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4. Figures and Tables should be titled and marked successively with Arabic numbers. The data source should be provided below the, while additional comments-explanations should be written in a new line under the data source.

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ALTERNATIVE BANKING MODELS FOR ANALYSIS OF RISK GENERATED BY CONSTRUCTION COMPANIES IN REPUBLIC OF MACEDONIA

Klimentina Poposka, PhD[1]

Marko Trpkoski, PhD[2]

Abstract:

Diverting the focus of banks' lending activities from corporate to retail customers is an expected result of the global financial crisis. The Macedonian banks are not an exception. The recent crisis has inevitably reflected on the business performance of the real sector in Republic of Macedonia and the economic condition in the domestic economy. As a result, banks started to direct their credit activities in the field of retail customers, specifically in housing (mortgage) loans. However, this trend cannot be infinite.

In recent years, the construction industry has recorded an enormous expansion shown through construction of many residential units, thereby presenting a real potential danger if they remain unsold or unpaid to creditors. The possible crisis in the construction industry, except for companies in this field, would undoubtedly

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cause negative consequences on the stability of the financial sector; banks' retail clients, and negative effects on the whole domestic economy.

Overcoming the current situation is impossible to be achieved only with measures and activities by one participant, but through cooperation and coordinated action between all relevant stakeholders' e.g. the regulatory authorities, banks and companies in the construction sector. In this research, we recognize the need of reducing the legal reserve rates on the deposits targeted on housing loans, decreasing the banks interest rates and use of adequate real estate assessment method according to the specific conditions specific for the Macedonian market, utility charges reduction by relevant government bodies and correction of the real estate prices by construction companies.

We believe that through above-mentioned measures and activities, the necessary economies of scale could be achieved, leading to lower costs for all stakeholders and enhanced credit risk management, while offering competitive housing loans for the retail customers.

Key words: *construction companies, housing (mortgage) loans, non-performing loans, significant variables, retail customers.*

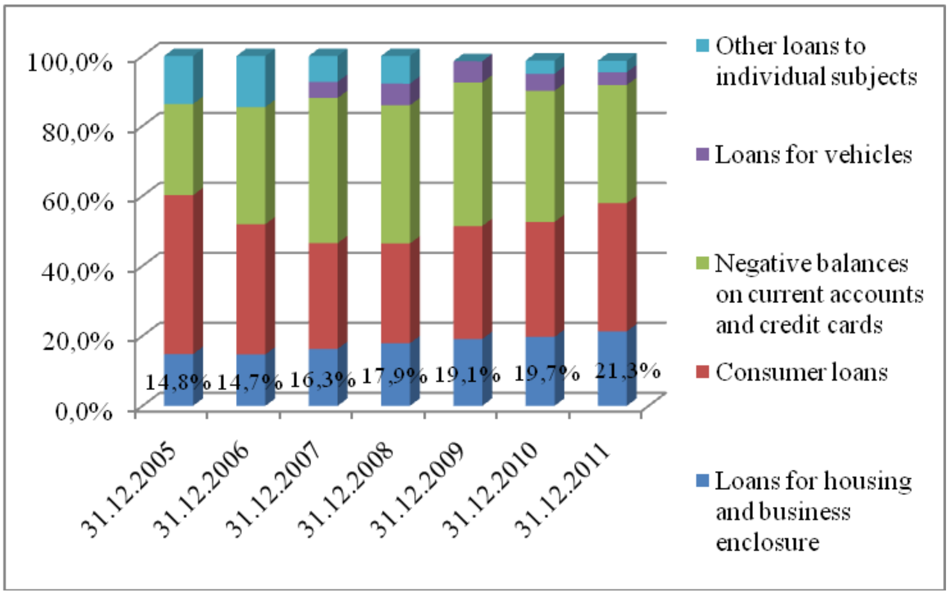
JEL classification: *G21*

1. Household lending as an alternative during financial crisis

The share of housing and business loans showed a tendency of growth in total amount of loans to households made by banks. The above mentioned is confirmed with the analysis in Graph 1.

Graph 1

Share of housing loans in the total exposure to the household sector



Source: Individual calculations based on data obtained from the National bank of Republic of

Macedonia, www.nbrm.mk.[3]

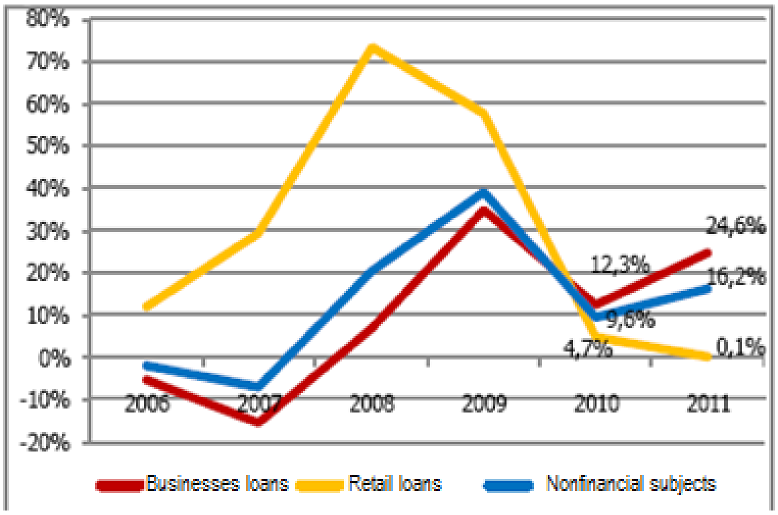
Analyzing Graph 1, it can be concluded that, from banks' perspective, housing lending activities are definitely considered as an alternative for expansion in the past few years. Their share was 14,8% in2005, while at the end of 2011 about 22% in total exposure to the households sector.

In periods of financial crisis, banks focus on dispersion of credit risk from smaller to larger number of customers. Rationalization of this approach can be verified with Graph 2, which is a review of the rates of non-performing loans and their multi-year trend for the loans issued to companies and households.

[3] The calculation of NBRM is based upon data obtained by the commercial banks in the national economy.

Graph 2

Annual grown rates of non-performing loans



Source: National bank of Republic of Macedonia, www.nbrm.mk.[4]

Graph 2 clearly shows that non-financial companies are key factor for the increase of bank non-performing loans. On the other hand, the rates of change in the retail non-performing loans are minor (0, 1%). Here, once again, we can confirm the need of credit portfolio diversification from corporate to retail loans.[5]

Housing loans as of 31.12.2011 accounted circa 22% of the total number of retail loans in the Republic of Macedonia.[6]Except in the area of retail loans, housing loans join the basis for construction industry activities in the country. This group of loans is the least risky one and their expansion directly stimulates the growth of the construction industry.

[4] The calculation of NBRM is based upon data obtained by the commercial banks in the national economy.
[5] Poposka Klimentina, Trpkoski Marko, Alternative models for a retail banking products development – The case of banking sector in Republic of Macedonia, Journal of Sustainable Development, FBE, Skopje, 2013.
[6] Individual calculations based upon annexes from the "Annual report for banking system in Republic of Macedonia for 2011". More detailed data may be obtained from: http://www.nbrm.mk/?ItemID=9791972CF72F8845B7DE65F739FC430A _13.02.2013.

When discussing about the area of housing retail loans, it should be mentioned that banks usually act as a creditor of the construction company and the larger number of users of loans for personal residential units for a specific object of that company. The connection between them is especially important and therefore, during the research in this paper we bring considerable attention to these business entities with particular emphasis on the specific risks for the banks that may arise from their cooperation. In most cases, this cooperation is regulated with a special arrangement between banks and construction companies, in which they determine the benefits for potential customers of residential units e.g. housing loans. However, if credited construction facility remains unfinished for some reason, banks are facing potential non-performing loan issues from their corporate as well as from their retail clients. Even if the credited facility is properly finished, the risk of individual retail clients' inability to service the housing loans remains.

In addition, some of the main risks for the banks would be identified in this research paper. The discussion would be focused on construction facilities as well as the risks of lending to individual housing loan customers.

2. Identification of the main risks generated by the construction companies and housing loans for the Macedonian banking sector

The banks' risk in the construction industry has been separated into two groups: risk generated from construction companies and risk of personal housing loan users. Identified risks from construction companies, generally lead to conclusion that there is a need for establishing proper banking procedures, while risks from retail customers are mainly related to proper management of their personal creditworthiness. For both categories of customers, dealing with the potential risks could be more successful if banks applied proper method of property assessments, taking into consideration and tailored to IVS standards. [7]

[7] More detailed information about IVS standards may be obtained from the web site of theInternational Valuation Standards Council (IVSC):www.ivsc.org.

Several key risks, related to loans to construction companies for facilities under construction, for which proper actions need to be predicted in the banking procedures, are identified:

1. Altering the projected value of the project by the construction company – The construction company (investor), immediately upon the receipt of the first tranche of the loan, rapidly changes the initial financial project and program. The changes could refer to the first concept of real estate project or documentation with legal or illegal activities, without prior permission/approval from the bank creditor. In this way, the projected value credited by the bank is threatened and in the same time the risk of the project is higher. Here, we could mention the risk of withdrawal of significant funds at the beginning of the project for preparatory activities that cannot be controlled without daily continuous presence of experienced engineers in the field of facilities construction;
2. Requests for additional funds for secondary activities (horticulture, fence, illumination, etc.) that do not significantly affect the final market value of the project;
3. Enormously high costs of some (aspects / elements) of the project – banks have limited opportunities to respond to contracts between construction companies and their subcontractors;
4. Concealed costs of the future investment by the construction company before the final conclusion of the credit agreement with the bank.

Some of the potential risks for banks could be reduced before credit arrangement with proper assessment of:

1. Complete technical documentation (all phases of the project), ownership over the construction site, properly regulated payment obligations for the project, final approval for the construction, adequate building site, developed and fully dynamic implementation plan and a statement that the project will be conducted in compliance with the enclosed documentation and that the bank would be informed for any serious obstacles in operations;

2. Eventual disruption of activities during the phases of project presents a high credit risk for the banks. Therefore, other/additional security (or collateral) provided by the construction companies is more than necessary;
3. By contract or otherwise, the construction company needs to prove that funds obtained from the bank would be used for their specific/intended purpose. The bank should not have obligation to credit additional aspects that arise beyond the projected financial plan;
4. If the construction company acts outside the project's framework (changes in the content, dimensions, displacement of the object and alike), the bank should have the right to terminate the credit agreement and the right to reimburse the given loan/capital with proper interest.
5. Banks should set up a mechanism to protect from construction companies that initially request smaller amount of credit, and once the requested amount is obtained they make further demands for new funds. These types of clients are unpredictable and banks cannot properly monitor their loan portfolios.

The second group of risks is connected to users of housing loans. These types of loans are usually issued with proper mortgage which mainly consists of real estate collateral which is subject to the contract between the client and the bank. However, assuming that banks will receive adequate collateral for all its loans regarding the value, other risks remain present. Some of them could be identified through the following questions:

1. What if the Macedonian market has reached its limit and a surplus of housing units is not likely to be absorbed?
2. What if the number of housing units, from statistical point of view, is adequate to the needs of the population, but the low purchasing power of the population doesn't generate enough creditworthiness capacity for repayment of housing loans obligations?

At the same time, the potential owners' fear from issues with the previous owners,[8] which is a specific characteristic of the Macedonian real estate market, presents a real set back in the sale of foreclosed real estate, especially individual apartments, even if their prices are lower than regular market prices. Foreclosed properties generate additional costs for banks if they are not converted into liquid assets. Some of the challenges in this area could be overcome withproper adjunctions into the methodology of property assessment in the Macedonian market.

Currently, the estimations of the real estate value in Republic of Macedonia are conducted through the application of the cost –assessment method. This method is primarily based on the costs of the materials - used for construction of the facility.[9]This method doesn't take into consideration the liquidity of the objects and the potential revenues that could be generated with their usage. These issues could be overcome with a combination of this method with comparative or revenue based methods, depending on the specific characteristics of the particular estate.

The management concepts of the identified risks need further continuous improvement. One of the possible approaches in this area could be reached through identification of the key variables that affect the housing loans, as well as key variables that have influence on non-performing loans in the retail segment through development of suitable econometric models. Some of the models of this type are discussed hereinafter.

3. **Developing alternative models for housing and non-performing retail loans management**

In order to analyze housing and non-performing retail loans we offer two models.

The following external and internal independent variables should have significant statistical impact on the amount of housing retail loans (H.R.L.):

[8] http://faktor.mk/archives/6604_08.02.2013.

[9] More detailed information about the legal framework in this field in Republic of Macedonia may be obtained from "Official Gazette of RM", no.54, of 27.04.2012, web page: www.mtc.gov.mk.

1. External independent variables – net wages paid by sectors' employment

    a. Net wages in industry sector – in the case of the banking sector in Republic of Macedonia, this variable is constituted by net amount of income (disposable income) of persons engaged in this sector;

    b. Net wages in service sector – this variable includes the amounts of net income (disposable income) of persons engaged in service sector;

    c. Net wages in agricultural sector – this variable includes the amounts of net income (disposable income) of persons engaged in agriculture sector.

It is uncertain how these variables (net wages in industry, services and agriculture) would influence the amount of housing retail loans. The need for financing through bank housing loans could be replaced with the increase of disposable income on one side, but on the other hand, the growth of net wages is possible to generate a need of more funding for increased spending activities.

2. As internal independent variables the following could be listed:
    a. Accrued interest on domestic value (MKD) retail loans (H.R.L.)
    b. Accrued interest rates on foreign currency retail loans (H.R.L.).

It's expected that an increase in the calculated interest rates would lead to an increase in the amount of housing loans, while decreasedamounts would lead to reduction in the demand for retail loans.

In the second model, the following independent variables would be tested on the total amount ofnon-performing retail loans (N.P.R.L.)- in domestic value (MKD) and foreign currency:

1. External independent variables:

    a. Legal reserves on deposits in domestic currency (MKD);
    b. Legal reserve on deposits in foreign currency.

It's expected that an increase in the calculated legal reserve would lead to an increase in the amount of non-performing loans, while a decline in the amounts would lead to reduction in non-performing loans.

2. Internal independent variables:

    a. Interest rates on domestic value (MKD) retail loans;
    b. Interest rates on foreign currency retail loans;

It's expected that an increase in interest rates on retail loans would lead to an increase in non-performing loans, while reducedrates would lead to somereduction of non-performing loans.

    c. Interest rates on domestic value (MKD) retail deposits;
    d. Interest rates on foreign value retail deposits;

It's expected that an increase in interest rates on retail deposits would lead to an increase in non-performing loans, while decreased rates would lead to some reduction of non-performing loans.

    e. Accrued interest rates on domestic value (MKD) retail loans;
    f. Accrued interest rates on foreign currency retail loans.

It's expected that an increase in the calculated interest rates would lead to an increase of non-performing loans, while reduced rates would lead to reduction in the amount of non-performing loans.

To recognize the influence of the above mentioned factors on the H.R.L. and N.P.R.L. it is necessary to develop suitable econometric models. The first model refers to the testing of above variables on the dependent variable represented by housing retail loans (H.R.L.), while in the second model the variables have been tested on non-performing retail loans (N.P.R.L.). Both models would be tested by applying the least square method.

Subject of the observation are data for the banking sector in Republic of Macedonia for the period 01.01.2010 – 30.09.2012. The data are obtained from the web site of the National bank of Republic of Macedonia (www.nbrm.mk).

The first model, where the dependent variable is H.R.L. could be presented with the following formula:

$$y = b_0 + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + b_5x_5 + u$$

$b_0 - b_5$ - denote the coefficients of the variables used in the regression model

$x_1 =$ NET WAGES IN INDUSTRY– the disposable income of persons engaged in industry sector

$x_2 =$ NET WAGES IN SERVICES – the disposable income of persons engaged in services sector

$x_3 =$ NET WAGES IN AGRICULTURE - the disposable income of persons engaged in agriculture sector

$x_4 =$ ACCRUED INTEREST ON R.L. IN MKD – Accrued interest on all types ofretail loans in domestic currency

$x_5 =$ ACCURED INTEREST ON R.L. IN F.C. - Accrued interest on all types ofretail loans in foreign currency

$u =$ CTOHASTIC ERROR – random error.

The non-performing retail loans (N.P.R.L.) present the dependent variable in the second model. This model could be presented with the following mathematical formula:

$$y = b_0 + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + b_5x_5 + b_6x_6 + b_7x_7 + b_8x_8 + u$$

$b_0 - b_8$- denote the coefficients of the variables used in the regression model

x_1 =INTEREST RATES ON DOMESTIC VALUE RETAIL DEPOSITS (D.V.R.D.)–interest rates on retail deposits in domestic currency (MKD);

x_2 =INTEREST RATES ON DOMESTIC VALUE RETAIL LOANS (D.V.R.L.) – interest rates on retail loans in domestic currency (MKD);

x_3 =INTEREST RATES ON FOREIGN CURRENCY RETAIL DEPOSITS (F.C.R.D.)– interest rates on retail deposits in foreign currency;

x_4 =INTEREST RATES ON FOREIGN CURRENCY RETAIL LOANS (F.C.R.L.) - interest rates on retail loans in foreign currency;

x_5 =ACCRUED INTEREST ONRETAIL LOANS (R.L.)– Accrued interest on retail loans in domestic currency (MKD);

x_6 =ACCRUED INTEREST ON RETAIL LOANS (R.L.) IN F.C. –Accrued interest on retail loans in foreign currency;

x_7 =LEGAL RESERVE IN FOREIGH CURRENCY (F.C.)-– the legal reserves on deposits in foreign currency;

x_8 =LEGAL RESERVE IN DOMESTIC CURRENCY (D.C.) -the legal reserves on deposits in domestic currency

u =CTOHASTIC ERROR – random error.

The results of the tests of alternative models for housing and non-performing retail loans management are presented in Table 1 and Table 2.

Table 1

Results of regression analysis of the independent variables' impact on housing (mortgage) retail loans for the period 01.01.2010– 30.09.2012

Dependent Variable: HOUSING (MORTGAGE) RETAIL LOANS

Method: Least Squares

Date: 02/06/13 Time: 23:21

Sample: 2010M01 2012M09

Included observations: 33

Variable	Coefficient	Std. Error	t-Statistic	Prob.
NET WAGES IN INDUSTRY	0.561398	0.165820	3.385577	0.0022
NET WAGES IN SERVICES	0.277652	0.134505	2.064249	0.0487
NET WAGES IN AGRICULTURE	0.118358	0.182437	0.648759	0.5220
ACCRUED INTEREST ON R.L. IN MKD	6.811689	1.064135	6.401149	0.0000
ACCURED INTEREST ON R.L. IN F.C.	57.76751	24.55962	2.352133	0.0262
C	-14503.67	3838.537	-3.778438	0.0008

R-squared	0.958836	Mean dependent var	16656.79
Adjusted R-squared	0.951213	S.D. dependent var	1541.066
S.E. of regression	340.3856	Akaike info criterion	14.66100
Sum squared resid	3128283.	Schwarz criterion	14.93309
Log likelihood	-235.9065	Hannan-Quinn criter.	14.75255
F-statistic	125.7837	Durbin-Watson stat	1.799289
Prob(F-statistic)	0.000000		

Source: Individual calculations obtained from E-Views 7 usage, based on the time series data for the banking sector, published by National Bank of Macedonia.

Prior to the analysis of each group of data presented in Table 1, based on the calculations presented in the same table, the following formula shouldbe devised:

$$y = -14503.67x_0 + 0.561398x_1 + 0.277652x_2 + 0.118358x_3 + 6.811689x_4 + 57.76751x_5 + \\ + u$$

The individual values of coefficients in the equation have the following meaning:

1. The coefficient b_0 = -14503.67presents the value of the stretch.
2. The coefficients b_1, b_2, b_3, b_4 and b_5 shows the impact of independent variables on the dependent variable "HOUSING RETAIL LOANS". In the present case, they all have a positive impact and are directlyproportional to the dependent variable y.

The determinationcoefficient R^2 shows that the amount of HOUSING RETAIL LOANS is more than 95% determined by the presented independent variables.

From the data presented in Table 1, itcould be verified that the value of F statistics (125.7837) is greater than the critical value of F statistics (0.000000). It could be concluded that the hypothesis oncommon statistical influence of independent variables on dependent variable (i.e. total amount of H.R.L.) is acceptable.

Regarding the values of t statistics presented in Table 1, which determines the statistical importanceof each independent variable on the dependent one, it can be seenthat the values of coefficients t_{b1}, t_{b2}, t_{b4} and t_{b5}, are statistically significant for the dependent variable "HOUSING RETAIL LOANS".

The value of Durbin-Watson statistics in the first model (Table 1) is 1.799289,[10] which means that there is not significant autocorrelation in the model. Following the autocorrelation check, the model could be classified as a relevant

[10] The acceptable value of Durbin-Watson statistics ranges from 1.8 to 2.2.

sample of linear regression model. The results of the second model that was subject to testing could be analyzed through the data presented in Table 2.

