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TOWARD DEVELOPMENT OF SUSTAINABLE BANKING BUSINESS MODELS

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ABSTRACT

This study focuses on the context of development of sustainable banking business models as one of the strategic management issues and major aspects of the banking corporate governance. First, the general perspectives on banking business models are discussed. Second, an adequate approach is given under the major evolving business model patterns in the global banking system with special remarks to the shadow banking and financial innovations and the possible effects on sustainable development. Finally, this study concludes with some general recommendations for the corporate governance.

KEYWORDS: sustainable banking, banking business models, financial innovation

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In the context of development of sustainable banking business models, the strategic management issues are one of the major aspects of corporate governance. Primarily, the strategic management creates bank's vision and mission that are subsequently incorporated into a comprehensive strategy, with clear determination of the medium and long term goals and priorities in the market positioning of the bank. The bank's strategy is a starting point for policy making as an integral part of the operational framework for the implementation of strategic objectives and determination of the resources and organizational structure required for their implementation. All these elements together define the business model of the bank's risk profile as its pendant (Stiroh 2006). The system of corporate governance when properly set according to the characteristics of the business model and risk profile is acceptable basis for the organization of an efficient operational structure and implementation of specific tasks for successful change management in banking. The development of the strategic way of thinking at all levels of the operation is the basis for maintaining healthy, flexible and effective system of performance management and consistency in the implementation of the banking strategy.

Changes are no longer an option for the banking management - they are a must. Especially latest analysis regarding the treatment of banking risks suggest new perspectives in perception and benchmarking desirable degree of risk tolerance and ensuring requiring treatment. In fact, some economists are setting up parallels with other complex systems and how these systems react to shocks, especially taking as an example the human immune system, and the ability to survive certain organisms as a result of their ability to rapid change. By analogy, in terms of the bank's management capacity building for frequent changes is imperative for successful work in a dynamic globalizing business environment. Flexibility and economic efficiency may somewhat contradict such principles of operation, but in the case of risk management, flexibility in corporate governance is a foundation for rapid response to changes in the banking industry and the real economy.

It involves: monitoring changes in the banking environment and initiative for appropriate adjustments in the bank and contrary: initiating changes in banking in terms of encouraging leadership and initiating changes in the wider environment. Thus, strategic management through strategic analysis, planning and decision-making processes generated that reflect both on the macro and micro level. The micro approach primarily involves activities that affect the selection, implementation and development of a banking business model and risk profile.

GENERAL PERSPECTIVES ON BANKING BUSINESS MODELS

Despite the overlapping of models at specific segments (and their possible coexistence with universal banking institutions), separately we have analyzed and categorized various banking business models from operational, organizational, financial, and even prudent aspects. The analysis is primarily set in the context of the application of the international standards in the heterogeneous global environment, particularly in countries in transition, to obtain relevant conclusions of critical importance by correlating different aspects. There are multiple reasons including: determining the adequate pace and manner of implementation of financial innovations, evolution of sustainable banking business models, evolution of the international banking regulations and so on. At the micro level the expected result shall benefit in the establishment of internal criteria regarding the acceptable levels of risk and micro prudent modeling risk profile of the bank. At the macro level the expected result shall be managing the financial stability in the context of differing levels of liberalization and globalization of banking activities, promotion of business models that facilitate sustainable economic growth and foster the processes of financial inclusion.

First, according to their organizational structure we can single out three bank models: Bank unit (Unit bank), Bank branches (Branch banking) and various forms of banking groups (formal or non-formal: Group banking, Bank Holding company, Correspondent banking).

Banks that are organized as a single legal entity represent banking business model that supports close linkage between the management and the ownership function. Organizational, management is set on a functional basis, by division of the banking operations in related areas: financial management, retail banking, operations with securities, international operations and so on. Strategic guidance, coordination and control is accomplished by setting up sectoral organization of work. Operating policies, recruitment of human resources, availability of funds, control and supervision of the ongoing activities remains within the scope of the lower management levels, i.e. within the scope of operational management.

Banks that have branches in its organizational structure represent the only entity with certain autonomy in the branches as organizational parts. Branches initially can be formed within the bank itself, but can also be formed by merging with other banks, establishing specific relations between the Headquarter and the branches. Banking group or bank holding is a form of organization of the bank exercises control over another two or more independent banks (subsidiary banks or other companies) established as a separate entity or banks with their own affiliates.

Secondly, regarding different bases of operation and approach to creating and maintaining relationships with customers two different business models are indicated: the **traditional banking business model** or traditional banking - based on maintaining relationships with customers (relationship oriented banking) and **modern banking business model** or the modern i.e. transaction banking (transaction banking) (Gambacorta & Mistrulli, 2011). Traditional banking is based on establishing long-term relationships with customers, usually governed by a general agreement on cooperation. Customers commit to focus its full operation with one bank. The bank arranges necessary conditions and usually follows customer's financial operations and customer's needs for its business development (La Porta et all, 2001). From the operational aspect it means numerous advantages for the banking institution: shortening the time needed for the preliminary analysis of the client, as well as establishing and maintaining direct sources of information, which comes to mitigate the principal-agent problem. In recent decades, banking innovation creates competitive pressure process of dis-intermediation in banking as a result of forcing the transaction access to the operation, new information channels, and outsourcing certain activities. Banking relationships are predominantly of short-term nature, and during the crisis - the financial contraction relations with customers who have an inadequate credit rating are ceased - the qualitative data and the future expectations of customers are not taken into account for decision-making. Relations are strictly regulated by the contract. The agreement is modeled depending on the competitive aspects of the bank, because the client when choosing the best contract compares the terms and conditions between different banks. The relationship bank - client is based on strict fulfillment of the contract.

Between these two extremes there are many alternatives in terms of orientation towards banking based on relationships with customers on a selective basis in respect of certain customers, products, or transactional approach to other customers or products. The global financial crisis from 2007 was evidence that in global terms, the relationship based banking is the core of the banking industry from the risk and sustainability perspective. Business models (Roengpitya et all, 2014) are differentiated by the scope of activities, the marketing strategies adopted etc. Banks operating retail (retail oriented banks), for example: commercial, savings and cooperative banks usually provide traditional banking services, and deposits are the primary sources of funding.Investment banks are predominantly focused on activities in the field of trading, providing a variety of funding sources, often maintaining its own business network (retail network). Primarily these two business models are distinguished by the scope of activities, the network of business units that work, the number of employees, types of activities they perform, the sources of funding.

Wholesale banks represent separate business model. Their specific characteristic is the dominant activity on the interbank market. The adoption of a business model means putting all these major aspects (resources, market aspects (orientation toward specific client segments, market positioning, market share), regulatory requirements and investor relations) in a particular matrix and creating an appropriate risk profile of the bank. The risk profile* determines the performance of the bank as well as the potential for the occurrence of certain losses in operation. This is certainly part of the strategic planning of the top management of the bank, and the basis for determining and providing the capital requirements.

THE BANKING BUSINESS MODEL PERSPECTIVE EMERGING IN THE AFTERMATH OF THE 2007 FINANCIAL CRISIS

In the financial crisis of the last decade was particularly remarkable the failure of the wholesale bank model. Retail banks regardless of their size were a generator of stability in the banking system. Investment banks due to the close connection with other parts of the financial system were subject to complete collapse. What is the essence of the evolution of business models that came after the financial crisis? The focus is on two dominant processes at the micro level: a growing integration between the different agents of banking markets, primarily through the interbank market and

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wholesale banks as dominant players and makers of over-indebtedness and mutual exposure in order to find alternative sources of funding. Intra-sectoral connections between banks, hyperactivity of the interbank market and high levels of exposure as a result of high activity of wholesale banks create channels through which further intensified the external activation of the risks regarding individual banking agents. The fragmentation and outsourcing of certain functions is emphasized in modern banking, that traditional model integrates into a whole and creating a process of quasi integration with other independent non-bank entities and spillover risks from other under-regulated sectors (mainly focused on the administration, credit scoring, credit rating etc.). The wholesale bank model creates another occurrence of the diversification strategy of providing resources.

As one of the subsequent repercussions occurs the problem of pro-cyclical bank's behavior and favoring short terms. On the long run this model does not give good results at the micro level. At the macro level there is a possibility of generating some positive effects in terms of strengthening market discipline on banks for the purpose of providing a better credit rating of the agent and the favorable terms of financing resources.As a result of the deregulation, a process that enabled the creation of economies of scale and economies of scope in banking, it was evident the growth of the model of universal banking. The universal banking generally speaking generates positive implications at the micro level in terms of encouraging diversification of risks. At the macro level such movements may give adverse effects due to systemic risks which may be activated as a result of the fact that the banking system becomes “too diversified” and “contagious” (especially in the case of intense growth of innovative hybrid banking activities undertaken by the universal banks).

THE EVOLUTION ASPECTS OF THE UNIVERSAL BANKING MODEL

The adoption of the universal banking business model resulted in creation of additional open space for regulatory arbitrage, transformation and channeling of banking risks in the various business segments and creating new risk profiles of banks. From the foregoing, we refer to modalities that exist among universal banking business models, that largely reflect the macroeconomic environment in which banks operate (banking regulation, level of competition - barriers to entry to other banks on the market etc.). If we take as an example two universal banks operating in developed and developing financial economies, for example: Deutsche Bank, and secondly - Bank of China. It is evident that the banks perform different risk profiles mainly determined by the level of the development of the financial markets where the banks operate. Deutsche Bank is mainly present in developed markets, where the level of regulation allows the presence of competition, leading to a significant decline in interest margins. Consequently, banks are forced to switch to activities that carry large non-interest income that are by their nature relatively riskier. At the contrary, banks that operate in markets with strict regulation and substantial (high) barriers to entry for new banks, where the central bank determines the minimum interest margin, are forced to orient its operations on activities that bring non-interest income and risk model presenting it is characterized by a significant germination levels of risk exposure in comparison with banks operating in liberal markets. (Mishkin, 1995).

THE SHADOW BANKING SYSTEM

As a distinctive model and extreme manifestation here we must emphasize the shadow banking as quasi banking model operating outside the regulatory framework. The shadow banking plays a major role especially on the territory of the United States. The banking segment is defined as a group of non-banking (non-deposit) financial institutions and markets, offering services that are similar or related to the services provided by traditional commercial banks. The shadow banking sector consists of financial institutions that have no activities of accepting deposits as traditional banking institutions, consequently - their work is not subject to sanctions of the regulatory bodies. The enforced regulatory requirements in the domain of traditional banking institutions carry the potential for further expansion of quasi-banking sector (the shadow banking) and intensify the potential for further escalation of the risks in this risk profile and failure of the related banking institutions.

Regarding the geographic aspects of operations and the regulatory domain, the banking institutions can be local, regional and global banks. Local banks are present in only one banking market that is their business focus is only within a national economy. Regional banks are present in more banking markets within the broader geographic region. Global banks have internationalized their operations globally. Global (multinational) banks stand out for their global systemic importance and identified as a separate business model, because they have imposed requirements for particularly sophisticated mechanisms for individual identification and monitoring of potential risks in operation, and predict their interaction due to international emphatic sensitivity of transmission of adverse effects through liberalized banking markets. The global banking institutions are easily prone to involving into shadow banking activities, due to the regulatory arbitrage in global terms. Their special role in global terms is unprecedented for the sustainability of the world economic growth and financial development.The growth of the shadow banking system is potentially stimulated by the tendencies for liberalization in banking due to the growth of the sharing economy (access economy) in global terms and the pressure for entry of fin-tech companies into the financial system to offering substitution for some traditional banking services. The sustainability of this tendency will be determined by setting proper regulatory requirements in this infant phase of development of the block-chain technologies in banking.

– THE CORPORATE MANAGEMENT PERSPECTIVES

The role of banking management exceeds its importance due to the scope of the adverse effects into the society. That is why the economic proponents are louder than ever about the evolving premises of sustainable banking management. The further observations lead toward determining sustainable strategies, processes, activities, measures for implementation of sustainable banking business models.

The sustainable strategy creates framework for decision-making on the long run enabling ethical principles among the general banking principles. Ethical banking requires actions for financial inclusion, social risks management, social responsibility, environment friendly banking, non-discriminatory banking, anti-corruption measures etc. The implementation of the sustainable banking strategy requires certain adjustments of the banking processes and activities, enforcing effective follow up processes in order to verify and evaluate the effects on sustainable financial development. **The sustainability of banking processes requires** review of business policy in the areas of research, resources and third parties (market segments: the stakeholders approach). Banking processes should review the adequacy of the processes with regards of the relationships with third parties, considering all of the parties from the investors perspective, with accent on the ownership rights, transparency requirements and quality management. The quality of the processes is tightly connected with undertaking certain organizational and innovation activities, improving the consultancy services within banking institutions and strictly governed introduction of the innovative financial products conducted by firm stakeholder's principles in banking.

SUSTAINABLE BANKING BUSINESS MODELS IMPLEMENTATION ISSUES – THE MAJOR PERSPECTIVES ON INNOVATIONS

The stakeholders' principles in banking are generally funded on the premises to STAKE – SHARE and INTEGRATE. That means taking steps toward stakeholders oriented banking, driven by client's expectations for efficiency, real -time, integrated and flexible, accessible, individualised and integrated banking system.

The stakeholders' principles should be implemented into the banking regulatory requirements. Positive example is the FINMA's step toward licencing financial services providers engaging FIN TECH innovative companies, by discussing the enforcement financial institution licences with limited banking activities and adequate capital requirements. The purpose is lowering the entry threshold for providers of payments systems, applications for managing assets digitally and crowdfunding platforms. So the regulatory bodies should be market drivers toward greater sustainability. The barrier for financial innovation should be safety net against not-acceptable risk levels. In the same time, they should not block the economic development and the benefits from the new technologies in the financial industry. The role of banks in financing the economy and promotion economic growth. The new regulatory proposals also fine-tune some aspects of the regulatory framework where necessary to make it more growth-friendly and proportionate to banks' complexity, size and business profile (www.europa.eu) It also includes measures that will support SMEs and investment in infrastructure. The cultural barriers will remain within the evolution process of the client's habits and expectations until catching up certain levels of technological integration and development.

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THE CIRCULAR ECONOMY - A PATHWAY TO SUSTAINABLE FUTURE

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ABSTRACT

The circular economy is an attractive, smart and innovative concept, promising the efficient use and reuse of resources and a strong business case. It is a sustainable development strategy that is being proposed to tackle the problems of environmental degradation and weaken the dependence of economy on natural resources and environment. Through embedding the 3R principles of materials use Reduce, Reuse and Recycling into production and consumption process, the Circular Economy aims at greater resource productivity, higher energy savings and lower greenhouse gasses emission.

Several different approaches that encourage the transition to a circular economy exist. Among them, *the approaches to closing material loops* and use the *product as a service system* in a circular economy are developing most intensively and till now many innovative business systems and models proved effective in delivering resource efficiencies, both, within the manufacturing process and at the end of product life. The transformation is a complete systematic change comprising of innovation in technological and organizational terms too. By helping to decouple economic growth from resource use the transformation to circular economy offers a prospect of sustainable growth that will last.

The majority of reported initiatives on the circular economy is targeted at waste and secondary raw materials, whereas only few countries have explicitly commented that Circular Economy requires going beyond increasing recycling rates and a higher use of the secondary raw materials by utilization of different innovative approaches that have to be combined and implemented across the whole supply chain.

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KEYWORDS: Circular Economy, Sustainable Development, 3R principles, innovative, Product Service System

JEL CLASSIFICATION: Q01, Q55

INTRODUCTION

Recently, the concept of Circular Economy (CE), has received increased attention among the academia, business community and the policy makers because in perspective the transition towards more sustainable economy will address many of today's fundamental challenges. Traditional linear consumption patterns (take-make-dispose) are coming up against constraints on the availability of resources (Ellen MacArthur, 2013). The challenges on the resource side are compounded by rising demand from the world's growing population which undoubtedly will result in unsustainable overuse of resources, higher price levels and more volatility in many markets. Contrary, the CE will enable greater resource productivity, higher energy savings and lower greenhouse gasses emission and creation of local jobs and opportunities for social integration as well (EC Report, 2017).

The main purpose of this paper is to look deeper into the concept of circular economy and its connections to sustainability in order to provide a better understanding and support for effective implementation of circular economy. The article will also give information about the most common circular Economy practices and business models. At the end the barriers that might slow down the implementation of the circular economy will be also explained.

1. SUSTAINABLE DEVELOPMENT AND CIRCULAR ECONOMY

The significant environmental burdens related to population growth, intensification of global warming, environmental degradation and resource scarcity, happening in the recent three decades, have been major concern around the world. Under the demand of economy growth, balancing the relationship among economic development, environment and resources has become the greatest challenge and has caused many countries to seek innovative approaches to address these problems. Therefore, the concept of sustainable development, originating from the Report of the Brundtland Commission, Our Common Future (Bruntland, 1987) is considered as the main pathway for meeting human development needs while protecting the earth's life support systems. It presents an international consensus and presents important objective of international and regional cooperation (Li, 2016). According the Millennium Development Goals (MDGs) Report (MDGs, 2015) the global emissions of carbon dioxide, increased by over 50 percent for a period of two decades (from 1990 to 2012) and their acceleration was mostly driven by the growth in developing regions.

As not all the MDGs were met globally, depending on regions and the stage of a country's development, but significant progress was made in several areas, the 2030 Agenda for Sustainable Development with 17 sustainable development goals (SDGs) as core was adopted by world leaders at the UN Sustainable Development Summit in September 2015.

Addressing the unabated rise in greenhouse gas emissions and the resulting likely impacts of climate change still remains an urgent, critical challenge for the global community. Therefore, the Paris Conference on climate change in December 2015 (Paris Agreement, 2015) was seen as the first test of political will to implement the 2030 Agenda for Sustainable Development. During the conference the participants worked on providing a framework for strengthening international action to mitigate climate change and for the first time, every country in the world has pledged to curb their emissions, strengthen resilience and act internationally and domestically to address climate change. Furthermore, as a response to the 2030 Agenda EU has also adopted a sustainable development package

[1] in order to implement its SDGs internally and globally. There are also many EU strategic documents dedicated to the sustainable development with the EU Sustainable Development Strategy and the Europe 2020 Strategy – A strategy for smart, sustainable and inclusive growth (Communication, EU Action plan, 2015) being the most important one. According this document smart, sustainable development is based on knowledge and innovation, with environmental issues taking into account. Responsibilities of the Member States can be realized by promoting and implementing the concept of the circular economy which provides the stability of the products, materials and resources value and reduction of waste.

The 2030 Agenda for Sustainable Development calls for an equitable economic growth among countries. One of approaches to achieving equitable economic growth

[1] http://europa.eu/rapid/press-release_IP-16-3883_en.htm

is circular economy, which requires 3R principles and its technology，policies, programs and infrastructures as basic instruments (Li, 2016).

One of the proposed approaches for achieving sustainable development which aims at closing the loop of materials flow and weaken the dependence of economy on natural resources and environment is the Circular Economy (CE). Through embedding the 3R principles (of materials use Reduce, Reuse and Recycling) into production and consumption process, the circular economy will enable minimization of the use of raw materials and primary energy input and reduce the load on natural resources (Zhu, 2007, Heck, 2006). Zue and Qiu (2007) see the CE as a sustainable economic growth model which aims at effective use and circulation as the principle. This kind of model considers the low demand and consumption, low emissions of greenhouse gasses, efficient use of water and energy in production, and maximal utilization of renewable resources as the most important. Reduction means to minimize the use of primary energy and raw materials as inputs, which can be achieved by improvements in production efficiency. Reuse refers to using byproducts and waste from one stage of the production in another stage which enables the use of products to their maximal capacity. Recycling of used materials substitutes consumption of virgin materials.

The environmental reasons rise from the natural resource scarcity and the negative environmental impact of the unsustainable production and consumption where as one of the main economic reasons is the volatility of commodity prices (Taranic, 2016). There are four major causes of environmental problems: population growth, wasteful and unsustainable resource use, poverty and a failure to include the harmful environmental costs of goods and services in market prices (Miller and Spoolman, 2012). When population growth is concerned it should be noted that an exponential growth of population is observed with an estimation of 9.6 billion people in 2050 (UN, 2013) which may cause increased pressure on earth's life supporting systems. The wasteful and unsustainable use of resource coming out from the high levels of globalized production and consumption also harm the environment. Although poor people have a lower ecological footprint per person, due to lower consumption, the large population size of less -developed countries leads to a high overall environmental impact. The failure to include the harmful environmental costs of goods and services in market prices is because in today's economic system the businesses producing goods and services are not required to pay for the environmental costs and thus they do not take these costs in to account in the production decisions and defining the market price.

All these problems are interconnected and it was observed that a major root cause to the current unsustainable situation is the prevailing economic system which is related to at least three of the environmental problems mentioned previously. According to the UN “the major cause of the continued deterioration of the global environment is the unsustainable pattern of consumption and production“ (UN 1992) built up by our economic system” .

TRANSITION TOWARDS CIRCULAR ECONOMY

The starting point for the ideas on circular economy was to change the currently prevailing linear economic system of “take-make-waste” so that the natural resource use and waste of natural capital will be decreased. So far the natural resources are extracted and used to create products which are then consumed and subsequently disposed after usage. After usage, products are regarded as “waste” although they still contain a valuable amount of resources. As a result of the growing population and increased consumption the finite natural resources will reach their limits much earlier. Hence, it is important to know how much resources we can extract as well as how much “waste” we can emit back into the system.

According the estimates of Ellen MacArthur Foundation (2013) 65 Billion tonnes of raw materials entered the economic system in 2010. This result is expected to grow to 82 Billon tonnes in 2020. At the End-of-Life, the majority of materials (60%) were either incinerated or landfilled. Only 40% of the materials were used in a circular option (recycling or reuse) (Ellen MacArthur Foundation, McKinsey Center for Business and Environment, 2015).

Moving from this linear economic model to a circular economy entails much more than to recycle as much as possible of the materials contained in products at the end of their usage-phase. It includes among others:

- The elimination of the use of toxic substances
- Strategies that improve the reuse, remanufacturing, repair and recycling of products
- Strategies to stimulate new consumption patterns
- The potential and the necessity to establish new business models

Based on the notion that cycles in nature are fueled by solar energy, where nothing is wasted but just goes around in loops, the model of CE decouples economic growth and development from the consumption of finite resources and very often it is identified as circular innovation. The main characteristics of the linear, transition and circular models are given in Table1:

Table 1. Main characteristics of linear, transition and circular economies

Linear economy	Transition economy	Circular economy
○ **Linear flows (landfill, incineration.)** ○ **Efficiency and waste avoidance** ○ **No-renewable energy**	○ Low-value circular flows (e.g. recycling) ○ Mix of renewable and non-renewable energy	○ High value circular flows (e.g. reuse, cascaded value extraction for organics) ○ Circular business models (e.g. sharing, leasing) ○ Renewable energy

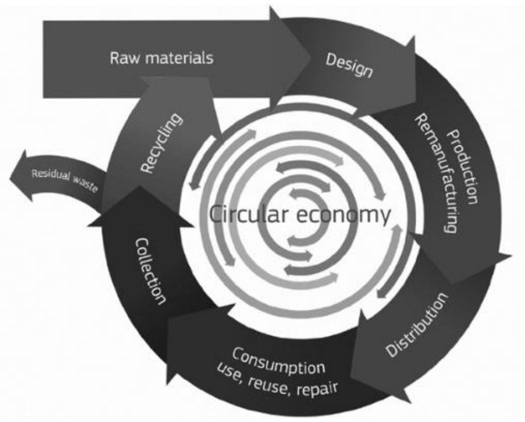
Source: Raftowiz-Filipkiewicz, M., (2016) From Sustainable Development to Circular Economy, Economic and Environmental Studies, vol. 16, no. 1, pp. 103-113

For a successful transition from linear to circular economy the following three requirements will have to be considered at least:

- The disposal sector,as it is established today,will have to rethink itself and towards a cleaner collection of products. This goes beyond the discussion on mono-material collection.For example, there might be an emerging market for collecting components and reselling them, which is not the standard today
- A standardisation and modularisation of components will have to be provided so that a product design which allows easier disassembly will be created.
- Business models will have to be re-innovated. There will be a shift from product ownership to product usage (Technopolis group, 2016).

The main advantage of the circular economy is the possibility of being more sustainable and competitive. According the research of Ellen MacArthur Foundation (2015a: 24) the main benefits of the implementation of circular economy concept is growing GDP by 0,8-7%, adding 0,2-3% jobs and reducing carbon emissions by 8-70%. In addition, the analysis of successfully implemented circular economy practices, done on a subset of EU manufacturing sectors, has shown that there is a great potential for annual net material cost savings ranging from €265 to 490 billion, which equates to up to 23% of these sectors' current total input costs. The cost savings potential was mostly pronounced in the automotive sector, then in the machinery and equipment sector, and electrical machinery (Ellen MacArthur Foundation, 2012). In addition, more circular business models were found to be associated with significant (technological and organisational) innovation and employment potential (for instance in the recycling sector), as well as with reduced liabilities and warranty costs of firms due to longer-lasting, healthier and more environmentally friendly products (Ellen MacArthur Foundation, 2013). However, it is a long-term transformation and requires a lot of reforms which are implicitly included in each phase of the value chain (figure 1), starting from the product design phase, the new businesses and market models (closed circulation of water, non-waste technology, limiting waste and harmful emissions, use of ecological returnable packaging), through new ways of turning waste into a resource up to the new consumer behavior (prolonging products life). The main advantage of the circular economy is the possibility of being more sustainable and competitive.

Figure 1. Main phases of the Circular Economy model



Source: Wojtach, A., (2016) Ecosystem Services in The Circular Economy, Ekonomia i Środowisko, 4 (59)

This transformation is a complete systematic change and the innovation is not only technological but in organizational terms too. By helping to decouple economic growth from resource use the transformation to circular economy offers a prospect of sustainable growth that will last.

Up-to-date, the majority of reported initiatives on the circular economy are targeted at waste and secondary raw materials and at the abiotic part of the economy, and only few countries (Heshmati, 2015) explicitly have commented that the Circular Economy requires going beyond increasing recycling rates and a higher use of secondary raw materials by implementing different innovative approaches and initiatives.

1. CIRCULAR ECONOMY PRACTICES

Several different approaches that encourage the transition to a circular economy by utilizing initiatives that go beyond waste and recycling exist. Among them, *the approaches to closing material loops* and use the *product as a service system* in a circular economy are developing most intensively and till now many innovative business systems and models proved effective in delivering resource efficiencies both within the manufacturing process and at the end of product life.

1.1. Closed loop manufacturing

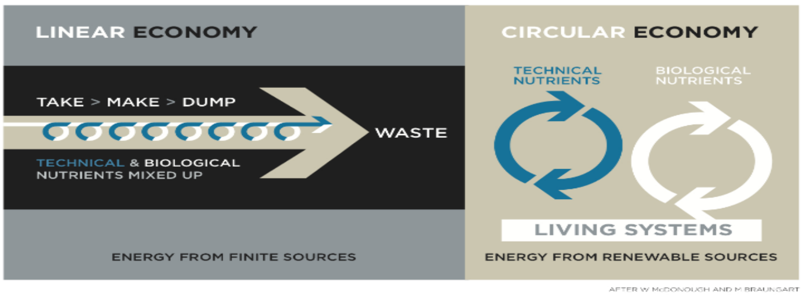
The Circular Economy involves a distinction and careful management of two different types of materials:

- *materials of biological origin* which can return to the biosphere as feedstock (called biological nutrients, e.g. forest products) and

- *technical materials* which cannot biodegrade and enter the biosphere (called technological nutrients, e.g. plastics and metals)

The aim of closing the material loop is to go beyond the 'end of pipe' approaches of the linear and seek transformational changes across the breadth of the value chain (Figure 2) in order to retain both types of materials and preserve their value for as long as possible.

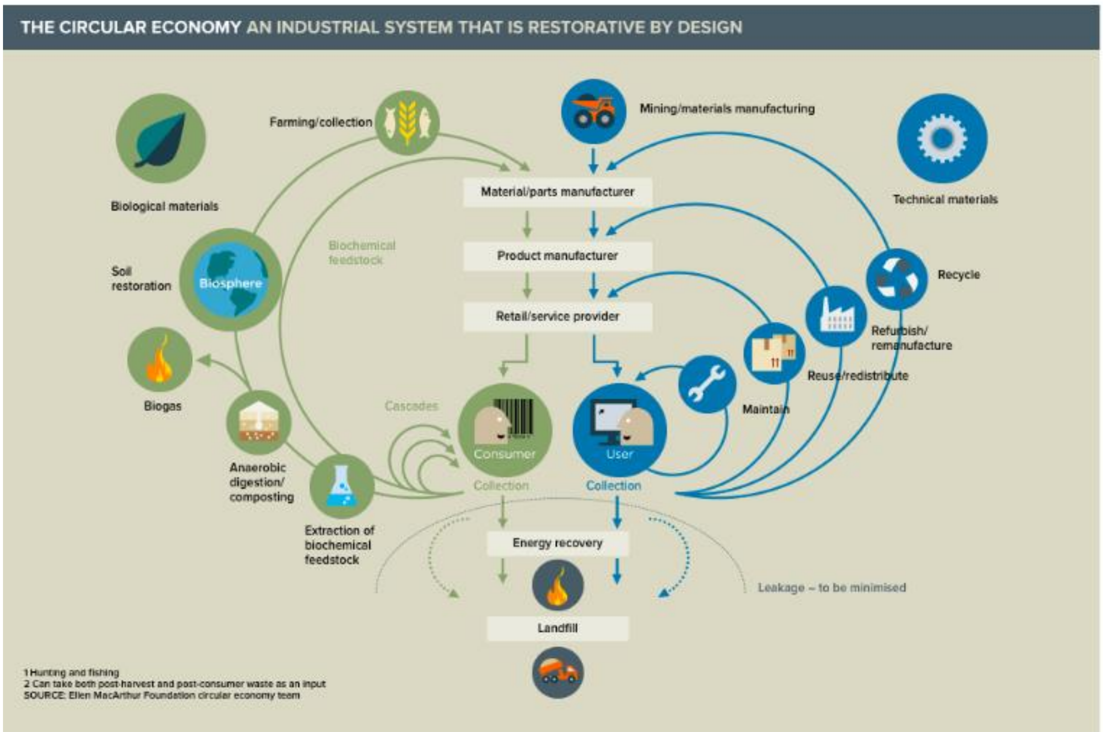
Figure 2. Transition to Circular Economy



Source: http://www.ellenmacarthurfoundation.org/circular-economy/circular-economy/rethinking-the-economy

In order to maintain high quality and enable effective circulation of nutrients (both, biological and technical) the respective businesses keep the circulation of different nutrients in separate loops (figure 2 and 3). The smaller the cascading loop (Figure 3) the higher the value kept in the resource and with less need for adding energy and other resources to keep it circulating (EMAF 2012, p. 111). A circular economy is often displayed in the butterfly chart of the Ellen MacArthur Foundation (Figure 3).

Figure 3. Visualization of a Circular Economy



Source: http://www.ellenmacarthurfoundation.org/circular-economy

Reducing the generic nature of mass-produced products can allow products to be dismantled easily and reused in the supply chain or used for repairs (Braungart & McDonough, 2009). Closing loops and increasing the re-use of materials will reduce demand for virgin materials and thus help to mitigate both demand -driven price volatility on raw material markets and supply risks (World Economic Forum et al., 2014).

In order to have viable process of closing the loops investments for the various forms of infrastructure such as collection services are necessary, but on the other hand job creation within industry will be promoted.

3.2. Product Service System

Material circularity is a necessary but not a sufficient tool for a circular economy because the service industry generates a new approaches of circularity applied to consumption and use of materials as well. Many researchers (Stahel 1986, Zhu, 2005, Stahel, 1998, Agarwal et al. 2015) suggest a system of renting and a service economy as a shift from a system of selling and buying to just utilization of products. This integrated approach will enable "to create the highest possible utilization value for the longest possible period of time while consuming as few material resources and as little energy as possible". In that respect, the approach of Product Service System (PSS) as a CE tool offers an alternative to the simple sale of goods and can take a variety of forms, including *renting* and *leasing schemes*, and *repair services*. It also includes *customers owning goods*, but with maintenance provided by the company and *the purchase of access to a product for a period of time*, with ownership of the product retained by the business. There is also the potential for *purchasing 'utility as an outcome'*, for example as in a clothes washing service.

The CE makes a sharp distinction between the consumption and use of materials. It advocates the need for a *'functional service*' model in which manufacturers or retailers increasingly retain the ownership of their products and, where possible, act as service providers by selling the use of products, not their one-way consumption.
Many small enterprises are taking advantage of the increased demand for sharing, lending, swapping and renting to develop viable businesses that deliver products to customers while breaking the traditional hyper-consumption model and, again, creating much needed employment.

2. CIRCULAR ECONOMY IMPLEMENTATION

Numerous studies (Raftowicz-Filipkiewicz, 2016, Geng and Duberstain, 2008a, Su at al., 2013, Yuan et al., 2006, Zhu and Huang, 2005) emphasize that ideally successful implementation of the CE practices must take place simultaneously at all levels: micro, meso and macro.

At micro level producers are encouraged and required to adopt cleaned production methods and eco-designs. Cleaner production refers to low levels of greenhouse gasses emission, whereas eco-design is in terms of incorporating environmental aspects in production process designs and products that are efficient and sustainable.

The implementation of CE practices at meso level includes development of eco-industrial parks and eco-agricultural systems complemented with environmental friendly design and effective waste management. The concept of creating such parks and agricultural systems will enable utilization of common infrastructure and services and will provide mutual managing of the resource flows and trade of the obtained by-products. Hence, it is expected that environmental externalities will be decreased and dependence on resources will be reduced.

At macro level the implementation of CE practices requires forming of eco-cities, eco-communities and eco-regions by developing an extensive cooperative networks and active cooperation between industries and industrial parks including all sectors in production areas and in the residential sector as well. It will enable replacing the energy intensive and polluting technologies with new, environmental friendly technologies and activities (Heshmati, 2015)

2.1. Circular Economy Business Models

The Circular Economy consists of a number of new business models, which can be categorized into three main categories:

1. Circular Innovation Models (CIM) which focus on the developing phase. Products and materials are designed to last longer and-/or be easy to maintain, repair, upgrade, refurbish, remanufacture or recycle.Additionally, new materials are developed and/or sourced, e.g. bio-based, less resource intensive, or fully recyclable materials. In the same context, innovative processes are developed to increase the reuse potential and recyclability of industrial and other products, by-products, and waste streams. In this group the models can be divided as:

- *Product design model*: This model provides products that are designed to last longer and-/or be easy to maintain, repair, upgrade, refurbish, remanufacture or recycle.
- *Process design model*: develops processes that increase the reuse and recyclability potential of by products and waste streams
- *Circular supplies model*: provides input materials such as renewable energy, bio-based, less-resource intensive or fully recyclable materials

2. Circular Use Models (CUM) which focus on the use phase by optimally using the product and its added value. These business models make it possible to retain ownership of the product (e.g. by servicing a product rather than selling it) and/or take responsibility of the product-lifetime (e.g through maintenance services, or add-ons to extend the lifetime of a product).

The CUM group consists of the following sub-models:

- Product as a Service model which delivers product performance rather than the product itself through a combination of product and services. Ownership of the product is retained by the service provider. Primary revenue stream from payments for performance delivered.
- Sell and Buy-back model that sells a product ond the basis that it will be purchased back after a period of time.
- Sharing Platforms model that enables an increased utilization rate of products by enabling or offering shared use/access/ownership.
- Lifetime Extension model which extends the useful life of products and components through repair, maintenance, or upgrade.
- Tracing facility model that provides services to facilitate the tracing, the marketing and trade of secondary raw materials.

3. Circular Output Models (COM) which focus on the output and its added value after the use phase**.** In these business models revenue is generated through transforming waste into products or useful resources.

The models in the COM group can be divided in several sub-models as follows:

- Model of recaptured material supplier: Sells recaptured materials and components to be used instead of virgin or recycled material.
- Refurbish and Maintain model: Refurbishes and maintains used products in order to sell them.
- Recycling facility:transforms waste into raw materials. Additional revenue can be created through pioneering work in recycling technology.
- Recovery provider: Provides take-back systems and collection service to recover useful resources from disposed products or by-products
- Support lifecycle: Sells consumables, spare parts and add-ons to support the life cycle of longlasting products.

It has to be emphasized that adoption of one of these circular business models does not necessarily ensure a circular business. In order to achieve a complete circularity all three categories of the business models have to be implemented across the supply chain. Collaboration among the designers and suppliers as well as service providers and end-of-life companies must exist in order the water and energy resources and the information and services to be shared. Only in that way circularity in the economy can be fully reached. Additionally, if the product is fully designed and produced according to all circular principles but the customer throws it away after use, the outcome is still linear.Hence, a systematic collaboration in all parts of the supply chain is necessary.

3. BARRIERS TO THE IMPLEMENTATION OF THE CIRCULAR ECONOMY

Various studies have shown that there are a broad range of barriers that might slow down the implementation of the Circular Economy, and they can be categorized as:

- Institutional (legislative and regulatory),
- Cultural,
- Financial and
- Technological barriers.

Institutional barriers. These barriers will be discussed in terms of the existing legislatives concerning the integration of the green solution into businesses operations and the regulatory documents (directives, legal frameworks, standards etc). The lack of a strict formal legislative framework greatly influences businesses' consideration of the necessity to integrate green solutions in to their operations. This is reinforced by the fact that small firms are more influenced by regulators and local authorities regarding the improvement of their environmental performance than larger companies. Another obstacle is that most tools for environmental management areproduced for larger companies, without taking into account the specificities of the business sector (Calogirou et al., 2010; Studer et al., 2006).

The first assessment of the EU Environmental Compliance Assistance Programme (ECAP) highlights the need for a better regulation agenda in terms of the design and implementation of environmental policies (Miller et al., 2011). Despite the enormous progression there is considerable room for improvement in the design and implementation of EU legislation, especially in the clarification of several concepts of EU legislation such as the producer responsibility, quality of separate collection and definitionsof recycling, re-use and recovery. The concept of waste hierarchy could also be more explicit because member states are given the flexibility to divert from the hierarchy. Also, the existing lack of sustainable procurement incentives by public authorities and the weaknesses in policy coherence (e.g. bioenergy and waste policies) needs further enhancement.

Due to lack of effective regulations and standardized quantitative measurements and goals, there is a possibility that producers transfer the higher costs of resource saving measures to consumers through pricing thus reducing their incentive to introduce costly and advanced production and distribution technologies (Heshmati, 2015). The environmental policy and the governments' price policies are expected to be linked to macroeconomic policies and be targeted at low income groups' welfare policies.

Cultural barriers. The efforts of moving towards a circular economy require a change in the attitudes and behaviours of the businesses and mass consumer as well. In the case of business companies, the decision to take up a circular economy solution usually depends on the managers' opinion. Very often the manager is also the owner of the Company and thus has significant power on the strategic decisions of the firm. As such, some managers may have a positive attitude towards green business, while others may not. Naturally, the extent to which the businesses are usually willing to adopt 'green' measures, as well as their attitudes towards green policies also depends on the sector in which they operate (Bradford & Fraser, 2007).

On the other hand, the mindset of the consumers has also to be changed. Hence, the challenge for businesses is to make changes or innovations with minimal need for consumers (or users) to feel that they are dramatically adjusting or adopting behaviour. Improving the overall public awareness about environmental protection and resource conservation, environmental certification of products and establishing and overall plan for CE implementation is necessary.

Financial barriers. One of the major barriers for implementing the circularity concept is the cost of 'green' innovation and "green" business models because the business companies, especially the smaller ones, are more sensitive to the additional financial costs resulting from the green business activities. In many cases they cannot establish and manage a recycling scheme because of the lack of financial resources and sometimes for the businesses that produce low volumes of waste collection and recycling of waste are less economically favorable options. The financial barriers usually arise from the upfront costs of any type of investment and the anticipated pay-back period but also from the lack of time and human resources that businesses need to devote to make the environmental improvements. Also, when it comes to bank financing, SMEs, and especially very young small businesses, face difficulties in obtaining the funds required from the banks, which often consider SMEs financing a risky business. Therefore, access to finance and suitable sources of funding is essential for SMEs seeking to improve their sustainability performance and/or introduce an innovation. The smaller a company is the more difficult it is to understand and assess different funding options, such as EU support programmes and government grants, mainly due to staff and management restrictions.

Technological barriers. The advanced technologies and the technological capabilities are considered as one of the key factors for successful implementation of the Circular Economy at all levels. The significant investments necessary for upgrading the existing technologies to a more advanced ones are considered as an obstacle that prevents the implementation of CE principles at all levels. Also the skills of the staff engaged *to identify, assess and implement the more advanced technical options and* to upgrade the production facilities and equipment so that they would satisfy environmental requirements while realising cost savings is an additional obstacle that prevents the transition towards Circular Economy. As a consequence , businesses usually prioritise technologies with which they are already familiar and do not depend on the suggestions of their suppliers for new technical solutions.

CONCLUSION

The main purpose of this paper was to look deeper into the concept of circular economy and its connections to sustainability so that a better understanding and support for its effective implementation will be provided. Therefore, a thorough literature review was done in order to provide information about the possibilities for the transition to circular economy and the most commonly used circular economy practices and business models up-to-date. Also, the barriers that might slow down the implementation of the circular economy were analyzed.

The results show that the circular economy is mainly business focused and business driven today. It is a transformative business model that by developing closer relationships between suppliers, manufacturers, retailers and consumers enables more efficient use of raw materials and resources, waste reduction and prolonging product life cycle.

Overall, the successful implementation of the circular economy practices and business models would contribute for increasing the GDP by 0,8-7%, adding 0,2-3% jobs and reducing carbon emissions by 8-70% with a great potential for energy and material cost savings. Through a creation of employment opportunities and minimizing the dependence on raw materials, a sustainable future becomes more achievable. However, there are some barriers that might slow down the implementation of the circular economy practices. They are mainly financial, but there are also other obstacles like the lack of a strict formal legislative framework and effective and standardized quantitative measurements and goals, which greatly influences businesses' decision to integrate green solutions into their operations. Additionally, raising consumer awareness about about circular economy business practices and products is crucial factor that influences the successfulness of its implementation.

