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CORPORATE GOVERNANCE AND FOREIGN DIRECT INVESTMENT: LESSONS FOR THE FUTURE OF THE WESTERN BALKANS

Korporativno upravljanje i strane direktne investicije – lekcije za budućnost zemalja Zapadnog Balkana

Abstract

Stability of a financial system depends on the ability of the system to adapt to the demands of the time in which it should exercise its functions. If these functions are not fully incorporated in the laws and regulations governing the financial system of a country, it is understandable that there is a need for such legislation and such a system to be aligned with the current needs and requirements of the financial market. In everyday life, changes are becoming increasingly normal and commonplace. The need for change has become one of the biggest challenges facing the modern strategic management of companies. Looking at the macro level, a varying success in coping with the coming changes affects the relative position of individual countries, their industrial base, wealth and power. Corporate governance system refers to the entirety of laws, quality institutions, professional chambers and business ethics. Corporate governance is based on elementary rules of protection of property rights and is a prerequisite for achieving the market institutions' integrity.

Foreign direct investment (FDI) is an important driver of the economic development in the Western Balkans. The Western Balkans countries include Albania, Bosnia and Herzegovina (B&H), Croatia, Macedonia, Montenegro and Serbia. We also analyze Croatia among the countries of the Western Balkans, despite the fact that it joined the EU in July 2013. The countries of the Western Balkans, in comparison with the countries of the Central and Eastern Europe, received less FDI during the 1990s. The main reason for this is that most of the countries of the Western Balkans were in transition or involved in war conflicts. Countries such as Albania, Bulgaria, Croatia, Macedonia, Romania, except for Bosnia and Herzegovina which was at war, were observed from 1990 to 1996, when they realized FDI inflows amounting to USD 3.4 billion or 5.7% of total FDI in 27 transition economies in the world.

Keywords: *corporate governance, foreign direct investment, transition, institutions*

Sažetak

Postojanost jednog finansijskog sistema zavisi od sposobnosti tog sistema da odgovori zahtevima vremena u kojem treba da ostvaruje svoje funkcije. Ukoliko ove funkcije nisu u potpunosti implementirane u zakonima i drugim propisima kojima se uređuje finansijski sistem jedne zemlje, razumljivo je da postoji potreba da takvi propisi i takav sistem budu usklađeni sa aktuelnim zahtevima i potrebama finansijskog tržišta. I u svakodnevnom životu promene sve više postaju normalna i uobičajena stvar. Potreba za promenom postaje jedan od najvećih izazova sa kojim se susreće strategijski menadžment savremene kompanije. Posmatrano na makro planu, zahvaljujući različitoj uspešnosti u suočavanju sa nastupajućim promenama, preuređuje se relativni položaj pojedinih zemalja, njihova industrijska osnova, bogatstvo i moć. Kvalitetno korporativno upravljanje obezbeđuju odgovorne upravljačke strukture uz uvažavanje interesa akcionara i svih zainteresovanih subjekata za uspešno poslovanje korporacija. Ono je u osnovi izvedeno iz elementarnih pravila zaštite svojine i predstavlja preduslov integriteta tržišnih institucija.

Strane direktne investicije (SDI) su važan pokretač ekonomskog razvoja u zemljama Zapadnog Balkana. Zemlje Zapadnog Balkana su: Albanija, Bosna i Hercegovina (BiH), Hrvatska, Makedonija, Crna Gora i Srbija. Među zemljama Zapadnog Balkana se analizira Hrvatska uprkos činjenici da je ušla u Evropsku uniju u julu 2013. Zemlje Zapadnog Balkana su, u poređenju sa zemljama Centralne i Istočne Evrope, primile manje direktnih stranih investicija tokom 1990-ih. Glavni razlog za to je činjenica da se većina zemalja Zapadnog Balkana nalazila u tranziciji ili u ratnom sukobu. Zemlje, kao što su Albanija, Bugarska, Hrvatska, Makedonija, Rumunija, osim Bosne i Hercegovine, koja je bila u ratu, u periodu od 1990. do 1996. godine imale su priliv SDI u iznosu do 3,4 milijardi dolara ili 5,7% ukupne SDI u odnosu prema tranzicionim ekonomijama u svetu.