Table2

Results of regression analysis of the independent variables' impact on non-performing retail loans for the period 01.01.2010– 30.09.2012

Dependent Variable: D(NON-PERFORMING RETAIL LOANS)[11]

Method: Least Squares

Date: 02/14/13 Time: 21:23

Sample (adjusted): 2010M02 2012M09

Included observations: 32 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(INTEREST RATES ON D.V.R.D.)	-127.8020	229.1002	-0.557843	0.5823
D(INTEREST RATES ON D.V.R.L)	-617.1339	295.4329	-2.088914	0.0480
D(INTEREST RATES ON F.C.R.D.)	-354.4251	522.5873	-0.678212	0.5044
D(INTEREST RATES ON F.C.R.L.)	-611.1327	449.8630	-1.358486	0.1875
D(ACCRUED INTEREST ON R.L. IN D.C.)	4.164142	0.629705	6.612840	0.0000
D(ACCRUED INTEREST ON R.L. IN F.C.)	1.572981	14.16511	0.111046	0.9125
D(LEGAL RESERVE IN F.C.)	0.253922	0.141553	1.793832	0.0860
D(LEGAL RESERVE IN D.C.)	0.036179	0.101844	0.355235	0.7257
C	-102.3954	34.97535	-2.927646	0.0076

R-squared	0.762554	Mean dependent var	14.37469
Adjusted R-squared	0.679964	S.D. dependent var	190.8399
S.E. of regression	107.9615	Akaike info criterion	12.43368
Sum squared resid	268080.6	Schwarz criterion	12.84592
Log likelihood	-189.9389	Hannan-Quinn criter.	12.57033
F-statistic	9.233008	Durbin-Watson stat	2.031487
Prob(F-statistic)	0.000013		

Source: Individual calculations obtained from E-Views 7 usage, based on the time series data for the banking sector, published by National Bank of Macedonia.

[11] Here, it should be taken into consideration that the dependent variable is lagging with one timeperiod (one month) in relation to the independent variables.

The following formula can be devised from the calculations presented in Table 2. :

$$y = -102.3954x_0 - 127.8020x_1 - 617.1339x_2 - 354.4251x_3 - 611.1327x_4 + 4.164142x_5 + 1.572981x_6 + 0.253922x_7 + 0.036179x_8 + u$$

Based on the calculations in Table 2 the following conclusions can be reached:

1. The coefficient b_0 = -102.3954 presents the value of the stretch.
2. The coefficients $b_1, b_{2,} b_3$ and b_4 have a negative impact and are not directly proportional to the dependent variable NON-PERFORMING RETAIL LOANS, while the coefficients $b_5, b_{6,} b_7$ and b_8 have a positive impact and are directly proportional to the dependent variable y.
3. The determination coefficient R^2 shows that the amount of NON-PERFORMING RETAIL LOANS is more than 76% determined by the presented independent variables.
4. The value of F statistics (9.233008) leads to a conclusion that the hypothesis on common statistical influence of independent variables on dependent variable (i.e. total amount of N.P.R.L.) is acceptable.
5. Regarding the values of t statistics presented in Table 2, it can be concluded that the values of coefficients t_{b2}, t_{b5} and t_{b7}, are statistically significant for the dependent variable" NON-PERFORMING RETAIL LOANS".
6. The value of Durbin-Watson statistics in the second model (Table 2) is 2.031487, which means that there is not significant autocorrelation in the model.

Conclusion

Overcoming the current challenges in the bank's retail and corporate lending activities creates a need for a number of coordinated measures and activities by all relevant stakeholders. Some of the proposed concepts focus on improvement of the traditional principles in lending activities to construction companies, as well as to personal users of housing loans, while others to other activities and measures for proactive management in this area of the business.

Within the group of activities suggested for improving the lending processes to construction companies, some of the key risks were subject of analysis. The main risks in this group refer to the value of the project and the construction company's management principles.

Alternative models present an additional tool that enables obtaining useful information, recommendations and guidance for better performance management of housing loans and their interaction with non-performing loans in retail segment of the business. The results from the first model, where the amount of housing loans occurs as a dependent variable, provide information on the statistically significant impact of the independent variables "net wages in the industry sector" and "net wages in the service sector", while there's not statistical significance of the variable "net wages in the agricultural sector". Housing loans for employees in agriculture is still a rising market and could be an adequate target group for banks and construction companies. More tailor-made services and campaigns are necessary to attract this category of customers. In the same model, the variable "accrued interest on retail loans in domestic currency" as well as the variable "accrued interest on retail loans in foreign currency" show exceptional statistical significance on the dependent variable, which could not have been foreseen prior to the analysis of the model.

Based on the results obtained fromthe second model, aconclusioncan be drawn that the interests rates are not statistically significant variable for the amount of non-performing retail loans for the analyzed period, except the interest rates on domestic value retail loans, but here the results were contrary to the earlier expectations. This main reason for this result could be analyzed more detail in some other research study.

On the other hand, the statistical influence of interest rates could be partly analyzed from the aspect of the amount of accrued interest. The statistical significance of the amount of accrued interest as independent variable has led to a conclusion that this variable has a high degree of statistical significance in relation to the growth of non-performing retail loans in domestic currency as well as to housing loans in the previous model.

As key conclusions that have been reached from the tests of the second model, it could be emphasized the need of reduction of the rate of the legal reserve obligation of the deposits in the banking sector, for the assets placed in housing loans. This measure would lead to reduction in the interest rates on housing loans, which would also have an influence on increased dynamics of lending activities to this category of bank clients. Decreasing interest rates should also affect the reduction in the amount of accrued interest and further on the decrease in non-performing loans.

These measures, supported by a reduction in utility costs, should result in lower prices of housing apartments offered by construction companies, particularly in the territory of the capital. Implementing the proposed measures would undoubtedly lead to some positive effects for all parties that are directly or indirectly connected to the construction industry activities and thus revive the real estate market in Republic of Macedonia.

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THE MACEDONIAN STOCK EXCHANGE 2001-2012

Krste Shajnoski, PhD[1]

Abstract:

The sharp crash in prices of the Macedonian Stock Exchange activities after 2007, when the Macedonian Stock Exchange Index has reached the highest value of its establishment and several-years reduced daily turnover of only about 200 thousand euros, indicates that the central institution of the capital market of the Republic of Macedonia has fallen in its own development crisis. Although there are listed more respective reasons for the state of the Stock Exchange, each of them separately is not sufficient enough to explain the occurrences. It is a matter of complex of reasons dominated by several ones in a certain period. There is no doubt that Macedonia faces the political and security risks, which reason the investors (both home and foreign ones) out of investing in long-term securities. The global crisis has an adverse influence upon the economic flows in the country, and that reflects negatively on the motivation of investing. It does not have to be underestimated the insufficient experience of working with long-term securities (as it was the adverse experience of some investors in 2007). It is talked least about the domestic investment climate as if there are no problems in the development and macroeconomic policy of the country. The improvement of the investment climate depends, in fact, upon the solving of problems and there can be explained the lost

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relationship between the prices of shares and their value in the Macedonian Stock Exchange.

Key words: *Macedonian Stock Exchange, shareholding, shares, share price indices, boom and crash in prices, investment climate*

JEL classification: *G1*

1. Introduction

Upon the establishment of the market economic system in Macedonia, an important place and role have been given to the development of the shareholding and of the share market as an important segment of the capital market. Despite the certain delay, there were created formal legal and institutional conditions for the functioning of the Macedonian Stock Exchange in 1995. The first purchases and sales of shares were effected rapidly. The Macedonian Stock Exchange Index of shares started functioning too. However, about 10 years had to pass in order to be felt its presence in the economic life. That happened as a result of the boom of share prices in 2005 and later in 2007. Since then till now, it has come to reduction of the share prices due to the global crisis, and later due to the stagnant situations within the country's economy. In most of the quoted companies, the share prices dropped at a level lower than the one in 2005. The share price indices of the largest Foreign Stock Exchanges returned themselves at the pre-crisis level, whereas the Macedonian Index still does not show any signs of improvement, and it is far from reaching the pre-crisis levels. What is it which prevents it from pulling away from the bottom?

Within the response to this question, we will show the movements of the Stock Exchange and the reasons for the oscillations of the turnover and share prices. In that context, there will be indicated the problems that caused the Stock Exchange positions to be the way they are now and the manner of reviving the Stock Exchange. There are not any external events that should happen in order to be made a permanent switch in the economic development of the country, unless it is improved the domestic investment sphere at the same time. The Stock Exchanges have almost reached the pre-crisis levels of prices within the developed economies, whereas the Macedonian Stock Exchange Index (MBI-10) is not even moved away from the bottom in a situation when the market prices of the best companies' shares are far below the level of their book values. Within this gap, in the first boom of share prices in 2005, the investors found a strong motive for investing. But, nowadays, it does not exist. The potential capital profits of the actual establishment of the relationship between the companies' book values and the market price of their shares is not even instigated. The credibility of investing in shares and acquiring the funds for investing through emission of shares is reduced.

2. Stock Exchange Boom and Crash

In its former existence, the Macedonian Stock Exchange of long-term securities went through all stages of development up to the stage of a representative market institution of the country. The Stock Exchange went through the so called "baby" development stage, which characterized itself with very little activity. In the period 1999 - 2003, the Stock Exchange was primarily performing the function of necessary market infrastructure of final privatization of the social and state capital and consolidation of the proprietary structures created by privatization. This was manifested in the form of domination of block transactions and state auctions in the attained turnover of the Stock Exchange, and in the absence of voluntary participation of the companies at the Stock Exchange.

Since 2004, it has begun to be slowly recognized the new life cycle of the Stock Exchange, where, despite the fact that the processes of consolidation of ownership in the companies have not been finished yet, it is notable the component which has to be a top objective – the Macedonian Stock Exchange to become a place, where at a moderate risk, it can be invested and doubled up the free funds of home and foreign investors. The significantly increased turnover in 2005, only justified that statement.[2] The rapid growth in the turnover of shares and the increase of the Macedonian Stock Exchange Index (MBI-10) in 2006 and 2007 indicated a switch in the working of the Stock Exchange, showing both the positive and negative effects.

Table 1 Stock Exchange Trading 2001 - 2012 In bil. Denars

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Trading in best	2	1.566	1.79	2.8	6.7	10.8	30.4	8.1	4.1	3.3	3.4	2.75
-Shares	0.941	0.857	0.51	1.3	4.6	8.6	28.8	6.7	2.8	2.0	2.1	1.6
-Bonds	0.981	0.709	1.28	1.5	2.1	2.2	1.6	1.4	1.3	1.25	1.3	1.2
Block transactions			0.27	5.2	1.7	14	11.2	4.1	2.6	2.5	8.96	2.4
Governement auctions			0	0.40	0.44	6.2	0.10	0.10	0.02	0.04	0.32	0.35
Other securities		0.304	0.26	0.02	0	0.02	0	0	0	0	0.93	0.10
TOTAL	**1.922**	**1.87**	**2.31**	**8.3**	**8.9**	**31**	**41.7**	**12.4**	**6.7**	**5.8**	**13.7**	**5.6**
Daily average turnover (**million denars)**	14.1	9.3	11.4	14	33	43	123	32.8	16.8	13.2	14.2	11.2
Daily average number of transactions	74	68	85	86	159	208	574	175	141	104	96	60
Number of listed security				68	57	43	38	38	36	34	32	32
Macedonian Stock Exchange Index	978	1095	1179	**1352**								
MBI-10 - 4.01.2005				**1000**	2292	3703	7741	2096	2752	2270	1975	1731
Macedonian Stock Exchange Index of companies - 18.06.2007- index=10000							8414	2214	3036	2459	2084	1735

Source: Annual Report of Macedonian Stock Exchange

[2] From the opening of the sixth Conference of Macedonian Stock Exchange, published on the website of Stock Exchange, 16.09.2005

The total results of the Stock Exchange trading clearly show that the turnover of long-term securities, with the beginning of the new millennium, is in permanent growth, whereas the absolute record was achieved in 2007, when on all the grounds, there were traded nearly 42 billion denars. Out of this amount, 28.8 billion or 69% refer to the classical turnover of shares, 3.8% to trading in bonds and 26.9% to trading in block transactions, whereas the rest of the amount refers to trading in public stock-exchange auctions.

After the boom noticed in 2007, and during the global financial and economic crisis, it has come to a profound reduction in the Stock Exchange activities. By the end of 2012, the total turnover of securities has reduced itself by 7.4 times. The turnover of shares has reduced itself by 18 times, whereas the turnover of bonds by only 25%. The turnover of block transactions has reduced by 4.7 times.

The data of the average daily turnover speaks very illustratively about the dynamics of trading. From imperceptible 9 million denars in 2002, the average daily turnover increased to 123 million denars in 2007. It is also rapid the growth of the average number of transactions. From 68 in 2002, the number of transactions in the Stock Exchange mounted to 574 in 2007.

After 2007, it has come to a sharp reduction in the average daily turnover of the Stock Exchange. By the end of 2012, the daily turnover has decreased by 11 times, thus coming down to 11.2 million denars. The average number of transactions made in the Stock Exchange has decreased itself by 10 times.

To the Stock Exchange, it has happened what usually happens to the Stock Exchanges after periods of rapid growth of share prices. However, that happened not because it has to happen, but because the growth of share prices detached itself from their real values in 2007, and in accordance with the economic regularities, it had to be corrected.

Table 2

The market capitalization as a percentage of GDP

	2004	2005	2006	2007	2008	2009	2010	2011	2012
Market capitalization in billion denars	54.4	74.4	108.9	309.07	124.5	137	135.1	127.6	120.4
GDP in billion denars - current prices	272	295	320	365	412	411	434	462	
Market capitalization as a percentage of GDP	**20.0**	**25.2**	**34.0**	**84.7**	**30.2**	**33.3**	**31.1**	**27.6**	

Source: Macedonian Stock Exchange and Ministry of Finance (Republic of Macedonia)

Through the share price fluctuation in the Stock Exchange, Macedonia overcame the situation of insignificant share in the market capitalization of GDP. The market capitalization had a share of 20% in 2004, and 25.2% in 2005. In 2006, its share increased to 33.3%, whereas in 2007, it surpassed a level of 84.7% of the social product. Of course, with the crash in prices of long-term securities, after 2007, the share in the market capitalization has reduced, and it was 27.6% in 2011. The low share in the market capitalization of GDP, before 2005, was a consequence not only of the little turnover, but also of the high depreciation of the securities traded in the Stock Exchange. The state changes itself along with the growth of the prices of auctions. The market capitalization had been increasing the share in GDP till the boom in 2007. However, after 2007, it has reduced itself with the crash in prices of securities.

3. Reasons for the rise in prices of shares

The reasons for the rise in shares in the Stock Exchange in 2005 were primarily the profits that the investors could expect at a certain short time and with relatively little risk, purchasing shares at market prices, which in the concrete case were significantly underestimated. It comes down to a situation, where the market share prices of companies comprising the Macedonian Stock Exchange Index (MBI-10), did not reflect the real values of the companies, considering the already attained values and the possibilities for generating future profits. After the completed proprietary re-construction and initial determination of the capital value (registration of the companies' principal), they managed to function profitably and to increase the allocations for strengthening the capital base of the companies. However, as a result of the ineffective functioning of the capital market, the realistically increased values did not come to the fore in the Stock Exchange. The fact that the market prices of shares were far, not only below their book values, but also below their nominal prices, was a strong signal for the investors to purchase them. The investors who have understood the situation, started to purchase, and the more they buy, the more the share prices increase.

The increase in allocations for strengthening the base of development has caused the book value of the companies to be over their nominal value.

Table 3

The nominal and book price of the selected companies' shares in 2004 and 2012

Company	**Nominal price**	**Book price 2004**	**Index 3:2**	**Book price 2012**	**Index 5:2**
1	**2**	**3**	**4**	**5**	**6**
Alcaloid	1549	3697	239	4859	314
Heating	3095	3514	114	3627	117
Commercial Bank*	5514	10675	194	4180*	418
Makpetrol	30658	32581	106	33.974	111
Skopje Market	3092	7280	235	9027	292
Commercial Bank Bitola	3596	5199	145	3003	84
Granit	369	679	184	1278	346
Macedonia Tourist	1549	3539	229	4629	299
Europe	2407	2817	117	Not available	
Ohrid Bank	2470	3138	127	3884	157

Source: Macedonian Stock Exchange, www.mse.gov.mk

* In March 2005, Commercial Bank lowered the nominal value of the share of 1000 denars and accordingly increase their number

The data clearly shows that the book values of the companies surpassed their nominal value in 2004. However, due to the already mentioned reasons, the discrepancy between the market price of shares and their book value was present till 2004. In 2005, there was a large growth in the share prices, but it culminated in 2007.

Despite the fact that the higher book values of the companies in relation to the nominal values of shares, were not decisive, they were very important for

the fluctuation of the market prices of their shares. During the boom, the shares, whose book values were lower than the nominal prices, have shown significantly higher growth of their nominal values. However, before the rise in prices, the coefficient market price/book values of shares of the companies of the Macedonian Stock Exchange Index (MBI-10) varied from 0.13 to 0.66% in 2004, but in 2005, this coefficient showed everywhere that the market value of shares surpassed the book value. It is a fact that this discrepancy between the market price of shares and their book value, which guaranteed good contributions out of the deposits in purchasing the shares of the companies comprising the Macedonian Stock Exchange Index (MBI-10), did not stay unnoticed by home and foreign investors. Their more increasing demand was extorting a faster growth of the share prices. In conditions like these, the vendors did not hesitate to sell them, considering the long period of holding "valueless paper". That brought to reduction of the discrepancy between the book and market prices of shares, whereas some market prices surpassed even the book values in the spring boom. That especially came to the fore in 2007, when the prices of the Stock Exchange reached the highest values. The market prices of most of the shares have surpassed the book values of the companies several times.

In the share price boom, in 2006, there were certainly signs of inflation of the share price bubble, but in 2007, the bubble burst. It was like that, not because of the beginning of the global crisis, but primarily, because the purchasing of shares by market prices of the Stock Exchange became unattractive, considering the existing and realistically expected values that the companies could attain. During the "market selection" of winners and losers at the Stock Exchange, it has been realized that the share prices depend upon the profit growth made during the year (including also the payment of dividends) and on the realistically expected profit in the next years.

4. Some Reasons for the crash in share prices

Following the logic of the fundamental analysis of the fluctuation in share prices of the Stock Exchange, which showed that the material base of the rise in share prices in 2005 was their underestimated value, it is normal the reasons for the crash in share prices of the Macedonian Stock Exchange after the boom in 2007, to be searched in the exaggerated, economically unjustified rapid growth of share prices and, of course, in the objective non-maintenance of that situation at the market. If the relationship between the share prices and the existing or anticipated profit loses, sooner or later, it will come to imminent adjustment of the real values of the companies with the market value of the shares they have issued. If the values are underestimated (and the profits per share, in such a case, surpass the interest rates on deposits by far), the share prices are being corrected upwards, and vice versa, if the value of companies is overestimated (the profit per share falls below the interest rates on deposits), the share prices are being corrected downwards. That actually happened to the Stock Exchange. That could even be expected, but there were not any pessimists who would predict that the prices would fall below the level of 2004.

In this context, we present data which shows the discrepancy between the market prices of shares of the companies comprising the Macedonian Stock Exchange Index and the indicator profit per share in relation to the market price of the share.

Table 4

The indicator profit per share/price during the period 2004 – 2007 and in 2012

Company	2004	2005	2006	2007	2012
Alcaloid	9.7	6.5	5.2	2.7	10.0
Heating	15.7	6.3	1.7	2.4	1.0
Commercial Bank	54.3	6.9	7.0	7.3	17.7
Makpetrol	9.6	6.7	7.2	1.3	0
Skopje Market	42.9	9.8	16.4	4.0	5.2
Commercial Bank Bitola	19.9	12.2	5.0	5.7	0
Granite	49.7	28.8	20.7	5.9	28.5
Macedonia Tourist	21.5	12.2	9.5	4.6	13.7
Ohrid Bank	15.1	9.4	4.4	3.1	7.2

Source: Macedonian Stock Exchange, www.mse.gov.mk

The data shows that the growth of share prices in 2006 and 2007 significantly reduced the percentage of the profit per share in relation to the market prices of shares, as a result of what, in 2007 the earnings fell below the interest rates on one year fixed-term deposits. That is, of course, not attractive at all to purchase shares. Thus, the reduced demand extorted an accelerated falling of the share prices at the end of 2007 and continued in the next five years. The expectations that the downward trend of share prices will stop soon, were not realized, because the falling of the share prices increases the profits made per share. That did not happen even till the end of 2012. The imminent adjustment of the real values of companies with the market values of shares was dropped out. It remains to hope that the investors will soon perceive the underestimated shares, expressed by the low coefficients of price/book value and the increased per cent of profit/price, and will accelerate the purchase of shares in order not to be late in the anticipated upward trend of an adjustment of the market prices of shares with their real values.

In terms of the already mentioned expectation especially speaks the indicator profit/price at the end of 2012. With the beginning of the financial and economic crisis, the large gap between the market prices and book values started to reduce, and at the beginning of 2013, it happened again, the book values of even the best companies to be higher than their market prices. There was formed a picture as if nothing happened at the Stock Exchange in 2004. The largest number of shares is sold by lower prices than the value of companies, according to their book value, but even besides that there is no demand. For some investors, it is not even important that some companies pay dividends at a rate higher than the interest rates on fixed-term denar savings.

The consequences of the crash in prices of the Stock Exchange are still felt, and a reason for that is also the slow recovery of the economies of the developed countries (although some of the Stock Exchanges in the developed economies reached the pre-crisis indices of shares), particularly the assessments of adverse influence upon the domestic economy.

Upon the crash in prices a strong influence, especially a psychological one upon the home investors, has the withdrawing of foreign investors from companies in Macedonia. After 2008, it has been constantly reduced the share of foreign investors in the home companies' principal, whereas the share of foreign legal entities and physical persons in the sales of the Stock Exchange was larger than their share in the purchase.

