MASTER THESIS

A RESEARCH PAPER ON THE ADVANTAGES OF PRIVATIZATION THROUGH FOREIGN DIRECT INVESTMENT

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ABSTRACT

Following the dissolution of the Socialist Federal Republic of Yugoslavia in the early 1990s and the subsequent pursuit of European integration, the Republic of Serbia faces the challenge of swift economic transition. Privatization of state owned enterprises (SOEs) is key and has been a sensitive and recurring issue in the country. Anno 2015, Vucic's large scale transition program is expected to increase the influx of foreign direct investment (FDI) through privatization and in theory FDI is believed to have a positive effect on its recipient. By drawing on data from 14 semi-structured interviews, this study examines the potential advantages of privatization through foreign direct investment (FDI) as compared to privatization through domestic investment in Serbia. It describes the underlying theory of FDI and its effects on a recipient economy. The findings from the case study show that foreign investors invest more capital in their enterprises and make larger acquisitions than domestic investors, carrying advanced technology. Side note, however, is that the first are also responsible for massive cuts in employment.

Keywords: Republic of Serbia, Privatization, Foreign Direct Investment, Domestic Investment, Economic Development, Spillovers

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Writing this thesis, to say the least, has been an enormous challenge. Yet, also a very important invaluable learning experience and journey that marks the end of my university career. In retrospect I found it an enjoyable endeavor, I hope that you will enjoy reading it.

I want to thank Prof. Dr. Dijkstra for her guidance and invaluable advice - I am grateful for your patience, encouragement and clear feedback. Likewise, I would like to thank the Prof. Dr. Haverland, as the second reader of this thesis, and all the respondents, without whom this research would not have been possible. Lastly, to my parents, sister and friends — I sincerely thank you for supporting me throughout the entire process in every possible way.

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ABBREVIATIONS

BD4	Benchmark Definition of Foreign Direct Investment: Fourth Edition
BMP6	Balance of Payments and International Investment Position Manual: Sixth Edition
CEE	Central Eastern Europe
CEFTA	Central European Free Trade Agreement
DDR	German Democratic Republic
DFI	Direct foreign investment
DITEG	Direct Investment Technical Expert Group
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
EU	European Union
EUR	Euro's (currency)
FDI	Foreign direct investment
FOEs	Foreign owned enterprises
GDP	Gross domestic product
IMF	International Monetary Fund
IPFs	Investment Privatization Funds
IPO	Initial public offering
LDCs	Least developed countries
LOEs	Local owned enterprises
MEBO's	Management Employee Buyouts
MNC	Multinational corporation
MNEs	Multinational enterprises
M&As	Mergers & acquisitions
OECD	Organization for Economic Cooperation and Development
R&D	Research & development
SOEs	State owned enterprises
SIP	Share issue privatization
SME	Small or medium sized enterprise

SPA	State Property Agency
TFP	Total factor productivity
UNCTAD	United Nations Conference on Trade and Development
USD	United States Dollars (currency)
USSR	Union of Soviet Socialist Republics

CHAPTER 1

INTRODUCTION AND RESEARCH AIM

In August 2013, as MSc student International Public Management and Policy, I started a six month internship at the Economic and Trade Department of the Netherlands Embassy in Belgrade. During my stay in Serbia various ideas and perceptions about foreign capital and foreign involvement were debated and discussed, especially with regard to the privatization of state owned enterprises (SOEs). Existing literature has provided conflicting predictions concerning the (growth) effects of foreign investment. Numerous academics found a positive correlation between foreign presence and economic growth (Caves, 1974; Globerman, 1979; Blomstrom, 1986), whereas others found evidence that suggests that foreign investment has a negative impact on growth and can actually harm domestic firms and markets (Djankov & Hoekman, 1999; Carkovic & Levine, 2002; Mencinger, 2003).

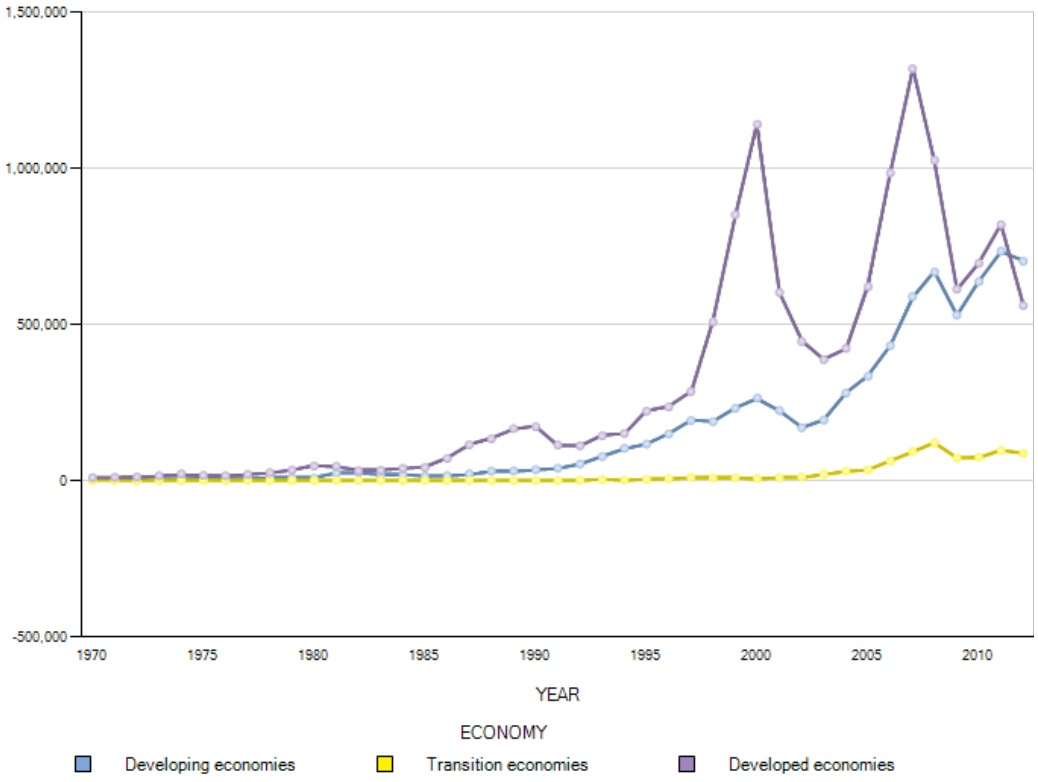
1.1 INTRODUCTION

Today, economic globalization is obvious, but at the end of World War II, few predicted that the world economy was about to embark on a long run of intensifying international trade and investment. International trade and economic relations between industrialized and developing countries expanded at a rapid pace. The scope and scale of international production accelerated, initiated by foreign direct investment (FDI). Many were convinced that the Third World would profit from foreign capital entering its less developed markets with e.g. the introduction of new technologies, know-how and better management practices. Besides, neoclassical growth theory stipulates that with the help of foreign capital less developed economies will experience higher growth rates. Though, in contrast to the industrialized and wealthy First World, so far only part of the Third World managed to grow sufficiently. The Asian Tigers (Hong Kong, Singapore, South Korea and Taiwan) for example, experienced rapid economic development between the 1960s and 1990s and were often touted as a model for developing countries, as policymakers and economists attempted to identify the secrets to their success. Others, such as China, India and Brazil, received an enormous amount of FDI, yet continue to struggle with poverty and unemployment, not to mention deficiencies in human rights and other aspects of social and economic welfare. In today's

increasingly globalized world FDI is a hotbed for discussion. Questions remain about the conventional wisdom regarding FDI, as numerous studies suggest that it may provide little net economic benefit and can actually harm domestic firms and markets.

According to the World Bank, foreign direct investment (FDI) is the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. Traditionally, FDI was a phenomenon that primarily concerned highly developed economies. Developed countries have been attracting a larger share of world-wide FDI than developing countries. The table below contains information on FDI inflows per group of countries, expressed in millions of dollars. It illustrates that the overall amount of FDI has risen significantly since the 1990s. However, in its World Investment Report of 2013, the United Nations Conference for Trade and Development (UNCTAD) writes that in 2012 developing countries have, for the first time ever, absorbed more FDI than developed countries, accounting for 52 per cent of global FDI flows.

Figure 1: inward FDI flows, 1970 - 2014



Source: UNCTAD, www.unctad.org/fdistatistics

1.1.1 FDI, A CATALYST TO DEVELOPMENT?

Foreign direct investment is generally considered, by many international institutions, politicians and economists, as a factor that enhances the host country's economic growth, as well as a solution to the economic problems of developing countries. At first glance it seems as though recipient developing economies can benefit from FDI with the influx of capital and the increase of tax revenues. Through the transfer of new technologies and know-how, increase of competition and better management practices, the host country is likely to experience economic growth and the local population can benefit from employment opportunities created by new businesses. Empirically, a variety of studies confirms these assumptions (Van Loo, 1977; Borensztein, De Gregorio & Lee, 1998; De Mello, 1999; Shan, 2002; Kim & Seo, 2003; Wang, 2009). However, there is also evidence that FDI is a source of negative effects. Bornschier and Chase-Dunn's study, for example, shows that a reliance on FDI in developing countries leads to economic growth in the short-run, but an economic slowdown in the long-run (1985, p. 83). According to the authors, FDI installs firms with an enhanced monopolistic or oligopolistic market position. Eventually, these firms will start to export surplus out of the penetrated country (1985, p. 81-82). The dependency theory stipulates that, even controlling for the level of development achieved at the starting point of the observed development process, there is a clear and negative trade-off between multinational corporation (MNC) penetration of a country and income or growth redistribution (Velasco, 2002, p. 45). The ambiguity resulting from contradicting findings is an obvious reason for analysis on the subject.

1.1.2 PRIVATIZATION PULLS FOREIGN CAPITAL

Since Thatcher's first modern privatization program and the dissolution of the Soviet Union, countries, both developed and developing, have devised and installed policies and methods in order to reduce the state's footprint in the economy and make more room for free market competition. Like FDI, privatization has made significant progress worldwide as economic globalization and market integration increased. Boubakri, Cosset, Debab and Valery wrote that the deeper international competition, the liberalization of (stock) markets worldwide and the lift of trade barriers across countries helped strengthen the need to develop and foster private sector activities, leading to an international shift towards private sector development (2009, p. 81). Megginson adds that, apart from being an economic issue, privatization is also a political act, as it represents an

ideological and symbolic break with a history of state control over a country's productive assets. Nowhere is this symbolism more apparent than in the economies of Central Eastern Europe (CEE) and the former Soviet Union, where privatization of SOEs has come to signal a nation's transformation from communism to democratic capitalism (2000, p. 14). An interesting side effect is that, when countries engage in economic policies favoring private ownership, they simultaneously attract much attention from foreign investors, particularly from MNCs, in the form of FDI. In 2009, Boubakri et al. examined the link between FDI and privatization in a multi-country sample that includes both developed and developing countries. They found empirical evidence that there is a two-way relation running from privatization to FDI and vise versa, which implies that by improving the investment climate, privatization contributes in attracting investors. From the FDI perspective, the intensity of privatization programs is strengthened by increases in FDI flows, contributing to the sustainability of the privatization process. Boubakri et al. presume that this two-way interaction, in turn, will stimulate economic growth and development (2009, p. 91).

1.2 AIM AND PROBLEM STATEMENT

In the late 80s, Serbia began the process of economic transition, slowly directing its planned economy towards a more open and competitive one. At the beginning its position was rather favorable, but ended up being heavily impacted by the dissolution of former Yugoslavia together with Milosevic's mismanagement, leaving the economy only half the size it was. Fortunately, after the deposition of Milosevic in 2000, the country went through a radical economic liberalization process. State owned enterprises (SOEs) were being restructured and privatized, and before the onset of the global economic crisis, Serbia achieved a relatively high rate of economic growth over a number of years with real gross domestic product (GDP) growing at rates between 5% and 6% per annum. However, the country's economy proved to be vulnerable to external shocks slowing down transition reforms and development. Today, Serbia is still struggling with serious structural weaknesses. Many large enterprises, including power utilities, gas and telecommunications, are still publicly owned. In addition, one out of fours Serbians is unemployed and about 30% of Serbia's work force (about 720,000 people) is employed in the public sector. Major challenges lie ahead, such as the need for job creation, new government borrowing and cutting back the high government expenditures together with attracting new foreign direct investment. Fortunately there are also favorable factors, including Serbia's strategic location, a relatively inexpensive and skilled labor

force, and free trade agreements with Russia, Turkey, the European Union (EU) and countries that are members of the Central European Free Trade Agreement (CEFTA).

Nevertheless, Serbian economy is in bad shape (which is the prevailing problem identified by both Serbian government and the EU). Over the past few months, the country's new Prime Minister Vucic has stressed the necessity of comprehensive economic measures, such as cutting public wages, reforming labor laws and privatizing SOEs. These measures are believed to be imperative and supposed to address structural problems such as high unemployment and high government expenditures. Also, in the light of EU accession reshaping Serbian economy is a priority. In 2013 the European Commission wrote that the state's presence in the economy is rather significant and state owned companies continue to accumulate losses (Progress Report, 2013, p. 17). Long delayed structural reforms have slowed down the transition process and in order to meet the Copenhagen economic accession criteria within a reasonable amount of time rapid action is needed. In addition, empirical examination of Central European EU candidates sheds light on the intricacy of links between the 'troika' of privatization, FDI inflows, and integration into international markets. With liberal trade policies and a business environment friendly to both domestic and foreign firms, FDI can be a powerful agent of economic development and integration. A well-conceived privatization program may in turn contribute to their inflows (Kaminski, 1998, p. 1).

Today, SOEs still dominate many of the leading sectors of the economy, including energy, transportation, utilities, telecommunications, infrastructure, mining and natural resources. According to the European Commission's 2013 Progress Report for Serbia, SOEs are responsible for approximately 1 billion EUR in combined losses annually (approximately 40% of all losses in the economy). In addition, SOEs prove to be overstaffed and employ more than 10% of all employees in legal entities. Furthermore, total government subsidies and transfers to SOEs amount to an estimated 2.3% of GDP (2013, p. 25).

Serbia's first wave of economic transition and privatization started in the early 90s. A second wave occurred from 2000 to 2010, in which the government privatized 2,380 SOEs (to both domestic and foreign investors) and generated a revenue of 3.4 billion USD for the Serbian budget (Department of State, 2014, p. 3). Alas, Serbian government was later forced to cancel 646 of these privatizations, noting that investors did not meet contract obligations related to employment and investment. The economic situation improved, but not radically. Meanwhile the number of workers

employed at privatized companies decreased significantly, from 680,000 to 270,000. In 2011, privatization practically came to a halt, only four enterprises were sold that same year. As a result, in July 2014, the Serbian parliament adopted a new privatization law which is expected to ease and speed up the privatization process. According to Dusan Vujovic, Serbian Minister of Economy, the bill allows a more flexible selection of models, methods, and measures of privatization which should enable the subjects of privatization to find potential partners and make the entire procedure efficient and transparent. There are still about 600 SOEs, including 161 that are undergoing restructuring, to be privatized, employing over 100,000 people and the bill stipulates that the whole process is to be completed not later than 31 December 2015. However, if the privatization program is to succeed significant private sector investments are required in order to provide jobs for the thousands made redundant. Some have argued that the new law on privatization will open the door to less transparent deals and higher unemployment, yet government officials argue it will speed up the sale of more than 500 troubled companies. In September 2014, following the new law, the Serbian Privatization Agency published a public invitation on its website for letters of intent for the purchase of 502 SOEs and their subsidiaries, solely excluding the defense industry. The invitation is directed to both domestic and international buyers.

Through this research I aim to shed light on the possible consequences of the speed up of the sale of more than 500 troubled SOEs. Though, at this point, to forecast its impact is impossible. When asked what can Serbia learn from the privatizations which took place in its neighbor countries, the Director of the European Bank for Reconstruction and Development, Matteo Patrone, whose institution defines privatization as their „first priority" in the country, remarked: „Serbia itself has a mixed track record of privatizations and the authorities are paying a very high level of attention to lessons learnt from the past" (Prelec, 2014, p. 4). Also, instead of examining privatization in general, I will examine the effects of two types of privatization, namely privatization through FDI (privatization FDI), as compared to privatization through domestic investment. In order to accomplish this, I will focus on qualitative changes in SOEs privatized (by both foreign and domestic investors during the second wave of privatization) and possibly even changes in financial indicators that allow insight in how business performance alters after the entry of a new investor. Moreover, with Vucic's ambitious, large scale transition program the influx of foreign capital through privatization is expected to rise and in theory FDI is believed to have a positive effect on its recipient. As such, the main research question is:

What are the advantages of privatization through foreign direct investment as compared to privatization to domestic investors in Serbia?

The sub questions:

1. *In general, how does foreign direct investment affect the host country's economic development?*

2. *What are the differences for economic development of privatization to foreign investors as compared to privatization to domestic investors?*

3. *What have been the effects on economic development of privatization to foreign investors as compared to privatization to domestic investors in Serbia?*

1.3 THEORETICAL FRAMEWORK

According to the Organization for Economic Cooperation and Development (OECD, as cited in Fortanier, 2007), FDI and MNCs affect economic growth (and other dimensions of development) through three key mechanisms: *size* effects, *skill and technology* effects and *structural* effects (2007, p. 43).

1. Bosworth and Collins (1991) argued that size effects refer to the net contribution of FDI to the host country's savings and investment, thus affecting the growth rate of the production base (as cited in Fortanier, 2007, p. 43). In addition, FDI and MNCs are expected to raise the host country's tax income. Caves (1974), in addition, stressed the contribution of FDI to productivity and employment. Other literature generally refers to these as *direct effects of FDI*.

