side of entrepreneurial activities such as pricing, revenue sources, and volume of production or service provision, revenues and profits. These factors although seemingly very well researched and known, still comprise many different aspects, such as influence of venture capital availability on entrepreneurial activity (Samila & Sorenson, 2011). If there is ample venture capital available, then it is more likely that an entrepreneurial activity will occur, obviously for reasons of financial resources at entrepreneurs’ disposal, but also and perhaps equally important for reasons of increased overall entrepreneurial experience available related to the source of the venture capital and that inevitably follows this kind of capital.

The final group of factors that will be described and analyzed within the framework of a business model viable for international entrepreneurs comprise factors influencing the entrepreneur individually such as time available to him personally for entrepreneurial activities, scope and size of planned or intended entrepreneurial activities. These factors encompass many important considerations such as personal motivation and the aim one has when embarks upon any kind of entrepreneurial activity (Fairlie, 2013). This is especially true for international entrepreneur activities, since the stakes for the entrepreneur are usually much higher in such activities than in the one with predominant local features. Having in mind that the volume of activity, financial interest and time invested are much larger than in local or national business framework, all kind of different personal issues specific for international entrepreneurs, such as reputation in certain markets and in general, networking and experience, may arise.

By having a deliberate business model description involving so many factors is advantageous for analyzing entrepreneurial activities because of the complexities involved in conducting business in the international

environment that is nowadays characterized by globalization processes and cultural influences that demand innovative and creative business solutions. Business model is closely related to various concepts coming from the field of strategic management that make analysis of international business ventures and other international entrepreneurial activities more accurate. One important concept is defined as strategy, which is the creation of a unique and valuable position, involving a different set of activities (Porter, 1996). Another one, similar, but very distinctive and different, is defined by the same author as operational effectiveness. This concept encompasses the notion of performing activities better, with fewer inputs and defects than competition (Porter, 1996). It is important to note that business model as defined previously contains elements of both strategy and operational effectiveness proving to be a powerful tool for analysis of international entrepreneurial activities.

Finally we will discuss the concept of entrepreneurial activities as an important addition to business model framework which we will use in next sections to analyze international competitiveness and entrepreneurial business initiatives. Business is conducted through implementation of various activities and thus inherently a business model builds framework that groups, describes and organizes the business activates and provide relationships among them in order to describe a meaningful overall picture or map of the business. Such grouping of activities provides good basis for describing elements of a business model and therefore an entrepreneurial business activity may be considered as a founding element for the business model describing overall entrepreneurial activity (Siggelkow, 2002).

Having this in mind we will examine once more the role of the business model and its usefulness for the entrepreneur as it is inextricably related to building successful international business venture and international competitiveness related to it. Advantages an entrepreneur can find in pondering over his business model are numerous, and four major incentives for this can be defined as: conceptualization of the business through set of strategic choices that are interrelated; seeking relationships that may be complementary, primarily these may be some of the elements that posses unique combinations; developing sets of activities around a framework that is logical in the given business environment; ensuring consistency of strategy, architecture, economics, growth, and exit intentions (Morris, Schindehutte & Allen, 2005). Interrelation between concepts of business model, strategy, operational effectiveness and business activities can provide an overall framework for efficient analysis of international competitiveness, so important for success of any entrepreneurial activity in contemporary business.

3. THE SIGNIFICANCE OF INTERNATIONAL COMPETITIVENESS FOR ENTREPRENEURS

When international competitiveness is mentioned the first thought that comes to one's mind is international competitiveness of countries. With readily available instruments that measure this phenomena on a yearly basis, such as The Global Competitiveness Report of World Economic Forum (Schwab & World Economic Forum, 2013) it is no wonder that such inspiration is probable. International competitiveness is of utmost importance for entrepreneurs and the prospect their enterprises have in an international market. There is of course relation between the two and some research provide data describing international competitiveness of countries supplemented by data describing dynamic trends of companies (Dosi, Grazzim & Moschella, 2013).

Country competitiveness is defined as the set of institutions, policies, and factors that determine the level of productivity of a country. Productivity determines rates of return and consequently investments in economy of a country, thus making a more productive economy, the one that grows faster over time (Schwab & World Economic Forum, 2013). According to same source twelve groups of factors are underlying for competitiveness.

Institutions' features make the first group of factors that determine competitiveness of an economy. By providing legal and administrative framework for entrepreneurs and their activities institutions largely define what is possible for organizations and in which timeframe.

Infrastructure available to the economy provides another important framework that determines what is possible and when for entrepreneurs. Transport infrastructure such as roads, ports and information infrastructure such as availability of the broad bend Internet defines the rate of flow of business and the rate of flow of information, which often is crucial for successful international entrepreneurial activity.

Macroeconomic environment and health and primary education make the third and the fourth group of factors that determine competitiveness of an economy by providing yet another layer of environment defining context for activities of entrepreneurs. Thus, macroeconomic environment provides possibilities for long term planning if it is stable and predictable. Basic features of demographics that are important for many decisions in business are determined by health and primary education.

Higher education and training define fifth group of determinants explaining competitiveness of an economy. These determinants are very important in contemporary business that is mostly driven by innovation and managed by creative drive of the leaders. A knowledge economy and innovative, knowledge related business operation that are the goal of economies and of particular companies are standing on the shoulders of higher education and vocational training that mostly define the quality and the scope of skills that human resources may provide to businesses.

Efficiency of markets, the one of goods, the one of labor and the financial one are next three determining groups of factors for competitiveness of an economy. Efficient markets allow for flow of goods, experts and capital thus providing resources and inputs for entrepreneurial activities and means of distributing the outputs of these activities.

Ninth group of factors encompass technological readiness of companies to adopt and implement modern technologies with an emphasis on ICT that has become general purpose technology (GPT) of our times. Many times foreign direct investments determine the level of available technologies in an economy, thus the separation of this group of factors describing technology availability and the readiness to implement it from innovation.

Market size determines with great effect competitiveness of an economy in that the growth have been found to be related to trade openness i.e. market size. The inclusion of domestic and foreign market in overall market description and measurement provides for the unique measurement tool that can be applied for both developing and transitional economies and those more developed. It is also of utmost importance for international entrepreneurial activities to consider the size of the markets available worldwide.

Eleventh group of factors involve business sophistication that encompasses the quality of a country's overall business networks and the quality of individual firms' operations and strategies (Schwab & World Economic Forum, 2013). Both of these are especially important in very developed economies where more simple production improvements have been exhausted as a driver for productivity increase. Business network quality is also very important for an entrepreneur because of the cluster phenomena that is so influential in contemporary business.

The final, twelfth group of factors is related to innovation. It is very clear that this group of factors is the most important one since it alone can in a long run improve standards of living and productivity. It is especially true for developed economies that have existed means of improving productivity by application of existing technological solutions. As for the developing and transitional countries the globalization effects and dynamics of change in contemporary business environment make the innovation a must even for the companies in those economies that have ambitions to compete in world markets. The importance of innovation for international entrepreneurship activities is tremendous and usually such activities are depending heavily if not completely on an innovative service or a product.

In order to provide for better understanding of the described factors that determine the competitiveness of an economy, they have been grouped into three groups relating to the stage of economic development that each of these groups decisively influence. Thus, the first four groups determine predominantly the competitiveness and development of so called factor driven economies. These economies compete based on their factor endowments of which most important are unskilled labor and natural resources. Consequently the companies and entrepreneurs of these economies base their competitiveness on the price and are involved in activities such as sell of basic commodities and services. As an economy develops it becomes the efficiency – driven economy. The name comes from the fact that since the wages have risen in these economies they also have to maintain the increase in efficiency of production and quality of products and services in order to be able to increase their prices. In such economies factor groups five to ten are mostly responsible for determining competitiveness of an economy. Finally, when wages go even higher, the only way to sustain this is by having innovative and cutting edge products and services that are new and unique and are based on innovations. Such economies are labelled as innovation – driven economies and factor

groups eleven and twelve determine predominantly their competitiveness. As an illustration we will provide rankings of some economies according to (Schwab & World Economic Forum, 2013, 11, Table 2). Factor driven economies are mostly those of countries of Africa, South and Central Americas and Asia, such as Ethiopia, Nicaragua, India and Pakistan. Some of economies that are in transitional phase from factor driven towards efficiency driven are Azerbaijan, Iran, Saudi Arabia, and Venezuela. Efficiency driven economies encompass those of Bulgaria, China, Montenegro, Serbia and Romania. Transitioning towards innovation driven stage are among others economies of Hungary, Brazil, Poland, Russian Federation and Turkey. And finally some of the innovation driven economies are Austria, Czech Republic, Germany, Israel, Italy, Slovenia, Taiwan, UK and USA. Having this in mind one can assess the important competitive factors for companies and entrepreneurs willing to compete and start entrepreneurial activities aiming at international markets coming from certain economies and thus focus the attention of both theoretical analysis and practical efforts at these factors.

International entrepreneurial activities are dependent on Internet in variety of ways, from information gathering to product delivery and customer relations building. If Internet related entrepreneurial activities are analysed their success is positively related with three characteristics: Internet or online reputation, technological competitiveness related to Internet technologies and finally existence of Internet communities related to entrepreneurial activity, entrepreneur or the brand. The life cycle of an organisation that relates its business activities to Internet is shorter in general. Only 37% organisations with less than 20 employees reach the fourth year of the existence and 9% endures more than ten years in business ventures. All of these aspects have to be grappled with and pondered over by entrepreneurs planning to start international business activities that are nowadays almost exclusively Internet related.

4. THE VARIATY OF ENTREPRENEURIAL BUSINESS INITIATIVES

The importance of entrepreneurship in economy was very well researched and defined (Drucker, 1985), (Schumpeter, 1934). Many different theories and a well sized body of research exist on different features of entrepreneurship in an effort to get a better understanding of this complex phenomenon and find ways to foster it, all in line with its enormous importance for contemporary societies and economies. The role of individual entrepreneur has been also looked into and it seems to be one of the crucial factors influencing competitiveness of an entrepreneurial activity, especially if it is aiming for more complex and knowledge intensive international markets. High importance of entrepreneurs has been often related to their ability to advance innovative business operations, thus innovativeness and entrepreneurship are related in many ways some being straight forward, and some being more complex. Although this fact may be almost self-evident it has been for years that researchers have treated these two fields as almost separate and data have been collected through unique research dealing with either of these two topics and seldom with both as noticed in (Sandberg, Hurmerinta & Zettinig, 2013). In this paper researchers define some individual traits of those prone to innovate and those prone to entrepreneurial activities and then look at what traits are common for these two groups. Innovators have these unique traits according to this research: willingness to change and curiosity and interest in problem solving. Entrepreneurs have the following unique traits: high need for achievement, internal locus of control. Both group share traits of: risk-taking propensity, high tolerance of ambiguity, persistence and self-efficacy. Having these traits in mind, it is important for fostering competitiveness in e.g. efficiency driven economies to focus efforts in higher education and vocational training to individuals with such traits since they are highly likely to be the ones to engage in entrepreneurial activities. In order to create competitiveness in international entrepreneurial ventures such individuals should be educated to a highest degree practicable having in mind their field of interest and character traits that have been described, in order to maximize the competitiveness of the companies they might be establishing and running in the future. A fine example of importance of education for entrepreneurial individuals is depicted in biography of Steve Jobs, founder and CEO of Apple Inc, nowadays a very successful company started exclusively by entrepreneurial activities of Jobs. He has always underlined how crucial for his individual development has been the educational experience from elementary school where a teacher who made a difference made an enormous impact on him, to the college that he never graduated from, but where he learned many useful thing, not obviously related to ICT, such as calligraphy, that made a lasting impact not only on ICT industry, but on the whole Western civilization and its culture (Isaacson, 2011).