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THE INSTITUTIONAL DETERMINATE OF COMPETITIVENESS: SURVEY OF SELECTED EMERGING AND EU COUNTRIES

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ABSTRACT

The paper focuses on the influence of the institutions determinate of competitiveness in emerging and EU countries. Based on survey of literature including Scott's (2001) idea of three institutional pillars: regulatory, normative and cultural-cognitive pillar, we constructed framework of institutional competitiveness index. Our framework also offers a modified methodology for the estimation of a theoretically grounded and empirically validated measure of the institutional competitiveness which is expected to contribute to the development of literature for emerging countries. This paper captures interrelated drivers that collectively represent each of these pillars and estimate this framework using multiple data sets covering 22 emerging economies and 14 EU countries over the period 2006-2014. The findings indicate and confirm a positive and separate influence between the institutional mechanism and competitiveness as both are very much interrelated and they depict the general level of efficiency of a particular country. While the institutional mechanism in emerging nations is developing, results for the EU countries present positive and significant relationship between rule of law and national competitiveness. These insights might be useful in the formulation of improved national economic policies and institutional reforms towards attainment of national competitiveness.

KEYWORDS: institutional competitiveness, institutional competitiveness index

JEL CLASSIFICATION: O4; O5

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INTRODUCTION

For the purpose of this study, we examine the influence of the institutional mechanism on competitiveness through the sample of selected EU countries and emerging economies. As evident from the extant literature, the institutional mechanism is the key determinant of competitiveness (DiMaggio & Powell, 1983). This perspective insists on the relevancy of institutional mechanism in encouraging development of nations and hence in increasing the level of competitiveness. So, the degree of efficiency in institutional mechanism is perceived to drive competitiveness as both are very much interrelated as they depict the general level of efficiency of a particular country.

The institutional mechanism relies on three pillars and on that basis is defined as the “regulative, normative and the cognitive structures and activities of a nation that provide the desired stability and meaning or social behavior” (Scott, 2001, p. 33). The institutions are representation of social order or pattern (Jepperson, 1991) and as such, they constrain and shape interactions among the economic actors and provide a structure to everyday life (North, 1990, p. 3). So, the enterprises that operate in that set up tend to incorporate organizational forms, structures, strategies and practices that are socially legitimate - that is, "isomorphic" or consistent with the regulatory, cognitive, and normative institutions (Meyer & Rowan, 1977; Powell & DiMaggio, (eds.), 1991). By setting limitations, institutions facilitate and reduce the cost of the exchange interactions (North, 1990, p. 36) but also they convey stability and continuity (Scott, 2001) which in turn drives towards competitiveness.

On the other hand, the concept of competitiveness aims to capture the economic development process as a necessary condition for the improvement of the living standards and for the determination of the level of productivity of a particular country. Therefore, it includes wide range of factors (e.g. entrepreneurship, technological innovations, knowledge, science and education, creating of more convenient institutional and system ambient and so on) which influence of productivity growth and economic performance. So, according to the World Economic Forums’ (WEF) this concept is defined as: "a set of institutions, policy and factors which determine the productivity level of a country" (The Global Competitiveness Report (GCR) 2011-2012, WEF, 2012, p. 3) that clearly suggests that competitiveness and institutions are interconnected.

The institutional pressures on decision making for competitiveness are very different in different country markets and some institutions prevail over others. For example, a subsidiary of a multinational enterprises (MNEs) operating in India as emerging country (or any other emerging market) faces a very different regulatory, normative and cultural-cognitive context than the subsidiary of the same MNE in any developed economy (i.e., Germany) where the legal framework has already developed. In addition to this, the institutional mechanism of EU nations is perceived to be much more developed and defined than the emerging nations. Further, the convergences of institutional mechanism of the emerging nations seem to be evolving like EU. As the post socialist countries which joined the EU in 2004 have been in the continuous process of adjusting their institutional (both political and economic) mechanism in order to converge to existing EU practices ever since they started their accession process of joining. The EU membership negotiations also proved to be an important shaping power of national policies, institutions and governance structure (Lippert et al. 2001). The process could be characterized as the attempt to adjust to a moving target as the EU itself is undergoing the process of substantive changes too prompting researchers to probe its impact on competitiveness. From the extant literature, it is evident that two levels of institutional mechanism do affect the level of country's competitiveness for the EU nations (Cuckovic & Jurlin, 2009). That is their own domestic institutional mechanism (policies, norms and institutions) and EU institutional mechanism. It is expected that this two pronged strategy would drive nations towards competitiveness. Though emerging nations do not have EU type two tier institutional mechanism, yet they are also on the same path of evolution and convergence in institutional mechanism taking into account their political, social and economic background.

Based on this background, we felt the need for examining the influence of institutional mechanism on competitiveness of emerging nations as there is scant of research literature on this evolving area. But along with target emerging economies, we incorporate EU countries with the intention to make a comparison between the impact of their drivers of institution and competitiveness.

The paper is organized in five sections. The second section provides a theoretical construct based on the survey of extant literature thus helps in finding our key propositions. The third section depicts the methodology adopted for this study.

The fourth section presents the analysis and discussion of the results. The last section pertains to conclusion with a focus on scope for further research.

THEORETICAL FRAMEWORK

In the last two decades a large body of literature has come into prominence around the institutional theory and the concept of competitiveness. So, for more than two and a half decades, thanks to Nobel laureate, Douglass C. North, the opinion prevails that *institutional factors* and the *competitiveness* of the economy are of the biggest importance for the growth of economy (North, 1990, p. 107). North asserts, for example, that "the inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World…" (North, 1990, p. 54) because the absence of secure property and contractual rights discourages investment and specialization. According to Acemoglu, there is now a growing understanding that economic, political, legal, and social institutions are essential to the economic success and failure of nations (Acemoglu, 2008). He further asserts that the institutions of a country create incentives for investment and technology adoption, for its businesses to invest, and the opportunity to accumulate human capital for its workers, thus propelling economic growth. Opposite scenario could be that country's institutions may discourage such activities and as a result leading the economy to stagnation.

The sound, credible and efficient institutional framework is an imperative precondition for economic activity and growth (Acemoglu, 2003; Rodrik, et al. 2004; Bouis, et al. 2011). This includes the role of governance, how fiscal and monetary policy can stabilize economic activity and to which extent the public sector and regulation supports or hinders firms in the long run. The rule of law, absence of corruption and trust in institutions are widely accepted as determinants of efficiency as well as growth for firms and countries. Moreover, a number of empirical evidence confirms that the institutions of the most developed economic systems have played a crucial role in their voyage to higher levels of growth. For example, it refers to relationship between economic freedom, democracy and economic growth (Barro, 1996; Minier, 1998), property rights and economic growth (North, 1990), the impact of inequality and political instability on growth (Alesina & Rodrik, 1994; Barro, 2000), social capability, trust and economic growth (Knack & Keefer 1995, 1995, 1997a, 1997b; Hall & Jones, 1999; Zak & Knack, 2001).

Institutional mechanism: Institutions are the rules of the game in a society, or, more formally, are the humanly devised constrains that human interaction. Some scholars (Scott, 2001; Bresser & Millonig, 2003) distinguish three interaction pillars of institutional capital: regulative, normative and cognitive.

The *regulative* pillar reflects ―the existing laws and rules in a particular national environment and promote certain behavior and restrict others (Kostova, 1999, p.314). *Regulatory institutions* stem from the governments, trade associations, professional organizations who set "explicit regulative processes" (Scott, 2001, p. 35), which include rules, monitoring and sanctions in case of non-conformity (Scott, 1995). The mechanisms through which the regulative processes function can be informal (i.e. shaming and shunning activities) or highly formalized and assigned to specialized actors (Scott, 2001. p. 52). For examples, government bodies, such as state agencies (Baum & Oliver, 1991; Ruef, & Scott, 1998) on different levels – local, regional, national, international.

The *normative* pillar refers to ― the values and norms held by the individual in a given country (Kostova, 1999, p.314) and it is ― rooted in societal beliefs and norms and prescribes desirable goals and the appropriate means of attaining them (Xu & Shenkar, 2002, p.610). *Normative institutions* refer to the broadly-accepted values and norms within a society (Scott, 2003, p.136). Moreover, the normative component places emphasis on "normative rules that introduce a prescriptive, evaluative, and obligatory dimension into social life" (Scott, 1995, p. 37). In other words, organizational actions are evaluated whether they are "the right thing to do" (Suchman, 1995, p. 579). It is important to note that organizations have to apply not only generalized societal norms but also a variety of standards that have originated in different professional. Often, a source of normative legitimacy are the public opinion (Deephouse & Carter, 2005) (expert and non-expert), and professional associations (Ruef & Scott, 1998).

The *cognitive,* reflects ―the cognitive categories widely shared by the people in the particular country such like schemas, frames, inferential sets and representations affect the way people notice, categorize and interpret stimuli from the environment (Kostova, 1999, p.314) or―the social knowledge, national symbols and the way and ability that the people understand and interpreted things in a certain country (Xu & Shenkar, 2002, p.610). In general, they are deeply embedded in the socio-cultural environment and provide frame on which normative and regulative systems are constructed (Ruef & Scott, 1998). *Cultural-cognitive institutions* are “the rules that specify what types of actors are allowed to exist, what structural features they exhibit, what procedures they can follow, and what meanings are associated with these actions” (Ruef & Scott, 1998).

Competitiveness: In a traditional approach competitiveness is considered on two levels: micro-economic (firm level) and macro – level (national competitiveness). On the *firm level*, competitiveness can be taken as its ability to do better firm strategies and rivalry between firms based on non-price factors (as technology, innovation, skills, knowledge, human capital etc.) as main inputs to reaching productivity. This view is supported by Porter, who emphasized the role of productivity to an extent that productivity is the only meaningful concept of competitiveness at the national level (Porter, 1985, 1990, p. 6).

On the *macro level*, national competitiveness is related to the extent to which the country is able to adapt the policies that directly affect the ability of companies to compete internationally and to provide rise of standard of living to its citizens, under free and fair market conditions (through foreign trade, production, and investment). It can be illustrated by the following definitions:

- *OECD (1992) define competitiveness as “the degree to which a nation can, under free and fair market conditions, produce goods and services that meet the test of international markets while simultaneously maintaining or expanding the real incomes of its citizens”.*
- *“An economy is competitive if its population can enjoy high and rising standards of living and high employment on a sustainable basis. More precisely, the level of economic activity should not cause an unsustainable external balance of the economy nor should it compromise the welfare of future generations.” (*European Competitiveness Report 2000).
- *European Commission (2001) defines it as: "the ability of an economy to provide its population with high and rising standards of living and high rates of employment on a sustainable basis".*

The definitions and statements mentioned above points out that the ultimate goal of competitiveness is to maintain and increase the real income of its citizens, so it is highly likely that more competitive economies will tend to accomplish higher income levels for their citizens. Considering that the productivity level determines the rates of return from investments in economy it is clear that the speed of economic growth depends on the rates of return, and hence the economy which grows faster in the middle and long run is also more competitive.

METHODOLOGICAL APPROACH

In order to operationalize this study, we have broadly borrowed Scott's (2001) idea of three institutional pillars and modified it in *empirical institutional competitiveness framework* that relies on two pillars: (1) regulatory pillar and (2) normative pillar. To get a meaningful understanding of the institutional competitiveness environment these two pillars (see Figure 1) are created by a number of institutional factors that can have a potential impact on national competitiveness of an economy and by using literature on creation of OECD composite indices (OECD/JRC, 2008). So, the first, regulatory pillar is divided into two sub-pillars as: the *rule of law* and *regulatory efficiency*. The *sub-pillar Rule of law* incorporates protection of property rights, intellectual property protection, and labour freedom while the *sub-pillar Regulatory efficiency* involving factors of business freedom, efficiency of legal framework in settling disputes, burden of government regulation, strength of auditing and reporting standards, level of financial freedom and judicial independence. Further, the normative pillar relies on the *sub-pillar Normative mechanism* and includes factors of cognitive pillar.

Grouping the normative and cognitive aspects of institutions into one concept is reasonable because these two aspects of institutions are quite similar to one another (Scott, 1995; Gaur & Lu, 2007). Some of the components of this combined pillar are freedom from corruption, voice and accountability, political stability and absence of violence, irregular payments and bribes, transparency of govt. policy making, favoritism in decisions of govt. officials, business costs of crime and violence, ethical behavior of firms, health expenditure and life expectancy. The indicators included in each of these two pillars are given in Table1.

All these indices are extracted from four data sources: the Global Competitiveness Report (World Economic Forum); World Bank Governance Indicators (World Bank); World Development Indicators (World Bank); and Index of Economic Freedom (Heritage Foundation).

Figure1: The institutional competitiveness framework

Pillar	Sub pillar	List of indicators (and data source)*
REGULATORY PILLAR	**Rule of Law**	• Property rights (GCR) • Intellectual Property protection (GCR) • Labour freedom (IEF) • Rule of law (WBGI) • Fiscal freedom (IEF)
	Regulatory efficiency	• Regulatory quality (WBGI) • Business freedom (IEF) • Efficiency of legal framework in settling disputes (GCR) • Efficiency of legal framework in challenging regulations (GCR) • Burden of government regulation (GCR) • Strength of auditing and reporting standards (GCR) • Financial freedom (banking efficiency) (IEF) • Judicial independence (GCR)
NORMATIVE PILLAR	**Normative mechanism**	• Freedom from corruption (IEF) • Voice and accountability (WBGI) • Political stability and absence of violence (WBGI) • Irregular payments and bribes (GCR) • Government effectiveness (WBGI) • Transparency of govt. policy making (GCR) • Favoritism in decisions of govt. officials (GCR) • Business costs of crime and violence (GCR) • Organised crime (GCR) • Ethical behavior of firms (GCR) • Availability of financial services (GCR) • Ease of access to loans (GCR) • State of cluster development (GCR) • Quality of scientific research institutions (GCR) • Health expenditure (WDI) • Life expectancy (WDI)

Note: *The data sources: GCR = Global Competitiveness Report; IEF = Index of Economic Freedom; WBGI = World Bank Governance Indicators; WDI = World Development Indicators

Sample: In this study we used institutional indicators for 22 emerging economies[1] and 14 EU countries (see Appendix, Table 1)[2] over the period 2006-2014. The emerging economies selected for analysis are listed in the MSCI emerging markets index.[3] While there are 23 economies listed in that index, we had to drop Taiwan as a large amount of data was unavailable for this economy. The EU-15 is selected with the base of 2004 just before accession of the ten new countries. However, we have to drop Greece from this list as it is included in the emerging nations MSCI index. Thus, we have extracted relevant data for 22 emerging countries and 14 EU countries. These two the data sets structured unbalanced panel data.

Base on above methodological approach we intend to explore how the regulative and normative pillar impacts of competitiveness for the two sets of nations (emerging and EU countries). For these purpose the following propositions are introduced:

1. *The development of rule of law is likely to impact competitiveness of nations.*
2. *Quality of regulative efficiency is likely to drive competitiveness of a nation*
3. *Quality of normative mechanism is likely to drive competitiveness of a nation*

Dependent variable: Following the Delgado et al. (2012) we have used national competitiveness as measured of output per potential worker, i.e., log of GDP per working age individual. ***Independent variables:*** As mentioned before, our independent variables are the two sub pillars (rule of law, regulatory efficiency) of regulatory pillar and the normative pillar of institutional environment.

Method of analysis: We have first employed the Principal Component Analysis (PCA) to extract the principal variables in each of the pillars. Before applying the PCA, we first conduct the Kaiser-Meyer-Olkin (KMO) statistic and Bartlett's test of sphericity to see if the data can be subjected to PCA (If the KMO statistic is greater than 0.5, it indicates that PCA can be used for the given set of data. Further, Bartlett's test of sphericity tests for the significance of the correlation matrix of the variables).

[1] 22 emerging economies include: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Russia, Qatar, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates

[2] 14 EU economies include: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Poland, Portugal, Spain, Sweden, Netherlands, United Kingdom

[3] see https://www.msci.com/resources/factsheets/index_fact_sheet/msci-emerging-markets-index-usd-price.pdf or at https://www.msci.com/emerging-markets, accessed on 22.06.2016

Once the KMO and Bartlett's test validate the use of PCA, we use the PCA for data reduction. With the indicators that we have considered for institutional environment, there is bound to be a high degree of correlation amongst independent variables. Retaining all variables generally leads to multicollinearity (as in this case). On the other hand, eliminating some variables affects the explanatory power of the model. To deal with this, we employ the PCA and determine the 'principal factors'. This does not affect the explanatory power of the equation because the retained variables contain the information of those which are eliminated. (For rotation, we use the Varimax method with the Kaiser normalization. The purpose of the rotation is to make the interpretation of the PCA more meaningful). The retained or principal variables are the ones with the highest factor loadings in the rotated component matrix. Once we choose the principal variables for each category, their respective weights are determined by using the component scores. These weights are then used to construct the composite index.

To ensure that the index does not suffer from scaling problems, the variables included in the index were normalized. Thereafter, a composite index is constructed for each sub-pillars of the regulatory pillar same as for the normative pillars as follows:

$$\mathbf{CI = \Sigma\, x_j w_j} \tag{1}$$

where CI = composite index for the respective pillar

x_j = retained variables from PCA

w_j = weights (component scores)

After constructing the composite indices, we then run fixed effects panel data regression separately for the emerging economies and the EU-14 economies. A fixed effects model is more suitable in our case as we want to account for country differences. The Hausman test was also done and the results favoured a fixed effects specification. We take investment freedom, trade freedom and infrastructure to be our control variables. The functional form of the equation is as follows:

$$\textbf{lnnc = f (cirl, cire, cini, lpop, lgdppc, invf, tradef, infra)} \qquad (2)$$

where
K

lnnc	=	log of national competitive advantage measured as GDP per working age individual	**lpop**	=	log of population
cirl	=	composite index for rule of law for the group (emerging economies/ EU-15)	**lgdppc**	=	log of gdp per capita
cire	=	composite index for regulatory efficiency for the group (emerging economies/ EU-15)	**invf**	=	investment freedom
cini	=	composite index for normative institutions for the group (emerging economies/ EU-15)	**tradef**	=	trade freedom
			infra	=	infrastructure

The importance of institutional framework has been validated by a large body of theoretical and empirical work which shows that sound, credible and efficient institutional framework is an imperative precondition for economic growth and competitiveness (Acemoglu, 2003; Rodrik et al.,2004; Bouis et al.,2011; Sala-i-Martin, X., et al. 2013). This includes the rule of law, regulative efficiency and normative institutions can stabilize economic activity and are widely accepted as determinants of efficiency as well as growth for firms and countries. Population has been used as a control variable. The explanatory variables are used in this study on the basis of their relationship with national competitiveness. The explanatory variables of investment freedom and trade freedom are being referred to encourage efficiency and competitiveness (Barro, 1996; Minier, 1998). This also leads to a dynamic business environment which impacts competitiveness as it perceived to hinder corruption and nepotism. The level of development in infrastructure also incentivizes the business environment and thus, helps in growth and competitiveness of countries.

ANALYSIS AND DISCUSSION

As mentioned above, we first try to create composite indices CI for the three sub-pillars: *rule of law, regulatory efficiency and normative institutions* using the PCA. The retained variables (along with component scores) for the three sub-pillars in case of emerging economies and EU-14 economies are given in Table 2 and Table 3 respectively. Using component scores of the rotated component matrix as weights, we then construct a composite index for each of the pillars. Thereafter, we run a fixed effects panel regression model as mentioned in the methodology.

Table 2: Retained Variables for the three sub-pillars in case of Emerging Economies

REGULATORY PILLAR						NORMATIVE PILLAR		
Sub-pillar1: Rule of Law			Sub pillar2: Regulatory Efficiency			Sub-pillar3: Normative Mechanism		
Retained variables	Component scores	% of variance explained	Retained variables	Component scores	% of variance explained	Retained variables	Component scores	% of variance explained
Property rights	0.934	88.459	Burden of govt. regulation	0.918	85.051	Political stability and absence of violence	0.847	73.848
Fiscal freedom	0.966		Business freedom	0.876		Transparency of gov. policy making	0.786	
Labour freedom	0.955		Strength of auditing and reporting standards	0.878		State of cluster development	0.837	
						Business costs of crime and violence	0.521	

Note: Based on Rotated Component Matrix; Rotation Method: Varimax with Kaiser Normalization

Table 3: Retained Variables for EU-14 economies

REGULATORY PILLAR						NORMATIVE PILLAR		
Sub-pillar1: Rule of Law			Sub pillar2: Regulatory Efficiency			Sub-pillar3: Normative Mechanism		
Retained variables	Component scores	% of variance explained	Retained variables	Component scores	% of variance explained	Retained variables	Component scores	% of variance explained
Property rights	0.963	96.982	Efficiency of legal frame in challenging regulations	0.855	90.159	State of cluster development	0.865	84.085
Fiscal freedom	0.964		Business freedom	0.8476		Orgainzed crime	0.956	
Labour freedom	0.978		Financial freedom	0.890		Political stability and absence of violence	0.531	
						Enrollment in tertiary education	0.970	

Note: Based on Rotated Component Matrix; Rotation Method: Varimax with Kaiser Normalization

The results of the fixed effects regression are for the emerging economies are shown in Table 4. The regulatory efficiency pillar is **positively impacting competitiveness** of emerging countries as evident from the significance this from the summary regression results given in Table 4. The normative pillar is found to be positive though not significant. However, rule of law is found to be negative and indicating towards evolving stages of legal framework and related institutions.

Another important finding is the LGDP per capita positive and significant as it supposed to affect both institutional predictability and legitimacy which impact competitiveness. Because inequality of income distribution may encourage institutions that in turn, tend to perpetuate to the cause of inequality and thus creating a vicious circle of inequality, low institutional quality (Engerman & Sokoloff 1997, 2002, 2005, 2006) which contributes negatively to competitiveness.

Table 4: Summary Results of Fixed Effects Panel Data Regression for the EE

Dependent Variable: LNNC
Method: Panel Least Squares

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-10.26028	2.330012	-4.403529	0.0000
CINI_EMERG	0.019100	0.061002	0.313113	0.7546
CIRE_EMERG	0.128698	0.076417	1.684164	0.0940
CIRL_EMERG	-0.060565	0.052490	-1.153835	0.2502
LPOP	0.389190	0.120555	3.228325	0.0015
LGDPPC	1.315246	0.071875	18.29916	0.0000
INVF	-0.001062	0.001534	-0.692308	0.4897
TRADEF	0.001737	0.001901	0.913829	0.3621
INFRA	-0.032835	0.034029	-0.964901	0.3360

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.989786	Mean dependent var	9.442795
Adjusted R-squared	0.988012	S.D. dependent var	0.933643
S.E. of regression	0.102225	Akaike info criterion	-1.583926
Sum squared resid	1.745136	Schwarz criterion	-1.083945
Log likelihood	186.0167	Hannan-Quinn criter.	-1.381530
F-statistic	558.0173	Durbin-Watson stat	0.940480
Prob(F-statistic)	0.000000		

As is evident from Table 4, degree of investment freedom and infrastructure negatively influencing competitiveness of nations as level of openness and availability of infrastructural facilities would encourage a more conducive and competitive environment aimed at controlling corruption and nepotism. The institutional mechanism in emerging nations are evolving and developing and hence the result was not unexpected.

Table 5 gives the results of the fixed effects regression in case of EU-14 economies. The results are somewhat mixed. As expected the relationship between rule of law and national competitiveness are positive and significant. Same is the relationship for normative pillar though level of significance is 10%. However, we could not find any evidence of this for regulative efficiency. And this has been done after dropping GDPPC from the model since there is a high correlation between GDPPC and POP. Unlike the general perception, the infrastructure variable for EU-14 nations found to be negative and significant. Physical infrastructure clearly plays an important role in productivity, though there remains debate about the size of its effect (Calderon & S erven, 2004).

Table 5: Summary Results of Fixed Effects Panel Data Regression for the EU-14

Dependent Variable: LNNC
Method: Panel Least Squares
Sample: 2006 - 2014
Periods included: 9
Cross-sections included: 14
Total panel (balanced) observations: 126

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.120110	8.983982	0.681225	0.4972
CINI_EU	0.076931	0.047376	1.623851	0.1074
CIRE_EU	0.057446	0.052490	1.094431	0.2763
CIRL_EU	0.231577	0.054777	4.227658	0.0001
LPOP	0.135199	0.551664	0.245074	0.8069
INVF	0.001987	0.001314	1.511949	0.1336
TRADEF	0.029864	0.004889	6.108162	0.0000
INFRA	-0.122501	0.025035	-4.893128	0.0000

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.980330	Mean dependent var	11.01140
Adjusted R-squared	0.976583	S.D. dependent var	0.433052
S.E. of regression	0.066268	Akaike info criterion	-2.439214
Sum squared resid	0.461099	Schwarz criterion	-1.966501
Log likelihood	174.6705	Hannan-Quinn criter.	-2.247166
F-statistic	261.6540	Durbin-Watson stat	1.679380
Prob(F-statistic)	0.000000		

The negative results might be indicating that, for upgrading and improving infrastructure, funds need to be injected which seems to be a deterrent in the studied period as it coincided with the crisis period. As has been reported in the other studies, trade freedom is positively impacting competitiveness of the European nations. The other explanatory variable investment freedom is also found to be positive though not significant. These factors of openness enable a nation to improve competitiveness through advancement in local productivity by accessing more advanced knowledge and technology from abroad.

CONCLUSION

This paper captures interrelated factors that collectively represent each of three selected pillars and estimate this framework using multiple data sets covering 22 emerging economies and 14 EU countries over the period 2006-2014 as explained earlier. The findings indicate and confirm a positive and separate influence between the institutional mechanism and competitiveness as both are very much interrelated and they depict the general level of efficiency of a particular country. While the institutional mechanism in emerging nations is evolving and developing, results for the European nations present positive and significant relationship between rule of law and national competitiveness. Accordingly, this analysis reveals few important insights for further investigation into the national competitiveness like; the institutional pressures on decision making for competitiveness, which are very different in different country markets; some institutions prevail over others and the extent of enterprises competitiveness because they are "isomorphic" or consistent with their regulatory, cognitive, and normative institutions. These insights can help in the formulation of improved national economic policies and institutional reforms. Our framework also offers a novel methodology for the estimation of a theoretically grounded and empirically validated measure of the institutional competitiveness

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APPENDIX

Table 1. List of Selected Countries

EU-14	Emerging-22
Austria	Brazil
Belgium	Chile
Denmark	China
Finland	Colombia
France	Czech Republic
Germany	Egypt
Ireland	Greece
Italy	Hungary
Poland	India
Portugal	Indonesia
Spain	Malaysia
Sweden	Mexico
Netherlands	Peru
United Kingdom	Poland
	Qatar
	Russia
	South Africa
	South Korea
	The Philippines
	Thailand
	Turkey
	United Arab Emirates

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HOW INVESTMENT BANKING INFLUENCED THE APPEARANCE OF THE WORLD ECONOMIC CRISES - THE CASES OF LEHMAN BROTHERS AND GOLDMAN SACHS

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ABSTRACT

The purpose of this research is to enable one to understand whether and how investment banks became one of the major influencing factors for the appearance of of the 2008 world financial and economic crises. Due to the lack of control and supervision, during the last two decades the investment banks exercised enormous freedom and were profit oriented taking highly risky trades and investments. The inability of the regulatory bodies to follow the actions of many multinational corporations clearly illustrates a weakness into the legal system as well as the rules and regulations applicable to the companies from the financial sector. The poor work of the rating agencies and regulatory bodies gave almost unlimited freedom to investment banks. The root of that is the amendment of the U.S. Glass - Steagall act (1999) which allowed intermingling of investment and commercial activities, the holes in the international standards and the introduction of two new products on the market: securitization and derivative trading. The investment banks started acquiring other businesses and became holdings. They engaged themselves in very risky trades, investments and transactions and were not able to repay its short term obligations. The trading with derivatives expanded the crises worldwide. The crises took massive measures and drew the entire world economy into financial crises and the biggest recession in the history.

KEYWORDS: Investment banks, financial crisis, securitization, financial derivatives, financial regulation

JEL CLASSIFICATION: F20 – General; F23 – Multinational Firms; G01 – Financial Crises

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INTRODUCTION

The importance of investment banks in the world stage has significantly increased compared to their beginnings and expanded their activities. Investment banking today includes public offering of debt and equity securities, private placement of debt and equity securities, mergers and acquisitions, financial advisory, fairness option, structured finance, risk management, merchant banking, public trading of securities, wealth management, other investments, government financing, underwriting debt and equity securities.

All of investment bank's activities contain certain type of risk. Investment banks have to deal with business, investment, operational, market, legal and compliance risk. To be able to manage the risks and to prevent fraud, many regulatory bodies take different measures to ensure that work is done in accordance with specified rules and regulation.

Special part of the paper is dedicated to the weaknesses in the banking system and the US housing crisis, its spread and its impact worldwide. A particular accent is put on the securitization and derivatives as the major causes of the crisis. Moreover, the US housing crises is the setup of the thesis' analysis. This topic will be examined through the analysis of two case studies: Lehman Brothers and Goldman Sachs. These are ones of the main major players in the US housing crisis and therefore, this study will assess their influence on the crises and based on that, draw conclusions on how to prevent financial crises in the future.

1. THE EVOLUTION AND ROLE OF INVESTMENT BANKING

1.1. History

The development of investment banks can be traced back to the eighteenth century, to Adam Smith and his invisible hand. Grossman (2010) stipulates that with the new free market capitalism, banks were able to start functioning independently from the government and "the new banking system" was born. Subsequently, in the USA, companies like J.P. Morgan and Dillon Read recognized new opportunities on the financial market. Rhee (2010) and Morrison et all (2008) emphasize that the new banking system led to a development of new banking activities, investing activities, which were different from the old, merchant banking ones. The merchant banking was conducted among closed circles between the richest individuals. Both, Grossman (2010) and Fleuriet (2008) point out that in contrast to the old merchant banks, the new investment banks gave opportunities to companies willing to raise capital to issues securities and exchange them in the major financial centers. These firms started engaging in all sorts of financial activities including giving loans and taking deposits. The financial activities were expanding and they did not underlie almost any rules and regulations. The unrestricted liberty of these new institutions led to the "Great Depression" of 1929.

The huge hit on the U.S. economy clearly illustrated that stricter regulations of the banking system are of huge necessity for the economic stability of the country. Subsequently, after the "Great Depression," the US government had to find a way to protect its citizens from fraud and possible loss of money. According to Rhee (2010), the Glass-Steagall act of 1933 was brought with an aim to prevent panic, rapid withdrawal of money and collapse of the banks. This act separated the activities of the commercial and the investment banks. Grossman (2010) and Fleuriet (2008) emphasize that commercial banks manage deposits and loans for individuals and businesses while investment banks participated in the buying and selling of stocks, bonds and other investments as well as to help companies to go public. Compared to commercial banks, investment banks are able to tolerate higher level of risk. That is mostly because the commercial banks have a fiduciary responsibility towards their clients' best interest.

Grossman (2010) and Fleuriet (2008) think that this step led to a more stable economic situation until the year of 1999 when the Gramm-Leach-Biley Act was brought. This act allowed big banks to offer both, commercial and investing services. The main purpose of the amendment was to modernize the financial industry and to create an umbrella organization which can simultaneously offer different financial activities. But, there were no well-defined rules and regulations that were able to regulate the operations of these multinational corporations. This complex holding type of system was difficult to control and contributed towards the outburst of the internet crises of 2001 and the global recession of 2008.

The past has shown that the mixture of the two types of banking creates bubbles and disastrous busts. Subsequently, the main question that arises here is whether commercial and investment banks need to function separately and if yes, why!? Thus, in order for one to be able to understand the development of the 2008 crises, this study has to address this question.

1.2. The role of investment banks

Investment banks facilitate the flows of funds and the allocation of capital between those who are in need of capital and those who have money at their disposal to invest. Moreover, investment banks serve as intermediaries between the two parties, make the market and regulate the price during the transaction. Investment banks operate with high level of capital and large scale investments. Moreover, as Liaw (2012) and Morrisomet all (2008) illustrate, they engage themselves in trading with shares warrants, bonds, capital notes and derivatives. They assist companies to go public and they participate in transactional banking internationally. Investment banks provide various services: Public offering of debt and equity securities, private placement of debt and equity securities, Mergers and acquisitions, Financial advisory, Fairness options, Structured finance (securitization), Risk management, Merchant banking, Public trading of securities, Trading with derivatives, Wealth management, Other investments (private equity, real estates, international investment), Government financing, Underwriting debt and equity securities etc. Each of their activities encounters different level of risk and therefore, the profit for the investment bank for the allocation of capital and the settling of the price in these transactions varies.

2. RISKS IN INVESTING BANKING

There are four main types of risks that the investment banks encounter. This risk types and what they are consisted of can be seen on the figure on the next page:

Figure 1: Basic Types of Risk

Source: Jacobs, Andreas (2015) Modern Portfolio Theory.AZEK. Zurich, AZEK Inc, p. 67

The study will examine each risk separately:

a) Business Risk:

Concerning investment banking, business risk means the threat of earning less profit that the bank has anticipated. According to Jakob (2015) and Agranovich (2015) this can occur due to the fact that the value of the capital can drop, an incident might occur that will endanger the reputation of the bank, some of the key employees might leave the bank, the interests of the bank might not be aligned with the interest of the clients which might cause loss of clients, disagreements between the management board might.

b) Investment Risk

Jakob (2015) and Agranovich (2015) emphasize that the investment risk is the probability that the bank might encounter losses of particular investment which can be related to: a change in demand on the market, liquidity problems so the investment might be stopped, to leverage problems, the leverage can lose value or can have additional problems attached to it, insufficient diversification which will increase the risk of loss, and a possible failure of the entire investment plan which can take place due to various internal or external circumstances.

c) Legal & Compliance Risk

The legal and compliance risk is the risk from failure to work in accordance to the rules and regulations and other by law binding requirements. Jakob (2015) and Agranovich (2015) emphasize that investment banking is strictly regulated and the failure to comply with the rules and regulations can jeopardize the functioning of the bank. In addition, the financial stability of the company, concentration of work and the neat documentation have to be taken in considered because when not well-managed they will threaten the proper functioning of the company. Therefore, internal control as well as control from an independent body is necessary in order to prevent law compliance problems.

d) Operational Risk

Operational risk is related to the internal risk that comes from the internal processes and procedures as well as from the soft and the hard resources. Therefore, as Jakob (2015) and Agranovich (2015) portray the investment banks should take all necessary measures to prevent fraud prevention, to maintain regular control over the entire working process and the communication between the employees. In addition, the technology and the systems they use should be regularly checked and maintained.

3. REGULATIONS AND INVESTMENT BANKING

In order to diminish the risk there, exist various international rules and regulations concerning investment banking. Eichengreen (2015) emphasizes that one of the most important internationally applied regulations are the Basel standards.

There are three Basel accords. However, the third one was brought after the outburst of the financial crises of 2008. Eichengreen (2015) explains that the first one was created in 1988 and its main intention was to control credit risk by assigning risk weights to the assets. Banks that work internationally are obliged to hold capital close to 8% of risk-weighted assets. In addition, each bank was obliged to report all non-financial assets. The starts of the second Basel Accord date to the year 2005. However, its final framework was established in 2007.

These accords served as the basis for the regulation of investment banking. However, as Schooner and Taylor (2009) illustrate, given the fact that the first one was very limited and the second one was not fully defined by the year of 2007, when the collapse was already happening, made the regulatory institutions very fragile.

There exist more agencies which regulate banks. And ensure the compliance with the Basel standards. Most of these institutions are private and they facilitate the function of the bigger governmental regulatory bodies. Moreover, it is mandatory that all agencies and banks that participate in investing and financing activities cooperate with a smaller regulatory agency that directly reports to the main one. This is to ensure that every rule and regulation is implemented and the work performed by the investment bankers, brokers or advisors is strictly in accordance with the law and for the best benefit of the client. Eichengreen (2015) and Stowel (2008) point out that a system with tight supervision is designed to prevent fraud and financial misbalances and possible financial collapse.

But, the presence of the international standards and regulatory bodies failed to protect the US economy from collapse. Schooner and Taylor (2009) emphasize that the existence of many weaknesses in the regulatory system, the poor work of the rating agencies and the insufficiency of the Basel standards led to the outburst of not only US, but world economic crises.

4. SIGNS OF WEAKNESSES IN THE BANKING INDUSTRY AND FINANCIAL COLLAPSE

After the removal of the separation of Investment and Commercial banks in 1999, the control over the investment banks was much more difficult. Due the different nature of the two types of banking system, the regulatory bodies were not able to properly asses the working of the banks. Mayer (2009) point out that the level of risk toleration is totally different for the both banking systems. Subsequently, the functioning of the systems as well as the profile of the customers was totally different.

The big banks were the leading banks and therefore, their failure to comply with the rules and regulations imposed by the regulatory bodies created greater and greater tension in the society.

Given the fact that the investment banks tolerate higher level of risk, the commercial banks had very big liberalization in their way of working. Mayer (2009) points out that the big banks started giving easy housing loans to clients by using mortgage securities and collateralized debt obligations. In addition, private agencies started giving loans with mortgage securitization. As the prices of the houses begun to rise, more and more people demanded the housing mortgages in the USA. The banks and private loaners were giving credits without any control

The rising prices of the houses attracted investors to invest in the US housing business. The investors also acted through the big US banks as they were both, commercial and investment banks. Mayer (2009) points out that the rating agencies were pumping up the prices even more by giving very bias valuations and a housing bubble was created, that reached the peak in 2004. The asset prices began to fall rapidly. The investors started losing huge amounts of money. Moreover, as the prices went down, the people were not liquid enough to repay their debts and the banking system started to become very fragile.

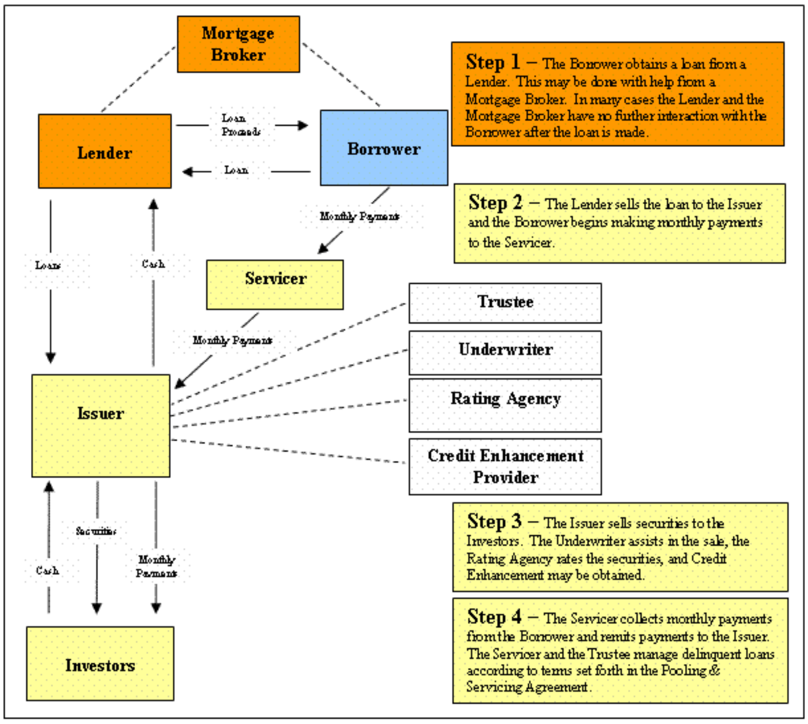
In 2007-2008 the credit markets collapsed completely. Hundreds of mortgage lenders went bankrupt. In addition to this, the investment banks and hedge funds were also encountering loses. And, in order to try to cover the losses and earn profits they entered into borrowings which expanded the bubble. The leverage of these institutions was so high that only a small drop in their asset-value meant collapse. Mayer (2009) emphasizes that the financial markets were very unstable, the prices were constantly dropping and many hedge funds and investment banks also collapsed. The entire financial US system collapsed, the US government was not able to offer bailout for all financial institutions and that lead to a recession and a severe economic crisis in 2008.

In addition, the US investment banks worked with derivatives and forwards, options, swaps and futures were bought and sold all around the globe. Thus, when the prices started falling, the crises spread all around the globe.

5.SECURITIZATION, AN ACTION FOR FINANCIAL STRENGTH OR WEAKNESS?

Another reason for the outburst of the crises was the process of securitization. With an aim to explain how securitization functions, the following figure will be used:

Figure 2: How Securitization Functions?



Source: Federal Deposit Insurance Corporation: Laws and Regulations (2014). Available from: https://www.fdic.gov/regulations/laws/rules/1000-400.html

Through the figure above, The Federal Deposit Insurance Commission (2007) explains the entire procedure of the securitization. First, the bank or another saving institution gives a loan to a borrower. The lending can be done directly or through a mortgage broker. Then, the lending institution will find a way to finance the loan. Furthermore, securitization involves selling a loan by the lenders to someone else. The new owner of the loan who in the figure is referred to the issuer then sells the loan in form of a security to an investor. The Federal Deposit Insurance Commission (2007) points out that the issuer can be a bank or a private financial institution. In the process of issuing securities, the investors involve trustee, underwriters, rating agencies and/ or credit enhancement providers in order to protect their interest. In return for the loan, the borrower is paying out the loan on monthly basis, and the issuer is paying the investor on monthly basis as well. In case of default, the issuer and the lender were able to restructure the loans.