   However, most of the potential benefits of foreign capital result from more *indirect effects of FDI* either through the transfer of skills and technologies or through structural change in markets, such as competition and linkages (OECD, 2007, p. 43).

2. Blomström and Sjöholm (1999) argued that technology brought in by MNCs through FDI can spill over to local firms through demonstration effects, labour migration or linkages with buyers and suppliers. Local firms use the new technologies to increase their productivity and thus

contribute to economic growth (as cited in OECD, 2007, p. 43). Also, Findlay (1978) postulated that through the *contagion effect*, FDI increases the overall rate of technological progress in the host country.

3. Structural effects include both horizontal (competition) as well as vertical (linkages with buyers and suppliers) developments.

   - Horizontal: FDI can stimulate competition and improve the allocation of resources, especially in industries where high entry barriers are limiting the degree of domestic competition, such as utilities (OECD, 2007, p. 44). This way, according to Lall (1979), the entry of a MNC may contribute to the dynamics and innovation in the local market and thus to economic growth (as cited in OECD, 2007, p. 44).
   - Vertical: linkages, or sourcing relations with suppliers, can raise the overall output of local supplier firms, and if paired with training their productivity and product quality (OECD, 2007, p. 44).

The OECD framework described above might be appropriate for the purpose of this study. It is designed to both categorize the effects of FDI on economic development and make a distinction between direct and indirect effects. It is through these size, skill and technology, and structural effects that FDI can affect the economic welfare of host countries. In addition, this study might use the work of, for example, Caves (1974), Van Loo (1977), Findlay (1978) and Borensztein, De Gregorio and Lee (1998) who argued that FDI can help promote economic growth.

1.4 METHODS OF INQUIRY

The overall aim of this research project is to provide a picture of a phenomenon, FDI through the acquisition of SOEs, as it occurs in Serbia. In order to enhance the rigor of the proposed study I aim to make use of more than one method of data collection (triangulation). Therefore, the study will be conducted in two stages, based on the sub questions, respectively.

I. In general, how does foreign direct investment affect the host country's economic development?

II. *What are the differences for economic development of privatization to foreign investors as compared to privatization to domestic investors?*

First, I will attempt to map and review most of the important and applicable previous research done on the subject. Sub question I and II will be answered through a thorough literature review, using essentially academic and empirical literature. Subsequently, on this basis, a theoretical framework is developed, which will guide the empirical, second stage of this study, in which sub question III is central.

III. *What have been the effects on economic development of privatization to foreign investors as compared to privatization to domestic investors in Serbia?*

Up to this day, according to a document (in which all sold SOEs are listed) retrieved from the Serbian Privatization Agency in January 2015, 118 SOEs have been bought by foreign investors and 1483 have been bought by domestic investors.

The second part of this study flows from stage one and is built on the answers to question I and II. It aims to determine the impact and benefits of the phenomenon being studied. As such, both quantitative and qualitative data will be used. With the help of semi-structured interviews with e.g. executives, informants, experts and key individuals, (where possible) coupled with data on business performance, I will attempt to answer sub question III.

A preliminary idea (likely to be altered and extended following stage one) derives from the theoretical framework described in paragraph three and implies a distinction between *direct* and *indirect* effects of investment. The direct effects, for example, are to be analyzed through the collection of data concerning *size*, such as investment, savings, productivity and employment (quantitative data). An analysis of indirect effects can be carried out through the collection of in depth information regarding *skill* and *technology* effects and *structural* spillovers (qualitative data).

The interview is one of the commonly used methods in case study research. It is a flexible way of retrieving data, as it allows the researcher to ask additional questions and obtain profound, in depth answers. This method of inquiry is highly appropriate, as it will enable me to guide the interview as much as possible towards answers relevant to this proposed study. In addition, the qualitative study

design allows me to development causal explanations and identify unanticipated phenomena and influences, useful for further research.

A semi-structured interview is an interview on the basis of a so called interview manual or topic list. This implies that the topics of discussion and questions are determined in advance based on the knowledge accumulated from the literature review/desk research. The order and wording can be altered during the interview depending on the respondents' responses (Van Thiel, 2010, p. 109).

1.4.1 SAMPLING

Naturally, examining the entire population of former SOEs throughout this study is not feasible. In addition, there is a confined number of cases to choose from, as obtaining cooperation can be rather challenging. The sample selection will be made consciously and purposefully based on relevant criteria and willingness. I aim to select eight SOEs privatized through FDI and eight SOEs privatized by domestic buyers, over the period of 2000 - 2010 (the second wave of privatization). The businesses must be somewhat comparable and preferably operate within the same sector and region.

1.5 RELEVANCE

This research project will fit into the public administration and international development body of knowledge. For I seek to examine whether foreign capital entering the Serbian market via privatization brings about growth and development. In providing a clear theoretical background I expect the literature on both privatization and FDI to be particularly useful. Furthermore, it would be beneficial if with the help of this research project I would be able to provide better insight into the conflicting findings concerning foreign investment.

1.5.1 POLICY RELEVANCE

The analysis of privatization FDI outcomes is also important for several societal reasons. First, numerous government officials of CEE countries (including the present Serbian government) consider FDI inflows as an engine for future economic growth and institutional development.

Examining the role of FDI through privatization is thus important for policy purposes. Second, several CEE governments faced riots and social opposition as they were engaging in privatization reforms, further fueled by the announcement that the potential buyers were foreign. Therefore, empirically assessing an often opposed policy, such as privatization, and an equally controversial phenomenon, such as FDI, is important. This understanding will not only be useful for Serbian policy makers and politicians, but also for those seeking to reinforce or oppose associated policies in similar countries, such as Montenegro, Bosnia and Herzegovina, Kosovo and Macedonia.

1.6 OUTLINE

This thesis is organized as follows: the next chapter deals with the history and transformation of Serbia since the early 90s, describing the privatization process and the macro-economic condition of the country up to today. Chapter two expounds the theory of FDI and reviews the academic and empirical literature on its effects and relation to privatization through identifying similar experiences in CEE and other countries. The third chapter comprises the theoretical framework and the resulting hypotheses. In chapter four I describe the methodology used. The results are presented in the fifth chapter. Conclusion is made in the last section.

CHAPTER 2

LITERATURE REVIEW

The purpose of this chapter is to provide answers to subquestion I and II through defining key terms and definitions, and identifying theory and research on the subject. The chapter is divided according to the subquestions. The first starts by elaborating on the composition, modalities and motivation of FDI. It addresses the theory of foreign owned production and the OLI-Framework in order to comprehend the channels through which FDI is likely to affect recipient economies' economic development. Subsequently, these channels are split and scrutinized following endogenous growth theory. The second starts by explaining and discussing different modalities of privatization and their relation to FDI. Finally, the implications for economic growth and development are discussed. On this basis, a theoretical framework will be established.

2.1 In general, how does foreign direct investment affect the host country's economic development?

The literature also refers to FDI as *direct foreign investment* (DFI), *direct investment* or *foreign investment.* Definitions of FDI are listed in the Benchmark Definition of Foreign Direct Investment: Fourth Edition (OECD, 2008) (BD4) and in the Balance of Payments and International Investment Position Manual: Sixth Edition (BPM6) (IMF, 2009). Both specify FDI as a "category of cross-border investment with a resident in one economy *having control* or *a significant degree of influence* on the management of an enterprise that is resident in another economy" (OECD, 2008, p. 48; IMF, 2009, p. 100). The foreign *direct investor* is either a natural person or a corporate body in the ‚source' or ‚home' country, and the enterprise or subsidiary in the ‚host' country in which direct investment is made, is referred to as the *direct investment enterprise.* Further, the direct investor's purpose is to gain an *effective voice* in the management of the enterprise.[1] Since it is too complex to evaluate this criterion on a case-by-case basis, the BD4 and BPM6 suggest a threshold of 10 percent of equity ownership to qualify an investor as a *foreign direct investor* (some degree of equity

[1] The most important characteristic of FDI, which distinguishes it from foreign portfolio investment, is that it is undertaken with the intention of exercising control over an enterprise (UNCTAD, 2015).

ownership is almost always considered to be associated with an effective voice in the management of an enterprise).

As soon as a *direct investment relationship* is established, all subsequent capital transactions between *direct investor* and *direct investment enterprise* are considered to be *direct investment*. On the basis thereof, a direct investment relationship can exist between a number of related enterprises, regardless of whether the linkage involves a single chain or a number of chains. The relationship can extend to a direct investment enterprise's subsidiaries, sub-subsidiaries and associates. The European Central Bank (ECB) further distinguishes three different components of FDI: equity capital, reinvested earnings and ‚other capital'. Equity capital makes up for the main part of FDI and includes equity in branches, subsidiaries and associates. Reinvested earnings refer to the direct investor's share of earnings not distributed as dividend, plus earnings belonging to the investor (recorded as investment income) that are not remitted. Other capital basically covers all other financial operations between affiliates, such as the provision of long-term and short-term intra-company loans (Wacker, 2008, p. 5).

Moreover, the Direct Investment Technical Expert Group (DITEG)[2] distinguishes different modalities of direct investment: *mergers & acquisitions* (M&As), *greenfield investments* and *brownfield investments* (Bertrand, 2004, p. 2). A merger or acquisition, strictly defined, occurs when an enterprise acquires control over the whole or a part of the business of another enterprise (Kang & Johansson, 2000, p. 6). Cross-border M&As, that is, those taking place between firms of different national origin or home countries, have grown rapidly in the 90s. Dunning writes that the surge of FDI is best demonstrated by the increasing role of M&As as modalities of FDI (2009, p. 9). This partly reflects a flurry of corporate takeovers, and partly the large-scale privatization programs that were implemented throughout much of the world in the 90s (OECD, 2002, p. 7 - 9). According to UNCTAD (as cited in Dunning, 2009, p. 9), between 55 and 60 percent of FDI flows over the period 1985 - 1995 was accounted for by M&As. Most of these were concentrated within North America, Europe and Japan, and in knowledge and information intensive sectors. In developing and transition countries, however, greenfield investment has remained the predominant mode of entry for direct investors.[3] DITEG defines greenfield investments as „the creation of a subsidiary from

[2] Part of the Directorate for Financial and Enterprise Affairs, Investment Division, OECD.

[3] Followed by foreign companies' participation in privatizations.

scratch by one or more non-resident investors" (Bertrand, 2004, p. 2). Brownfield investments, in contrast, involve extension of capacity: „increase in the capital of established direct investment enterprises" (Bertrand, 2004, p. 2). Although many factors determine investment decisions (elaborated below), greenfield investments are mostly targeted to less competitive markets. Brownfield investments, on the other hand, are common in transition countries in the middle of a privatization process.

Another important characteristic of FDI that should be taken into account is the motivation of the direct investor. The theory of foreign owned production seeks to explain the extent and pattern of value added activities by multinational enterprises (MNEs) outside their national boundaries. Some pioneering work on this issue was done by Stephan Hymer in the early 60s. Hymer's dissertation '*The International Operations of National Firms: A Study of Direct Foreign Investment*' (1960) placed emphasis on the organization of economic activity by international firms as a means of advancing monopoly power, rather than the reduction of costs or improving product quality. Hymer asserted that firms were motivated to produce abroad by the expectation of earning economic rent on a package of resources, including technology, management skills and entrepreneurship. In 1966, Vernon, used a microeconomic concept, that is, *the product life cycle*, to help explain a macroeconomic phenomenon, the foreign activities of American MNEs in the post-war period. His theory suggests that early in a product's life cycle all fundamental resources related to the product come from the area in which it is designed. Gradually, as a product becomes standardized or mature, producing firms shift their primary focus towards minimizing the costs of resources and value adding activities, and as foreign markets expand, the attractions of retrieving resources from and siting value added activities in a foreign rather than domestic location increase. As a result, production steadily moves away from the area of origin and in some cases a product ends up being imported by the country of origin (Vernon, 1966).

Economist John H. Dunning (1988), considered as the father of the scientific field of international business, was of the opinion that the theories offered by Hymer and Vernon were incomplete. He argued that they did not clarify, nor purport to explain, resource based or strategic market seeking direct investment, addressing only some of the issues surrounding international production. Consequently, Dunning sought to integrate the leading theoretical approaches by introducing an all encompassing paradigm, *the OLI-Framework*, also referred to as *the eclectic paradigm* (1988, p. 31). The OLI-Framework was developed in a series of publications (Dunning, 1980, 1981, 1988)

and built upon *the theory of internalization* developed by Dunning's colleagues Buckley and Casson, in 1976. Internalization theory, in short, is a firm-level theory that asserts that international production is likely to occur whenever the benefits of an internal organization of transactions are perceived to exceed those offered by external markets.

Dunning builds on this theory and claims that there are three factors that determine the international activities of MNEs. These are ownership (O) advantages, location (L) advantages, and internalization (I) advantages. Ownership specific advantages refer to the competitive advantage(s) of the firm wishing to engage in FDI, these include not only the firm's intangible assets, such as knowledge, organization structure and management skills, but also natural factor endowments, that is, labor and capital (Rugman, 2010, p. 3). The OLI-Framework suggests that MNEs develop competitive O advantages at home and then transfer these abroad to specific countries (depending on L advantages) through FDI, which allows the MNE to internalize the O advantages (Rugman, 2010, p. 2). The premise behind location advantages distinguishes resource based (vertical) foreign investment and market seeking (horizontal) foreign investment. While vertical direct investment is carried out to establish access to raw materials or basic resources, the latter is made in order to enter an existing market or create a new one. Thus, the more ownership advantages possessed by an enterprise, the greater the inducement to internalize them; and the wider the attractions of a foreign rather than a home country production base, the greater the likelihood that an enterprise, given the incentive to do so, will engage in international production (Dunning, 1988). Together, internalization and eclectic theory lay the foundation for present studies on foreign owned production and MNE activity.

2.1.1 THE EFFECTS OF FDI

Today, the world economy is characterized by the increasing globalization of economic activity. Continuous increasing FDI levels render the latter and instigate an abundance of (policy-oriented) research and literature discussing the relationship between foreign investment and economic growth. In 2013, FDI inflows rose by 9 percent to 1.45 trillion USD. It is projected that the sum will rise to 1.6 trillion USD in 2014, 1.75 trillion USD in 2015 and 1.85 trillion USD in 2016 (UNCTAD, 2014, p. 1). Besides, in many developing and transition economies, policy makers have cleared trade and investment barriers, and actively attempt to attract foreign investment using fiscal and financial incentives. Of 145 regulatory changes made by 60 countries in 1998, 94 percent

created more favorable conditions for FDI (Görg & Greenaway, 2004, p. 171). The rationale behind this special treatment stems from the belief that FDI carries much-needed capital and employment and is likely to generate (productivity) spillovers (Aitken & Harrison, 1999, p. 605).

In ‚*Foreign Direct Investment for Development'* the OECD (2002, p. 9) writes:

> „*Beyond the initial macroeconomic stimulus from the actual investment, FDI influences growth by raising total factor productivity and, more generally, the efficiency of resource use in the recipient economy. This works through three channels: the linkages between FDI and foreign trade flows, the spillovers and other externalities vis-a-vis the host country business sector, and the direct impact on structural factors in the host economy.*"

The OECD makes a clear distinction between initial or direct effects of FDI and secondary or indirect effects of FDI (elaborated below). However, it is important to note that all of these are believed to contribute to higher economic growth. The first, the initial or direct stimulus, can be attributed to the influx of capital and, in several occasions, employment (originating abroad). According to the neoclassical model of economic growth, introduced by Solow and Swan in 1956, output or growth is, indeed, produced by the factors labour and capital. It implies that varying shares of labour and capital inputs determine production (Sardadvar, 2011, p. 12). Blomström, Lipsey and Zejan (1993) examined this correlation for more than 100 countries (over successive five-year periods between 1965 and 1985) and observed that high rates of capital accompany rapid growth in income. Thus, since it is likely that MNEs carry capital many agree on the assumption that FDI induces economic growth (Caves, 1996). It is, therefore, no surprise that policy makers seek to attract the more FDI.

Moreover, back in 1960, MacDougall discussed the benefits and costs to Australia of private investment from abroad. He was among the first to apply the neoclassical model in order to asses the difference made to Australia's income by the presence of foreign owned private capital (1960, p. 189). The main conclusions of MacDougall's analysis were fairly straightforward and obvious. He writes that the most important direct gains to Australia seem likely to come through increased capital and higher tax revenue from foreign profits (if the investment is not induced by lower tax rates). In addition, Buckley and Artisien examined the employment impact of MNEs (in Greece, Portugal and Spain) in 1987. Direct employment consequences of FDI are alleged to depend on the

mode of entry chosen by the MNE. While both green- and brownfield entry are expected to spur employment instantly, M&A entry is not. Though, Buckley, Hartley and Sparkes (1979) add that there is also a possibility that the capital of the acquired enterprise will be used to invest in employment creating activities. Regardless, Buckley and Artisien's study found that foreign investment by MNEs, in fact, is employment creating. In addition, Lall writes that, apart from direct employment creation, foreign investment carries indirect employment creating benefits arising from e.g. subcontracting, demand for transport and other services (Lall, 1979, p. 1).

MacDougall also noted that it may well be that through the presence of foreign firms, local Australian firms appropriate foreign know-how (as they are forced by foreign competition to adopt more efficient methods), affecting, according to OECD, „the efficiency of resource use in the recipient economy" (2002, p. 9). This ultimately brings about higher domestic investment and output, further increasing Australian income (MacDougall, 1960, p. 210). Accordingly, the linkage between FDI and economic growth, as emphasized by Blomström, Lipsey and Zejan (1993) and the OECD (2002), is more complex and involves more channels. Endogenous growth theory, luckily, offers more insight in the latter. It builds on neoclassical theory by adding factors to the production function, also referred to as total factor productivity or TFP, and puts high emphasis on the importance of technology, human capital and openness to international trade and investment. The theory suggests that FDI fosters economic growth by playing a supportive or complementary role to domestic investment through both direct and indirect effects such as investment in production and positive spillover occurrence respectively (Gachino, 2010, p.5).