The personal story of Steve Jobs is indicative for another phenomena regarding entrepreneurship. It is a relationship between start-up entrepreneurship and the one that is exercised in later phases of a company life-cycle. This phenomenon called strategic entrepreneurship plays a key role for entrepreneurs that are

searching, combining and trying out new resource combinations in the pursuit of profits under uncertainty (Bjornskov & Foss, 2013). The idea of combining research of early phase of activities of an entrepreneur when his company is called a start-up and later phases in which he is wheeling an established company, but still is driven by same entrepreneurial drivers and same individual traits, taking risks, trying out new ideas, etc. brings to life a holistic approach to role of entrepreneurship in defining the comprehensive output of an economy and competitiveness of both economy and individual companies. Therefore this approach must be considered when discussing international entrepreneurship and its competitiveness especially in the future, since rise in body of research and knowledge in this area is expected along with its importance as an even greater number of economies will move towards innovation driven economic model.

Having discussed different personal traits of entrepreneurs and their importance for establishing international competitiveness of companies and economies, primarily their personal traits and their performance throughout the whole lifecycle of companies they are leading, it is not hard to come to understanding of the concept of the born global entrepreneurs. Those are the ones who start their entrepreneurial activities right in the middle of an international competition game, aiming for the global market right from the start-up phase of their companies. There are four propositions important for the born global entrepreneurs (Persinger, Civi & Vostina, 2007). The first deals with fact that the entrepreneurs with high need for achievement in the global arena will start globally oriented companies. If he is thinking in terms of international competition and thus international competitiveness, then it is likely that a company started will plan and execute its business operations in these relations. Next the entrepreneurs who decided to run as start-up that is aiming for the global or international market will not perceive their own behaviour as bearing special or higher risks. Again one is to consider the mind frame of the global born entrepreneur who thinks, informs himself, plans the business activities in global and not in local or national terms and therefore when it comes to acting on those thoughts information and plans it is not perceived as something very unusual or that bears a special risk. The third proposition deals with proactive attitude of an entrepreneur and such entrepreneurs will be more persistent in overcoming challenges in international markets (Persinger, Civi & Vostina, 2007). This is related to the final proposition of the authors, the one that makes relationship between strong global orientation of an entrepreneur and the high chance he will start a born global company. Again we see how important is the mind set of an entrepreneur in both overcoming challenges in new markets and for embarking on international or global entrepreneurial venture.

Having all this in mind, it seems like a good idea to provide a fuzzy comprehensive evaluation method for evaluating international competitiveness of entrepreneurial activities which is exactly what (Yanrong, Yu & Kang, 2011) propose in area of high-tech entrepreneurial enterprises. Their competitiveness evaluation index system comprise six indexes that deal with R&D ability, entrepreneurial ability, financing ability, marketing ability, profitability ability and growth ability. We have discussed in some length entrepreneurial ability driving mostly from personality of the entrepreneur and have concluded that it is a complex area influenced by many factors, an area that is very good suited for fuzzy logic solution. Therefore, further research building on proposed method is needed that will encompass additional elements and factors that influence entrepreneurs individual traits that are so important for competitiveness of international entrepreneurial ventures.

Finally, we will look into some of the activities of Internet entrepreneurship in Serbia that are international in their scope of activities as analysed in (Sofronijevic, Milicevic & Ilic, 2012). The good example for this is company Nordeus. It embarked on international business venture by launching Top Eleven software game through Facebook and Internet app stores for Android and iOS devices. By reaching global markets Nordeus established an international brand that brought it one of the prestigious The Europas awards for the best start-up in computer games in Europe 2011 (www.nordeus.com).

5. CONCLUSION

When contemplating business model as a basis for the analysis of international competitiveness of entrepreneurial activities in contemporary business, one have to bear in mind the broadness and complexity of business model concept. There are several emerging areas of interest related to business model concept such as business model being a new unit of analysis, its holistic approach to describing of how companies do business, relationship between business activities of the company and the underlying business model and explanation of how value has been created departing from the idea of explaining just how value is captured in a certain business model (Zott, Amit & Massa, 2011). Ideas as such present great expansion and

broadening of conceptual base of business model concept that allow for broader and more complex and all encompassing analysis of the entrepreneurial business. On the other hand, one always have to include the institutional context in the analysis of entrepreneurial activities, for especially in contemporary business there is no such a thing as a intervention free market or total freedom of capital, labor or product flow. A good example of such tendencies is presented by analysis of 2.854 life histories of entrepreneurs from twenty Chinese cities in order to conclude that the institutional background plays a very important role in defining entrepreneurial activities in China (Lu & Tao, 2010). The level of institutional influence is not the same all over the world, one may say that in China it plays a more important role than in some other markets and economies, but when one is envisioning an international entrepreneurial activity and analyze related competitiveness of the company involved, one has to factor in the important role of institutions in the economy. In order to do it, entrepreneur has to be very well informed and interested in international and global envisioning of his business.

International competitiveness of entrepreneurial activities is highly related to traits of the entrepreneur, but other factors influence this important business feature. In order to understand well and use it to one's own advantage, international competitiveness needs to be analyzed and business model lends itself as one comprehensive and practical, though complex tool for this purpose. Therefore those looking into area of international competitiveness of entrepreneurial companies and entrepreneurs need to grapple with and make best use of business model concept if they are to analyze, envision, plan or research this complex phenomena.

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THE EVOLUTION OF THE PUBLIC DEBT IN ROMANIA AND SERBIA, DURING AND AFTER THE GLOBAL RECESSION

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Abstract: *This paper describes the special evolution of debt of Romania and Serbia, during and after the recently completed global recession, with a focus on public debt. After a brief theoretical introduction and an equally short review of the recent literature devoted to the subject, the authors stress both the common elements and the particular aspects of the upward trends of borrowing in the two economies, concluding with some final remarks and a tentative anticipation of short-term and medium-term evolution.*

Keywords: *external or foreign debt (ED), public debt (PD), governmental debt (GD), Gross Domestic Product (GDP), export (X).*

1. INTRODUCTION

Debt issues dominate economic history, and the economic history of the last three decades has dilated it in point of volume and impact, up to limits that are hard to accept and not in the least anticipated. Two concepts prevail in the language of this significant economic chapter: external/foreign debt and public debt, and in particular the last one has caught the attention of recent research.

External Debt (ED) means an amount in foreign currency payable, at a given point in time, by an economy to other economies and/or international financial institutions, in keeping with the loans received by the government and private companies, under the government's guarantee, and is to be paid over a period longer than one year. This sense is used in international statistics, and is understood as external public debt, not including loans with maturities under one year, which were contracted without the government's guarantee. Foreign debt can be gross or net, after deduction, from the gross external debt, of its own claims in relation to non-residents. In determining net foreign debt, only claims (rights) are taken into account, or those that can be easily mobilized (for which there is the perspective of collecting it from foreign debtors is clear).

Public Debt (PD) represents all the obligations that the state (government) assumes when contracting internal and/or external loans to finance public economy. Public debt is related to the financial intervention of the state (government) in the economy, which aims at forming public capital, stimulating investment, increasing employment. In its broadest sense, public debt also includes visible debt, resulting from cash deposits in public vaults, which is payable at any time by the depositors. In terms of material content, it can be of goods and values, in terms of its destination it may be of consumption and of production, and in terms of duration it may be long-term, short-term, etc. *Encyclopaedia Britannica* definition shows that "*public debt represents the obligations of governments, particularly those evidenced by securities, to pay certain sums to the holders at some future time, being distinguished from private debt, which consists of the obligations of individuals, business firms, and nongovernmental organizations.*"

The debt owed by national governments is usually referred to as the national debt and is thus distinguished from the public debt of state and local government bodies (http://www.britannica.com/).

Much of the literature on the topic of debt produced in recent years has tried, and it is still trying, to provide and present original solutions and new methods of reassessment of those phenomena and thresholds, and especially of forecasting external and public debt (Knedlik, Von Schweinitz, 2012), or even extends the analyses related to the same range of problems in geographic behavior areas (Hrvoje, 2013), considered similar in point of behaviour.

Contemporary theory continually redefines the essential role of foreign and public debt and the financial development of an economy, while delimiting a number of debt sustainability problems that are increasingly acute, so the tendency always appears of expanding the universe of financial research and enrich it with new instrumental or cross-disciplinary solutions – crossdisciplinarity being accepted today as the *application of field-specific methods and their recognized use in fields that are altogether different from the original ones*, with special effects and an increased relevance in understanding the phenomena in question (Săvoiu, 2014). In this regard we can mention the identification and statistical quantification of certain limits through indicators having the nature of restricting debt by the budget, going as far as the maintenance, through close monitoring, low thresholds for reference interest rates, a phenomenon of quantification of incipient “financial repressions”, through statistical indicators (Reinhart, 2012; Prabha and Savard, 2013), continually assessing and predicting a phenomena which is hard to achieve in practice, suggestively called *liquidation of public debt*, particularly aimed at *government debt* (Reinhart and Sbrancia, 2011).

A new approach to adjusting the level of public debt in a more sustainable manner is more clearly distinguishable, based on a slightly more stable fiscal measures, or on measures with no temporary character, there being constant monitoring and the analysis of results being conducted at an ever shorter time intervals, noting that tax recovery and reducing debt, however, require a long time, as process management activities (the current Eurostat indicators system operates, during the recession, and especially after recession, with quarterly periodicity). The attempt to scale, through innovative indicators, “the hidden areas of public debt” (IMF Survey, 2013) is another original solution for analyzing debt, stratified in keeping with the level of development of the economies.