The aim of this system was to protect the financial markets of potential crises. However, things went out of control and the system which was aimed to protect the US financial market took other direction. As the prices rose, there were more and more investors and more and more borrowers present on the market. However, what was failed to be taken in consideration, as the Federal Deposit Insurance Commission (2007) explains, is the fact that:

- the shadow market was also developing in parallel with the official financial market
- the credit ratings that the issuers performed were inaccurate
- the mixture of investment banking and commercial banking made it difficult for regulators to assess the lenders and the issuers which resulted with decreased regulation.
- the different kind of existing risks were not adequately calculated

Subsequently, when the bubble exploded, both the commercial and the investment banks were stacked in the middle. Mian and Sufi (2009) and the Federal Deposit Insurance Commission (2007) emphasize that the borrowers were not liquid to repay the debt and the investors were losing money. The securitization took the opposite direction and lead the financial market to a collapse because the two types of banking systems were involved in the same process, so there was no way to assist one another in a period of crises. Both, commercial and investment banks have different activities and if they wouldn't work jointly in the securitization, one of them could have acted to help the other one and prevent financial disaster. However, as the prices started dropping the entire population was in panic and everyone was trying to save oneself, which at the end led to disaster.

6. DERIVATIVES, A NEW OPPORTUNITY, OR A TOOL FOR DISASTER?

Derivative instruments are not new – they have been around for years. However, the main turning point was the year of 1995 when Wall Street's rocket scientists started creating new, complex, sophisticated financial derivative instruments. Most of these innovations were of the interest of the US investment banks which started adopting them and spread them around the globe.

Dr. Roman von Ah (2015) explains derivatives on the following way:

There is a market place where the trade, takes place, for example: bilaterally over the counter or on derivatives exchanges (fully standardized contracts). The type of their underlying asset, which can be a financial instrument, a physical asset, or more generally any risk factor that can be measured (e.g. temperature, freight rate, etc.) are sold and bought on the exchanging platforms through four types of products, forwards, futures, options and swaps. The products differ in terms of their dependence on the price of the underlying as well as on the nature of their initial and final payoffs.

During the housing bubble, the US banks favored trading with futures. Every market transaction has three components, trading, clearing and settlement. In a future transaction, as Mian and Sufi (2009) point out, the trading and clearing happens immediately, but the settlement will only occur at a specific future date. When the future matures, an exchange of the underlying asset should take place. However, the buyers of the future usually close the position before its maturity date and new future contract is concluded.

Mian and Sufi (2009) explain that the US banks used, the real estates as underlying asset of the futures, selling (short position) or buying (long position) them. Investors from all around the world started investing in futures expecting the prices of the real estate to rise. Closing the positions before their maturity and trading them further, they expanded the trading on global levels.

The prices of the real estate properties were constantly rising and the rating agencies were giving favorable valuations. Given the poor work of the rating agencies the prices of the real estates were artificially pumped up. Subsequently, when the bubble exploded, the prices of the real estates started dropping and panic among traders and investors arose. Every person that held a future wanted to sell it as soon as possible which pushed the prices of the real estates even more down.

Given the fact that the futures were transferred from one person to another on a global scale, the US crises expanded internationally and affected the world economy.

Consequently, the process of securitization, the trading of derivatives, the intermingling of the investment and commercial banking systems and the poor regulatory standards and the rating agencies played a major role in the US recession and economic crises and its expansion worldwide.

7. CASE OVERVIEW

This paper is going to focus on case study analysis in order to examine the connection between investment banking and the economic crises of 2008. For that purpose, the study is going to take in consideration two cases, Lehman Brothers and Golden Sachs. The main reason why the study will examine these two banks are:

- the fact that Lehman Brothers is was one of the biggest and strongest investment banks that failed during the housing bubble and as a multinational holding affected the entire world stage.
- Goldman Sachs is one of the rear cases that survive the housing bubble and the crises. Thus, it serves as a good comparison to Lehman Brothers.

How they acted and what preventive measures they have taken and how that influenced the world economy is of crucial importance to finding out the connection between investment banking and the recession of 2008.This section of the study consists of financial and non-financial analysis for both cases, Lehman Brother and Goldman Sachs.

7.1. Lehman Brothers

a) Fraudulent management behavior

As Augar and Harper (2008) illustrate the complex structure prevented the regulatory bodies to assess the firm's compliance with the banking rules and regulations and encouraged the management team to use unacceptable accounting practices in order to earn higher profits.

Far away from prudent corporate governance, as Lubben (2011) emphasizes Lehman modified its financial statements with an aim to demonstrate stability to the potential investors and gain their trust. Thus, the management team illustrated a strong financial stability of the company despite of the real situation. Moreover, they used bribery in order to cover its activities. Lubben (2011), Augar and Harper (2008) explain that the auditors doing company's financial statements, employees at Ernst & Young, participated in the fraudulent practices of the company. They violated the Sarbenes-Onexely Act and many other rules aimed at strengthening external auditing in order to disguise their finishing financial statements which later on created accounting scandals.

Another point that brought collapse to the company, as Augar and Harper (2008) portray, was the fact that the management board protected the individual interest over the interest of the company. They brought decision to increase the compensation bonuses of the senior management executives. Their bonuses increased to 480 million dollars which made Lehman's executives, the executives with the highest level of income.

Moreover, the company was crossing its own risk limitations and performing risky transactions just to gain profits. Lubben (2011) points out that the Security Exchange Commission was aware of these practices, however, due to bribery was ignoring the actions taken by the company.

As Augar and Harper portray (2008) that all these activities misrepresented the image of the bank in the public. Subsequently, before its failure there was neither time, nor space to do anything to save the bank.

The internal structure was completely weak, but from the outside it looked very strong. Given the poor work of the regulatory and rating agencies no loopholes could have been found on timely manner and therefore, no bailout strategy could have been developed.

Once the fraudulent behaviour was discovered, the company lost the trust from its collaborators and the public. Consequently, when it had short-term liquidity problems, no one really wanted to offer help to Lehman Brothers, so they had no choice, but to declare bankruptcy.

b) Risk exposure, lack of regulations and complex capital structure

With its too high leveraging the company entered into a signaling level of credit risk. Randall and McGee (2008) state that the allowed leverage level was 60% of its assets, however, the company leveraged over 90% of its assets.

With an aim to expand its business operations, Lehman Brothers took advantage of very risky investments, which expanded the already existing investment risk. According to Murphy and Kimberly, independent analysts, one of these investments was the acquiring of Residential Mortgage Backed Securities (D'Arcy, 2009). Murphy and Kimberly state that the financial statements of this company failed to illustrate its objective financial situation. Residential Mortgage Backed Securities accounted for 8.3 billion dollar losses in the process of securitization leading Lehman Brothers closer to bankruptcy.

In addition, as Randall and McGee (2008) portray, Lehman Brothers decided to enter into the derivative market and to engage in speculations in order to decrease their substantial credit risk. However, by taking this step they entered into a trap. Once the prices of the underlying assets started dropping, there was almost no way out. The bank encountered trillions of losses due to a default in collateralized debt obligations.

Nonetheless, the engagement in these highly risky activities could have been stopped and excessive exposure to risk could have been prevented. However, the regulatory bodies lacked regulations and strong structure and therefore, their ability to prevent the crises was limited. In addition, they were not even able to apply most of the existing rules and regulations to Lehman Brothers because their capital structure was very complex and required too many in-depth analyses which gave the company additional freedom of action.

c) The influence of the Lehman Brothers' collapse on the world stage

The bankruptcy of Lehman Brothers caused serious economic problems worldwide. The value of the real estates diminished significantly on the real estate market. Farndale (2008) points out that the receivables from the derivatives lost billions of dollars in value. To be exact, 70% of the value of all receivables of Lehman Brothers depreciated. Many hedge funds lost the value, since they relied on Lehman Brothers, as the market leader in the financial world.

Most of the debts of Lehman Brothers were written off. This caused the value of the stocks of many US and foreign companies to drop on the exchange market. Farndale (2008) emphasizes that the derivative trading, the German Banks immediately experienced instability, reporting 500 million euros of financial loss. Blute (2010) states that UK investors experienced 1.5 to 1.8 billion pounds losses. Japanese banks lost more than 2.4 billion yens. Many other countries encountered significant losses which caused shock in their economies.

Consequently, one can notice that the entire world was negatively influenced by collapse of Lehman Brothers. Murphy and many other scholars proclaim that the company caused the 2008 recession worldwide. This all could have been prevented if the signals would have been taken in consideration by the management team of the company, the regulatory bodies and the rating agencies.

7.2. Goldman Sachs

a) Fraudulent management behavior

The management team of Golden Sachs made similar steps to the management team of Lehman Brothers. Gordon (2015) emphasizes that they fabricated their financial statements in order to portray a good image about themselves on the market which was totally different of what was happening in reality. The richer the managers were getting, the more instable the holding was.

Goldman Sachs was accused for fraud, misrepresentation, intentionally omitting important facts about financial products. The company was selling mortgage securities created by hedge-fund firm and it was secretly betting in a sharp drop in the housing prices and market collapse. The bank had a power to drive the economy into crisis. These actions made the crisis even more severe and the losses devastating.

b) The influence of Goldman Sachs on 2008 financial crisis and its survival

Goldman Sachs survived the crises of 2008, but the main question to pose here is: how did they manage to do it!?

First of all, the company made enormous profits at the beginning of the crises. As Carney (2009) portrays while selling mortgage securities, the company secretly bet against the housing market. Goldman Sachs was playing double game and with good timing and excellent salesmanship as many external analysts portray, it managed to survive while the market was collapsing. Carney (2009) emphasizes that they managed to find investor who bought preferred stocks with a total value of 5 billion dollars. In addition, the company had close ties with the government given the fact that it was providing the US government with finances during the Second World War. Subsequently, they managed to obtain loan from the Federal Reserves in one day and that help them to overcome the crises.

Despite its survival, Goldman Sachs had also a negative impact on the world economic crises. The double game enabled them to stay in operations, but their clients encountered huge losses. The double game enabled them to stay in operations, but their clients encountered huge losses. Carney (2009) points out that Goldman Sachs sold $40 billion in mortgage back securities, but omitted to tell the buyers that they are secretly betting that a sharp drop in U.S. housing prices will take place.

	Lehman Brothers	Goldman Sachs
Management behavior	profit oriented (high management salaries); inflated asset prices;	profit oriented (high management salaries); inflated asset prices; modified financial
Profitability ratios	rising profitability with small fluctuations and	rising stable profitability
Leverage ratios	very high (critical) level of leverage	very high (critical) level of leverage
Liquidity ratios	lack of short term liquidity	lack of short term liquidity
Cash flow	dependent on equity and external financing	dependent on equity and external financing
Financial markets	safe investments; positive signs	safe investments; higher positive signs

7.3. A parallel between Goldman Sachs and Lehman Brothers

Let us compare the companies:

Table 1: Goldman Sachs VS Lehman Brothers

If one takes in consideration the table above, one can notice that both companies engaged in illegal activities. The main difference is that Goldman Sachs secretly engaged in betting that market collapse will take place and they managed to earn lots of money. From the table above one can notice that both companies suffered liquidity and leverage problems, meaning that a small drop in the value of their assets could mean bankruptcy. Concerning profitability and financial market indicators, Goldman Sachs shows more stable results than Lehman Brothers does. Moreover, the investors and the public considered Goldman Sachs to be more reliable than Lehman Brothers.

Both of the companies encountered the same problems with liquidity and leverage and both of them were dependent of external financing. Goldman Sachs managed to survive due to the greater financial stability coming from the secret betting and from the assistance of the Federal Reserves (history based) and the external investors. Lehman Brothers failed to find external investor and the Federal Reserves did not support them which brought the bank into bankruptcy.

8. IS THERE A NEED FOR SEPARATION BETWEEN INVESTMENT AND COMMERCIAL BANKS?

One of the main causes of the crises was the amendment of the Glass-Steagall Act in 1999 which allowed the bigger banks to function as both commercial and investment banks.

In contrast to investment banks, commercial banks have other role. Commercial banks take deposits from clients and give them loans. For their services they get payments usually charged in interest. Due to the different nature of the activities, the investment banks can accept higher level of risk. The risk tolerance level of the commercial ones is very low because the commercial banks have to take care of their clients and ensure that panic will not arise. Ingram (2015) points out that he moment panic arises, every client will withdraw its deposits and the bank will lose liquidity and collapse. Thus, in order to ensure security and reduce the conflict of interest that might appear between the customers and the bank a separation of the two branches is inevitable. Historians, economists and scholars point out that, issuing securities creates threat for depositors. Moreover, as Senate Barkley states: “the banker who has nothing to sell his depositors is much better qualified to advise disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantage of this, that, or the other investment on which the bank is to receive an originating profit or an underwriting profit or a trading profit” (The Economist, 2012).

On the other hand, as Eichengreen (2015) points out, many economists say that the risk toleration level of investment banks is not necessarily higher than the one of commercial banks because both, investment and commercial banks try to minimize risk in order to protect themselves and its clients.

However, despite the contra-argumentation, the history showed that the economy is exposed to greater shifts and problems when the two banking systems function under one roof. Their separation tends to lead to much greater economic stability and smoother flow of money.

9. CONCLUSIONS

The entire situation points out that due to lack of control and supervision, the investment companies exercised enormous freedom and were profit oriented taking highly risky trades and investments. The hunger for additional profits encouraged the managers to engage in fraudulent behavior. These actions put them into a very difficult financial situation which did not affect only the financial market, but the entire US and world economy.

Nonetheless, the inability of the regulatory body to follow the actions of Lehman Brothers, Goldman Sachs and many other multinational corporations clearly illustrates a weakness into the legal system as well as the rules and regulations applicable to the companies from the financial sector.

According to many experts from the field of finance, if all rules and regulations were respected and applied properly, the crises wouldn't have been so severe because the companies would have been able to survive. Though, the gaps in the international standards would have still caused destabilization in the economy.

The poor work of the rating agencies and regulatory bodies gave almost unlimited freedom to Lehman Brothers, Goldman Sachs and other investment banks. The root of that is the amendment of the Glass - Steagall act which allowed intermingling of investment and commercial activities. The amendment of the act which was primarily meant to modernize the financial industry and create a new financial institution, a holding, turned out to be a key factor to destabilizing it. The Federal Reserve Board was convinced that the new regulation system is strong enough to sustain these changes. However, the new system combined with the emergence of new financial products, securitization and derivative trading, created holes in the international standards which diminished the control over the newly shaped institutions.

From the entire analysis it can be concluded that the biggest world economic crises of 2008 was initiated by the collapse of the mortgage market, the extremely complicated innovative financial instruments, the bankruptcy of the big banks, the lack of rules and regulations in the banking industry and the underperformance of the regulatory bodies.

Everything started from the moment the investment banks started acquiring other businesses and became holdings. There were no well-defined rules and regulations that were able to regulate the operations of these multinational corporations. Moreover, these companies used very complicated financial tools and the regulatory bodies were not ready to deal with them on the right manner.

The analysts required well-formulated standards that will be able to analyze every action performed by each of these corporations. However, since there were black holes in the Basel and other standards, the entire functioning of the multinational corporation was vogue to the regulatory bodies. Moreover, the line between right and wrong actions was blurred and that led to deregulations on the financial markets.
Given the freedom and the motivation for higher financial gains, instead of being an example on the market, these corporations started engaging into fraudulent behavior and illegal practices. They all fabricated their own financial statements in order to gain the public support and to increase their reputation and value in the society. The rating agencies, hungry for extra profits, supported the banks, pumping up their asset-values even more. The investors, blinded with the greater expected returns, overlooked the signs in the economy.

Everything was happening very fast and there was no space for intervention. The governments had limited funding and they were not able to offer much assistance to the corporations. The trading with derivatives expanded the crises worldwide, turning the US collapse into international collapse. The appetites for greater profits on the cost of enormously high risk-acceptance level brought billion-dollars of losses. The financial crises took massive measures and drew the entire world economy into the biggest recession in the history.

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DE-EUROISATION - IS IT NECESSARY AND VIABLE PROCESS FOR THE WESTERN BALKAN COUNTRIES?

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ABSTRACT

The process of unilateral euroisation in the economies of the Western Balkan countries is encouraged by the progress in financial markets integration, harmonisation oflegislation and increasing free movement of capital and labour.

While low and moderate euroisation brought to these countries certain financial stability and economic growth, the massive euroisation has shown significant drawbacks, particularly for central banks, in terms of reducing the effectiveness of monetary policy and creating certain financial stability challenges.

This was emphasized particularly in the period of recent European sovereign debt crisis, when fearing from the crisis spill-over effect, as well for the euro survival, Western Balkan countries started the reversible process of so called de-euroisation. However, the process of de-euroisation turned out to be slow and not very certain process, as there are varieties of factors preventing this effort.

The paper aims to analyze the positive impact and drawbacks of euroisationon Western Balkans countries 'economies, as well as the factors that are preventing their authorities' effort to de-euroise their economies.

KEYWORDS : euroisation, de-euroisation, financial stability, economic growth, financial crisis

JEL CLASSIFICATION: F36, F43

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1. INTRODUCTION

Euroisation is voluntary, market forces driven use of the euro in the domestic monetary system alongside the national currency.

The literature makes a clear distinction between de jure euroisation (also referred to as fully, unilateral or official euroisation) and “de facto” euroisation (also referred to as partial, financial or unofficial euroisation).

Therefore besides the formal adoption of euro through the institutional process prescribed by EU, which have already been adopted by 19 out of 28 EU member countries , the theory and practice recognize: *unofficial, unilateral* and *consensual euroisation.*

Unofficial euroisation denotes a phenomenon where economicagents voluntarily use the euro alongside the national currency. Thespontaneous euroisation results from business concerns and is not adeliberate government policy of unilateral adoption of the euro.

Unilateral(andofficial) euroisation is the unilateral decision of a sovereign country to abandon its national currency partially or entirely in favor of adopting the euro as legal tender without joining EMU.

Consensual euroisation can be defined as an official introduction of the euro as legal tender, without respecting the institutional path of EMU, but resulting from an agreement betweenthe euroising country and EU officials

Spontaneous confidence in the euro by citizens in Western Balkans countries, was more than evident in the past ten years, as euro became the most important foreign currency for the denomination of deposits, loans and liquid assets in all the region, leading to unilateral euroisation in Kosovo (under UN 1244/99) and Montenegro and high levels of unofficial euroisation in the other Western Balkan economies.

However, the recent sovereign debt crisis and negative impact which was made on the EMU members put forward a question of euro survival and many countries in Europe outside the euro-zone, analyzed whether to support further euroisation or to undertake the measures that would moderate the trend of euro growth, starting the reversible process of so called de-euroisation.

2. EUROISATION PROCESS IN WESTERN BALKAN COUNTRIES

The specificity of the Western Balkans is that both "de jure" and "de facto" euroisation are present in the region. While, Kosovo and Montenegro abandoned their independent monetary policy via unilateral euroisation, the other WB countries are unofficially euroised, however to a different extend.

In fact, disparity among the countries is considerable: currently, Macedonia's lending euroisation rate is about 47% and deposit euroisation rate is 43%, in Serbia, lending as well deposit euroisation rate is about 75%, the deposit euroisation rate in Bosnia and Herzegovina is 44%, while Albania keeps about 50 % of the loans and deposits denominated or indexed in euro. In general (with the exception of Albania), data suggest somewhat lower financial euroisation in 2015 compared to the pre-crisis levels.However , the euroisation process was not only voluntary action and behavior by the citizens and private sector – it was also supported by Western Balkans countries' national authorities, aiming to achieve the following goals[1] :

- Increasing the economic growth of the domestic economies (tendency to achieve convergence to Eurozone's GDP level);
- Solving inflation legacy problem and therefore improve macroeconomic stability of the country (achieving inflation and interest rates convergence to euro zone level);
- Achieving stronger economic and financial integration with EU members, through better trade integration, lower transaction costs and the elimination of exchange rate uncertainty.

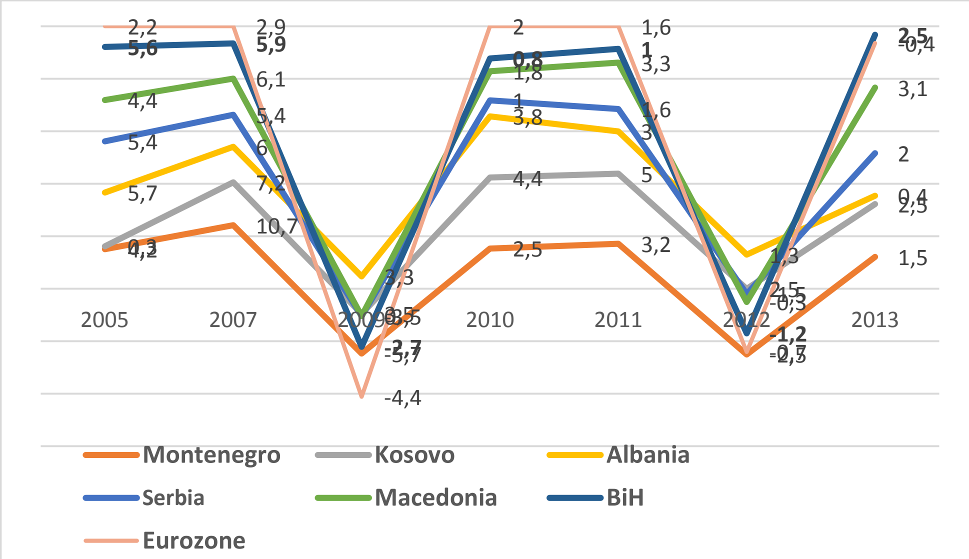
2.1. *Were the goals of the euroisation achieved in Western Balkan countries ?*

Analyzing the data related to GDP growth, annual inflation rate change, as well as FX rate stability it might beconcluded that euroisation helped Western Balkans countries (especially those with lower level of economic development) to accelerate their economic growth rate and stabilize the inflator turbulences. Also, national currencies pegged to euro decreased the foreign exchange rate turbulences and decreased the foreign exchange costs.

[1]Lucia Országhová "Euroisation in the Western Balkans (Part III)"-EU Enlargement ed. 23, 2/2015

More precisely, analyzing the GDP annual growth rate, it can be identified high level of positive correlation between the annual GDP growth rate in West Balkan countries and the one in the Eurozone. In fact, the trend line follows the same shape as the one in Eurozone countries but with different amplitude. (Figure 1).

Figure 1: GDP annual growth rate as % of GDP (WBC vs Eurozone)



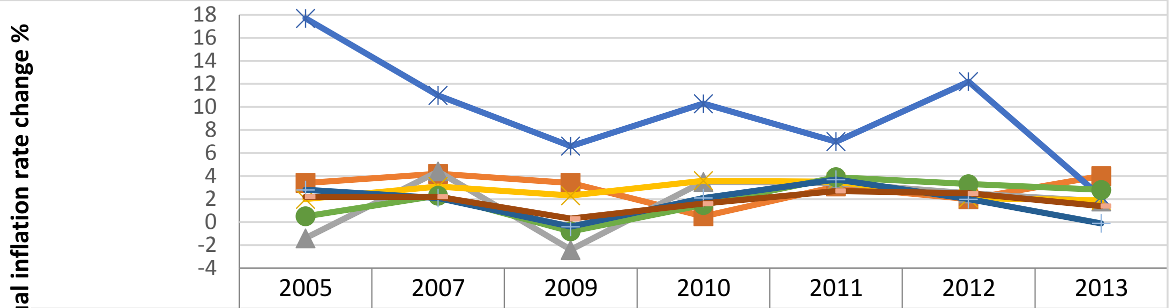
Source: World Banka database, compilation by the authors

The highly euroised West Balkan countries, as well as officially euroised countries (Kosovo and Montenegro) experienced "catch up" moments and higher economic growth. The foreign direct and portfolio investors as well as trade partners (all of them mostly from Eurozone), have increased their activity on the Western Balkans directly increasing the level of euroisiation, but in the same time presenting an essential accelerator for the economic growth in each of these countries.

However, in the financial crisis period, they have all faced the lowest level of GDP growth (negative one) due to the sudden stop of the foreign capital inflow, which has caused a sharp monetary contraction and consequently a drop in output. The same positive correlation of euroisation can be identified related to macro-economic stability, analyzed through the annual inflation rate change. (Figure 2)

All counties felt the inflatory and deflatory trends the same way as the countriesin Eurozone, except Albania which has more moderate and less turbulent inflation rate over the analyzed period.Even more, at the early years of extensive euroisation for example , the Serbian economy succeed to decrease the extensive inflation rate at reasonable level, but during the crises period , the country still experiences turbulances and inflatory shocks.

Figure 2: Annual inflation ratechange in % (WBC vs. Eurozone)

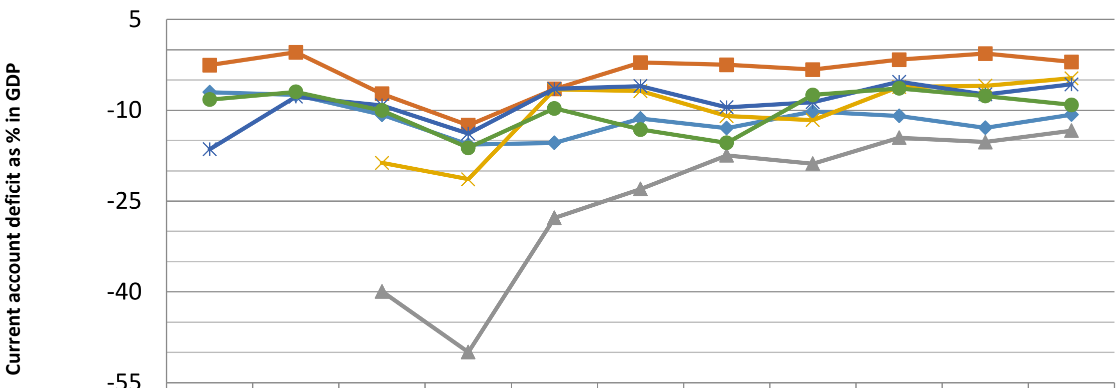


	2005	2007	2009	2010	2011	2012	2013
Montenegro	3,4	4,2	3,4	0,5	3,1	2	4
Kosovo	-1,4	4,4	-2,4	3,5	3,4	2,5	1,8
Albania	2	3,1	2,3	3,6	3,5	2,1	1,9
Serbia	17,7	11	6,6	10,3	7	12,2	2,2
Macedonia	0,5	2,3	-0,8	1,5	3,9	3,3	2,8
BiH	2,8	2,1	-0,4	2,1	3,7	2	-0,1
Eurozone	2,2	2,2	0,3	1,6	2,7	2,5	1,4

Source: World Banka data base, compilation by the authors

The objective of achieving stronger economic and financial integration with EU members, through better trade integration, (increased net export of goods and services) and net primary and secondary income is analyzed through the indicator of the current account balance as % of GDP.

Figure 3 : Current account balance as % in GDP in WBC



	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Albania	-7	-7,461	-10,75	-15,67	-15,37	-11,34	-12,95	-10,21	-10,92	-12,88	-10,72
MK	-2,545	-0,416	-7,266	-12,47	-6,484	-2,108	-2,494	-3,275	-1,638	-0,632	-2,019
MNE			-39,92	-49,95	-27,78	-23,01	-17,43	-18,82	-14,54	-15,23	-13,36
Serbia			-18,68	-21,39	-6,569	-6,822	-10,95	-11,61	-6,139	-5,959	-4,712
BIH	-16,43	-7,757	-9,192	-13,84	-6,45	-6,005	-9,488	-8,649	-5,297	-7,391	-5,702
Kosovo	-8,236	-6,954	-10,03	-16,19	-9,675	-13,17	-15,36	-7,453	-6,382	-7,642	-9,093

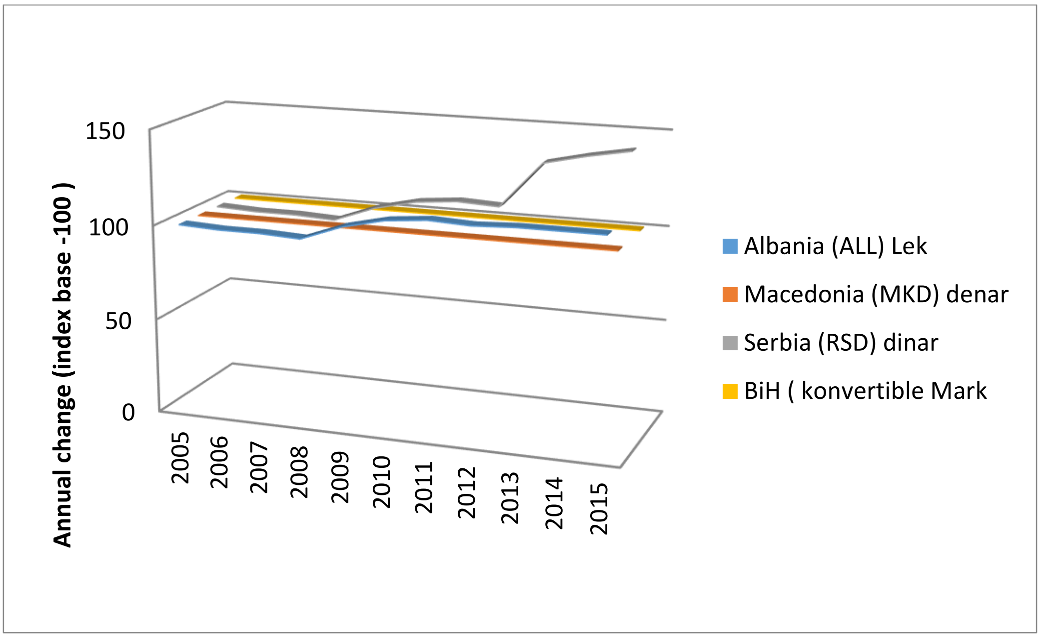
Source: World Banka data base, compilation by the authors

Current account balance is the sum of net exports of goods and services, net primary income, and net secondary income which are presenting improvements since 2008 with exception of Albania which is presenting slightly bigger current account deficit in the recent years than at the beginning of the observed period (2005th and 2006th). On the contrary, Montenegro which have experienced high current account deficit over the financial crisis, has improved its current account position from almost -50% (in 2008 year) to 13% in 2015.

In order to avoid or decrease the national currency exchange rate uncertainty the most of West Balkan countries have either practiced fixed exchange regime, pegged to euro or unilaterally adopted euro as their sole legal tender (Kosovo and Montenegro), while only Albania and Serbia practice floating exchange regime.

The West Balkan countries which practiced fixed exchange rate and pegged their currency to euro (Macedonia, BiH) have had stabile foreign exchange rate, while the ones with floating exchange rate experience small (Albania) or more intensive (Serbia) increase of the national currency exchange rate towards euro in the period of sovereign debt crisis.

Figure 4: Annual national currency exchange rate change against EUR (baseline 2005)



Source: The World Trusted Currency Authority, Created by the author

Having in mind the liability currency structure at micro and macro level, (which was predominantly expressed in euro) the national currency exchange rate stability was achieved in the period of the Global financial crisis (2007), but some systemic risks appear to be less manageable in the period of sovereign debt crisis, which affected the macroeconomic stability in these countries.

3. CHALLENGES OF EUROISATION -NECESSITY TO DE-EUROISE

The debt crisis in Eurozone, brought new challenges for WBC highlighting many side effects from the euroisation process[2]:

- vulnerability of WBC' financial systems to sudden changes in capital flows
- risk for nominal exchange rate volatility,
- weakening of the central bank's effectiveness in conducting of monetary policy and of its function as a lender of last resort,

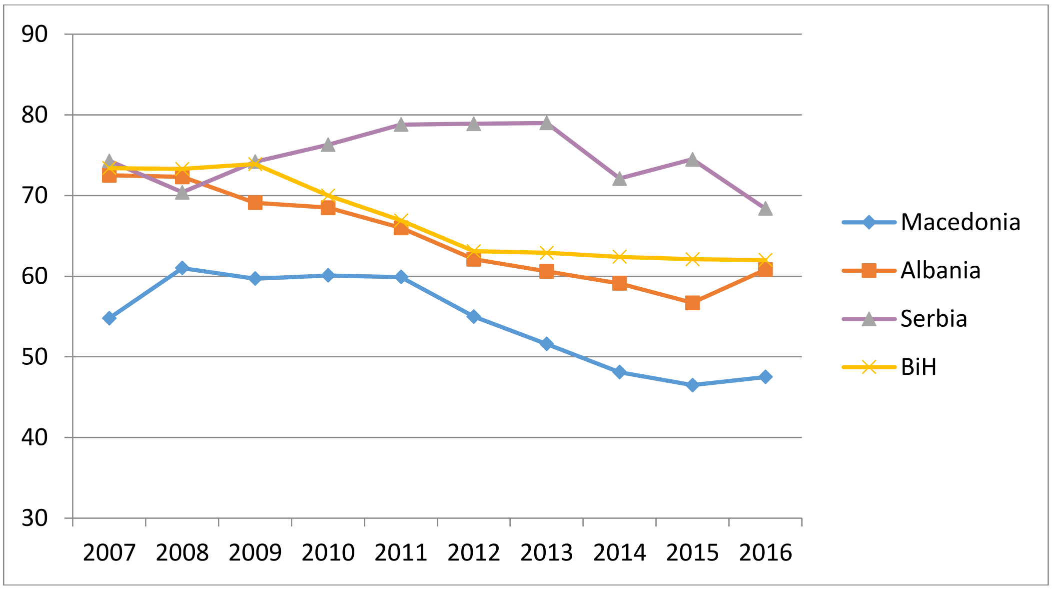
In fact, the sovereign debt crisis, change the attitude of the monetary authorities, banks and private entities in the Western Balkans countries to be more

[2]Roland Back at all "Financial stability challenges for EU acceding and candidate countries "Occasional paper series, No 136, Sept. 2012.

cautious regarding the extensive use of euro in their financial transactions, savings and credit activities. This stressed the necessity of reversible process of so called de-euroisation. Namely, over the past 6-7 yeas these countries have deployed some of the macro prudential measures to moderate or even stop the trend of eurosiation such as: ceilings on foreign exchange exposure, higher reserve requirements for foreign exchange denominated liabilities, liquidity requirements for foreign exchange denominated assets as well as provisioning.

Due to these measures and even more to the rumors about euro sustainability in Eurozone, caused by sovereign debt crisis as well as the consequences of Brexit vote, the de-euroisation process started to be more obvious in almost all Balkan countries. In fact, share of FX deposits has dropped more intensively at the liability side, while the loans indexed in euros were still at the high level in the bank's total assets. The most evident drop of euro denominated deposits and loans is registered in Macedonian banking sector, decreasing its euro denominated deposits and loans from 60% to 43% for deposits and 47% for loans at the end of 2016, thus increasing the portion of loans and deposits expressed in local currency. However, Serbian banking sector faces extensive euroisation, reaching the level of euroisation of over 75% regarding the euro denominated deposits and loans in the Serbian banking system. The other countries have shown the tendency of de-euroisation process but with limited effect. As over 95% of the foreign and foreign indexed deposits and loans in West Balkan countries banks are expressed in euro, the trend of de-euroisation , can be seen through analyzing the foreign exchange lending rate (% of foreign and foreign indexed in total loans to non-financial corporations and households) and foreign exchange deposit rate (% of foreign and foreign indexed deposits in total deposits from non-financial corporations and households) in the period 2007-2016. (Figure 5 and 6)

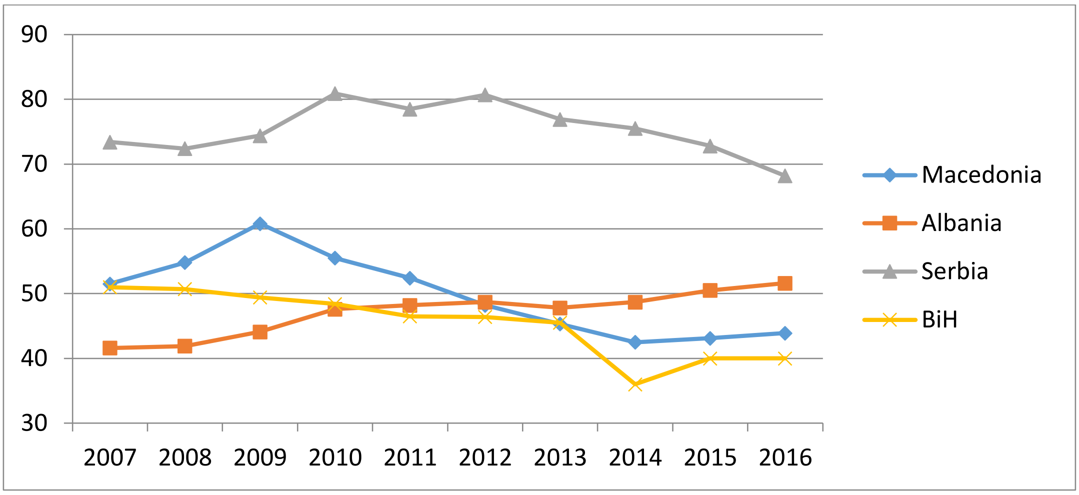
Figure 5: Foreign exchange lending rate 2007-2016 (% of foreign and foreign indexed loans in total loans to non-financial corporations and households)



Source: WB countries' Central banks bulletins-, Created by the author

The figures in the analyzed period clearly demonstrate that the lending in foreign currency as a share of total lending has fallen between 2009 and 2015 in all countries except in Serbia. Namely in this period the FX lending rate dropped between 11% and 15 % respectively, while in Serbia it peaked at 80% in 2012 before falling to 72% and then raised to 75% in 2015.However in 2016 it can be noticed that the quite opposite trend. In the countries which showed more significant trend of de-euroisation (BiH, Macedonia and Albania) the process of de-euroisation has been stopped, even the portion of foreign or foreign indexed loans slightly raised, while only Serbia has shown drop in the portion of foreign or foreign indexed loans in total loans, partly due to the implemented measures envisaged in recently introduced Dinarisation Strategy. Yet, the level of lending euroisation is still high, at the level of 70%. The foreign exchange deposit rate in the Western Balkan countries over the observed period is presented in Figure 6.

Figure 6: Foreign exchange deposits rate 2007-2016 (% of total deposits from non-financial corporations and households)



Source: WB countries' Central banks bulletins-, Created by the author

Albania the share of FX deposits in total deposits rose from 42% to 50% and Serbia (72% to 77%) and in 2016 slightly fall below 70%. Macedonia decline over the same period (from 49-60% to 43%) BiH decline from 51% to 44%. No matter the different level of success in fostering use of the local currencies, it is a fact that the euroisation rate in all Western Balkan countries is still high. It is a phenomenon that is widespread in all Western Balkan countries , despite the introduced regulatory measures in favor of the local currency, due to many factors[3] that are practically prevent the effectiveness of these measures and make irreversible process of euroisation harder to be realized.

4. IS DE-EUROISATION VIABLE FOR THE WESTERN BALKANS COUNTRIES?

It is argued that the process of de-euroisation in Western Balkan countries is slow and uncertain process due to the following factors[4]:

- Lack of confidence and trust in local currencies
- Inflation legacy and macroeconomic stabilization
- Trade integration with the euro area and remittances
- Presence of foreign banks in WBC
- EU and euro area accession perspective of WBC

[3]The factors are presented in the following chapter 4

[4]Ulrich Windischbauer "Strengthening the role of local currencies in EU candidate and potential candidate countries "ECB Occasional Paper Series, No 170 / April 2016

a) Lack of confidence and trust in local currencies

The lack of confidence in the WB countries national currencies has strong history background. Namely most of the current West Balkan countries are small economies in transition, emerging from the former Yugoslavia (only Albania is exception) and are still in the process of creating credible monetary policy and institutions, which should be totally independent and apart of the political influence. In order to enable foreign exchange stability and increase the confidence in their domestic currencies the WB countries policy makers usually pegged the exchange rate of their local currencies first with Deutsche mark and then with Euro. This policy additionally reinforced the already prevailing use of foreign currencies at both lending and deposit side. Thus the citizens shifted savings into the pegged foreign currencies, which were perceived as stronger and more stable from the monetary authorities as well. The banks on the other hand, have a tendency to avoid foreign exchange risk and increased the volume of foreign lending through more favorable interest rates of foreign currency denominated loans.

According to Beckmann and Scheiber (2012), the relative assessment of the domestic currency will be lower as long as high inflation rates persist or inflation is very volatile. Research results based on the euro survey conducted semi-annually by the Oesterreichische Nationalbank in EU candidate and potential candidate countries of the Western Balkans confirm that trust in the respective domestic currency is lower than in the euro. However, the overall trend in all countries observed has been positive recently as trust levels have increased over the last four to five years, judging from developments up to the latest available data of autumn 2014. Looking at individual countries, trust levels are lowest in Serbia reflecting the country's inflation legacy and volatility even in recent years. On the other hand, looking forward, the perception of domestic currencies is on the whole positive in Albania, Bosnia and Herzegovina and Macedonia. The assessment of the stability and trustworthiness of the euro is relatively higher compared to the national currency. Although the relative trust in euro related to the domestic currency decreased between 2010 and 2012, due to sovereign debt crisis, this trend has been reversed since then.