Fundamental to the above argument is Dunning's eclectic paradigm that underpins the generally held assumption that competitive ownership advantages of a MNE, such as knowledge, technology and skills, induce higher efficacy and effectiveness than their equivalents. As Graham and Krugman (1991) argue, domestic firms have better knowledge and access to domestic markets; if a foreign firm decides to enter the market, it must compensate for the advantages enjoyed by domestic firms. It is most likely that a foreign firm that decides to invest in another country enjoys lower costs and higher productive efficiency than its domestic competitors. In addition, Blomström and Kokko (1998) point out that in developing industries the competitive assets of MNEs are likely to be related to new products and processes. In mature industries, MNEs may base their competitiveness more on marketing skills or organizational advantages (Blomström and Kokko, 1998, p. 3).

Hence, in contrast to the traditional neoclassical growth model that diminishes returns to mere reproducible factors and limits the possible contribution of foreign investment, endogenous growth literature stresses that foreign investment may bring about positive spillover effects. In fact, the study of FDI as a driver of economic growth in host countries is based on endogenous growth reasoning (Fortanier, 2007, p. 51). Yet, what are these indirect, positive spillover effects or externalities, and how do they manifest themselves?

2.1.2 SPILLOVERS

Buckley, Clegg and Wang define productivity spillover effects from inward FDI as „the influence of the presence of foreign owned enterprises (FOEs) on the productivity of locally owned enterprises (LOEs)" (2010, p. 193). They are generated by non-market transactions involving MNEs, in particular when knowledge is spread to LOEs of the host country without a contractual relationship. Plus, Blomström and Kokko explain that productivity spillover effects are likely to occur when MNEs are not able to internalize the full value of productivity or efficiency benefits (1998, p.3).

The pioneering work on this issue was carried out in 1974 by Richard E. Caves on a quest for evidence on the effects of foreign investment in the manufacturing sectors of Australia and Canada. In „*Multinational Firms, Competition and Productivity in Host-Country Markets*" Caves writes that, aside from the evident and tangible advantage for the host economy arising from the increase in corporate income tax collected, more, yet doubtful and intangible, advantages lie in the effects of foreign investment on the productivity value of resources owned by the host economy. These are subdivided into: allocative efficiency; technical efficiency; and technology transfer (1974, p. 176 - 177).

The first, allocative efficiency, refers to competition in the host economy: an MNE may reduce monopolistic distortions as it tends to populate industries where entry barriers are high. The following, technical efficiency, covers the MNE's competitive force or advantage: suppliers, competitors and buyers of the subsidiary (the role model) are likely to adopt a higher level of technical efficiency due to the demonstration (or ‚contagion') effect. The latter, technology transfer, involves faster dissemination of technology and innovation among domestic firms supplying or competing with the subsidiary (Caves, 1974, p. 177). Caves' early study is one of many that

empirically support the existence of a positive interaction between foreign presence and the average value added per worker of domestic firms in the same sector.

Globerman's study, inspired by Caves and sponsored by the Canadian-American Committee, also investigated the presence of productivity spillover effects in Canada and obtained similar findings. Globerman writes that: „differences in labour productivity among Canadian owned plants (…) derive from spillover efficiency benefits associated with foreign direct investment" (1979, p. 53). In 1983, following Caves and Globerman, Blomström and Persson wondered whether differences in technical efficiency in Mexico (a developing economy) derived from spillovers associated with FDI. In line with those who preceded them, Blomström and Persson found a positive link between labour productivity and foreign presence in Mexico's manufacturing industry, indicating the existence of spillover efficiency benefits from FOEs to LOEs (1983, p. 499).

Similar results were obtained for Indonesia by Blomström and Sjoholm in 1999. Their study was built on the hypothesis that local participation with foreign enterprises might expose some of their proprietary knowledge, which would occur through various trainings in foreign enterprises or by gathering experience at work (also referred to as human capital development, elaborated below). Blomström and Sjoholm's findings demonstrate that labour productivity in domestic enterprises varies with the amount of foreign enterprises. Indonesian FOEs, indeed, have the advantage of a relatively high level of labour productivity. As a result, Indonesia's manufacturing sector experiences intra-industry spillovers from foreign investment (Blomström and Sjoholm, 1999).

Furthermore, in 1996, after surveying the vast economic literature dealing with MNE activity, Caves issues „*Multinational Enterprise and Economic Analysis*". Caves points out that, apart from the increase in the average value added per worker (Caves, 1974; Globerman, 1979; Blomström and Persson, 1983; Blomström and Sjoholm, 1999), other positive effects of foreign investment, such as technology transfer, human capital development and access to international markets, have been detected worldwide (Caves, 1996). Besides, (economic) literature seems to identify technology transfers as perhaps the most important channel through which FDI may produce positive spillovers in the host (developing) country (OECD, 2002, p. 12). Findlay (1978), for example, addressed the technology gap between backward and advanced regions and captured some relevant and interesting aspects of the way in which the transfer of technology takes place. He postulates that FDI increases the rate of technical progress in the host country through a ‚contagion' effect from the more

advanced technology and management practices used by MNEs. After all, the OECD, notes that: „*MNEs are the developed world's most important source of R&D activity"* (2002, p. 12). In his paper, Findlay presents a model in which the rate of *technological progress* in a backward country is assumed to be an increasing function of both the technology gap and the amount of FDI (Wang, 1990, p. 256). Hence, the more FDI and the bigger the technology gap observed, the faster the pace of technology transfer (Findlay, 1978, p. 14). Borensztein, Gregorio and Lee (1998) concur with Findlay. The results of their cross-country study, employing data on FDI flows from industrial countries to 69 developing countries from 1970 to 1989, suggest that FDI is an important vehicle for the transfer of technology (Borensztein et al., 1998, p. 133). Their findings further emphasize that foreign enterprises contribute more to growth than domestic enterprises (1998, p. 133).

De Mello (1999), supporting Findlay's and Borensztein's statements, touches on *knowledge transfers*. He argues that FDI also augments the existing stock of knowledge in the recipient economy through labour training and skill acquisition, on the one hand, and through the introduction of alternative management practices and organizational arrangement, on the other (1999, p. 134). De Gregorio refers to the latter as *expertise* carried by MNEs (2003, p. 5). Furthermore, knowledge transfers, also referred to as *human capital development* by the OECD, are closely interrelated with the above elaborated technology transfers. The OECD, however, as opposed to Findlay, points out that: „*technologically advanced sectors and host countries are more likely to see human capital spillovers and, conversely, economies with a high human capital component lend themselves more easily to technology spillovers*" (OECD, 2002, p. 15).

Furthermore, FDI generally occurs in tandem with international trade integration and increased exports, categorized as *market access spillovers* by Blomström and Kokko (1998, p. 2). Given the strong competitive benefits possessed by MNEs in entering world markets (such as experience and knowledge of international marketing, established international distribution networks, and lobbying power in their home countries), MNEs may pave the way for local enterprises to enter the same export markets. Trough e.g. collaboration, or more likely imitation, domestic firms can learn how to penetrate export markets (Aitken, Hanson and Harrison, 1997). Sun scrutinized the macroeconomic impact of foreign investment in China from 1979 to 1996, and discovered that FDI significantly promoted Chinese economic growth by contributing to domestic capital formation, creating new employment and, more importantly, increasing exports (1998, p. 691).

In „*Multinational Corporations and Spillovers*" Blomström and Kokko elaborate in detail on FDI's impact, categorizing the known productivity spillovers based on the linkage of the affected enterprise and the MNE, in forward and backward (1998, p. 11). While backward linkages arise from the MNE's relationships with suppliers, forward linkages stem from contacts with customers. An example of a forward linkage is when an MNE's costumer receives higher quality of inputs and as a consequence becomes more competitive. A backward spillover arises, for instance, when an MNE provides technical assistance or information to raise the quality of suppliers' products or to facilitate innovations.

Next to being either forward or backward, spillovers can take place on either inter-industry (vertical) or intra-industry (horizontal) level. Yet, over the past decades, a vast majority of existing studies and literature predominantly focussed on the latter analyzing productivity spillovers in e.g. the manufacturing sector (Caves, 1974; Globerman, 1979; Blomström and Persson, 1983; Blomström and Sjoholm, 1999; Rappaport, 2000). Hardly any empirical studies analyze vertical spillovers (Blomström et al., 2000). In 2004, Javorcik went beyond existing literature. Her study tests for productivity spillovers taking place through backward linkages and forward linkages. Javorcik explains that MNEs actually profit from preventing information leakage that could boost the performance of local competitors and thus spillovers are most likely to occur via backward linkages, that is, contacts between domestic suppliers of intermediate inputs and their multinational clients (as MNEs do benefit from transferring knowledge to e.g. their local suppliers) (2004, p. 606). In addition, she examines whether benefits stemming from vertical linkages are related to the extent of foreign presence. Javorcik's study results (based on data from Lithuania) confirm the presence of productivity spillovers taking place through backward linkages. In contrast, she did not find any evidence of forward linkages.

Thus, recapitulating the above, a large number of empirical studies (single and cross country) suggest that FDI is an important source of capital and new job opportunities. Furthermore, it is assumed that FDI enhances the transfer of technology and human capital development, complements domestic investment and further integrates the host economy into international markets. All the above mentioned effects are believed to be beneficial, boosting the host countries' economic growth (Chowdhury & Mavrotas, 2005, p. 2) De Gregorio exemplifies this according to an analysis of growth determinants in 12 Latin American countries between 1950 and 1985. He asserts that FDI is about three times more efficient than domestic investment. His analysis indeed

demonstrates that by increasing total investment by 1 percent of GDP, economic growth is increased by 0.1 to 0.2 percent a year; but by increasing FDI by the same amount, economic growth is increased by 0.6 percent a year (1992, p. 5).

2.1.3 CONFLICTING FINDINGS

Still, it is important to note that the above listed linkages and spillovers are not necessarily beneficial for the host country. For instance, domestic suppliers can experience difficulties with competing with their foreign competitors that have some sort of competitive proprietary advantage. Thus, the data obtained on positive externalities in the above studies can be challenged in that spillovers could result following disappearance of weak and inefficient local firms. Gachino (2010) rightly argues that: „industries, sectors and firms are characterized by high levels of heterogeneity with significant differences in technological capabilities and capacities to learn and innovate". Alas, after in-depth investigation, he claims that none of the studies mentioned above controls for these discrepancies (2010, p. 7). Another confounding issue appears when one takes into account that MNEs are clever and calculated, and likely to invest in enterprises and sectors which are dynamic, innovative, and, most importantly, profitable. As a result, a selectivity bias problem arises; MNEs invest in firms with above-average productivity.

Also, contrary to the above studies, some studies do not find positive spillovers. For instance, Haddad and Harrison (1993) examined the impact of foreign firms on domestic firms in Morocco's manufacturing sector from 1985 to 1989, and found productivity dispersion to be smaller in sectors with many foreign firms. They attribute this to the competition induced by foreign enterprises, causing other enterprises that cannot approach the ‚best practice frontier' to exit the industry. Haddad and Harrison's findings thus rejected the hypothesis that FDI accelerates productivity growth in domestic firms (1993, p. 54). Aitken and Harrison's study on more than 4000 Venezuelan plants between 1976 and 1989, even asserts that foreign firms negatively affect the productivity of domestically owned plants. Moreover, the gains from foreign investment appear to be entirely captured by MNEs (1999, p. 617). Firm level data for the Czech Republic from 1992 to 1996 (the initial post-reform period), collected and analyzed by Djankov and Hoekman in 2000, suggests the same (p. 62).

Firebaugh (1992) provides additional insight in the above. He writes that there are absolutely compelling reasons for expecting developing countries to gain less from foreign investment than from the indigenous kind. FDI as compared to domestic investment is: (1) less likely to contribute to public revenues, as transnational corporations are often able to avoid taxes; (2) less likely to encourage the development of indigenous entrepreneurship; (3) more likely to use inappropriate capital intensive technology; (4) less likely to reinvest profits in the host country (1992, p. 106). Thus, allegedly FDI is likely to be more „outward looking" (Firebaugh, 1992, p. 107). Moreover, based on data from 76 least developed countries (LDCs), Firebaugh's study (1992) derives that ownership matters as homegrown capital appears to outperform imported capital. Nevertheless, his study also confirms that both, that is domestic and foreign capital, stimulate and generate economic growth (1992, p. 124)

In „*Much Ado about Nothing? Do Domestic Firms Really Benefit from Foreign Direct Investment?*" Görg and Greenaway (2004) evaluate the empirical evidence on intra-industry productivity, wage and export spillovers in developing, developed and transition countries. In total, they enumerate 40 studies of horizontal productivity spillovers in manufacturing industries. Of those, 20 report unambiguously positive and statistically significant horizontal spillover effects; five report negative effects; and 15 report inconclusive results (2004, p. 177 - 178). Interesting, however, is the fact that most studies on transition economies find at least some evidence of negative results (2004, p. 179). Mencinger (2003), for example, explored the relationship between FDI and economic growth in eight transition countries (Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia) in their post-transition period (which is also the period of their gradual accession to the EU and high reliance on FDI). Surprisingly, a statistical robust negative causal relationship between FDI and growth emerged (Mencinger, 2003, p. 507). Mencinger attributes this development to the modality of foreign investment. As, in the observed period, M&As were the predominant mode of entry (2003, p. 507). This, in turn, can be interpreted through large scale privatization (elaborated below, subquestion II), a centerpiece of transition reforms. Dunning, after all, writes that M&As (as modalities of FDI) generally go together with SOEs on sale (2009, p. 9).

Lipsey (2000) scrutinized the macro empirical evidence on the effects of FDI. He pointed out that studies analyzing discrepancies in productivity almost always find FOEs to be more productive than LOEs. Thus, according to Lipsey, a combination of ubiquitous spillover studies and strong evidence for higher productivity in FOEs (as above exemplified by Dunning), suggests that overall

production will improve with inward foreign investment (2000, p. 371). Firebaugh's study (1992), which is based on data from 76 LDCs, affirms Lipsey's assumption. It demonstrates that FDI, indeed, has a significant impact on economic growth. Yet, in 2002, Carkovic and Levine reassessed this relation using new macro-economic statistical techniques and two new databases (World Bank and IMF) (2002, p. 2). Their results, in contrast, show no evidence of FDI exerting a strong independent positive influence on production and economic growth (2002, p. 13).

Altogether, different studies show different results. Yet, the evidence for a positive relationship dominates: a large number of enquiries finds evidence of beneficial effects, others report negligible or negative effects. Differences between data sets and period of measurement, together with the conceptual difficulties of quantifying the impacts of FDI help explain these conflicting findings. Nevertheless, as mentioned by Lipsey (2000), there is no universal relationship between FDI and growth.

2.2 What are the differences for economic development of privatization to foreign investors as compared to privatization to domestic investors?

After the onset of the global debt crisis in the early 1980s, growth rates, which during the 1970s oscillated around 6 percent, collapsed to an average of 1,8 percent (Berry & Serieux, 2006). Macroeconomic disorder and inflation prevailed, clouding future growth prospects. As a result, policy makers of both developed and developing countries were highly concentrated on alleviating strained public budgets. The noted success of Thatcher's privatization program, in turn, inspired and persuaded many into divesting SOEs (Megginson & Netter, 2000). The number of global privatization transactions grew rapidly from only 62 in 1988 to 862 in 1993. Sader states that overall, for a total of 93 countries, 2,655 transactions were recorded during this period, generating a total sales revenue of 271 billion USD (1995, p. 3)[4]. Today, governments of very different political and ideological backgrounds appear to be determined upon privatizing. Also, governments that were already privatizing are moving from selling small retail outlets and industries, to selling larger mining and utility enterprises (Shirley, 1992, p. 23). Next to short term budgetary benefits, this

[4] The World Bank Privatization Database excludes privatizations from the former German Democratic Republic due to a lack of detailed information. However, estimates indicate that the Treuhandanstalt has sold about 12,000 entities for approximately 28 billion USD since the start of the program in 1990 (Sader, 1995, p. 3)

development promotes the creation of an attractive business environment in many countries, intensifying the interest of foreign investors (Sader, 1995, p. 2).

Shirley writes that there are as many definitions of privatization as there are analysts. Her interpretation, however, is rather simple: privatization is the transfer of ownership of assets to the private sector (1992, p. 24). According to Savas (2000), Shirley's definition holds for countries with many SOEs including post-socialist countries and countries in Western Europe. Here, privatization is also known as denationalization. In the United States, however, which has relatively few SOEs, the term privatization is commonly applied to the act of contracting for public services[5] (Savas, 2000, p. 1).

An important decision to be made by a privatizing government is the modality (and speed) through which the state owned asset is transferred to private ownership. Megginson and Netter (2000, p. 338) write that this decision is a complex one because, as in addition to the economic factors such as valuing the assets, privatizations are generally part of an ongoing, highly politicized process. In „*From State to Market: A Survey of Empirical Studies on Privatization*" they enumerate nine factors that affect the privatization modality (2000, p. 338):

> „(1) *the history of the asset's ownership,* (2) *the financial and competitive position of the SOE,* (3) *the government's ideological view of markets and regulation,* (4) *the past, present, and potential future regulatory structure in the country,* (5) *the need to pay off important interest groups,* (6) *the government's ability to credibly commit itself to respect investors' property rights after divestiture,* (7) *the capital market conditions and existing institutional framework for corporate governance in the country,* (8) *the sophistication of potential investors,* (9) *and, the government's willingness to let foreigners own divested assets."*

Bennett, Estrin, Maw and Urga argue that, in practice, the choice of privatization modality appears to be driven primarily by ideological factors (2004, p. 5). In addition, Megginson and Netter (2000) add that scholars yet have confined insight in the determinants and implications of privatization modalities. This can be explained by the differing objectives of privatization (Megginson & Netter, 2000, p. 339). Regardless, Savas sought to provide a comprehensive taxonomy that includes three

[5] For a comprehensive overview of privatization interpretations read E. S. (2000). *Privatization and Public Private Partnerships*. New York: CQ Press.

broad methods of privatization: (1) *delegation*, where government retains responsibility and oversight, but uses the private sector for service delivery, for example, by contracting for services, or outsourcing; (2) *divestment*, where government relinquishes responsibility, and; (3) *displacement*, where the private sector grows and displaces a government activity. Subsequently, each one of these encompasses various distinct approaches or modalities classified in Table I.