Kenneth Rogoff and Carmen Reinhart, who analyzed and quantified the phenomenon of debt over nearly eight decades, between the two great historical recessions (starting in 1929, and in 2007), noting that, after more than three years of financial crisis of the system, plus another three years of recovery (basically, over a period of about six years, i.e. the duration of the latest recession in the Balkans), the debt of a country tends to increase, on average in the first three years, with 86 percent of its original level, and after six years it tends to double in relation to the volume of exports, because of these very hidden areas of the debt; the delimitation of the hidden area especially regards commitments for future budgetary payments related to the pension scheme, which is under the pressure of an aging population; thus, those thresholds or limits of debt are set, where its effects turn from positive to negative, and the debt itself becomes *unsustainable*. (Cecchetti, Mohanty, Zampolli, 2011).

In the European community the preference is maintained related to primarily evaluate public debt, and more especially government debt, whose theoretical limit amounts, in general terms, within the European Union (EU) and European Monetary Union (EMU), to 60% of GDP. In Romania, secular studies (Reinhart, Rogoff, 2010) place the alarm threshold even lower (at about 41%), while for Serbia, which has a much higher per capita income and a higher degree of development, the general alarm level remains that proposed in pre-accession (EU) and (EMU), i.e. the same 60%.

The intention and the originality of the present paper is to exploit the method of confronting, in statistical terms, the phenomenon of borrowing and the statistical indicators in the two Balkan economies (that of Romania, a member of the EU, and of Serbia, which is currently in the pre-accession phase), behaving in a relatively similar ways in their modern history of nearly one and a half centuries.

2. A BRIEF STATISTICAL ANALYSIS OF THE ALARMING UPWARD EVOLUTION OF PUBLIC DEBT IN SERBIA AND ROMANIA

Due to a series of social and geopolitical discontinuities in Serbia, analysis of public debt in the period before the year 2000 are not suitable. After that, the public debt of the Republic of Serbia shows two distinctly different trends:

- decreasing trend between the years 2000 and 2009, and
- increasing trend since 2009 until today.

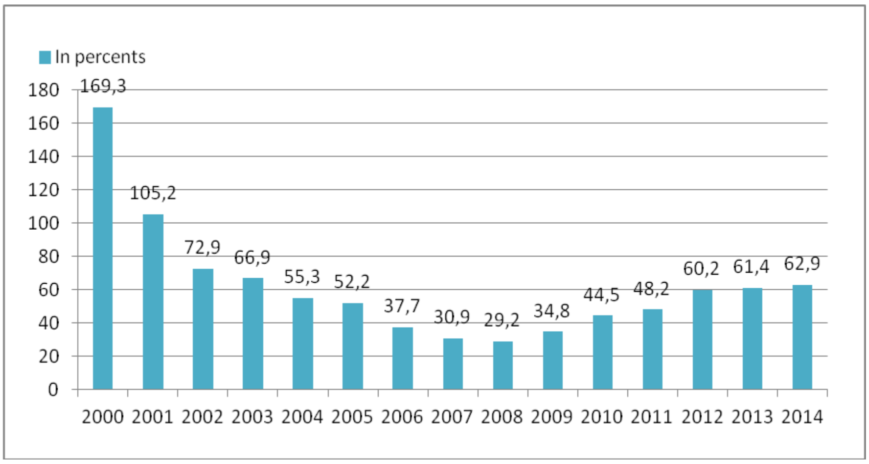

Figure 1: Public debt of the central government share of GDP%
Source: Uprava za javni dug, February 2014, page 9

If we analyze trend and base for the decrease of the public debt share of GDP in the period up to year 2008, we can carry out important conclusions. The most significant debt reduction occurred by the year 2004, based on agreements on writing off debts (66% of the debt to the Paris Club, 62% of the debt to the London Club of Creditors (until 2003)). Further reduction is a result of repaying a debt of 1.3 billion euros on the basis of old foreign currency savings and domestic debts based on delays. Since 2004, the acceleration of the privatization process and the use of privatization revenues to cover the budget deficit made it possible to achieve the low amount of new loans, and in 2008 Serbia was in the group of low-debt countries.

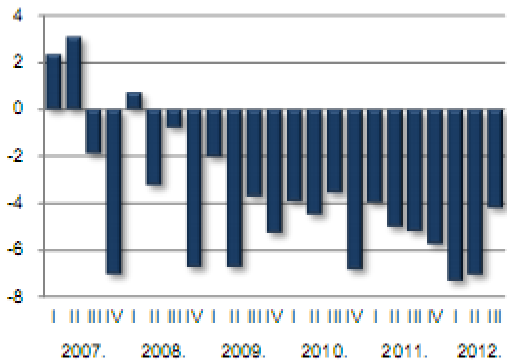

Figure 2: Fiscal budget deficit/suficit share of GDP% for Serbia, 2007-2012.
Source: Šljivić, S.,Jevtić, B., Šljivić, S. 2013. page 508

Since 2009, with the first effects of the global economic crisis, public debt starts to grow both in absolute figures, as well as a share of GDP. The main causes for this increase were: primary fiscal deficit which was financed by the loans, as well as the activated government guarantees for debts of public enterprises, but also a remarkable decline in net foreign direct investments. Correlation between budget deficits and public debt points to the key motive for borrowing, and that is maintaining the budget stability, while the relationship between the public debt trends and economic activity is negative.

For example, Romania can be extrapolated, as lying relatively close to the average trend of the South-Eastern European area, and especially the Balkans. Romania makes a relatively common instance for the two areas in point of overall trends in the phenomenon of borrowing. We exploit three waveforms that cyclically dismantle (in a Kondratiev manner) three similar historical periods in the two economies, defined by upward-downward repeatability, based on the visual support of the graph for a logical statistical thinking, the quality of which is recognized for the phenomenological approach to temporal variation (Figure 3)

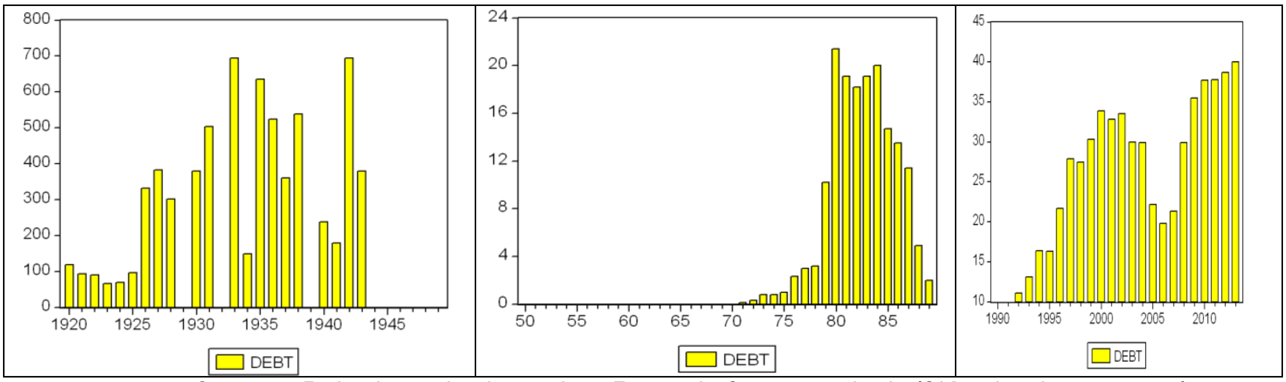

Figure 3: Debt dynamics in modern Romania for two and a half Kondratriev type cycles
Source: Săvoiu, G., (2014), figures 5-7 pages 5-7.

The main statistical indicators of public debt are the indicators of public indebtedness (PD, PD/GDP, PD/inhabitant and total annual change of PD in %), and, in separation, the indicators of public debt service or the annual financial burden of public debt repayment (PDS, PDS/GDP, and PDS/inhabitant) (Săvoiu, Apostol, 2013). A breakdown of the values of these indicators in the first category shows rising levels developments, and especially increasingly alarming dynamics.

Table 1: Major statistical indicators of the level of public debt of Romania and Serbia, during and after the crises

	Romania						Serbia					
	2007	2008	2009	2010	2011	2012	2007	2008	2009	2010	2011	2012
Public debt - PD – mil. USD	24863	33906	39704	45280	48645	55293	12526	12901	12908	14539	16105	18667
PD/GDP (%)	17.1	19.6	22.3	26.8	29.3	31.9	35.8	30.4	30.8	37.1	43.5	48.5
PD/Population - USD/inhabitant	1152	1576	1849	2108	2268	2580	1695	1748	1754	1985	2205	2567
Total annual PD change (%)	47.3	36.4	17.1	14.0	7.4	13.7	2.4	3.0	0.1	12.6	10.8	15.9

Source: *Economist Intelligence Unit,* available on-line at: http://www.economist.com/content/global_debt_clock.

Public debt in early 2013 was, according to World Bank data, 172.5% of Romanian exports, and 182.2% for Serbia, as the general theoretical limit accepted for PD/X is 200%. Much more serious, however, is the debt level reached after six years of analysis, i.e. multiplied by 2,224 times for Romania, and only 1.49 times for Serbia. At the same time, the negative legacy of debt (i.e. the debt inherited) rises from the parents to their children 2.24 times in Romania, and 1.52 times in Serbia. The GDP/inhabitant indicator in the two economies is totally different at the beginning, which appeared to require separate analysis thresholds, but is strikingly close at the end of the period analyzed. The most serious evolution remains the structural one: the share of public debt in GDP in Romania increased from 17.1% to 31.9%, and 35.8% to 48.5% in Serbia, in about six years of recession and post-recession, and the outlook becomes really alarming, asking for immediate concrete policies with major financial impact.

Table 2: Short-term and medium-term outlook for public debt indicators in Romania and Serbia

	Romania			Serbia		
	2013	**2014**	**2015**	2013	**2014**	**2015**
Public debt - PD – mil. USD	59481	**63670**	**67859**	21359	**24052**	**26745**
PD/GDP (%)	34.4	**36.9**	**39.4**	60.3	**72.2**	**84.1**
PD/Population - USD/inhabitant	2778	**2975**	**3172**	2950	**3333**	**3715**
Total annual PD change (%)	7.6	**7.0**	**6.6**	14.4	**12.6**	**11.2**

Source: *Economist Intelligence Unit* for public debt* (http://www.economist.com/content/global_debt_clock).

The question whether there is a statistical association between public debt and economic growth, or, to put it differently, if public debt is justified as a factor of development and, especially, as infrastructure investment support intended to change the economy, has a disappointing answer.