The reasons for the crash in prices, however, should be searched the most in the adverse climate of investment. The stagnant situations within the economy and the uncertainties for the further development of the country have an adverse influence upon the motive for investing. That is why the market of shares is still not started, and there is also no interest for starting new investments. Therefore, the interest for acquiring funds through emissions of new shares is imperceptible so that the investors' interest, especially of the institutional ones, will be increased, because it is difficult to prompt the individual investors that underwent losses in 2007.

Contrary to the turbulent occurrences at the secondary market of long-term securities, the occurrences at the primary market are not even noticed. From time to time, there have been published notices of sales of shares of new emissions in separate companies, most often banks.

Table 4

Number of emissions, types of long-term securities, type of offer

Year	Number of issues	Volume (in mil. denars)	Shares	Bonds	Private offers	Public offers
2000	40	6..342	39	1	40	0
2001	20	2..585	20	0	20	0
2002	24	4..832	24	0	14	10
2003	25	2..383	25	0	19	6
2004	17	5..394	16	1	14	3
2005	14	11.475	13	1	14	0
2006	16	943	16	0	13	3
2007	10	1..728	9	1	10	0
2008	22	6..130	21	1	21	1
2009	7	5..395	7	0	7	0
2010	6	4..289	6	0	6	0
2011	11	3..655	11	0	8	3
Total	212	55.151	207	6	186	28

Source: Annual Report of the Securities and Exchange Commission

In the period 2000-2011, the Securities and Exchange Commission of the Republic of Macedonia issued 212 approvals for emission of long-term securities in the amount of over 55 billion denars. The average value of a single emission is 260 million denars. However, it can be seen by years that the lowest average value per emission was noted in 2006 – with 59 million denars, whereas the highest value was recorded in the previous year i.e. 2005 in the amount of 820 million denars (this refers to a major effect because of the emission of shares upon the privatization of the Macedonian National Grid, which had a share of 75% of the totally emitted securities in the mentioned year).

An essential characteristic of the emission of long-term securities in Macedonia is that it is dominant the issuing of proprietary securities (shares), but it is insignificant the issuing of debt securities (bonds). In the mentioned period, there have been approved 207 emissions of shares and only six emissions of corporate bonds. With reference to the mode of emitting securities, it is dominant the reaching out at the model of private offer, i.e. an emission to a known purchaser. In this way, there have been accomplished 186 approved emissions of long-term securities, whereas with the model of public offer only 28 emissions.

The data of the rapid growth of share prices in the Stock Exchange in the period 2005-2007 and of their vertiginous crash by the end of 2012, clearly shows that the Macedonian Stock Exchange experienced time of underestimated values and their imminent adjustment with the real ones, an occurrence of more intensive speculations where had been used events as a result of whose occurrence, there had to be opened a process of growth in prices of most of the shares, as an expression of the recovery of the economic and security situations in the country (becoming a member of NATO and EU).

With an experience like this, the existing and future investors have no more illusions about the capabilities of the Stock Exchange, and they are aware of the restrictions and risks of the Stock Exchange. This is particularly important for the potential issuers of new shares considering the need for a real presentation of the situation in the companies and of the anticipated investment revenues. Only such offers can attract a sufficient number of investors that will invest in purchasing shares emitted for acquiring funds for realization of certain projects. The exaggerated optimism in relation to the future revenues becomes unacceptable, as well as the offer of low and uncertain earnings. Given the fact that practically, in our country, it was shown that the income is generated in the real sector, and not in the financial one (although the sector's efficient functioning accelerates the income's growth), the argumentation about the attraction to new emissions has to rely on the real powerful company of generating profit, which would satisfy the interests of the potential investors. This means that in the current circumstances, when the expectations of the businesses are objected (due to the destruction of illusions of fast earnings) there opens up a space for financing good projects and for emission of long-term securities. An assumption for that is the creation of conditions in which the potential investors can clearly see their interest of the investment.

The Stock Exchange boom and crash "sobered up" the players who "played their luck" at the Stock Exchange and marked the beginning of time when the investors will make their decisions on purchasing shares on the basis of the perception of the current profitability of the companies and the rate of returning the invested funds in purchasing their shares, including the estimations of the companies' future profits. This means that it begins the time when the companies' management will be assessed according to the values of shares managed by the companies, and because of that, they will pay more attention before now, to the increase in profit. All this is a good base, finally, for the profit to promote itself as a key motivational factor in the boards of directors. This is of interest to the shareholders, the potential investors and managers. The switch in this direction will approve the price paid by the investors in the phase of an on-going considerable correction (downwards) of the share prices in the several past years.

5. Conclusion

The several-years reduction of the turnover of the Macedonian Stock Exchange and, the almost unchangeable low level of the Macedonian Stock exchange Index (MBI-10) speak about a crisis in the functioning of the Stock Exchange. While explaining the reasons for this, there are listed more individual reasons, but no one can separately explain the happenings in the last three years, particularly the fact that the prices of most of the shares are below the level of their book values, and some of them are below the level of the nominal ones, but there is no interest in investing in the purchase of shares. When the potential investors do not show interests despite the prices that promise profits, then obviously there is not something right with the entire atmosphere of investing. It has to be improved by creating conditions for the potential investors to see their interests of the investment clearly, with minimum risks.

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THE ADVANTAGES OF ON-LINE PROMOTION AS A NEW APPROACH TO MARKETING COMMUNICATION

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Abstract:

Along with all the changes, which nowadays are happening on a global level, a lot of changes are happening in the sphere of marketing and its implementation. Information technology, which is already entered almost in all spheres of socio-economic life, has its influence on different aspects of living, thus radically changing the the definition of time and space in a physical sense. Hundreds of millions of people from different destinations all over the world - which is more or less confirming itself as a "global village" - are interrelated and are communicating on the Internet.

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There are many new users on Internet and unavoidably it becomes one of the most powerful media in the world. The expansion of Internet has also brought a new way of doing business. Many companies present and sell their products and services online.

Internet is the most important interactive instrument for marketing communication, especially for promotion. The purpose of this article is to define the aims and tools of promotion on Internet in order to become more applicable in establishing the business activities in Republic of Macedonia. Acknowledging the lack of effective use of Internet in promoting products and services in Macedonia some experience is indicated that can be used in business practice, especially in developing the e-business as a potential in positioning Macedonian companies on the global market).

Key words: *e-business, Internet, promotion, interactivity, communication*

JEL classification: *M37, L81*

Introduction

The emergence of Internet, determined by the emergence and development of information revolution as well as the developed process of globalisation and the competition on a global level, have resulted in more or less virtual companies as business entities.

In such a cyber space begins an era in which the companies and their clients have an intermediary in the process of sale so that they can exchange information that is available throughout the world. With the Internet, people and business entities get an opportunity to overcome the geographical and time barriers as well as to have fast and cheep communication on a global level.

Business people have quickly perceived the great potential of the Internet that may be used as a media through which most of the commercial activities can be undertaken, a promotional media, a research media or a media through which the complete business is managed.

The digital revolution has opened the door to information as a "global product", which is needed in order to define the market performance of the companies in different world destinations defined as target markets. That gives an opportunity to the companies to become equal partners on the global, world market. Being in an equal position, they can use the benefits from the information revolution in all the aspects of the business performance as well as to gain an opportunity to meet the market needs on great distances with lower costs and minimum effort.

The on-line research procedure for defining the process of products and services promotion comprises several specific characteristics as the character of the population and sample (exemplar) determination, questionnaire preparation, choice of research method etc. In this sense, the online marketing research as part of the complex marketing communication process assumes a new, innovative, and more active role) and more active role in these contemporary conditions and circumstances in which the companies from all over the world are operating.

Online promotion and traditional promotion media

By comparing the online promotion and the traditional promotion media, a new depth and width could be defined. Further in the text, different points of view and comparisons of the online marketing promotion and the traditional promotional means are elaborated including accessibility, frequency and effectiveness of these means.

Outdoor promotion: Billboard.

Web banner ads very often are compared with promotional billboards, panels that as of recently are also very present on the streets of our country. Web banner ads can direct and point to specific web pages. While the outdoor billboards, panels are static, the web banner ads are interactive and the users can simply, only by clicking on them, reach other web pages and in that way receive more information. Some web banner ads even provide separate activities (like playing games) to be performed without leaving the specific promotional message. From the attendance point of view, the advantage of online promotion is that the advertiser can measure how many times a separate web banner ad was clicked. This, however, isn't possible with the panels. The only exception is the case when a feedback information can be obtained through phone calls on a separate telephone number.

Press

In a newspaper or magazine, the promotion on a quarter, half or whole page can clearly and easily be identified. Promotion and announcements are modeled in a way which is very easy recognized and read by the readers. If a specific promotion or announcement in a magazine looks like editor's text, then a magazine specifies on its own "special advertisement part" on the top of the page. On the Internet, web banner ads are clearly separated by easily recognizable borders, or frames. Currently, the space on the Internet pages, web pages designed for web banner ads, is limited – generally with less than 10% of the visible surface. Although, promotion on the Internet is not only about the web banner ads and it can not always be identified as a promotion, advertising; sometimes it could be very difficult for the customer to make the difference between the propaganda and the actual content on the separate page.

Television promotion, advertising

Promotional message of 30 seconds advertised on TV is one of the leading quality promotional mode. Such a promotion provides the advertiser with a complete use of the screen and gives him an opportunity to present a dynamic message, which will influence the interests, needs and even the emotions of the customers.

Because of the effect that the TV promotion has on the customers, there is often a dilemma about whether the promotional messages on the Internet should look like those on TV. However, there are different opinions regarding this issue.

Advertising, promotion on cable TV

Cable TV has expanded the scope of TV influence in a way that it directs the messages to a selected/targeted audience. The cable TV audience is purely attractive as a target market where specialized promotional messages are presented. Similarly to the Internet, the cable TV offers very specific advertising messages created for specific targeted group of customers. Predicting the advantage of the Internet over the classical media and means of promotion, some researchers are pointing to the rapid development [4] of the use of Internet as a unique promotional media (see **Table 1).**

Table 1. Growth of the Internet over other media[5]

MEDIA	YEARS NEEDED TO ACHIEVE A NUMBER OF 50 MILLION USERS
Radio	38
TV	13
Cable TV	10
Internet	5

As it can be noticed, the time necessary to reach a number of 50 million users on the Internet and radio as a media is 5 years and 38 years, respectively.

The Internet as a unique promotional media

The contemporary marketing literature frequently offers explanations about crucial differences between the traditional media and the Internet. According to some of them, traditional communication media offer promotion with one-way communication as the communication is made between advertisers (companies) and

[4] Source – Ambush Interview, November 2001
Available: http://www.i-frontier.com/news_articles/press_new/59.html
[5] Source – Morgan Stanley Technology Research

potential customers). Thus, the customer can choose whether to see the promotional message or not simply by changing the TV channel or radio station or by ignoring the newspaper pages which consist promotional messages. There is no possibility for direct conversation between the customer and the promoter or the possibility for the customer to give suggestions referring to the advertising message. The situation is different when using online relations i.e. the Internet as a promotional media.

The uniqueness of the Internet as a promotional media emerges from its interactivity and possibilities for choice, which are offered to the customers. The advertising message can be transmitted on the Internet in several ways such as conveying the message as a web banner ad on the screen or on the web pages of separate companies. Nevertheless, shown as a web banner ad on the screen, the promotional message says very little to the customer. The customer will gain more information for specific product by clicking on the banner. The web page presents excellent promotion for companies and offers very useful information for products, but it is necessary that the customer chooses to see the exact web page.

Promotion on the Internet

Promotion needs also to be understood as a way in which companies communicate with the market and the customers. The business environment of developed production, open markets and high technologies, in order for a product or a service to be sold it is necessary for them to be promoted through the media. Based on the nature and type of the product or service and whether it is a local, national or international, global market, an optimal media through which the products and services will come closer to the customers should be chosen . This can be a local newspaper, radio and TV station, national magazine, satellite or cable TV or the Internet.

As a result of the significant technological development, the phrase 'informational highway' became very common in the literature, pertaining to the future of the communication networks. The ultimate goal of the communication networks development is every individual to be able to use the resources, which will be widely available in the future in the realm of global and universal network.

The Internet, the globalization and the hyper competition have significantly transformed the markets and have changed the manner of conducting business. The new environment forces companies to redefine their markets, market offers, as well as their marketing operations in order to be able to successfully compete in the new globally connected market.

Lately, the economic potential of the Internet is attracting significant attention. According to "The Economist", hundreds of millions of companies are present on the Internet with nearly couple of million computers with great capacities, which are organized among them. A market of products and services catalogue marketing is developed on the Internet with a value bigger than $100 billion. The process of buying on the Internet is very simple: a specific company, which has multimedia presentation on the network, is searched and an order of wanted products and services is made through a specific network services. The marketers can monitor the reactions of the users on their brands and learn what is important to their current and potential buyers. For example, a car manufacturer can follow the page navigation of the users to discover whether the users are more interested in information, security or the additional equipment for the specific car model.

Companies can also measure the reaction to the specific promotion (measuring the number of times the users have clicked on the particular promotion, the number of sales or directions as a result of the sales) which is very difficult to be done in traditional promotion media such as television, press or billboards, panels. The web banner ad has a significantly great role in the promotion on the Internet. It can appear in a form of skyscraper, horizontal rectangle, a little picture or animation on the web page, which by click in on it will lead customers to the website of the company where they can find more information. The appearance, design and the position of the banner ad is found to be very important since it has to attract the attention of the visitors in order to make them click on it. Usually the visitors are ignoring the banner ads since most of them are only interested in that for which they have connected to the Internet.

Online Promotion on social networks

Social networks have huge impact on people's lives. Facebook, Twitter, Youtube, LinkedIn are all examples of social media. Social media is a type of online media that expedites conversation as opposed to traditional media, which delivers content but doesn't allow readers/viewers/listeners to participate in the creation or development of the content. Social media is a category of online media where people are talking, participating, sharing and networking. Actually, they represent low-cost tools that are used to combine technology and social interaction with the use of words, and these tools are typically internet or mobile based. There is a wide variety of social media, ranging from social sharing sites such as Youtube through social networks such as Facebook and Twitter.

Social media has shot to the forefront of people's attention because it's fun. Thanks to social media it's easy to share ideas, photos, videos, likes and dislikes, with the world at large-and find out they think of them. Social media gives people what TV never could, a chance to be engaged and engage others. Because of this, social media is of particular interest to business. Currently, businesses of all sizes are experimenting with social media marketing, grappling with the question of how to get in on what appears to be an especially viral way to spread their message (and product).

Social media marketing like any other marketing consists of the attempt to persuade consumers that one company's products and/or services are worthwhile. The main problem with social media from a business perspective is that it can be incredibly time-consuming. Social media marketing campaigns are not one-shot affairs - they need to be nurtured over time. Companies need to have a marketing budget that will allow them to assign a number of staff to conduct and manage social media marketing campaigns. Maybe this will sound like a waste of time and money to many companies, but when they investigate a little and find out that there are millions of people all over the world using these sites daily, they become a part of their lives. Because social media channels attract so much continual attention from internet users, this is becoming a powerful venue for advertisers to create interest and traffic. Here are some of the benefits of social media that are important to businesses:

- building a network of core supporters (loyal followers)
- increasing traffic which leads to a higher ranking among search engines
- cost reduction by decreasing staff time
- easier to announce new products, promotions and special offers, contests

Social media takes patience; it is not an immediate return on the investment. If a company is willing to accept this premise, and invest the time, energy and budget needed, social media can be an effective venue and can help in the growth of the business. When the company starts to see the non financial impact on the business, it is obvious that the probability of a financial impact on the business is increased. Non financial impacts on the business that should be considered are:

- Increase of website visitors
- Increase of impressions
- Positive press mentions
- Click-troughs
- Positive word-of mouth mentions
- Employment applications submitted to the company
- Blog mentions
- Increased followers through social media venues such as Facebook, Twitter, and LinkedIn

When companies begin to see these things, they know that the probability of financial impact from social media on their business has increased. It also shows that they are in fact, utilizing social media in the most effective manner. If a company has been utilizing social media for a while and can't see any of the above than it's time to check the strategy, investigate tactics and figure out what is done wrong.

Websites selection factors

Main factors that should be taken into account when selecting a site where company's product or services will be promoted are:

Audience: the first and most important factor is the target audience of the specific company that can be reached on the website, because the best promotion in the world is not enough if it does not reach the right people. There are two different methods to determine who are the visitor of a certain page. Moreover, other factors are also important for finding the best location to place the promotion, but they are secondary in comparison to the audience as a factor.

Reporting: it is necessary to have timely access to the reports from the particular website in order to determine the activities that will increase the effects of promotion on the website.

Possibilities for fast creative changes. And the fastest received reports will not be efficient if it is not possible to make the creative changes quickly and on-time. Even if it looks unbelievable, at certain web sites the procedure to implement creative changes takes several days. This should be taken into account when promotion space is bought.

The size and the location of the promotion line on the web site. One of the factors that influence the advertisement is its size and location on the web site. Anyway, it should be determined what is best for the particular promotion. So, larger promotion lines produce greater promotion. This might be obvious, but sometimes it is important to mention the obvious as well. Additionally, the promotion lines placed on the top of the site do not have such an effect as those placed near the top. The promotion line on the top can be confused with the top of the web site instead to be understood as promotion on which it can be clicked. The next picture is an example of ideal placement of the promotion line, which is not the first element on the web site, but it is near to the top. Certainly, the location should be in the first upper part of the web site so that the visitor does not need to go to the bottom of the web site to see the promotion.

The success of the promotion message

To determine the budget for the web site and to select promotion techniques and the content of the web site, it is necessary to predict the effects on the visitors. The traffic on the web site does not depend only on the quality of the web site and the products that are offered, but also on the possibility to be accessed by the visitors. The promotion message that is send through any banner or other site on the internet will be directly linked with the appropriate web site which is one of the potential sources to access the specific web sites. It is proved that there is a positive link between the number of pages on which the message is placed and the traffic of the promoted website.

Also, campaigns in traditional media can help increase the traffic of the web site. To achieve the above, the following is necessary:[6]

- All promotional and advertising materials like letters, business cards, flayers etc should be on the web site.
- To use all the conventional knowledge of public relations to popularise the web site.
- In order to improve the sales, competition should be organized on the site in which the visitors can participate

[6] Bickerton P, Bickerton M, Pardesi U (2000), "*Cybermarketing*", BH, p.202

- To decide whether something to be given for free since people positively react to free gifts

- To be different in order to attract attention but not violate the rules for good behavior since it might have long term negative consequences.

All these approaches should be taken into account, however the most important is the technical side, i.e. to be sure that the web site is widely available.

When users of search engines write their request in the special part of the screen, it shows their interests and what they want to see or buy. Most search engines now offer promotion with focused keywords, while companies where you pay for a certain message to be displayed on the screen when the specific keywords are typed. Sites like Yahoo display banners with promotion messages when certain keyword is typed, while Google displays textual messages based on the keyword that is typed.

Advantages of promotion on the Internet

Internet promotion has four main advantages:

- Possibility for targeting – Internet publishers have completely new opportunities for targeting. They can focus on the users from different companies or on geographical regions and nations and on the following criterions: certain time in the day, computer platform and search engine. They can target them using the data, which support the direct marketing. They can target certain preferences of the people or their behavior.

- Tracking – the marketers can follow how the visitors react on their brands and learn what is important for their current and future consumers. For example, car manufacturer can follow how the visitors are moving through the site to determine whether customers are more interested in information, security or additional gear which accompanies certain model. The publishers can also assess the reaction to certain advertisement (counting the number of clicks on certain commercial, the number of sales or directions as a result of the advertisement, etc.), which is much more difficult with the traditional advertising i.e. television, print media and billboards.

- Availability and flexibility – on the Internet, the advertisement is available in real time 24 hours a day, 7 days a week, 365 days in the year. Furthermore, the promotional campaign can be launched, updated and terminated immediately. The advertiser is following the daily progress of the campaign, so when the campaign generates insufficient reaction in the first week the advertiser can change it immediately in the second week. This is much more different from the press, where the advertisement can be changed only when the new edition is published or from the television where the high costs for advertisement development often limit the changes.

- Interactivity – the goal of the advertiser is to lock in the potential clients for specific brand or product. This can be done much more efficiently on the Internet which enables the interaction between the customer and the product, testing the product and potentially purchasing the product. For example, advertisement for software can bring the user directly to the location from which it can download the demo version of the program and try it immediately. If the customer likes the program he or she can buy it directly. No other medium converts the customer from information searcher to buyer so easily and fast.

Conclusion

The specific characteristics and the power of the Internet as a media are reflected in the possibility for interactive communication as its most significant feature. Especially this characteristic makes the Internet the most attractive and desirable media for marketing research activity.

The appearance of the Internet as a new, contemporary, unconventional media gives all the marketing research activities a whole new dimension. The instruments of the Internet (www, e-mail, Listservs, Usenet forums, chat and the instant messaging) offer considerable opportunity for conducting a research with which, based on the needs and the method used, secondary or primary data can be obtained.

The Internet as a medium has great number of advantages in relation to other traditional media for advertising. One of the most significant characteristics is the interactivity which offers more quality and comprehensive communication with the potential consumers. This advantage has contributed to the right positioning of promotion mix in large number of companies.

Advertising on Internet is a complex process with many challenges and possibilities, as well as risks in the process of conceptualization of the plan and analytic approach. It is a new process in the marketing industry and it is a result of a worldwide popularization of the Internet.

The Internet as a medium has many advantages over the other (traditional) promotion media as newspaper, radio, TV etc. Its greatest advantage is the possibility for interactive communication with the potential customers and the possibility for precise targeting.

Businesses using social media want to sell their products or services. To use social media marketing effectively, businesses have to be perceived as members of the social media community, willing to interact with other members.