Table I: Privatization Modalities	
Delegation	Contract Public Private Competition Franchise Public Private Partnership Grant or Loan Voucher Mandate
Divestment	Sale Free Transfer Liquidation
Displacement	Default Withdrawal Voluntary Action Deregulation
Source: Savas, E. S. (2000). *Privatization and Public Private Partnerships*. New York: CQ Press.	

Unfortunately, it is beyond the scope of this study to elaborate on all modalities. Brada (1996), however, managed to point out the prime techniques of privatization employed across Central and Eastern Europe in the early 90s, that is: (1) privatization through restitution; (2) privatization through sale of state property; (3) mass or voucher privatization, and; (4) privatization from below. He writes that, in general, SOEs in Eastern Europe and the former Union of Soviet Socialist Republics (USSR) were a grand failure as units of production (as opposed to providing secure employment). It is therefore hardly surprising that policy makers generally chose divestment or sale techniques whilst privatizing these malfunctioning enterprises.

Brada writes that the first modality, *restitution of property expropriated by the state*, such as real estate and agricultural land, is generally applied when previous owners or holders able to prove their past ownership exist (1996, p. 68). This form, as mentioned by Estrin, is favorable in that it instantly creates an equity or estate holding middle class and reestablishes real ownership (2007, p. 7). In the Czech Republic restitution of larger properties accounted for 5 to 10 percent of all state property. Nevertheless, as Megginson and Netter point out, this form of privatization is rarely

observed outside of Eastern Europe (2000, p. 339). Savas also included this type of modality, yet referred to it as „free transfer" since this type of divestment does not require the sale of an enterprise. In contrast to Megginson and Netter, he adds that restitution did not only occur in Central and Eastern Europe: New York City, for example, proposed to privatize its municipal hospitals by handing them out to local, non-profit, community based establishments (Savas, 2000, p. 9).

The second modality, sale of state property (under which a government trades its ownership claim for an explicit cash payment) is expected to meet several goals: (1) producing revenue for the state; (2) speeding the process of restructuring, and: (3) getting foreign investors involved in the economy. In general, SOEs were sold quickly, even with antiqued capital, redundant workers and poor financial prospects (Brada, 1996, p. 70). Megginson and Netter explain that this category takes two important forms. The first being direct sales or asset sales of SOEs to an individual or business (often through auction or tender procedures, elaborated below). The second being *share issue privatization* (SIP), which implies that the government's shares in a state enterprise are exchanged through a public share offering. A public share offering, in fact, is very similar to an *initial public offering* (IPO) or stock market launch. An IPO, however, is merely created to raise revenue, whereas a SIP deals with both budgetary and political issues (Megginson & Netter, 2000, p. 339). Megginson further comments that governments often tend to restrict the participation of foreign investors in SIPs (2010, p. 19) Moreover, Savas writes that there is also the possibility of selling a state enterprise to its managers or employees, or even to its users or customers. A rural, electricity or water system, for instance, can be sold to a collective of local users (Savas, 2000, p. 8).

Another interesting discrepancy is addressed by Brada (1996). He distinguishes the sale of small SOEs, service establishments like shops and restaurants, and the sale of large SOEs, such as utility and infrastructure enterprises. It appears that the first has been among the most popular and least difficult to privatize (generally by means of action procedures, elaborated below). The latter, however, has proven rather controversial and generally less successful (Brada, 1996, p. 70). Brada cites a few examples: the Treuhandanstalt (also referred to as Treuhand), for instance, was the agency in charge of privatizing the state enterprises of the German Democratic Republic (DDR) in the early 90s. Between 1990 and 1994, Treuhand disposed and sold 8,500 SOEs. Despite the fact that the agency succeeded to privatize a bulk of enterprises in a short amount of time, the costs were

significant. As, throughout the course of its existence, Treuhand took in 50 billion but spent 243 billion USD (Brada, 1996, p. 71). Not to mention the 2.5 million lost jobs throughout the process.

The Hungarian privatization process, in comparison, could be characterized as rather slow and less aggressive (Major, 1994; Brada, 1996). Their experience emphasizes that Brada's second modality does not guarantee rapid, desired results. In Hungary, the State Property Agency (SPA), to begin with, obliged SOEs to reorganize and modify themselves. In turn, the SPA would pick out and prepare these modified firms for privatization through e.g. public share offerings, auctions and direct negotiations with potential buyers and management buyouts (Brada, 1996, p. 71). However, according to estimates, after three years of transition, the SPA managed to privatize a mere 30 percent of assets (Major, 1994, p. 108). The biggest constraint, as reported by Major, was a lack of sufficient domestic interest in state property (1994, p. 107). FDI finally accounted for half of the SPA's sales. Such development, according to Brada, is not necessarily detrimental. In accordance with some of the above elaborated theory regarding FDI, he writes that foreign investment often is accompanied by advanced technology and access to global markets (Brada, 1996, p. 72).

To increase the pace of privatization, several countries engaged in mass or voucher privatization programs, Brada's third modality. Such program enables eligible citizens to utilize vouchers[6], generally distributed free or at nominal cost, to submit and bid for shares of state enterprises and further assets being privatized (Brada, 1996, p. 72). Estrin summarizes two types of mass privatization related to two issues. The first being whether officials decide upon distributing vouchers to the all eligible citizens (both „outsiders" and „insiders") or exclusively to employees and managers (categorized as insiders). Researchers usually refer to the latter as „*Management Employee Buyouts*" (MEBOs). The second revolves around officials determining whether vouchers were to be exchanged directly for shares in state enterprises or through selected intermediaries, such as Investment Privatization Funds (IPFs). These are agencies that bid for shares on behalf of their investors (Estrin, 2007; Brada, 1996). Brada argues that this type of modality is advantageous due to its fast pace and relative transparency. In addition, it is less likely to eliminate insider power, which, in turn, circumvents political opposition and public disquiet (1996, p. 75).

[6] Vouchers, in effect, constitute a stock of savings matching the stock of state assets being privatized. In order to avert inflationary issues due to such wide scale „money creation", vouchers are non-transferable and not valid for any transaction other than the purchase of state assets (Estrin, 2007, p. 7)

Brada's final modality, privatization from below, is a rather ambiguous and all-encompassing one. It involves private sector development through the creation of new firms by both domestic and foreign entrepreneurs (Brada, 1996, p. 75). Still, these firms do not emerge as start-ups. They generally emerge by means of restitution and small privatization (Brada, 1996). Naughton, however, pointed out that, in China, the key to this type of process is *entry*, rather than privatization per se. He writes that entry sets up competition and spurs market development, ultimately leading to a decline in state control and monopoly (1994, p. 266).

Apart from the privatization modalities discussed above, there are still numerous other methods for governments to apply (Table I). Overall, each government employed a mixture of modalities, divesting different sorts of firms in different sorts of ways. Estrin, in line with Brada (1996), highlights that small firms were generally transferred through public action. Large firms, in contrast, were rather strenuous to privatize and therefore often exchanged through public tender (2007, p. 8). Public auction, as a method of privatization, aims to collect the highest selling price for an individual asset, often concerning a small or medium sized enterprise (SME). The terms and conditions of sale are fixed and require the asset to be sold to the highest bidder (World Bank, 2015). A public tender, in contrast, is a lengthy and strategic technique designed to find a suitable buyer for rather large and often complex enterprises. The process commences with the advertisement of an enterprise on sale. Subsequently, for a certain period of time, interested parties are given the opportunity to provide a written price and investment proposal. Public officials, in addition, are given the opportunity to negotiate and debate the submitted proposals. Altogether, the general principles for public auction and tender procedures are prescribed by national privatization laws (World Bank, 2015).

2.2.1 OWNERSHIP

SOEs, in effect, can be sold to both domestic and foreign purchasers or institutions, such as investment funds. However, in practice, only Hungary and Estonia were inclined and competent to sell a significant share of state enterprises to foreigners (Estrin, 2007, p. 6). Here, FDI finally accounted for about 20 and 50 percent of sales respectively. Overall, according to Estrin, governments in Central and Eastern Europe are more likely to privatize their SOEs to their own citizens: either to „outsider" domestic investors or via „insider" MEBOs (2007, p. 7). Moreover, a majority of transition countries does not seem to be able to attract foreign investors, which are often

dissuaded by political and economic instability and unclear property rights. As a result, firms are sold at preferential prices to insiders (Brada, 1996).

For a comprehensive overview Table II encompasses the prime privatization modalities applied per transition country based on various transition reports from the European Bank for Reconstruction and Development (EBRD). It illustrates that mass or voucher privatization was most popular: out of the 23 countries listed eighteen used some type of mass privatization as either primary or secondary method. According to Bennett et al. (2004) this should be considered as a positive development (elaborated below). In addition, it is rather remarkable that privatization through sale of state property or direct sales, which is believed to be a rather conventional method, occurred least.

Table II: Country Privatization Table

Country	Classification of privatization	Year of privatization	Primary method	Secondary method
Albania	Mixed	1995	MEBO	vouchers
Armenia	Mass	1994	vouchers	direct sales
Azerbaijan	Mass	1997	vouchers	direct sales
Belarus	Mixed	1994	MEBO	vouchers
Bulgaria	Direct sales	1993	direct sales	vouchers
Croatia	Mixed	1992	MEBO	vouchers
Czech Republic	Mass	1992	vouchers	direct sales
Estonia	Direct sales	1993	direct sales	vouchers
FYR Macedonia	Mixed	1993	MEBO	direct sales
Georgia	Mass	1995	vouchers	direct sales
Hungary	Direct sales	1990	direct sales	MEBO
Kazakhstan	Direct sales	1994	direct sales	vouchers
Kyrgyzstan	Mass	1996	vouchers	MEBO
Latvia	Direct sales	1992	direct sales	vouchers
Lithuania	Mass	1991	vouchers	direct sales
Moldova	Mass	1995	vouchers	direct sales
Poland	Direct sales	1990	direct sales	MEBO
Romania	Mixed	1992	MEBO	direct sales
Russia	Mass	1993	vouchers	direct sales

Country	Classification of privatization	Year of privatization	Primary method	Secondary method
Slovakia	Direct sales	1995	direct sales	vouchers
Slovenia	Mixed	1998	MEBO	vouchers
Ukraine	Mass	1995	vouchers	MEBO
Uzbekistan	Mixed	1995	MEBO	direct sales

Source: Bennett et al. (2004). Privatization Methods and Economic Growth in Transition Economies.

More importantly, Bennett, Estrin, Maw and Urga (2004) write that the choice of an appropriate method of privatization could play an important role in jumpstarting economic growth (2004, p. 2). Research, after all, points out that different methods of privatization lead to different majority ownership structures (Bennett et al., 2004). Which, in turn, bring about different economic consequences (Bennett et al., 2004). In „*When Does Privatization Work?*" Frydman, Gray, Hessel and Rapaczynski (1999) clarify *why* and *how* different majority ownership structures affect post-privatization firm performance. In addition, they provide empirical evidence that shows that firms controlled by *outsiders* outperform those owned by *insiders* in terms of their revenue performance. Then, for the purpose of this study it is important to distinguish *domestic* and *foreign outsiders*[7].

First, Bennett et al. (2004) observe that privatization through sale of state property, Brada's second modality, frequently leads to outsider ownership, with e.g. *outsider foreign ownership* prevailing in Estonia (Estrin, 2007, p. 6). Further, mixed methods of privatization are likely to induce a majority of *insider ownership*, often dominated by MEBOs as observed in Romania and Slovenia. Alas, the consequences of mass or voucher privatization are more complex, given that country case studies show conflicting results. In the Czech Republic and Poland, for example, one can observe mostly *outsider ownership*. Contrary, in Russia and Ukraine policy makers purposefully strove to achieve widespread insider ownership (Bennett et al., 2004). As mentioned by Estrin (2007), it is up to the government to determine whether to allocate vouchers or certificates to all eligible citizens, or just to the enterprises' employees.

Second, Djankov and Murrell's study (2002) provides insight in how different types of post-privatization ownership affect firm performance (Figure II). They assert that insider ownership is detrimental, whereas outsider ownership is significantly beneficial (Djankov & Murrell, 2002, p.

[7] Insiders are, in essence, always domestic.

34). Also, privatization to foreigners appears to be three times as productive as privatization to insiders. Overall, in line with Frydman, Hessell and Rapaczynski (1998), Djankov and Murrell emphasize that ownership matters.

Furthermore, Bennett et al. (2004) are one of the few who analyzed the consequences for economic growth of different privatization methods. They stress that privatization through the sale of state property as compared to mass privatization offers the advantage of adequate and concentrated ownership, whereas the latter offers the converse (2004, p. 19). Nevertheless, their results dictate that the conventional method, privatization through sale, has no significant impact on economic growth. Mass or voucher privatization, on the other hand, does have a significant positive impact. Bennett et al. (2004) subsequently suggest that privatization through sale of state property in countries with underdeveloped capital markets can be rather ineffective. Under these conditions mass privatization, which, in fact, rejects and excludes foreign investment, is believed to be the appropriate method (Bennett et al., 2004, p. 4).

Finally, Brada concludes that grand designs for privatization cannot be drawn up (1996, p. 84). Any country hoping to make serious progress should employ a broad range and combination of methods. He stresses, in line with Bennett, that unless countries are willing to try a „giveaway" method of mass privatization, thus privatization to domestic in- and outsiders, they will find it rather difficult to privatize a majority of SOEs (1996, p. 84).

Altogether, it is evident that particular privatization modalities limit the entry of foreign investors. Policy makers generally chose to apply either privatization trough sale or privatization through vouchers (also referred to as mass privatization), or a combination thereof. Whereas the first modality allows access to foreign investors, the latter, often based on the (political) conviction that state owned property ought to be returned to the people, does not. Besides, it seems that literature and studies addressing the impact of privatization on economic growth and development are rather limited. In addition, the research conducted reveals conflicting results. Whereas Djankov and Murrell (2002) suggest that privatization to foreign investors is significantly advantageous and Borensztein et al. (1998) even argue that foreign enterprises contribute more to growth than domestic enterprises, Bennett et al. (2004) advocate that privatization through the sale of state property, which, contrary to residual modalities, enables foreign investors to participate in the privatization process, has no significant positive impact on economic growth. Therefore, for the

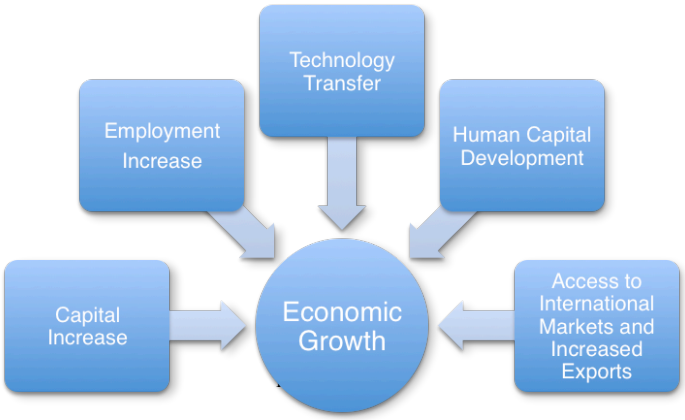
following stage of this study, I return to subquestion I that provides insight in the channels through which FDI is likely to affect the host country's economic growth. Subsequently, by means of comparing the outcomes of these channels for both foreign and domestic owned former SOEs this study aims to answer the main research question.

2.3 THEORETICAL FRAMEWORK

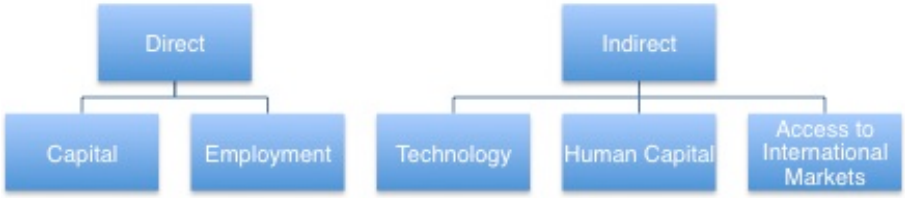
This section comprises the most pertinent factors and subjects discussed throughout the chapter and serves as a prelude to the empirical, second stage of this study. FDI, in short, can be characterized as a category of cross-border investment with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. There are three types of FDI based on „the mode of entry", namely: (1) *M&As;* (2) *greenfield investments*, and; (3) *brownfield investments*. Overall, M&As appear to be predominant, reflecting the worldwide large scale privatization programs.

In order to comprehend the channels through which FDI is likely to affect the host country's economic growth it is important to understand the rationale behind FDI. The OLI-Framework specifies three factors that determine the international activities of MNEs: ownership (O), location (L), and internalization (I) advantages. The more ownership advantages possessed by an enterprise, the greater the inducement to internalize them; and the wider the attractions of a foreign rather than a home country production base, the greater the likelihood that an enterprise will engage in international production. Moreover, it is assumed that vertical FDI is carried out in order to establish access to raw materials or basic resources. Horizontal FDI, on the other hand, is carried out with the objective of entering an existing market.