Table 3: Associable or correlated potential indicators characterizing public debt and economic growth

Year	Romania				Serbia			
	GDP growth (%)	PD(%)	GDP/ capita	PD/ capita	GDP growth (%)	PD(%)	GDP/ capita	PD/ capita
2007	6.3	47.3	8170	1152	5.4	2.4	5277	1695
2008	7.9	36.4	9949	1576	3.8	3.0	6498	1748
2009	-6.8	17.1	8069	1849	-3.5	0.1	5498	1754
2010	-0.9	14.0	8139	2108	1	12.6	5073	1985
2011	2.3	7.4	9064	2268	1.6	10.8	5964	2205
2012	0.4	13.7	8437	2580	-1.7	15.9	5190	2567

Source: http://data.worldbank.org/indicator

A correlation matrix, even considered for a very small number of terms, delimits both similar and different behaviours in the two economies according to the values of the determination coefficient in Table 4 (which contains the values of the correlation ratio, or of simple R resulting from the classic R squared):

Table 4: Correlation Matrix

	Romania				Serbia			
	GDP growth (%)	PD(%)	GDP/ capita	PD/ capita	GDP growth (%)	PD(%)	GDP/ capita	PD/ capita
	SER01	SER02	SER03	SER04	SER05	SER06	SER07	SER08
SER01	**1.000000**	**0.655422**	**0.644427**	**-0.457696**	0.907705	-0.062483	0.486256	-0.161364
SER02	**0.655422**	**1.000000**	**0.160833**	**-0.906713**	0.722941	***-0.628160***	0.178830	-0.666111
SER03	**0.644427**	**0.160833**	**1.000000**	**-0.068513**	0.405304	-0.089228	0.932734	-0.053051
SER04	**-0.457696**	**-0.906713**	**-0.068513**	**1.000000**	-0.660397	0.827000	-0.211983	0.897560
SER05	0.907705	0.722941	0.405304	-0.660397	**1.000000**	**-0.209301**	**0.318033**	**-0.414691**
SER06	-0.062483	-0.628160	-0.089228	0.827000	**-0.209301**	**1.000000**	**-0.371959**	**0.897362**
SER07	0.486256	0.178830	0.932734	-0.211983	**0.318033**	**-0.371959**	**1.000000**	**-0.271773**
SER08	-0.161364	-0.666111	-0.053051	0.897560	**-0.414691**	**0.897362**	**-0.271773**	**1.000000**

Source: Data from table 3. Software used: EViews

The analysis of the correlation between GDP growth (%) and PD (%) identifies an average connection between *public debt and economic growth*, visible and relevant in Romania, which has now a much more open economy under the impact of the crisis and the recession, and also under the impact economic of restarting growth, as a EU member, and a negative relationship, or almost a non-existent one, meaning at the limit of statistical testing, in Serbia (R= *- 0.209301*).

Large inflows of foreign capital through credits, privatization and foreign direct investment (FDI) has been a major source for financing high consumption in Serbia in the period between 2005 and the middle of 2008 (Popovic, N. Jaško, O, 2012), which had the influence on economic activity, with the GDP growth rate greater than 5%. However, the economic crisis has refocused the use of these sources to cover the budget deficit, in which was observed, opposite of the required, permanent reduction of spending on infrastructure projects and the economy (up to 5% of the national budget), while the allocation for salaries in the public sector and pensions grants remained at the same level (about 55% of the national budget). On the other hand, FDI were almost stopped, given that many companies performed operations contractions during the crisis in order to fit these new circumstances.

Reduction or stabilization of the public debt is possible on the basis of reductions in public spending or through tax increases (budget inflows). In the short term, reforms in public sector in order to reduce budget expenditures may be sufficient to stabilize the debt of Serbia, while the long-term debt reduction needs tax policy that is associated with the stimulation of investments in the real sector and individual demand. Particulary acceptable operations are those that operate in both directions, especially Public Private Partnership (PPP), which do not increase public debt, and substitute public sector investment and increase demand.

On the other hand, after statistical confrontation between the two countries, the values of R highlight a strong positive relationship (having an evolving nature) between the dynamics of economic growth in Romania and Serbia, and between the debt dynamics per inhabitant, as well as a contradictory reversed, or staggered (R= *- 0.628160*) relation between the temporal trends of indebtedness of the two countries, according to their financial and monetary policies, which are distinctly separate at the moment, but are probably likely to be common in the near future, as EU member states. From this emerges an important remark, highlighting the advantages of EU integration, i.e. synchronicity and integration into the EU economic cycle can bring about, through "contagion", in addition to other advantages, some optimization in debt policies: public debt is much better correlated with economic growth and much more appropriate in times of recession in Romania, compared to Serbia; the remaining trends are similar for the two economies.

A tentative econometric modelling could only be achieved for the Romanian economy (Săvoiu, Apostol, 2013), where comparative data are available for a longer period of time (minimum 15 years or items in the model).

Table 5 summarizes two specified econometric models for Romania, parameterized and validated, with public debt as endogenous variable (a unifactorial and multfactorial model as possible examples).

Table 5: Two econometric models of public debt (PD) in Romania between 1997 and 2012

Dependent Variable: PD Method: Least Squares Specified models for the 16 – term series	R-squared	F-statistic
$PD_i = 31.90 + (-2.41) \times FDI/GDP_i + \varepsilon_i$	0.621825	23.01993
$PD_i = 111.70 + (-1.55) \times FDI/GDP_i + (-3.56) \times EUFCF_i + (-0.669) \times$ Savings in $EU_i + \varepsilon_i$	0.802784	16.28232

Software used Eviews. Source: (Săvoiu, Apostol, 2013a, page 25-26)
Note: Foreign Direct Investment as % of GDP = FDI/GDP_i; European Union Fixed Capital Formation as % of EU GDP = EU FCF_i.

The major conclusion of this analysis shows that econometric models can be made to simulate and estimate or predict the dynamics of public debt, as well as some aspects of the most important exogenous variables that contribute to an optimized and efficient debt service applied to various periods or horizons.

3. SOME FINAL REMARKS

The present paper started from the idea to emphasize the importance of public debt, of statistical confrontation on this issue between the economy of Romania and Serbia in general, and also the assessments and modelling which are possible, but did not limit tiself to the public debt, which requires a special, detailed treatment, exceeding the space of a midsize paper. The significance of public debt issues goes beyond many other important economic policy issues relating to accession and convergence processes, because of its effect on major economic equilibria, and especially on economic growth, optimizing the ability to consistently and sustainably manage the public debt process, turning it into a process of investment and development impact, in parallel with a process of inflation control.

Of course external debt is also important (i.e. at the beginning of 2013, Romania's foreign debt already exceeded the alarm level of 100 million, i.e. about ¾ of the official GDP), but the monitoring tools to do that are much more improved, and the solutions are much more efficient, and the experience of both economies is already relevant from the periods prior to transition, through the balance of payments and balance of trade analyses.

The aggravating prospects of global public debt, which is likely to exceed USD 55.802 billion no later than at the end of 2015, and the prospects of Romania's and Serbia's public debt, which at the end of the same year 2015 will be around USD 67.9 billion, and 26.75 billion respectively, require statistical analyses based on innovation both instrumentally and methodologically, foresight solutions and policies focusing on new econometric modelling and simulations. In the past six years, public debt has followed an upward trajectory aggravating through its consequences speeding up, and even defining, a globalizing process. Public debt has relevant advantages and disadvantages. The first category includes help to the National Bank in the monetary policy, the ability to avoid the negative effects of taxes against incentives and increased government spending, finally managing to develop the economy of any country, but leaving an unsustainable legacy for next generations. However, when public debt exceeds the theoretically admissible limit, more and more long-term economic difficulties are generated, and this is what really happens in the case of Romania and Serbia.

If for the economy of Serbia, which is on the eve of EU accession, there are no previous secular studies, which induces the threshold of 60% of GDP as the natural limit of the moment, for the Romanian economy there are international researches. Thus, in a famous 2003 paper, which examined debt carefully in relation to GDP, a threshold of 41% of GDP was established, upwards of which the effects of debt start inducing not the economic growth required of an EU economy towards the EU-28 average, but rather to the diminishing of its economic growth (Reinhart, Rogoff and Savastano, 2003).

The analysis in that paper highlights, among other things, that both Serbia and Romania have exceeded it in the short and medium term, that is rapidly and dangerously approaching the *sustainability* limit the of public debt, i.e. 60% and 41% of GDP respectively, or the maximum level accepted by investors for these countries. The paper mentioned insistently emphasizes the importance of the phenomenon, and generating new economic policies that do not *neglect the signals provided by the general public debt indicators, and by internal debt, especially*, first, because "*internal debt is already nearly two-thirds of the public debt*" (Reinhart and Rogoff, 2011), and secondly, because the indicators are becoming ever more explicit and turning into increasingly lower warning thresholds, and thirdly, because the domestic market needs to be increasingly investigated and monitored, confronted with similar markets and simialr effective solutions, largely ignored in the literature on the complex phenomenon of public debt.

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THE ECONOMIC CONVERGENCE PROCESS TO EUROPEAN UNION: SOME TRENDS AND CHARACTERISTICS OF ROMANIAN AND SERBIAN ECONOMIES

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Abstract: *This paper analyzes economic convergence of economies of Romania and Serbia. First part of the paper is dedicated to theoretical description of knowledge and its relation with other evolutionary concepts such as transition, convergence, teleonomy, semiconvergence, accession and integration. After that three hypothesis of convergence are analyzed and described in short. Economies of Romania and Serbia are descibed using convergence criteria, namely: price stability, sound public finances or a sustainable fiscal position, exchange rate stability and low long-term interest rates. Similarities are observed between those economies, and trends and characteristics are described. Paper concludes with evaluation of future prospects for sustainable convergence or economic divergence on the other side.*

Keywords: *Economic convergence, transition, EMU, public debt, budget deficit*

1. INTRODUCTION

This paper describes several evolutionary concepts (transition, convergence, emergence, teleonomy, semiconvergence, accession, integration), which are specific to the economies of Romania and Serbia, from the transition to a market economy to convergence, emergence, etc., focusing on real convergence of countries in Europe. After an introductory overview of the major concepts, from emerging convergence to teleonomy, devoted to the subject, the authors highlight and detail the concrete criteria for evaluation economies of Romania‟s and Serbia‟s according to the convergence criteria, ending with a few conclusions regarding semiconvergence rather than complete convergence.

An open economic system, analyzed as a specific structure, either static or dynamic, as in the national economies of Romania and Serbia interpreted in keeping with the systems theory, can become unstable and generate a new structure, through processes of self-organization, which reinstates, in a broad sense, the subsystems of the respective economies, through an adaptive evolution focused on survival and change, being also characterized by evolving complexity and non-linearity, and generating, in terms of the same systems theory, *order out of chaos* (Holland, 1998).

Convergence is: a) a circumstantial concept, defined by a state of similarity, either structural or complete, and also partial or incomplete, or limited, of a small number of parameters of level, which an economy, seen as a complex open system, must reach in over a certain period or range of time; b) a mainly process significance, containing at the same time components of the concept of similarity, and also complementary elements, finally generating a broader concept of harmonization; c) a term having a forecasting nature, which implies reaching a level or target, to which an economic phenomenon is converging, which is approached both spatially and temporally, as a gap or recuperation period (a time interval of development in advance, or a period of lag recovery); d) an instrumental concept of financial economics and financial statistics, intended to confront or compare, watching the coherent economic fusion of economic subsystems, or even economies, into a larger system or an economic union, by constant identification and ranking of developments and by dealing with a number of performance benchmarks, or values considered mid-level of a standard subsystem (an economy parameter, the average level of the aggregate, a modal or median value of a normalization phenomenon, etc.); e) an integrative phenomenon of a dynamic and systemic nature, involving pooling in order to achieve economic and social objectives that are assessed and updated regularly based on historical requirements.