It is understandable that the advertisement on Internet will become necessary part of the promotional mix of the companies. Since this becomes a reality it is important to have organised approach concerning this issue. An online advertising campaign, like any media campaign, requires strategic planning to ensure that money is well spent and that objectives are achieved.

Advertising on the Internet in Republic of Macedonia is still at its beginnings, however it will develop and grow simultaneously with the development of the Internet in the Macedonian society and economy.

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SIGNIFICANCE OF BANKING REGULATION AND SUPERVISION

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Abstract

The global banking sector has faced with big changes in the last decades and banks get more diverse roles in the economy. Taking into consideration the important position which the banks have in the economy, it is impossible their activities to be released and free regulated only from the market conditions. A key objective of banking regulation and bank supervision is to reduce these risks in order to enhance the soundness and efficiency of the banking and the financial system. The states regulate the work of the banks and the bank activates because they are not convinced that the market with its mechanisms is capable of minimizing the risk which impact the banks. They call for stronger regulatory and supervisory policies as key factors to stabile and sound banks, excessive risk taking and minimize moral hazard in the banking system.

Key words: *banks, banking regulation, bank supervision, financial stability*

JEL classification: *G 18, G 28, G 38*

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1. INTRODUCTION

In the past thirty years, the financial crisis which have been affecting different regions in the world, have constantly proved that the true value of the financial stability is highly desirable within the periods of financial instability. The stable financial system is capable of efficient allocation of resources, of assessing and managing the risks, maintaining the level of employability and managing the pries movements which can affect the financial stability and the level of employability. In a contrary, the economy growth stagnates, the industrial production decreases, some of the banks face in with serous problems with their liquidity and solvency, and the others are more restrictive about financing projects. These problems can produce in confidence within the public and negative impact to the reputation of the bank system.

From time to time, the banks can run into difficulties, therefore it is necessary an effective crisis preparation and management, regulation framework and measures, for those banks, and for the banking and the financial system as a whole. Although it is not a bank supervision's role to prevent bank failures, the supervisory oversight is designed to reduce both the probability and impact of such failures.

The aim of this effort is to review some aspects of the banking regulation and bank supervision in the Republic of Macedonia due to maintenance the soundness and stability of the banks and the financial system as a whole and to impel the competitiveness in the financial markets.

2. THE SIGNIFICANCE OF BANKING REGULATION AND BANK SUPERVISION

The global banking sector has faced with big changes in the last decades and banks get more diverse roles in the economy. This diversification of bank activities has made daily bank practice very complex, such that investors, small depositors, shareholders and regulators are inable, to monitor bank activities properly.

Banks' position at the heart of the payments infrastructure and their key role as credit providers mean that any disruption quickly spills over and damages the real economy. In the banking sector interconnectedness of financial institutions can also result in the failure of one player quickly affecting others, because other institutions are directly or indirectly exposed to a failed bank or because of a loss of confidence amongst banks in each other's ability to meet future obligations.

The most compelling reasons for regulating and supervising financial institutions are to prevent the failure of one institution from affecting the financial system and the economy. A key objective of prudential regulation and supervision is to reduce these risks in order to enhance the soundness and efficiency of the financial system.

Despite above "the time shows that banking will accompany the humanity forever in terms of the life style we are in. The technological advances in information processing, in means of access to the information faced the banks with the need to change the way services provided. The rapid development of cyber world puts the need for adjustments for the digital money that is quite and apparently new invention. Some observers at the time, projecting these developments, concluded that the bank of the future would hold virtually no assets, would require virtually no funding, and would have no branches."[2]

In such dynamic international financial system, domestic and international bank need effective banking supervisory practices and supervisors are often swift to encourage banks to adopt "best practice". In this help and Basel Committee on Banking Supervision set up rules as minimum standard for sound prudential regulation and supervision of banks[3] and banking systems as a benchmark for assessing the quality of supervisory systems and for identifying future work to achieve a baseline level of sound supervisory practices.

[2] Özsoy, Ismail; Sayfullin, Salavat, Banking: Past and present, IBSU Scientific Journal (IBSUSJ), ISSN 1512-3731, 2006, Vol. 1, Iss. 1, pp. 75, http://hdl.handle.net/10419/54616

[3] Core Principles for Effective Banking Supervision, Basel Committee on Banking Supervision, Bank for International Settlements 2012, www.bis.org

The state regulates the work of the banks and the bank activities because it is not convinced that the market with its mechanisms is capable of minimizing the risk which impact the banks. Such interfering, on the other side, has the role of protecting the bank clients, the employees and the bank`s shareholders, impel the competitiveness of the financial market and the development of new products and services. The mechanism which uses the state to implement and control the banks regulation within the banks operation and activities banks is the supervision. The bank supervision operates in accordance with the laws, bylaw acts, regulations, policies and measures of the supervisory bodies which constitute the legal environment as framework for soundness and stability maintenance. The part of the bank regulation related to the implementation of instruments of the monetary policy and does not prescribe the organizational and administrative segment of banking constitutes the economic aspect of the banking regulation.

In the cases where the banking regulation is not properly implemented or there exists systemic weaknesses in the bank supervision is potentially dangerous threat to the soundness and stability of the banks. If this situation rise into wide scope and enough long duration than damages can be expected. The damages which can arise can be heavy burden on the state budget and taxpayers because of bad banks sanation.[4] This is not unknown in advanced economies as well, which are not immune to the state interference due to bank failure sanation. "The fiscal costs of banking crises in developing countries since 1980 have exceeded $1 trillion, and some estimates put the cost of Japan's banking problems alone over this threshold."[5] During the crises in the good intention to send positive signal to financial markets, the liders of the biggest economies stated explicitly that they are standing ready to act if banks are in need of help, and this behavior open the question for impel to moral hazard in banks activities. "In addition to the liquidity

[4] In the Republic of Macedonia, in 1995, was adopted the Law on sanation and reconstruction of part of the banks in Republic of Macedonia because of the damages which arise of the former economic system and the position of the banks, and the bank supervision system as well. This law prescribed that the future paying off of the blocked foreign currency deposites would be considered as state responsibility. It also prescribed cleaning of balance shits of liabilities from foreign creditors, and sanation, reorganisation and privatisation of Stopanska banka.

[5] Levine Ross, Bank regulation and supervision, Bank regulation and supervision, NBER Reporter Online, National Bureau of Economic Research (NBER), Cambridge, Mass., Iss. Fall 2005, pp.9, http://hdl.handle.net/10419/61872

provision by central banks, governments around the world have constructed very large rescue packages consisting of capital injections into banks, all-out nationalizations, explicit guarantees on bank lending and purchases of troubled assets. During 2009, total resources committed in these packages amounted to e5 trillion or 18.8% of GDP for 11 large western countries (Australia, Canada, France, Germany, Italy, Japan, the Netherlands, Spain, Switzerland, the United Kingdom and the United States.)"[6]

The current situation in banking and financial sector in Greece shows that the week financial controls, misinform in the financial statements, tax evasion and the inefficient bank supervision can provoke serious damages not only to the national economy, but they can be a threat for international finance. For example, until 2014 the state members of EU and IMF will pay 380 billion euro to Greece, which is 177% from Greek GDP i.e. 33.000 euro pro citizen.

Due to the abovementioned, the banking system has always been one of the most regulated segments in each state, because each political elite has interest in maintaining the efficiency and stability in banking system and high level of confidence in banks.

3. Different approaches in banking regulation and supervision

Taking into consideration the important position which the banks have in economy, it is impossible their activities to be released and free regulated only from the market conditions. "Some governments choose an active, hands-on approach, where the government owns much of the banking industry, restricts banks from engaging in non-lending activities such as securities underwriting, insurance, real estate, and non-financial services, limits the entry of new banks, and creates a powerful supervisory agency that directly oversees and disciplines banks. Other countries rely substantially less on direct government control of banks. These countries place

[6] Rob Nijskens, Bank Risk, Bailouts and Ambiguity, CentER Dissertation Series: 338, Tilburg University, 2012, p.37. http://arno.uvt.nl/show.cgi?fid=128250

comparatively greater emphasis on forcing banks to disclose accurate information to the public as a mechanism for facilitating private sector governance of banks."[7]

Thus, while many countries have followed the Basel guidelines and strengthened capital regulations and empowered supervisory agencies to a greater degree, existing evidence does not suggest that this will improve banking-system stability, enhance the efficiency of intermediation, or reduce corruption in lending. Although some countries have reformed their regulations to empower private monitoring, consistent with the third pillar of Basel II, there are many exceptions and even reversals along this dimension.[8]

The survey[9] of the Word Bank provides data for 143 countries, 37 of which are advanced economies and 106 are emerging markets and developing economies (EMDEs) showed that there exists significant differences between crisis and non-crisis countries in several aspects of regulation and supervision. The results show that: crisis countries had less stringent definitions of capital and lower actual capital ratios; banks in crisis countries faced fewer restrictions on non-bank activities such as insurance, investment banking, and real estate; and regulations concerning the treatment of bad loans and loan losses were less strict in crisis countries.

The results from another survey about Banking Regulation show that more open political systems tend to have greater limitations on supervisory powers and fewer restrictions on what banks can do.[10] The differences are noted about which body or agency is the bank's supervisory authority in the country. According to the survey in more than 60% of jurisdictions, central banks are the agencies that supervise the banks for prudential purposes. But if the countries are divided in two income groups: emerging markets and developing economies (EMDEs) and advanced economies, than the results show that the central banks are the banks supervisory bodies in

[7] Levine Ross, Bank regulation and supervision, Bank regulation and supervision, NBER Reporter Online, National Bureau of Economic Research (NBER), Cambridge, Mass., Iss. Fall 2005, pp.9, http://hdl.handle.net/10419/61872

[8] James R. Barth, Gerard Caprio, Jr., Ross Levine, The Evolution and Impact of Bank Regulations, The World Bank, Policy Research Working Paper, WPS6288, 2012., p.4.

[9] "Bank Regulation and Supervision around the World: A Crisis Update", Policy Research Working Paper, WPS6286, The World Bank, 2012.

[10] James R. Barth, Gerard Caprio, Jr., Ross Levine, The Evolution and Impact of Bank Regulations, The World Bank, Policy Research Working Paper, WPS6288, 2012., p.21.

about 75% of EMDEs, and only about 40% of the advanced economies have the central banks as bank supervisory bodies. At about 50% of the advanced economies use separate bank supervision agency instead of central bank.[11]

These different approaches in national systems in banking regulation and bank supervision, will be to overcome in the future with developing stronger supra-national bank supervisory authorities which will continuously take over parts of jurisdiction from the national bank`s supervisory authorities.

4. Development of banking regulation and supervision in the republic of Macedonia

When we look at the development of the banking regulation and supervision in the Republic of Macedonia in the past, we can divide this development in two periods with their own specific characteristics. The first period starts with the constitution of the Yugoslav Federation and Macedonia becoming a part of it federation, and it continues till the end of Yugoslav Federation. The second period begins with the independence of the Republic of Macedonia in 1991.

The development of the banking regulation and supervision, in the first period, is marked with the specific characteristics of the political and economical system where it functions.

The beginning of the development of the banking regulation and supervision starts with the Committee of finance of Macedonia, established on the first meeting of ASNOM, which have been governing with the state banks as well, and have also controlled the other financial institutions as State regulatory body. [12]

[11] "Bank Regulation and Supervision around the World: A Crisis Update", Policy Research Working Paper, WPS6286, The World Bank, December 2012, p.44.

[12] Мангова-Поњавиќ, Кики, Централно банкарство во Република Македонија 194-2006, Зборник на трудови на Правниот факултет „Јустинија Први" – Универзитет „Св. Кирил и Методиј" и Правниот факултет при московскиот државен Универзитет „М.В. Ломоносов", Правен факултет, Скопје, 2007, стр. 207.

Within this period, the Federal Government dominates[13] in the process of establishing, operating and abolishing of the banks. The main authorities for bank supervision are the Federal Ministry of Finance and the low level financial inspections.

At the beginning of the 60-ties, the Yugoslav National Bank (YNB) takes part in bank supervision over the implementation of general credit policies and banks liquidity, but the supervision of the bank compliance with the regulations is still responsibility of the financial inspections.[14]

In the middle 70-ties, with new banking law[15], YNB obtains more responsibilities in banking supervision and now it is responsible for maintaining the value and stability of national currency - dinar and the State liquidity, but without sufficient real instruments. Later, with the introduction of new concept of market oriented banks, have been also defined the first prudent regulations for banks[16] and YNB obtains more mechanisms for bank supervision.

The end of this period begins with the adoption of the last federal law on YNB[17] in 1989. In accordance with this law, YNB has strong position of bank supervisory authority and has the authority to adopt prudent regulation and does the control of the implementation of the banking regulation.

The beginning of the second period is in 1992 when the law on National Bank of the Republic of Macedonia[18] (NBRM) is adopted. Comparing some of the provisions in regard of bank supervision and control, can be remarked that there are not significant changes within the control system of bank operations between this and

[13] Ordinance for banks and saving houses, Official Gazette of FNRJ No. 4/1954, 13/1954;
[14] Banking Law, Official Gazette of FNRJ No. 10/1961, 30/1962, 53/1962.
[15] Law on the National Bank of the Yugoslavia and common monetary activities of the National banks of Republics and Provinces, Official Gazette of SFRJ No. 49/1976, 41/1981, 26/1984, 71/1986.
[16] Мангова-Поњавиќ, Кики, Централно банкарство во Република Македонија 1946-2006, Зборник на трудови на Правниот факултет „Јустинија Први“ – Универзитет „Св. Кирил и Методиј“ и Правниот факултет при московскиот државен Универзитет „М.В. Ломоносов“, Правен факултет, Скопје, 2007, стр. 221-222.
[17] Law on the National Bank of the Yugoslavia and common monetary activities of the National banks of Republics and Provinces, Official Gazette of SFRJ No. 34/1989, 88/1989, 61/1990.
[18] Law on the National Bank of the Republic of Macedonia, Official Gazette of RM No.26/1992.

last federal law. With the amendments from 1996[19] qualitative movement to modern bank supervision has been made.

The enhancement of the bank supervision continuous in 2002, when NBRM[20] is defined as Central Bank of the Republic of Macedonia and one of its functions is executing bank supervision with an authority to adopt decisions, methodologies and standards. In this period, the focus of the bank supervision is the compliance of the banks with the banking regulations and supervisory standards.

The second qualitative movement in the development of the banking regulation and supervision is made in 2007 with the adoption of the new law on banking. [21]

With this law wider implementation have the international standards for banking and bank supervision, and the issues related to soundness and stability of banking system and banking management are compliant with the requirements of the EU Directive 2006/48[22] and the EU Directive 2006/49.[23] The thing that is meaningful for the bank supervision is shifting the focus from bank compliance supervision to risk based supervision. This line of development of banking regulation and supervision is also preserved in the Law on the National Bank of the Republic of Macedonia[24] from 2010.

[19] Law for amendment of the Law on the National Bank of the Republic of Macedonia, Official Gazette of RM No. 17/1996.
[20] Law on the National Bank of the Republic of Macedonia, Official Gazette of RM No. 3/2002, 51/2003, 85/2003, 40/2004, 61/2005, 129/2006.
[21] Banking Law, Official Gazette of RM No. 67/2007, 90/2009, 67/2010.
[22] Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), (OJ L 177, 30.6.2006, p. 1)
[23] Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast) (OJ L 177, 30.6.2006, p. 201)
[24] Law on the National Bank of the Republic of Macedonia, Official Gazette of RM No.158/2010, 123/2012.

5. Comparison of bank regulation and supervision system in Macedonia, Bulgaria, Serbia, Greece and Kosovo

Despite the historical development of the banking regulation and supervision of the Republic of Macedonia, it is important the current system to be put into the context with other states and their banking regulations and bank supervision systems, to be shown whether it is different from the other modern systems.

Taking into consideration the significance of the regional context in the economic, legal and social development, to compare have been taken the neighbor countries:

Bulgaria, Serbia, Greece and Kosovo.

Additionally, the comparison of Macedonia with the above mentioned group of countries is because two of them are EU and NATO members, and two of them including Macedonia have aspiration to become EU and NATO members.

Into the analysis of the national bank regulation and bank supervision systems, part of the questions and answers which these countries have given in the survey of the World Bank about bank regulation and supervision in the world. [25]

In Figure.1. are stated the answers for each country separately including the answers for Macedonia which are given in accordance with the banking regulation.

[25] Macedonia is not a part of this survey of the World Bank, but the answers for Bulgaria, Serbia, Greece and Kosovo are taken for each country separately from the following dataset http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTGLOBALFINREPORT/0,,contentMDK:23267421~pagePK:64168182~piPK:64168060~theSitePK:8816097,00.html

Fig.1. Comparison of characteristics of the bank supervision systems of Macedonia and its neighbor countries

	BULGARIA	SERBIA	GREECE	KOSOVO	MACEDONIA
How many commercial banks were there at the end of ...?					
2008	30	34	19	8	18
2009	30	34	19	8	18
2010	30	33	19	8	18
What body/agency grants commercial banking licenses? Please include the name of licensing agency. If more than one, please describe their respective	Bulgarian National Bank/Gov. council	the National Bank of Serbia	Bank of Greece	Central Bank of Republic of Kosovo	The National Bank of Republic of the Macedonia
What body/agency supervises commercial banks for prudential purposes?	The Central Bank	The Central Bank	The Central Bank	The Central Bank	The Central Bank
Are there any banks that are not under the jurisdiction of this agency?	No	No	Yes, The Loan and Consignments Fund which is public owned specialised credit institution	No	No
Can the supervisory authority force a bank to change its internal organizational structure?	Yes	Yes	Yes	Yes	Yes

To whom is the supervisory agency legally responsible or accountable?	A legislative body, such as Parliament	A legislative body, such as Parliament	According to Art.5B of BoG's Statute), the Governor is not accountable against the Government, but he, when asked, may appear before the competent parliamentary committee to report on matters relating to the Bank's fields of competence.	The head of government (e.g. President, Prime Minister) and The Finance Minister or other cabinet level official	A legislative body, such as Parliament
Does the supervisory agency need to obtain approval from the government in order to …?					
a.Issue binding secondary regulations for the banking sector	No	No	No	No	No
b.Determine its budget	No	No	No	No	No
c.Obtain funding	No	No	No	No	No
d.Hire and fire senior staff	No	No	No	No	No
e.Define salaries and benefits structure of staff	No	No	No	No	No
f.Define its organizational structure	No	No	No	No	No
Can individual supervisory staff be held personally liable for damages to a bank caused by their actions or					

omissions committed in the good faith exercise of their duties?	No	No	No	No	No
Can the supervisory agency be held legally liable for damages to a bank caused by its actions?	No	No	Yes	Yes	No

From the answers can be concluded that there are not significant differences between the countries which are subject of this comparison. In each country, the Central banks have the main role in the national bank supervisory system. They also grant licenses for banks, have high level of independence within the organization and the operation, have the authority to force a bank to change its internal organizational structure. The Central banks are supervisory authorities for all banks under their jurisdiction and their staff cannot be held liable for damages to a bank caused by their actions or omissions committed in the good faith exercise of their duties. Certain differences are noticed in the area of legal responsibility of the supervisory agency and that the National banks can be held legally liable for damages to a bank caused by its actions. Anyway, these are not big differences compared to the other systems.

We can come to a conclusion that, in accordance with the issues which were subject of this analysis, the bank supervisory system in the Republic of Macedonia is similar to the systems in the other countries.

Conclusion

Recent crises in U.S.A and Europe banks shows that the world's financial system, the regulation and the institutions will be object of reconstruction in near future in regard to create a safety net that can prevent financial disasters and preventing imprudent behavior by financial institutions. This is promoted by those who think that the weakness of the regulation and supervision of the financial system is viewed as a major factor, contributing to the emergence of bank failures and financial crisis.[26] They call for stronger regulatory and supervisory policies as key factors to stabile and sound banks, excessive risk taking and minimize moral hazard in the banking system. Anyway, each bank failure should not be treated as weakness of the regulation and inefficiency of the bank supervision because the banks in their operation are amenable of the market regulation and the process of business selection.

Ultimate objective of prudential regulation and supervision of the banking sector is stabilizing the financial system and obtaining public confidence and protect the clients.

In the past twenty years, NBRM as central monetary authority, achieved significant improvement in direction of creating a modern bank supervisory system in compliance with the international banking regulation and supervisory standards. The maintenance and the enhancement of this system are not easy, and it should be worked on continuous improvement of the system in future.

Although, the supervisory bodies will make efforts to improve supervision and prudential standards so as to ensure that the banks meet the capital requirements, make adequate provision for bad loans, limit the connected lending, and disclosure financial information, they will not stop crises.

The parallel processes of development of international finance and run for profit and the prudential regulation and bank supervision, always will be on opposite sides.

[26] Aytül Ganioglu, Prudential Regulation and Supervision of the Banking Sector and Banking Crises: A Cross Country Empiricial Investigation, BDDK Bankacilik ve Finansal Piyasalar Cilt: 1, Sayi: 2, 2007,p.12. http://www.bddk.org.tr/websitesi/turkce/Raporlar/BDDK_Dergi/4216Makale-1.pdf

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5. Law on the National Bank of the Republic of Macedonia, Official Gazette of RM No.26/1992.