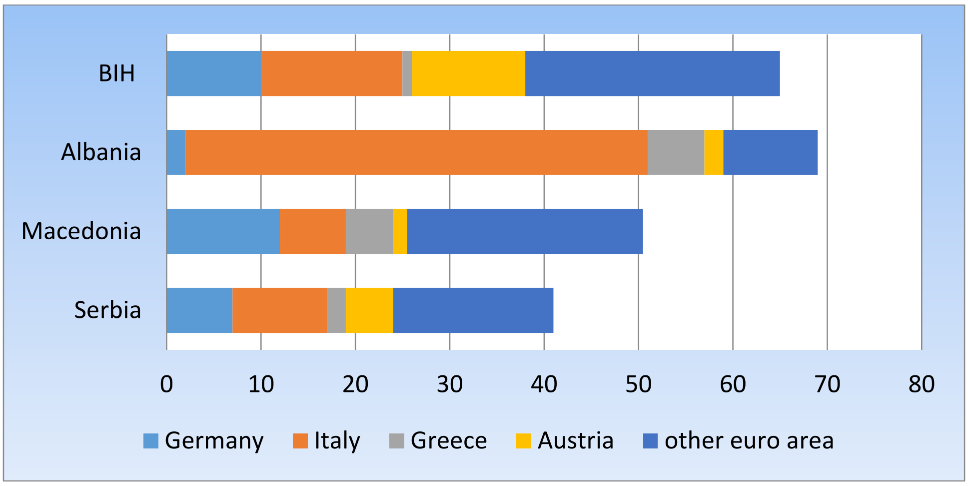
a) Inflation legacy

The wide-spread use of foreign currencies in the Western Balkan countries is to a large extent the legacy of former Yugoslavia and a direct consequence of the economic and political turmoil following its break-up. Many of Yugoslavia's successor states were hit by periods of high or even hyperinflation in the 1990s. Serbia (in the state union with Montenegro and including Kosovo at the time) even displayed one of the most devastating hyperinflation periods of history between October 1993 and January 1995. Estimates suggest that the price increase in that period reached some 5 quadrillion % , peaking in January 1994 when the monthly inflation rate was estimated at 313 million %. However, it was not only the successor states of former Yugoslavia that experienced periods of very high inflation: inflation rates were also high in Albania, where the annual rate peaked at 50% in 1997 after the collapse of financial pyramid schemes that had led to severe political and economic turbulence. Between January 1991 and April 1998, the Yugoslav dinar was officially devalued 18 times (three of which exceeded 99%), and 22 zeros were lopped off. These developments led to a complete (and official) abandoning of the Yugoslav dinar in Montenegro and Kosovo (besides political considerations in the run-up to independence). A period of hyperinflation was also experienced in Bosnia and Herzegovina from April 1992 – January 1994 with the peak of monthly inflation reaching 322% in June 1992 in the Croat-Bosniak Federation and 297 million percent in January 1994 in the Republika Srpska which had pegged its currency to the Yugoslav dinar. In Macedonia, annual inflation peaked at 1,700% in 1992 .

b) Trade integration and remittances from the euro area

Western Balkan countries show a high degree of integration with the euro area, as the half of their trade on average level is realized with the countries from Eurozone. In fact, the trade with the euro area presents between 40% (Serbia) and over 65% (Albania)of all traded goods, but intra-regional trade among the Western Balkans countries is also often invoiced in euros. Within the euro area, Italy is generally the most important export market for the region, especially for Albania, while the trade linkages with the rest of the euro area are mostly dominated by Germany. (Figure 7) Accordingly, both the corporate sector and private households have income streams in foreign currency with little incentive to convert them into local currency.

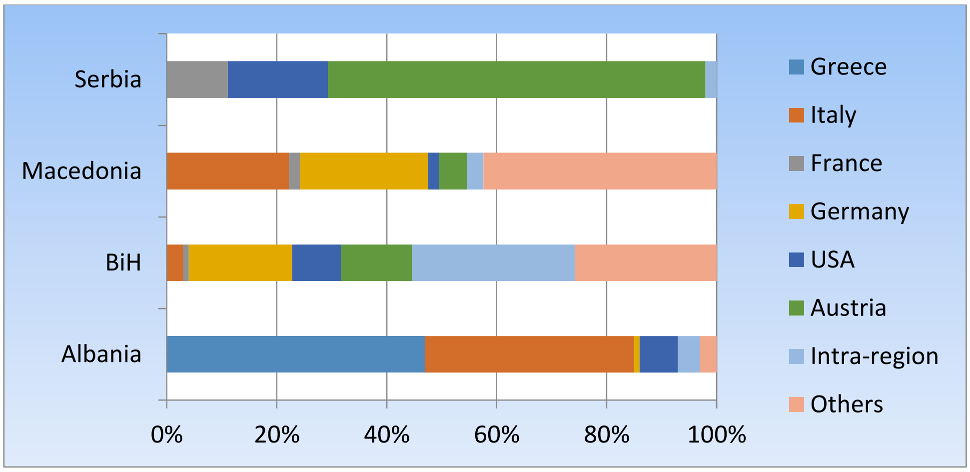
Figure 7: The main trading partners of Western Balkans countries



Source: World bank data, created by the author

Personal remittances from the EU play an important role in financing the current account for the Western Balkan countries, ranging from 3,2% of GDP in Macedonia, about 9% in Albania, Montenegro and Serbia, to 11% of GDP in BiH. According to World Bank's estimation, more than 70% of remittances come from Western Europe (more than 60 % from EU countries.

Figure 8: Personal remittances in Western Balkans countries



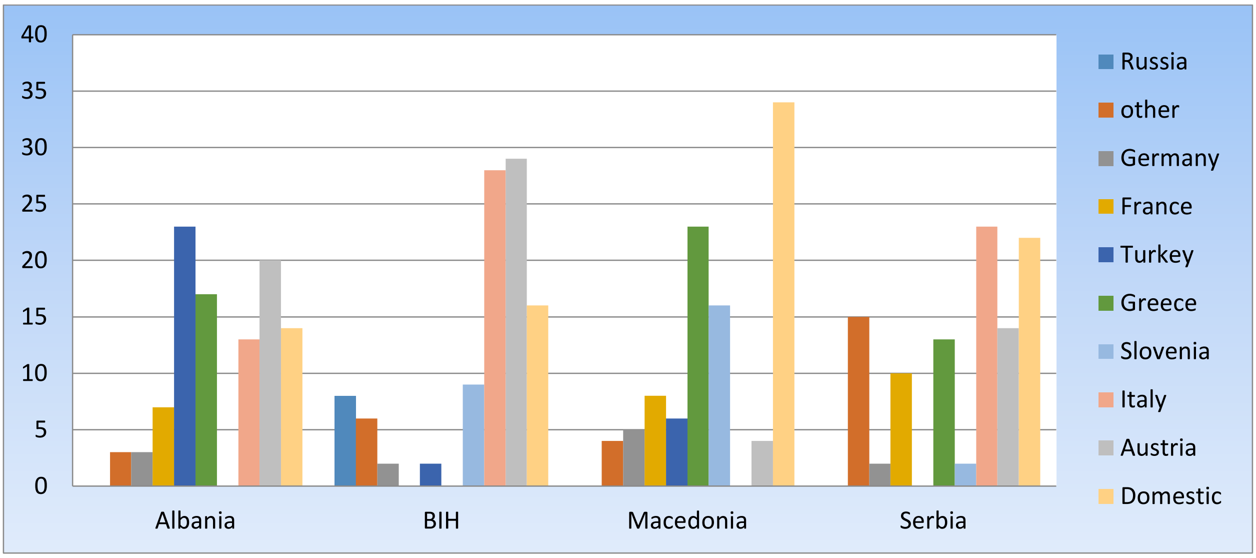
Source: World bank data

Analyzing the structure per country almost 80 % of all remittances in Serbia are sent from Austria and France, in Albania 85 % of remittances come from Italy and Greece while 45% of the remittances in Macedonia derives from Germany and Italy. All of these remittances present income streams in euro with little incentive to be converted into local currency.

d)Strong presence of euro area banks

Financial systems in Western Balkan countries are characterized by high foreign ownership, mainly from the euro area. The share of euro area-headquartered banks in total banking sector assets in the Western Balkans ranges from 48% in Macedonia to just below 70% in Bosnia and Herzegovina and Serbia. (Figure 9)

Figure 9: Ownership of the bank assets per country %



Source: Bankscope 2014

The entry of foreign banks into the banking sectors of the Western Balkan countries has not only increased competition, but is also another contributing factor to the euroisation of deposits and lending, as these banks usually have better access to funding in foreign exchange via their respective parent banks. However, it needs to be noted that euroisation in an environment with a large presence of foreign banks is less risky for financial stability than would otherwise be the case, precisely because foreign banks have easier access to "hard currency" in international markets.

e) EU and euro area accession perspective

As all of the WBC have candidate or potential candidate status for EU membership there was dabate if the de-euroisation and therefore greater use of local currency would weaken the long-term goal of euro adoption. On the contrary, greater monetary policy control would facilitate the stability of macroeconomic conditions, which is a precondition for euro adoption .

CONCLUSION

Partial substitution of assets that results from the euroisation, facilitates the development of financial intermediation, by allowing further reduction of the costs of international financial transactions, lowering of market risks and diversification of asset portfolios.

There is and evidence that highly euroised Western Balkans countries at first stage experienced higher level of economic growth, improved macroeconomic stability of the country, achieving inflation and interest rates convergence to euro zone level, as well as decreased exchange rate uncertainty.

However, during the sovereign debt crisis period, they experienced the turbulences and drawbacks even more evidently than the Eurozone countries. Although the financial sector in Western Balkan countries hasn't suffer the turbulences as the Eurozone, there was still present spillover effect in terms of capital outflow from the West Balkan countries to the foreign owned bank (mostly from Eurozone), the limited inflows of foreign remittances, as well as the sudden stop of the foreign capital inflow (mostly from Eurozone countries) has caused a sharp monetary contraction and consequently a drop in production in the real sector

Despite the euroisation's merits as a device for achieving macroeconomic stability, the Western Balkan countries monetary authorities introduced different regulatory measures in order to moderate the trend of euroisation, or even to revert it in the process of de-eurosiation. However, different measures seem to have rather limited effects on de-euroisation process, as the Western Balkan countries' citizens and entities are still aware of historical macroeconomic instabilities and hyperinflation in their countries, which led to relatively low levels of trust in local currencies. Furthermore, close trade and financial linkages with the euro area, the presence of euro-area headquartered banks as well as workers' remittances from the euro area tend to increase the use of the euro in the Western Balkan economies.

Their status as prospective EU and, eventually, euro area Member States is a further contributing factor to euroisation.

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CUSTOMER SATISFACTION WITH ELECTRONIC BANKING IN THE REPUBLIC OF MACEDONIA

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ABSTRACT

Modern society and the fast technological development are pushing the traditional banking towards electronic access. There is a growing number of consumers who replace the old approach of using banking services, with a new one i.e. with electronic banking.

In order to examine the degree of consumer satisfaction with the use of electronic banking in the Republic of Macedonia, a research was conducted on a total of 154 respondents that were considered for the statistical analysis of data. The empirical research lead to the conclusion that most respondents use electronic banking, half of which are completely satisfied with the services. In terms of bank care for consumer satisfaction, there is a great deal of gridlock and negligence by banks in the country and they need to initiate more care.

KEYWORDS: banks, banking system, satisfaction, consumer, electronic banking
JEL CLASSIFICATION: M30, M31

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1. INTRODUCTION

In the Internet era, clients have easy access to all the necessary information, so prior to deciding for a certain banking product, they will make a research for a few competitor banks offers. (Kotler and Keller, 2016). Client's satisfaction from banking services highly depends on what the bank has promised as a service, what has been realized and with what quality. Satisfaction is the feeling of content or disappointment in people which comes from the comparison of the perceived effect from the product with the expectations. If the effect is smaller than the client's expectations, he/she will not be satisfied. If the effect fulfils his/her expectations, the client will be satisfied, and if the effect exceeds his/her expectations the client will be trilled. Clients grade satisfaction prior and after the use of banking services.

Judging the satisfaction prior to using banking services is the final phase in the process of looking information in order to choose alternatives for purchasing a service (Kotler and Keller, 2016).

The core point is that when the bank decides to measure satisfaction, there is a desire to enhance the product or service according to client's suggestions. On the contrary, it would only bother clients wasting their time in gathering information, without using them to satisfy their demands.

Dissatisfaction can occur due to inefficient processes or undesired product characteristics. If they exist client's satisfaction will drop significantly. If they don't exist, client's satisfaction will be increased.

Satisfaction occurs from the expected characteristics of the promised service. Strategy to achieve client's satisfaction is analyzed through various factors which induce "seducing" the client. Actually those are the characteristics that are nor expected nor specified and the client is acting positively when he/she encounters them (Kotler and Keller, 2016).

The standard ISO 9001: 2000 puts the client in the center of quality management processes whose goal is to constantly improve client's satisfaction. According to ISO 9001:2000,measuring client's satisfaction would give: accurate identification of client's demands and their relative importance; understanding how clients look at the organization and whether the current working satisfies their needs; identifying priorities for improvement- areas where improving performances would result in the biggest increase in client's satisfaction; improving service and advancement in tracking the index of client's satisfaction; increasing profits through the increase of client's loyalty.

Even though in Europe measuring client's satisfaction from services banks offer is a practice and has a special meaning, this is not a case in Macedonia. As the banking sector evolves, one of the key factors for success is measuring client's satisfaction. If a company or an individual want to advance and follow dynamic market trends, be efficient and effective, one must always be led by what would make clients happy. A developed banking sector is very important for service users. It offers more possibilities to choose from, and with that improved service quality. Banks in Macedonia offer similar products and almost equal prices, which means they differ mostly in the way they work and in the quality of services they offer (Riquelme, 2009).

In the working of banks so far, it has been proven that clients are the ones who influence markets the most, so according to that, banks cannot skip that element if they yearn to survive on the market. In the article "Client's satisfaction and how to measure it?" the main reasons affecting measuring client's satisfaction are defined (Kos et al, 2011):

- Keeping clients;
- Defining areas of work that need to be improved;
- Feedback from clients when introducing new products and services on the market;
- Measuring the degree of satisfaction;
- Maintaining quality products/services.

Keeping already existing clients is very important, mostly because of the fact that keeping clients is cheaper for the bank than attracting new ones. Also the effort to keep current clients can result with loyalty, something each bank strives for. If the bank acts on time and satisfies the needs and wants of its clients, it is more than certain that it will get loyal out of satisfied clients. Measuring client's satisfaction can lead to identifying areas that need to be improved. This is exactly why banks that don't measure client's satisfaction remain short on important details and don't have the opportunity to act on time in detecting and solving problems their clients are facing. As a consequence, they end up losing clients very often. Measuring satisfaction can give banks the answer whether to introduce an additional product/service or withdraw an existing one. In order to attract new clients, and satisfy existing ones each bank strives to be in line with the wants and needs of its clients, are they satisfied from the services they get (Dlacic, 2005)?

Due to the previously stated, banks need to be sure they gave their best in their work, prior to decide measuring client's satisfaction. Very often banks stay with their primary products and services and don't introduce any additional innovations that would satisfy client's wants and needs. As a consequence, they get dissatisfied clients. That is why customer satisfaction and their loyalty depend exclusively on the bank's working. This fact is confirmed with the ISO 9001:2008 standard where the client is set in the center of quality management and its goal is to constantly maximize client's satisfaction (Kotler and Keller, 2016).

The intensity of competition of today's banking market urged banks into finding more profitable ways to differentiate themselves in comparison with their competitors. Modern banks reoriented themselves from focusing on products and services towards focusing on clients (customer centered focus). That way they get comparative advantages and higher profits based on the invested funds in innovations (Madan and Kumari, 2012).

Electronic banking has a lot of advantages when compared to classic banking, such as: saving time and resources, detailed account balance anywhere in the world where there is Internet, paying bills from home, work or any other place, lower commissions, tracking of all services the bank has to offer, learning on tine for new products or promotions etc. (Baskar and Ramesh, 2010).

According to the State Statistical Office of Republic of Macedonia in 2015, 69% of the total population had Internet access. Out of these 69%, only 7% of citizens of the country used e-banking services. (State Statistical Office, 2015).

Despite the fact that paying and using banking services via the Internet is safe, a lot of citizens are skeptical regarding this issue. Most common reasons for not using this service are not enough information, conservative thinking, distrusting the system of electronic payments and the habit of physically making payments on counters.

Considering the fact that the quality of services is a condition for having satisficed e-banking users, it is important to research the degree of satisfaction citizens have had with using e-banking in Macedonia so far. This will serve as the basis for defining a strategy to increase client's satisfaction and increasing their loyalty towards the bank.

2. SATISFACTION OF E-BANKING USERS IN THE REPUBLIC OF MACEDONIA-EMPIRICAL RESEARCH

For the needs of this article, a quantitative research has been conducted on respondents with different socio-demographic structure. The research was conducted in the period January-March 2105 on the territory of Republic of Macedonia. The research and analysis are based on primary data gathered with a method of interrogation via questionnaire distributed both online and offline.

In order to cover a different demographic structure of respondents, online questionnaires have been distributed to 250 respondents and additional 50 questionnaires in hard copy. In the process of research, answers were received from 154 respondents. Questionnaires that were not completely answered were not taken into consideration in the statistical data processing. The questionnaire consisted of 17 multiple choice questions, and one opened question related to sociodemographic characteristics of respondents such as gender, education and age.

The first part of the questionnaires gives data of the socio-demographic structure of the interviewed respondents, while the second part is focused on examining the customer satisfaction with e-banking. The distribution of respondents according to their socio-demographic characteristics is illustrated in Table 1.

Table 1. Demographic structure of respondents

Demographic structure of respondents					
Gender structure	Male	Female			
	79	75			
	51%	49%			
Age structure	18-25	26-35	36-45	46-55	+56
	36	58	25	20	15
	23%	38%	16%	13%	10%
Degree of education	Primary	High-School	College	Master	PHD
	3	49	77	20	5
	2%	32%	50%	13%	3%

Source: Own research

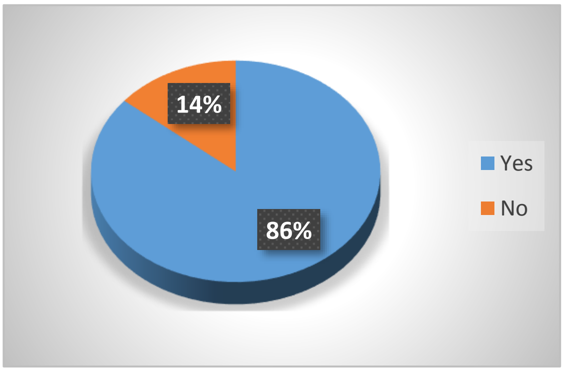
The results show almost equal representation of male and female respondents. In other words, 51% of respondents are male and 49% are female.

Regarding age structure, a non-proportional layout of respondents is present. To be more specific, most respondents (38%) are at the age of 36 to 35 years, then comes the group of people at the age of 18 to 25 years, 16% are at the age of 36 to 45 years, 13% are at the age of 46 to 55 years and 10% are people over 56 years. People at the age of 18 to 25 years are the group that uses e-banking the most since they don't doubt online shopping safety and they conduct electronic transactions freely while shopping for products electronically (Vasquez andXu, 2009), which is also confirmed with the results of the research.

1.1. Electronic banking in Macedonia - conditions and perspectives

This part of the article presents an analysis of the answered questions in the questionnaire which refer to the conditions and perspectives of electronic banking in the Republic of Macedonia.

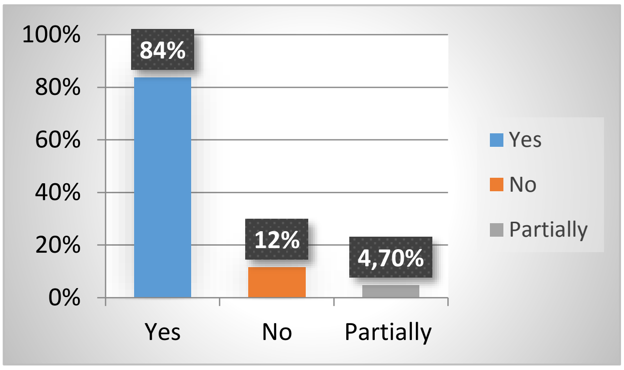
Graph 1. Usage of electronic banking



Source:Own research

From Graph 1., we can see that 86% of respondents use e-banking and 14% do not use it. This is not in accordance with researches from some of the biggest banks in Macedonia like NLB Tutunska Bank AD Skopje, they stated that only 10 to 20% of their individual clients use e-banking. In Stopanska Bank AD Skopje around 10% of the total number of clients use electronic account payments. (National bank of the Republic of Macedonia, 2014).

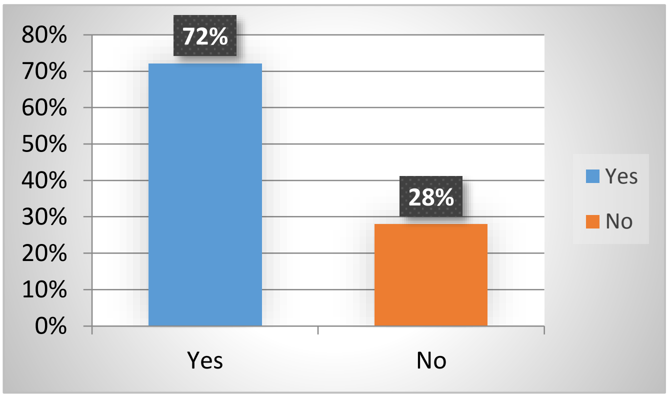
Graph 2. Advantages of electronic banking compared to traditional banking



Source:Own research

According to the answers of the question "**Do you consider that e-banking has more advantages compared to traditional banking?**" it can be pointed out that 83,7% of respondents agree that e-banking has a lot of advantages when compared to traditional, 4,7% partially agree, and the rest 11,6% have a negative attitude. This is in accordance with the statement that e-banking has a lot of advantages among which the most common is unlimited space and time, speed of doing transactions, low price and wide range of banking services (Vidovic, 2014).

Graph 3. Buttons to mark satisfaction of users on banking counters

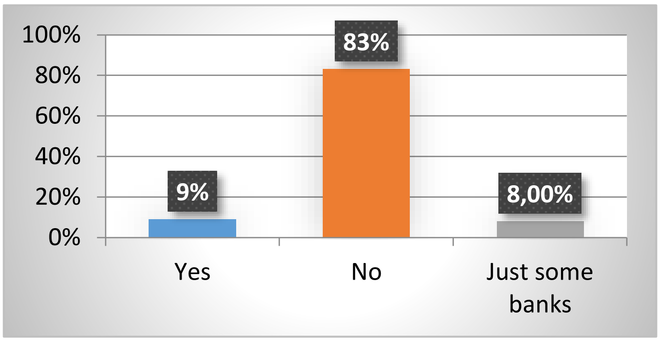


Source:Own research

According to the results shown in Graph 3. it can be concluded that 72% consider that banking counters should have keys with red (not-satisfied), yellow (partially satisfied) and green (satisfied) buttons which will represent your satisfaction from the service received from the bank officer and 28% have a negative attitude.

Using buttons to measure satisfaction from the offered services in banks is a small financial cost for purchasing and distributing buttons in all offices of one bank, and it is a huge benefit for a bank, since it can serve as a survey, thus banks can easily research the degree of service quality, banking officers provide to customers. The same tool for measuring satisfaction can be used in electronic banking with an electronically designed button for measuring user's satisfaction when using the e-banking system of a bank.

Graph 4. Current experience with phone surveys for satisfaction of banking services

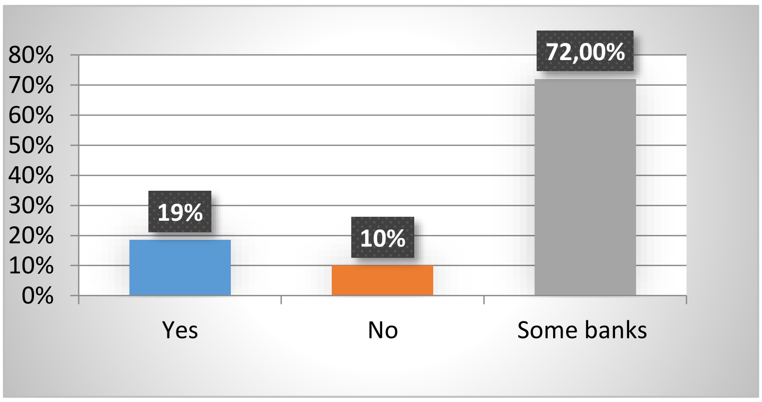


Source: Own research

According to Graph 4., we can conclude that 9% of respondents have been contacted over the phone from the bank whose services they use, for their satisfaction, 83% were not contacted and 8% pointed out that they were contacted just from a few banks and not all banks whose services they have used.

Therefore, we can get the impression that banks don't pay too much attention for the degree of their users' satisfaction. In the past, phone surveys were very often, but nowadays electronic surveys are most common. This is a problem because not all users of banking services have Internet. So, we come back to the previous suggestion to introduce buttons for measuring the satisfaction from banking services and online survey question for e-banking users.

Graph 5. Dedication to development of e-banking services of Macedonian banks



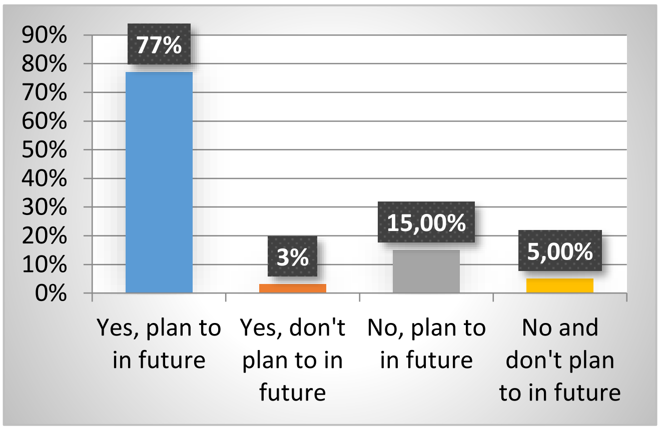
Source: Own research

According to graph no. 1.6, we can conclude that 19% of respondents consider banks to be dedicated towards e-banking service development, 10% have some other opinion and 72% think that only some banks have a certain degree of dedication.

We can conclude that only a part of Macedonian banks take care of developing banking services in terms of e-banking. Widely seen, i.e. on a national level it is not enough because it backslides banking with no advancement of services.

Because of this, it is suggested to come up with a time frame of 1-2 years in which every bank would have to introduce an electronic system for accessing services, but also introducing more advanced options.

Graph 6. Consumer's experience so far with buying products online



Source: Own research

According to the gathered responses shown on Graph 6., it can be concluded that 77% of respondents have bought products online using electronic payment and they plan to repeat it in future; 3% bought, but don't plan to do it again in the future, 15% have never bought, but plan to use e-banking in future; and 5% haven't bought and don't plan to. This is not in accordance with the survey conducted in 2014 by NLB Tutunska Banka AD Skopje where people in Republic of Macedonia fear to pay online due to potential damages, and 34% of respondents stated they don't trust conducting online financial transactions at all (National bank of the Republic of Macedonia, 2014).

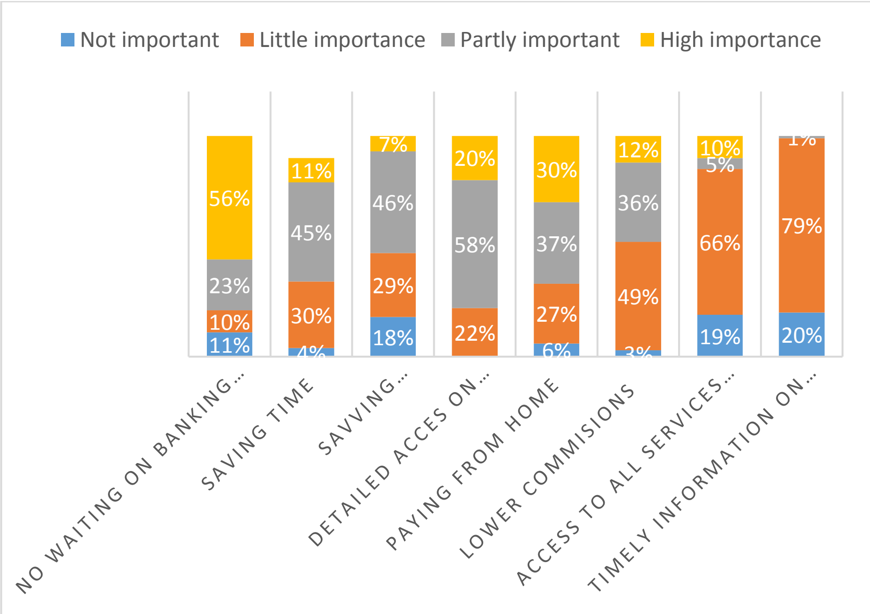
From this we can conclude that most of the respondents have trust in the electronic system of Internet payments, and they like the modern way of buying products from the comfort of their home.

Most of the respondents (77%) have bought something online and plan to do it again in future. It is recommended that banks strengthen e-banking campaigns and where the accent would be put on the security in online payments.

1.2. Factors affecting consumer's satisfaction from e-banking in Macedonia

In this part of the article, we analyze the results that refer to factors affecting consumers' satisfaction from e-banking in the Republic of Macedonia.

Graph 7. Advantages of e-banking according to users



Source: Own research

Among factors that have an impact on accepting electronic banking. we can identify the following: problem of collision of the bank's working time and the users of banking services, slowly finalizing payments, transportation costs, costs for bank pressure and the progress of the transaction.

Main factors for commercial success for the use of e-banking are speed, safety transaction and "friendly" user interface (Sarlak and Hastiani, 2011).

Factors that could affect the acceptance of e-banking using mobile phones are (Mahmood and Clarke, 2009):

- easy to use;
- to which extent mobile payments can improve life quality;
- trust, maintaining confidentiality as well as a possibility to cancel a transaction in case of a mistake;
- availability of the system 24 hours a day, 365 days of the year;
- costs that include commission for registration and the price of a transaction.

According to the results presented on graph 1.8, we can conclude the following:

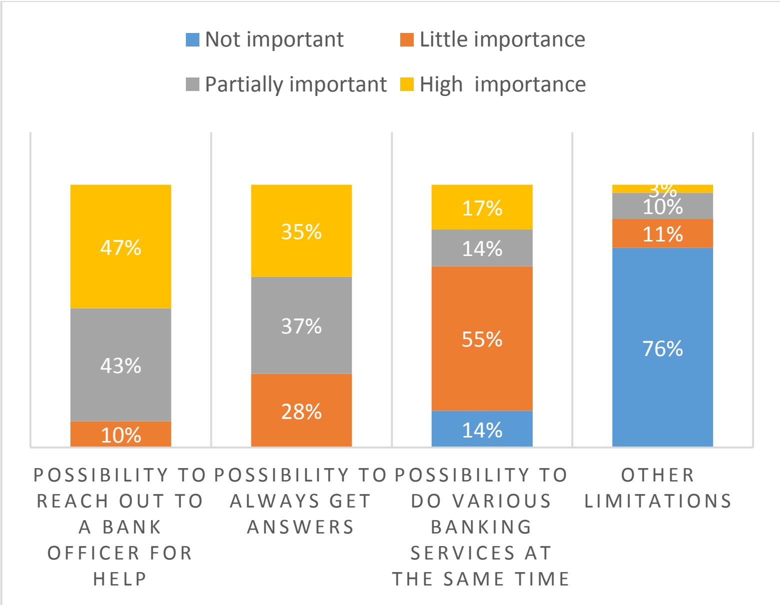
- Avoiding waiting on banking counters, according to 56% of respondents is the biggest advantage this kind of working system has to offer, 23% consider it is partly important, 10% consider it has little importance and 11% claim that this has no importance.
- 11% of respondents consider that the time they save using e-banking is a huge advantage, 45% consider it to be partly important, 30% little important and 4% don't consider it to be important at all.
- Saving transportation costs with the use of e-banking according to 7% is a huge advantage, 46% consider it to be partially important, 29% consider it to be little important and 18% think it is not important.
- 20% of respondents consider that the continuous opportunity to have detailed insight on your account from the comfort of your home is a huge advantage, 58% consider that is has partial importance and 22% that it has little importance.
- Paying from home according to 30% of respondents is very important, 37% consider it to be partially important, 27% think it has little importance and 6% think it is not a significant advantage.
- Paying lower commissions using e-banking is a big advantage for 12% of respondents, 36% consider it to be partially important, 49% consider it little important and 3% think it is not important at all.
- Access to all services the bank offers is important according to 10% of respondents, 5% consider it is partially important, 66% consider it to be little important and 19% consider it not important at all.
- 1% of respondents consider the possibility for learning on time for the latest services of the bank to be important, 79% consider it to be little important and 20% think it is not important at all.

Respondents think that the biggest advantage of e-banking is skipping the crowds in banking branches and the simplicity of home payment, as well as the constant possibility to have access to their accounts. Other advantages they rate as important are detailed insights on accounts from home, saving transportation costs to the bank and saved time. In these turbulent times wasting time on banking counters is not necessary so users consider saved time to be a huge advantage.

Less important advantage is considered to be timely information for the bank's latest services and access to bank's services (loans, deposits etc.)

Out of this we can conclude that according to the users of the banking system in the Republic of Macedonia, the most important advantages of e-banking are considered to be saving time and the fact that with the use of an electronic system, waiting in lines on banking counters can be avoided.

Graph 8. E-banking limitations according to respondents



Source: Own research

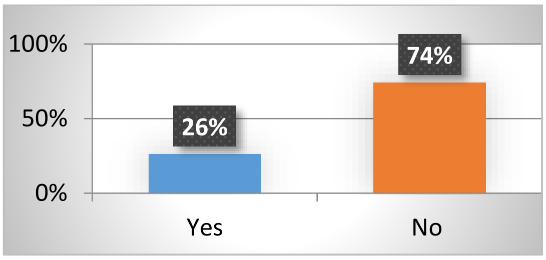
According to the results on Graph 8, we can conclude the following:

- The possibility users to reach out to a bank officer is a disadvantage of high importance for 47% of respondents, 43% consider this limitation to be partially important and 10% consider it to be little important.
- The possibility to get answers at any time is a big disadvantage for 35% of respondents, 37% consider this to be partially important and 28% think it has little importance
- The possibility to get more banking services done at the same time like bank officers on bank counters do it is considered to be a significant limitation according to 17% of respondents, 14% consider it to be partially important and 55% consider it to be a limitation with little importance.
- 3% of respondents consider other limitations to be more important than the previously listed, and 10% partially agree with this, 11% agree little and 76% consider there are no other limitations.

E-banking users consider the inability to address a bank officer for help or getting an answer at all times when using a certain bank service, as the greatest disadvantage. All of this can be easily solved by introducing a chat option on the website of the bank. Introducing this option would be an expense for the bank, in terms of hiring software engineers to develop the chat and also to hire people that will help online users. The bank can hire external associates that will work in other companies but for the needs of the bank or outsource employees who with the help of an Internet connection will work as bank agents, which will save the bank financial assets which would be given if they were employed in the bank directly.

Regarding the inability to do multiple banking services at the same time when using e-banking, this could also be solved with new coded programing solution. In other words, by introducing a new menu in the e-banking system, the user has access to, where on the right side all of the bank's services would be listed and a blank field would be included right next to it where the user could write down an amount in denars or other currency and a field for ticking the service. That way the user can quickly and easily finish all banking services faster than the time it would take a bank officer on a counter to do multiple services the client asks for. All of this would contribute towards increasing the number of e-banking users, greater user satisfaction and less crowd on bank counters.

Graph 9. Previous experience with surveys for customer satisfaction in bank branches



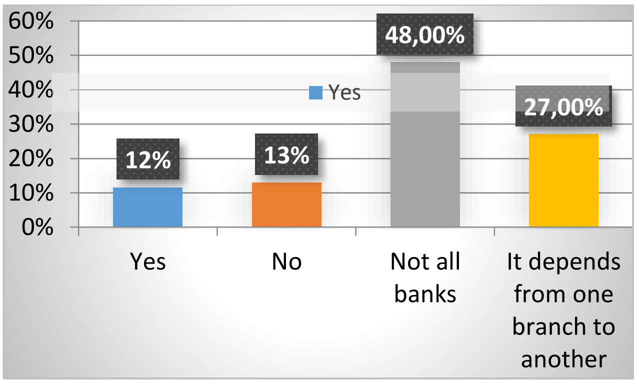
Source: Own research

According to the results, it can be pointed out that only 26% of respondents claimed they have been asked to fill in a survey for satisfaction of the quality of received service in a bank, and 74% gave a negative response.

This means that most banks don't measure user's satisfaction for their services. As it was pointed out previously, buttons for measuring user satisfaction on counters can be used for traditional banking users and an e-question after using e-services.

There is a possibility to place interviewers on bank's exits who could ask clients a few short questions, but this would not have that much information output as would a counter button, since users are often in a hurry and don't have the time to answer additional questions that could take 5 or more minutes of their time, as well as missing on clients while interviewing another client.

Graph 10. Attention given towards user's satisfaction in Macedonian banks



Source: Own research

According to the results, we can point out that 12% of respondents consider that Macedonian banks pay enough attention on users' satisfaction, 13% have a negative attitude, 48% consider that it is something done by a few banks and 27% say it depends from one branch to another. This is in accordance with the yearly report of NBRM in 2014, where only NLB Tutunska Banka, AD Skopje and Stopanska Bank AD Skopje have conducted researches, which means they were the only banks paying attention to user's satisfaction. (National bank of the Republic of Macedonia, 2014)

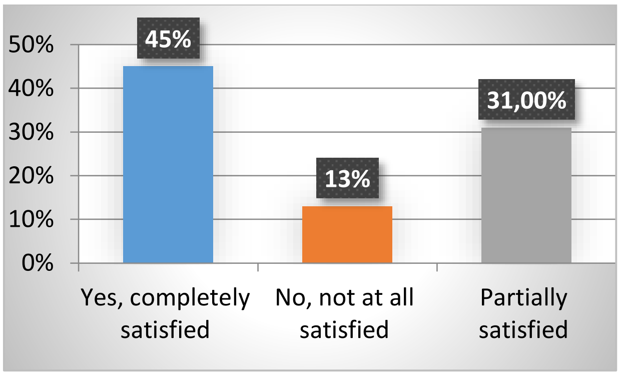
It can be pointed out that users of the banking system think that banks don't pay sufficient attention on user satisfaction and that the time dedicated to satisfaction depends from one bank to another and from one branch to another.

Banking services are used by almost every adult, the competition in the banking market is getting bigger and because of that banks shouldn't put aside the (dis)satisfaction of their users because if they are not satisfied of the way they are approached and the services they get they will go to another bank. If the number of users leaving increases drastically the stability of the bank could be at stake, so it is recommended that banks take greater care for their users' satisfaction and seek to win their loyalty.

1.3. Satisfaction of e-banking users in Republic of Macedonia

This part of the article refers to results from the questions in the survey which refer to user's satisfaction of e-banking in Republic of Macedonia.

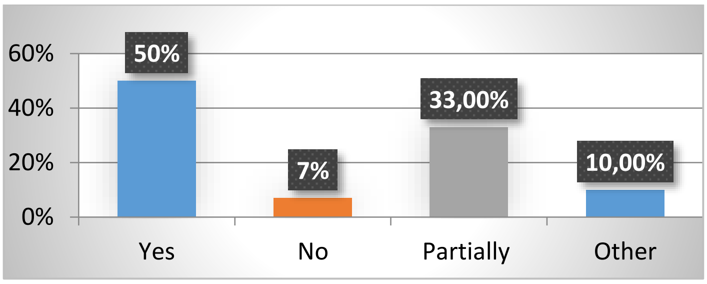
Graph 11. User satisfaction from e-banking



Source: Own research

According to the results, it can be pointed out that almost half, or 45% of respondents are completely satisfied out of e-banking services, 13% are not at all satisfied and 31% are partially satisfied.

Graph 12. Users' satisfaction out of banking changes and the transition from traditional banking to e-banking

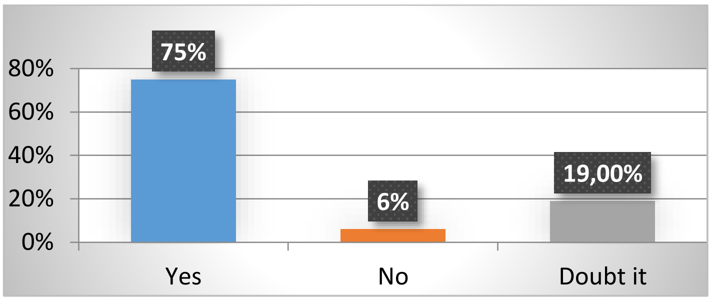


Source: Own research

According to the results shown it can be pointed out that 50% of respondents are satisfied from changes in banking and the transition from classic towards e-banking, 7% have a negative attitude, 33% partially agree and 10% stated other as their answer.

Mostly respondents are satisfied from the use of e-banking in Macedonia and more and more users replace traditional banking with electronic banking.

Graph 13. Attitude of respondents towards security of online payments



Source: Own research

According to the presented results, it can be pointed out that 75% of the respondents think that online payment is safe, 19% think it is partially safe and 6% consider it not to be safe. This is in accordance with the survey conducted in 2014 by NLB Tutunska Banka AD Skopje, where Macedonian citizens fear to pay online due to potential damages, and 34% of respondents stated they don't trust conducting online financial transactions at all (National bank of the Republic of Macedonia, 2014).

Out of this, we can point out that e-banking users have trust in online payments. But those who don't use electronic system of banking services fear to have their accounts emptied from hackers or something similar, so the need to print flyers, which will trigger broader use of e-banking and strengthening the trust in the use if these services, is seen here as well.

CONCLUSION

The development of e-banking is dependent on the degree to which the bank is complied with modern information technologies which change very often. All of this can be seen as a process which carries a huge value because conducting banking transactions is significantly eased up for clients as well as for banks.

From the conducted research, we found out the following conclusions:

- Most respondents (86%) use e-banking;
- 84% respondents consider e-banking has more advantages than the traditional banking;
- Regarding e-banking shortcomings compared to traditional banking, only 11,6% respondents consider e-banking to have more shortcomings;
- 72% of respondents consider that banking counters should have testers to indicate satisfaction of a used service;

- Only 14% respondents stated that after using e-banking they got a question asking about their satisfaction from the service;
- Small portion (9%) of the respondents have been contacted from the bank whose services they are using and to be asked for the satisfaction of the services they got;
- Regarding bank's dedication for developing e-banking, 19% consider banks to be dedicated to the development and 72% partially agree.
- 77% of the respondents have bought a certain product online and plan to do it in future;
- Most important e-banking advantages are the following: no waiting like on bank counters, saved time and saved transportation costs;
- The biggest disadvantage of e-banking is the impossibility to address someone for help;
- 74% of respondents stated that they have never been given to fill in a question for the satisfaction of the services they got;
- Most respondents stated that not all banks (48%) pay attention to users of the banking system satisfaction and 27% stated that it varies from one bank branch to another;
- Users who use e-banking, 45% are completely satisfied and 31% are partially satisfied;
- Half of respondents (50%) are satisfied with changes in banking in the state and the transition from traditional to e-banking;
- 75% respondents consider online payment safe.