Convergence systemically implies other phenomena as well, or at least some aspects of them, generally having a biological origin, such as *emergence* (Chalmers, 2006) and *teleonomy*. The former concept, *emergence*, defines *a complex phenomenon, part of a cycle of change* (Holman, 2010), *the result of a simple* *combination between low level mechanisms in simple ways, being an intrinsic property of open complex systems of any kind*, or describes the appearance of a new organ, of new structures or some new properties of higher order, a form of change, and from that angle it is regarded as actual birth of something entirely new in an open environment (it is easier to illustrate it physically by radiations, bodies escaping an environment after travelling through it).

Emerging phenomena are related to meta-equilibrium, even if at the level of subsystems everything may seem unbalanced, from a global perspective the system can remain stable and orderly (hence *the theory of emerging evolution in the process of development* argues that the emergence of new qualities is absolutely spontaneous and unpredictable. Theoretical systems purely emerging as complex adaptive systems generate *novelty*, are *unpredictable*, ensure *consistency* and *integrity*, determine *self-maintenance* or relative stability against environmental variations and any changes that occur in their internal structure, also being *asymmetrically causal* – the newly acquired properties are determined only in the “bottom-to-top” direction, never the other way around).

The emergence of such systems takes the form of *weak emergence*, or emergence *explained in a deterministic sense* (a complex statistical causality that is measurable as direction and intensity), or *strong or indeterministic emergence* (Osberg, Biesta, 2007) based on a high degree of risk and uncertainty (the probabilities and their dynamics or their historicity outlining emergence scenarios, or scenarized emerging trajectories of an evolutionary type).

Convergence is not identifiable to transition, in terms of its significance, although apparently, or purposefully, it can be confused with that concept. The example raised for nearly half a century in the national economies of Romania and Serbia (1945-1990) was that of transition from capitalism to socialism, which was in fact *nothing more than the emergence of a system or regime of state capitalism under the leadership of a single communist party*, followed, for nearly a decade and a half or two decades, by the transition to a market economy in both Romania and Serbia, a post-communist transition inspired by (neo-) liberalism, in search of a structural, procedural and organizational end superior in economic efficiency.

Transition is in itself a transitory, temporary or transient phenomenon or process, a transformation phased as a *stage* or period, a transformation or a change in the economy, but *a radical and temporally limited one* (Dăianu 1997; Dinu, 2000). On organizational level, changes are dominantly implemented by interweaving periods of incremental changes with periods of radical transformation (Lewin, 1951; Dulanović&Jaško 2007). In the history of any economy there coexist a larger or smaller number of transitions and several ways to express these “sudden changes” or “paths of accelerated development” from one type of economic and social structure (form of government, economic organization, etc.) to another, which “accelerate” the natural phases, as are styled economic transitions in dictionaries or in an economic literature generating a genuine theory and various distinct patterns or models of transition (for example, writing about the transition in Romania, Joseph Stiglitz identified the main factors of a predominantly negative role as being the too restrictive fiscal policy, the legislation that kept changing, and the absence of programmes meant to create opportunities for business,).
A recent signification of convergence has dominated the last decade and a half, being in a visible expansion, both in frequency of terminology usage, and intensity and depth of statistical determinations; it is narrowing to the scope of the European Union, and conceptually characterizes the time course of a number of processes related to the conditions of pre-accession, accession and post-accession to this interstate union focused on regional componency, as well as and phenomena generated by ensuring economic and monetary stability concerning the criteria for accessing the Euro region, as a natural and constitutional consequence of state membership, derived from intra-community evolution towards higher stages of the integration process.

In this particular manner, and referring the vast and complex phenomenon that brings together both joining and integration into the EU, *economic convergence* grounds, in the new millennium, the macro-financial architecture of the countries or economies that are to become members of the euro area, and globally it concerns the very globalization process. The birth EU was conducted around three main axes, or three pillars: a) the pillar of the European Communities; b) the pillar of common security policies; c) the pillar of judicial cooperation in criminal and police matters. Later the concept of European citizenship was introduced, and the European Parliament‟s powers were strengthened, to shape, as early as 1999, with the advent of the euro, an original economic and monetary union, within which the economic convergence of the component countries or states became the fundamental issue. The meanings of economic convergence multiplied suddenly: a) a phenomenon of transition and integration of economies within a common monetary area with internationalization trends, through economic stability-oriented processes (the euro currency is illustrative in parallel with the requirements of the Maastricht treaty, which became gradually financial criteria expressed in a rigorously statistical manner, maintained and subsequently consolidated at Amsterdam in 1997, institutionalized in Nice in 2001, legally customized in Lisbon in 2007, etc.); b) synchronization of business cycles against asymmetric shocks (Frankel, 2004), felt integratively or community-wise, and anticipated and eased as impact limiting thresholds); c) the generally valid assumption that income per capita (GDP per inhabitant or national income available per capita, etc.) of the developing economies tend to grow faster and with higher rates than in developed economies, to finally find that all economies show a clear trend of convergence concerning income per capita (Le Gallo, Dall'Erba, 2006), due to the effect of recovery, in time and space, of the gap between economies, which is called the *catch-up effect*); d) similarity by gradual harmonization of the level of productivity and export share of non-tradables, in an aggregate context of trade integration of national economies (but also taking into account the Balassa-Samuelson effect, revealing faster productivity growth in tradable sectors than in the non-tradable sectors, in the economies of less developed countries)[1]; e) similarity of economic structures, which become synonymous with complementarity and harmonization of economies in an aggregate or intra-community space (the usual example starts from the shares of agriculture, industry and services in GDP), as pointed out in a recent study, in which a deeper analysis is conducted by another author (Dinga, 2008);

Extended economic convergence holds in practice as many as four dimensions: a) *nominal* or strictly monetary convergence, targeting economic stability and the transition to the single European currency; b) *actual* convergence, which is intended to diminish disparities (especially felt by income and productivity); c) *institutional* convergence, i.e. ensuring compatibility of institutions; d) *structural* or *complete* convergence (Iancu, 2006). There coexists, in the theoretical field, still other classification of convergence, one of an instrumental and parameter type: **β** (conditional on the initial state), **σ** (similarity GDP/capita), **γ** (business cycle synchronization), **δ** (similarity of convergence factors), **α** (similarity of the economy structure), etc., a classification which is frequently used in the structuring of the phenomenon and its distinct modelling instances. In essence, the neoclassical theory of economic growth postulates that all economies that are characterized by formal similarity of the basic parameters (of the production function) will achieve the same level of development, regardless of their initial position.

Based on these findings, three hypotheses of convergence were formulated in the convergence theory: a) *the absolute* (or unconditional) *convergence hypothesis*, according to which the level of income per capita across countries converge in the long term, regardless of their initial conditions b) the *conditional convergence hypothesis*, according to which the level of income per capita in countries having fundamentally identical structures converges in the long term, independently of the initial conditions; c) the *club or group convergence hypothesis* (Baumol, 1986), in which the GDP per capita in countries that have the same fundamental structure, converges in the long term either by an increase in GDP per capita, leading to clubs (groups) of nations with very high incomes, or by a decrease in GDP per capita, generating clubs (groups) of nations with very low incomes, assuming that the initial conditions are similar. Testing those hypothesis has led to the initial definition of several types of convergence:
a) *type* **β** *or "beta" convergence*, arguing that, in the long term, in the context of the absolute convergence hypothesis, according to its own regression equation and its own *regression coefficient* (Sala-i-Martin, 1996), developing economies tend to grow faster than developed ones, and in the context of the conditional convergence hypothesis, there is the same phenomenon, but with some altered parameters, depending on a number of determinants (focused on the link between classic convergence of the quantitative type, and contemporary convergence, which also includes qualitative aspects, also reflecting reducing disparities or processes of deletion of the *gaps* (whether *dimensional gaps* or gaps of macroeconomic correlation, gaps *of dynamics* in the real economic variables, and *simple structural* gaps, or structural differences that exist between two entities segmented methodologically), rather than the *catching-up* ones, defined as dynamic recovery, at different rates, on short and medium term, for the less developed economies and developing economies relative to developed economies (generating economic paradoxes or dilemmas, such as the Lucas type of paradox or the Tosovski dilemma);
b) *type σ or "sigma" convergence*, indicating a decreasing variation of income per capita in a group of countries; this type of convergence is expressed by the statistical indicator of the *coefficient of variation of GDP per capita*, and is fairly commonly exploited in analyses of convergence or economic studies, through the mathematical expression based on an indicator resulting from the classical statistical algorithm of the coefficient of variation ($\boldsymbol{\sigma_t}$); its interpretation is quite straightforward when $\boldsymbol{\sigma^2}$ or the dispersion of the phenomenon considered is decreasing over a certain period of time, or a transverse process (or in a certain

[1] In a study conducted on a total of 111 countries, and implicitly as many national economies, during the two decades between 1970 and 1989, Jeffrey Sachs and Andrew Warner (1997) concluded that the economies of the developed countries had increased by only 2.3% / year per capita, while developing countries had a 4.5% increase, and isolated countries or closed economies similar to an apparently closed system barely reached 2%.

spatial delimitation) of national economies (and even parts of these), or when the value of the coefficient of variance **σ** decreases, then a convergence process (**$\sigma_{t+1} < \sigma_t$**) is identified;
c) *type* **γ**, *or "gamma" convergence* (quasi-real convergence), which can be described as synchronization of business cycles, is valid even in conditions in which, structurally, there are notable differences between the economies analyzed as open system or ensemble of open phenomena (synchronization of business cycles may have positive effects in terms of eliminating asymmetric shocks by making them symmetrical shocks, as exemplified by the general monetary policy in the euro area);
d) *type* **δ**, *or "delta" convergence* (Dinga, 2008), which requires *similar levels of real convergence factors for two or more economies*, or at least an identical "list" of convergence factors, yet not necessarily also similar levels of these (once the convergence factors become similar in two economies, the convergence process would be an already completed one);
e) *convergence of type α or "alpha"*, which involves "the final target or ultimate destination type" of any economic development, and is emphasized by *a similar structure of the economies compared, although permanently raises important issues of methodology and dimensions that are hard to solve* (once solved, the idea of a process of convergence disappears as well).