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10. Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), (OJ L 177, 30.6.2006, p. 1)

11. Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast) (OJ L 177, 30.6.2006, p. 201)

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NEW MARKETING TENDENCIES - TOWN BRANDING

Danco Arsov, MA[1]

"Far away up, where you are settled, I have built a 'King's Palace of the High'. Now, similar to it, I shall also build down on the earth"

An extract by the Babylonian version of

"An Epic about Creating" [2]

Abstract:

According to Babylonian's version of evolution, during the "gods" colonization on the earth, arriving by the decision of the supreme leader Marduk, who told them: " When you descend the earth by the heaven, you will have a place to stay, which I shall call Babylon - the gods' door". Thus, the earth shall not be a place for a short stay, but shall become "a home, far away from home". [3]

The history of the evolution and town development does not integrates "the physical scenarios" only, it covers the space development, implied as eternal, always present cause for inconceivable deity or invisible power, being a root of the entire material and universum.[4] *This is an everlasting scenario, enabling the town to be as*

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[2] http//www.scrbd.com/doc/13848910/sitchin-dvanaesti-Planet

[3] www.scrbd.com/doc/13848910/sitchin-dvanaesti-Planet.
[4] Helena Petrovna Blavacka; "Tajna doktrina" Tom 1, Kosmogeneza; Metaphysica; Beograd.

Marduk imagined it, as a habitat for constant stay. However, from today's aspect, it becomes actual, paralel to the role of the town actuality on the global scene, and its irreplaceable role of a communication chanal between the present time and the past, as well as - the way the presence stipulates the past.

This work is focused on underlining the importance of the brand and town branding as a new tendency in marketing, resulting of the enforced process of globalization, and with this, as well, enforced importance of the town in the fight for keeping its economic development.

Key words: brand, branding, town-brand, competition, town/city branding targets, branding advantages

JEL classification: R19, M31

Introduction

In an atmosphere of intensive globalization, the focus of our attention is directed to town promotion, as one of the links, participating in the construction of economic, communication and political development assumptions regarding global economy. This results with an open opportunity for implementation of marketing instruments and development of new marketing activities, with a simple target for positioning and promotion of less-known or unknown towns. Towns branding is one of the contemporary marketing tools, which enables defining the image of the town, its better positioning, popularization on the international market, as well as its promotion to the global scene, to attract new and keep the already existing businesses and investors, attract greater number of tourists, new inhabitants and economic development.

2006, page 81.

In the actual process of world communication and creation of a "global village", the town branding seems a challenge because of the opportunity it offers, to proclaim and introduce the world the unique characteristics of the town, as well as promotion of its real values, the puls and soul of living, and material assumptions, which all together will encourage the town to develop in the desired direction.

1. Definition of the concept brand and branding

The most popular marketing term in any company, institution and also in the everyday life is the term "*brand*". In the theory could be found more definitions which refer to the brand. Among others, the American Marketing Association (AMA)[5] defines the brand as a name, term, sign, symbol, design or combination of all these, oriented to identify the product or service of a certain producer or a group of producers, as well as to make difference or distinguish from the competitor's product or service. The brand is defined as a symbol of the product or service, which instigates comsumers' perception for "additional value" of the product, instigating them to buy the same products, or to buy that brand, not considering the price or the accessibility of competitors' brands.

It seems that Philip Kotler's[6] definition is acceptable by which the brand is a name, term, symbol or design (or combination of all stated) identifying the creator or the producer, where the product may be material goods, service, organization, place, entity or idea. Concerning this, the brand or the name/mark is a kind of identification of the product for the consumers, by which is enabled obvious conspicuousity, adding significance and importance to the product and a kind of quick recognition of the searching product.

[5] Philip Kotler, David Gertner; "Country as a brand, product and beyond; a place marketing and brand management perspective", destination branding, second edition, Ebevier Butterworth Heinemann, 2004; Oxford, UK. p.46.

[6] Kotler Philip, Lee Nancy; "Marketing u javnom sektoru" Mate; d.o.o. Zagreb, 2007, p.114-115.

Thus, it could be concluded that the brand or the trade mark is a mean for recognition of the product by the consumers, supplying clear observation, adding meaning and quick recognition of the searching product. In essence, the good brand makes easier the buying decision, or ensures certain quality.[7] Due to this, it could be concluded and underlined that the brand is more than a simple product or a service, whereas the trade mark is the name, symbol and identification, which provides the customer with functional and psychological priority.

The term "*branding*" origins from the root of the term "brand", and also, as the brand term, is used in its original form in the scope of all family languages, not being translated. The "branding", as a process, is identified by the terms "*mark*" and "*brand*", and as such, it is defined as a term for providing products or services with all required elements about the identity of the product mark. In fact, branding is wider term which absorbs: the name, design, symbol and legally reserved elements, that are integral parts of the product or service identity. Evaluating all previous definitions about branding, it could be concluded that very often it is understood as a mix of art and science by which are managed the associations between the brand and the memory in the mind of the targeted group.

Some initial samples of the brand (mark) are connected by being granted names in the trade, mainly indicated by the owner's name, with a simple purpose to differ from others.[8] Recently, when the brand (mark) is used, in the case of some producers, even towns, states and nations, do insist on creating various kinds of communication with their consumers - users of their services, which shall distinguish them from the competition.

Talking about the brand (mark) of the product or service, it is necessary to be made difference and to be distinguished: the name of the mark, the sign of the mark and

[7] Sally Dibb, Lyndon Simkin, Wiliam M. Pride, O.C. Ferzell; "Marketing", Mate, Zagreb, 1991, p.224.

[8] Bruno Grbac: "Osvajanje Ciljnog trzista"; Ekonomski fakultet Sveucilista u Rjeci, Rijeka, 2005, p.33.

the trade mark of the mark.[9] One of the best known experts for branding - Walter Landor[10] has pointed out: "Products are manufactured in the factories, but brands are mind creation", that is the reason when talking about mark - it seems like - talking about actual intellectual property.

As from the aspect of the towns, the brand or the mark represents designation of the town, or better, it is a sum of: expectations, thoughts, meditations, considerations, knowledge, feelings and associations we "carry" in our heads. For example, Paris is a mark, as well as Hollywood , California, Milan or London. Taking into consideration all this, it could be concluded that the best brand towns are successful, because they had thrived synergy in creating emotional link between them and the targeted group.[11] From the aspect of marketing, the town represents a market or network of various inside relations, where are occurred exchange of products and services, as well as a lot of other functions.[12] However, the observation of the town as a kind of goods, should not be considered that could be bought its parts, services or immovables.

In respect to this work, the town is observed as an urbanized space, which changes permanently and constantly, spreading or shortening, increasing or decreasing. The town, as any company, with implementation of the marketing concept, moves to the direction of realization of the wishes, necessities and requirements of the targeted group, and development of long-term strategic values.[13]

[9] ibidem.

[10] Jasmina Fijacko; "Robna marka donosi profit"; 05.05.2006, p.1; www.croatiabiz.com;

[11] Peter W.Williams, Alison M.Gill, Neil Churo; "Branding mountain destinations"; The battle for "Placetuless", Tourism review, no.59, 1/2004, r.6.

[12] Marko Paliaga,, Brending & konkurentnost gradova,, Samostalna naklada, Rovinj, 2007, p. 68.
[13] ibid., p.46

2. Competition between towns as a reason for branding

Decentralized world and its economy are more and more place for competition fight between towns, not being only consequence of the changes in the social consciousness, but it also results to the great world technological changes, and the political changes after the Berlin wall fall, dissolution of the former Soviet Union and blocks separation. The competition between the towns is a consequence of the decentralization processes, and in such conditions, towns are forced to search for an alternative and mode for attaining additional value.

Taking all these into consideration, the effective and coordinated branding of the towns in their severe competition fight, may contribute in its differentiation and also, in realization of their political and economic results. The competition between towns initiates very quick thinking because of differentiation, and with a goal to be recognizable. To be recognizable, unique and exceptional is the basis for branding.

2.1 Understanding the competition between towns

Besides having a quality urban town service, everybody wants to have a safe town. As from today's aspect, security is main factor, if are considered the increased radical activities at the greater number of world metropolises. Example, in London had happened terrorist attack, which, from the aspect of security, it needed a long period of time to restore the citizens' confidence and security. The same example could be found in New York, and many other cities that have been displayed and exhibited to terrorist attacks.

The town/city, as well as the product, is necessary to satisfy the citizens' necessities and requirements. In nowadays conditions, the competition between towns is stronger, and that is the reason why should be conducted marketing research, which will enable to identify and establish the necessities of the users of the tons' products and services, and the results to be compared with the competition.

In this context, it is completely illusory to think that creation of a brand for a town - not accepted by its citizens, could be accepted by its visitors. It is the same as, when we throw a stone in the water, the circles will be formatted contrary to natural laws, and from the periphery will move up to the centre of the circle, which understandably is not possible. If a town does not reflect the positive energy of its citizens, that exists only if there is citizens' love towards their town, relax and satisfaction, nobody will feel like staying in that town. The only reason will be that, in an atmosphere of bureaucratization, you "feed" only the emotional body of the citizens' pain and make odious repulsive and rejection at potential visitors.

In respect to the competition between the towns, should be differed two basic terms, as: ranking and competition.[14] The towns' ranking is in correlation with confirming and identifying the clear rank by an/some issue(s), advantages or disadvantages compared to other towns. The goal is to attain clear scale of values between the towns, which is reached by defining, measuring and aggregating certain quantitative indicators (employment/ unemployment, GDP, number of companies, citizens, etc.). The competition between towns concerns the official announcement that a certain town is to compete with other competitors in respect to some inputs (working places, companies' headquarters, financial means and capitals, etc.).

The competition could be presented and reviewed by ranking the quantitative indicators on the already set scale. For this purpose, between the towns, could be differed various strategies in relation to their history, policy, as well as by the territorial predispositions that create that competition. This priority may be set and founded on the following predispositions:[15]

- towns that historically dominate, and are well known (Rome, Berlin, London, Paris);

[14] Marko Paliaga; "Branding & konkurentnost gradova";op.cit., p. 21.
[15] Victoria Pike Bond, Abby Cook; "New perceptive, Competiton and Local development Policy"; Public Policy Institute of California; 1994, p.12.

- towns with a role of a capital city;
- having an important role in its state as financial, traffic artery, fashion centre, etc. (Milan, Frankfurt);
- having an important role in the sense of some world significant associations (European Union, Brussels);
- being host-town for some sport happenings (Athens, Barcelona, Atlanta), and
- being specialized for certain industrial branch (Singapore, Shanghai, Hamburg).

The above listed elements give competitive priority to some of the towns. However, should not be forget in any case, the fact that, every day the evolution throws innovations out, new and ambitious projects, which in any sense, enable the towns, that in the start did not have any competition priority, to ensure an important place on the world market.

2.2 Particularities in the Competition between Towns

Talking about particularities in the competition at towns and public services, it has to be underlined and to emphasize its peculiarities. Competition between different territories, in greater part, arises as a result of foreign investors' attracting. Towns, as a territory will be successful as much as being competitive in their production, internal and external traffic accessibility, quality of their labour forces and ability for learning and adjustment.

The market of local public properties is in interaction with the state and regional market of public properties, which is an integral part of theirs. It means that on the local public properties market, the towns make competition among themselves for allocation of the local resources, the budget and services they offer. As of geographical aspect, it could be stated that the market of public properties and services embraces an administrative region - limit of the Local self-management Unit, because on that region and in the frame of its scope, each town autonomously manages its resources. Buyers of the local public properties and services are residents, non-residents and companies that had already decided their headquarters to be located there.

The users of the town services by paying local taxes, utility taxes and other commitments and duties, are paying indirectly for the services performed by the town. The local government and the city administration, as per the budget resources, being at their disposal, offer certain mix of local services and products. Sometimes this could provoke collision with the preferences of the residents, but according to Schneider[16], buyers can use their vote, thus making an impact over the offer. There are two key modes of making impact, as:[17] pooling of the buyers (to use the institutional means and forms) and, the buyers can "go" on strike (using the democratic right for strike, and other forms of self-expressing).

At the end, it is always necessary to be taken into consideration that all involved parties in the town story, do have freedom for asking these services and proprieties that will satisfy their wishes and requirements in an optimal way.

3. Causes and targets for town branding

In the process of adopting the concept for branding towns, it is basic principle the town to become a mark, and as a result of this to create psychological picture in the consciousness of the members of the targeted group, which will help in the estimation of the town products and services, and will help the tourists in their decision making about visiting or not the town. At the same time it will make an

[16] Mark Schneder;"The Competitive City"; University of Pittsburg Press; Baker&Taylor International, 1991.p.7

[17] Marko Paliaga; "Branding & konkurentnost gradova";op.cit., p. 29.

impact over the decisions of the potential investors. These were only a part of the reasons and targets for implementation of the branding concept, which will be elaborated in details further on.

3.1. Reasons for implementation of the towns branding concept

Commencing and initiating with the statement that towns and cities have always been brands through the history, the rating of the towns depended on their sovereigns, politicians and governments. Throughout the history of the development of the town are known cases when their sovereigns, and rulers, very often, were bringing well known philosophers, orators, painters and writers with the only aim to popularize it. In the contemporary, up to-date time, it is not rare the local authorities of the town to bring actors (example, Saint Tropez became known because of Brigitte Bardot), directors, writers, conductors, sportsmen, and others that could, by their presence, improve the rating of the town.

After certain period of time, a good brand of a town transforms into desirable perception of a town, and the result reflex to expansion of investments, better promotion, increased export and import, and new working places. The brand- town, besides development of its economic strength and wealth, should develop city creativity, philosophy, confidence, wisdom and challenge.

Reasons for implementation of the town branding concept is in the tendency to create emotional values about that town, which results from the associations of all the targeting groups in the contact with the town brand. Such positive associations do impact over the entire city trade, economy and management administration of the town.

3.2. Goals for implementation of the town branding concept

Goals[18] for implementation of the town branding concept, may be proponent in the need for raising the conscience of the citizens and creating strength emotional relations with the town, to increase the confidence in its own abilities, strength and power, to create new and keep already existing businesses, encourage the tourists to recognize the town as an attractive and amiable one, and increase the influence of various kinds of companies, social political groups, economic lobby groups, local domestic and foreign enterprises to attract and realize new investments.

Realization of the goals necessary for implementation of the town branding concept do enable reaching a competitive, attractive, safe, ecological town with high quality infrastructure and persistent economy. Only this kind of a town could realize its traced directions for own development.

4. Challenges, strategies and benefits from towns branding

The towns and their efficiency have reached their maturity. The actuality of a town, nowadays, is not stipulated by architecture constructions, socio-political and economic events. Today, in conditions when the admission to greater number of products and services offered by the towns generally is the same, the uniform of certain outstanding services or products for one town only, is a past. The residents, non-residents, as well as potential investors are more and more interested for eventual economizing that could get in one town, or simply, all the subjects have tendency of identification with one town, for their personal emotional experience. Thus, in that battle on the global scene, through the process of towns branding, it is endeavored to be developed and established an emotional relation between the town and the residents, non-residents, and the investors as well, who all together do expect certain benefits.

[18] Marko Paliaga; "Branding & konkurentnost gradova";op.cit., p. 25.

The process of towns branding bears some challenges; it imposes set strategies by which - success depends on the benefit of the town and its citizens. Towns branding is not an ephemeral process, it is not accidental and not founded on the personal experiences of a single person from the local authorities, as main bearers of this process.

4.1. Challenges and strategies of towns branding

Adaptability and existence of the local community is *a* challenge for each town, under the existing conditions of enormous international competition, where anyone fights to attract new investors, companies, tourists and citizens.

If it is considered that every town is limited by its resources that are at its disposal, also, bigger mutual connection, than it is understandable that each local community has to compete for its place on the global scene.

Attracting and demonstrating interest by the subjects about certain town, is the next challenge faced by each town. Taking into consideration that a small number of products can have impact over the human consciousness, as effective and strong brands. From the aspect of towns, it is a challenge to create a brand that shall be alive in the consciousness of the users of the town's services and products.

The strong and powerful town brand is necessary to offer an unique and exceptional priority in respect to the competition. However, besides this, it must offer an unique and complete multi-sensible experience. In this context, it is necessary to underline that it is not enough only visual representation of the town's product or service, but, besides the sense of sight, should be challenged other senses. The final goal of the city/town brand is creation of an emotional link. The act of its creation and establishment is so called branding, which provokes creation of a strategy that cannot be uniformed, but each to be special, immanent to the particularities of each town.

4.2. Benefits of towns branding

As well as the well-known companies, also, towns, regions or states by introduction of the process of branding, will be enabled for an easier recognition of sale channels of their own products or services, it will be an easier way to reach the best labour forces, greater number of tourists and investors, to establish an emotional relation with the residents and non-residents (when the town brand decreases the pain, and increases the satisfaction).

In a certain sense of identification with the brand, under the conditions of individual materialistic living in an egocentric epoch, makes the brand appearance as a kind of substitution to the religion belief, in other words, the brand represents a kind of "human identification in stipulations of confused competition on the scene of a global village".[19]

Conclusion

The recent process of globalization, as well as decentralization, enabled declination of the state role for the account of the increased importance and role of the town. Such a situation has been reflected to the rest of social flows, that contributed to be declined the importance and the role of the collectivity, and to be much more strengthened the role of the individuals. From the aspect of the towns, besides the increased freedom in decision making, these processes imposed the need to find solutions which will enable the town to stand straight and to fight for its so much desired economic development on the global scene. In the meantime, it should be valorized the fact that, the competition that was based on an inexpensive land so far, deducted tax rates, and infrastructure investments, with a simple wish to attract new investors, as from today aspect is past , and as such is not enough to keep the

[19] In conditions, when the interaction of the religion is obviously decreased in the human living, only the human need remains unchangeable in respect to - believing and identification

already existing and attracting the new customers, citizens and investors. The reason for this situation is that the citizen, besides the above stated elements, is more and more interested about the factors related to the pulse and life style in the town, cultural inheritance, especially the image, or in one word, the factors that represent the link for construction of an emotional connection.

The brand and branding, turned out as a very successful and powerful tool in the commercial sector, and taking into consideration the actual and rushed off process of globalization, the brand and town branding, as a new tendency in the marketing, emerges as a need that should be accepted and understood by all relevant town authorities, for successful adaptation and adjustment, existence and development on the global scene. Analogically, the meaning and the benefit of acceptance and implementation of this concept, enables and makes possible not only to be reflected in the economic, but also in the non-economic sectors, as health care, education, art, culture, tourism.

Towns' branding is contemporary mode for their development or help, if this development has been jeopardized. It can help in overcoming development problems, and, at the same time, will enable prevention and protection of cultural and historical traits and the town identity.

While the town promotion enables its positioning on the global scene on the basis of its real values, the total effect of the town branding could be seen in its recognition, development of its essential values, as well as encouragement of its own development through consolidation of its relations with its own citizens, increase of employment, enforcement of entire historical and cultural relations that are reflected over the local economic development.

Attracting new and keeping the already existing businesses, development of strong emotional relations with the residents and non-residents of the town, as well as encouraging the local economic development, by increasing the export and opening new working places, is the reason and the highest positive output of the town branding. In the 21st century, the brand and town branding can not be observed as an alternative to the strategy for promotion of the town, but as a concept presenting direction to be used for the future development of the town.

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FINANCING OPTIONS AND ALTERNATIVE FINANCIAL SOURCES FOR MACEDONIAN SMES

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Abstract:

Small and medium enterprises are the core of each economy. Therefore, it is not unusual to connect SME growth to economic growth in a system. However, it is difficult to state whether Macedonia provides sufficient and adequate SME financing options. The paper will focus mostly on financing options available to SMEs, but will also cover other options that are not widely used by SMEs as well as the reasons for their usage omission. Further, the paper will explore "alternative" financing options, which have currently appeared as financing solutions, or propositions for financing solutions for Macedonian SMEs. Given that this is a rather vaguely explored field of interest, data for conducting a research are few, which may be a limitation to the conclusion. But in order to Researches on this subject matter may lead to further education of the business environment on the subject of SME financing, leading to a strive for improvement of financing conditions of SMEs in the region.

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1. Introduction

Small and medium-sized enterprises (SMEs) have always been considered as the backbone of any economy. They are considered as the pillars of economies, in the sense of providing employment, leading to market development and inducing economic growth. And as such, their existence is essential to economic growth. Therefore it is not surprising that most developed economies are comprised of SMEs, in over 90% of their composition.

One of the main issues regarding the creation, development and success of SMEs worldwide is the financing of SME operations. Obtaining finance for SMEs has always been a managerial challenge, especially when it comes to financial sources for micro and small companies. Despite the essential role SMEs play in economies worldwide, obtaining funds and financing SMEs has never been an easy task. However, throughout their growth and development, many countries have tackled this issue by providing more financing sources and increasing the governmental support for SMEs.

Macedonia is still a rather small and developing country. The private sector is rapidly developing, but many issues of economic growth have not yet been dealt with. SMEs in Macedonia represent the largest portion of the Macedonian market composition. However, operations and financing of SMEs are yet difficult processes and many SMEs liquidate their businesses because of the harsh operating environment. Financing options are limited for SMEs, although in the Macedonian economic environment, this is the case for large companies as well. Additionally, compared to neighboring countries, Macedonian SMEs have a very limited spectrum of financing options. Standard financing solutions that are commonly used are own sources or bank loans. The choices have extended throughout recent years, but still mainly focus on pure debt or pure equity financing options. Very recently, introduction to "alternative" finance attempts have been made, although it is yet too soon to discuss the success of this type of finance. "Alternative" financing sources include mezzanine financing, venture capital and business angels. Although in theory there is favorable ground for the development of these financing options, it is yet to be seen whether there will be practical implications of the same.