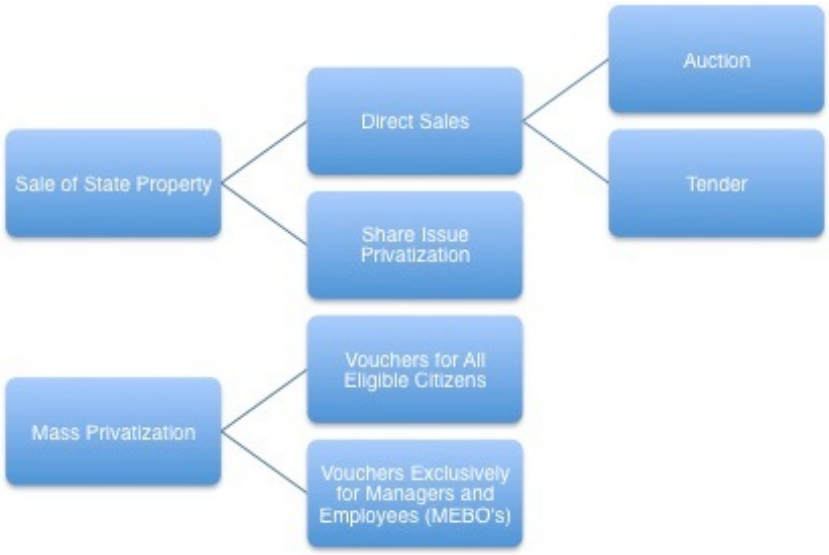
FDI is likely to affect the host country's economic development through various channels:



In general, a distinction is made between direct and indirect effect of FDI. The initial or direct gains are attributed to the arrival of additional capital together with employment. The latter, however, is more likely to occur in the case of a brownfield investment rather than a merger or acquisition. The secondary or indirect gains occur due to spillover effects from foreign to domestic enterprises, affecting among other things the efficiency of resource use in the recipient economy. These are subsequently subdivided into technology transfer, human capital development and market access spillovers.



Privatization involves the transfer of ownership of assets from the state to the private sector. Governments in Central and Eastern Europe and the former USSR often chose to employ either mass privatization or privatization through sale of state property, or a combination of both. The figure below illustrates both modalities and sub modalities. Yet, it is important to note that mass privatization obstructs the entry of foreign investors in the privatization process, whereas sale of state property does not.



Different privatization methods, however, bring about different ownership structures, which, in turn, bring about different consequences for economic growth. Sale of state property, for instance, often leads to outsider ownership. Voucher privatization, on the other hand, is likely to transfer SOEs to both indigenous in- and outsiders, limiting the entry of foreign investors. Finally, the empirical literature asserts that a combination of the above privatization methods (also referred to as mixed privatization) predominantly leads to insiders ownership.

2.4 CONCLUSION

The conclusion that can be drawn from this chapter is that foreign direct investment is likely to affect a host country's economic development through both direct and indirect effects. The initial or direct stimulus can be attributed to the influx of capital and employment. Direct employment creation, however, is alleged to depend on the foreign investors' mode of entry: while both green- and brownfield entry are expected to spur employment instantly, entry through M&A is not. The indirect effects cover technology transfer, human capital development and access to international markets. In addition, it is strongly believed that these effects spill over to local enterprises. Competitors, suppliers and customers of the foreign enterprise are likely to appropriate its technology and know-how, ultimately affecting the efficiency of resource use in the recipient economy. Finally, the differences for economic development of privatization to foreign investors as compared to privatization to domestic investors are closely related to the indicators elaborated above and the employed method of privatization. The latter, after all, determines the ownership structure. Mass privatization methods overall limit and obstruct foreign participation, yet are likely to induce economic development. Sale of state property, in contrast, allows foreign entry, but is less likely to induce favorable effects. Therefore a merger or mixture of methods may be the most advantageous, in order to generate progress. It will be interesting to see whether this applies to Serbia. After all, research shows different, conflicting results varying by country or region. Thus, there is strong need for further investigation.

CHAPTER 3

RESEARCH DESIGN

The following chapter marks the start of the second stage of this study and provides a detailed overview of the empirical research process. First, it touches upon the research perspective followed by a description of data collection, operationalization and analysis. Finally, the trustworthiness, also referred to as validity and reliability, of present study is discussed.

3.1 SOCIAL SCIENCE PERSPECTIVE

This study takes an interpretive approach, supporting the notion that there are many truths and realities. This particular paradigm, according to McNabb (2008), considers *reality* or *truth* to be composed by various individuals and organizations taking part in the phenomenon under scrutiny. Each of them, for example, assign a subjective interpretation to the effects of foreign direct investment. Furthermore, it is important to note that such interpretations are only temporarily and subject to change, considering the social environment and context in which they take place. Hence, White (1999) explains that the primary goal of this particular type of research approach is to cater multi-layered descriptions and interpretations of specific (social) phenomena during a given period of time. In this case, the study is focused on uncovering insights on the effects of privatization through foreign direct investment and domestic investment. By means of detecting a structure or order within these (often differing and subjective) insights I aim to identify the so-called „*dominant reality"* as mentioned by Deetz (1996, p. 202).

The insights or observations are collected by means of qualitative research methods. In contrast to quantitative research, qualitative research is generally better suited to address research questions that aim for an in-depth understanding of specific phenomena. It involves the use of non statistical inquiry techniques and processes, and typically relies on small samples to produce richer data than otherwise possible (Collis & Hussey, 2003). A qualitative approach is especially useful here, as it takes into account the complex nature of privatization and FDI, and the importance of (social) context. It goes beyond the simple description of events and phenomena, which cannot be

encompassed by numbers and statistics alone (McNabb, 2008). Also, conceptual difficulties arise in quantifying or measuring the effects of privatization through FDI (particularly regarding indirect effects) coupled with limited access to reliable datasets. This study, after all, unsuccessfully made an attempt to obtain strong co-operation with the Serbian Privatization Agency[8]. The latter is responsible for the collection of important data, yet unwilling to contribute to this study (note that the subject of research obviously concerns a politically sensitive issue). Access to solid statistics was thus limited and partly due to such conditions qualitative, instead of quantitative methods are applied.

Van Thiel speculates that the choice of a particular research method is closely tied to one's scientific paradigm (2007, p. 157). Little more than a decade ago, many thought that following behavioral research principles, taking a positivist approach, was the only truly scientific way to conduct research, with analysis focussing primarily on measurements and statistical inquiry. Today, qualitative research methods have become part of the mainstream in public administration and international development studies (McNabb, 2008). After all, as mentioned by Mack, Woodsong, MacQueen, Guest and Namey (2005), the great contribution of qualitative research is the culturally specific and contextually rich data it produces.

3.2 OPERATIONALIZATION

The following describes the process of defining or conceptualizing the indicators or themes that form and shape the research. The insights derived from the literature review are central and presented in the table below. The overall purpose is to lay down order and structure in order to make sure the essential data is collected (McNabb, 2008, p. 293).

Variable	Indicator	Operationalization
Capital	**Investment** • Do foreign owned privatized enterprises invest more in the acquired enterprise than domestic owned privatized enterprises?	- Did foreign investors invest in the newly acquired enterprise? How much? - Did domestic investors invest in the newly acquired enterprise? How much?

[8] The Serbian Privatization Agency was approached for the purpose of this study, yet it was prepared to grant minimal information elaborated in paragraph four of this chapter.

Variable	Indicator	Operationalization
	Reinvested Share of Profit • Do foreign owned privatized enterprises invest a larger share of their profit in the acquired enterprise than domestic owned privatized enterprises?	- Did foreign owned privatized enterprises invest a share of their profit in the enterprise? - Did domestic owner privatized enterprises invest as share of their profit in the enterprise?
Employment	**Reduction of Employment** • Did foreign owned privatized enterprises dismiss more employees than domestic owned enterprises?	- Did foreign owned privatized enterprises dismiss employees? How many? - Did domestic owned privatized enterprises dismiss employees? How many?
	Increase of Employment • Did foreign owned privatized enterprises create more jobs than domestic owned privatized enterprises?	- Did foreign owned privatized enterprises create jobs? How many? - Did domestic owned privatized enterprises create jobs? How many?
Technology Transfer	**Firm Efficiency** • Is there a difference in firm efficiency between foreign owned privatized enterprises and domestic owned privatized enterprises?	- Was firm efficiency of foreign owned privatized enterprises improved post privatization? - Was firm efficiency of domestic owned privatized enterprises improved post privatization?
	New Technology • Is there a difference in the introduction of new technology between foreign owned privatized enterprises and domestic owned privatized enterprises?	- Did foreign owned privatized enterprises introduce new technology? - Did domestic owned privatized enterprises introduce new technology?
	New Management Practices • Is there a difference in the introduction of new management practices between foreign owned privatized enterprises and domestic owned privatized enterprises?	- Did foreign owned privatized enterprises introduce new management practices? - Did domestic owned privatized enterprises introduce new management practices?
	Spillover of Technology and Management Practices • Is there a difference in spillover of new technology and management practices to local competitors, suppliers and customers between foreign owned privatized enterprises and domestic owned privatized enterprises?	- Did the new technology or management practices introduced by the foreign owned privatized enterprises spill over to local competitors, suppliers and customers? - Did the new technology or management practices introduced by the domestic owned privatized enterprises spill over to local competitors, suppliers and customers?

Variable	Indicator	Operationalization
Human Capital Development	**Labour Training** • Is there a difference in the labour training offered by foreign owned privatized enterprises and domestic owned privatized enterprises?	- Did foreign owned privatized enterprises provide labour training to their employees? If yes, what kind of training? - Did domestic owned privatized enterprises provide labour training to their employees? If yes, what kind of training?
	Spillover of Knowledge • Is there a difference in spillover of knowledge to local competitors, suppliers and customers between foreign owned privatized enterprises and domestic owned privatized enterprises?	- Were local competitors, suppliers and customers of the foreign owned privatized enterprises able to benefit from knowledge transfers? - Were local competitors, suppliers and customers of the domestic owned privatized enterprises able to benefit from knowledge transfers?
Access to International Markets	**Volume of Exports** • Is there a difference in the volume of exports post privatization between foreign owned privatized enterprises and domestic owned privatized enterprises?	- Did the volume of exports of foreign owned privatized enterprises decrease/increase? - Did the volume of exports of domestic owned privatized enterprises decrease/increase?
	Export Markets Change • Is there a difference in the export markets post privatization between foreign owned privatized enterprises and domestic owned privatized enterprises?	- Did the export markets change of foreign owned privatized enterprises? - Did the export markets change of domestic owned privatized enterprises?
	Spillover of Access to International Markets • Is there a difference in spillover of volume of export and export markets to local competitors, suppliers and customers between foreign owned privatized enterprises and domestic owned privatized enterprises	- Did the volume of export and export markets of local competitors, suppliers and customers of foreign owned privatized enterprises change? - Did the volume of export and export markets of local competitors, suppliers and customers of domestic owned privatized enterprises change?

In addition to the above, this study also pays attention to explanatory or additional information that, for example, gives insight in the interconnectedness of the indicators under scrutiny. After all, its purpose is to explain, rather than simply describe the potential advantages of privatization through foreign investment.

3.3 METHOD: THE SEMI-STRUCTURED INTERVIEW

This paper presents an empirical study that aims to identify the advantages of privatization through foreign direct investment as compared to domestic investment. The heart of this study is a series of semi-structured interviews with a total of 14 respondents, including two experts on the matter, six representatives of foreign owned former SOEs and six representatives of domestic owned former SOEs, conducted in June 2015. The consulted representatives held different functions within the companies (both high and low positions). This study, initially, however, set out to interview mainly managers and directors. Due to a lack of response and willingness from the companies' side this was not possible.

Furthermore, the semi-structured interviews were set up to investigate both the effects of privatization through FDI and privatization through domestic investment. The rationale behind using semi-structured interviews is briefly explained here.

McNabb (2008) writes that semi-structured interviews occur as conversations between a researcher and a subject or respondent. To keep the conversation focused, the researcher uses a topic list or interview guide in which key points to be covered in the interview are listed. Overall, it is a flexible way of collecting data, as it allows the researcher to ask additional questions and obtain profound, in depth answers (Van Thiel, 2010, p. 109). Also, the respondent is free to give any answer that comes to mind.

This particular method of data collection, which is one of the most commonly used methods in case study research, was selected due to three primary considerations. The first and foremost instinctively revolves around the collection of data related to the indicators of research elaborated in previous paragraph. Due to a lack of (access to) solid statistics, this study resorted to consulting respondents. Second, as mentioned by Gordon (1975), semi-structured interviews are well suited for the exploration of ideas and perceptions of respondents regarding complex and often sensitive issues and enable probing for more information and clarification of answers. After all, the literature review (Chapter II) has pointed out that, while the effects of FDI have been studied extensively, findings remain complex and inconclusive. Moreover, privatization, which is an often opposed policy, and FDI, an equally controversial phenomenon, can be characterized as rather sensitive issues to investigate. This way, additional insight in the possible interconnectedness of the

indicators under scrutiny is obtained. Third, the diverse professional, educational and personal background of the sample group excludes the use of a standardized interview schedule (Barriball and While, 1994). Finally, and perhaps more importantly, face to face contact with a researcher can instigate respondents to cooperate who would otherwise not bother with a questionnaire (Gordon, 1975).

Moreover, flowing from the semi-structured character of the interviews the scope and nature of the key points of discussion were predetermined (described in the paragraph above), and given that my sample consists of both firm representatives and experts on the subject under scrutiny (elaborated in the paragraph below), this study employed two interview manuals. Contrary to the standardized interview, these interview manuals (Appendix I and II) enabled a more flexible and responsive consultation and dialogue. The sequence and wording of individual questions was changed and adapted to the situation. Key points were not discussed in a rigid linear sequence. The interviews lasted from 45 to 60 minutes each.

3.4 SAMPLING

The sample selection was made consciously and purposively based on a dataset provided by the Serbian Privatization Agency, comprising all privatized enterprises in Serbia. As the purpose of the second stage of this study is to uncover the effects on economic development of privatization to foreign investors as compared to privatization to domestic investors, the following criteria were taken into account. The sample was limited to medium and large sized privatized enterprises in order to be able to scrutinize the effects and possible discrepancies. Another important prerequisite was that each enterprise selected had a counterpart or partner, accordingly operative within the same industry or sector, approximately the same size and preferably characterized by the same features prior privatization, such as the year of privatization, with the (only) difference being the type of ownership, that is domestic or foreign. This, in turn, resulted in a preliminary sample selection comprising *sets* of firms active in various industries to address and approach.

Subsequently, general managers and other executives of these enterprises were addressed. The subject of research and the key points of discussion, however, turned out to be rather sensitive issues, more than initially expected. As a result, the response was low. I had no choice and was

forced to switch to the social networks of my initial informants. I kindly asked them whether they could persuade any of their acquaintances that match the profile described above to agree to an interview. Silverman refers to the latter as a snowball sample (2010, p. 194). Finally, I managed to interview representatives of six sets of enterprises, comprising six former SOEs privatized by foreign investors and six former SOEs privatized by domestic investors. All interviewees held different functions. In addition, two local experts on the matter were consulted and interviewed. This study, after all, was also restricted by time and resources.

3.5 DATA ANALYSIS

The data analysis was carried out in three steps. First, the data was collected by means of semi-structured interviews. As a majority of respondents objected the recording of the interview, I took detailed notes on my laptop and wrote down all answers as accurately as possible. Only two conversations were captured as digital audio files by the consent of the interviewees and transcribed within 24 hours after the interview to utilize optimal recall (Van Thiel, 2010, p. 160). Second, the collected data was scanned, ordered and coded. This was done in accordance with Miles and Huberman who recommend pre selecting relevant and useful material, and employing an indexing or coding system in order to be able to retrieve every peace of research information efficiently at any time (1994, p. 45). The coding system was built on the indicators: capital, employment, technology, human capital and international markets, as described in the operationalization paragraph above. Lastly, the collected research information was analyzed and included in tables.

However, as qualitative research is characterized by methodological pluralism, it is rather difficult to appoint and determine one clear blueprint of analysis (Van Thiel, 2010, p. 158). This primarily relates to the explanatory or „why" questions. Generally, a variety of techniques is employed. This study, first, followed the strategy of *pattern-matching* as proposed by Yin (1994) looking for orderliness and patterns in the accumulated and coded data. Finally, comparisons were made and findings interpreted in depth. The results of this interpretation, including many quotes to maintain the validity of respondents' answers, are presented in the next chapter.

3.6 VALIDITY AND RELIABILITY

External validity, according to Yin, deals with establishing the domain to which a study's findings can be generalized (2013, p. 46). This study, however, is a case study and therefore the external validity in essence is rather low. Critics, after all, consistently state that (single) case studies provide a poor basis for generalization. But, while quantitative research, for instance, using surveys aims at statistical generalization as a form of achieving external validity, case studies rely on analytical generalization, whereby particular sets of results are generalized to some broader theory (Riege, 2003, p. 81). The latter may lead to the bettering of existing knowledge and may form new ground for theory development (Van Thiel, 2010, p. 106). Accordingly, Riege argues that external validity in case study research can be somewhat safeguarded through defining the scope and boundaries of reasonable analytical generalization. Ultimately, the focus of this study lies in the understanding and exploration of theoretical assumptions.