2. CRITERIA, LIMITS OR THRESHOLDS OF CONVERGENCE, AND ILLUSTRATIONS FOR ROMANIA AND SERBIA

According to the Protocol and Article 109j.1 of the *Maastricht Treaty* (the original article was later renumbered to become Article 121.1 of the *Treaty of Amsterdam*, and later again renumbered as Article 140 of the Treaty on the Functioning of the EU), the criteria of nominal convergence and the explanatory elements, thresholds, limits and normal bands of variation (fluctuation) in the European Union refer to: a) *price stability* (the average inflation rate recorded during one year before the euro zone access must not exceed by more than 1.5 percentage points the inflation rate of three member states scoring the best results in terms of price stability); b) *sound public finances or a sustainable fiscal position* (limiting public debt below 60% of GDP; limiting budget deficit below 3% of GDP); c) *exchange rate stability* (respecting the ± 15% band as the normal band of variation (fluctuation) provided by the exchange rate mechanism for at least the last two years before the country‟s access to the EMU, and the absence of action of devaluation of the national currency against the euro during the same period); d) *low long-term interest rates* (achieving a level of long-term interest rates that does not exceed by more than 2 p.p. the average of the interest in the three countries with the lowest interest) Note: p.p. = percentage points.

In international economic literature, among the numerous opinions, an increasing clear conceptual similarity is identified between *the properties of optimum currency areas (points 1-5)* and the *real convergence criteria*, but other additional criteria are requisite, which have an increasing spreading and frequency of occurrence (6-10): 1) *high degree of economic openness*; 2) *synchronization of business cycles*; 3) *labour mobility*; 4) *flexibility of prices and wages*; 5) *high level of financial development*; 6) *high levels of foreign direct investment*; 7) *high rates of saving*; 8) *improving competitiveness*; 9) *high standards of education*; 10) *the flexibility of the economy as a whole*. The more flexible a national economy is, the easier real convergence is – and this criterion is rather an aggregate of the other nine previous criteria (Traşcă, 2007).

The international financial crisis has revealed *significant asymmetries* between the EU and EMU member states and the three candidate countries, and also *the need to review* and rethink them, starting from *their asymmetry* and the fact that *their standards are too ambitious* (Darvas, Pisani, 2009). In conclusion, the essential criterion of real convergence remains reducing the gap between incomes per capita, a real process conditioned by significant gains in productivity and relative price convergence. If all nominal convergence criteria relate to a set of financial, monetary, foreign exchange, tax policies, indicators are also more efficiently systematized compared with the same major typology of (actual, nominal, institutional) convergence, obviously following the same policies, from Moritz Schularick‟s original manner, presented as early as 2002 (Table no. 1).

The updated 2013 version stipulates six EU indicators of convergence for the Maastricht Treaty, structured according to Table 2: a) three based on money criteria, i.e. inflation (≤ IM3 + 1,5 p.p., where IM3 is the average inflation of the three EU member states that have the lowest inflation), *the nominal interest rate on long-term bonds* (≤ D3 + 2 p.p., where D3 is the average of nominal long-term interest of the three EU member states having the lowest inflation), and *nominal exchange rate* (keeping the nominal exchange rate within the band ±15% of the pilot); b) two having to do with taxation and the budget: *total public debt* (percentage of GDP ≤ 60%) and the *general government deficit* (percentage of GDP ≤ 3%); c) one of a legislative nature: *national financial legislation* (including the legislation for the national central bank – with emphasis on the status of the central bank).

Table 1: Baseline variables, turned into 16 official indicators, structured in the EU by convergence classes (Schularick, 2002), pp. 16-22.

CONVERGENCE		
Nominal= 6 variables	**Real** = 6 variables	**Institutional** = 4 variables
I. Degree of monetary and fiscal stability (3 variables): inflation, (3 variables) inflation, budget deficit and external government debt *II. External economic relations* (3 variables): current account balance, foreign direct investment and trade integration with the EU	*I. Level of economic development* (4 variables): GDP/capita, unemployment rate, share of agriculture in GDP and share of private sector in GDP *II. Dynamics of the real economy* (2 variables): GDP growth rate, growth rate of productivity	*I. Institutions and economic policies* (4 variables): legislative reform, competition policy, financial sector liberalization and liberalization of trade and foreign exchange markets

Table 2: Concrete monitoring of meeting the Maastricht criteria for Romania in 2011

Criterion	**Thresholds, limits and bands of variation, and level of fulfilment**		
Public debts	Maximum 60% of GDP	Fulfilled (33,4%)	**YES**
Budget deficit	Maximum 3% of GDP	**Shortfall (-4,9%)**	NO
Inflation rate	1,8%+1,5%=3,3%	**Shortfall (5,8%)**	NO
Nominale long-term interest rates (10 years)	2,4%+2% = 4,4%	**Shortfall (7,0%)**	NO
Exchange rate	2 years without devaluation of ERM* II	**Shortfall**	NO

Source: *** (2012), Academic Society of Romania (SAR), *Euro, mai devreme sau mai târziu?* (*Euro, sooner or later?*), accessible online http://www.romaniacurata.ro/spaw2/uploads/files/SAR-13-24.pdf. *Note: ERM II stands for Exchange Rate Mechanism. By 1999, the exchange rate (as an important element of the European Monetary System) was a multilateral system of parities which allowed each currency to fluctuate within a band limited in relation to each of the currencies included in the system, establishing also central parity rate in ECU. This was the first exchange rate mechanism (ERM I). When the single currency, the euro, was adopted in 1999, a new exchange rate mechanism, called ERM II, was adopted. Through this mechanism, the multilateral system was replaced by the bilateral one, whereby each participating national currency has a defined central parity rate expressed in euro.

Table 3: Analysis of the fulfillment of convergence criteria for Romania and Serbia, as of 31 March 2013

Country	Average inflation rate (in last 12 months)	Budget deficit as % of GDP	**Public debt as % of GDP**	Member country ERM II	Long-term interest rate (last 12 months)
Annual limits (thresholds / limits)	up to 2,5% (31 March 2013)	up to 3,0% (fiscal year 2012)	**up to 60% or fall (fiscal year 2012)**	minimum 2 years (31 March 2013)	up to 4,81% (31 March 2013)
Romania	**3.9**	**2.9**	**37.8**	**Not a member**	**6.43**
Serbia	**7.3**	**6.4**	**59.2**	**Not a member**	**No data available**

Source: http://appsso.eurostat.ec.europa.eu/ and http://en.wikipedia.org/wiki/Euro_convergence_criteria

As can be noted, the above variables cover the combined criteria, but only partly explain the factors of convergence, whose spectrum is very broad, as they appear in the econometric modelling dedicated to this phenomenon. To be sustainable, the European Monetary Union is structured based on a fiscal union, and this in turn implies the existence of a political union, as suggested by the so diverse convergence factors, such as: stability or economic balance, mobility of production factors, similarities in inflation and interest rates, comparable productivity, relatively equivalent economic structure, price flexibility within acceptable parameters, integrability of financial markets, comparable degree of economic openness, diversification in production and consumption, fiscal integration, and especially political integration.

3. CONCLUSION

The integration of the new states in the European economy involves, amomg other things, attaining socio-economic convergence targets, which are defined and updated periodically, in keeping with the imperatives of the historical moment, as the topic still holds an important place in the theory of economic growth. If the neoclassical theory of economic growth postulated that all economies characterized by uniqueness of their basic parameters can achieve the same level of development in time, regardless of their initial position, detailing the three major hypotheses of real convergence (absolute or unconditional, conditional and club), testing these hypotheses empirically confirms, with an acceptable error level, the quantitative definition of real convergence of the **β** type, which shows that, in the long term, in the context of the absolute convergence hypothesis, poor economies tend to grow faster than richer ones, and of real convergence of type **σ**, which stresses a decreasing variation of income per capita in a group of countries, and also convergence of type **γ**, which is aimed at synchronizing the business, **δ** – the similarity of the convergence factors, **α** – similarity of economy structure, etc.

In the context of the last global financial crisis, the European Union considered inappropriate to review the criteria stipulated by the Maastricht Treaty, but this is required from practical considerations, along three new dimensions (Darvas, 2010): a) anchoring the average EU criteria in order to avoid that the performance of small economies in the euro area affect the target level of criteria, and reducing disparities; b) criteria of inflation, interest rate and budget deficit should be covered within a variation interval as to the average euro area, provinding a wider decision-making solution for anti-cyclical fiscal policy; c) government debt to GDP should be limited to the same average of the euro area, or it should follow a downward course, decreasing at a satisfactory pace and reaching below the threshold.

Accelerating Serbia"s EU accession and Romania"s convergence to the European Union (EU), as a member state ranking in one of the last two positions in most indicators, are regarded both from the nominal angle, when time seems to be contracting, but also the real angle, when, quite on the contrary, time is much longer. From the first sight, two approach horizons co-exist and subsist, one nominal or short-term, obviously, and one real, i.e. longer. Finally, joining the EU and EMU, respectively an initial convergence and a final convergence, complete or of the structural type, involve a *favourable compromise* between real and nominal convergence, given that Serbia must fulfill the conditions of accession, and Romania, after two years of ERM II, must meet the Maastricht criteria in full. In reality, the current state of both economies certainly describes stages of real and criterial semiconvergence rather than full convergence.

However, convergence is not so easily achievable, if there are no open economies and macroeconomic government policies meant to stabilize excessive fluctuations. In the context of free competition, of real economic freedom and liberalized markets, all of the above can achieve the desideratum of convergence together. The problem of *sustainable convergence* cannot be solved in the short term because it depends on what was actually achieved in the past, and criteria have their essential role not to hinder this difficult process of convergence as a whole, by their level or timeliness, especially when, placing themselves above allowable thresholds, they may lead to an actual increase in disparities, virtually resulting in *economic divergence*.

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THE IMPORTANCE OF LEGAL AND FINANCIAL SYSTEMS FOR DOING BUSINESS IN INDIA

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Abstract: *This paper researches the importance of legal and financial systems for the functioning and development of an economy. In addition to the theoretical discussion on this issue, the paper draws on empirical research of legal and financial systems of India as one of the representatives of the emerging economies. The research has shown that the rapid and steady growth of the India's economy is largely owed to the development of informal institutions and their impact on the regulation of business operations in India.*

Keywords: *financial system, legal system, business, company, India*

1. INTRODUCTION

Analysis of legal and financial systems occupies an important place in the theory of economic growth and development of countries. In the scientific literature one can find numerous papers in which the high growth rates of developing countries are explained by the effective functioning of the legal and financial systems. The most important early works that deal with this issue come from a group of prominent scientists such as La Porta, Lopez - de - Silanes, Shleifer, and Vishny. In their papers in the field of law and finance they point out that the English common law countries provide stronger legal protection of shareholders , creditors and investors , which is achieved through the efficient functioning of the institutions, resulting in better financial and economic outcomes (Allen etal.,2007). The above views on the importance of legal and financial systems for the development of countries as well as the superiority of English common law were used to explain the high growth ratesof the India's economy since its liberalization in 1992. Later papers to have explored the causes of the high rates of Indian GDP growth highlighted the methodological shortcomings of previous studies and pointed at the possibility that the above conclusions on the high importance of English common law for the growth of India's economy might be incorrect.