Finally, the current state of e-banking in the Republic of Macedonia, according to the attitude of respondents, is not at satisfactory level, but there are tendencies for development and wider usage by citizens in the future. We propose the following measures for increasing the level of e-banking usage: a campaign for spreading the positive sides of e-banking, clearing up the safety measures for website protection, increasing the awareness about the safety usage of e-banking etc.

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THE IMPACT OF FEMALE LEADERS ON MANAGEMENT AND IMPLEMENTATION OF ORGANIZATIONAL GOALS AND OBJECTIVES

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ABSTRACT

The leader influences the staff without coercion, i.e. in a manner that creates trust, respect and implementation of effective actions aimed at achieving developmental changes and accomplishing the objectives the company has set.

The purpose of the present paper is to establish the management's awareness for setting higher criteria regarding female leadership development in the organization and how it will affect the management's efficiency and the realization of organizational goals and objectives. The following techniques were used in the research: surveys, interviews and content analysis. The general conclusion is related to the need and usefulness of investing in professional development of the management staff and their career advancement, i.e. the participation of employees, especially women and women leaders in leadership training courses.

KEYWORDS: leadership, female leaders, organizational objectives, criteria
JEL CLASSIFICATION: M1

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1. INTRODUCTION

The main commitment of each person is to be successful in their life and work. Organisations should take advantage of it as to improve its profit. Successful people can only be motivated if they can apply teamwork. One of the challenges of the new approach to organizational development, inter alia, is redefining the concepts of leadership and management. We are all born with a desire to win, to become successful. When we talk about leadership, we can start with a very useful and clear definition that leadership is a behaviour or conduct that enables others to achieve the planned objectives.

The organization needs leaders who are able to lead the process of change, who are one step ahead of the others, who think long term and who understand that the efforts to preserve the "status quo" situation is fatal in times of turbulent change.

Such managers are the leaders, those who lead the organization toward achieving superior performance, and such leaders have become the most expensive resource pushing the organization to ultimate success. But this individual, no matter how capable, cannot come to the result alone. What one needs are supporters (followers) who would understand what the leader aims to do for the organization, who would trust him/her, generously and fully commit to work and realization of the organization's goals.

When it comes to the features that a leader should have, we can say that: the leader is a person, good or bad, which can attract or motivate people to follow him/her. The leader must have a strong character to be able to inspire others to voluntarily follow him/her. The leader shall:

- Have contagious optimism
- Demonstrate observance of principles and work means, even when he/she is not sure of the tangible results.
- Have a sense of justice in which others will have confidence.
- Have a good knowledge of human nature,
- Have self-control,
- Be a good evaluator and selector of people,
- Be able to dominate and ultimately manage everything around him/her.

The leader shall also have four main virtues:

- Mindfulness, wisdom and tact
- Righteousness
- Tolerance, self-control, sensitivity and patience,
- Courage,

To be a leader means to develop all aspects of the human personality, that is, to be, to know and to work. On the other hand, the features of a female leader indicate that women can successfully cope with such challenges.

Having into consideration that this field has not been researched a lot in our country, more and more interest rises, so certainly, there will be new results in the forthcoming period.

2. FEMALE LEADERSHIP

Strong leadership begins with the demonstration of capability to form a group of individuals - who may have nothing in common – who would share a vision of being a team which can achieve above-average results.

The characteristics of a female leader are as follows:

- Female leaders are more aggressive and convincing,
- They have a stronger need to carry out the tasks to reaching the final outcome,
- They demonstrate better readiness to take risks than male leaders,
- They demonstrate readiness for openness, consensus decision-making, cooperation and collegiality,
- They have a higher degree of tolerance, a sense of building interpersonal relationships, and women have natural predisposition to analyze human relationships and emotional aspects.

The above characteristics have been determined in the study of "Caliper", a management consulting company from Princeton, USA. Recent studies (Sexton et al., 2013, Heath, 2010; Daft, 1999) have shown that the most common qualities, as being nice and understanding, are actually feminine qualities while the most organizational qualities, such as self-confidence and competitive spirit, are qualities associated with males.

It is these organizational features that are considered crucial to successful leadership. But despite that, although stereotypes still prevail – almost always, a man would be appointed to a leading position, the situation is likely to begin to change and leadership is being looked on as a profession for both genders.

Today, Macedonian economy needs brave, innovative, expert and positive individuals and companies who would motivate and encourage women, in order to:

- Provide support and motivation by the senior male managers for the activities of female entrepreneurs and promotion of female leadership,
- Improve the efficiency of networking among Macedonian female business leaders,
- Share and use foreign experience to overcome the social barriers to the development of female leadership,
- Motivate women and their focus on positive examples for strengthening the capacities of female leadership in the Republic Macedonia.

The research of Fejgenson and Coleman on the value systems of men and women entrepreneurs (Sexton et al., 1993) are very interesting. They concluded that the value systems of men and women entrepreneurs have more similarities than differences, leading to the conclusion that any gender stereotype based on the value systems is groundless.

In fact, any comparative study in men and women entrepreneurs highlights the similarities between the genders, rather than the differences between them.

Chaganti says that between the genders, there are no significant differences in terms of the desire for success, autonomy, persistence, aggression, independence, conformism, understanding of purpose, self-esteem, conduct and control (Sexton et al., 1993).

Many experts argue that female entrepreneurs and leaders, much more than their male colleagues, support employees in their ambitions for further education, support teamwork, reduce hierarchy and tend to constantly increase the quality of their offer. Studies at Boston University showed that "women are more cooperative, informal, they build their leadership behavior on mutual understanding." In contrast, men leaders tend to be competitive, formal and systematic managers. In other words, women support and motivate others the same way they have been raised and educated. This natural feature, along with hard, are used in entrepreneurship and working with people: they always support their collaborators in their ambitions.

Women measure work success in a different manner. Naturally, everybody works for profit, but women also consider the highest goal is achieved when employees develop and the customer's expectations are met. Women spend more money on educating their employees because they believe it would bring about greater competitively for the company. The female style of management has been built on development of the individual – the employee.

The female management manner is recognizable. Analysts believe that in the small and medium sized businesses, job quality is relatively low, wages are generally lower and there are fewer incentives than in large companies. However, studies on women entrepreneurs/leaders show that women offer basically the same conditions of employment. Despite this, women entrepreneurs and leaders offer:

- reimbursement of costs and flexible working hours,
- share in the profit,
- additional opportunities for parental leave.

Jobs created by female entrepreneurs and leaders, compared to the average rate for small and medium sized business, are usually much more reliable. But, on the other hand, according to the economic indicators, companies owned by women do not grow at such pace as companies founded by men do. This results from the costs made on development of employees, quality and relations. According to US data, "women" enterprises make less jobs redundant than the average for small and medium sized businesses. At the moment, there are no such data for Macedonia, but it is likely that the situation would be similar.

3. RESEARCH METHODOLOGY

The aim of this paper is to find out about the awareness of the management staff about establishing higher criteria for advancement of female leadership in organizations and its impact on the efficiency of management and implementation of organizational goals and objectives. In the research, the techniques of surveys, interviews and content analysis are used.

The problem being researched in the present paper is the unjustified lack of involvement of women leaders in the decision making processes.

The phenomena, subject of research in this paper, is the promotion of female leadership and the role of the woman - leader in the efficient management and business organization.

3.1 Research sample, techniques and measuring instruments

The research was conducted on a representative number of 130 respondents from the public and private sectors. The target groups were managers (52 respondents) and employees (78 respondents). The following techniques were used in the research: surveying, analysis and synthesis, as well as comparative and descriptive method. The measuring instruments used in this research were questionnaires for each target group of respondents and opinion scale (Table 1, Appendix 1).

3.1.1 Characteristics of the companies:

1. Type of company:
- Public company / institution = 6
- Private company = 18
2. Size of the companies based on the number of employees:
- Up to 9 employees = 10 companies
- From 10 to 50 companies' employees = 9 companies
- From 51 to 250 employees = 5 companies

3.1.2 Characteristics of the respondents:

1. Status:
- Founder of the company = 40 persons
- Top Management = 4 people
- Middle Management = 8 persons
- Employee = 78 people

Out of the total of 52 people - managers (founders, top management and middle management): 39 women and 13 men.

2. Level of Education:
- Primary education = 0
- Secondary education = 24
- College education = 31

- Higher education = 70

- Master/PhD degree = 5

3. Gender:

- Men = 42

- Women = 88

4. Age:

- Up to 30 years. = 12 respondents

- 31-45 years. = 41 respondents

- Over 45 years. = 77 respondents

4. RESULTS

The following hypothesis has been elaborated in the present paper: Setting higher criteria for advancement of female leadership in the organization, will directly affect the efficiency of the management and the accomplishment of organizational goals and objectives.

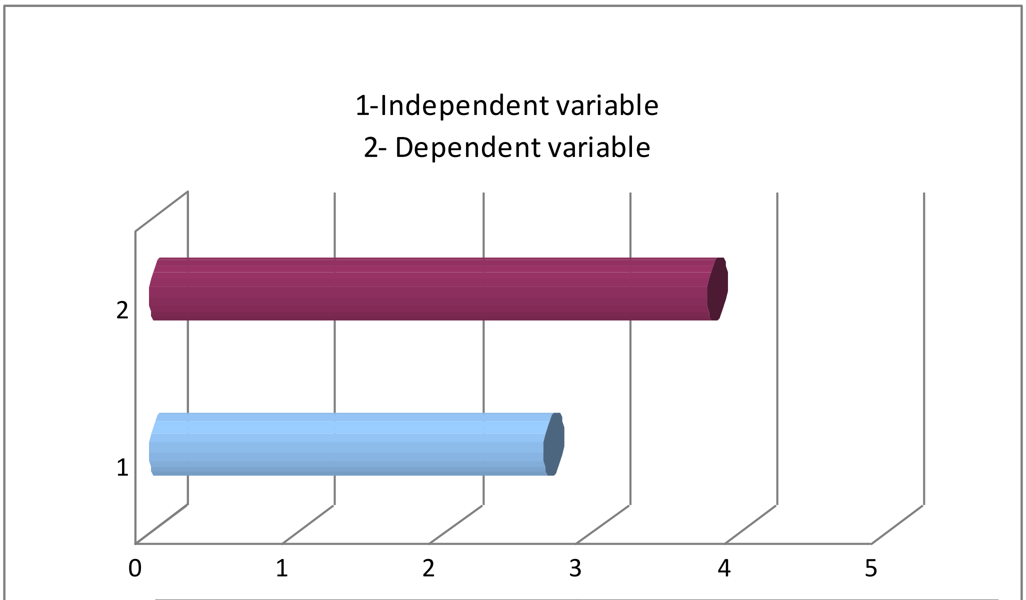
Indicators: Answers to the questions, i.e. statements related to the criteria for female leadership advancement.

Independent Variable: Setting criteria for the advancement of female leadership.

Dependent Variable: Effective management and operation.

According to the research results, the attitudes of managers and employees in terms of the independent variable, Table 2 (Appendix 1) covers the questions i.e. statements 7,8,9 for the employees and 7,8,9 for the managers of the questionnaire enclosed herein as Table 1 in Appendix 1. The continuum line for the independent variable is 2,6730.... which indicates sufficient results and shows that employees and managers have not yet established sufficiently higher criteria for professional development.

Figure 1. Qualitative changes of the independent and dependent variable



	1	2
Series1	2,673076923	3,77991453

The dependent variable refers to the attitudes of employees and managers about how the setting of higher criteria for the female leadership advancement in the organization increases efficient management and operation. The dependent variable in Table 2 (Appendix 1) is covered under questions/statements No. 10,11,12 for the employees and No. 10,11,12 for the managers of the questionnaire. The continuum line is 3,77, i.e. on the scale of values, it is considered a good result (Fig.1), representing an improvement of female leadership in the organization.

The foregoing leads to conclusion that the independent and dependent variable:

- on the scale of values, are ranged between 2,67 and 3,677,
- have a relatively good match and show a good result,
- in conditions of relatively low value of the independent variable (2,67) in practice, the dependent variable results are in a good value (3,77), which proves the feasibility of investing in higher training criteria,
- prove the set hypothesis true - setting higher criteria for advancement of female leadership in the organization will directly affect the efficiency of the management and the accomplishment of the organizational goals and objectives.

In addition to the explanation about the values of the independent and dependent variables, we herein state that low values indicate rejection of the set hypothesis and, on contrary, relatively high values indicate proving of such hypothesis.

In addition, the following text is a brief explanation of the data in Table 2 and the method of calculating the values of the independent and dependent variables:

Column 1: Type of respondents (employees and managers),

Column 2: Ordinal number of the question from the questionnaire presented in Table 1 in Appendix 1,

Column 3, 4, 5: Answer to the respective question ("yes," "sometimes" and "no"),

Column 7: Total number of answers to the respective question (for employees 78, for managers 52),

Column 7, 8, 9: The number of answers "yes" and "sometimes" are multiplied by 5, i.e. 3,

Column 10: Sum of the values from columns 7, 8 and 9,

Column 11: The amount in column 10 divided by the amount in column 6,

Finally, the value of the independent i.e. dependent variable is the sum of the amounts in column 11, for all answers (in this very case 6), divided by the number of questions (6).

5. CONCLUSION

The conducted research focused primarily on the role of a female woman in the effective management and accomplishment of organizational goals and objectives. The research was conducted in 24 public and private companies, surveying 52 leaders (managers) and 78 employees.

The research showed that:

- The dynamic development of the society requires leaders with high performances and emphasized ability to motivate and energize the employees in the company,
- Greater involvement of the female leaders as decision makers is necessary,
- The management shall continually work on strengthening leadership, moreover, female leadership, as a key factor in the development of the company,
- It is necessary to motivate women and focus them on the positive examples of strengthening the capacities of female leadership in the Republic Macedonia.
- Increase of the impact and the willingness of legal entities for practical actions in favour of female leadership development.

The research findings show the importance of investing and supporting women leaders in their professional development and career advancement. In this sense, setting higher criteria for female leadership development in the organization, will directly affect the efficiency of the management and the accomplishment of organizational goals and objectives.

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Appendix 1:

Table 1: Questionnaire for managers and employees

No.	QUESTION / STATEMENT
1	Does your organization apply alternate methods - arbitration and mediation, as to effectively resolve disputes and conflicts?
2	Does your organization invest in specialized training and mentoring for leadership?
3	Does your organization invest in specialized training and mentoring for the purposes of arbitration and mediation?
4	The application of alternative methods - arbitration and mediation results in efficiency of resolving disputes and conflicts, as well as in effective accomplishment of organizational goals and objectives.
5	Specialised training and mentoring for leadership increase the competencies of efficiency in operation.
6	Specialised training and mentoring for arbitration and mediation increase the competences of efficiency in operation
7	Has your organization set criteria for female leadership development?
8	Are the employees allowed to participate in the decision making process?
9	Do women have equal treatment with men when it comes to promotion to managerial positions?
10	Establishing criteria for female leadership development directly impacts the efficient management of the organization and the results of its operation
11	Better education and involvement in the decision making process by women significantly influence the improvement of their leadership skills or effective management and operation.
12	Do female leaders have a positive contribution to the success of an organization?
13	Do you think that with adequate investment in promotion, mediation can become the primary form of dispute resolution, while the court shall be an alternative means in case no agreement is reached?
14	Will investing in publication of specialized magazines on leadership, arbitration and mediation have a positive impact on the overall climate associated with their greater application?
15	Promotional activities increase awareness of application of female leadership and alternative methods of conflict resolution - arbitration and mediation.

16	Specialized revisions of leadership, arbitration and mediation have a positive impact on increasing the awareness of female leadership and the implementation of alternative methods - mediation and arbitration.
17	Do you think that the employees' participation in training courses, especially the existing and potential female leaders, the subject of such courses being the basic principles of leadership, shall help increase their competences?
18	Do you think that the employees' participation in training courses, especially the existing and potential female leaders, the subject of such courses being the basic principles of mediation and arbitration, shall help increase their competences?
19	Do you think that training courses on mediation are useful in disputes and conflicts resolution between employees and employers?
20	Training courses meant for professional development of women will contribute to increase their capacity for career development.
21	Judiciary, mediation and arbitration are complementary.
22	Mediation training will increase the competences of the participants in the decrease of the number of business conflicts and effectively address the current conflicts.
23	Do you think that mentoring knowledge transfer is useful?
24	Do you find mentoring knowledge transfer training useful?
25	Mentoring knowledge has a direct impact on the mentioning capacities and competences.
26	Mentorship is particularly in the mutual transfer of knowledge between male and female leaders.

Source: Mirjana Markovska, Leader Role of Women in the process of resolving business conflicts by applying alternative methods, Master Thesis, Skopje, 2014

Table.2: Qualitative analysis of the hypothesis

	Independent variable	Establishing criteria for the advancement of women's leadership								
Type of respondents	Question number	Yes	Sometimes	Not	Number of respondents	Yes x 5	Sometimes x 3	Not x 1	Total	Points
1	2	3	4	5	6	7	8	9	10	11
employees	7	8	22	48	78	40	66	48	154	1,974359
employees	8	10	49	19	78	50	147	19	216	2,769231
employees	9	16	50	12	78	80	150	12	242	3,102564
managers	7	12	13	27	52	60	39	27	126	2,423077
managers	8	10	28	14	52	50	84	14	148	2,846154
managers	9	12	26	14	52	60	78	14	152	2,923077
		A set of points:								16,03846
		A set of points / number of questions:								2,673077
	Dependent variable	Effective management and operation								
employees	10	45	20	13	78	225	60	13	298	3,820513
employees	11	50	19	9	78	250	57	9	316	4,051282
employees	12	46	22	10	78	230	66	10	306	3,923077
managers	10	26	14	12	52	130	42	12	184	3,538462
managers	11	28	15	9	52	140	45	9	194	3,730769
managers	12	25	18	9	52	125	54	9	188	3,615385
		A set of points:								22,67949
		A set of points / number of questions:								3,779915

1. Source: Mirjana Markovska, Leader Role of Women in the process of resolving business conflicts by applying alternative methods, Master Thesis, Skopje, 2014

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DEBTOR'S PLAN OF REORGANIZATION IN THE REPUBLIC OF MACEDONIA

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ABSTRACT

The essence of bankruptcy legislation is to enable efficient and rapid liquidation or reorganization of the company in order to keep on its business, to stop the financial decline and pay back the creditors. The aim of this paper was to analyze the national legislation, particularly the reorganization of the debtor as a second chance of the economic entity to remain active in the economy, but also to pay the overdue and current liabilities to creditors. The investigation was done by studying legal provisions regarding this issue as well as by critically reviewing the existing literature in this area. It was observed that concerning the EU legislation, reforms in this area aim in increasing the possibility and necessity of debtor's reorganization, rather than its liquidation, in order to achieve several economic effects, such as resuscitation of the debtor, which will enable to continue creating capital, debtor's ability to meet its commitments to creditors and an opportunity to continue working in the labour market.

In Republic of Macedonia, the number of proceedings for reorganization in bankruptcy is small because in most cases the debtors submit a plan of reorganization too late i.e. usually when they are financially completely exhausted, and their revival is almost impossible.

KEYWORDS: bankruptcy, debtor, plan of reorganization

JEL CLASSIFICATION: K35, K39

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1. INTRODUCTION

The essence of bankruptcy legislation is to enable efficient and rapid liquidation or reorganization of the company in order to keep on its business, to stop the financial decline and pay back the creditors. Statistically, about 98% of open bankruptcy proceedings end with liquidation, which indicates the lack of capacity, bankruptcy authorities to enforce the second option provided by law, i.e. conducting bankruptcy procedure for debtor's plan of reorganization.

In the EU legislation, reforms in this area aim in increasing the possibility and necessity of debtor's reorganization, rather than its liquidation, in order to achieve several economic effects, such as resuscitation of the debtor, which will enable to continue creating capital, debtor's ability to meet its commitments to creditors and an opportunity to continue working in the labour market. National insolvency legislation, too provides for the institute reorganization, as a tool of revitalization of economic entities as a method to achieve two main goals: return of blocked funds into economy and maintenance of the business of the company.

The subject of this paper is an analysis of national legislation, particularly on the reorganization of the debtor as a second chance of the economic entity to remain active in the economy, but also to pay the overdue and current liabilities to creditors. The analysis will be done through an analysis of legal provisions regarding this issue as well as analysis of research and professional literature in this area.

2. BANKRUPTCY MAIN FEATURES

The method and conditions for establishment, organization and conditions of operation of trade companies are essential prerequisites for competitiveness and development of national economies. Thereby the speed and simplicity in their establishing, working conditions, decision-making for the efficient operation or termination of the companies are basic elements that determine the competitiveness of national economies.

Termination of the company is regulated by the Companies Law provisions that apply to the liquidation. Basically, it is a liquidation which is provided or agreed in advance in the acts of companies or voluntary liquidation, or liquidation by force of law. For these ways of termination of the companies, the basic requirement is to have sufficient funds that are required for the procedure as well as complete repayment to creditors. On the other hand, the national legislation provides an opportunity for implementing a bankruptcy procedure in a situation of permanent inability to fulfill its due obligations, or when the debtor has insufficient assets for full repayments to creditors.

In most legal systems, bankruptcy[1] takes place in litigation and it is initiated by creditors, which is the same in Macedonian legislation where the bankruptcy procedure is a judicial procedure with economic characteristics. It is a specific, sui generic procedure which is a result of specific authorities with specific rules that apply to it.

The bankruptcy procedure aims collective settlement of debtor's creditors through liquidation of the debtor's property and distribution of realized assets to creditors or by signing a special agreement for settlement of claims established in the plan of reorganization that is directed towards debtor's further maintaining the business venture in order to work again[2].

The current version of the Bankruptcy Law of March 2006 and its amendments should provide security market, promote economic stability and development, shorten the duration of bankruptcy procedures, improve mechanisms for fulfillment of the creditors' rights, also regulating the relations of insolvent companies, but also to provide a real opportunity for the reorganization of companies in bankruptcy.

The basic prerequisite for initiation of bankruptcy proceedings is debtor's insolvency in at least 45 days from any of its account, with any payment carrier.[3] The bankruptcy procedure is initiated upon the creditor, debtor or other person authorized by law, if the debtor finds that it is not able to pay debts and no later than 21 days after the reasons for initiating the procedure are concluded.[4] It should be made a possible existence of the reasons for bankruptcy.

Locally competent is the court in whose jurisdiction is the debtor's headquarter. Once specified local jurisdiction of the court, from the date of submission of the

[1] The word bankruptcy is derived from the Italian word banca rotta which means broken bench/table. In the Middle Ages, when Italian merchants were unable to repay their debts, i.e obligations to creditors, the state took the right to trade activities through the symbolic gesture of breaking the table on which the checkout was.

[2] Article 3 of the Bankruptcy Law (Official Gazette of RM No.34 / 2006, 126 / 06,84 / 07, 47/11, 79/13, 164/13, 29/14, 98/15, 192/15)

[3] Article 5 Paragraph 2 of the Bankruptcy Law

[4] Article 51 Paragraph 9 of the Bankruptcy Law

proposal to open bankruptcy proceedings, cannot be changed, regardless the circumstances of the case. Besides the local, the court that decides in the procedure for bankruptcy, should have subject-matter jurisdiction, which according to the Law on Courts should be extended, which means that only particular courts have jurisdiction for conducting bankruptcy proceedings.[5]

When there is a proposal for bankruptcy proceedings, the debtor must make available and submit all required data and information regarding its operation to the bankruptcy judge, as well as written report about its own economic financial condition.

In addition, if the insolvency judge requests, the required information must be also given to the interim trustee, the bankruptcy trustee, board of trustees and assembly of creditors. Creditors shall promptly report claims, according to the published deadline in the announcement for opening bankruptcy proceedings, with a written application attached to the evidence for the claim.

Generally, bankruptcy, assumes a condition in which the debtor cannot perform obligations towards its creditors, but on the other hand, forced execution of the claims of all creditors on the debtor's assets will lead to loss of debtor's property and fixed assets, which represents an economic base of its legal status.

Bankruptcy as a tool for collective settlement of the debtor does not always necessarily result in the termination of its activities and legal status. Bankruptcy Law of the Republic provides for the possibility to extend the business activity of the debtor, by applying the instrument of reorganization.

Properly and consistently implemented reorganization of the debtor in practice, i.e implementation of a plan of reorganization may contribute to the settlement of obligations of the debtor to creditors and an opportunity to return to normal economic life of the borrower and the continuation of its commercial activity.

[5] Art. 23. Paragrph.2 and Article 31 paragraph 2 and 3 of the Law on Courts (Official Gazette of Republic of Macedonia no. 58/06, 35/08 and 150/10)

3. REORGANIZATION of the DEBTOR in the REPUBLIC of MACEDONIA

The company, that has fallen into financial instability and is threatened with the opening of bankruptcy proceedings, or the bankruptcy proceedings has been already opened, has two options as a possibility to remediate the poor financial condition; formal and informal reorganization.[6]

Generally, reorganization is a legal instrument[7] that enables debtor restructuring in order to repay as much as possible of the liabilities and ultimately, continuation of its economic activity.[8] Informal reorganization[9] is a procedure that takes place beyond the bankruptcy proceedings in the early stages of identifying company's financial crisis. This procedure takes place with the joint activities of the debtor and creditors. In this procedure there should be a plan that would stop the financial decline of the debtor and take actions for its organizational and functional rearrangement in order to strengthen financial and renewed competitiveness of the company.

Due to the fact that informal reorganization is beyond the strictly formal court proceedings, it is conducted according to freely established rules between the debtor and creditors, as a result of earlier good business cooperation. Hence, the major shortcomings and the reason for frequent failure of this procedure. On one hand the key role belongs to the creditors, mostly only the largest creditor, on the other hand they are very often insufficiently competent to establish, manage and control the reorganization.

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[6] Dejan Kostovski Verica Hadzi Vasileva-Markovska: Restructuring of enterprises in bankruptcy, USAID 2007

[7] Reorganization as a legal institution was initially used in American law. Bankruptcy Law of 1978 provided a possibility the judge to give a period of 120 days in which to compile a plan for the reorganization of the debtor; if it was accepted, the bankruptcy procedure would be revoked. More: David G. Epstein, Steve H. Nickles at all: "Bankruptcy", Volume 1, Sections 1-1 to 6-45, 1992, p.111

[8] Companies bodies that are in financial crisis, i.e which have opened insolvency proceedings, have the right to choose between the opening of insolvency proceedings under the rules of the Bankruptcy Law contained in Part II or the rules according to the reorganization plan contained in Part Six of law.

[9] In fact, the management bodies of the company or the executive members of the Board of Directors/Management Board are obliged to take measures when impaired financial condition of the company. According to Art. 354 of the Company Law, Official Gazette of Republic of Macedonia No. 28/04, deterioration of its financial condition is:

- Generated loss is higher than 30% of the Company's assets or 50% of the share capital;
- There is a circumstance for opening bankruptcy proceedings against the company, according to Bankruptcy Law;
- The Company is unable to pay its liabilities and
- The Company is indebted

The formal reorganization is a procedure carried out under the bankruptcy proceedings, according to legal provisions set out in the Bankruptcy Law.

According to these provisions, the reorganization is the process by which the financial position, economic activity and competitiveness of the debtor can be restored and the company has a chance to keep on functioning as a result of offered possibilities by the law, such as debt relief, delay in debt payment, conversion of debt into shares in the company and sale of the company as a whole or a part of it.

Therefore, the procedure for reorganization includes the proposal of the debtor, creditors or the bankruptcy trustee for initiation a procedure for reorganization, discussion and voting of creditors on the proposal, the preparation of the reorganization plan, voting of creditors in the reorganization plan and other activities regarding the reorganization, according to the Law and undertaken by the bankruptcy judge, the debtor and creditors about.

Thus, the key role in the process of reorganization is the plan of reorganization as a document from which, in fact, depends on the success of the reorganization.

The stages of reorganization may be defined as: a proposal to start proceedings for reorganization; discussion and voting of creditors on the proposal for initiation of proceedings for reorganization; preparing a plan of reorganization; investigation hearing and assembly for discussion and vote on the proposed plan of reorganization; bankruptcy locking procedure; execution of the approved plan of reorganization and supervision and control over the implementation of the reorganization plan.

From an economic point of view, it is indisputable that the reorganization represents the most appropriate form of protection the legal and economic interests of bankruptcy creditors, as well as rehabilitation of the debtor. On the contrary, in terms of legal effect of long-term bonds that exist between the debtor and its creditors, the reorganization procedure creates risks for the entity that is in contractual relationship with the debtor that proposed reorganization plan, because it is a chance of not fulfilling contractual commitments that arise from obligations. The plan of reorganization can be implemented in the following ways: a status change will be made or transformation of a debtor to transfer property or part of the debtor's assets to one or more entities that are or will be established; the debtor will be merged with one or more entities; all or part of the debtor's assets will be sold, with or without the rights to separate settlement; all or part of the debtor's assets will be split among the creditors, the payment of obligations of the debtor will be reduced or delayed, the debtor's liabilities will be replaced into credit, some or all liabilities to creditors will be replaced into shares, it will be allowed increasing of the debtor's core capital by issuing shares or stocks to creditors or new investors.[10]

Namely, authorized entities that initiate reorganization, following their own economic rationality, in a particular moment will have to either join the reorganization of the debtor or to its liquidation, without any delay.

4. IMPLEMENTATION OF DEBTOR'S PLAN OF REORGANIZATION

The plan of reorganization will be submitted to creditors, in order to become familiar with its contents through:

- depositing the plan of reorganization in bankruptcy files and reporting that it can be reviewed;
- revision of the plan at the meeting of the Board of Trustees, and
- adopting the plan by employees.

For creditors, reviewing the contents of the plan of reorganization is extremely important and directly related to decision making which has, primarily, an economic character.

Therefore, the procedure for adopting the plan of reorganization is divided into two stages: voting on the plan and its acceptance and approval.

4.1. A statement upon the plan of reorganization

The first stage is voting on a plan of reorganization. This phase begins with the submission of the proposed plan for reorganization.

Bankruptcy Trustee, who according to the Decision of the Assembly of Trustees is obliged to prepare a plan of reorganization, has 45 days to submit a plan of reorganization to the bankruptcy judge. This deadline can be extended for another 15 days by the bankruptcy judge or longer with a decision of the Board of Trustees. A plan of reorganization can be also developed and delivered from the debtor or by hiring another expert on behalf of the debtor.

Besides delivery to the bankruptcy judge, the Board of Trustees and the representative of the employees, the applicant of the plan of reorganization is obliged

[10] Art. 228 Paragraph 2 of Bankruptcy Law

to submit it in the bankruptcy file of the debtor in the court that is in charge of the bankruptcy proceedings. In this way all creditors can get an immediate possibility to inspect the proposed plan. Thus, all interested participants may inspect the plan of reorganization within eight days of its deposition in the bankruptcy file. The statement upon the plan of reorganization must be submitted within fifteen days.

4.2. Procedure for acceptance and approval of the plan of reorganization

This phase begins with convening an assembly of creditors which is supposed to debate and vote on the proposed plan for reorganization. This assembly is convened by the bankruptcy judge within three days after the deadline of eight days provided for inspection plan deposited in the bankruptcy file for bankruptcy debtor. Otherwise, the assembly of creditors can be held within a period of not less than 21 days or longer than 30 days from the date of convening the assembly. Bankruptcy judge calls creditors and the debtor to announce the date of the General Meeting by:

- public announcing in one of three daily newspapers with the largest circulation published in the RM;
- highlighting the bulletin board in the court;
- and the debtor

Hereby, he informs the public that the plan of reorganization and received opinions are deposited in the bankruptcy file for inspection by the participants in this process - creditors.

At the meeting of the assembly of creditors who are to vote on the proposed plan of reorganization, the bankruptcy judge, after determining the voting rights and creditors' voting on the proposed plan, will allow all entitled creditors to vote on the proposed plan.

It will be considered that the plan of reorganization is approved by creditors, if it is approved by a simple majority of the total amount of the claims of the creditors present at the assembly, including those who voted in writing.

Besides creditors' voting on the proposed plan of reorganization, there should be cumulatively met two conditions, in order to become effective:

- debtor to agree to the proposed plan of reorganization by submitting a written agreement, and
- bankruptcy judge to approve the proposed plan of reorganization to become

enforceable document that is mandatory for all participants in the proceedings. Subject to evaluation of the Bankruptcy judge ex officio is determining procedural legal requirements for its adoption. Within three days after the completion, the assembly should take a solution about the held meeting and decisions.

4.3. Legal action of approved plan of reorganization

If the decision of the bankruptcy judge for approval of the plan of reorganization has become effective, regardless whether the case has been previously appealed (or not), it gets an executive document. From that moment the plan of reorganization becomes mandatory for all participants in the bankruptcy proceedings. The plan of reorganization applies to bankruptcy creditors, those who supported debtor's proposal for reorganization and those who have not submitted their receivables, as well as those participants who voted against the proposed plan of reorganization.

It will be considered that the debtor has not fulfilled its obligations under the plan of reorganization, if the outstanding debt is not paid. If the creditor claims that the debtor seriously fails to fulfill its obligations under the plan of reorganization, it will need to be proved to the judge that the debtor was called, in written form, to fulfill its obligation and the deadline is foreseen.

Just in terms of reported and recognized receivables, the approved plan of reorganization is valid and has the force of an enforcement order under the conditions provided therein. If there are disputed claims, determined by final judgment, it is considered that those were not even disputed.

The approved plan of reorganization does not affect to the following issues:

- rights that the creditors in bankruptcy proceedings have against the debtor's joint co-debtors and guarantors;
- rights of the creditors that they have on objects or rights that are not a part of the assets comprising the bankruptcy estate.

The approved plan of reorganization exempts the debtor from claims of its joint co-debtors and guarantors, as well as other claims of recourse against him.

Supervision and control over the implementation of the plan of reorganization is under the jurisdiction of the Bankruptcy Trustee, who is obliged, at least once a year, to submit a report to the bankruptcy judge and the board of trustees.

5. PRACTICING THE REORGANIZATION IN REPUBLIC OF MACEDONIA

In Republic of Macedonia, the number of proceedings for reorganization in bankruptcy is small because the debtors submit a plan of reorganization too late, i.e. usually when they are financially completely exhausted, and their revival is almost impossible. By 2011, about 2% of bankruptcy proceedings end with plans for reorganization.

Table 1. Bankruptcy proceedings in progress

Way of conducting proceedings	2008		2009		2010		2011	
		%		%		%		%
Liquidation	271	75,1	277	81,9	282	78,8	323	92,0
Reorganization plan	9	2,5	8	2,3	6	1,7	4	1,1
Not decided	81	22,4	53	15,9	70	19,5	24	6,9
Total	**361**	**100,0**	**338**	**100,0**	**358**	**100,0**	**351**	**100,0**

Source: http://www.iorrm.org.mk/doc/kpu_2012/Dec/05.12IORRM-MT_RobertManasiev.pdf

For the purposes of this paper, there was an attempt to get statistics data for the last three years, information about the number of bankruptcy debtors where a procedure for reorganization was implemented. The Ministry of Economy, as the competent authority, did not properly respond to requested information. Failure of this attempt is one of the weaknesses of the system. Namely, it is a proof that there are no data suggesting incomplete implementation of the Bankruptcy law.

The amendments to the Bankruptcy Law of 2013[11] gave the priority to the reorganization, as a desirable solution for insolvent debtors compared to cashing the assets of the debtor's property. The Law in details describes the procedure of reorganization, among other things envisaged and specialization of trustees to implement a plan of reorganization and keeping a special registry with records of those trustees. Nevertheless, four years after effectuation of this law, the proposed changes have not been implemented.

Amendments to the law in 2013 were focused on actualization of the reorganization. It was expected that more commonly will be approached to reorganization, thereby economic entities will be given a second chance due to

[11] Law on Amendments to the Bankruptcy Law, Official Gazette no. 79/2013

subjective or objective reasons that have caused financial instability. On the other hand considering the fact that the equity of bankruptcy debtors, today is mostly privately owned, there will be of greater interest to give the opportunity for a second chance to the company.

The purpose of the legislative changes from one side is to create a potential at trustees to plan and propose a realistic plan of reorganization, that will be accepted by the bankruptcy bodies and will have the capacity to stabilize the debtor, but on the other hand to create an incentive to timely initiate proceedings for reorganization, just when there is still a realistic chance to remediate the company and restore its business.

Although it it is possible to have a small increase in the percentage of companies that during the bankruptcy proceedings end with plans of reorganization, knowing the fact that companies that are bankrupt debtors in recent years are mostly solely private, the debtor should be concerned to respond in time and to propose a realistic plan of reorganization. However, it would be a slightly increase of the percentage for the reorganization because the level of the European Union is on average about 8%[12]. Within the EU members there are many uneven implementation of the reorganization, statistics ranges from 20% of the number of companies that have gone bankrupt in the UK to 0.8% in the Czech Republic.[13]

[12] http://vecer.mk/ekonomija/vo-stechaj-polovina-godina-potoa-likvidacija

[13] Commission Recommendation on a New Approach to Business Failure and Insolvency, European Commission, Brussels, 12.03.2014

CONCLUSION

Effective insolvency law should enable quick and successful implementation of the bankruptcy proceedings. Its essence is to enable efficient and rapid liquidation or enabling reorganization of the company in order to continue working, to stop the financial downturn and to maximize the value that could get creditors.

The purpose of this paper is to analyze the possibilities that provide bankruptcy law regarding the reorganization and prepare a plan of reorganization, as a tool that should frequently serve companies when they fall into financial crisis, in order to continue working on the labor market and to create capital.

Bankruptcy as a tool for collective settlement of the debtor does not always result with its termination, on the contrary statutory provision provides an opportunity of the economic activity of the debtor. The continuation of the debtor's economic activity during the bankruptcy proceedings and after its completion, it is in fact a reorganization of the debtor.

The main objectives for development and implementation of a reorganization plan are:

- settlement of the creditors in a higher percentage, especially those without providing their claims in circumstances where the debtor, through the continuation of the business, provides resources for its implementation;
- maintenance of the debtor's company with a set of measures and activities that are taken against the debtor to create profit;
- creating conditions for employees' extension of employment
- avoiding protracted bankruptcy proceedings in which the debtor's property is depreciated
- avoiding large processing expenses for bankruptcy proceedings.

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THE RELATIONSHIP BETWEEN THE ATTITUDES OF MARX, KEYNES AND THE NEW KEYNESIANS TOWARDS THE ECONOMIC CRISIS

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ABSTRACT

In terms of the treatment of the global financial and economic crisis after World War II, Karl Marx and John Maynard Keynes rose to the surface after a long period of suppression of their knowledge about the crisis whereas the New Keynesians made a contribution to overcoming it.

Starting from the crisis as an economic phenomenon having an internal logic of development, we have analyzed whether there exists a relationship between the attitudes of Marx, Keynes and the New Keynesians. After having reviewed separately the apparently contradicted opinions of the authors, we found out that there is a relation between them which makes them complementary. The differences arise out of the method for analysis of the crises and of the conditions under which they emerged and needed to be overcome. However, their common denominator is the insufficient demand even though they find its reasons within the different phases of expanded capital reproduction. They mostly differ in the way of overcoming the crises taking into account the different systemic conditions which they had at their disposal and the constant tightening of the contradictions in the national economies and at a global level. In fact, the changes of the systemic conditions were made in order to mitigate those contradictions.

This knowledge elicits a contemporary political economic approach to crises in order to accost them more effectively or to overcome them efficiently if they occur, taking into account their negative socio-political repercussions.

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INTRODUCTION

It follows from the comparative analysis of the scientific findings of Karl Marx, John Maynard Keynes and the New Keynesians about the economic crises and the way of overcoming them that there are significant differences. The differences grow out of the method for analysis of the crises and of the conditions under which they emerged and needed to be overcome. However, their common denominator is the insufficient demand even though they find its reasons within the different phases of expanded capital reproduction (Marx within the production and distribution, Keynes within the consumers' conduct due to the larger tendency towards austerity, and the New Keynesians within the distribution because of the increase in inequality).

It is a fact that a certain crisis can be avoided or overcome more quickly by settling the insufficient demand. This means that their attitudes are not as contradicted as they seem when being reviewed separately and superficially, but in fact, they are complementary, especially when looking at the reasons for the crisis. It can be even said that the chronology of their findings creates a sense of comprehensive political economic approach to the economic crises since they occur both in the national economies and at a level of the global economy. Hence, in order to avoid future serious violations in separate countries and at a global level, there have to be found global solutions. The absence of such solutions led to the largest economic and global crisis after World War II.

By reviewing the attitudes of Marx, Keynes and the New Keynesians, we will show the similarities and differences in the treatment of the crises, and we will point out to the significance of the insufficient demand as their common denominator.

The pointing out of the reasons for crises is not sufficient unless they are perceived as phenomena which manifest themselves both in the national economies and at a global level depending on the way of regulating the international payments. For Marx, the gold standard system is objectively given with characteristics of the consequent market economy both in the national economies and at a global level.

Keynes finds weaknesses within the gold-exchange standard (due to the possibilities of inflation of the national and global economies). However, he directed his attention to the settlement of national crises in the course of making efforts for getting out of the Great Depression, not bringing into question the need for a global currency (preparing a proposition for bancor). On the contrary, Stiglitz does not evade the need for a reserve global currency so that the national and global economies start to balance themselves.

FOR MARX, THE CRISIS IS INHERENT TO THE CAPITALIST WAY OF PRODUCTION

In the economic analysis of capital reproduction, Karl Marx shows that the economic crises are inherent to the capitalist way of production, and consequently, they can be overcome by changing the system. By placing the capital at the center of analysis, he finds out that it generated inequality in the capital reproduction (and as a result of that, the poor become poorer, and the wealthy – wealthier), and it leads to a crisis of hyper-production because the produced commodity values cannot be realized. During the crises there is a decrease in the production and turnover, the productive forces are destroyed, the insufficiently competitive companies go bankrupt, the workers' unemployment grows up, the prices and wages come down, the capital value falls down, the credits and investments decrease. Therefore, the economies are at a common standstill and undergo the largest disruptions.