Ključne reči: *korporativno upravljanje, strane direktne investicije, tranzicija, institucije*

Introduction

The relation between the real sector and financial markets needs to be adequately controlled to reduce the risk of all participants. The main objective of the Organization for Economic Cooperation and Development (OECD) is to ensure, through the Global Forum on Corporate Governance, the improvement of standards of corporate governance and, in particular, to ensure their application in developing countries and countries in transition, the development of entrepreneurial spirit, improved accounting, transparency, accountability and integrity in business. One of the major shortcomings of capital markets in transition countries is the lack of transparency, low efficiency in detecting financial irregularities and unexpected price fluctuations of stock prices, indicating that the integrity of the market is not built. The main areas of the research of IFC/MIGA are the development of entrepreneurship and the efficiency of private investment, as well as the development of suitable business environment. The intention is to integrate environment, corporate and social governance and to ensure that problems in corporate governance do not inhibit investment. These goals are accomplished through various forms of political dialogue, convening of conferences on corporate governance and organization of round tables at the national and regional levels [3, p. 11]. They can be applied in countries with "civil law" and "common law" legal tradition, at different levels of ownership concentration. Activities of international organization whose focus is to help corporate management in industry are reflected on policy segment. These goals are achieved through the transfer of knowledge and by ensuring private sector project financing with good corporate governance, research and consulting. They do not have a primary activity, strong competitiveness in the projects and ensuring the elements of corporate governance. Therefore, the supervisory role of the market depends on the size and sophistication of the local capital market. Thus, the risk of getting to know the local corporate governance imperfections (idiosyncratic risk) and their alliance with the cost of capital is an important foundation for a stable business environment of the domestic economy. Scenario in which privatization has as its aim the increase of social wealth, and not legislation that will provide an indirect route to reaching this goal, leads to property theft and dilution of wealth. This topic is of great importance for the development of economic science in the field of financial markets in the Balkan region, which is characterized as a determinant of market transition.

FDI inflows within the Western Balkans countries observed from 1989 to 2000 amounted to 15.3 billion dollars or 9.4% of total FDI in 27 transition economies. The Western Balkans countries have achieved FDI of 5.8% in 2010, and all the countries of South Eastern Europe recorded 14.7% (South East European countries are all the countries of the Western Balkans as well as Romania and Bulgaria) [10, pp. 11-32].

One of the main goals of this paper is to explore the main determinants that affect the inflow of FDI in the Western Balkans countries: first of all, the size of gross domestic product per capita (GDP), growth rate of gross domestic product, the share of trade in GDP and inflation rates. Accordingly, the aim of this study is to assess which of these variables have greater impact on FDI inflows into a country and identify the reasons as to why some variables have less influence in attracting FDI.

Institutional and corporate infrastructure

The investment climate is not the same for every business in any one state. In order to advance the business environment, the opinion of international institutions is that it is necessary to create opportunities for both domestic and foreign institutions.

Investor protection is a priority for modern regulation of developed financial markets, including transition markets. In terms of transition, a special problem is the process of conversion of a company from the state or private structures or mono-ownership structures to open joint stock company. By a standard definition, an open joint stock company is obliged to report on its financial position, legal status and procedures as well as business, to report to narrower and the general public regulators [17, p. 123] and only regulated market is a framework for the financial indicators and results.

A necessary precondition for the proper functioning of corporate governance and capital market [15, p. 31] is a stable legal system in the country and development of institutions [13, p. 27]. Therefore, the study of various aspects of corporate governance is in the initial stages of development, with no single international organization covering the area of corporate governance with a clear vision in all its segments. The transition conditions are necessary. In transition economies, the process of concentration of ownership is very dynamic due to the widespread distribution of property rights in the models of mass privatization. One of the causes of accelerated concentration is a low level of investor protection. Investor protection and protection of all external and internal shareholders and creditors from expropriation or impairment of standard rights of ownership is the problem which is present when there is external financing of business entities. Consequently, the low level of investor protection and dispersed and non-concentrated ownership structure are mutually opposing structures. Reducing the level of investor protection, which normally happens in a crisis situation, causes rapid concentration of ownership and further endangers the external investors as to the concentration realized by the undervalued equity securities regime.