Internal validity is related to causality and legitimacy (Van Thiel, 2010, p. 58). It deals, as stated in Rowley (2002, p. 20), with establishing a causal relationship whereby certain conditions are proven to lead to other conditions. Yin adds that in case study research internal validity revolves around the issue of making inferences (2013, p. 47). Thus, for the purpose of this study it is important to assess the degree to which the inferred conditions are directly linked to the benefits of either foreign or domestic investment. However, „a case study involves an inference every time an event cannot be directly observed" (Yin, 2013, p. 47). As a result, it is rather difficult to evaluate the degree to which the inferred conditions are accurate. The issue occurs in the fact that the simple presence of a certain condition (the indirect effects in particular) does not prove it was caused by either foreign or domestic investment. After all, it is likely that there are additional conditions or factors at play. Yin dictates analytical tactics for preserving internal validity, these include, among others, pattern matching and explanation building (as mentioned in previous paragraph) (2013, p. 45). The qualitative research method applied in this study enables the latter. Close attention is paid to explanatory, additional information by probing questions giving insight in the interconnectedness of the indicators under scrutiny.

Reliability or replicability of research refer to „demonstrating that the operations of a study - such as the data collection produced can be repeated with the same results" (Rowley, 2002, p. 20). However, whilst employing qualitative research methods much of the procedures, data collection

and analysis take place in the mind of the researcher. Silverman points out that this is inherent to such study, asking and answering any question, for example, can never be marked by mutual interpretations which are innately subjective and non-standardizable (2010, p. 286). Therefore reliability of research is generally achieved through thorough documentation of procedures and appropriate record keeping.

In this light, it is important to briefly review the sample selection and data collection of present study. Whilst approaching and determining respondents, competences and knowledge were taken into account. Interviewees must be in a position and naturally benevolent to give accurate and reliable answers to the questions. Subsequently, throughout the interviews the latter were encouraged to talk freely about the topics of research, but were also kept to the point on issues of interest to this study. Notes of all relevant remarks were taken and pursued until there was no more to be gained by further probing (Silverman, 2010; Van Thiel, 2010).

CHAPTER 4

FINDINGS

The following chapter presents the findings from the semi-structured interviews and seeks to answer the final subquestion of this study: what have been the effects on economic development of privatization to foreign investors as compared to privatization to domestic investors in Serbia? It opens with an outline of the studied case setting out the context and sample characteristics, after which it delves into the pre-determined core of analysis comparing foreign and domestic owned privatized enterprises across key dimensions of post privatization restructuring.

4.1 CONTEXT

This section presents contextual information that respondents expressed before being confronted with the questions related to the key themes of this study. It serves as a preface and outline of the conditions and circumstances under which the phenomenon under scrutiny took place. At the beginning of each interview, respondents were asked to describe the privatization process of the firm in order to ground the dialogue and get participants thinking about the changes and consequences. Surprisingly many respondents felt it was important to provide background information before discussing the characteristics and course of events of the firm under scrutiny. They stressed that in order to understand the effects one must be aware of the events preceding privatization. These include, amongst others, the detrimental wars of the nineties and the subsequent heavy economic sanctions imposed, impeding the country's transition process. Not to mention the legacy of social ownership. Thus, Serbia's starting conditions for privatization, to put it mildly, were not ideal. One of the experts consulted stated that:

> *„At this particular moment in time 99 percent of people was preoccupied with recovering and getting through the day. No one had his or her mind set on buying company shares. There was, in fact, no money, there were no resources and, worst of all, there was no knowledge! (…) I witnessed uneducated people dealing with a process they are not familiar with; they are hesitant and indecisive, fearing the unknown"*

An additional widely discussed issue concerns the public attitude towards privatization. The measure was not greeted with enthusiasm by many. People often refused to accept the conviction that the concept of private ownership was found to be superior to any type of collective ownership. Some, in accordance, referred to the process as „necessary evil", others, in contrast, consider privatization as a „cure". Such discrepancies in opinion do not come as a surprise. Privatization in Serbia, after all, is characterized by both failure and success. There are numerous examples of damaged, malfunctioning former socially owned enterprises. Some were transformed into strong, prosperous and profitable enterprises serving as an example to those approaching bankruptcy and execution. Others, in contrast, lack a positive outlook as investors failed to revive the enterprises. In addition, there are various cases of rather faultless, promising state enterprises that were sold to „greedy grabbers" and ended up being „milked". One respondent drew an interesting comparison in order to grasp and illustrate the challenging conditions and difficulties surrounding the process of privatization in Serbia, with an emphasis on residual state enterprises:

> *„Imagine the state enterprises as wrecked, damaged cars and note that some of these cars are not even registered. They were produced in the mid seventies or early eighties. One car, for example, is serving three drivers and two mechanics. In addition, this car was financed by third parties or debt providers. At the moment, the car is on sale. All three drivers expect that, after sale, they will be driving the car again and the creditors expect to be repaid. From time to time, the State provides funds for fuel and the salaries of the drivers and mechanics. But, since the car is not working, the funds set aside for fuel are being used for the drivers' and mechanics' salaries. Meanwhile, the little functioning valuable parts of the car start disappearing, while the drivers and mechanics await their retirement age. Still, all look forward to welcoming a new buyer. But, this buyer is expected to keep at least two drivers and two mechanics for a period of at least three more years. Now imagine a buyer being interested in that … Still, in the absence of a buyer, as a last resort, the State must pay the creditors in order for the car to be taken to the car dump."*

Naturally, not all SOEs in Serbia are wrecked and damaged, nor dealing with a workers surplus and debts. Furthermore, the worrisome conditions described above do not necessarily mark the downfall of an enterprise. So far, many Serbian SOEs that experienced similar difficulties as the ones described above, have been privatized and revived. Today, many are a success. This study, in fact, examines a majority of such revived or successful privatization cases.

Furthermore, it is important to note that the privatization process in Serbia was carried out on the basis of various models over the course of 25 years. In the early 1990s, the State adopted the Ownership Transformation Act (OTA). This law limited the access of foreign investors, as policy makers essentially called for a change in the legal form of the state enterprises concerned. Privatization was carried out from the inside. A majority of shares, often 60 percent, was distributed free of charge amongst management and employees; the remaining shares were offered for sale, but only to insiders. This model or method was more of less in line with voucher privatization, frequently applied in transition countries (Chapter II). As of 2001, following the adaption of the Law on Privatization, state property is being sold through public auction or tender (the size of the enterprise being decisive) enabling access to outsiders and marking the start of the so-called second wave of privatization. Policy makers, after all, recognized the importance of expertise, often carried by strategic investors. Mass privatization would merely transfer ownership to citizens without ensuring substantial change in management practices (two examined enterprises, elaborated below, substantiate this belief). The latter was assumed to be of utmost importance in order to secure efficiency and profitability. Consequently, majorities of enterprises' shares, usually 70 percent, were offered for sale. The remaining shares were transferred to both employees and citizens, by means of „free distribution" and the interposition of the „Akcionarski Fond", or „Share Fund" (SF) in English, respectively.[9]

4.2 SAMPLE CHARACTERISTICS

Twelve companies active in rather traditional manufacturing sectors were examined (Table III), comprising six foreign and six domestic owned to ensure comparability of results. Prior to privatization, all enterprises were heavily undercapitalized and operating below capacity. In addition, their machinery and equipment was either old or out of service.

Three companies are operative in the pharmaceutical industry. They were bought by a large Icelandic MNE, a Macedonian MNE and a domestic Serbian enterprise respectively. The Icelandic acquisition is a well-known profitable takeover, the new foreign investor managed, among other things, to secure a stable annual growth level of eight percent. The second foreign takeover, in

[9] The SF is the legal entity in charge of all residual shares from all (previously) privatized enterprises, both under old and new laws.

contrast, was not as promising. This company, however, had already been privatized prior to the entry of the foreign investor from Macedonia.

The second pharmaceutical company illustrates the above-mentioned various privatization models applied. In 2001, under the Ownership Transformation Act about 58 percent of shares were distributed free of charge amongst the enterprises' employees. A year later, consecutive to the Law on Privatization, the SF sold the remaining shares to the Macedonian MNE. This takeover is characterized by negative net business results. Today, the firm faces bankruptcy procedures. The third pharmaceutical company was acquired by a strategic domestic investor with considerable experience and know-how. At the moment, this firm is Serbia's largest export producer.

Table III - Number of Companies by Sector

Sector	N
Pharmaceutics	3
Metal Processing	3
Paper Processing	2
Mining	1
Cement	1
Agriculture	1
Port Authority	1

The following three enterprises are active in the metal processing industry. As opposed to the ones elaborated above, all are rather prosperous. One of them was bought by a regional MNE from Slovenia who managed to triple the enterprise's sales revenues within a short amount of time. The second firm was revived by a strategic domestic investor. Today, it runs at full capacity. The third takeover concerns a rather uncommon type of acquisition, that is insider privatization through public auction. The workers of the firm did not receive any shares for free. The firm, in fact, was auctioned off. But, its workers were predetermined to take over the firm themselves and decided to set up a „consortium" and buy the majority of shares at the auction.

This study also examined two paper processing enterprises, one of which was bought by an Austrian MNE. At the moment, this firm is performing relatively successful. The other firm, in contrast, is not performing well. A majority of shares were transferred or given to its management

and workers under the OTA back in the late 1990s. Subsequently the workers sold the firm to a private domestic investor, which, unfortunately, did not manage to invigorate the company up to present day.

The remaining four enterprises include companies active in agriculture and mining, one cement factory and one port authority. The first two were bought by a domestic private investor. Both managed to increase the companies' sales revenues considerably by means of restructuring and several capital injections. The cement factory, a relatively old company, was bought and revived by a large French MNE. The port authority, on the other hand, deals with numerous liabilities and downscaled its activities. Today, the foreign buyer's intentions are disputed, while the prospects for the company remain gloomy.

4.3 INITIAL FINDINGS

Table IV and V present an overview of the companies elaborated above. They contain general information provided by the respondents on the year of privatization, the price paid for the state enterprise and the method of privatization employed.

Table IV - Foreign Ownership - Year of Privatization, Price Paid and Method Employed

	I	II	III	IV	V	VI
Year	2002	2001 - 2002	2002	2004	2002	2004
Price	3,500,000	15,500,000*	6,500,000	163,000	59,000,000	42,000,000
Method	TENDER	INSIDER / SF SALES	TENDER	TENDER	TENDER	TENDER

*The price paid by the second buyer

Table V - Domestic Ownership - Year of Privatization, Price Paid and Method Employed

	VII	VIII	IX	X	XI	XII
Year	2002	2003	1998 - 2007	2004	2006	2003
Price	14,600,000	325,000	4,000,000*	1,100,000	1,700,000	1,200,000
Method	TENDER	TENDER	INSIDER - STOCK MARKET	AUCTION	AUCTION (BOUGHT BY INSIDER)	AUCTION

*The price paid by the second buyer

Initial or direct benefits of foreign investment are attributed to the arrival of additional capital (elaborated in detail in subsequent paragraph). The total price paid for the SOEs by foreign buyers is equivalent to the additional income received by the Serbian government through the sale of these enterprises. This amounts to a total of approximately 126 million EUR for the foreign enterprises examined in this study. Indigenous investors together paid about 23 million EUR in comparison. It appears that foreigner investors make larger acquisitions than domestic ones, which is consistent with the belief of both consulted experts. Expert I argued: *„the distinction here is quite clear. FDI enables much larger transactions. Telenor, for example, could not have been bought by a domestic investor"*.[10] Expert's II opinion goes beyond the latter statement, as he believes the *„capital contribution of local investors to be negligible"*. Overall, the prices paid for state enterprises in Serbia vary tremendously. Some enterprises, indeed, have huge outstanding liabilities, legal disputes and workers surplus devaluating its value and price. The State, however, often decides to let off or remit a SOE's debt in order to attract a reputable strategic investor and enable the successful sale of a firm.[11] Yet, this does not apply to all.

Altogether, this study includes 12 former state owned enterprises, which, today, are owned by six foreign and six domestic investors. Two enterprises bought by foreign capital are facing bankruptcy procedures, while the other four prosper. Indigenous investors appear, at first glance, to outperform the foreign ones, as in comparison only one examined domestic firm is dealing with poor operating results. The following sections present the aggregate findings based on the pre-determined key dimensions or indicators of research. The findings are presented in tables and elaborated in detail. Respondent's quotes are used for illustration purposes.

4.4 CAPITAL

One of the introductory questions raised concerns the performance of the former SOE. Respondents were asked whether their firm managed to improve its revenue post privatization. All foreign firms report increase in revenue (thus: positive results), except for two: firm II and VI experienced a rise in the first year, yet, the years thereafter were marked by continuous revenue decline (thus: negative

[10] In 2006, Telenor Serbia became a wholly owned subsidiary of Telenor (Norwegian MNE) through the acquisition of Mobi 63. Telenor Serbia is the country's largest foreign investor and mobile operator.

[11] In the case of firm XI, for example, the State decided to cancel the firm's debt in order to attract investors and ultimately sell the firm at a higher price.

results). The majority of domestic investors also enjoyed positive revenue results. Firm XI, for example, stated it quickly reached full operational capacity: *„only a few months after privatization we signed big contracts with US Steel and EPS"*.[12] As a consequence, their revenue figures doubled. Firm IX, on the other hand, at the start saw production stagnate and plunge down.

Overall, the majority of respondents appear to consider the post-privatization revenue performance to be related to either the success or failure of their firms. Table VI and VII contain details regarding post-privatization revenue performance, investment and the reinvested share of profit, the latter was interpreted to be either large or small based on the respondents' comments.

Table VI - Revenue, Amount of Investment and Reinvested Share of Profit - Foreign Ownership

	I	II	III	IV	V	VI
Revenue	Positive	Negative	Positive	Positive	Positive	Negative
Investment*	50,000,000	/	64,000,000	4,000,000	110,000,000	/
Price	3,500,000	15,500,000	6,500,000	163,000	59,000,000	42,000,000
Reinvested share profit	LARGE	n.a.	LARGE	LARGE	LARGE	n.a.

* Over the course of 10 years post privatization

Table VII - Revenue, Amount of Investment and Reinvested Share of Profit - Domestic Ownership

	VII	VIII	IX	X	XI	XII
Revenue	Positive	Positive	Negative	Positive	Positive	Positive
Investment*	500,000,000	10,000,000	/	5,500,000	4,000,000	2,000,000
Price	14,600,000	325,000	4,000,000	1,100,000	1,700,000	1,200,000
Reinvested share profit	LARGE	LARGE	n.a.	LARGE	LARGE	LARGE

* Over the course of 10 years post privatization

In theory, the influx of additional capital, as mentioned in previous paragraph, is also brought about by the investments carried by (foreign) investors. In Serbia, prior to acquisition, all (potential)

[12] EPS or Elektroprivreda Srbije is a state owned electric utility power company employing over 31,500 employees. It is the largest enterprise in the country.

[13] Expert I, however, explains that today, due to numerous amendments in the Law on Privatization, the rules and guidelines on acquisition have been softened

buyers are obliged to provide, among other things, written investment proposals.[13] Firm I, for instance, stated that:

> *„We made a deal to invest about 20 million EUR within the first 5 years after privatization. This was necessary as the facilities and equipment were outdated (...) We invested in the renovation of the old factory, the installations and laboratories for microbiological research, a modern IT system (...) new production material and in the overall quality of our products. All was done in line with the newest GLP standards. Today, I believe we invested a total amount of approximately 50 million EUR alone in refurbishing and modernizing the firm."*

Firm V even indicated that it invested a total of 110 million throughout the course of 10 years. In contrast, Firm II and VI declare that post privatization no noteworthy or appreciable investments (indicated by a solidus or "/" character) were made (it is interesting that both also indicate a negative revenue performance).[14] One of the respondents explains that through the acquisition of Firm VI:

> *„The new owner only bought subsidiaries (...) these were the only investments made. He would transfer the assets of our firm to a subsidiary and, in turn, the subsidiary would supposedly buy assets from us. Through this type of construction, the new owner simply took care of his own pocket (...) No surprise, as in these times everyone was guilty of something."*

The consulted foreign former SOEs collectively invested an amount of 228 million EUR. The domestic owners, in comparison, invested an aggregate of 521,5 million EUR, of which 500 million

[14] An interesting remark regarding Firm II and VI was made by Expert II, who stated that: *„In order to evaluate the „real" effects of FDI on Serbian economic development, please make sure to distinguish real foreign investors from foreign investors of former Yugoslavian origin, thus: investors from former Yugoslavian republics. I consider the latter to be domestic investors".* In the case of Firm VI, for instance, the origin of the capital is foreign (Cyprian). The investor, on the other hand, is Serbian, thus: domestic. Yet, the investor had parked his savings abroad, through which he acquired the enterprise in 2004. Nonetheless, the SOE was formally acquired through FDI. Firm II was bought by a Macedonian investor, thus: former Yugoslavian, according to the statement made by Expert II. It is rather interesting to observe that both firms are characterized by negative revenue performance and zero investments post privatization. Expert II argues that this is due to the fact that such investors are familiar with „institutional defects" and likely to exploit these to their advantage.

EUR can be attributed to one single firm, that is Firm VII. However, only shortly after its acquisition by a domestic investor in 2002, Firm VII was sold to a large German multinational in 2006. The latter made an initial investment of more than half a billion EUR. The domestic acquisitor, in comparison, made an initial investment of approximately 50 million EUR.[15]

Reinvested earnings refer to the investor's share of earnings not distributed as dividend, plus earnings belonging to the investor (recorded as investment income) that are not remitted. Respondents were asked whether their firm booked profits post privatization and the extent to which existing profits were reinvested (either large, small or non applicable). Table VI displays that four out of six foreign owned privatized firms have reinvested a large portion of their profits. Domestic investors, highlighted in table VII, also reinvested a large portion of their profits, except for one, that is Firm IX.

4.5 EMPLOYMENT

An additional direct gain of foreign investment can be ascribed to the arrival of additional employment. Theory, however, asserts that this is more likely to occur in the case of a brownfield investment rather than a merger or acquisition. Thus, respondents were questioned about the number of dismissals and job creation post privatization.