The acting of the law of the tendency of the rate of profit to fall is of main significance for the emergence of crises. By trying to maximize the profit, capitalists initiate more and more perfect means of production, and they prompt a growth in the organic composition of the capital and as a result of that, a decrease in the rate of profit. The growth in the organic composition of the capital decreases the share of the variable capital and as a result of that, it increases the mass of the unemployed. It also comes to a contradiction between the tendency for unrestricted development of the production and the restricted possibility for realization of the products and growing of the capital. That leads to tightening of the contradictions between the capital and the hired labor with all the consequences that arise out of that in the reproduction of the capitalist society (disturbances, strikes, revolutions).

In the age of Marx, the crises emerged in periods of every seven to ten years which suit the time when the fixed asset was renewed. Each of the crises was sharper than the previous one.

It is known that none of the crises in the age of Marx led to a failure of the capitalist relations in some of the countries. However, he did not expect anything like that. He only drew a conclusion what could happen in one market economy having commodity money whereas later, Keynes assumed that the absence of the State's intervention in the mitigation of the contradictions between the labor and the capital could lead to a collapse. Ignoring some of the measures that the capitalists have at their disposal in order to increase their own rates of profit (increasing the rate of exploitation, decreasing the wages below the labor value, a constant presence of unemployment or half-employment, a development of the world trade), Marx had in mind that when the fixed asset was renewed reproduction upon capital- relations at that time will last. However, the contradictions (between the social production and the private appropriation expressed also as a contradiction between the bourgeoisie and the proletariat; between the planned production in the enterprises and the anarchy in the production of the society; between the tendency for unrestricted development of the production and the restricted possibilities for realization of the products and growing of the capital) are of such a kind which leads to a failure of the capitalist relations. As a human who has in mind his own political attitudes, he probably hoped that it could happen earlier, but as a scientist, he clearly showed the historical place and role of the capitalist reproduction in the social development and its historical character, and in that context in the economic crises of hyper-production.

The crises of hyper-production are perceived as national crises in the analysis of Marx (because of the ignorance of the external trade). Practically, they had their own international dimension, but theoretically, because of the needs of the analysis, they were analyzed within the framework of the capital reproduction in a single country. Therefore, because of the mechanisms of the international gold standard, the crises were overcome by undertaking measures and activities in the national economies due to the fact that the international stability was presupposed on the basis of the internal one. The interference of the State in the economic activities was unacceptable. Nowadays, it is insisted on providing the internal stability (especially of the countries with favored currencies) at the expense of the international one. It is even calculated to what extent the international stability can be disrupted without endangering the privileged position[1], but if the global commodity value functions, this will not be possible.

If the mentioned abstraction is ignored, the implications of Marx's statement about the necessity of crises due to the way of capital reproduction in separate countries also apply to the capital reproduction at a global level, given the fact that the crises are global as well, and because the struggle for profit is led at a global level. And because the law of the tendency of the profit to fall, functions at that level, it comes to increase in the inequality not only in separate countries but also between them. A proof of this presents the global crisis which manifests itself in the global imbalances, the tightening of contradictions between the national capitals, the currency and trade wars and even through war conflicts. And instead of working on their overcoming by establishing a new economic order, the protectionism has been growing, and the processes of deglobalization have been reinforced.

Although Marx's analysis of the crisis of the capitalist way of production refers to the liberal phase of capitalism, it has been shown that under the conditions of functioning of the system of international gold standard, the mentioned laws act modified in the next phases of the development of capitalism. They cannot be evaded, even after leaving the currency convertibility into gold and after taking the fluctuating exchange rate. These changes only enabled the development of capital reproduction in the developed economies with fewer tensions rather than in such cases when the commodity money would function (including the system of paper money directed on the basis of the principles of commodity money) because it was abandoned the priority of maintaining the external stability in favor of the internal stability. However, at the same time, the contradictions between the national capitals were getting tightened much more than in the liberal phase, when the crises were overcome by making efforts

[1] In this context, it is indicative the thinking of Olivier Blanchard and collaborators of IMF whether the inflation target should increase from 2% to 4%. „The crisis has shown that large adverse shocks can and do happen. In this crisis, they came from the financial sector, but they could come from elsewhere in the future—the effects of a pandemic on tourism and trade or the effects of a major terrorist attack on a large economic center. Should policymakers therefore aim for a higher target inflation rate in normal times, in order to increase the room for monetary policy to react to such shocks? "(Olivier Blanchard, Giovanni Dell'Ariccia, and Paolo Mauro, Rethinking Macroeconomic Policy, IMF Research Department, February 12, 2010). Two years ago, before them, Kenneth Rogoff suggested „raising inflation to 4% or more for a period of a few years to deflate the debt overhang and accelerate wage adjustment ". (Kenneth Rogoff, The 4% Non-Solution, Project Syndicate, Jun 5, 2014)

in the national economies according to the rules of the gold standard system. A proof of this are the emergences of currency and trade wars, the global imbalances and the mutual accusations of stating the one who is guilty because there is no single measure of the value and measurement of the prices.

KEYNES'S ROLE IN SAVING THE CAPITALISM

Even as Marx spoke about the reasons for crises and found them in the capital reproduction, under the necessity of the capital to make much bigger profits (and at the expense of the earnings of the working class), John Maynard Keynes looked for a concrete solution for overcoming the Great Depression of the 1930s in the last century. In the course of the persistence of the crisis lasting several years, he saw that the insufficient effective demand was a key problem. Because he did not get in that more profoundly, it led to insufficient demand. However, he looked for a more concrete solution how to instigate it in order to decrease the unemployment and to overcome the crisis and also to avoid it in future. And when he tried to explain, he believed that the insufficient demand was a consequence of the consumers' conduct i.e. of their insufficient propensity towards consumption. [2] The larger tendency towards austerity decreases the funds for consumption, and that affects not to effectuate the production, and because of that, the productive activities are discouraged, and it comes to a crisis. Keynes pointed out directly that the mechanism of the market was not sufficient to redress the balance in the economy and to avoid the crises, and in that direction, he believed that the State's commitment was indispensable.[3] For the truth's sake, the Americans showed a practical solution for overcoming the Great Depression in the

[2]It is interesting that Keynes, despite the emphasis of the tendency, brings in data (in a period of 15 years) about the relative share of the physical labor in the national income in Great Britain and in the USA. Probably, he had an intention to see how much the decreased consumption is dependent on the labor's share in the national income. Therefore, he states: „The fluctuations in these figures from year to year appear to be of a random character, and certainly give no significant indications of any tendency to move against labour in years of increasing output. It is the stability of the ratio for each country which is chiefly remarkable, and this appears to be a long-run, and not merely a short-period, phenomenon. "(General Theory…)

[3] „In conditions of *laissez-faire* the avoidance of wide fluctuations in employment may, therefore, prove impossible without a far-reaching change in the psychology of investment markets such as there is no reason to expect. I conclude that the duty of ordering the current volume of investment cannot safely be left in private hands". (General Theory…)

New Deal whereas Keynes formulated that in a theory. If the market cannot surpass the contradicted relations between the labor and the capital in the income distribution which led to the Great Depression (because of the insufficient demand), the State should do that by taking in more income and increasing the consumption for purposes in which the private capital is not interested (public works, expansion of the social security system). Keynes's perception of the insufficient demand as a problem which made more difficult the way out of the Great Depression can be brought in relation to Marx's attitude of impoverishing the working class. Therefore, for Keynes, the insufficient demand presents a result of the exaggerated tendency towards austerity whereas, for Marx, the insufficient demand is a consequence of the way of distribution between the labor and the capital which results in increasing the inequality. For Keynes, the insufficient demand is a consequence of the consumers' conduct whereas for Marx, it is a consequence of the objective process of capital reproduction in the phase of distribution and it is in accordance with the capital relations. In Keynes's attitude, there is no answer to this question: would people save so much money if they earned much more?

Marx has an explanation for the increase in inequality (under market conditions of working). The increase is a consequence of striving for a free evolvement of the expanded capital reproduction. By making efforts to earn a much bigger profit, the capital produces more and more goods and services. Because of the competition, it is forced to invest more in the modernization of production and in the introduction of new products. Therefore, capitalists insist on sustaining as a bigger part of the profit as possible when distributing it in order to finance the investment needs and to maintain it or make it dominant in the market. At the same time, this means that it remains relatively less profit for a compensation of the workers' labor. As a result of that, the inequality grows up (the wealthy get wealthier, and the poor get poorer), and the decline in the wages of the larger number of employees leads to a reduction of the demand. Because of the insufficient demand, this means that it is just a matter of time when the crisis of hyper-production will take place.

It is obvious that Keynes skips the problems in the phase of production and in the income distribution and believes that the crisis arises because the people are more prone to saving, and that leads to decrease in the consumption which reflects itself negatively on the economic growth and employment. He recommends the remedy according to the diagnosis. If people are not ready to spend something, that should be done by the State by implementing a redistribution of the GDP through the fiscal and monetary policy. That is an inevitable cost of maintaining the capitalist relations in the reproduction which can be brought into question because of the tightening of the tensions between the labor and the capital, between the poor and the wealthy, especially under conditions of great economic crises. This means that it should be made a certain correction of the free functioning of the market regularities (especially in the phase of income distribution) in order to avoid the tightening of the contradictions between the labor and the capital.

For Keynes, the insufficient demand presents a consequence of the people's conduct in the phase of income consumption. However, he finds out the solution to the problem in the phase of income distribution (until there is no way out of the recessive flows). The intervention is State-controlled. It increases the demand and has an influence on the economic growth and employment through the increased tax accumulation of the capitalists' profit and the inflationary provision of funds.

After World War II, it was no longer denied the need for intervention of the State in stimulating the consumption through a certain (state) correction in the distribution of the acquired market income. The point is about dosing i.e. how much it has to go to the State and how much to the business. The practice has also shown examples of countries in which the state portion reaches 50% of the GDP, and even more. As the practice has shown, in most of the West-European countries, the capital relations continue to function successfully both with the minimal and maximal accumulation of the created income. In order to prompt the consumption, the correction made in the phase of income distribution did not overthrow the capitalism even though it transformed it by enhancing the role of the State. It has been shown that the system can also function along with the corrections which do not endanger the phase of production in the activities in which the private capital shows an interest.

CONTRIBUTION OF THE NEW KEYNESIANS

Contrary to Keynes who looks for a concrete solution to the crisis, taking into account the Great Depression and having an intention to evade such crises in future, the New Keynesians focus themselves on the measures for getting out of the Great

Recession. [4] Therefore, burdened with the current problems, they start with the fact that the crisis can be overcome by increasing the consumption as it was indicated by Keynes, but the majority avoid explaining that as a reason for the greatest recession after World War II appeared the exaggerated expenditure in the period of flowering of the national economies in the most developed capitalist countries. However, this is contrary to Keynes's logic, i.e. to save in the period of flowering of the economies, and to spend more when the economies are in recession. It does not bother them the fact that it has come to a crisis as a result of bursting the bubbles of financial and real assets which were pumped up with cheap credits and with the growth of the budget deficit and public debt (of course, with the intention to mitigate the process of increasing the inequality). As if nothing happened before the crisis, they have been looking for a way out of the crisis in the much greater instigation of the consumption by continuing the relaxing fiscal and monetary policy, especially by applying the non-conventional measures of the monetary policy i.e. by running a policy of ultra-cheap money. It is believed that the overcoming of recession can be achieved by much more opulent financing of the personal and investment consumption. In this context, the Nobelist Paul Krugman is the most exposed. He has particularly imposed himself with the criticism of applying strong austerity measures for overcoming the debt crisis in the countries of the eurozone, especially in Greece.

According to him, "Basic economics said that austerity in an already depressed economy would deepen the depression. But the "austerians," as many of us began calling them, insisted that spending cuts would lead to economic expansion, because they would improve business confidence."[5] Pointing out to the weaknesses of the austerity policy under conditions of recession, Krugman constantly makes an effort for increasing the consumption. In this sense, he wholeheartedly supported the policy of Fed for applying the non-conventional measures of the monetary policy, and he even criticized it because it is not more expansive. He did that even when the economy of the USA was in a recession and when it went out of it, but still, the rate of unemployment and the rate of economic growth deviated from the pre-crisis rates. He

[4] „But this book is, I believe, different from most of those other books, because it tries to answer a different question. For the most part, the mushrooming literature on our economic disaster asks, "How did this happen?" My question, instead, is "What do we do now?" (Paul Krugman, End This Depression Now, W. W. Norton & Company, New York- London, 2012)

[5] Paul Krugman, Osborne and the Stooges, New York Times, December 19,2013

expounded harsh critiques in relation to the hesitations and reservation of the ECB in terms of the application of non-conventional measures i.e. the determination to lead an austerity policy.

Despite Keynes's arguments, in relation to the emergence of the crisis, Krugman pointed out the inequality in the society, but he dissociates himself whether it is a reason for the crisis. "Correlation is not the same as causation. The fact that a return to pre-Depression levels of inequality was followed by a return to depression economics could be just a coincidence. Or it could reflect common causes of both phenomena." However, he states that "So while rising inequality probably wasn't the main direct cause of the crisis, it created a political environment in which it was impossible to notice or act on the warning signs".[6] He does not suspect that "inequality probably played an important role in creating our economic mess, and has played a crucial role in our failure to clean it up".[7]

Joseph Stiglitz basically shares Krugman's attitudes towards the significant influence of inequality on the emergence of the crisis (because of the insufficient demand) and on the application of Keynes's arsenal measures for the way out of the crisis, enriched with the application of non-conventional measures of the monetary policy. However, after World War II, he started perceiving the greatest recession as a disruption in the capital reproduction, not only at the level of the national economies but also at a global level. The increase in inequality in separate countries and between them leads to insufficient aggregate demand both in the national economies and at a global level. He also sees a reason for the growth of inequality in the quickening of globalization even though he believes, with right, that "It is not true that inequality is an inevitable byproduct of globalization, the free movement of labor, capital, goods and services, and technological change that favors better-skilled and better-educated employees."[8] He points out to some examples of countries which managed to reduce the income inequality significantly, suggesting that inequality is a product of political and not merely macroeconomic forces. And for the situation in the USA, he states that "American inequality began its upswing 30 years ago, along with tax decreases for the rich and the easing of regulations on the financial sector. That's no coincidence. It has

[6] Paul Krugman, The Return of Depression Economics and The Crisis of 2008, p.113 and 121
[7] Paul Krugman, Why Inequality Matters, The New York Times, December 15, 2013
[8] Joseph E. Stiglitz, Inequality Is a Choice, The New York Times,

worsened as we have under-invested in our infrastructure, education and health care systems, and social safety nets. Rising inequality reinforces itself by corroding our political system and our democratic governance."[9] For Stiglitz, the reduction of inequality imposes finding a better balance between the market and the State, wherein "one of the roles that the government undertakes is to redistribute income, especially if the outcomes of market processes are too disparate."[10]

Joseph Stiglitz[11] explains that the west economies' slow recovery is due to the inequality between separate countries: "As in previous years, the fundamental problem haunting the global economy in 2013 remained a lack of global aggregate demand. This does not mean, of course, that there is an absence of real needs – for infrastructure, to take one example, or, more broadly, for retrofitting economies everywhere in response to the challenges of climate change. But the global *private* financial system seems incapable of recycling the world's surpluses to meet these needs. And prevailing ideology prevents us from thinking about alternative arrangements." Thus, he approaches the problem of the modern crisis in the capital reproduction from a position of the global market economy, contrary to Marx who perceived the crisis within the framework of one national economy (ignoring the international trade relations) because of the need for a scientific analysis. In this sense, it can be said that Stiglitz "brings down" Marx's abstraction in his economic analysis and he perceives the capital reproduction at a global level, stating that there is a deficiency of the global aggregate demand, not due to the absence of real needs, but as a consequence of the inequality's growth, not only in separate countries but also between the national economies. Taking into account the implications of this attitude, he estimates that "the prospect of significant improvement in 2014 – or in the foreseeable future – seems unrealistic. At both the national and global levels, political systems seem incapable of introducing the reforms that might create prospects for a brighter future." In those reforms, Stiglitz definitely has in mind the proposal for "a simple reform to the global reserve system, which holds out the promises of greater stability, higher output, and enhanced equity. It is, in some ways, an old idea—but

[9] Joseph E. Stiglitz, Inequality Is a Choice, The New York Times,
[10] Joseph E. Stiglitz, The Price of Inequality, W. W. Norton & Company, New York- London
[11] Joseph E. Stiglitz, The Great Malaise Drags On, Jan 5, 2014, www.project-syndicate.org/commentary

perhaps an idea whose time has finally come".[12] According to Stiglitz, "a new global reserve system is absolutely essential if we are to restore the global economy to sustained prosperity and stability."[13]

Nouriel Roubini[14] believes that the markets do not generate enough final consumption. "In the US, for example, slashing labor costs has sharply reduced the share of labor income in GDP. With credit exhausted, the effects on aggregate demand of decades of redistribution of income and wealth – from labor to capital, from wages to profits, from poor to rich, and from households to corporate firms – have become severe, owing to the lower marginal propensity of firms/capital owners/rich households to spend." Therefore, he emphasizes that "Karl Marx oversold socialism, but he was right in claiming that globalization, unfettered financial capitalism, and redistribution of income and wealth from labor to capital could lead capitalism to self-destruct. As he argued, unregulated capitalism can lead to regular bouts of over-capacity, under-consumption, and the recurrence of destructive financial crises, fueled by credit bubbles and asset-price booms and busts." That is why he stands up for an adequate resolution to the inequality, readjustment of the relative economic services of the market and the State with the object of avoiding the social and political instability which does harm to the long-term economic growth and welfare.

[12] Bruce Greenwald and Joseph E. Stiglitz, A Modest Proposal for International Monetary Reform, International Economic Association Meeting, Istanbul, June 2008

[13] Stiglitz, Joseph E. and Greenwald, Bruce (2010) "Towards A New Global Reserve System," *Journal of Globalization and Development*: Vol.1: Iss.2, Article 10. Available at: http://www.bepress.com/jgd/vol1/iss2/art10

[14] Nouriel Roubini, (2011) The Instability of Inequality, Project Syndicate, Okt.13.

CONCLUSIONS

1. Through Marx's, Keynes's and the New Keynesian's findings of the crisis, it can be followed the chronology which creates a sense of comprehensive political economic approach to the economic crises, with the object of avoiding future serious economic disruptions in separate countries and at a global level. It is particularly important to build up an international multilateral system of payments with a global commodity currency in order to establish a stable monetary link between national economies and the global economy. It is especially indispensable for the promotion of integration processes globally and to avoid global imbalances.
2. Crises are economic phenomena which manifest themselves in all the phases of the development of capitalism, and they are manifested and overcome depending on the level of freedom and functionality of the market mechanism and in accordance with the measures that the economic subjects including the Stare have at their disposal. It is clearly seen from the analysis of Marx's, Keynes's and the New Keynesians' attitudes towards the crises that the market itself is not the reason for their outbreak. The capital-relations in the reproduction present a problem. With the free functioning of the market game rules, there are only differentiated the successful from the unsuccessful subjects. The rise of the successful and the bankruptcy of the unsuccessful are normal market phenomena whose resultant presents a general progress of the society. At least it happened so in the period of functioning of the gold standard system. Then everyone was responsible for their destiny.
3. Since the Great Depression, in order to overcome it, it has emerged the need for a State intervention in the capital relations because the capitalists were not able to mitigate the sharpened relations between the labor and the capital, especially due to high unemployment. The crises have changed themselves from economic into political economic phenomena. The politics itself intervenes in the economy through the State, and it constantly increases the arsenal of funds it has at its disposal in order to maintain "the peace in the house" (in the country). Despite continual raising funds to boost

consumption, the State has repeatedly relaxed the market rules of the game not only globally but also in national economies.

4. A common denominator of Marx's, Keynes's and the New Keynesians' attitudes towards the crises is the insufficient demand as a reason. They are different because they find the reasons for the insufficient demand in the different phases of the expanded capital reproduction (Marx in the production and distribution, Keynes in the consumers' conduct because of their greater tendency towards austerity, and the New Keynesians in the distribution because of the increase in inequality in separate countries and between them). However, regardless of the fact where it appears, the insufficient demand needs to be accosted with adequate measures in order to avoid the more profound crises. The former practice has shown that the politics have no power to deal with the troubles caused by the bankruptcies, the increase in unemployment, the slow-down of the economic activities without enhancing the role of the State and without loosening the market game rules both in the national economies and at a global level. But its growing and uncontrolled power becomes counterproductive. And, instead of looking for the remedy in the increase in the economic subjects' and national economies' competitive ability, on the whole, it has been started a process of a gradual loosening of the market regularities.
5. The level of freedom of the market mechanism's functioning is different in separate phases of the development of capitalism, and it essentially determines the way for overcoming the crisis. In Marx's time, in the system of the gold standard being the most consequent solution to the market economy with commodity money, the crises were overcome on the basis of the functioning of the market game rules both at a national and global level. The maintenance of the external stability had an advantage over the internal one, and it could be provided by increasing the competitive ability of the national economy, above all, by increasing the labor productivity.
6. After the Great Depression, when under the compulsion of the market mechanism, it could not be started with the revival of the economy and the growth of employment, Keynes found a justification for getting the State involved in the instigation of the demand with the object of achieving an

increase in the productivity and employment. The success in achieving that opened a new phase of the development of capitalism, a phase in which the functioning of the market regularities was not abandoned, but it was improved with the State intervention in the direction of instigating the demand. And the price for that was getting the State involved in the income distribution in order to reduce the inequality as a result of which, it comes to insufficient demand.

7. The reduction of the market freedom can be followed through the strengthening of the State's role (even by supporting the too big to fail), and through the weakening of the external market impacts, achieved by the subsequent changes in the system of the gold standard (from gold specie standard, through gold exchange standard and gold dollar standard) up to its elimination with the transition to a dollar standard when it was suspended the convertibility of the dollar into gold, and it was made a change-over to the fluctuating rates in the currency cross rates in the world. The outcome of the constant reduction of the market game rules both at a national (by leading a relaxed monetary and fiscal policy) and at a global level (especially by manipulating the rate of exchange) ended up with the Great Recession.
8. The greatest recession since World War II and the difficulties in getting out of it have shown that it cannot be counted on overcoming the crises in the most developed countries even with the further functioning of the international monetary non-system. It can be no longer avoided the notion that among the reasons for the Great Recession is the functioning of some national currencies as world money. It is high time to create a global currency and conditions under which the economic problems of the great economies will be national, not global ones, and to make each political *é*lite bear the responsibility for the situations in their own countries. Without a global currency, there can be further expected new crises even sharper than the actual one because the relations between the national capitals will be sharpening much more. With the global currency, there should be offered solutions to the insufficient demand manifested at a global level. The insufficient demand has already led to slowing down the growth

of the world trade in terms of the growth of the world GDP. This is a signal of the insufficient demand at a global level (the point is not that there is no need, but that there is no political interest in instigating the demand, of course, due to the fact that there is an interest in solving the national problems preferentially). The problem of the insufficient demand at a global level will be particularly sharpened if there are brought about numerous forewarnings of undertaking different protectionist and retaliatory measures between separate countries. It has already been activated the alarm of the danger possibility for relapsing the relations between the two world wars. It is high time to surpass the neglect of the social and political instabilities which emerge from the insufficient demand and/or the inequality in separate countries and at a global level because with the outbreak of the crises it is endangered the long-term economic growth and welfare.

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BUSINESS PROCESS IMPROVEMENT OF THE SYSTEM INTEGRATOR COMPANIES THROUGH A CASE STUDY ANALYSIS

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ABSTRACT

The innovative information technology (IT) solutions represent the essential business platform for improvement and redesign of business processes within a specific organization. This paper shows the impact of modern IT solutions on the business processes towards improving their quality and effectiveness. For this purpose, the paper introduces the appropriate methodology and analyzes the effects of the implementation of the new IT solutions within the system-integrator companies.

In the framework of the presented methodology, an analysis of the strategic position of the system-integrator-companies is conducted, along with the identification of the weaknesses of the companies and analysis of the key existing business processes (AS-IS). Towards managing the defined weaknesses, the key processes are appropriately adjusted, redesigned and improved (TO-BE). For the constant quality maintenance and improvement of the business processes, the appropriate ISO quality systems are implemented. In this manner, the business processes can be significantly improved and adapted to the needs of the organization, through the optimization of the information solutions and technology.

KEYWORDS: information technology solutions, system-integrator companies, King ICT company, business process, ISO standards

JEL CLASSIFICATION: O31, O33

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1. INTRODUCTION

The information technology (IT) solutions are the core tools for managing the business processes and the business data, and represent the most important component of the organizations, regardless of their type, size and the industry the organization belongs. The quality and the effectiveness of the data processing is directly dependent on the implemented IT systems. On the other hand, a system-integrator company is a company that specializes in bringing together component subsystems into a whole and ensuring that those subsystems function together, a practice known as system integration. They also solve problems part of business process redesign and automation. System-integrators may work in many fields, but the term is generally utilized in the IT industry. The quality issues of business data represent an important part of the work of system-integrators.

Modern companies dispose unstructured and large volume of business data, known as big data. In fact, every organization is facing issues with related management of big data. According to Gartner, big data is defined as "high-volume, high-velocity and/or high-variety information assets that demand cost-effective, innovative forms of information processing that enable enhanced insight, decision making, and business process redesign and automation"[1]. Thus, the success of the organization is depending on the level of quality and effectiveness of data processing. Thereby, the achievement of organizational objectives is directly depending on their implemented IT processes for data collection, processing and transferring.

It should be stressed out that big data faces huge challenges around privacy, especially with the new privacy regulation by the European Union. Companies are forced to address the 'elephant in the room' around their privacy controls and procedures. The Gartner Group (2015) predicts that by 2018, 50% of business ethics violations will be related to data, and by 2020, predictive and prescriptive analytics will attract 40% of enterprises' net new investment in business intelligence and analytics. Consequentially, by 2020, new software application and data predictive analytics solutions will be developed[2].

This paper presents the essential characteristics of the system-integrator companies and their strategic market positioning. The strategic positioning of the

[1] http://www.gartner.com/it-glossary/big-data/
[2] http://www.gartner.com/newsroom/id/3165317

system-integrator companies is analyzed based on Michael Porter's model. The effects of the implementation of the new IT solutions within the system-integrator companies are also analyzed, through a real-case of the specific system-integrator company, KING ICT. Besides the strategic positioning of the company, the analysis encompasses the company's profile description, business portfolio and core business description as well.

2. STRATEGIC POSITIONING AND THE BUSINESS PROFILE OF THE SYSTEM-INTEGRATOR COMPANIES

2.1 Strategic positioning

The strategic positioning of the system-integrator companies is analyzed and defined based on the Porter's Five Forces framework model. Through this model the five key forces are defined, as most influential factors on the companies and their environment on the Macedonian IT market (Harmon, 2007). The identified forces are as follows:

1. **The competitive rivalry (market competition).** According to the conducted analysis, regarding the related force, i.e. factor, the main market threats to the system-integrator companies are the foreign investments as anew competition in the Macedonian IT market along with the disloyal competition.
2. **The suppliers power (distributors, partners).** The competitiveness of the solutions of system-integrator companies is directly dependent on the strength of its suppliers. In the vain of increasing their competitive advantage, productivity and efficiency on the Macedonian IT market, system-integrator companies have strong partnership with distributors and vendors of quality IT technology (equipment, solution and services).
3. **The buyer power (customers, clients, consumers, purchasers).** The buyer power is increasing along with thecompetitions growth on the market. Regarding this force, system-integrator companies are decreasing the buyer power on the Macedonian market through adaptation, adjustment and offering of the already implemented solutions in the region. From a financial perspective, these solutions are partially settled, which allows to the companies to offer more competitive prices on the Macedonian market.

4. **The threat of substitution (new products on the market – substitutes).** According to the theory of Porter, the threat of substitutes is a threat of replacing a product or service with adequate but more competitive one or with an appropriate alternative from another industry.In order to answer to this challenge, system-integrator companies have established (and have been establishing) partnerships with various suppliers and producers of ICT equipment, solutions and services. This strategy gives an opportunity to be present on the Macedonian IT market with a variety of products and services, which in fact are substitutes to each other.

5. **The threat of new entry (new potential competitors).** Recently, within the system-integration business segment of the Macedonian IT market, new competitors could be expected because of the new domestic and foreign investments.

2.1 Business profile

The core business domain of system-integrator companies is delivery and implementation and integration of IT business solutions, as well as providing respective IT services and support. The integration of various IT systems enables their unified functionality as one single IT platform (Prencipe et al., 2004). The general aim of the integration is the implementation of automated process for import of various data types (input data), their automated processing and sublimation (data processing), towards automated exporting of the respective results (output data) (Scheer, 2000).

In this paper, the methodology for installation, implementation and integration of various new IT solutions as single unified IT platform is elaborated on the real case of the system-integrator company KING ICT. According to the available official financial statements, KING ICT is ranked as one of the largest system integrators in the region[3]. The implementation of the integrated IT solution, results in significant efficiency and effectiveness improvement of the KING ICT core business.

The service portfolio of the KING ICT company includes consulting services, services for information systems dimensioning, services for development and implementation of IT solutions and ICT infrastructure systems, technical support and maintenance, and appropriate education for delivered solutions. According to the company's policies, the development and implementation of the IT solutions,

[3] http://www.banka.hr/tko-su-najvece-hrvatske-informaticke-tvrtke/print (accessed on12.11.2016)

providing the related IT services, the projects managing and the customer care, always have to be of the highest quality level. Thus, the business processes based on which the company methodology is underlying, must continually analyze and improve. Business processes improvement is usually done through implementation of the appropriate information systems, such as Customer relationship management (CRM); Time Sheet; Document management system (DMS); and Service desk system.

The implementation of the appropriate information systems was done on the ISO quality systems (standards), such as ISO 9001 Quality management system[4]; ISO 20000 IT service management system[5]; and ISO 270001 Information security management system[6].

KING ICT disposes a broad portfolio, consistent of IT solutions and services. The portfolio is defined based on the following principles:

- **Technological expertise,** which includes **c**ontinuous education of the personnel; certification by the global technology partners; and balanced portfolio (HW, SW, services).
- **Improving business processes** through the implementation of the quality standards, quality management system; system for environmental management; IT service management system; information security management system; and international business methodology application.
- **Research and development** through **i**nclusion of the world IT leaders solutions (Microsoft, IBM, EMC and others); development and implementation of custom and own solutions; and solution integration.
- **Customer centricity**which includes relationship management with the customers; customer support; and business analysis of the market requirements. The portfolio can be segmented according to various criteria (type, HW, SW, brand, purpose etc.). The KING ICT portfolio is divided into four main groups. Every group contains particular type of solution[7]:
- **Business process management** which includes ERP - Base Business Processes; Document Management System; and Satellite Technology Based Solutions.

[4]http://www.iso.org/iso/iso_9000 (accessed on 23.12.2016)
[5]http://www.iso.org/iso/catalogue_detail?csnumber=51986(accessed on23.12.2016)
[6]http://www.iso.org/iso/catalogue_detail?csnumber=63411 (accessed on23.12.2016)
[7]http://www.king-ict.com/en/ict-solutions (accessed on 17.04.2017)

- **Employees Management and Human Resources Development** which includes Human resources management system; Fleet management system; and Learning process management system.
- **Infrastructure management** which includes Construction and IT infrastructure optimization; Data centers; Security management system; and Automation systems and energy efficiency.
- **Information management which includes** Sales plan design and monitoring; Information security management; and Business reporting systems.

The portfolio is constantly improving and upgrading with new solutions and services. Based on the gained experience of the in-house implementation and integration of the Dynamics MS CRM, aktivManager DMS, BI, Time Sheet and KSL Service Desk system, KING ICT practically, have expanded the own portfolio with the mentioned solutions, IT consulting services and services for business analysis.

3. IMPLEMENTATION OF AN INTEGRATED IT SYSTEM

The previous section describes the core business of the system-integrator companies. In order to clearly present the core business of these companies, a case study is conducted, where the integration and implementation process of the various solution within the KING ICT environment as well as the main benefits of the integrated IT system are analyzed.

Based on the analysis, KING ICT has identified the weaknesses of the company and the needs of implementation and integration of appropriate IT solutions. The purpose of the implementation of these solutions into one single integrated IT system was improving the company's core business.

The implementation of the integrated IT system was realized in three main phases:

- Consolidation of the ICT platform and virtualization;
- Implementation of company (private) cloud;
- Implementation of an integrated ICT system (integration of the IT solutions).

3.1 ICT platform consolidation

The consolidation of the ICT platform represents the initial phase. This consolidation includes virtualization of the company's hardware infrastructure, which provides reliable, confidential and redundant IT platform to the KING ICT. The virtual platform is the centralized foundation of the computer cloud environment, which unifies and integrates the company's IT solutions and tools. The cloud incorporates all of the employees' IT tools, which are utilized by the personnel to perform their daily business activities (Grant and Meadows, 2016).

The general benefit of the virtualization is the reduction of the hardware equipment. The hardware reduction results in significant decrease of the high electricity costs and the costs for maintenance of the whole equipment. Thus, through the virtualization, the company's total cost of ownership (TCO) was significantly decreased (Thomas at al, 2013).

3.2 Cloud computing implementation

The implementation of the cloud computing technology enables central access to the IT tool, regardless the time, place or device (thin client, smart phone, tablet etc.) (Buyya at al, 2011). According to the company policies, each employee has particular privilege to access and use appropriate IT solution. Depending on the privilege, the employee can access to an appropriate IT tool or only to a specific functionality of it(Slack and Wise, 2014).

The KING ICT computer cloud incorporates and integrates the following existing and new IT solutions:

- ERP System (existing);
- CRM System (new);
- DMS System (new);
- Time Sheet (new);
- BI (business intelligence) System (existing);
- KSL Service Desk System (new).

The implementation of the computer cloud results in significant improvement of the reliability and confidentiality to the company critical data (Asha, 2012).

3.3 Integration of IT solutions

The integration of the solutions enables automated process of data processing and exchange as well as export of various ad-hoc and predefined reports and analyses(Reid, 2012). Below is presented the project managing process which involves data processing by several IT solutions and employees. This example includes all of the previously mentioned integrated IT solutions.

- **User registration in CRM**: Users' database is being created via CRM (employees, distributors, subcontractors, business partners, customers etc.)
- **Offer preparing in ERP**: The offers are being created via ERP (for the clients' purpose). The ERP is importing the data information for the appropriate client directly from the CRM database.
- **Project registration in CRM**: Based on the accepted offer (crated vie ERP), the project is being created via CRM (the project includes all of the respective offer's data)
- **Financial and accounting in CRM**: Each registered project in the CRM is being connected with the ERP. The income and outcome invoices related to that project, are being imported via CRM, and thereafter are being processed via ERP.
- **Milestones and WBS registration in CRM**: The engaged resources and related activities (WBS) are being created via CRM.
- **Employee time tracking in Time Sheet**: this solution enables access (to each involved employ) on the respective project and tracking the spent time for each single WBS, previously created via CRM. The spent time (by the related employees) on the predefined project tasks (WBS) is being recorded via Time Sheet.
- **Time tracking expense processing in ERP**: the tracked time in the Time Sheet, trough CRM is being processed via ERP. The expense is being calculated via ERP and it is being registered as appropriate project cost (on the respective project) via CRM.
- **Support and maintenance project registration in KSL**: The KSL system is applying on projects (previously registered in CRM) which are under support and maintenance by the KING ICT. The support and maintenance activities on these projects are being managed via KSL system.
- **Document managing in DMS**: the whole related project documentation is being managed via DMS. The income invoices are being digitalized and

approved via DMS. DMS. The digitalized documentation is storing to the related project into CRM.

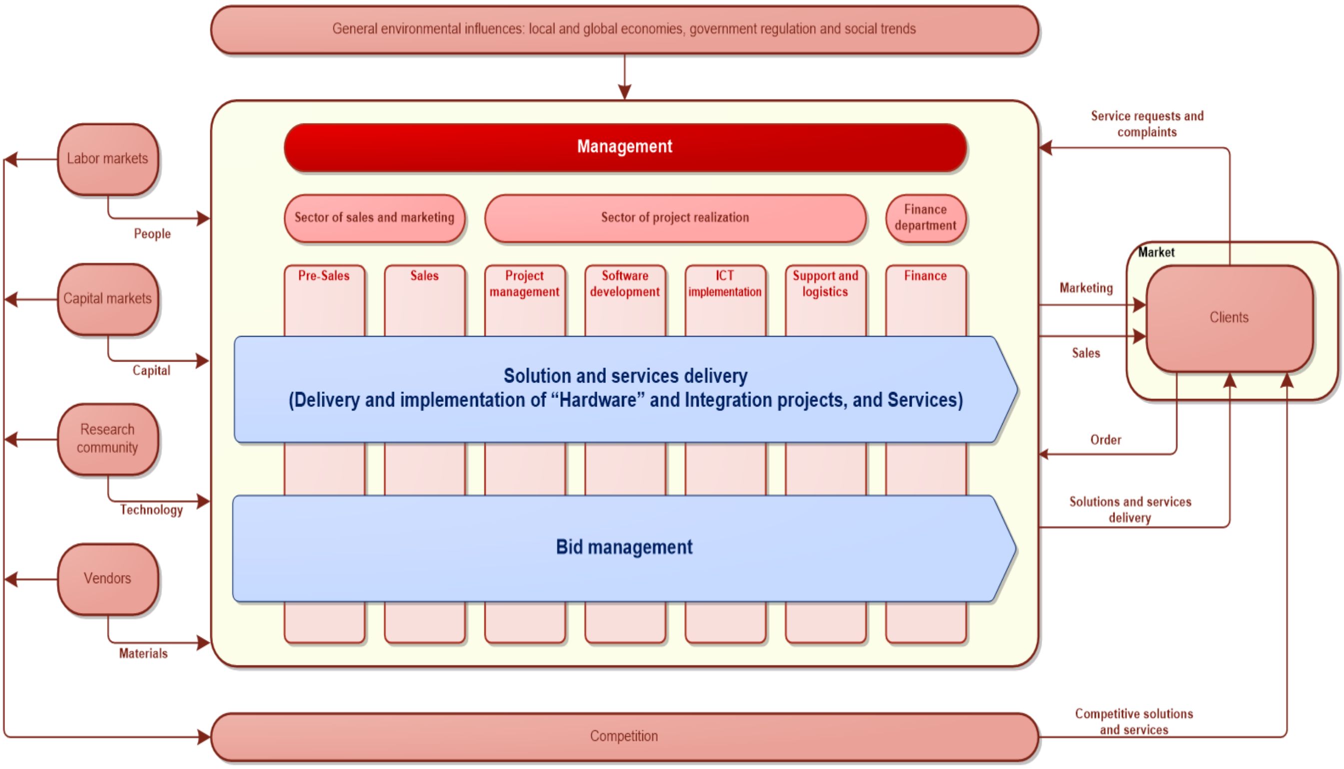
- **Financial reporting**: The BI (business intelligence) system is analyzing the financial data, previously processed via ERP. The BI system exports ad-hoc and predefined financial reports, based on numerous criteria (projects, project type, costs type, customer etc.)

The integration of the IT systems and solutions enables effective and efficient business. Based on the opportunities provided by the innovative technology, KING ICT has consolidated and significantly improved the company's core business processes (Prencipe et al, 2005).

4. ANALYZING THE PROCESS ARCHITECTURE

On the diagram given below, the process architecture diagram of the analyzed company KING ICT is presented. The diagram presents the structure of the company's core value chains and the company's organization positioning (Harmon, 2007). Additionally, the diagram presents the environmental impact to the company, company's inputs as well as respective outputs.

Diagram 1. Company's organizational diagram of a specific value chain



Source: Paul H. (2007), "Understanding the Enterprise", Business Process Change, Second Edition: A Guide for Business Managers and BPM and Six Sigma Professionals (The MK/OMG Press), Elsevier/Morgan Kaufmann Publishers, Burlington, USA

KING ICT is departmental structured, consisted of:

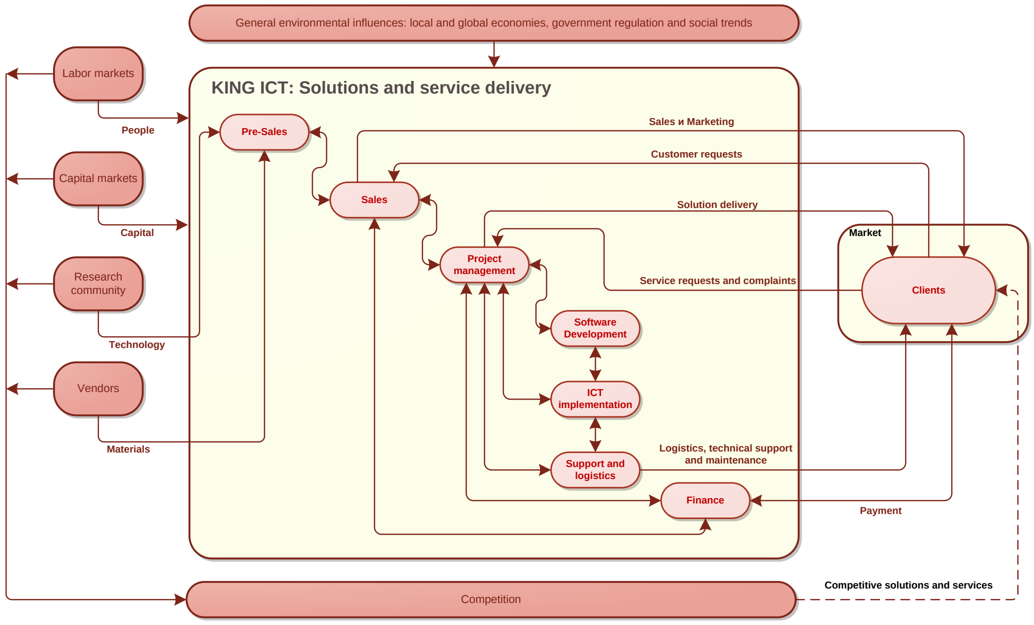
- Pre-sales department
- Sales department
- Project managing department
- Department of software development and deployment
- Department of ICT implementation
- Support and logistics department
- Finance department

The company's core value chains are crossing through the previously mentioned departments. KING ICT has identified two core value chains with their related processes, respectively:

- Delivery of solution and services (delivery and implementation of hardware, integration projects and services):
    - Process: "Hardware" – delivery and implementation of "hardware" segmented projects;
    - Process: "Software" – delivery and implementation of integration projects (hardware and software implementation and integration) or software development projects;
    - Process: "Services" – service delivery, technical support and maintenance (within the projects or as particular customer's demands);
- Bid management
    - Process: Pre-sales;
    - Process: Sales;
    - Process: Marketing.