For an objective and thorough understanding of any economic phenomenon, and therefore the growth of the India's economy and English common law as its factor, it is necessary to take into account a number of different approaches. For this reason the paper will present a theoretical discussion on English common law, India's financial system, and their importance for doing business, as well as the research into this topic based on empirical findings related to India.

2. THEORETICAL CONSIDERSTIONS OF ENGLISH COMMON LAW

The basic principle of common law is the principle of judicial precedent. Strict adherence to this principle ensures consistency of judicial decisions, which means that all decisions must be in accordance with the judges' decisions brought in the past. This creates a legal system with predictable results of litigation. In addition, many law schools have emphasized the superiority of common law compared to civil law when it comes to the regulation of business practice. In legal and economic literature this assumption is formalized through a *hypothesis on the effectiveness of common law*, which was first set up by Coase (1960) and later systematized and expanded by Posner. (e.g., Ehrlich and Posner 1974, Landes and Posner, 1994). According to this hypothesis, the rules of common law provide effective allocation of resources, where the efficiency implies Pareto's or Kaldor - Hicks 's effectiveness (Parisi , 2004) . This is explained by the fact that common law is based on the regulations and laws that are formulated by judges, based on the rules that have been already applied in practice. On the other hand, in the countries in which civil law is applied the laws and rules are passed by parliaments and they are not necessarily based on existing methods of dispute resolutions in real life. Hence it follows that English common law is easier to apply in practice. Besides, the application of this legal system provides greater certainty, as a parliament may decide to change the law at any time, while the rules of common law do not change.

The importance of a legal system as a factor of companies' business environment is reflected in the fact that numerous prominent theorists in the field of economy and law have been engaged in the analysis of efficiency in the regulation of business practices. This includes Nobel Prize winners F. Hayek and R. Posner who came to the same conclusion: English common law manifests superiority when it comes to the regulation of the economic sphere. It is interesting that they both came to the same conclusion, even though their analyses were significantly different. Posner explained the conclusion of his research in two ways. His initial reasoning was based on the assumption that judges, who determine the law at common law, prefer effective to ineffective rules. These preferences are derived from judges' decisions to affirmatively choose to prefer efficiency as a normative value against other values (such as the redistribution of wealth or any measure of social egalitarianism), or because even though in theory judges may incline to other values, in practice they still tend to maximization of wealth, i.e. efficiency, as to a goal that can be achieved most easily, in contrast to other goals, which, due to the limitations of judicial processes , cannot be achieved (Zywicky and Stringham , 2010) . Posner gives an alternative explanation of a *hypothesis on the effectiveness of common law* which is based on the philosophy of utilitarianism. He believes that judges are guided by the utilitarian philosophy according to which the social welfare is getting maximized by attaining the highest possible utility of each individual. Since the utility is not directly measurable, judges try to maximize the usefulness of economic efficiency or wealth instead. In the analysis of English common law Hayek (1974) raises an interesting analogy of the functioning of common law and the market. In fact, in the same way on which market prices are formed as a result of millions of individual decisions, common law has been developed on the basis of numerous independently made judicial decisions. By analogy to the market prices that cannot be affected by any individual, no judge or lawyer can specify the basis of common law, but it is rather created by all citizens. Finally, in the same way that the free market operation leads to the achievement of Pareto - efficiency, the common law results in effective outcomes.

The general conclusion of a brief overview of theoretical views of English common law is clear: English common law leads to effective judicial outcomes and exhibits superiority to civil law when it comes to the regulation of business practices. Consequently, the countries in which the legal system is based on English common law, which includes India, should have an effective legal system, which involves a high protection of creditors, debtors, minority shareholders, legislative, and transparency in operations when it comes to business. However, theoretical considerations are often not fully in accordance with the actual state of affairs, and the legal system in India is just one example that proves the possibility of discrepancy between reality and theory.

3. APPLICATION AND IMPORTANCE OF FORMAL LEGAL AND FINANCIAL INSTITUTIONS IN INDIA

The India's economy has experienced high growth rates after gaining the independence in 1951. While the average growth rates from 1951 to 1979 were lower than 4 %, during the 80s they experienced accelerated growth. On the basis of annual data on the Indian GDP it has been calculated that from 1980 to 2004 the average growth rates for a five- year period were higher than 5 % (Kotwal et al ., 2010) . Based on this we can estimate that in the period after liberalization, despite the difficulties that India faced in the 90s, the Indian economy has had a steady growth. After 2004 a further acceleration of growth occurs with the economy achieving average annual growth rates of up to 11% (2010) and the average annual growth rate for the period 2004-2012 amounts to 7.64 % (World Bank data) .
Fast-growing economies are in the focus of a large number of scientists. Economists are especially interested in the cause of high growth, i.e. what initial assumptions must be met in order to gain the opportunity for a rapid economic growth. In literature a frequently cited precondition for economic take-off points out at the existence of an effective legal system. As the basis of the legal system in India is English common law, so the rapid growth of the India's economy is interpreted as the result of a well-established legal system and efficient functioning of financial institutions.

When it comes to research into the economic growth of India, great importance is attached to the India's legal system. One of the causes of high rates of economic growth is the fact that India is among the countries with the strongest legal protection of investors and creditors (Allen et al., 2007), according to official indicators. This conclusion follows from the comparison of the index values indicating the degree of legal protection of investors and creditors (Creditor Right Index, Anti -Director Index, etc.) in different countries. The values of these indices for different countries are presented in Table 1.

Table 1: Calculated values of the indices indicating the degree of legal protection of investors and creditors by countries

	Creditor rights	Anti-director rights	Corruption perception index	Legal formalism index	Legality index	Disclosure requirement	Earnings management score
Panel A: India and other large emerging markets (EMs)							
India (E)	**2 (4)**	**5**	**3.3**	**3.51**	**11.35**	**0.92**	**19.1**
Argentina (F)	1	2	2.9	5.49	10.31	0.5	N/a
Brazil (F)	1	5	3.3	3.83	11.43	0.25	N/a
China	2	1	3.3	3.4	N/a	N/a	N/a
Egypt (F)	2	3	3.3	3.6	10.14	0.5	N/a
Indonesia (F)	2	4	2.4	3.88	8.37	0.5	18.3
Malaysia (E)	3	5	5.0	3.21	13.82	0.92	14.8
Mexico (F)	0	3	3.3	4.82	10.79	0.58	N/a
Pakistan (E)	1	4	2.2	3.74	8.27	0.58	17.8
Peru (F)	0	3.5	3.3	5.42	9.13	0.33	N/a
Philippines (F)	1	4	2.5	5.0	7.91	0.83	8.8
Russia	1	4	2.4	N/a	N/a	N/a	N/a
S. Africa (E)	3	5	4.6	3.68	11.95	0.83	5.6
Sri Lanka (E)	2	4	3.1	3.89	9.68	0.75	N/a
Thailand (E)	2	4	3.6	4.25	10.7	0.92	18.3
Turkey (F)	2	3	3.8	3.49	9.88	0.5	N/a
Average of EMs[A]	1.47	3.64	3.12	4.07	10.25	0.61	16.61
Panel B: LLSV country groups							
English-origin Ave.	2.28	4.19	5.33	3.02	15.56	0.78	11.69
French-origin Ave.	1.31	2.91	4.39	4.38	13.11	0.45	19.27
German-origin Ave.	2.33	3.04	5.58	3.57	15.53	0.60	23.60
Nordic-origin Ave.	1.75	3.80	9.34	3.32	16.42	0.56	10.15
Sample Ave.	1.80[a]	3.37[b]	5.24	3.58[c]	14.98	0.60[d]	16.00

Source: Allen F, Chakrabarti, R.,De, S, Qian, J., Qian & M. (2012), Financing firms in India, Journal of Financial Intermediation, 21.409-415.

Based on the data presented in Table 1 it can be concluded that countries that during the colonial period were under the governance of England, i.e. English -origin countries, have on average higher values of all the calculated indices compared to the average of the total number of analyzed countries, i.e. former colonies of France, Germany, England and the Nordic-origin countries. As an individual country, India is also characterized by a high index value of protecting the rights of investors and creditors. It is particularly interesting to note that the calculated index value of protecting rights of creditors - Creditor Right Index for India is maximal, i.e. calculated index value is 4, which is the maximum value of the index). In terms of *Anti - Director Right index* whose maximum value is 6, the value of this index calculated for India is 5, which is the highest value of the index of an individual country amongst 100 analyzed countries. The survey was conducted in2007 by the already - mentioned authors Djankov, La Porta, Lopez-de-Silanes, and Shleifer, and it was the basis for the conclusion that India had a well-established legal system that undoubtedly contributed to the growth and development of its economy.

However, in the literature that examines the causes of rapid growth of the India's economy, there are also some alternative explanations. We can say that these viewpoints are somewhat controversial because they assess previously conducted research as methodologically incorrect, which implies that the conclusions obtained from them are wrong. Allen et al. (2012) advocate an alternative explanation for the growth claiming the following methodological shortcomings of previous studies:

- Most of the existing studies were carried out on the basis of data obtained by comparing different countries without taking into account essential differences between them, including differences in geographical size, population, level of GDP and so on. The differences between countries in research and interpretation of results should not be left neglected, because they determine the differences in the initial conditions of countries and have a great impact on the further growth of economy. On the other hand, in the existing research, countries such as

Singapore and India were treated as equal, which clearly indicates methodological flaws in research. To highlight why it is important to take into account the differences between countries, the authors give an example related to the implementation and effectiveness of legal and financial systems : taking into consideration the essential difference between India and Singapore, we can expect Singapore to have a more efficient legal and financial system, because it can be adapted to the conditions of economy at a relatively low cost, while any change in the legal or financial system of a large and diversified country entails high costs.

- Research based on a data comparison of more countries treats each country as a homogenous unit, omitting potentially significant variations in the efficiency of financial and legal institutions typical of different sectors, such as differences in the importance of financial institutions e.g. stock exchange for the operation of small and large companies and/or regions, which is particularly important when the research includes large countries i.e. India.
- In previous research, the focus of analysis refers only to formal legal mechanisms (courts) and formal financial channels (stock exchanges and banks), while it excludes other (informal) ways of financing enterprises and resolving business conflicts.