The significance of financing SMEs is great. SMEs are the backbone of the Macedonian economy, and as such, their number and their effective operation must increase in order to achieve economic growth. The liberation of the financing market and the increase in financing options available for SMEs in Macedonia will indirectly be a factor to lead to economic growth.

2. Significance of financing small and medium enterprises

The development of the Macedonian market is intrinsically connected to the growth and development of its largest segments. A recent study shows that the most significant portion of the total business units in Macedonia are SMEs[2] - more than 95% of the total number of business units. In 2009, the employment in Macedonia has mostly been based on SMEs employees. In 2012, this number has risen significantly, with over 80% of the private companies job posts offered by Macedonian SMEs[3]. The market of small and medium sized enterprises has employed over 60% of the employed workforce in Macedonia[4]. An important note is the fact that most of the growth, as well as employment of workforce occurs in micro and small enterprises, well above the average of the European Union. These facts lead to the conclusion that perhaps the essence of growth lies in the development of Macedonian SMEs, with an accent on small and micro firms. Economic growth thus, can be related to growth of MSMEs as well. And a significant

[2] Informest Main International financial facilities available for SMEs. Project Recipient country survey: Macedonia, 2011.
[3] European Commission Progress Report - Macedonia, 2012.
[4] Ibid, pp.23.

issue of growth is that it needs to be financed. Therefore, the adequate financing solutions for SMEs can eventually lead to market growth.

However, the lack of proper financing can have the adverse effect on companies, with a negative impact on the economy as a whole. Recent studies show that in the period between 2004 and 2007, when the number of SMEs operating in EU has actually grown, the number of SMEs in Macedonia gradually diminished, by a rate of 2% over the period[5]. Lack of financing options has lead to the liquidation of a portion of Macedonian SMEs in the period. In the very same period, employment by SMEs has decreased by 5% percent in Macedonia, which can be compared to the 7% increase of employment by EU SMEs. Once again, such decrease in employment can be well caused by the lack of financing options for Macedonian SMEs, especially in comparison to the same period in the EU, when financing options such as venture capital and private equity flourished, leading the growth of EU SMEs as well. Setting comparison aside, still the 2004-2007 trend of SME financing is a negative one. The number of Macedonian SMEs diminishes in this period, showing a negative rate, and a trend to liquidate more small (especially micro) companies, than to open new businesses. The lack of proper financing has appeared to create not only stagnation of SMEs, but even deteriorating of SME operations. From this notion, it can be observed how the availability of financing options for SMEs has its own economic significance. In reference and consent to a 2007 statement in a Macedonian economic magazine:"...the failure of the Macedonian financial system to respond to the demand for finance by the local private sector appears to be a significant problem for economic growth"[6], it can be agreed that in five years, the financial situation for SMEs has not changed at all. This statement reflects on the exact current situation the entire private sector has been in, and it has had its toll on Macedonian SMEs.

At first glance, in the past two the situation is improving, as it appears that small but significant changes are made in the legislation and government support. Additionally, various sources state that the situation is improving since 2007, in

[5] European Commission, SBA Fact sheet: Former Yugoslav Republic of Macedonia, 2009.
[6] Karovska, K., Capital Market Analysis. Skopje, Macedonia:Centre for Economic analysis, pp.11, 2007.

terms of the positive changes made in the SME operational environment. Administrative barriers have been minimized, business operating costs have decreased[7]. These are the information placed publicly. However, the reality is that the development of the (M)SME sector has been rather slow, and with minuscule improvements. Several more favourable financing options have appeared on the Macedonian market, leading to once again, a slow pace of development of Macedonian SMEs. Commercial bank loans have begun offering loans strictly targeted for SMEs, for one. However, according to the report of the European Commission of 2010: "There are a number of strategies and annual programmes for supporting enterprises and the SME sector which need streamlining and proper public funding. Measures addressing traditional sectors received inadequate budgets"[8]. Since then, not much has changed on this subject. In the European Commission progress report of 2012[9], a continuous problem is outlined in the limit of access to financial sources for SMEs, which in turns is considered the major impediment to SME growth in Macedonia. As it can be seen, the adequate financing measures, vehicles, or perhaps options, have not yet been put into practice.

3. Breakdown of financing sources available for Macedonian (m)SMEs

The following section will discuss the current financing options in Macedonia. Briefly going over them, it can be seen that both equity and debt financing is very limited for SMEs. It is both difficult to obtain, and limiting in future operations of the recipient of financing. Therefore, the possibility of introducing new financing options should be examined, as a basis for SME market development, leading to potential economic growth.

The financial market in Macedonia altogether is still in the infant stage. Problems in financing operations are faced even by large companies. Therefore, it is understandable that for SMEs this is more than an overly problematic area. The main options for financing any company are solely based on either equity or debt based

[7] European Commission Progress Report - Macedonia, 2010.
[8] Ibid, pp.54-55
[9] European Commission Progress Report – Macedonia, 2012.

financing solutions. Crossovers between the two theoretical fundamental financing sources are rare to non-existent on the Macedonian market, although combined equity/debt financing solutions are not unknown worldwide, especially in the form of mezzanine or hybrid financing. Whereas mezzanine or hybrid financing is vaguely and only officially present on the market, most financing solutions are defined as pure debt or pure equity financing. Even in this traditional classification of financing solutions, Macedonian financing market lags behind the world in terms of new and innovative means of financing SMEs. Business angels and venture capital investors, for example, are rarely seen to invest in Macedonian SMEs. Therefore, the key question that is imposed is – **what are the financing solutions available to Macedonian SMEs?**

3.1 Equity financing

In terms of equity financing, there are two typical, traditional sources, which are more frequently used by Macedonian companies, other than the aforementioned business angels and venture capital investors. These readily available funding sources are limited to merely internal equity financing (**own resources/capital**) or financing through the **Macedonian stock exchange**.

Regarding **internal financing**, both reinvestments of net income and owners' capital injections are considered as financing sources. These two variations of the owner's financing option are currently the most widely used equity forms of financing for Macedonian SMEs. For SMEs, reinvestment or owners' financing is the most common source of financing, on the equity side. As it will further be discussed, most SME managers are partial or complete owners of the businesses. Therefore, the idea of sharing ownership, especially publicly, is not widely accepted by them. This is one of the main reasons, aside of readily available financing, which makes reinvestment/own financing appealing and exploited by Macedonian SMEs. Moreover, it is also one of the greatest reasons of lack of interest of equity investors in Macedonian SMEs.

External equity financing is currently represented solely by the Macedonian stock exchange, in its most basic shape – stocks. Trading in financial derivatives is not yet available. The Macedonian Stock Exchange (MSE) has been established in 1995, and it is the first, and currently only exchange for long term securities in Macedonia. Currently, it is one of the best known equity financing sources of large companies and corporations in Macedonia[10]. The primary stock market is in fact the basis for equity funding of companies' operations. Additionally to public stock offerings, the MSE also provides private stock offerings, for companies not publicly traded. Although the number of publicly traded companies increases each year, privately traded companies are many as well. However, according to the April 2012 report from MSE[11], less than 100 companies have regular cash collection via the stock exchange. Companies with stock issuance over 20.000 Euro are under direct regulation of the Macedonian Commission for Securities Exchange (MCSE), although even smaller IPOs can be made, without the MCSE regulated auditing. Such IPOs can be made at the most twice in one year.

Regarding financing for SMEs, the stock exchange is still rather unavailable. Although the formal requirements for entering the MSE as a method for funding are less stringent, and the exchange itself is better regulated nowadays, the informal requirements that stem from a potential IPO are rather unattainable for SMEs. The entire organization of an initial public offering, as well as the costs that go hand in hand with it (such as transaction costs, auditing), are some of the factors that avert Macedonian SMEs from using this funding vehicle for their operations. Currently, Macedonian SMEs still regard the stock exchange as an unfavourable and unrealizable funding option. Another reason this option seems to be closed to SMEs is the lack of knowledge of stock exchange operations for Macedonian managers. This factor is especially seen in Macedonian SMEs' managers, who see the MSE as an ineffective and risky tool for collecting cash. Therefore, they avoid the MSE as a funding option, regarding it as unsafe method of financing. Moreover, as it has been previously mentioned, many managers are owners as well. Although the manager-

[10]Macedonian Stock Exchange, MSE Report April 2012, 2012.

[11]Macedonian Stock Exchange, MSE Report April 2012, 2012.

agent relation has been regarded as an undisclosed problem in modern management, for Macedonian managers-owners, the lack of separation is in fact a large portion of the problem. The loss of company ownership is regarded as loss of company control, which is not in line with managers' preferences.

3.2 Debt financing

Debt financing offers a broader palette of financing options. Aside from commercial bank loans, there are sources such as inter-company financing, varied forms of leasing for capital financing activities, as well as government financing.

The most widely used debt form of financing in Macedonia is **commercial bank loan financing**. In fact, commercial bank loans are the preferred form of financing for both SMEs and large corporations[12]. However, the reality of the financing situation is not bright in this field as well. The general offer on commercial bank loans does not vary significantly from one bank to the other. Until recently, only one of the banking institutions offered a specialized loan programme an SME-financing focused programme, the Macedonian bank for development promotion. Funds available from the European Investment Bank have been offered as commercial bank loans, partially for financing Macedonian SMEs as well. International aid agencies and bodies have argued that the lack of information and mistrust in the system has lead to stringent conditions and strict screening process regarding commercial bank loans for SMEs. Although theoretically bank loans have been available to SMEs, the pre-assessment and post-reception requirements have been too difficult to take on for many SMEs. The over-collateralization of loans has been the greatest drawback for SMEs. . Commercial banks usually ask for a larger worth of asset collateral, which small and medium sized companies seldom have. Large companies can meet obstacles for financing which are not easy to overcome for SMEs. Therefore, many SMEs disregard this option at the very beginning of the

[12] Nikolov, M., Garvanlieva, V & Andonov V., Debt vs. Equity financing in Macedonia, Centre for Economic Analysis, 2007.

decision making process. Recently, various SME-funding EU programmes have become available in the form of commercial bank loans via more Macedonian commercial banks. EU financing is used to boost SME growth, which is evidenced to lead to economic growth in some countries. The European Bank for reconstruction and development (EBRD) for example, has issued a new 5 million Euro fund for bank loans specifically aimed at SMEs[13]. Another example of debt financing for SMEs have been USAID funds[14], which have been channelled through commercial banks via the Small & Medium Enterprise Development Credit Authority (SME DCA). The SME DCA provides a link between SMEs and funds needed for working and/or investment capital. The programme is estimated to last seven years, ending in 2014. Until the first halve of 2012, approximately 40 loans have been issued in to 35 companies in different sectors or industries. The financial injection in Macedonian SMEs is estimated to be over $2.000.000. Currently, it is stated that this financial aid, in the form of commercial bank loans, has helped generate over 70 new jobs on the market, and increase exports for more than $100.000. Although this may seem as a small contribution to Macedonian SMEs, it is important to note that prior to this programme, commercial bank loans have been more or less unattainable for SMEs, and mostly used by larger companies. The small input of finance via this source has had an impact on the growth and development of SMEs, which is a positive notion. However, the small scale of investment is alarming. This is not only caused by the small number of assisted companies (merely 35 SMEs nationwide), but also because of the lack of further financing development. Financial assistance such as foreign funds should not be the only applicable financing option on the market. The economic development should lead to opening of new international financing sources – often even private ones. However, until now, this has not yet occurred in Macedonia.

The main problem with commercial bank loans, regardless of the origin of funding, is the lack of non-financial support versus the surplus of bureaucratic application. Managerial or know-how assistance is not considered as a part of the "traditional" financing of SMEs. However, such support is as much worthwhile as is the financial

[13] Coretchi, I., EBRD's first local currency financing in FYR Macedonia, 2012.
[14] USAID Macedonia, Small and medium enterprise development credit authority, 2012.

support, especially for SMEs. Provision of a funding source that would provide a detailed guidance to how to spend received funds, is yet considered "alternative" on the Macedonian market. Moreover, commercial banks require far more evidence than a business plan to confirm efficiency of the venture that takes up a loan, and the response period is often too long. The interest rate of loans per se has never been high, but the elimination is made through the stringent screening process. One of the major drawbacks is the over-collateralization of loans, as well as the lack of unsecured loan schemes on the market. Unsecured debt does not really exist in Macedonian banking practice. Although legally it is possible to have junior debt in a company, there is no such source that offers it.

When debt financing is discussed, it is important to note that commercial bonds as financing form are still not available in Macedonia. Government bonds can be traded on the MSE, but commercial trading of company-issued bonds has still not been introduced to the Macedonian capital market. This is a significant drawback when exploring financing options, for any type of company. Commercial bonds worldwide have been seen as an important debt form of financing. Companies issue bonds in order to collect funds in investing periods. Additionally, commercial bonds may be regarded more positively by Macedonian SMEs, since of the appealing aspect of company control preservation. As it has been mentioned previously, one of the major drawbacks of IPOs for managers of SMEs is the possibility of change in ownership structure. Commercial bonds would be a better option in such case, since they would provide financing without the change of ownership structure. At this point, it is important to note that there is no distinct "pecking order" in terms of funding preferences in Macedonia. Because of this, debt financing, especially commercial bonds, if applicable, can be a preferable funding option.

4. „Alternative" financing solutions: a viable option?

Worldwide, different equity financing, debt financing or a combination of the both, practically dubbed hybrid or mezzanine financing, has been a hot topic when discussing SMEs or even start-up companies. Lack of conventional financing of SMEs is not an isolated problem of the Macedonian market – it has always been an issue of discussion. However, many derivative means have been implemented in developed countries to fill the financing gap between reinvested/own sources and the conventional financing sources. American and Canadian entrepreneurial companies and SMEs widely use venture capital as a financing source through early development and growth stage[15], for example. Additionally, EU start-ups, micro and small companies are usually boosted through private equity investment companies, in order to achieve growth stage. **Private equity investment** companies have been the missing link between early stage/seed financing and growth of SMEs in developed countries. The most appealing instance of these types of financing is that there is no strict regulation or form – investments are contractual, can be different for different enterprises, depending on specific requirements, can be a combination of debt and equity financing and offer managerial and know-how support in addition to financing. Such financing sources are **venture capital investments**, or even **business angel investments**. Developed markets all over the world report that these types of SME financing actually contribute towards SME progress and economic growth. But is there room for implementing these types of financial sources on the Macedonian market?

There are many factors that need to be researched in order to conclude the possibility of implementing “alternative” financing methods in Macedonia. Venture capital investments are usually used to finance companies’ growth. Contracts have equity instead of assets as collateral. As it has been stated previously, asset-backed loans are usually difficult to obtain for Macedonian SMEs, merely because of the lack of sufficient collateral. Over-collateralization is one of the major issues regarding SME financing. Therefore, it can be observed that equity-backed investments will be widely preferred by Macedonian SMEs. Equity-collateralization implies that in stead of an asset received by the lender in case of default on the loan, shares of the borrower’s company are received. Therefore, most private equity investments are structured as such – if the borrower cannot repay the principle and the pre-

[15] Amit, R. et al., Why do venture capital firms exist? Theory and Canadian evidence., *Journal of Business Venturing*, pp.441-466, 1998.

determined rate, the lender acquires a pre-determined portion of equity in the company. There are variations in contracts, such as recipient of equity shares in case of successful investment, decisions upon interest rate or rate of return on investment and so on. However, the notion that there is no need for large asset collateral would be welcomed by SME managers.

When mentioning managers of Macedonian SMEs though, one other thing has to be taken into consideration. It has been previously mentioned throughout the paper that Macedonian company owners, especially owners of MSMEs, do not like loss of ownership control, at any cost. Most MSME managers are partially or entirely owners, as well. Therefore, it can be expected that equity-based financing may be regarded as less desirable. However, when considering two options, both with some positive and negative aspects, perhaps managers would choose venture capital investments. Having the financing option to choose would be an incentive itself.

On the other hand, investors' preferences need to be taken into consideration as well. Would venture capital investors or business angels be interested in investing in Macedonian SMEs? Private equity markets in other countries of the region have been developing rapidly. However, it appears that the development of the market for financing SMEs is closely related to the EU accession and diversion of political and economic risk. In Croatia and Bulgaria such financing options are widely accessible to SMEs. Yet, the comparison of there countries to Macedonia, in terms of political and economic stability is difficult. Macedonian environment would still be rather risky to international investing companies.

However, during a short survey of international private equity investment companies, conducted for the purpose of this paper, it has been shown that over 87% of investment providing companies, based in the EU, would be interested in providing finance to Macedonian SMEs. However, one of the major prerequisite is the preparation of a viable long term plan. Investors have reached a conclusion that more needs to be done on the field of education of managers, in order to be able to project profitable and sustainable company development through a forecasted business plan. Still, according to a 2009 study of an equity investment company, it can be expected that this problem will be tackled and overcome soon, especially with the rise in business education and the higher percentages of new-generation, young, aspiring and well-educated SME managers[16].

In the end, it can be seen that new and "alternative" financing solutions can be offered to Macedonian SMEs. There is favourable ground on both sides, and there is definitely a well defined need for new financing options as well.

5. Conclusion

Small and medium sized companies are known to have more obstacles when looking for financing when compared to large corporations. This is especially evident on the Macedonian (M)SME market. The Macedonian business environment is a rather merciless one when it comes to financing MSMEs. Whereas traditional options are readily available, there is no essential choice between options in truth. It cannot be stated that the financing situation is grim; however, it is not the best situation for Macedonian SMEs. Although there is a slow growth in SME employment and profitability, it has been seen that lack of proper financing has caused stagnation and decline in growth at periods. This is a situation that needs to be avoided in the future. Additionally, the fluctuation of SME growth is a negative aspect – SME growth needs to be steady and less volatile. Good financing market can provide such growth.

The need for new options is evident, as well as there prospect place on the Macedonian financing market. Additionally, broadening the palette of financing options for SMEs will lead to creating more favourable offers from "traditional" sources. Thus, a more favourable financing environment for SMEs will lead to SME growth and development. And it has been outlined at the very beginning of the paper, as SMEs are the backbone of the economy, their growth and development will lead to economic growth, through new employment, innovative products and export increase. Therefore, creating favourable financing solutions for Macedonian

[16] AltAssets, Venture capital in CEE, Research by AltAssets group, 2009.

SMEs needs to be a priority issue. In the end, several recommendations can be made. Firstly, financing solutions must be broadened; there is a distinct need for the opening of the Macedonian financial market. This does not necessarily need to apply only to private equity and venture capital investments; commercial bonds are another method of financing companies. Additionally, Macedonian managers/owners need to be well educated in order to be more successful. Different financing options will require broader views and understanding as well. It is important to note that this is not a real obstacle – it can be easily overcome, especially with new and young entrepreneurs. Additional to that, the process of non-formal business education is at large in Macedonia, which should lead to a more informed and prepared business environment.

In the end, there is a silver lining in the financing situation for Macedonian SMEs. However, there is still much to be done in order to achieve sustainable SME growth on the Macedonian market. And this needs to be of vital importance, as it is one of the pillars of Macedonian economic growth.

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EVALUATION OF THE EFFECT OF FDI DETERMINANTS ON FDI INFLOWS IN R. MACEDONIA

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Abstract:

It is common that foreign direct investments (FDIs) are very important factor for the transfer of technology, know-how, employment generation, range of new products and services and increasing competitiveness in the host country. Therefore, this paper aims to investigate the FDI inflows in R. Macedonia for the period from 2005 to 2011 and to define the effect of GDP, GDP growth rate, country's openness to the global market and country's resources, as FDI determinants, on FDI inflow using regression analysis. The results reveal that among all observed explanatory variables FDI inflows in R. Macedonia are significantly influenced by the GDP growth and openness to global market. It was also found that non-linear regression method may be used as appropriate econometric model for describing unstable economic movements over a time period fairly good.

Key words: *Foreign direct investment, FDI determinants, regression analysis*

JEL classification: *C51, F19*

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Introduction

Foreign direct investments are listed among the most important factors for economic growth of transition economies, as they are considered to be important instrument for stimulating the production, import of "know-how" technologies, employment growth, infrastructure development and poverty reduction in the national economies and as a valuable tool for filling the gap between the resources and available technology in the particular country. In accordance with the report by the UNCTAD (United Nations Conference of Trade and Development) the general trend in the global FDI market grew by 17%.[1] Particularly indicative is the fact that the growth of FDI observed in transition countries in 2011 had increased by 31%.

Generally, the foreign direct investments can take the form of new investments so called "green field" investments and "merger and acquisition" investments.

Green field investments are most favorable form of foreign investment for the developing countries as they comprise designing of completely new operating facilities and enable creation of new and long-term jobs. On the other hand, the merger and acquisition investment refers to acquisition of existing interest instead of new investments; this kind of investment enables transfer of skills in terms of specialization of the labor and management, more efficient use of the capital equipment and increased "market power" as well. Having in mind the benefits arising from the FDIs, like technological spillovers, R&D, creation of new working places etc., they can be considered as very important input in the creation of strategies for economic growth of developing and especially for underdeveloped countries.

However, it has to be emphasized that besides the evident direct effect of FDI on investments in the host economy, which is significantly higher comparing to those of other capital flow, there are so-called indirect effects that can be positive or negative. [2] The positive effects arise from the transfer of new technologies, expertise and practices with FDI inflows, but also from the fact that FDI generate new investments by other domestic companies, where the relationship input - finished goods or inversely could be set up. Contrary, the negative effects could appear from the cases where foreign companies are financing their activities from limited domestic savings and in that way causing an increase in the domestic interest rates and therefore the cost of financing of domestic companies.[2]

The economic development of Republic of Macedonia is one of the greatest challenges of the country, since the declaration of independence in 1991. In these two decades Republic of Macedonia was going through periods of adjustment from economic model of planned production to market economy model i.e. internationalization of the domestic market for trade and investments.