In this paper, we take into consideration the first value chain – Delivery of solution and services. The organizational diagram with the mentioned value chain is presented on Diagram 2.

Diagram 2. Company's organizational diagram on Solutions and service delivery

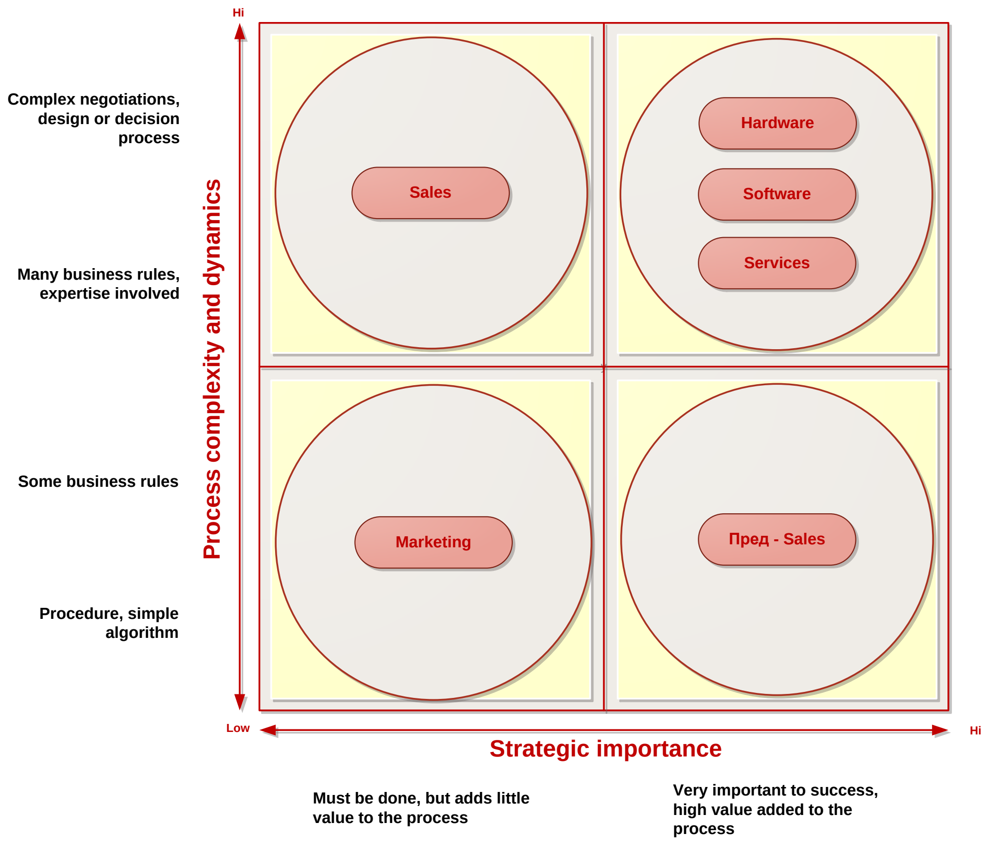


Source: Paul H. (2007), "Understanding the Enterprise", Business Process Change, Second Edition: A Guide for Business Managers and BPM and Six Sigma Professionals (The MK/OMG Press), Elsevier/Morgan Kaufmann Publishers, Burlington, USA

4.1 Matrix of the process complexity and strategic importance

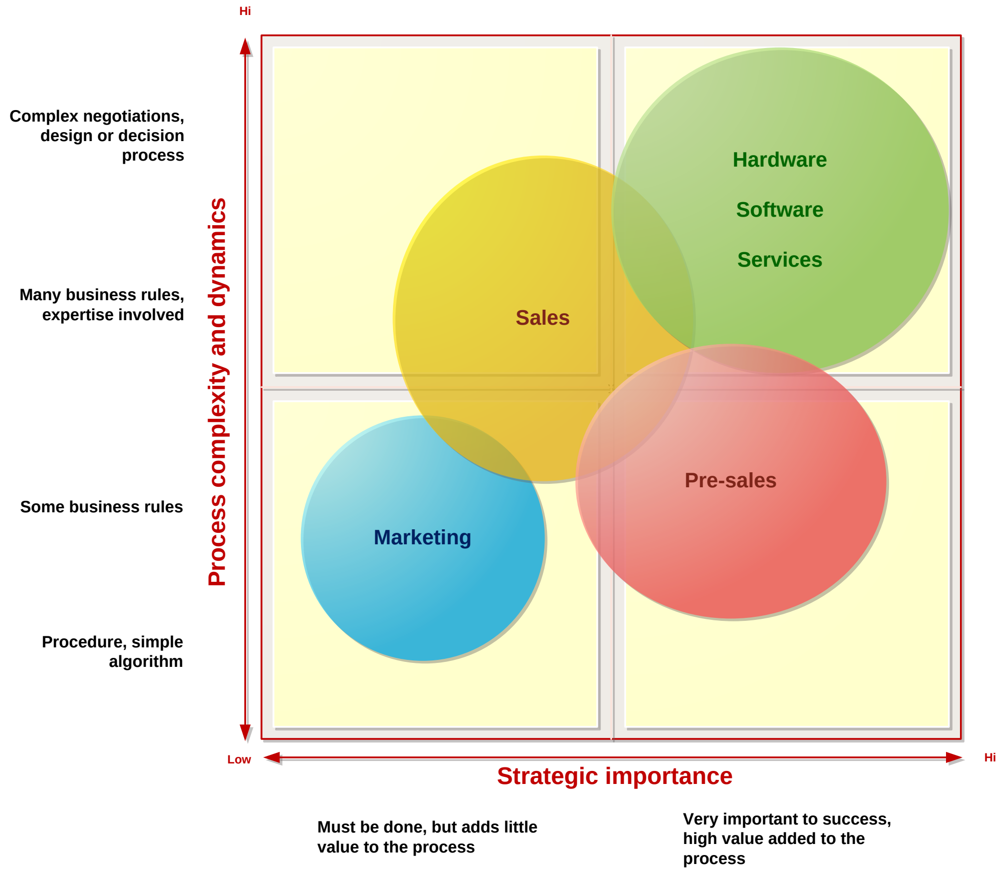
The business processes can be measured by their complexity and strategic importance to the company. On diagrams 3 and 4 are given two matrixes related to KING ICT value chains. The matrixes present the core business process referred to their complexity,dynamics and strategic importance within the company(Harmon, 2007).

Diagram 3. Process complexity and strategic matrix



Source: Paul H. (2007), "An Executive Level BPM Group", Business Process Change, Second Edition: A Guide for Business Managers and BPM and Six Sigma Professionals (The MK/OMG Press), Elsevier/Morgan Kaufmann Publishers, Burlington

Diagram 4. Generic solution matrix



Source: Paul H. (2007), "An Executive Level BPM Group", Business Process Change, Second Edition: A Guide for Business Managers and BPM and Six Sigma Professionals (The MK/OMG Press), Elsevier/Morgan Kaufmann Publishers, Burlington

4.2 AS-IS and TO-BE business processes diagrams

The AS-IS diagram presents the initially implemented business processes within the KING ICT company. The diagram involves all of the processes which are contained to the most important value chain to the company - Delivery of solution and services. The TO-BE diagram presents the redesigned and improved business processes, based on the AS-IS processes, respectively (Harmon, 2007). Currently, within KING ICT, the TO-BE processes are being implemented. The business processes redesigning and improving are directly supported by the implementation of the new modern IT solutions and their integration with the existing ones. Thereby, the implementation and integration of the IT solutions within the KING ICT company is enabled by the usage and application of the core information technologies such as virtualization and cloud computing.

Thus, the conclusion is that the business process improvement is directly depending on the used and implemented information technologies and solutions. The optimal usage and incorporation of the innovative IT technology results with significant business improvement within the company.The AS-IS and TO-BE diagrams of the most complex process: “Software” – delivery and implementation of integration projects (hardware and software implementation and integration) or software development projects, are given as appendix.

CONCLUSION

The quality of the business, the market competitiveness and the success of organizations directly depends on the implemented business processes. The flexibility of the organization is the essential element in defining the strategic market positioning towards improving their business processes and efficient managing. Also, the key point is the recognition of the opportunities offered by the modern information technology as core platform for implementation and support of the redesigned business processes towards achieving the company’s strategic objectives. This paper presents the improvement of business processes in the company KING ICT by implementation of the modern information technologies and IT systems. According to the official statistical records, the usage of the IT systems for automated data processing (ERP, CRP, BI etc.) into Macedonian information society is constantly increasing. The presence of the leading information technology vendors (IBM, HP, Microsoft, SAP, etc.) have strong impact on the local companies and organizations in the usage of previously mentioned solutions.

KING ICT, as system-integrator company, has recognized the opportunities and the benefits of the implementation of the modern IT solutions. Thereafter, the company has conducted appropriate analysis for weakness identification within the existing business processes. The analysis concluded inconsistencies within the existing processes for the project delivery management (delivery of "hardware", "software" (integration) projects and IT services). Based on the conclusion, KING ICT has established new business process values, i.e. the company has consolidated and redesigned the respective business processes. The business processes were redesigned and implemented upon the innovative IT system. In parallel with the business process improvement, KING ICT has implemented appropriate ISO standards for: quality management (ISO 9001), IT service management (ISO 20000) and Information security management (ISO 270001). These quality systems are fully supportive and complement to the implemented IT systems. KING ICT, via implemented ISO standards, guarantees the quality of the business, effective project delivery and the security of the confidential data.

As elaborated in the paper, the integrated IT system is a complex solution, consisting of new and existing IT systems. The existing IT systems include ERP system; BI (OLAP) system; and Intranet, while the new IT systems include Customer relationship management system – CRM; Time Sheet; Document management system – DMS; and Service Desk system. These solutions are integrated and interconnected into one single unified integrated system. This system in fact represents the essential company's IT platform towards providing the business process automation in fully accordance with the abovementioned ISO quality standards.

The main benefits following the implementation of the new IT platform as well as the redesign of the respective business processes are:

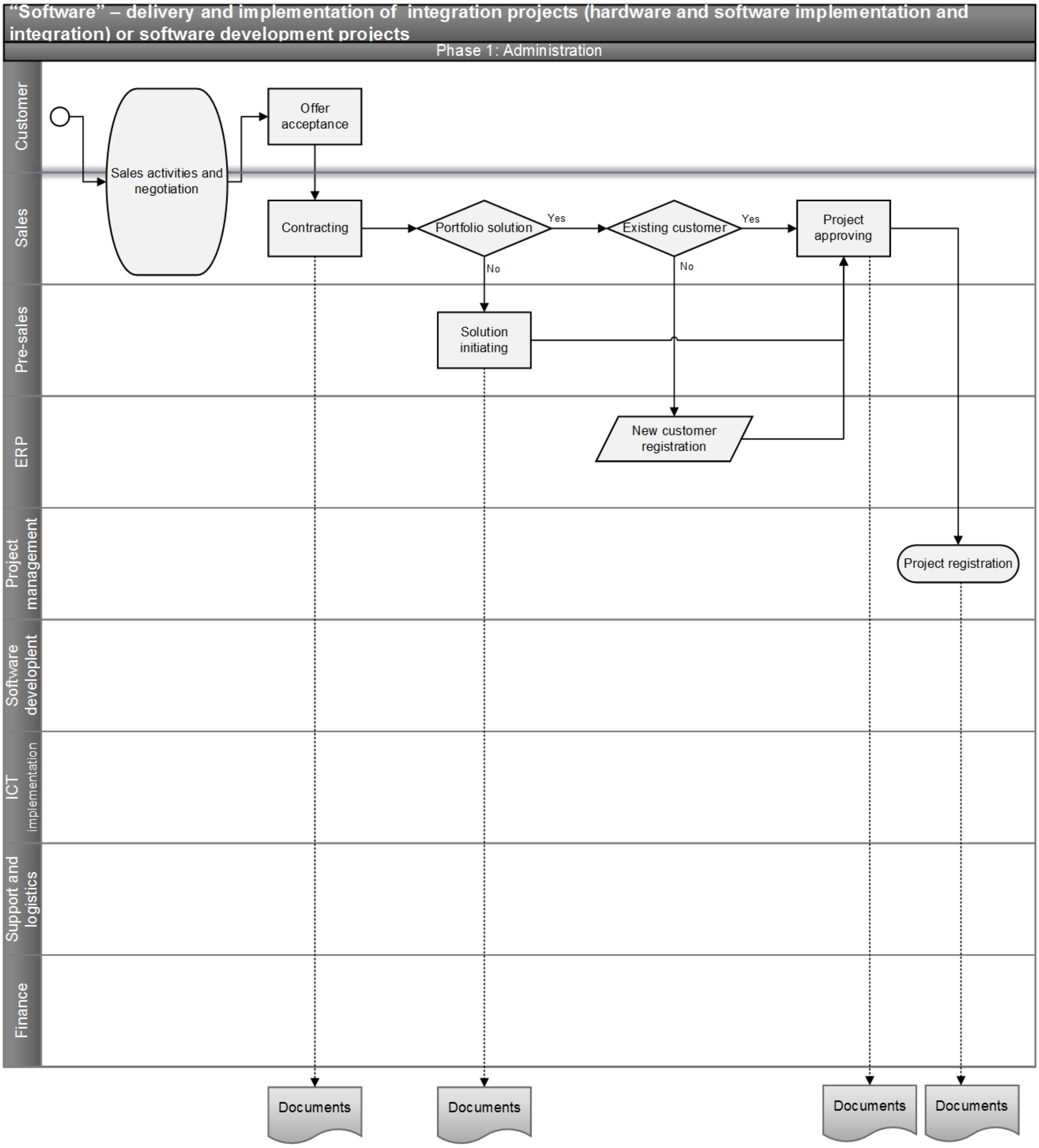
- Effective management and automatization of the project delivery processes:
    - Delivery and implementation of "hardware" projects;
    - Delivery and implementation of integration projects (hardware and software implementation) or projects which includes only software development;
    - Delivery of IT services, technical support and maintenance (within the projects or as particular request by the customers);
- Improved business performances
    - Increased profit and cost reduction;
    - Increased confidence, satisfaction and loyalty by the clients;
    - Increased credibility and market competitiveness;
- Increased satisfaction and sense of belonging for the employees
    - Business automatization;
    - Minimized error risk;
    - Improved business efficiency;

The summary of this case study is that the business processes and the information technology are interdependent and inseparable elements. The optimal usage of the IT solutions could result in maximum business process improvement in accordance to the organizations' needs towards accomplishing their strategic objectives.

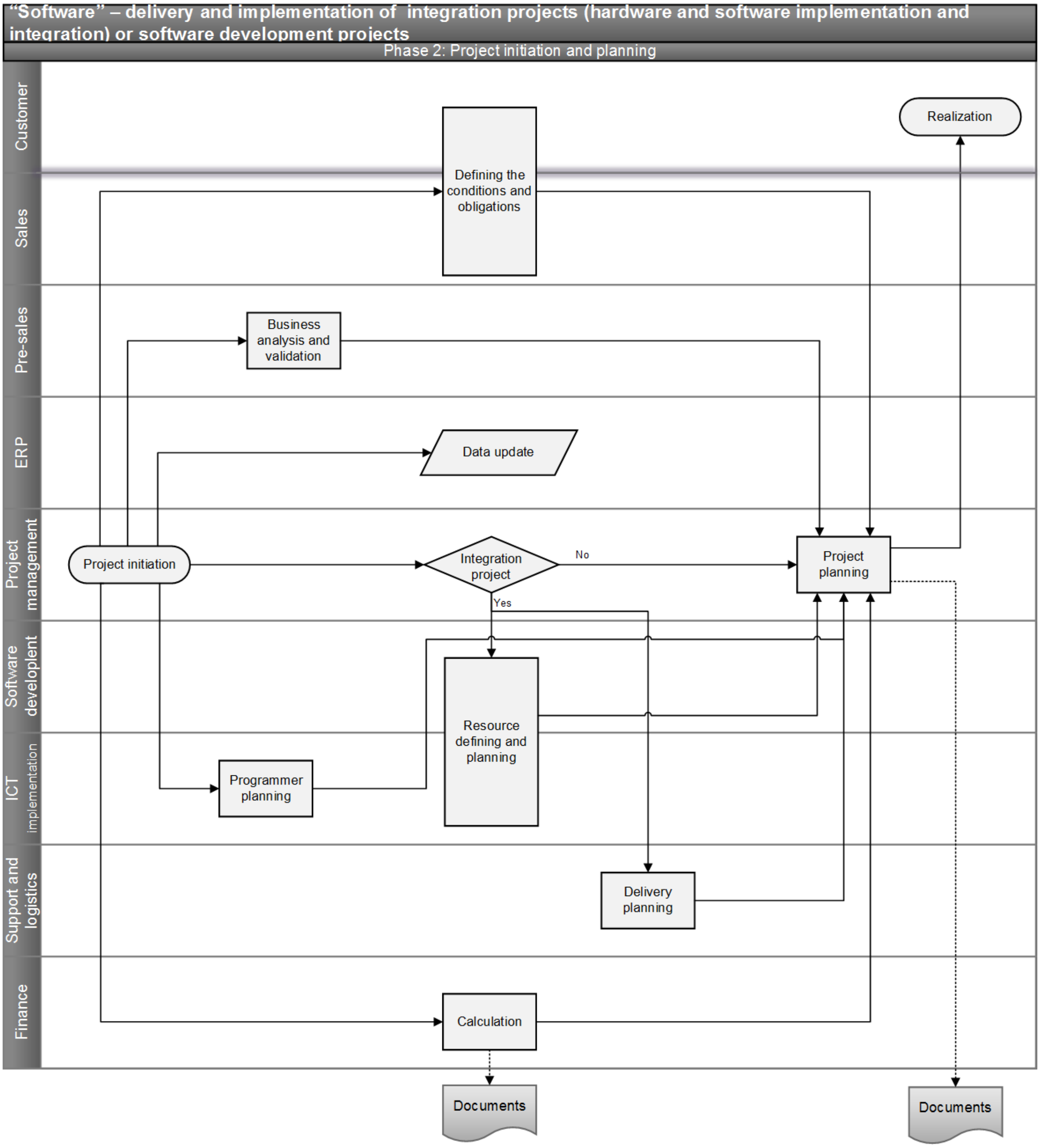
Appendix

AS-IS process diagram

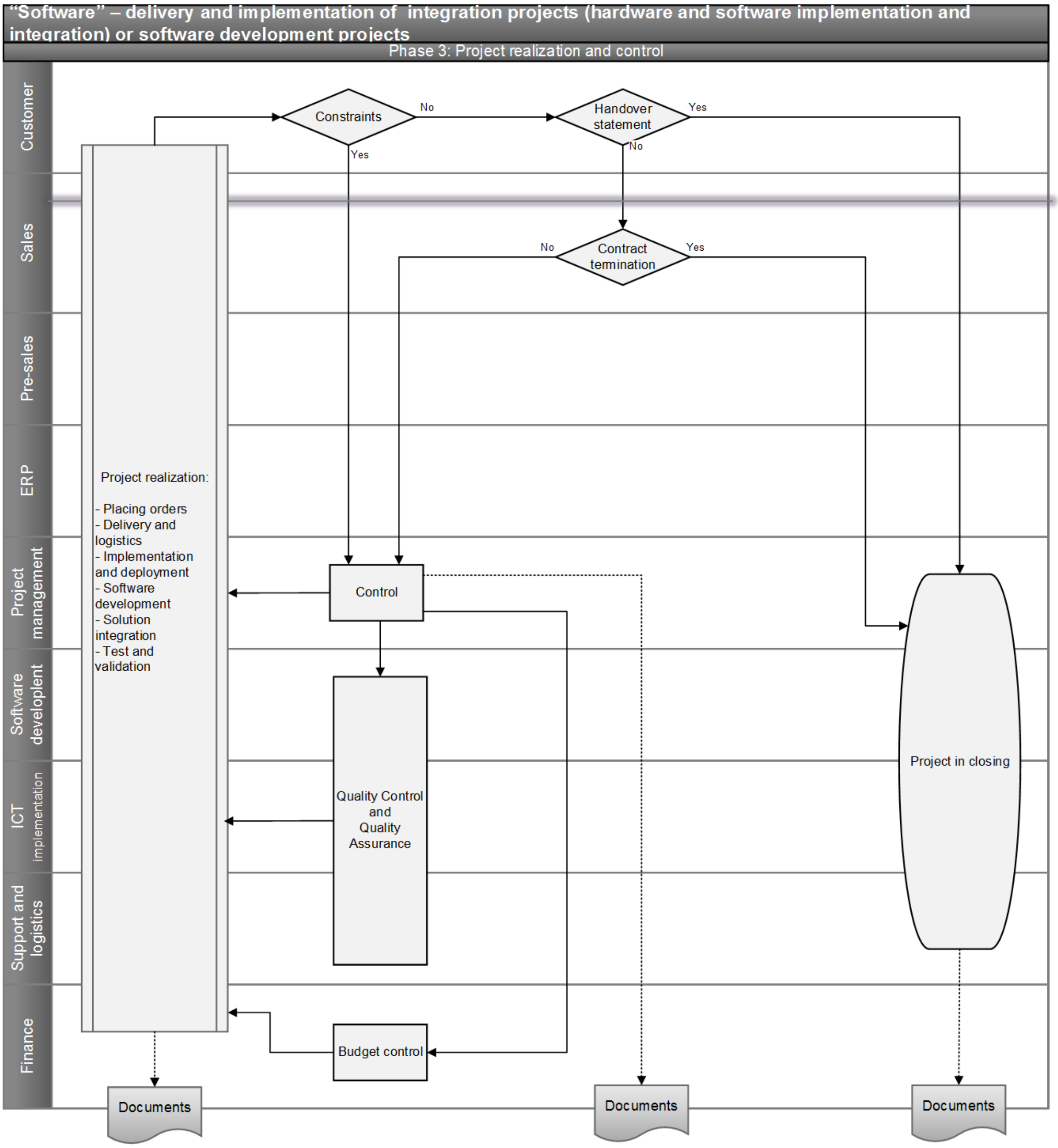
Phase 1: Administration



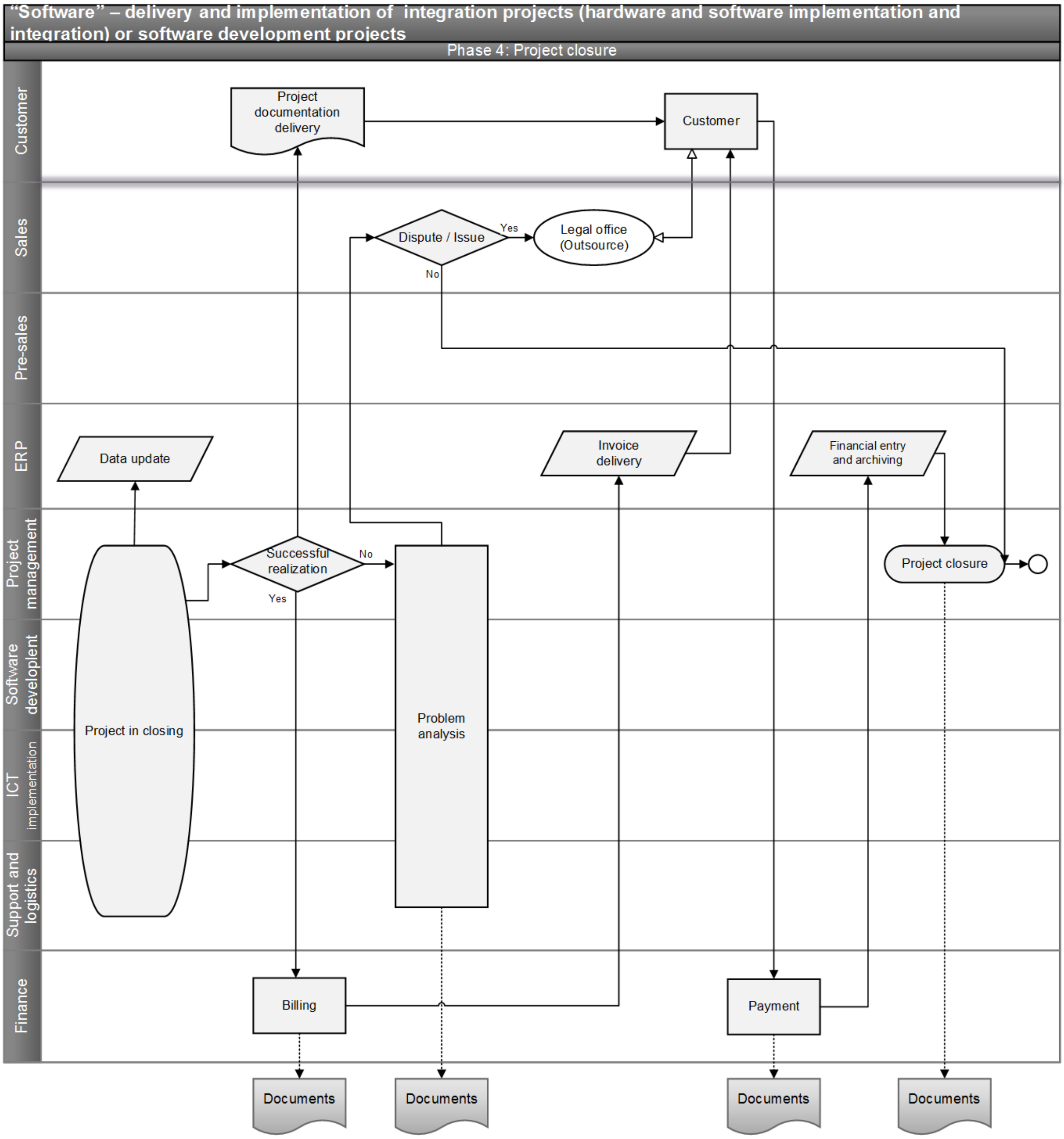
Phase 2: Project initiation and planning



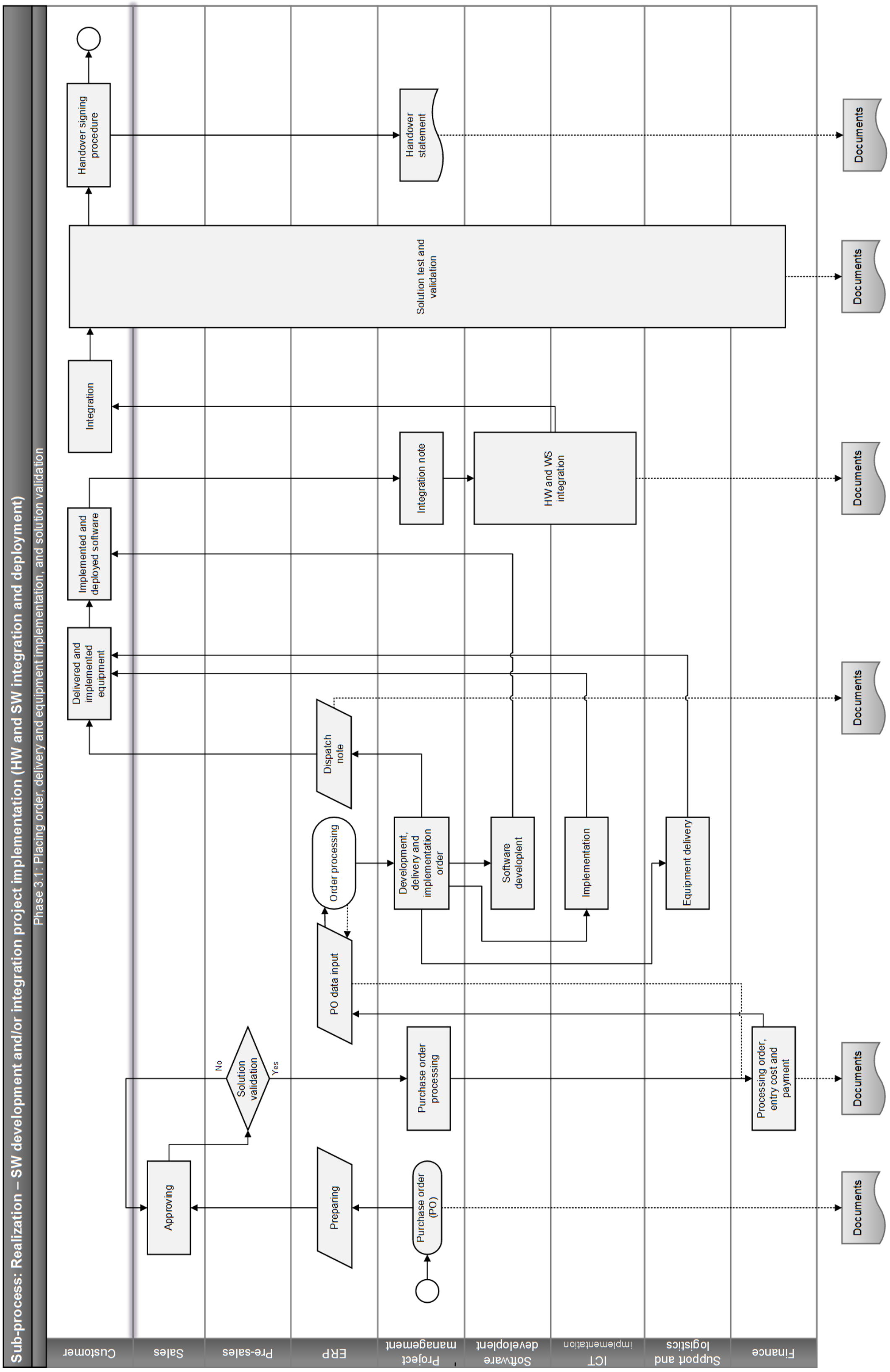
Phase 3: Project realization and control



Phase 4: Project closure

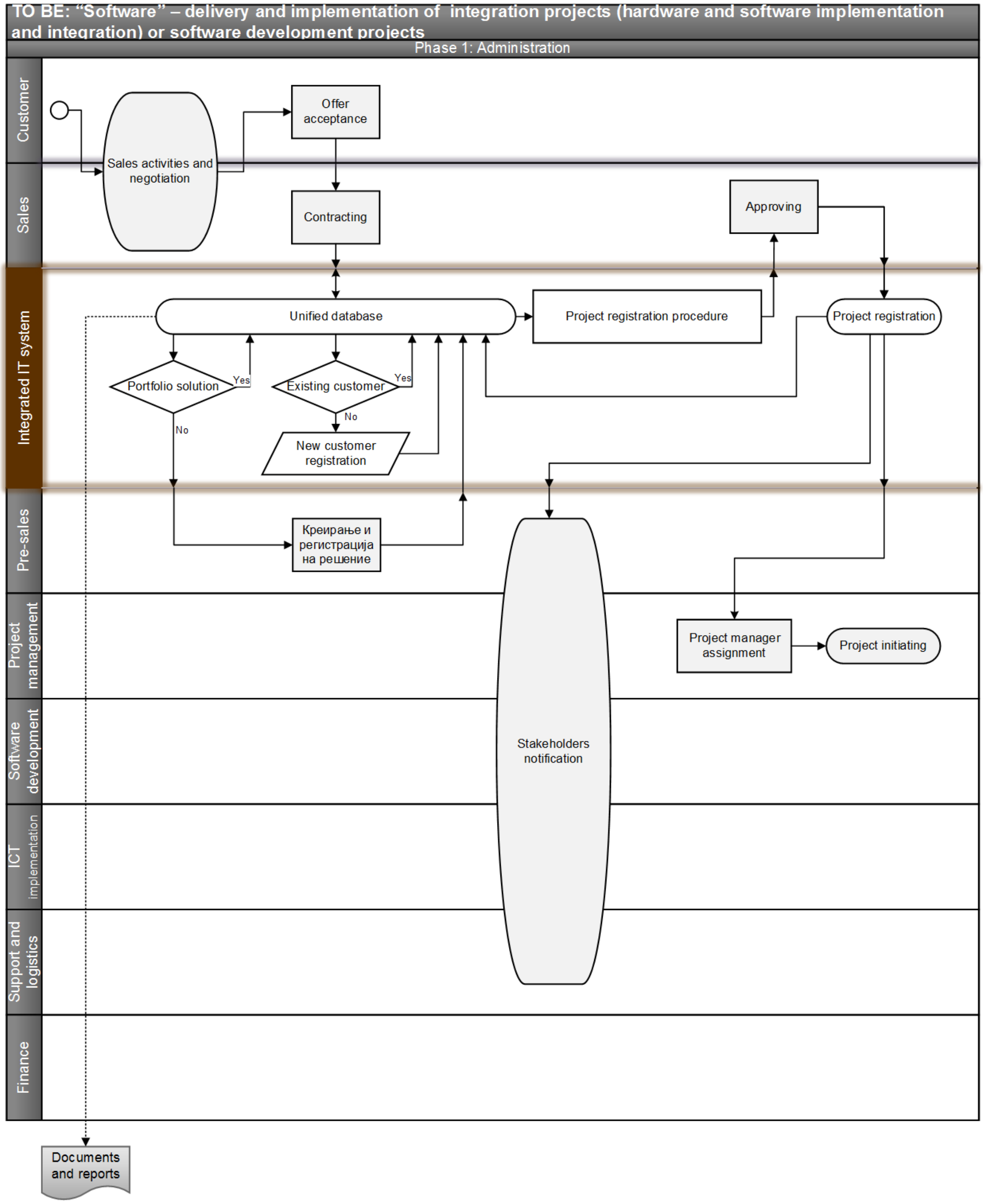


Sub-process: Project realization

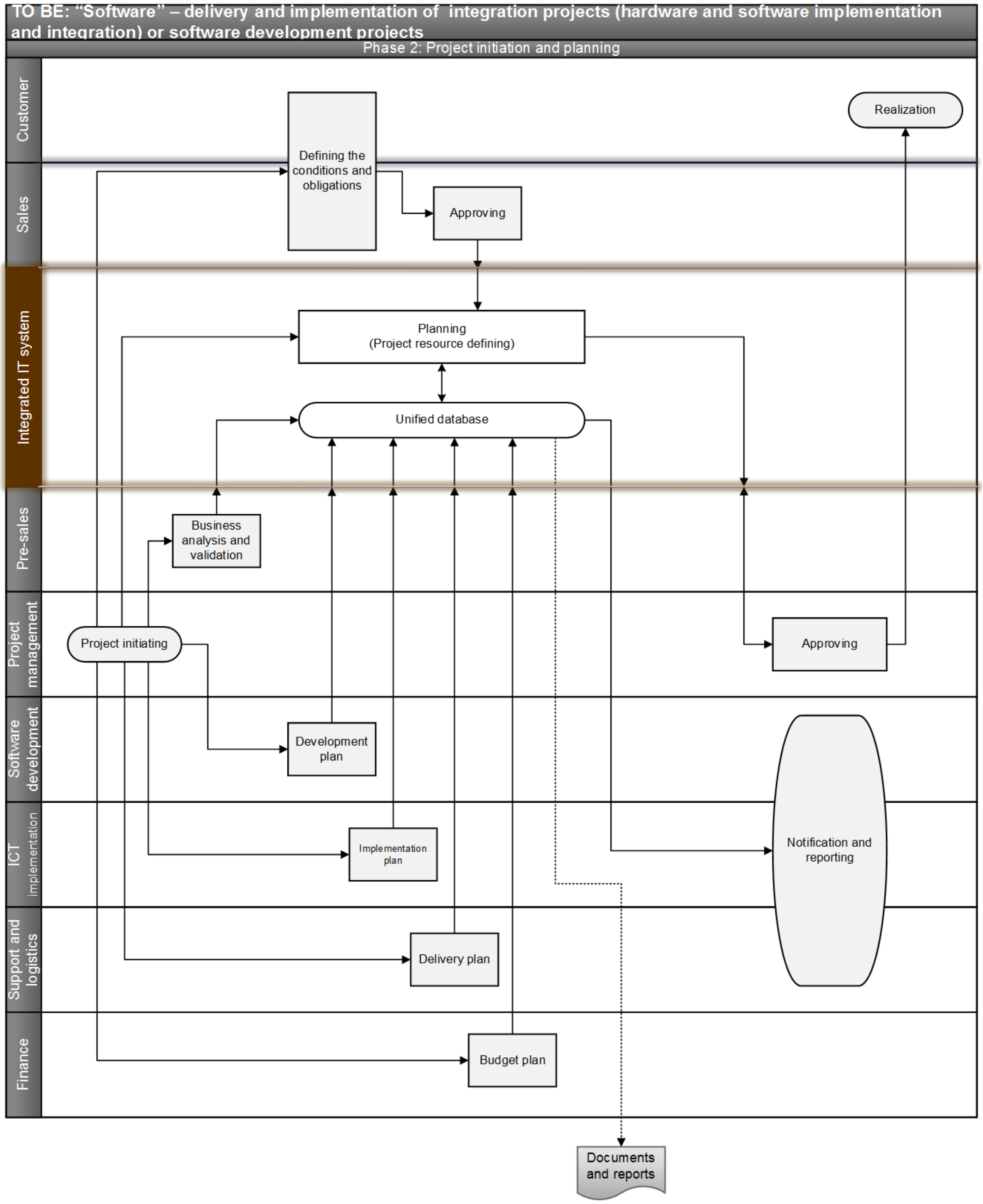


TO-BE process diagram

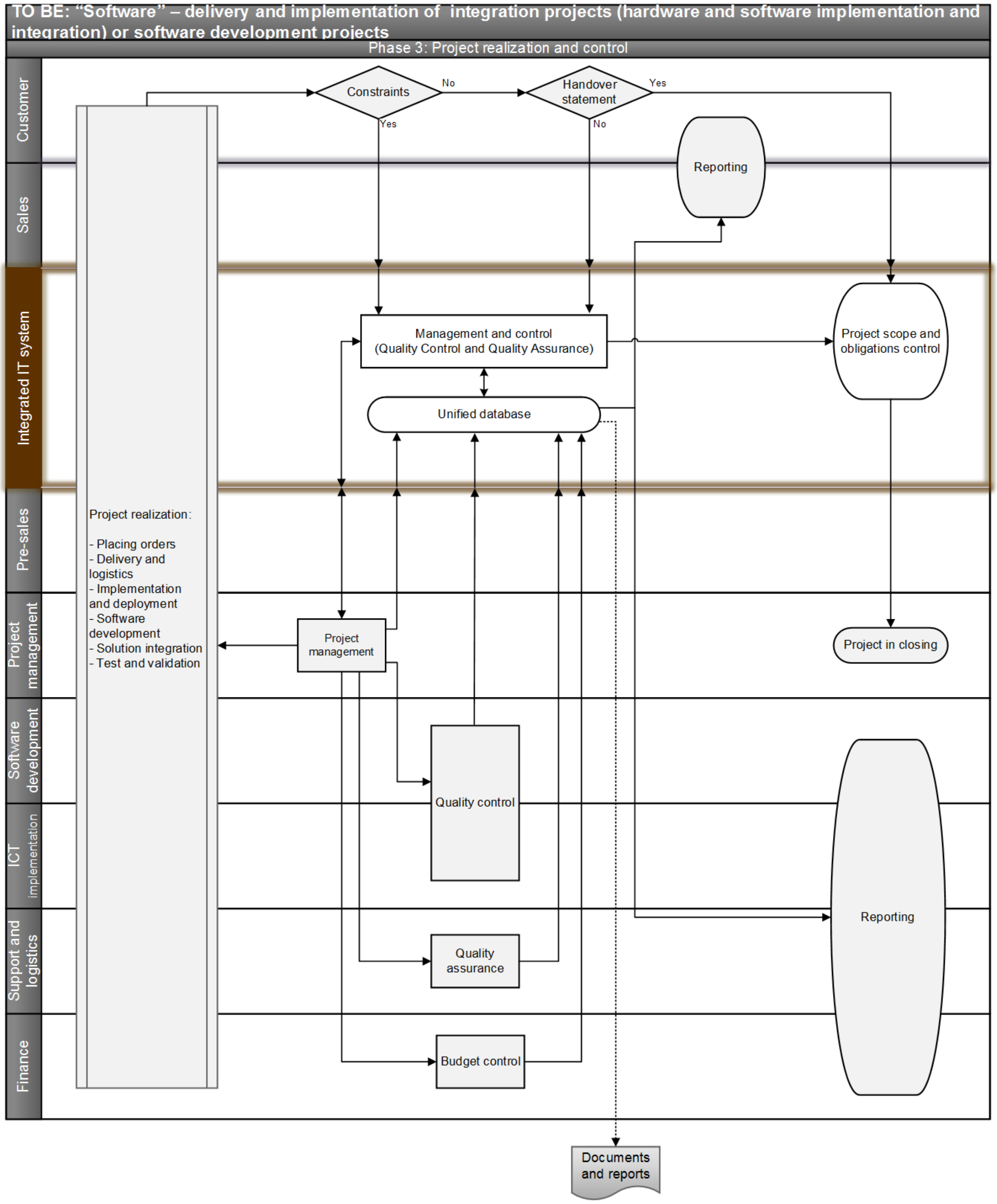
Phase 1: Administration



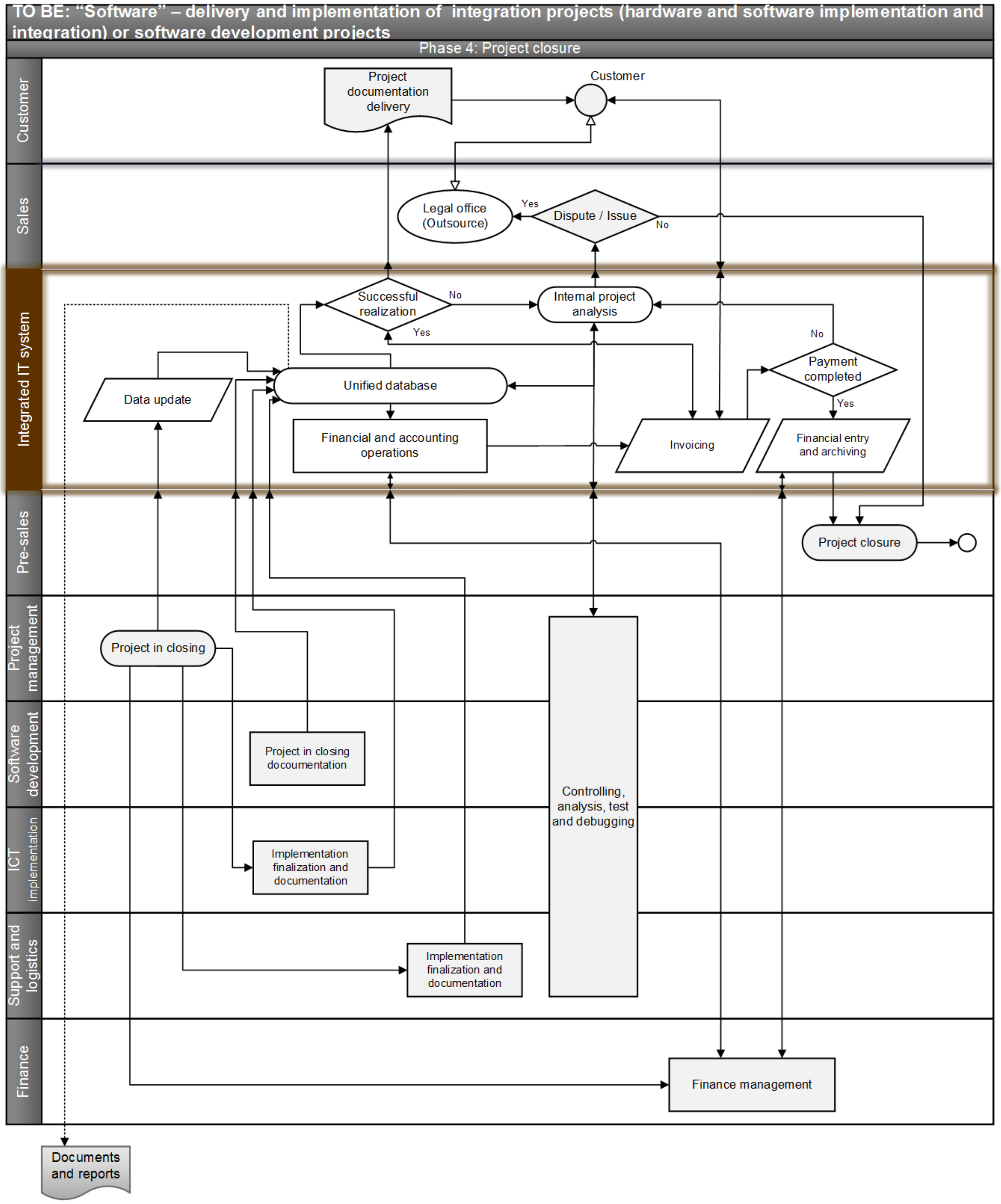
Phase 2: Project initiation and planning