Table VIII illustrates the changes in employment post privatization by type of ownership. It shows that over a period of 10 years, all foreign owned privatized firms cut back their personnel, of which two decreased their work force with more than 75 percent. Two domestic investors, on the other hand, are responsible for a significantly large increase in employment. Still, the majority of acquisitions is characterized by clear cuts in personnel. Appendix III includes Table XVIII and XIX which provide detailed information on the developments per enterprise.

[15] Firm VII is not the only consulted former SOE that received both foreign and domestic capital. The initial investment and acquisition was done by a domestic investor, after which a foreign investor came into play. However, it is the domestic investor that was able to revive the malfunctioning former state enterprise within a short amount of time, subsequently drawing the attention of a strategic foreign investor. As a result, for the purpose of this study Firm VII is considered to be a domestic acquisition. Firm II and Firm IX deal with similar discrepancies.

Moreover, there are a number of issues important to mention concerning employment post privatization, including the legacy of social ownership and contemporary social policies imposed by government or devised by the enterprises themselves.

Table VIII - Changes in Employment Post Privatization by Type of Ownership

Change (x)	Foreign	Domestic
x > 50%	0	1
0% > x < 50%	0	1
-50% > x < 0%	4	2
x < -50%	2	2

Practically all consulted firms report that at the time of purchase or takeover they found the former state enterprise with a surplus of workers. However, this came as no surprise, state owned enterprises in Serbia, after all, are known for employing and retaining an excess of workers. Being aware of the latter and fearful of the consequences of possible mass layoffs, the Serbian Privatization Agency was determined on discouraging new investors from immediately dismissing employees post privatization. Accordingly, it requested a social agreement with the purchasing party enforced by the sales contract, stipulating the conditions under which the new employer is entitled to dismiss existing employees. Usually, it would withhold the new investors from layoffs within the first three years post purchase. As a result, they were forced to devise creative solutions to a surplus of workers.

Firm I, for example, explains that it was forced to find an answer for its adopted excess of workers, otherwise it would not be able to revive and strengthen the business. After all, the new investor introduced new production lines for new markets, and together with the modernization of the plant and new technology a majority of employees were found to be unemployable. Accordingly, its management decided to consult the unions so that they could find a joint solution. Several measures were adopted, each part of the 25 million EUR worth social program:

- Employees were able to leave voluntarily and receive a severance payment. The latter would amount up to 350 to 700 EUR per year of service, furthermore;

- Employees were given the opportunity to start an own business, have Firm I as a client and employ co-workers, in addition[16];
- Firm I would annually reserve 250.000 EUR to buy five apartments which were inhabited by workers in financial distress, besides;
- Firm I would also offer its under-qualified personnel opportunities for retraining and reassignment.

This way Firm I managed to cut down their surplus of workers and maintain good relations with the unions. Its personnel gradually decreased from approximately 2000 to 390. Its respondent, however, also mentioned that, today, the management finally started hiring extra employees due to a new drug that is supposed to combat Parkinson's disease. Firm VI mentioned its new investor took measures similar to Firm I, offering severance payments to those willing to leave voluntarily. Yet, its respondent argues that, in this case, workers were less content and overall afraid of being reassigned, forced to perform a function with aversion. Therefore, many took the money and left. Those who did not settle with the offered severance payments were labeled as „tehnoloski visak"[17].

Firm VII and X, in contrast, were able to increase employment by 100 and 20 percent respectively, to the delight of the Privatization Agency. The first concerns a rather unique takeover elaborated in previous paragraph. The second was forced to narrow down its staff shortly after acquisition, in line Firm I and the remaining enterprises. Today, the firm prospers and, in contrast to others, employs more staff than prior to privatization. Also, the salaries are doubled. Its respondent, however, acknowledges that the size of its personnel is very sensitive to fluctuations in workload.

Altogether, four out of six foreign enterprises add they offered their unemployable staff some form of settlement, usually in the form of extensive social programs, laid down in the sales contract. Four out of six domestic enterprises note the same. Some also mentioned their personnel being able to receive bonuses and other benefits, prior to privatization such cases were unique.

[16] A group of employees, for example, established a maintenance firm. Another group started a cleaning company, while others took over the cafeteria and the cosmetics facility, which were no longer part of the firm post privatization.

[17] Literal English translation is „technological surplus". An umbrella name for redundant employees.

Finally, Expert II explains that due to the aftermath of social ownership employment is bound to decrease, pointing out that this is: *„not due to bad intentions of the new buyer, it is rather natural, the firm was bought to make profit"*. Expert II, on the other hand, argues that employment creation and privatization might go hand in hand, yet it very much depends on other factors and there are no clear examples of this correlation in practice up to present day:

> *„Privatization, as such, does not bring employment, in fact, privatization deducts employment. However, it might create employment, but only in combination with some other factors (…) Serbia, for example, is the only country that has a free trade agreement with both Russia and the EU, which is a rather unique situation. In that light, privatizing the entire automotive industry would bring about a positive indirect employment effect on, for example, suppliers of the automotive industry. Thus, if we would privatize a major SOE, indirect employment creation would be possible."*

4.6 TECHNOLOGY AND MANAGEMENT PRACTICES

This paragraph presents the findings concerning firm efficiency, new technology and management practices post privatization. In addition, Table XII and XIII present results regarding the spillover occurrence or indirect effects of the latter indicators.

Table IX shows that four out of six foreign owned privatized enterprises report their firm improved its efficiency or efficacy significantly post privatization, whereas two report minor or small improvements. In comparison, five out of six domestic owned privatized enterprises also report their firm improved its efficiency significantly — only one reports minor improvements. The majority argues that a significant increase in efficiency can be ascribed to a combination of production increase and employee decrease. This way, Firm III, for example, notes its new investor managed to double the value added per worker. In addition, others, such as Firm V and VII, explain they modernized their plants and facilities in order to save on energy consumption and guarantee optimal use of resources. Firm VI, on the other hand, explains, that at the time of privatization and reorganization there was an abundance of work and the firm was operating under full capacity. The new investor and its management, however, found that by simply cutting the amount of workers they could improve the firm's performance, as the same amount of work was done by a significant smaller amount of employees. They did not invest in capacity expansion. In 2009, however, shortly

after the global economic mayhem of 2008, their operations plunged down and the firm found itself in a rather disadvantageous position, struggling to carry through. [18]

Table IX - Improvements in Efficiency Post Privatization by Type of Ownership

Improvement	Foreign	Domestic
Significant / Large	4	5
Minor / Small	2	1
Zero	0	0

Respondents were questioned about the means through which the former state enterprise was able to improve its efficiency and efficacy, such as the introduction of new technology and management practices, as prescribed by theory. With regard to improvements in technology four foreign owned privatized enterprises describe significant improvements. Firm I exemplifies that they, for instance, altered the production lines of the former state enterprise. Today, the firm produces generic drugs adopting new production and laboratory technology. For Firm I technological growth is an ongoing process: *„we are always working on improving our production lines closely monitoring new developments, technology and methods"*. In comparison, only two domestic owned privatized enterprises describe significant technological improvements. Firm XI explains that concerning their field and operations: „There is no innovative, pioneering, avant-garde technology present or known worth employing. Our field is not to be compared to, let's say, personal computer technology, which evolves and advances at a rapid pace (…) We primarily invested in new equipment".

Table X - Improvements in Technology Post Privatization by Type of Ownership

Improvement	Foreign	Domestic
Significant / Large	4	2
Minor / Small	0	3
Zero	2	1

When asked to explain and elaborate on the discrepancy between foreign and domestic investors, Expert I argues that:

[18] A majority of firms consulted reports to have been affected by and shortly after the global economic crisis of 2008, which heavily disturbed Serbian economic development.

> *„There isn't really a big difference between foreign and domestic investors with regard to technology (...) The real difference is made by professional strategic reputable investors. Note that there are lousy investors from both foreign and domestic origin (...) And note that when we started the process of privatization no one knew, for example, what M&As are (...) It goes without saying that many were able to exploit our underdeveloped markets (...) However, imagine a domestic investor with a professional team or management, one with sufficient experience and knowledge ... but, let's just say this is indeed more likely to be the case with a foreign investor."*

Furthermore, five out of six foreign owned privatized enterprises indicate their new investor carried new management practices. The same applies to the domestic owned privatized enterprises. Firm VI reports that their management made significant changes, especially regarding work ethic and attitude:

> *„Our management really tackled these issues and I really liked how they were reorganizing everything. Suddenly we had „red, rad, disciplina", whereas it used to be organized chaos[19]. From one day to another we were all wearing ties and dressing accordingly. I wasn't allowed to wear short sleeves any longer, while a week ago I would go unshaved to the office. Such changes were good. We simply became more professional".*

Firm I, in addition, mentions that their new management practices are covered by „novi izazov", which is an umbrella name for a collection of new broad management measures[20]. Coupled with new standards regarding personnel (in accordance with Firm VI) Firm I imposed measures in order to preserve its surroundings and the environment:

> *„In former Yugoslavia all waste was dumped in rivers and ponds. Today, hospitals, for instance, still dump their rubbish and leftovers in local ponds and lakes (...) Horrible! Our firm, on the other hand, strives to make a difference. We make an effort to limit our contribution to such activities. Therefore, we pay a great deal of attention to the design of our assets, such as facilities and machines, taking into account our energy consumption for*

[19] English translation: „order, work and discipline"

[20] English translation: „new challenge"

instance, and our drain water and residual material, especially infectious and radioactive waste."

Firm I concludes by arguing that they operate in consonance with the Basel Convention Codes regarding waste treatment and disposal[21].

Table XI - Changes in Management Practices Post Privatization by Type of Ownership

Change	Foreign	Domestic
Yes	5	5
No	1	1

Moreover, respondents added that their executives managed to obtain Good Manufacturing Practice (GMP) certificates[22] or operate according to ISO standards[23]. Others further mentioned operations in line with Integrated Management Systems (IMS)[24].

When asked about the indirect effects of their new technology and management practices on local competitors, suppliers and customers, the answers of both foreign and domestic firms are practically unanimous, indicating that externalities of the latter indicators are not noticed nor observed. Firm VII, however, argues that there are, in fact, space and opportunities for such spillovers to occur and positively affect the Serbian economy. Yet, it is up the Serbian government to take action and create favorable conditions for domestic producers, or suppliers in this case:

„At the moment, we import a bulk of supplies from abroad. Yet, our executives are eager to utilize and stimulate local suppliers. Alas, at the moment, we have not been able to find

[21] The Basel Convention is an international treaty designed to reduce the movements of hazardous waste between nations, and especially to prevent the transfer of hazardous waste from developed to less developed countries.

[22] GMP is a system for ensuring that products are consistently produced and controlled according to quality standards. It is designed to minimize the risks involved in any pharmaceutical production that cannot be eliminated through testing the final product.

[23] ISO (9001:2008) is a norm that imposes conditions on the quality of management in an organization.

[24] An IMS combines all related components of a business into one system for easier management and operations. Quality, environmental, and safety management systems are often combined and managed as an IMS.

domestic enterprises able to produce large quantities of supplies according to international safety standards."

Another interesting remark was made by the respondent of Firm VI, who states that externalities, after all, are likely to occur, as *„Serbia was bought by three investors"*[25]. Lastly, the consulted experts differ in opinion. Expert I states that: „Spillover occurrence in Serbia is out of the question, if it were the case we would enjoy much more entrepreneurship in this country". Expert II, on the other hand, argues that

„Foreign investors do bring new technology and I believe this, indeed, spills over to domestic enterprises, however, I am not sure whether they are able to absorb it completely. Note that our capital market is underdeveloped, to say the least."

4.7 HUMAN CAPITAL DEVELOPMENT

Another benefit of foreign investment can be attributed to expertise and knowledge transfers. Theory prescribes that FDI augments the existing stock of knowledge in the recipient economy through, for instance, labour training and skill acquisition. Respondents were therefore asked whether their investor provided some form of labour training to the workers and whether local competitors, supplier and customers were able to benefit from this development.

Table XII shows that four out of six foreign owned privatized firms report some form of labour training, while two out of six report zero or minimal labour training appointed or offered to employees. Firm I highlighted that investing in the professional development of its staff was essential, as shortly after acquisition its management realized a majority of staff had to be re-trained. The new buyer, after all, had introduced new production lines. Besides, existing staff proved not to be familiar with (safety) regulations and procedures. Moreover, Firm III and VI stressed that the new investors put effort in strengthening the overall competences of existing staff by offering, for instance, language training courses and computer skills classes. Another example

[25] Firm VI's respondent is of the opinion that there are three major players involved in the privatization of SOEs in Serbia. He argues that due to this select group taking over a majority of former state enterprises the new management practices are very similar throughout the country. The respondent adds that „these similarities can also be observed in the massive layoff of employees"

was presented by Firm V, which notes that its executives enable its staff to, for example, travel to other plants of the firm abroad, in order to gain additional experience and knowledge over there.

In comparison, three out of six domestic owned privatized enterprises also reported some form of labour training, while the other three reported zero or minimal training opportunities. Firm X and XII, for instance, disclosed that its employees were merely instructed in the use of new equipment, guidelines and procedures, further schooling was not considered as essential. Firm XI, in contrast, reports that, after the acquisition, its new management set up a training center for its employees where they are instructed in safety measures and receive additional training in conformity with their function and tasks. On the whole, however, Firm VII stands out, as it owns its own internal business school for further educating and training its staff, stating that it: *„considers educated and motivated staff of highest importance"*.

Table XII - Human Capital Development by Type of Ownership

Improvement	Foreign	Domestic
Yes	4	3
No	2	3

Table XIII and XIV highlight the findings regarding the transfer of knowledge and expertise. It shows that only firm I (see Table XXII in Appendix III) among the foreign firms indicated that there is a possibility of human capital spilling over to its competitors. Its respondent, however, was not fully aware of individual cases, yet indicated that its firm occasionally might have lost skilled and trained personnel to its competitors. One domestic firm, on the other hand, Firm XI, confirms it regularly observed internally trained staff spilling over to local competitors. Its respondent explains that due to vast fluctuations in the amount of work, Firm XI employs a majority of personnel on short notice and, generally, for a limited period of time. Its personnel is trained and educated in welding and fitting during their contract period at the firm. Once there is a decline in workload, skilled personnel leaves and generally starts working for other local welding and metal processing firms carrying their acquired expertise. The same might apply to Firm X, after all, the mining company also deals with a large in- and outflow of workers, its respondent acknowledged knowledge transfer to competitors as a possibility. Firm VII's statement somewhat corresponded to the observations made by Firm I, both are indeed operative in the same sector.

Table XIII - Foreign Ownership - Human Capital Transfer

Human Capital Transfer	Yes	Maybe	No
Competitors	0	1	4
Suppliers	0	0	5
Customers	0	0	5

Table XIV - Domestic Ownership - Human Capital Transfer

Human Capital Transfer	Yes	Maybe	No
Competitors	1	2	2
Suppliers	0	0	5
Customers	0	0	5

Altogether, whilst discussing the potential benefits and gains of foreign investment through human capital development, Expert I pointed out that:

> *„This, again, goes back to the quality of the investor, whether its intention is to milk the market — which a lot of them do — or whether they are really in it for the long run. There is a difference between financial and strategic investors. But, one cannot really say that foreign investors invest in human capital where domestic ones do not, it is really up to the investing party itself."*

The same expert also stressed that to his opinion investors, either foreign or domestic, are not to be expected to educate (Serbian) people:

> *„These academics, if these things would be true* (refers to assumptions made by theory)*, the world would resemble a Björk music video, far from reality*[26]*. (...) Education is to be provided by government and companies are no social welfare communities (...) I would never turn to, for example, Telenor and ask them to please educate our people (...) Yet, stimulate people to pursuit this on their own. Companies are not the place to look for such things."*

[26] Björk is an Icelandic experimental singer. Her music videos are known for their surrealism and extravagance.

4.8 ACCESS TO INTERNATIONAL MARKETS

The final indicator of this study is examined and elaborated in this paragraph. It revolves around the volume of exports, export markets change and market access spillovers of both foreign and domestic enterprises respectively. Theory stipulated that MNEs or foreign direct investors may pave the way for local enterprises to enter export markets (through collaboration, or more likely imitation).

To begin with, respondents were asked whether their firm exports its products or services. Out of six foreign enterprises, only one does not export, that is the local port authority, which is mainly occupied with providing services in Belgrade. All domestic enterprises, however, do export their products and services abroad. As a result, Table XV contains the results of five foreign and six domestic owned privatized enterprises. It shows that four foreign firms report their volume of exports increased post privatization, only one reports a decrease. In addition, Table XVI holds the findings concerning the change in access to international markets: three out of five foreign firms report their export markets have increased or expanded. Firm III, for example, explains that their new investor consciously and deliberately shifted the firm's focus from local domestic market to foreign export markets. While closing its production lines tailored to the domestic market, the firm launched its new export oriented production lines: *„this was a strategic decision, today over 95 percent of our production is for export purposes and at the moment we are one of Serbia's biggest export companies, with exports amounting up to 100 million EUR annually"*. Firm III managed to increase exports fivefold. Besides, its respondent makes a valuable remark by arguing its new investor has been able to profit from Serbia's favorable export position defined by a free trade agreement with both Russia and the EU (previously mentioned by Expert I in paragraph IV).

Table XV - Change in Volume of Exports Post Privatization by Type of Ownership

Change	Foreign	Domestic
Increased	4	4
No Change	0	1
Decreased	1	1

Table XVI - Change in Access to International Markets Post Privatization by Type of Ownership

Change	Foreign	Domestic
Increased	3	3
No Change	1	2
Decreased	1	1

Altogether, the findings for both foreign and domestic enterprises are rather similar taking into account the difference in export oriented firms consulted (five foreign versus six domestic). In comparison, four domestic owned privatized enterprises also report an increase in volume, whereas one reports no change and another reports a decline. Firm VIII, for instance, states its exports doubled post privatization. Furthermore, Table XVI illustrates that three domestic enterprises mention their export markets expanded or increased, while two report no change and one reports a decline[27].