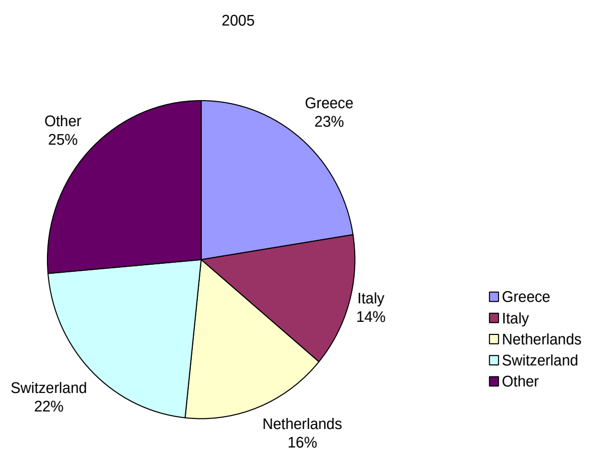
In the years after declaring the independence Republic of Macedonia faced several challenges like the extremely unfavorable macroeconomic conditions inherited from the former state, including the negative rates of GDP growth, high inflation, high unemployment rate and relatively large domestic and foreign debts and issues concerning the international recognition of the country. Despite these adverse circumstances, the country has implemented the first generation reforms including the price stability, liberalization of prices, foreign trade liberalization and privatization of smaller facilities relatively successfully. It was the first impulse towards the stabilization of the macroeconomic factors and the beginning of the positive trends in the development of the Macedonian economy. Additionally, the candidate status of R. Macedonia, granted by EU in 2005, the "one-stop-shop" system for registering business activities operated by the Central Registry since few years ago and the ideal place on the Balkan Peninsula for opening industrial capacities and branch offices R. of Macedonia continues to be very aggressive in the efforts to attract FDI.

Having in mind that potential foreign investors are very sensitive to numerous factors when making decision about investing abroad, like the market size, economic development and the growth of the economy, business climate, infrastructure, regulatory and administrative issues etc. this paper focuses on studying the effect of the size of host economy and its growth potential, host economy's openness and linkage with the global market and host economy resources on FDI inflow in R.

Macedonia. Therefore, before proceeding further on, a brief overlook on the FDI in R Macedonia in terms of country of origin, economic activities and type of FDI will be given.

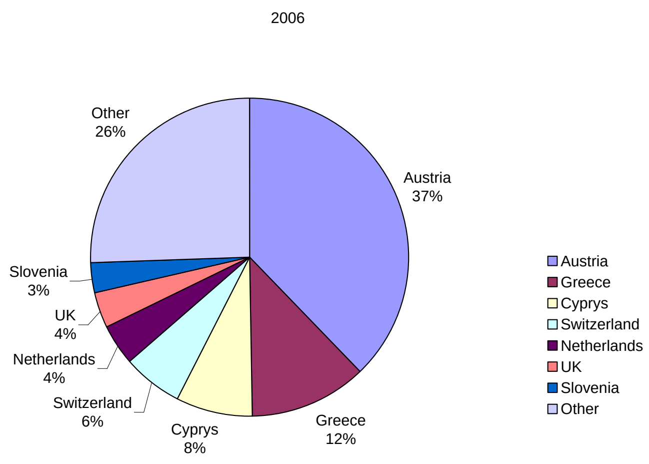
Foreign direct investments in R. Macedonia

FDI by country of origin. Detailed presentation on FDIs by country of origin during the period 2005 to 2011 is given in Figures 1-7. It can be seen that numerous international companies have invested in the country, mainly as green-field projects and through different types of asset acquisition and privatization.[3] The most important foreign investors in R. Macedonia during the period under observation were Mobilkom and EVN from Austria, Deutsche Telecom, Kromberg & Schubert and Dräxlmaier Group from Germany, Johnson Matthey and QBE Insurance Group from UK, Societe Generale-France, Johnson Controls and KEMET Corporation from USA, Van Hool-Belgium, Mittal Steel -Netherlands, Duferco-Switzerland, Titan Group, the National Bank and Hellenic Bottling Company S.A. from Greece.[3]



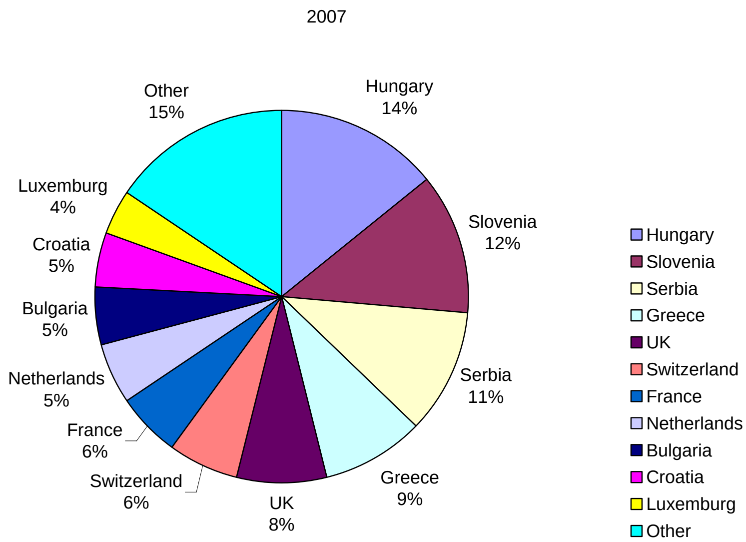
Source: National Bank of the Republic of Macedonia

Figure 1. FDI in R. Macedonia by country of origin, 2005



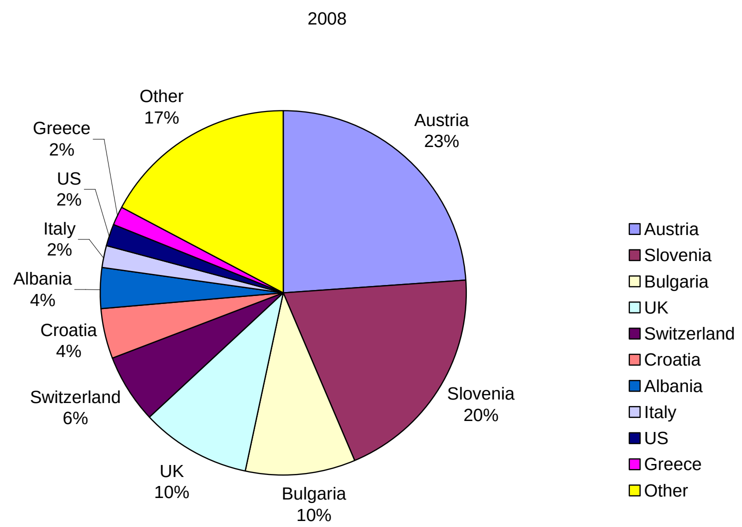
Source: National Bank of the Republic of Macedonia

Figure 2. FDI in R. Macedonia by country of origin, 2006



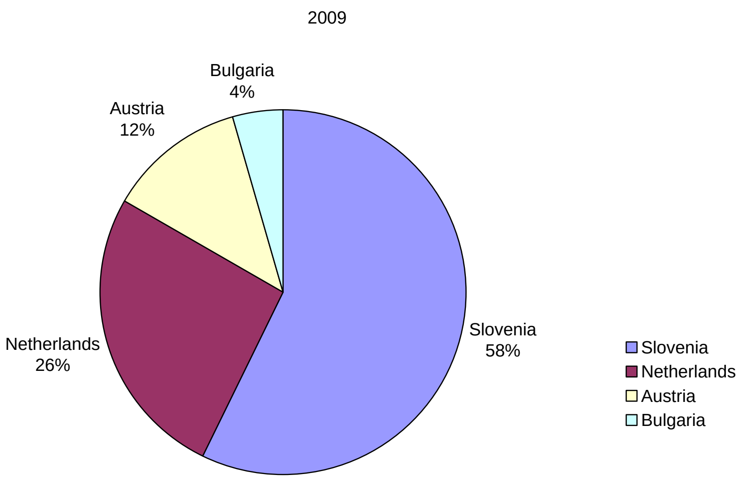
Source: National Bank of the Republic of Macedonia

Figure 3. FDI in R. Macedonia by country of origin, 2007



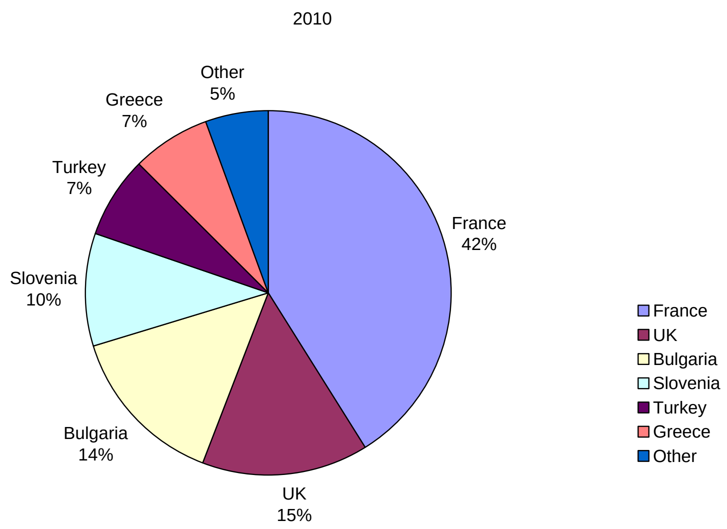
Source: National Bank of the Republic of Macedonia

Figure 4. FDI in R. Macedonia by country of origin, 2008



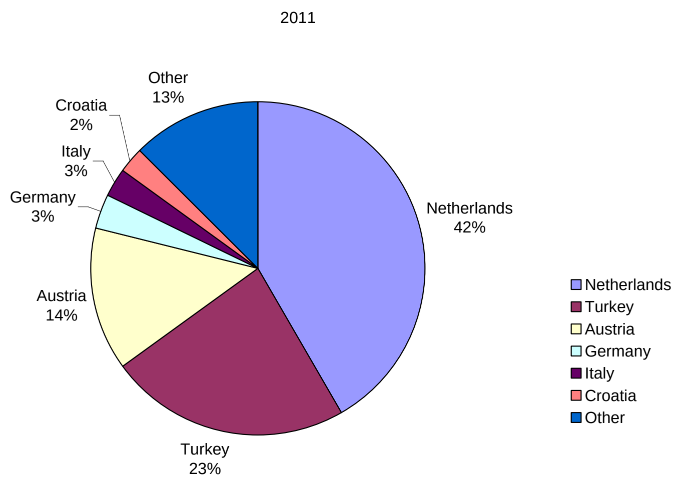
Source: National Bank of the Republic of Macedonia

Figure 5. FDI in R. Macedonia by country of origin, 2009



Source: National Bank of the Republic of Macedonia

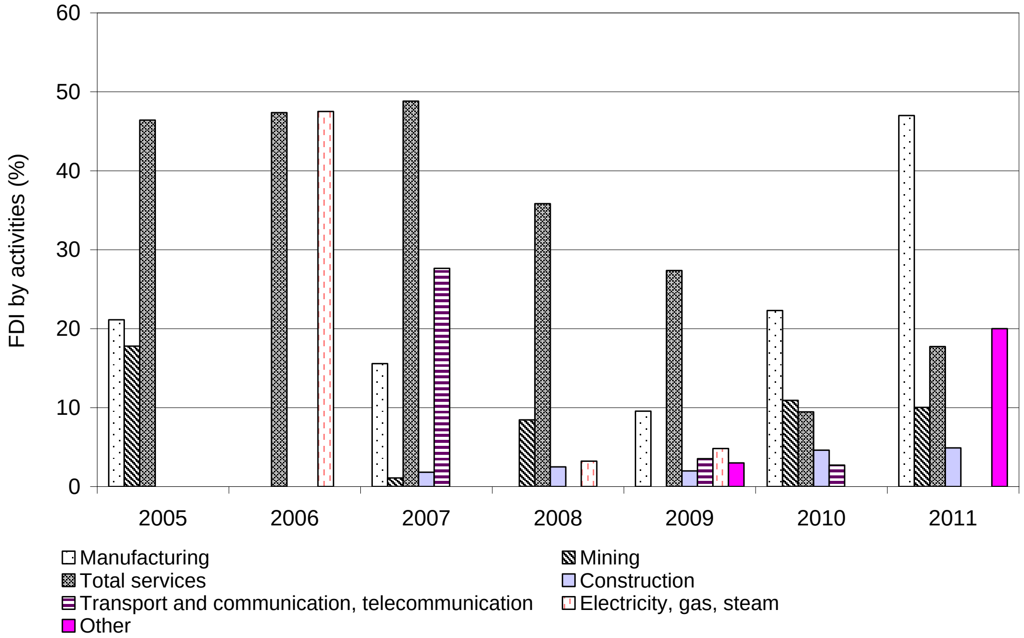
Figure 6. FDI in R. Macedonia by country of origin, 2010



Source: National Bank of the Republic of Macedonia

Figure 7. FDI in R. Macedonia by country of origin, 2011

FDI by economic activities. The main part of FDI to R. Macedonia form 2005 to 2011 was attracted by total services (which include whole sale and retail sale), and then manufacturing and mining, and telecommunication and electricity (Figure 8).



Source: National Bank of the Republic of Macedonia

Figure 8. FDI in R. Macedonia by economic activities

Regarding the greenfield vs. merger and acquisition investments, data reported in Table 1 indicate that up to now in R. Macedonia greenfield investments comprise larger part of the FDIs.

Table 1. Greenfield vs. merger and acquisition FDI in R. Macedonia[4]

	"Greenfield" (*% from the total FDI inflow)*	*"Merger and acquisition"* (*% from the total FDI inflow)*
2005	100,0	0,0
2006	91,1	8,9
2007	90,4	9,6
2008	97,8	2,2
2009	100,0	0,0
2010	99,1	0,9
2011	100,0	0,0

Source: Балукоска Д., *Влијанието на странските директни инвестиции врз економскиот раст и невработеноста на земјите во транзиција, со осврт на Македонија*, магистерска теза, 2012

Non-linear regression analysis

Literature review[5-10] showed that so far lots of attempts to establish the relation between the extent of FDI inflows and national economic growth have been made. However, the results imply that although great number of relations is found, they are not consistent and depend on the particular country, the period of observance and other specific conditions.

In order to complete the main task of the paper – determine the individual relationships between FDI's GDP, GDP growth, export, import and labour force – a certain appropriate empirical method should be used. For establishing the link between factors mentioned above the authors have chosen the regression analysis. Hence, a thorough understanding of this method is necessary and in the text below a brief description on its theoretical background is given.

There are variety of empirical models that are used to analyze economic data among which the most common are simple linear regression, multiple linear regression and nonlinear regression modeling.[11-13]

Regression analysis is a method for defining the relationship between a dependent (response) variable and one or more independent (explanatory) variables. In economic analysis it is used to explain movements of one variable caused by other factors and to make quantitative estimates of economic relationships that have been completely theoretical in nature. The main purpose of this modeling is for a given set of measurements $(x_1, y_1), (x_2, y_2), \ldots, (x_n, y_n)$ to determine the values of regression coefficients $a_0, a_1, \ldots\ldots a_m$ and establish the mathematical model which fits the best the real life situation.[11,12] The functional dependencies that are used to describe the relationship between the response and explanatory variable usually have the form of:

- Linear function $(y = a_0 + a_1 x)$
- Exponential function $(y = ae^{bx})$
- Power function $(y = ax^b)$
- Polynomial function $(y = a_0 + a_1 x + \ldots + a_m x^m)$

According to Studenmund[12] one of the most widely used methods for performing regression analysis is the ordinary least squares (OLS) estimation technique which calculates the coefficients $a_0, a_1, \ldots\ldots a_m$ so as to minimize the sum of the squared residuals (Figure 8). It is very simple technique applicable on the above given different functional forms of equations.

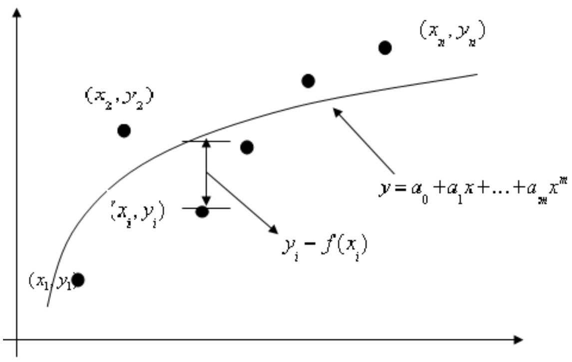


Figure 9. Polynomial model for nonlinear regression of y vs. x data[13]

When using the least square method to find the regression coefficients of a polynomial function it is necessary to find the following measures of variation: [13]

- *The sum of the square of the residuals*

$$S_r = \sum_{i=1}^{n} E_i^2 = \sum_{i=1}^{n} \left(y_i - a_0 - a_1 x_i - \ldots - a_m x_i^m \right)^2$$

where E_i gives the residual at each data point and can be written as $E_i = y_i - a_0 - a_1 x_i - \ldots - a_m x_i^m$

In order to find the constants of the above presented polynomial model, first derivatives of the sum with respect to a_i, where $i = 1, \ldots m,$ have to be set and equalized to zero as follows:

$$\begin{aligned}
\frac{\partial S_r}{\partial a_0} &= \sum_{i=1}^{n} 2.\left(y_i - a_0 - a_1 x_i - \ldots - a_m x_i^m \right)(-1) = 0 \\
\frac{\partial S_r}{\partial a_1} &= \sum_{i=1}^{n} 2.\left(y_i - a_0 - a_1 x_i - \ldots - a_m x_i^m \right)(-x_i) = 0 \\
&\vdots \\
\frac{\partial S_r}{\partial a_m} &= \sum_{i=1}^{n} 2.\left(y_i - a_0 - a_1 x_i - \ldots - a_m x_i^m \right)(-x_i^m) = 0
\end{aligned}$$

As the analytical solution of this set of equations is very tedious further on the matrix analysis is used as a tool for determining the regression coefficients and in that way establishing the polynomial regression model that fits experimental data the best.

$$\begin{bmatrix} n & \left(\sum_{i=1}^{n} x_i\right) & \cdot\ \cdot\ \cdot & \left(\sum_{i=1}^{n} x_i^m\right) \\ \left(\sum_{i=1}^{n} x_i\right) & \left(\sum_{i=1}^{n} x_i^2\right) & \cdot\ \cdot\ \cdot & \left(\sum_{i=1}^{n} x_i^{m+1}\right) \\ \cdot\ \cdot\ \cdot & \cdot\ \cdot\ \cdot & \cdot\ \cdot\ \cdot & \cdot\ \cdot\ \cdot \\ \left(\sum_{i=1}^{n} x_i^m\right) & \left(\sum_{i=1}^{n} x_i^{m+1}\right) & \cdot\ \cdot\ \cdot & \left(\sum_{i=1}^{n} x_i^{2m}\right) \end{bmatrix} \begin{bmatrix} a_0 \\ a_1 \\ \cdot\ \cdot\ \cdot \\ a_m \end{bmatrix} = \begin{bmatrix} \sum_{i=1}^{n} y_i \\ \sum_{i=1}^{n} x_i\, y_i \\ \cdot\ \cdot\ \cdot \\ \sum_{i=1}^{n} x_i^m y_i \end{bmatrix}$$

However, non-linear regression models are rarely used for prediction purposes because besides the relevant and accurate data these methods also require advanced knowledge of mathematics even though today's computer programs facilitate this part of the complex procedure.

Evaluation of the quality of a regression equation. A very important issue in regression modeling is the quality of the regression equation;a good estimated regression equation should fit the data well and explain the variation of response variable very accurately. The quality of the regression model depends on explanatory variables, accuracy of data and the chosen functional form. Most common measures used for evaluation of quality of the regression equation are the correlation coefficient R and coefficient of determination R^2.[14,15] The correlation coefficient shows the strength and direction of the relationship between two variables, whereas the coefficient of determination measures the percentage of the variation of the dependent variable around its mean that is explained by the regression equation. Typically an overall fit of 0,5 is considered a good result in cross sectional data sets. [12]

Data and methodology

The aim of this paper is to study the effect of the size of host economy and its growth potential, assessed through GDP and GDP growth values, host economy’s openness and linkage with the global market using the export and import amounts, and host economy resources, using the total labor force values, on FDI inflow in R.

Macedonia. Therefore, the annual time series data for FDI and above mentioned explanatory variables during the period of 2005 to 2011, provided by the National Bank of R. Macedonia[16] and State Statistical Office[17] were collected and presented as follows:

Table 2. FDI and GDP in Republic of Macedonia from 2004 to 2011[16,17]

	FDI (million euros)	*GDP* (million euros)	GDP growth rate	Import (million euros)	Export (million euros)	Labor force
2005	*77*	4600	4,4	1643	2501	869187
2006	*345*	5056	5	1914	2916	891678
2007	*506*	5761	6,1	2472	3653	907139
2008	*400*	6695	5	2693	4455	919424
2009	*145*	6652	-0,9	1933	3492	928774
2010	*160*	6907	2,9	2530	3977	938294
2011	*337*	7504	2,8	3179	4860	940048

Source: National Bank of the R. Macedonia, State Statistical Office of R. Macedonia

Data from export, import and GDP were used for calculating the degree of openness, O′, since it was shown that it is a better measure to evaluate the openness to the global market instead the export and import quantities.[17] Higher degree of openness means more open economy to the global market.