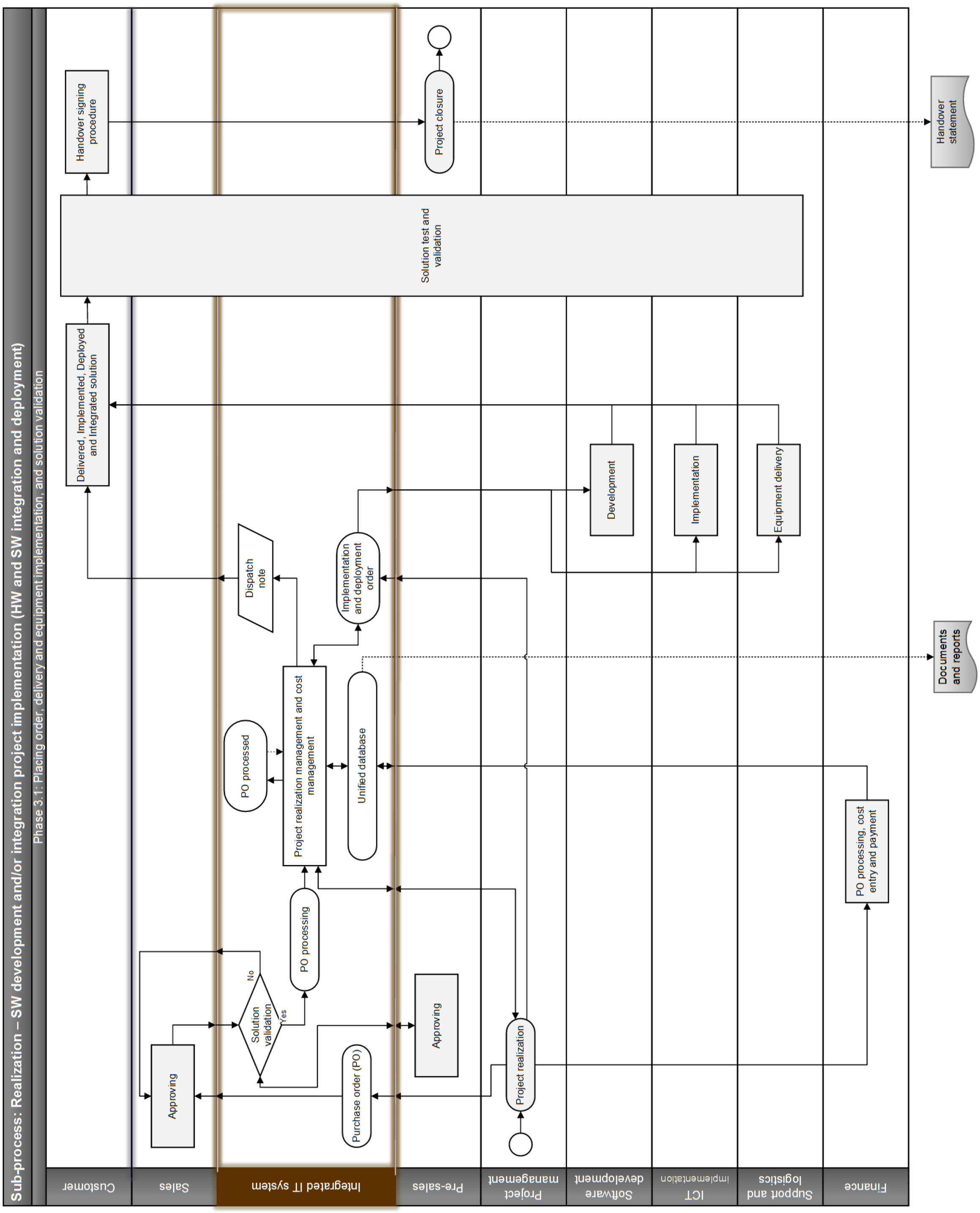
Phase 3: Project realization and control



Phase 4: Project closure



Sub-process: Realization



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UDC: 631.147(497.7)

ORGANIC AGRICULTURE IN REPUBLIC OF MACEDONIA AND POSSIBILITIES FOR ENHANCING

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ABSTRACT

Main characteristic of Macedonian agriculture is traditional extensive agriculture present in mountain areas, which is main precondition for the development of organic production. In recent years, the Republic of Macedonia notes increased inters for organic agriculture; in the organization of the organic sector are included: producers, cooperatives, associations, counseling stakeholders, control and certification bodies and government institutions. Practice shows that there is a lack of organization and coordination among them, which results with unstable sale of organic production. The attempt of the paper is to explore and analyze the organic agriculture production in the Republic of Macedonia in order to show some perspective trends for further enhancing and development of organization in the form of policy or strategy for quality work and organization of organic sector.

KEYWORDS: organic agriculture, organic production, farmer organization, Republic of Macedonia

JEL CLASSIFICATION: Q01; Q19

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INTRODUCTION

Organic agriculture is best known as a traditional farming method and it relies on ethical principles on protection and promotion of the environment and an economically viable production with recognizable organoleptic quality. It's based on a closed cycle of movement of nutrients within the system: soil - plants - animals - man. It aims to produce healthy and high quality food to the population without adverse effects in the environment that may jeopardize the balance in nature. Therefore, it has increased interest and an upward trend in terms of consumption and production worldwide.

It is doubtless that the Republic of Macedonia follows the world trends in organic production which is a significant part of Macedonian agriculture. The organic production has a great condition for development mainly due to the traditional extensive agriculture present in mountainous areas, the possibilities for the producers to show the same quality and the possibility of achieving safe placement and higher profit on the market. The practice shows that there's increased interest for this production by the farmers and the demand for organic food and products is increased. Also, there is an intensive pressure from the Government, local NGOs', EU accession process and market opportunities to incubate organic production as a main concept for further development of agriculture. However, the sale of the Macedonian organic products is unstable due to the inadequate organization of all participants in the organic agricultural production which results with inappropriate treatment of organic production i.e. sale of organic products as conventional or disorganized export.

Therefore, the main purpose of the paper is to analyze the organic agriculture production in the Republic of Macedonia, in order to show some perspective trends for further enhancing and development of the organization of organic agriculture. The research subject of the paper is the role, organization and main characteristic of organic agricultural production in the Republic of Macedonia, as well as providing perspectives in form of policy or strategy for quality work and organization, based on official data and a questionnaire conducted among farmers as main holders of the organic sector in the country.

The methodology of the research is based on the analysis of the official data and survey for the possibility of applying the concept Total Quality Management (TQM) in the organization and operation of associations of producers of organic products as a way of work and operation on previously prepared questionnaire, obtained through interviews with the members of associations with qualitative and quantitative data as well as their published information. The questionnaire contained twenty (20) questions, but in this paper I elaborated the questions about the general situation of organic production in the Republic of Macedonia from the perspective of farmers. The survey was conducted in the period between November 2012 - March 2013 and it was sent to the highest form of organized associations in the country - Federation of Producers of organic products which includes nine regional associations, of which four (4) Associations and sixty-five (65) members - producers responded to the questions.

1. ORGANIC AGRICULTURE IN THE ECONOMIC AND SUSTAINABLE DEVELOPMENT

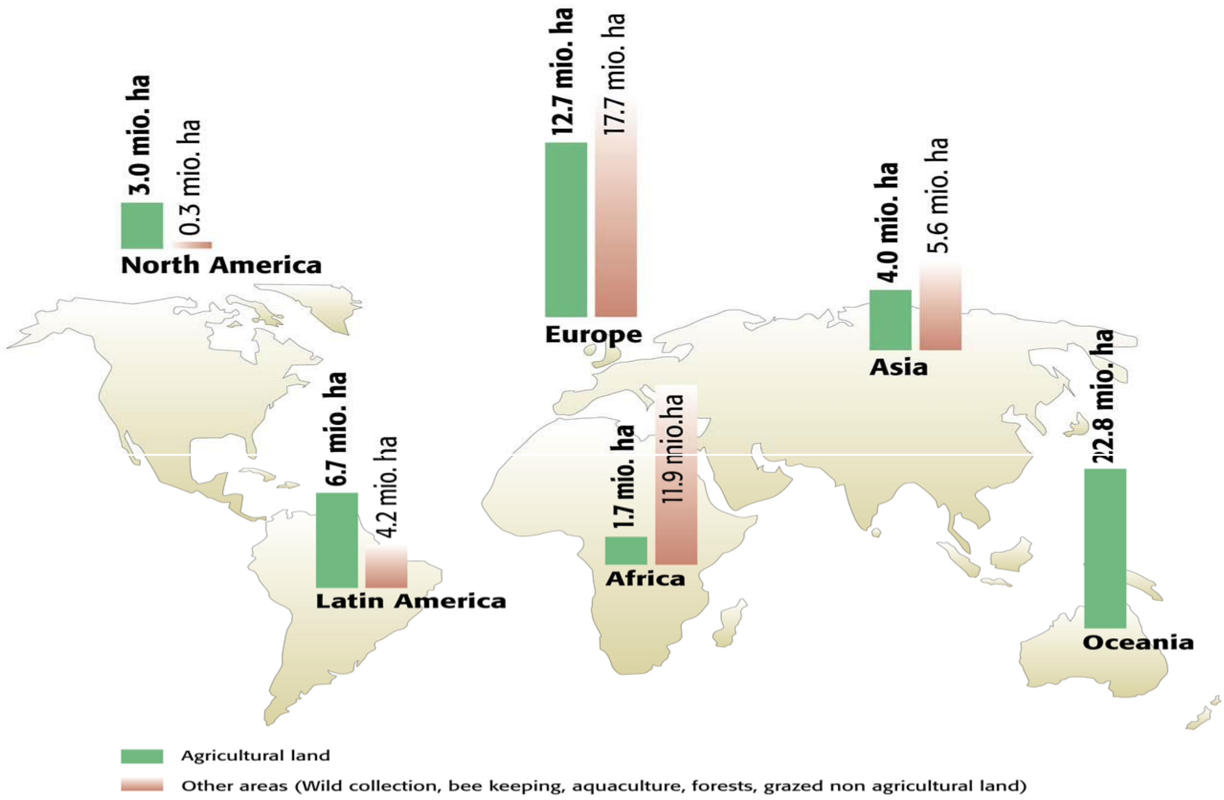
The modernization and industrialization of agriculture after World War II in order to meet the needs of the growing population and improve the living standards, led to intensive degradation, soil pollution and disruption of natural ecosystems. This condition stimulated interest in the development of a new concept: sustainable development. (Report of the World Commission on Environment and Development: Our Common Future, UN, 1987). The sustainable development provides an environmental protection and aims towards greater social justice. One important approach to sustainable development, which at the same time gives a good quality and safe product and has seen intense growth in the country, is organic farming.

Numerous studies suggest that organic produced food has better quality, contains more nutrients than food produced by conventional means (National Strategy and Action Plan for Organic Farming 2007-2013, MAFWE, 2007). We could say that organic farming offers a safe and healthy diet, on the one hand, and on the other hand, because it features traditional way of cultivation, builds and preserves local knowledge and tradition. The principles of organic production are utilizing local resources (seeds, seedlings, fertilizers, etc.) and it enables greater cost-effectiveness on one side and contributing to a more rational use of existing resources on the other.

The organic farms need more workforces, about 20% higher than conventional. Mechanical regulation of weeds and keeping animals outdoors requires more labor. In addition, many facilities for organic production take processed where is produced, grown and sold and it creates a huge workload. Therefore, it can be said that organic production is characterized by low costs and high efficiency investment in improving competitiveness.

Organic production has increased interest and an upward trend in terms of consumption and production worldwide. The total agricultural area in the world that is under organic method of production in 2015 amounted to 43.1 million hectares or 0.9% of global agricultural land of which Australia and Oceania accounted for 40%, Europe 27%, Latin America 15% Asia 8% North America 7% and 3% Africa. Countries with the highest agricultural land under organic production are Australia, Argentina and the USA (Image 1)

Image 1 Total organic agricultural area in 2015



Source: The World of organic agriculture, statistics and emerging trends 2017, http://www.organic-world.net/2419.html?&L=0, 18.4.2016

In the countries of European Union (EU) there's a great interest and public support for organic farming. This stems from the fact that in 1991 the European Union adopted Council Regulation br.2092 / 91 (EEC No.2092 / 91), which in detail defines the requirements to be met for certain agricultural products or food can be labeled as organic. Since 1999 the Council has included organic farming in its strategy on environmental integration and sustainable development, and as part of the common agricultural policy, the organic agriculture is tied to structural policies of the European Union. The application of structural policy which has been introduced in all EU Member States, indicate that it is a specific and very important trend that will determine the direction of this policy in the coming years. Thus, in June 2001 is adopted a declaration which states that (European Action Plan for Organic Food and Farming, Commission Staff Working Document, 2004):

- Organic agriculture is a very important tool for food production, rural development and environmental protection and animal welfare.
- Organic farming represents a major opportunity for the organic food because of the growing interest among consumers.
- Europe needs a further development of organic farming.

The aim of the reforms of the Common Agricultural Policy in 2003 is to support agriculture by three basic principles:

1. Economic sustainability through increased competitiveness, stronger market-orientation and more efficient income support (focused on the consumer).
2. Social sustainability through greater responsiveness to consumer demands, encouraging better quality and food safety and improved balance of funding for rural development.
3. Environmental sustainability through a clear framework for effective implementation and development of standards for environmental protection and animal welfare.

The methods of organic production that are used in many countries have shown excellent results in terms of biodiversity conservation, purification of soil and water from pesticides and artificial additives. Organic production is organized to protect all existing resources in the environment so is not harmful to the environment, technically appropriate, socially acceptable and economically viable.

2. ANALYSIS OF THE CURRENT CONDITION OF ORGANIC AGRICULTURE IN THE REPUBLIC OF MACEDONIA

Republic of Macedonia is situated in the southern temperate zone bordering the subtropical climate zone; soil structure is extremely varied (with over 30 types of soil) due to natural conditions, geological formations, topography, flora, the influence of the

Mediterranean, the mountain and continental climates, all indicate that almost all crops can be successfully produced in accordance with their requirements. Biological diversity in agriculture is especially important for the persistence of people, primarily because of gratification of basic needs for food. With the civilization's development a new type with better quality has been created. But in time, many of the types and breeds were destroyed as a genetic resource. Types, sorts and races who are domestic for Republic of Macedonia should be saved above all for economic, scientific, cultural, socioeconomic and ecological reason. Republic of Macedonia is characteristic for traditional agriculture especially in mountain areas. Organic agriculture is close to traditional agriculture, so it has a potential for development.

Organic production is recognized as one of the ways that lead to sustainable development, meeting social expectations when it comes to environmental and sustainable management of natural conditions and development of rural areas.

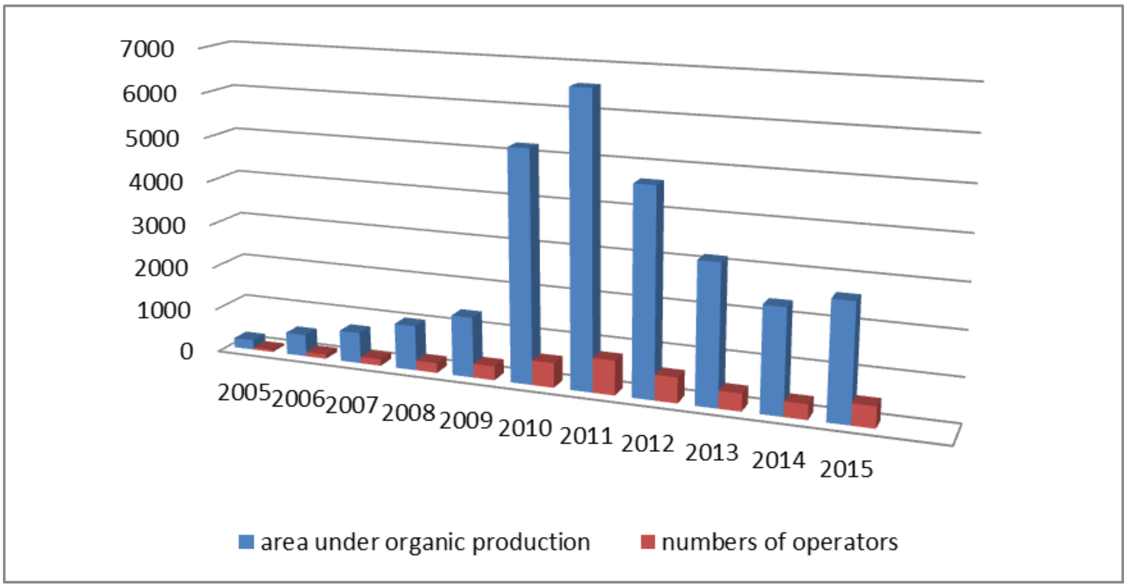
The first farmers who began the organic production according to the principles of the previously known buyers in the country were in 1998 in Ohrid, Strumica and Kumanovo. After that, an expertise was made to create a draft legal basis for organic production as part of the support of environmental NGO's that launched the project "Local initiatives to organic farming." Following the development of the EU Regulation, Ministry of Agriculture, Forestry and Water Management, in 2008 began drafting a new law on organic agricultural production, fully harmonized with the EU Regulation 834/2007. (National Strategy and Action Plan for Organic Farming 2007-2013, MAFWE, 2007). Law on Organic Agriculture came into force in 2010 and since, it regulates the production, preparation, processing, finishing, storage, transportation, distribution, marketing, sale, labeling and control of organic products that are used in the methods of organic production.

Organic production in the Republic of Macedonia is recognized because of traditional mode of production in some regions where they are produced. Macedonian consumers often say they are "ecological, quality and ours". The organic sector in the country is by no means a homogeneous economic area. As part of agriculture is characterized by a heterogeneous structure in which besides agriculture, there are included environmental, social, health and economic structures. The organic sector in the Republic of Macedonia is composed by producers, cooperatives, associations, counseling stakeholders, control and certification bodies and government institutions involved in the implementation of organic farming policy.

2.1 Characteristic and organization of organic agriculture in Republic of Macedonia

The Macedonian organic production comprises 2.74%s of the total cultivated land in the country. (National Strategy and Action Plan for Organic Farming 2007-2013, MAFWE, 2007). The graph 1 shows the interest for the conversion of organic production and the area under organic production. The area under organic production has intensive growth in 2010 and 2011 which is in the period of establishing of Law of organic production. In the last three years (2013-2015) the area decreases and the reason for that can be found in the inadequate internal organization of producers of organic products and insufficient quantity ranking (National Strategy and Action Plan for Organic Farming 2007-2013, MAFWE, 2007). That forces the producers to sell their products as conventional, for lower price in terms when it would have sold as organic products which leads to reduced interest in this way of production. Also, during last years, climate change has a significant impact on the overall agricultural production.

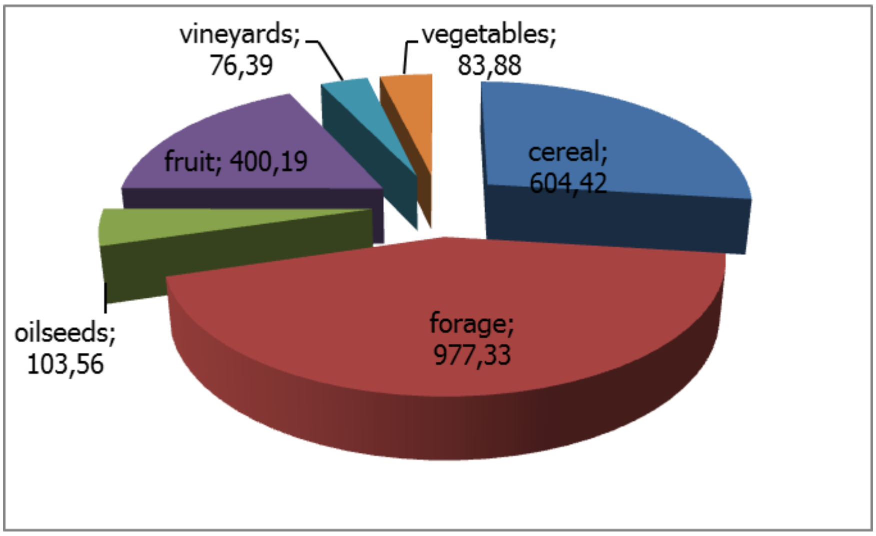
Graph 1 Area under organic production and the number of operators during the period 2005-2015



Source: Ministry of Agriculture, Forestry and Water Management of Republic of Macedonia, http://www.mzsv.gov.mk/organsko_zemjodelsko_proizvodstvo2013.pdf, 19.03.2016

Latest officially available data, shows that the leading crop in organic vegetable production in the Republic of Macedonia are the forage crop with 745,68ha organic certificated area and 231,65ha area in conversion, second are cereal with 417,13ha organic certificated area and 189,29ha area in conversion and fruit with 400,19ha are third (Graph 2). Most of the success has been achieved through the vision and enterprise of individuals and local farming groups operating with great support of the Government, both in terms of subsidies and legal framework.

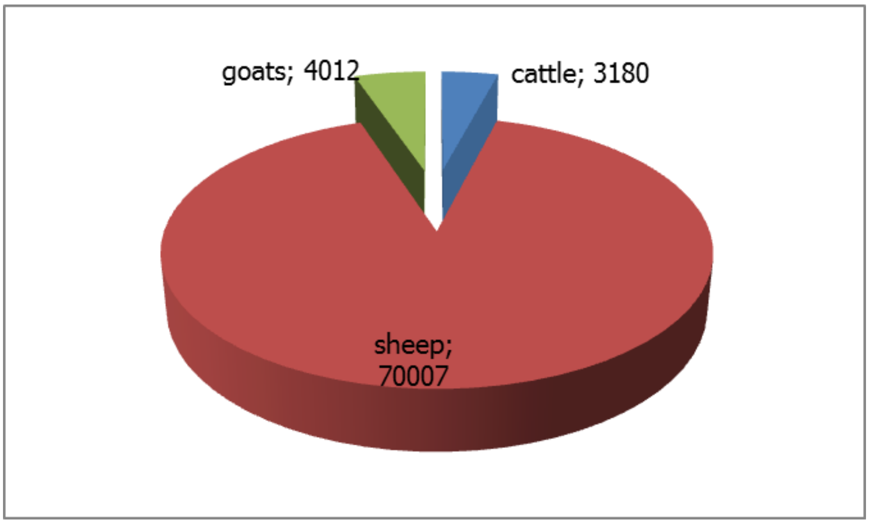
Graph 2: Capacities of organic vegetable production in 2015



Source: Ministry of Agriculture, Forestry and Water Management of Republic of Macedonia, http://www.mzsv.gov.mk/files/Organsko%20proizvodstvo_sostojba%202015.pdf, 19.04.2016

In animal breeding organic production predominantly are sheep – 35764 organic certificated and 34243 in conversion (Graph 3).

Graph 3 Capacities of organic livestock production in 2015



Source: Ministry of Agriculture, Forestry and Water Management of Republic of Macedonia, http://www.mzsv.gov.mk/files/Organsko%20proizvodstvo_sostojba%202015.pdf, 19.04.2016

The certification is an important key element of organic production which assumes defining the principles that must be met in order to be declared as "organic." The process involves engaging a certification body that will make an inspection and issue a certificate. Under the organic farming control and the certification of an organic production, there is an authorized domestic or foreign legal entity - control / certification body. In Republic of Macedonia there are two certification bodies accredited by the Accreditation Institute and authorized by the Ministry of Agriculture, Forestry and Water Management: Balkans Biocert and Pro-CERT. These certification bodies provide expert control in organic production in accordance with standard EN 45011 and ISO / IEC Guide 65.

The main holder in organic sector in Republic of Macedonia are the individual producers of organic production usually in form of family farm i.e. farm in which family members are the main labor force. Family farms are mainly manufacturers of primary production and the main objective is the production destined for the market, and a small part of their own household. The size of family farms is different, but it is small integrated farms or farms which also has vegetable and organic livestock production because organic farming is characterized by a circular system of cultivation.

The associations are often common form of jointly organizing the organic sector in the country. The main purpose of joining individual producers of organic products is a joint purchase of raw materials in order to be cheaper and timely, obtaining loans, purchase of equipment and other fixed assets, planning distribution channels and their common use in order to make production more competitive, exercising the rights to influence relevant government institutions when making important legal and sub-legal acts in the interest of both producers and end what matters most, successful research and approach to the market and identification of new markets and new market segments.

The highest form of association in the country's Federation of Organic Producers (FPOP) aimed at ensuring the coordination and leadership of the organic movement in the country. FPOP aims to protect economic, social and cultural interests of manufacturers of organic products and working to improve the conditions of market production.

In the implementation of organic agricultural policy, directly or indirectly participate in the following national institutions (National Strategy and Action Plan for Organic Farming 2007-2013, MAFWE, 2007):

• Ministry of Agriculture, Forestry and Water Management (MAFWE)
• Ministry of Environment and Physical Planning
• Ministry of Economy
• Ministry of Finance
• Institute for Accreditation of Macedonia (IARM)
• Standardization Institute of the Republic of Macedonia (ISRM).
• National Institute of Industrial Property (SIPO)
• Higher education and scientific research institutions
• Agency for Promotion of Agricultural Development (NEA)
• Agency for Financial Supports Agriculture and Rural Development (AFSARD)

State institutions aim to learn about the potential benefits, opportunities and problems faced by all stakeholders involved in organic farming so to be able to contribute to improving policies for organic farming in the country.

2.2 The role of producers of organic products in Macedonian agriculture

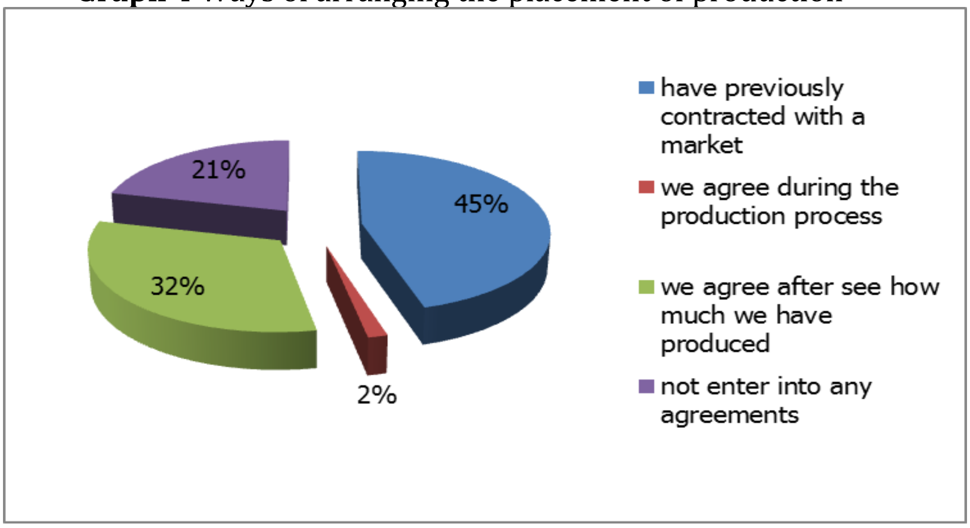
In the Republic of Macedonia organic agriculture is regarded as important to the development of the national agriculture and food production, which at the same time is environmentally sustainable and can generate many positive impacts to rural areas and the society in general. It enables the producers to perform on the same market with quality products which in turn is related to the possibility of achieving higher profits compared to when it could produce products in a conventional way, and large subsidies granted by the state. They, unlike other types of associations of agricultural producers, are united by a very important denominator that is certifying the method and procedure of producing organic products so the quality of the product is indisputable. However, researches show that producers consistently comply with the rules and procedures for organic production, but that also face serious problems in the performance and continue to present on the market (Hadzi Naumova-Mihajlovska K., 2014).

Namely, the producers are facing problems such as insufficient quantity for sale. Despite the establishment of association for common market there is a fragmentation among them i.e. the existence of several associations of producers of organic products for the same products in the same region. In addition, studies show that knowledge and consumption of organic food in the domestic market is at a very low level (Sekovska B., 2009, Hadzi Naumova-Mihajlovska K., 2014).

Within this research, it was also explored the possibility of applying Total Quality Management as way of work and organization in the organization and operation of associations of producers of organic products. The respondents were asked questions about the general situation of organic production in the Republic of Macedonia. Respondents' associations were established in the period between 2002-2003, which indicates that a great influence in the formation there had the holding of workshops and seminars at the time about the role and importance of organic farming as a production that will not be harmful to human health and the environment and able to create a business that has prospects and will be sustainable for the environment. The number of members who are associated ranges from 10-35.

On the question, "How you arrange the placement of production?" Thirty (30) respondents answered that they had concluded the agreements in advance, twenty (20) had arranged after the end of the manufacturing process, fourteen (14) producers said they would not sign any contracts and one (1) to be arranged during the production process (graph 4). This shows that the number of manufacturers who hadn't concluded their agreements in advance is higher i.e. the contracts are made during production or after the end of the production process.

Graph 4 Ways of arranging the placement of production

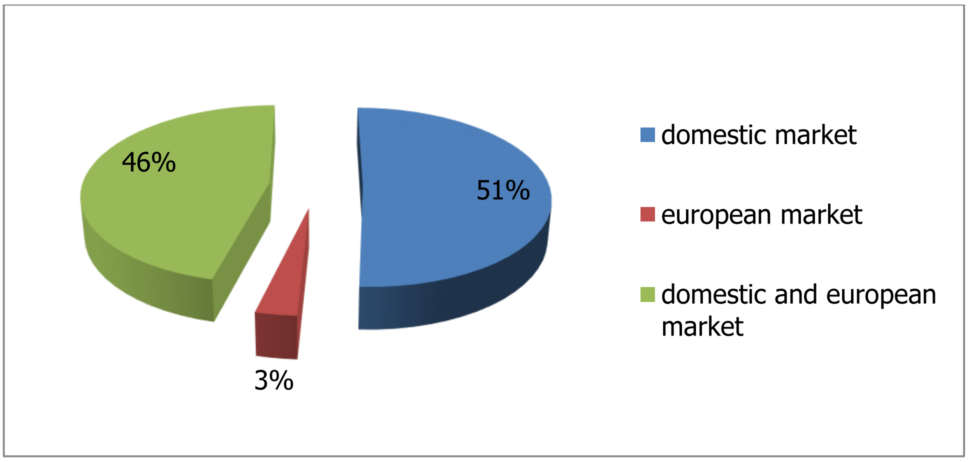


Source: Own research

On the question "On which market do you place your product?" thirty-three

(33) respondents said they place on the domestic market, thirty (30) on the European market if they have the opportunity and meet market conditions, otherwise they place on the domestic market and two (2) only in the European market (Graph 5). This shows that the placement is more focused on the domestic market with very little foreign markets.

Graph 5 Markets on which the production is placed



Source: Own research

The answers of the posed questions confirmed the problems that producers of organic production are faced with. The main problem is the orientation of the producers on the domestic market even though studies show that consumption of organic food in the domestic market is at a very low level (Sekovska. B., 2009). Development of organic agriculture is limited by uncertain sale of the production, export disorganized followed by inadequate organization of producers of organic products or associations. Also, there are significant weaknesses that are observed largely and remain an obstacle for more intensive development of organic production. This is related to the low supply of raw materials for vegetable production from the domestic market, including seeds and planting material and protection products which are permitted for use in organic crop production. Lack of adequate feed and veterinary medicine for organic livestock production is a weakness for the further development of Certified Organic meat and milk and their products. Additionally, the discontinuous and insufficient promotion of the benefits of organic agriculture for environment and human health, contributes to low consumer awareness of these products (IPA Rural Development Program "2014-2020", 2015).

Therefore, it's necessary to reorganize and redefine the activities associated with the maximum use of available resources (natural, human, organizational and technological) and thus to innovate the manufacturing process and meet the demands of market - food with high quality and low price.

3. POSSIBILITIES AND PERSPECTIVES FOR FURTHER DEVELOPMENT OF ORGANIC AGRICULTURE IN REPUBLIC OF MACEDONIA

Republic of Macedonia is predominantly mountainous country with heterogeneous natural conditions and land structure. The agriculture has been very significant for the national economy of the Republic of Macedonia. Besides the many policies and economic problems, that were previously stated, this sector has indicated an important flexibility, and for this period it has contributed significantly to the social and economic stability. The agriculture contributes with 10% of GDP of the country, and includes 19% of employed population and contributes a 9% of the total foreign currency income from exports of goods (State Statistical Office, http://www.stat.gov.mk/Publikacii/PDFSG2016/10-Zemjodelstvo-Agriculture.pdf, 20.2.2017). Main characteristic of Macedonian agriculture is traditional extensive agriculture, which is main precondition for development of organic production.

Organic agriculture production in the Republic of Macedonia is one of the high interest agricultural sectors because its concept that united traditional, health care, protection and promotion of the environment and economic viable of production. Although, the farmers are faced with problems in organizing the business process in the organic sector as uncertain sale of the production, export disorganized followed by inadequate organization of producers of organic products or associations.

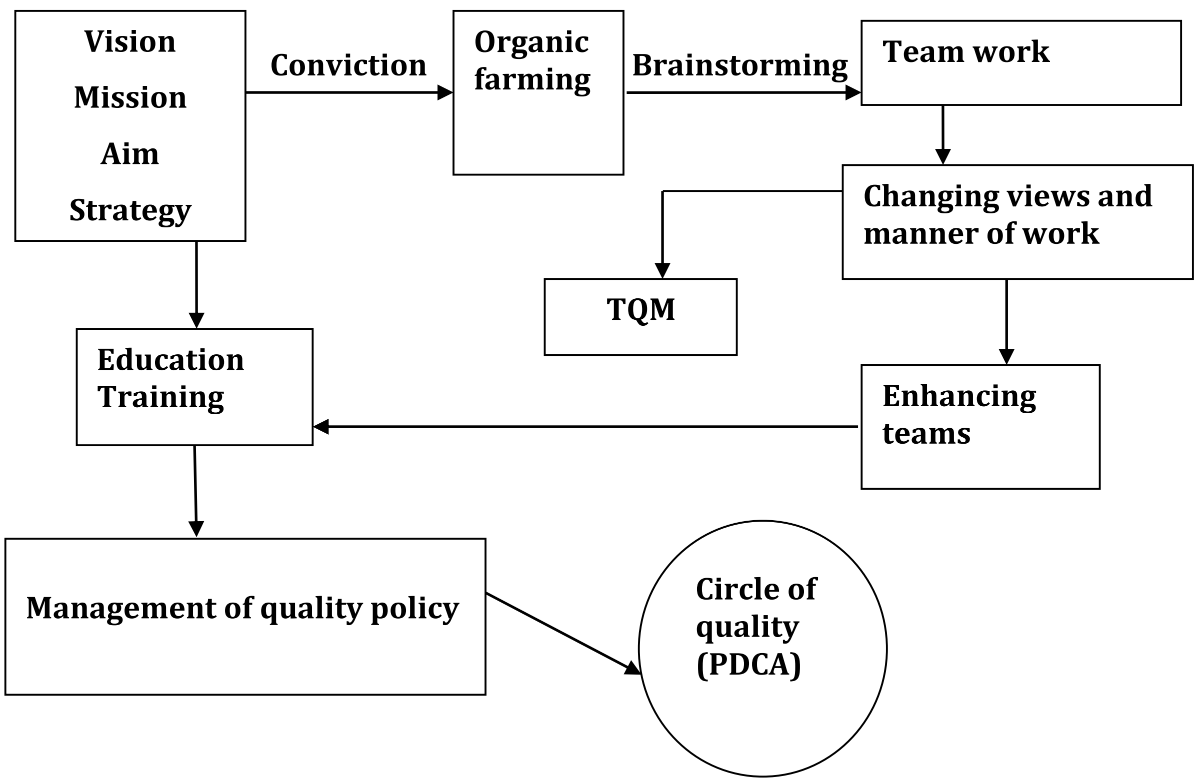
The main output of organic production is product with indisputable quality, but it needs the quality to come from within the production process and to spread among all actors in organic agriculture in their co-operation and communication, knowledge and education and thus to receive positive results in terms of operations, and thus achieving success in the business of all. Therefore, the first task is creating a policy or strategy for quality of work and organization. Key activities in this phase are (Image 2):

- Defining the vision, mission, purpose and strategy in terms of quality.
- Compliance with the requirements of customers.
- Plan for the implementation of the strategy.

At the first stage should be encouraged to expression of ideas and proposals, and to respect the opinion of all, i.e. to apply the technique of brainstorming because as a result is growing atmosphere of teamwork and the built spirit of teamwork and transmit the usual activities in operation. In the first instance need to be made long-term objectives to reflect the ecological, social and economic character of organic production. These objectives should be the starting point for all actors in organic production and should relate to the protection of the region, the preservation of family farms and ultimately maximizing profit.

This will change the current way of working and will strengthen teams and on the simplest way of assigning tasks and activities within a certain time period and determined order to allow work to be completed successfully and on time. This application shows the elements of TQM i.e. planning and quality assurance of product and process, quality information with feedback and training and motivation of staff. Also, the plan for the implementation of the strategy for achieving goals all tasks and activities should be clearly defined by the initial basis - Deming round quality (Plan, do, act, check) and thus accurately be determined who, why, what, where, when, who fits in the implementation of the plan.

Image 2 Activities for creating a policy or strategy for quality of work and organization in organic sector



Source: adjusted by Implement – from Quality to Organizational Excellence,
www.dti.gov.uk/quality/implementation,(15.03.2013)

The application of this order in the planning and implementation of the strategy for implementing the objectives consists of clear demarcation and establishment of long-term and short-term goals, determine the actions to implement the objectives that determination and application of specific techniques and methods, creating teams, comparing the effects with goals. For overall improvement it's necessary that the participants believe that the value of society is the application of organic farming and the same idea or vision to apply in daily operations and work.

CONCLUSION

Organic agriculture is important segment in Macedonian agriculture with excellent conditions for overall development in the country. Great advantage is the existence of indigenous species of crops traditionally grown and best adapted to areas where grown. Main holder in organic sector in Republic of Macedonia are the individual agricultural producers supported by a heterogeneous structure in which besides agriculture, are included environmental, social, health and economic structures as cooperatives, associations, counseling stakeholders, control and certification bodies and government institutions involved in the implementation of organic farming policy.

Although organic agricultural production in Republic of Macedonia is one of the fastest growing agribusiness sectors, there is a lack of organization, cooperation and communication between all participants. The research showed that problems they are facing are orientation of the producers on the domestic market, insufficient quantity for sale and poor market organization.

Therefore, because organic production is a synonym for quality in all aspects of life, it is necessary to create a policy or strategy for quality of work and organization of organic sector in Republic of Macedonia. It should incorporate objectives that reflect ecological, social and economic character of organic production and change the current way of working, strengthening teams and on the simplest way of assigning tasks and activities within a certain time period and determined order to allow work to be completed successfully and on time. It is a gradual, systematic and continuous process that should be clearly understood and create a strategic framework that will connect organic production and operation and organization of all stakeholders.

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