Finally, none of the respondents, both foreign and domestic, observed competitors, suppliers or customers obtain increased access to international markets due to collaboration with of imitation of their firm (Table XXVIII and XXIX in Appendix III). None were able to recall examples. Only Firm III highlights that its suppliers took advantage of the firm's increased exports and export markets. However, the suppliers merely gained from increased sales to Firm III. They themselves were not introduced to foreign buyers or distribution markets, nor did they profit from Firm's III international sales markets and experience.

Expert I, in addition, pointed out that:

> *„I do not think that anyone from Serbia will really benefit from this* (refers to: increased market access supposedly carried by FDI). *Especially non connected industries are not likely to benefit from, for example, Serbia's exports to Brazil. You cannot go over there and say: „listen, look at these great cars from Fiat we made … now you should also buy this*

[27] It should be noted that due to the desolation and collapse of former Yugoslavia, firms previously solely producing for the domestic market, instantly were producing for foreign markets as well. As the country gradually disintegrated in seven republics, the distribution networks, after all, were pre established. Three domestic firms reporting expanded export markets, also mention their objective is to gradually relocate or transfer their sales from former Yugoslavian republics to Russia and the EU, being convinced that the latter offer greater opportunities for expansion and development.

completely unrelated product". In a way, however, Fiat, for example, did open a door for local suppliers, but only as the firm itself bought products from them, they did not start to export these themselves."

4.9 CONCLUSION

This paragraph summarizes and compares the findings on the key dimensions of post privatization restructuring elaborated in previous paragraphs and attempts to answer the final subquestion of this study: what have been the effects on economic development of privatization to foreign investors as compared to privatization to domestic investors in Serbia? Table XVII contains a complete overview of the collected results.

Table XVII - Overview of Findings According to the Key Dimension of Research

Variable	Indicator	Foreign (N)	Domestic (N)
Initial Findings	**Total Price Paid for the SOEs**	126 million €	23 million €
	Positive Revenue Performance	4	5
Capital	**Total Investment**	228 million €	522 million €
	Large Reinvested Share of Profit	4	5
Employment	**Employment Decrease**	6	2
	Employment Increase	0	4
Technology Transfer	**Improved Efficiency**	4	5
	Introduced New Technology	4	2
	Introduced New Management Practices	5	5
	Spillover of Technology and Management Practices	/	/
Human Capital Development	**Offered Labour Training**	4	3
	Spillover of Knowledge and Expertise	/	1
Access to International Markets	**Increased Volume of Exports***	4	4
	Increased Access to International Markets*	3	3
	Spillover of Increased Exports and Access to International Markets	/	/

* Note: only five foreign enterprises included, as opposed to six domestic

Observing the initial findings and results on capital it becomes evident that foreign investors are likely to make larger transactions and acquire more expensive state enterprises. Domestic investors,

however, appear to inject more capital in their enterprises following acquisition. Yet, it is important to emphasize that the findings concerning aggregate investment are somewhat distorted. Firm VII alone, sold to a domestic investor in 2002, is responsible for half a billion EUR of investment. This amount, however, was catered by its new acquisitor of German origin (as mentioned in paragraph III). Hence, the findings suggest that foreign investors as compared to domestic investors make larger transactions and invest more capital. But, there is no significant discrepancy between foreign and domestic investors regarding revenue performance and reinvested share of capital. Moreover, the findings related to employment imply that foreign investors deduct jobs, whereas one-third of domestic investors do not. Despite the implementation of comprehensive and expensive social programs, massive layoffs are a fact. Foreign investors, however, do outperform domestic investors in terms of technology. The results regarding management practices, labour training, exports and international market access are practically the same for both type of investors. No clear discrepancies were observed. Finally, it is remarkable that hardly any spillovers occurred. Respondents were not able to recall or observe such cases, indicating that, again, there is no discrepancy between foreign and domestic investors.

In conclusion, based on the empirical second stage of this study, the effects on economic development of foreign investors as compared to domestic investors in Serbia are broadly similar, with the exception of capital injections and technology. Foreign investors invest more in their enterprises and are more likely to carry and introduce new modern technology in the host country. Withal, this study also points out that foreign investors have an adverse effect on employment, whereas domestic investors do decrease employment in all cases.

CHAPTER 5

CONCLUSION

The following chapter combines the theoretical and empirical part of this study and aims to answer the main research question: what are the advantages of privatization through foreign direct investment as compared to privatization to domestic investors in Serbia? First, it looks back on the individual sub questions elaborated in previous chapters and takes a closer look at the findings emerging throughout the research, after which it arrives at a conclusion. Finally, this chapter also discusses this study's limitations, along with suggestion for further research, and practical implications.

This study first set out to explore how foreign direct investment influences a host country's economic development (subquestion I). The initial and fundamental findings, based on a thorough literature review, indicate that FDI is likely to affect the latter through both direct and indirect effects. The first, initial or direct effects of FDI are attributed to the influx of additional capital and employment creation. The initial macroeconomic stimulus, appears to be rather self-evident and clear. MNEs, after all, carry capital (MacDougall, 1960; Caves, 1996). It is, therefore, no surprise that Serbian policy makers seek to attract more FDI. The second direct effect, on the other hand, is much disputed. Employment creation is believed to depend on the foreign investors' mode of entry: while both green- and brownfield entry are expected to spur employment instantly, entry through M&A is not (Buckley & Artisien, 1987). Thus, employment creation through privatization, which basically involves an acquisition or takeover, is not a given. Theory further prescribed that FDI carries expertise and knowledge in the area of innovative technology and management practices, and human capital development (Gregorio and Lee, 1998; Caves, 1996; Findlay, 1978). It is also considered to bring about increased exports and international trade integration (Sun, 1998; Blomström and Kokko, 1998). The latter comprise the second or indirect effects of FDI and are considered to be of utmost importance. Spillovers emerge when local competitors, suppliers and customers of the MNEs appropriate their technology and knowledge, ultimately affecting the overall efficiency of resource use in the recipient economy (Buckley, Clegg and Wang, 2010). In

contract, there are also studies that cast doubt on the above … emphasizing the strong need for more research on the matter.

Consecutively, this study scrutinized the differences for economic development of privatization to foreign investors as compared to privatization to domestic investors (subquestion II). The indicators or channels identified by means of subquestion I, were the focal point. They were used to guide and shape the follow-up sub questions and research. Moreover, whilst comparing the two types of privatization using empirical studies, it becomes evident that the so-called ownership structure is decisive when it comes to economic development and determined by the method of privatization employed. Scholars conclude that mass privatization methods, for instance, overall limit and obstruct foreign participation, yet are likely to induce economic development. Sale of state property, in contrast, allows foreign entry, but, according to research, it is less likely to induce favorable effects (Bennett et al., 2004). The argumentation is that allegedly FDI is more „outward looking" and less inclined to encourage the development of indigenous entrepreneurship and reinvest profits in the host country. Also, it is more likely to use capital intensive technology eliminating jobs (Firebaugh, 1992). Hence, privatization to foreign investors in the light of economic development, is not endorsed by science. The findings are, to say the least, contradictory. As a result, it only gets more interesting to explore whether this also goes for Serbia, therewith this study arrived at its final, empirical stage.

In June 2015, 14 semi-structured interviews were conducted with representatives of former state enterprises and experts on privatization in Belgrade, Serbia. The goal was to analyze the effects on economic development of privatization to foreign investors as compared to privatization to domestic investors in Serbia. The findings show that foreign investors overall invest more capital in their enterprises and make larger acquisitions. In addition, they carry advanced technology. A negative outcome, however, is that foreign investors appear to be responsible for massive cuts in employment. Finally, it is striking that neither foreign nor domestic investors seem to induce positive externalities on their local competitors, suppliers and customers.

Thus, in the search for advantages of privatization through foreign direct investment as compared to privatization to domestic investors in Serbia, the following issues were clarified. In line with the predictions by theory, foreign direct investment enables much larger transactions and carries more, additional capital into the host country. This is only beneficial, considering the fact that Serbia is

heavily undercapitalized and extra funding is very welcome. Neoclassical growth ideology, after all, stipulates that capital is the engine of economic growth. Another identified advantage is the influx of technology in the country. Foreign investors, in comparison, carried more innovative and advanced technology than domestic investors. Moreover, it is assumed that the latter advantages or benefits enjoyed by foreign direct investment, or MNEs, in Serbia, are related to access to finance and funding. Serbia's capital market, after all, is heavily underdeveloped, domestic investors, therefore, have little access to financial means. This way, foreign investors can distinguish themselves and more importantly contribute to development, especially in the capital market by fostering entrepreneurship. In spite of the advantages enumerated above, other less advantageous presumptions proved to apply as well. Foreign direct investment, for example, does not bring additional employment to Serbia - it, in fact, decreases it. Although it comes as no surprise, taking into account the legacy of social ownership, it is far from ideal. Serbia, after all, is dealing with a huge pool of unemployed workers impeding economic growth. The carried capital intensive advanced technology, as mentioned by Firebaugh (1992) might clarify the latter outcome. Finally, to come back to what scholars believe to be a driver of development, an advantageous side-effect of foreign direct investment, practically no spillovers were detected in Serbia throughout this study.

5.1 LIMITATIONS

This study employed a relatively small sample. Accordingly, its findings should not be presumed as representative of the entire population of foreign investors in Serbia. In order to increase its generalizability, present study should be replicated with a broader sample, encompassing a more representative enterprise distribution, together with more than one respondent per enterprise and preferably with different educational backgrounds and functions. In addition, the comparative element could be strengthened by conduction of cross-national research in different former Yugoslavian republics. Moreover, the simple presence of a certain condition or indicator, as mentioned earlier in Chapter III, does not indicate it was caused by either foreign or domestic investment. Aftel all, it is likely that there are additional conditions or factors at play (such as state measures related to business operations), challenging the internal validity of present study.

Finally, it is important to reckon with the replicability of this study, which suffers from the fact that respondents might not have been equally benevolent to share accurate and reliable knowledge and views on the issues under scrutiny. After all, in spite of the efforts made to counteract the latter,

there is always a possibility that respondents' answers were affected by personal aspirations and stakes in the former SOEs included in this study, limiting the reliability of the findings presented and conclusion drawn above.

5.2 POLICY IMPLICATIONS

Despite the lack of generalizability and replicability, a couple of tentative conclusions for policy makers seem appropriate. In essence, the findings of this study show that FDI is not so different from domestic investment - especially in terms of management practices and exports. Policy makers could therefore choose to make no distinction between the origin of investors and primarily focus on selecting and attracting reputable, experienced and strategic investors that are also willing to contribute to the development of the host country. Consequently, policies should be tailored towards attracting the latter (in particular in relation to the remaining SOEs to be privatized), regardless of origin. Finally, taking into account the results concerning employment, it would, then, be ideal for policy makers to pursue a policy that imposes restraints on „imported" capital intensive technology. Yet, then again, the consequences and outcomes are unpredictable and incalculable.

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APPENDIX 1

INTERVIEW MANUAL / FIRMS

Company:

Respondent:

Function:

INTRODUCTION

- General introduction
- Goal of the research
- Interview procedure: respondent if free to give any answer that comes to mind, the information will be processed confidentially and the anonymity of respondent is guaranteed. Does respondent have any objection to the recording of the interview?

QUESTIONS

A. What is your function?
B. For how long have you had this function at current company?
C. Were you involved in the privatization of current company?
D. Was performance, in terms of revenue, improved after privatization?

1. Capital Inflow

1.1 What was paid for current company?

1.2 Has current company made investments post privatization? Why (not)? If yes, could you give (an) example(s)?

1.3 Were there profits made for a period of 10 years post privatization? To what extent have they been reinvested?

2. Employment

2.1 What was the number of employees pre privatization?

2.2 What was the number of employees 10 years post privatization?

2.3 Why did the number increase or decrease?

Describe the market current company operates in

- Are there any competitors? Who are they? Are they foreign or domestic?
- Do you utilize locally supplied resources? From which type of firms?
- Who are your customers? Are they businesses or consumers? (If customers are consumer delete question 3.6 / 4.4 / 5.6)

3. Technology

3.1 Overall, did firm efficiency and efficacy improve post privatization? Why (not)?

3.2 Did the new investor introduce new technology? If yes, can you give an example?

3.3 Did the new investor introduce new management practices? If yes, can you give an example?

3.4 Would you be able to indicate whether your *local competitors* copied or were stimulated to adopt new technology or management practices?

3.5 Would you be able to indicate whether your *suppliers* copied or were stimulated to adopt the new technology or management practices?

3.6 Would you be able to indicate whether your *customers* copied (some of) or were stimulated to adopt new technology or management practices?

4. Human Capital Development

4.1 Did the new investor provide labour training to the employees? Why (not)?

If yes,

4.2 Would you be able to indicate whether *local competitors* were able to benefit from this development?

4.3 Would you be able to indicate whether *local suppliers* were able to benefit from this development?

4.4 Would you be able to indicate whether *local customers* were able to benefit from this development?

5. Access to International Markets

5.1 Does the firm export its products/services abroad? To which countries?

If yes,

5.2 Did the volume of exports change after privatization? How?

5.3 Did export markets change after privatization? How?

If yes,

5.4 Would this also apply to *local competitors*?

5.5 Would this also apply to *local suppliers*?

5.6 Would this also apply to *local customers*?

Do you have any questions or remarks of your own?

APPENDIX 2

INTERVIEW MANUAL / EXPERTS

Organization:

Respondent:

Function:

QUESTIONS

What have been the effects on economic development of privatization to foreign investors as compared to privatization to domestic investors in Serbia?

1. What have been the effects with regard to capital inflow?

- Is there a difference between foreign and domestic ownership?

2. What have been the effects with regard to employment?

- Is there a difference between foreign and domestic ownership?

3. What have been the effects with regard to technology transfer?

- Is there a difference between foreign and domestic ownership?

4. What have been the effects with regard to human capital development?

- Is there a difference between foreign and domestic ownership?

5. What have been the effects with regard to access to international markets?

- Is there a difference between foreign and domestic ownership?

APPENDIX 3

ADDITIONAL TABLES

Table XVIII - Foreign Ownership - Changes in Employment Post Privatization

	I	II	III	IV	V	VI
Before	2000	400	1100	260	2100	800
After	390	220	750	150	1100	200
Change	- 81,5%	- 45%	- 32%	- 42%	- 48%	- 75%

Table XIX - Domestic Ownership - Changes in Employment Post Privatization

	VII	VIII	IX	X	XI	XII
Before	1250	1200	850	360	910	91
After	2500	620	3	430	630	43
Change	+ 100%	- 48%	- 99%	+ 20%	- 31%	- 53%

Table XX - Foreign Ownership - Improvements in Efficiency and Technology, Changes in Management Practices and Human Capital Development

	I	II	III	IV	V	VI
Efficiency	Large	Smal	Large	Large	Large	Small
Technology	Large	Zero	Large	Large	Large	Zero
Management practices	Yes	No	Yes	Yes	Yes	Yes
Human Capital	Yes	No	Yes	No	Yes	Yes

Table XXI - Domestic Ownership - Improvements in Efficiency and Technology, Changes in Management Practices and Human Capital Development

	VII	VIII	IX	X	XI	XII
Efficiency	High	High	Zero	High	High	High
Technology	High	High	None	Average	Average	Average
Management practices	Yes	Yes	No	Yes	Yes	Yes
Human Capital	Yes	No	No	Yes	Yes	No

Table XXII - Foreign Ownership - Technology / Management Practices Transfer

	I	II	III	IV	V	VI
Competitors	No	n.a.	No	No	No	Maybe
Suppliers	No	n.a.	No	No	No	No
Customers	No	n.a.	No	No	No	No

Table XXIII - Domestic Ownership - Technology / Management Practices Transfer

	VII	VIII	IX	X	XI	XII
Competitors	No	No	n.a.	No	No	No
Suppliers	Maybe	No	n.a.	No	No	No
Customers	No	No	n.a.	No	No	No

Table XXIV - Foreign Ownership - Human Capital Transfer

	I	II	III	IV	V	VI
Competitors	Maybe	n.a.	No	No	No	No
Suppliers	No	n.a.	No	No	No	No
Customers	No	n.a.	No	No	No	No

Table XXV - Domestic Ownership - Human Capital Transfer

	VII	VIII	IX	X	XI	XII
Competitors	Maybe	No	n.a.	Maybe	Yes	No
Suppliers	No	No	n.a.	No	No	No
Customers	No	No	n.a.	No	No	No

Table XXVI - Foreign Ownership - Access to International Markets and Volume of Exports

	I	II	III	IV	V	VI
Markets	Increased	Decreased	Increased	No Change	Increased	n.a.
Volume	Higher	Lower	Higher	Higher	Higher	n.a.

Table XXVII - Domestic Ownership - Access to International Markets and Volume of Exports

	VII	VIII	IX	X	XI	XII
Markets	Increased	Increased	Decreased	No Change	Increased	No Change
Volume	Higher	Higher	Lower	Higher	Higher	No Change

Table XXVIII - Domestic Ownership - Access to International Markets Transfer

	VII	VIII	IX	X	XI	XII
Competitors	No	No	n.a.	No	No	No
Suppliers	No	No	n.a.	No	No	No
Customers	No	No	n.a.	No	No	No

Table XXIX - Foreign Ownership - Access to International Markets Transfer

	I	II	III	IV	V	VI
Competitors	No	n.a.	No	No	No	n.a.
Suppliers	No	n.a.	No	No	No	n.a.
Customers	No	n.a.	No	No	No	n.a.