To overcome these shortcomings of previous research, the authors Allen et al. (2007) have used a different methodology. They focused on a study of legal and financial environment in which companies do business in India. The results have not been compared with those of other countries, but they only compared the differences in the results by different regions of India. What makes this study particularly interesting and important is the fact that the research subjects were not only formal institutions (courts, stock exchanges, banks, etc...), but also informal business relationships, rules, conventions, funding channels, etc. By analyzing the economy of India in this way the authors came to a surprising conclusion:

1. Formal legal system is little applied

Based on a number of theoretical findings, lawyers and economists consistently emphasize the importance and strength of the legal system in India, yet the country's citizens attach little importance to these theoretical findings. In fact, India shows great distrust of the legal system and the effectiveness and fairness of the judiciary. Numerous empirical studies have shown that people rarely turn to the judicial authorities when they encounter irregularities in business practice, because they do not believe that such a step would contribute to solving the problem. If the research is correct and the legal system does not work as efficiently as the previous scientific considerations claim, undoubtfully the following question arises: How is it possible for a large economy like India's to have achieved relatively stable and rapid growth for more than two decades without meeting basic preconditions for economic take-off such as the protection of property rights and contracts and the corresponding financial system. The group of authors has given the answer to this seemingly contradictory question based on the research into the business environment and business practices in India.

The authors have come to the conclusion that strong legal protection is not a necessary condition for a successful operation of an enterprise, and consequently the growth of the whole economy , as long as there are strong ' institutional ' substitutes for formal legal system such as fear of loss of reputation, partners, future business opportunities and alike. Social connections and informal institutions attached to them are of major importance for doing business in India. A famous economist P. Adler wrote and spoke about the importance of trust between market actors for the functioning of economy. He believes that trust is the key coordinating mechanism of a society (Adler , 2001) and that it can be seen as the third component of a cooperation mechanism of the capitalist economy as a whole, in addition to government and markets. In India, this type of coordination has a special place, as amid the lack of implementation of legal measures to ensure the execution of contracted obligations, the Indians rely heavily on mutual trust and established social norms.

2. Formal financial channels (banks and stock exchanges) are a key source of corporate financing

Companies in India obtain only 26 % of capital through formal financial channels (Allen et al., 2007).This includes large corporations, which means that small and medium-sized businesses are almost entirely financed from informal sources i.e. from their own savings, borrowing from friends, relatives, and alike. The main reason for the use of informal sources of finance lies in that bank lending is expensive and the terms of loans are too harsh. We might conclude that companies in India are in an extremely unfavorable financial position due to high funding costs, causing problems to the very production activity of companies. Specifically, companies which are facing difficulties in obtaining funds have little or no opportunity for growth. In western countries such companies are often forced to decrease production, employment, and sometimes to exit the market.

However, there are important differences between the companies operating in western countries and those in India. In Europe, banks finance about 2/3 of the total financial needs of companies (Chaldwell , 2001), while in the United States about 60 % of the invested capital is acquired through issuance of shares or bonds,26 % of net investment comes from retained earnings, and only 17 % from other sources, including banks' financing(Gregory and Stuart , 2014). Thus, if banks tightened financing conditions in Europe, or if there was a deterioration of the situation on the stock exchanges in the U.S., the companies would be faced with a big problem because they finance business from formal sources, and finding new ways of financing requires time and additional costs. On the other hand, companies in India rely on bank financing to a much lesser extent, or financing by issuing shares, which makes their performances much less dependent on credit terms or conditions on stock markets. This can also explain why India was able to achieve relatively high rates of output growth although companies have had limited funding opportunities from formal sources.

3. Although a large number of companies operate outside the formal legal system and institutions, India has achieved high economic growth

Despite the poor investors' protection in practice, India's economy was growing faster than most other emerging economies of the 90s, which contradicts the belief that the key and unavoidable assumption of rapid progress lies in the stable financial system and the application of strong legal regulations in business. Proponents of the institutional theories of the development of capital markets consider the development of capital market and its successful functioning as a necessary condition for growth. If it is not developed, development costs can be high, which can lead to slower growth, or even to a change of this trend. High growth rates in India considerably weaken their conclusions. Other authors who hold the position that the developed and efficient legal system is primary conditions of growth, have very little opportunity to justify their claims on the example of India.

It should be noted that the assessment of the legal and financial system of India as "underdeveloped" does not imply a lack of legal and financial institutions, but is rather related to their poor implementation and therefore little significance for the development of economy. In fact, as it is said in the previous section of this paper, the legal system in India has its roots in English common law which is seen as superior. But citizens have little confidence in legal institutions, so that business irregularities are usually solved outside of judicial processes. When it comes to the financial system, the two major stock exchanges in India, according to the value of the market capitalization, the *Bombay Stock Exchange* and *National Stock Exchange* are of the world level significance. The total value of the market capitalization of the stock exchange in Mumbai is 67 443 983.8 INR, and the National Stock Exchange 65 907 848.1 INR (World Federation of Exchanges), which places these stock exchanges among the top twenty in the world. When it comes to the banking system, there is still a distinct dominance of state banks (state banks make up about 80 % of the total bank deposits). After the liberalization, several private banks have emerged, and several foreign banks entered the market. Private bank ICICI Bank is currently ranked the second by the size, while the state bank is ranked first. What is also important to note is that the banking system in India is characterized by much fewer non -performing loans thus making it more profitable and more stable compared to the banking systems of other countries in the region. However, the status of a "healthy" banking system is owed primarily to strict requirements set by the banks when issuing commercial loans; therefore, borrowing from banks is considered expensive and inappropriate to real possibilities of enterprises that need funding.

Despite the fact that India has two stock exchanges of the world significance, and the "healthy" banking system, the authors who deal with the entire financial system of India make the following conclusion (Allen et al . , 2007) : 1) stock exchanges , as well as the banking sector , are relatively small compared to the size and the needs of the economy , 2) the financial system is dominated by efficient (low overhead), but largely untapped (when it comes to providing loans) banking sector .

The results of the research conducted by Allen et al. (2007, 2012) may be summarized as follows: It is strong informal institutions that maintain India's economy steady; despite the results of previous research, formal institutions are under-utilized and have relatively little importance to the economy.

The support to the fact that the functioning of institutions in India is far from ideal is illustrated by the information on the rank of India by the Global Competitiveness Index and Index of Economic Freedom.

4. GLOBAL COMPETITIVENESS INDEX AND INDEX OF ECONOMIC FREEDOM

By the value of the Global Competitiveness Index (Global Competitiveness Index GCI) India ranks at 60th amongst 148 economies. Other BRIC countries (except Russia) have higher values of GCI, indicating the higher competitiveness of these economies compared to India's (World Economic Forum). We can conclude that India is ranked relatively low in terms of the total number, as well as in relation to the BRIC countries. According to the Global Competitiveness Report 2013-2014, a high level of innovation in an economy and a strong institutional environment have an increasing impact on the competitiveness of countries (PHD

Chamber), which is an alarming fact for India given its current performance in terms of the functioning of institutions . As India ranks at 72nd position by the efficiency of institutions, and at 110th by the benefits of the macroeconomic environment, it is not surprising that its competitive edge is relatively low. In addition, the three most significant problems companies face doing business in India are: 1. corruption; 2. inefficiency of state administration, and 3.In adequate infrastructure. From this follows that, according to the World Economic Forum, India is characterized by low efficiency of institutions and extremely unfavorable macroeconomic environment, which contradicts the results obtained by Allen et al. (2007,2012).
A similar conclusion can be reached on the basis of information that India is ranked 120 according to the Index of Economic Freedom (Index of Economic Freedom) constructed by the *Heritage Foundation* (2014). The report states that institutional shortcomings have largely a negative impact on long-term growth of the economy. The report also points out that India is characterized by a relatively stable democratic system, but that the size of the country and diversification of population are major challenges to effective and efficient governance/ management, or to achieve, what is known in economic literature as good governance. Excessive state intervention in the economy, and a relatively high level of state ownership, which has increased over the last years, contribute to the inefficiency of institutions and poor functioning of the whole economy. Companies are faced with a number of administrative barriers to business, while the private sector growth is largely prevented by a lot of non-tariff barriers and a high level of administrative regulations that burden the private investments (The Heritage Foundation, 2014).

When it comes to the rule of law, India has better protection of property rights than the average of the analyzed countries (53rd place), but, by the fight against corruption, it is well below the average and ranks at 97th place. Although the corruption is still one of the biggest obstacles to the development of India, there has been an increasingly strong pressure to reduce it in recent years. The executive branch of the judiciary system is considered to be independent, but trials are subject to political pressures, they are characterized by high costs, and individuals belonging primarily to political "elite" are protected from court charges. In order to facilitate a long-term growth and development of the India's economy, the primary task of the government must be committed to a resolute fight against corruption, given that the high level of corruption is said to be a major source of inefficiency of formal legal and financial institutions. Establishment of an effective judiciary and reducing bureaucratic barriers would provide significant opportunities for the development of India. Although the Indian government has strict measures in order to reduce corruption, the effectiveness of these measures are brought into the question due to the fact that little effort is made to reduce a large number of administrative and regulatory measures, as well as the state ownership of economy, and it is exactly the excessive administrative regulations and state owner ship that is recognized as the major sources of growth in corruption.

5. CONCLUSION

The development and effectiveness of the legal and financial systems of countries are key components of their macroeconomic environment. The way companies do business; their profitability and the possibility of further development are largely dependent on the general business climate in the country, which is defined above all, by the protection of property rights and contracts, bureaucratic restrictions on operations, the level of corruption in state institutions, access to finance, etc. The professional literature demonstrates the consent at countries with a legal system based on English common law have better regulations of business and more efficient functioning of legal institutions (e.g. Hayek 1974 Zywicky and Stringham, 2010). India, as one of the representatives of the BRIC countries, is characterized by a legal system based on common law and developed financial system, which involves primarily a sound banking system and developed stock market. According to official indicators (Creditor Right Index, Anti -Director Right Index) India has a particularly strong protection of investors and creditors (Allen et al., 2007). In the economic analysis of the Indian economy, a favorable macroeconomic environment, and a strong legal framework of business and a sound financial system in particular, are recognized as key factors of its high growth rates after the liberalization. However, later studies have pointed to the methodological shortcomings of previous studies, for which the conclusions drawn on the basis of them do not correspond to the actual state of the economy of India. According to the research conducted by Allen et al. (2007) companies in India are heavily reliant on informal institutions in their operations, such as trust, responsibility towards families and authorities, informal agreements, etc. The importance of informal institutions stems from the lack of confidence in the country's legal system, and a limited use of formal financial channels to raise the necessary funds. Although informal institutions are extremely important for the coordination of the market economy, they are still insufficient to establish a stable macroeconomic environment conducive to growth of competitiveness of the economy and its rapid progress. For these reasons, India is by the Global Competitiveness Index (60th place) and the Index of Economic Freedom (120th place) ranked relatively low as compared to the other BRIC countries, as well as in relation to the total number of analyzed countries . Excessive bureaucracy, high levels of corruption and the legal institutions subject to political pressures are the primary problems whose reduction is necessary in order to enable further growth and development of India's economy.

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