The country's openness ratio is defined as:

$$O' = \frac{X' + M'}{Y'}$$

where *X′* is the total export, *M′* stands for the total import and *Y′* is the GDP.

Calculated values for O' during the period from 2005 to 2011 are as given in Table 3.

Table 3. Degree of openness of R. Macedonia to the global market, 2005-2011

Year	O'
2005	0,90
2006	0,96
2007	1,06
2008	1,07
2009	0,82
2010	0,94
2011	1,07

It can be seen that for R. of Macedonia the openness ratio is generally less then unit, which is very common for small open economies. [17]

Results reported in Table 2 show that in the period from 2005 to 2008 there is a significant growth of all observed variables (except for the GDP growth rate which shows slight decrease of 1% in comparison with the GDP growth rate in 2007). The dramatic increase of FDI in 2006 is mainly due to the privatization of ESM as the major energetic capacity in R. Macedonia and Telekom Macedonia. Also, it can be noticed that global financial crisis, undoubtedly, affected Macedonian economy and the first serious consequences from this effect were felt after 2008, especially in 2009 where noticeable decrease in the GDP growth rate and FDI inflow is observed. With regard to import and export, they follow the same trend as FDI and GDP.

The *correlation matrix* in Table 4 provides some light on the factors that affect inflow of FDI. The second column presents the coefficient of correlations and the corresponding p-values between FDI and variables under consideration. According to these values although the relationship between the FDI and the GDP, GDP growth, degree of openness, labor force and import and export is positive, considering the p-values they are not statistically significant. Namely the relations $FDI = f(GDP)$, $FDI = f(labor\ force)$, $FDI = f(\exp ort)$ and $FDI = f(import)$ obtained by the linear regression method are not so reliable indicator for describing the real situation. It can be observed that the only positive and statistically significant relations are the ones between FDI and GDP growth rate and between FDI and O'. Hence, it implies that FDI inflow is mostly influenced by the GDP growth and degree of openness of the country, while as all the other explanatory variables observed in this paper have negligible influence.

Table 4. Correlation matrix among FDI inflow, the size of Macedonian economy and its linkage and openness with the Global Market during 2005-2011

	FDI	*GDP*	*GDP growth rate*	Degree of openness, O'	*Labor force*	*Import*	*Export*
FDI	1,00						
GDP	0,14 (0,76)	1,00					
GDP (growth rate)	**0,60 (0.15)**	-0,47	1,00				
Degree of openness, O'	**0,82 (0.02)**	0,29	0,68	1,00			
Labor force	0,14 (0.77)	0,97	-0,50	0,20	1,00		
Import	0,53 (0.22)	0,81	0,09	0,77	0,74	1,00	
Export	0,43 (0.33)	0,92	-0,11	0,63	0,85	0,96	1,00

Linear regression equations obtained for the relations $FDI = f(O')$ and $FDI = f(GDP\, g.r.)$ are as follows:

$$FDI = 1306\,O' - 991 \qquad R=0.82$$

$$FDI = 40.62\,GDP\, g.r. + 135 \qquad R=0.60$$

These results show that a unit rise in degree of openness can bring about 1306 units rise in FDI, where as a unit rise in GDP growth rate increases the FDI inflow about 40.62 units.

In order to obtain more convenient method for describing the relationship between FDI and variables under consideration an attempt was made to use the polynomial regression analysis.

By calculating the values of the coefficients, a_0, a_1, a_2 and a_3, as explained previously, the functions that best fit the observed data are obtained in the following form:

$$FDI = 2\cdot 10^{-7}\, GDP^3 - 0.003 GDP^2 + 18.57 GDP - 37307 \qquad R^2 = 0.71$$

$$FDI = 8.69(GDP\, g.r.)^3 - 59.26(GDP\, g.r.)^2 + 84.83(GDP\, g.r.) - 278.25 \qquad R^2 = 0.61$$

$$FDI = -272930\,(O')^3 + 773833(O')^2 - 725960\,(O') + 225561 \qquad R^2 = 0.89$$

$$FDI = 5\cdot 10^{-12}\, L.F.^3 - 1\cdot 10^{-5}\, L.F.^2 + 12.17\, L.F. - 4\cdot 10^6 \qquad R^2 = 0.66$$

$$FDI = 8\cdot 10^{-5} \exp ort^3 - 0.092 \exp ort^2 + 32.99 \exp ort - 516.06 \qquad R^2 = 0.44$$

$$FDI = 4\cdot 10^{-5}\, import^3 - 0.044 import^2 + 16.88 import + 565.44 \qquad R^2 = 0.45$$

Evidently, the polynomial functions of the third degree represent very well the observed set of data. Similar to results obtained with linear regression modeling, the non-linear regression showed that FDI inflow is mostly determined by the country's openness to the global market, GDP and labor force. The high values of the coefficient of determination indicate that the chosen model explains large percent of analyzed data when the GDP, GDP growth rate, degree of openness and labor force are concerned. These results may lead to the conclusion that when making decision about investing in R. Macedonia the foreign investors were very sensitive to country's openness to global market and GDP and GDP growth.

As a whole it can be noted that the polynomial model is the most appropriate model for representing data that are fairly unstable over time. Such a case was the unstable movement FDI inflow through growth and decline in the period under consideration in this paper.

Conclusion

In this paper the relation between FDI and GDP, GDP growth rate, country's openness to global market and total labor force was studied using regression methods.

The findings imply that the regression methods, especially nonlinear regression, may be used for obtaining appropriate econometric models for describing unstable economic movements fairly good.

Nonlinear regression estimation results show that in the period of 2005 to 2011 foreign direct investment inflows in R. Macedonia were influenced positively by the openness of the country to global market and GDP, the coefficient being significant and positive. Namely, these variables have explained about 89 and 71 percent variability in the FDI, respectively, while as the other explanatory variables were statistically insignificant.

Further more, results obtained from linear regression model also confirm that in the period under observation a strong positive correlation between the degree of openness and foreign direct investments exists. It was calculated that a unit rise in degree of openness can bring about 1306 units rise in FDI. Therefore, data obtained with both, linear and nonlinear regression analysis, imply that FDI inflow in R.

Macedonia from 2005 to 2011 was noticeably biased to trade openness and that this explanatory variable can be considered as the major catalyst for FDI inflow in the observed period. Similarly, FDI inflow is also biased to the economies with greater GDP and high GDP growth rates, even thought the statistical significance is doubtful and it is difficult to explain the low linear correlation existing between the FDI and GDP. Herein it has to be noted that regressions based on the equations presented are generally unable to explain causal relationships but can describe past correlations.

According to the findings from the evaluation of the effect of foreign direct investment determinants on FDI inflows in R. Macedonia it can be concluded that our country follows the World Bank recommendations "for developing economies to open up more their markets in order to make easier the transfer of goods and capital in and out of the host country and thus stimulate production and reduce costs increasing the growth in the country".[19]

As a whole, it comes out that in order to attract more FDIs R. Macedonia needs to follow more open trade policies, improve market size and to maintain economic growth.

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UDC 339.137.012.434:330.88

CRITICAL EVALUATION OF THE THEORY OF THE MONOPOLISTIC COMPETITION WITH SPECIFIC REFERENCE TO ORIGINAL WORK BY EDWARD CHAMBERLIN

Besa Xhaferi, MSc.[3]

Abstract:

Chamberlin and his co-workers failed to come up with canonical model embodying the key elements of the Monopolistic Competition theory. It was not so much Chamberlin's idea that were rejected but rather his modeling approach that was deemed unworkable. The aim of this paper is to critically evaluate the theory of monopolistic competition. This hybrid notion from the previous theories will challenge economists and economical thought. The first objective of this paper is to explain why a new theory was necessary. The next step is to point out the similarities and disparities between Chamberlin's and Robinson work both published at the same year. Then, the evaluation on Dixit and Stiglitz model is presented along with the comparisons with the Chamberlin's model. At the end there is a brief conclusion.

Key words: *monopolistic competition, rent, excess capacity*

JEL classification: *D4*

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1. Why monopolistic competition

Before 1930s. the belonging of an industry either in the perfect competition or in monopoly (both classified as different market structure) was a clear cut answer. The underlying assumptions of these market structures were well-defined and accepted between economists. After 1930s. some industries were operating in between these two theories, so this might be a signal that there is a room for a new look in the economic thought. Thus, new theory was born; concerning Chamberlin (1933) that was Monopolistic Competition, while Robinson (1933) called it, Imperfect competition. Moreover, "*Mr. Kaldor regarded imperfect and monopolistic competition as merely English and American equivalents for the same thing.*" (Edward Chamberlin, Theory of Monopolistic Competition, 1933 p.211)

2. Chamberlin v.s. Robinson

The notice of Chamberlin that most of the economic situations cannot be either monopoly[4] or perfect competition but they can rather be explained by Monopolistic competition is the beginning of a new challenge in the economic theory. In the same year Robinson pointed the same, but contrary to Chamberlin, she finds the explanation in Imperfect Competition. Giving different names is not the only difference between them, but they also consider different assumptions for the theory. According to Robinson there is "free entry" in monopolistic competition, but Chamberlin is more specific: firms are "free" to diversify products and are free to enter in the market by producing differentiated products[5]. Griffiths and Wall (2000) same as Robinson mention free entry as a characteristic of monopolistic competition.

[4] The monopolistic power is measured by Lerner index, closer to the greater monopolistic power

[5] Product differentiation: producing similar but distinctive product; each firm attempts to differentiate its product from the other firms in the Industry-Varian (1999)

Furthermore, they highlighted Chamberlin's product differentiation as another characteristic of monopolistic competition. Additionally, Varian (1999) adds that monopolistic competition can lead to less or excessive product differentiation.

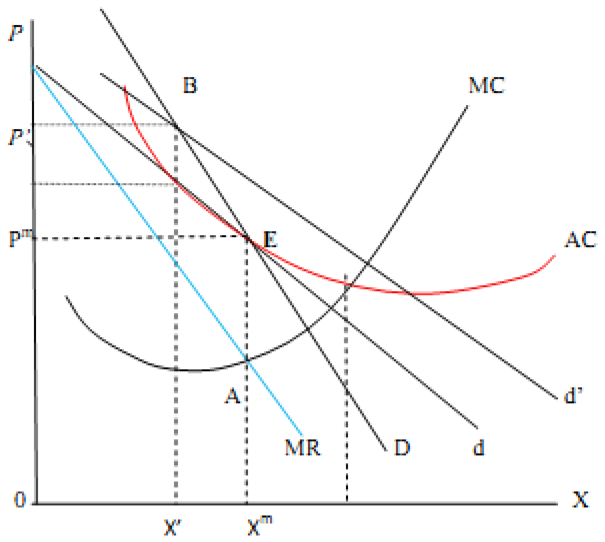
Chamberlin suggests that monopolistic competition is characterized by product differentiation. Hay and Morris (1991) find the Chamberlin's product differentiation questionable, since the product differentiation was meant to explain the monopolistic competition, it made difficult to define an industry[6]. The assumption of product differentiation is a subject on critique, because it causes inconsistency problem. Still, product differentiation makes the heterogeneity product assumption to hold, since it allows a variety of products to be disposable. In addition, a product which is considered to be different by the consumers, allows the industry to be a price setter and to have monopoly power. Thus one of the characteristics of monopolistic competition is that products (even though may be substitutes) because of their unique differentiation are not considered as substitutes by consumers. Hence in a monopolistic competition the both assumptions underlying the perfect competition and monopolistic competition are embodied *per se* as a mixture.

Chamberlin's uniformity assumption suggests that individuals and the group both face same (identical) demand and cost curves. In his model it is also suggested that the demand curve is downward sloping and the cost curves are U shaped. Koutsoyiannis (1979) argues that Andrew's critique concerning a downward sloping demand curve is true only in the short run. Moreover, Koutsoyiannis gives supporting hand that the demand curve is downward sloping even in the long run. According to the Chamberlin's basic model the equilibrium is achieved at the point where the tangency condition is fulfilled. The tangency condition is the point where the demand curve of the representative firm is tangent to average cost curve (Griffiths, A. and Wall, S. 2000). Chamberlin's equilibrium happens when each firm attempts to maximize its profit and entry of the new firms occurs until the marginal firm can only just break even. The other condition for equilibrium is that firms enter until the next potential entrant would make a loss. Based on the theory, new firms

[6] Industry: the set of firms that produce products that are viewed as close substitutes by consumers

will enter the market until all firms are left on a state of equilibrium. They maximize their profits given the demand curve, but entry of new firms pushes the profits down to zero. The Chamberlian monopolistic competition equilibrium is illustrated ine the figure below:

Figure (1) Chamberlinian monopolistic competition equilibrium:



Source: Bishop, 1967.

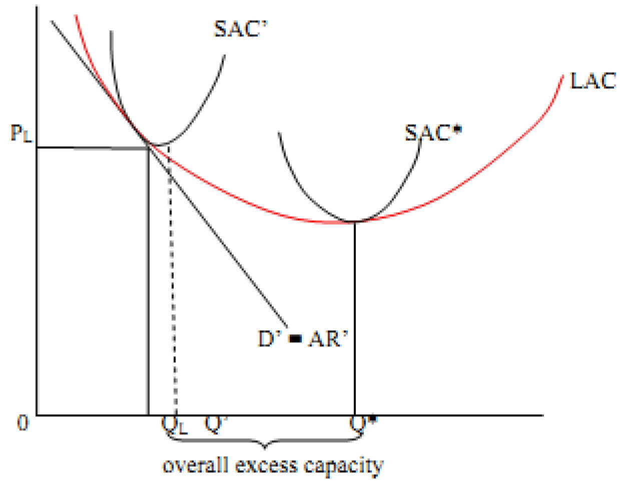
Keeping in mind uniformity assumption in the Chamberlin's equilibrium new firms will not tend to enter since the profit is zero. Moreover, the marginal curves are important for Chamberlin, since they give the profit maximization condition, the same as in perfect and monopoly competition[7]. Regarding Robinson they are "the heart of the whole matter", but Chamberlin disagrees with it.

According to Robinson employers are paid less than their marginal product in monopolistic competition. Robinson (1933) originally argue that a group of workers are being exploited when their wage is less than their marginal physical product that they are producing, valued at the price at which it is being sold. Chamberlin adds that there is no exploiter (the entrepreneur), just everybody is paid less.

[7] Maximization condition is the point where Marginal cost= Marginal revenues

It is argued that monopolistic competition yields "excess capacity" because the output level is lower than optimal level, but Chamberlin adds that this is rather a social cost as a consequence of product differentiation. The exces capacity is illustrated in the figure below:

Figure (2) Excess capacity:



Original source: *Griffiths, A. and Wall, S. 2000. Intermediate Microeconomics. Second Edition. Harlow: FT-Prentice-Hall, p. 258-259*

"In summary if the market is monopolistically competitive the output is lower than society would "ideally" like it to be; but the socially desired Price=Marginal Cost cannot be achieved without destroying the whole private enterprise system "(A.Koutsoyiannis, Modern Microeconomics, 1979, p.214). An important feature for the output under monopolistic competition, according to Chamberlin is selling cost because they affect the demand elasticity. Chamberlin is the first to note that except production cost there are selling cost; with advertising and other selling activities the firm seeks to accentuate the difference between its product and the product of other firms in the group (Koutsoyiannis, 1979). Accordingly firm may influence the demand decisions with differentiating its product, promotional activity and advertising. The assumptions that Chamberlins work is based on: many firms set their sale prices and maintain some monopoly power; there is no natural monopoly in the most of the sectors therefore firms operate within a certain degree of competitiveness.

The presence of competition makes the firm's surplus profit to vanish. The firms that were already in the marke beacues of free entry of new firms face with reduced volume of sales and higher average unit costs which will result with diminishing share of the market. This may lead firms to think of a price cut, belivining that the price cut will increase revenue and profit, but that could happen if none of the competitors noticed the change. The question is whether the increased demand for the product will generate enough revenues to cover the costs of differentiation and promotion and there still are entrepreneurial risks. If one firm can produce a new marketing scheme, the other firms can do the same as well. Hence, their efforts may simply cancel each other out, while they are spending more and getting less profit.

In the short-run, firms can use the heterogeneity of the brand to gain high economic profit, therefore attracting new firms to entry the market. These new firms will get some of the costumers firm by offering a differentiated product. This will bring down the product price and therefore in the long-run the firm will make zero economic profit. In the long run the old firms demand curve will shift to the left until it becomes tangential with the AC curve. At the break-even price they make zero profit, but if they charge other than the break-even price, they will face losses.

According to Donald Hay and Derek Morris, Chamberlin brought to the picture the importance of downwards-sloping demand curves and product differentiation on analysing different industries, as well as the role of new firms entering the industry and the barriers they face. He described that a different approach of entering the market is the determinant of the relation between cost and revenue curves for a firm.

3. Dixit-Stiglitz model

Dixit and Stiglitz (1979) are concentrated on the case when commodities are perfect substitutes[8] within a group or industry, but not with goods in other industries.

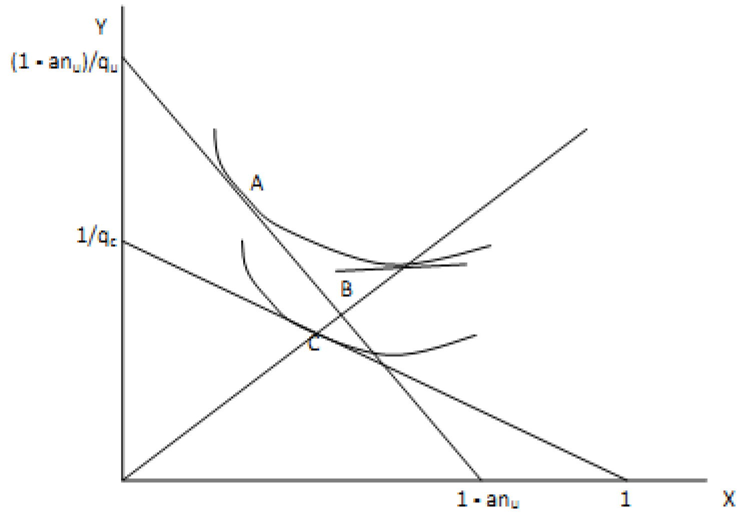
[8] If a consumer is indifferent in consuming two different goods, than they are considered as perfect substitutes

Regarding this an industry produces only perfect substitutes. The study uses interactions between products within industry, as well as interaction between industries.

Since the optimal output is not obtained in the Chamberlin's model (lower output is produced), leads to "excess capacity". Thus, Dixit-Stiglitz remark all economies of scale are exhausted. Dixit-Stiglitz suggests that the unconstrained optimum uses resources more efficiently. Consequently, they call in question excess diversity and excess capacity. In the Dixit-Stiglitz model, varieties of products (more than in the market) are produced, when the first best social optimum is achieved.[9] Dixit-Stiglitz model empirically suggests that "*unconstrained optimum allows more variety than the constrained optimum and the equilibrium*" (Avinash Dixit and Joseph Stiglitz, Monopolistic competition and optimal product diversity, 1977, p.302). Ilustratively constrained and unconstrained equilibrium are shown in figure 3:

[9] Note: The first best or unconstrained optimum requires pricing below average cost, and therefore lump sum transfers to firms to cover losses

Figure (3) constrained optimum and unconstrained optimum



Source: Dixitz and Stigliz, 1977

Dixit-Stiglitz paper examines earlier work where one firm produces a single product. Chamberlin's model suggests that there should be a variety of products without defining where the limits should be. Conversely, Dixit-Stiglitz study the case when market yields less variety of products. Dixit-Stiglitz, argues that, empirically Chamberlins fixed demand curve and diversity of product are inconsistent. In contrast of geographical model Dixit-Stiglitz model does not make a point on consumer's preferences and as a consequence we have consumer homogeneity-individuals act identically. Based on Dixit-Stiglitz work, Brakman and Heidra suggest a formulation (S. Brakman and Hejidra The Monopolistic Competition Revolution in Retrospect, 2004, p13)

$$Y \equiv \left[\sum_{i=1}^{N} x_i^{(\sigma-1)/\sigma}\right]^{\sigma/(\sigma-1)}, \quad 1 < \sigma << \infty$$

In this formula Brakman and Heidra bring together the existing number of different varieties (N), taste for variety (i), cross-partial elasticity of substitution (σ) in order to explain Y. This formulation is helpful to conclude how much do households want to spread the production, and what kind of substitutes are the goods considered. S. Brakman and Hejidra The Monopolistic Competition Revolution in Retrospect, 2004, p13) If a consumer is less likely to substitute a good, than σ will have small values and vice versa.

Stiglitz associates understanding modern economics with understanding product differentiation and limited competition (Joseph Stiglitz Reflections on the state of the theory of monopolistic competition, ,p.134). Wilfred Ethier emphasizes that Dixit–Stiglitz model influenced trade theory, explicitly international trade and growth theory.

Conclusion

Chamberlin, Robinson, Dixit-Stiglitz and the others made an attempt to come up with a theory about monopolistic competition but their theory was "imperfect" as well. Chamberlin was amongst the first who alarmed the necessity for the new theory, Dixit-Stiglitz attached empirical analyzes. Despite the merit of introducing Monopolistic Competition, Chamberlin has also merits for introducing product differentiation, selling costs, the attempt to explain falling costs. Dixit-Stiglitz have merit for their empirical model- a benchmark in monopolistic competition. Dixit-Stiglitz suggest that as a response to market imperfections in monopolistic competition there is no price competition but differentiating competition. Monopolistic Competition is considered as a blend of perfect competition and monopoly. It is a theory of contestability, disagreements; it is a chapter of unfinished book.

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