When it comes to improving capital markets and investor protection, the area of corporate governance is an unavoidable and essential need. The transition economies and developing economies do not have a lot of achievements in this area. The biggest problems of the market in transition and emerging markets relate to: instability, generally unstable economic conditions, liquidity, leaving the company with a listing and capital outflows, accounting standards and standards of the international comparative audit, inefficient political and legal environment, corruption (see Table 1) and lack of trust in the financial system [20, pp. 291-298].

The instability of the ownership structure has the effect of market volatility, thus protecting shareholders' rights should further regulate and promote the development of legal standards, more transparent adoption of appropriate laws and harmonization with the European Union. Markets in most transition countries in the Balkan region are dominated by systems of corporate governance and financial systems which provide a lower legal protection to investors compared to the systems that provide the strongest protection. Identified weaknesses that are characteristic of most of the capital markets in transition countries can be, to a great extent, alleviated by passing laws in the area of development of capital markets and corporate governance.

For advancement of the business environment, it is necessary to create investment climate for everyone who has taken part in business life – domestic, foreign, bigger and smaller investors. Effective institutions reduce transaction costs. The idea of a company as a legal form comprising a set of contractual relations between individuals should be minimization of agency costs between shareholders and managers [8, p. 13]. Namely, the agent will be paid to use the funds (to limit the charges) if he guarantees that he will not take action that may be harmful to the principal. Principals (shareholders) are taking the risk, transferring the right to decide to an agent.

System of corporate governance in a country includes formal and informal rules of conduct, accepted practices and enforcement mechanisms, whether private or public [21, p. 97], which with common interaction successfully control corporations ("corporate insiders") on the one hand, and all others who may invest, on the other.

However, many authors conclude that empirical findings depend on the selected research methodology. At the same time, they emphasize that the theory of corporate governance is underdeveloped.

Harmonization of national legislation and protection of investors to develop the financial market

The process of harmonization of national legislation in the field of business [16], is the process of creating legal norms

Table 1: Ratings of corruption in Serbia and the average score for the Balkan region

Year	2007	2008	2009	2010	2011	2012
Mark for Serbia	5.25	5.20	5.0	5.1	5.2	5.1
Average for the Balkan region	5.04	4.86	4.97	4.93	4.91	4.95

Source: Authors

under the EU law. The Europe Union has recommended the development of company law based on expansion transparency. Other important areas for the regulation of corporate governance are the financial services regulation and voluntary regulation - in the EU there is a number of codes of corporate governance adopted by various institutions, professional bodies and associations on a voluntary basis, with the voluntary national codes and their respect, who are performing convergence of corporate governance practices.

Harmonization [16, pp. 34-50] of national legislation with the EU regulations is aimed at improvement of chances of a country to become a member or to speed up the process[1]. Regime of foreign capital is an arranged set of rules.

In addition to shareholders' rights, equal treatment of shareholders, disclosure and transparency, within the framework of the OECD[2] principles of corporate governance, the information relating to the role of other persons with an interest in the work of the company as well as explanations of the duties of the management body play an important role. Control of the use and misuse of inside information is one of the most important means of protection of external investors. As the internal owners are the greatest beneficiaries of this type of information, the rules define users of privileged information. These are mostly insiders by virtue of the ownership or on the basis of employment status and may be the mediators and regulators. The use and abuse of insider information relates to the exploitation of the benefits for the purchase or sale of securities, directly or through another person, as well as to the communication of privileged information or counseling, on that basis, to third parties in order for them to take advantage of the benefits for the purchase or sale securities.

In the area of monitoring the reliability of operations (prudential control), one should adopt a directive on the winding-up of banks and insurance companies, on the treatment of "electronic money", improve the directive on money laundering and improve rules on the supervision of financial conglomerates.

1 The European Commission believes that there is convergence between voluntary national codes of corporate governance and practices and that there is no need for a single European code.

2 Code of Corporate Governance OECD can be downloaded from the website: www.oecd.org/home

Practices of corporate governance are of crucial importance in the banking sector [7, pp. 7-11]. It is well known that banks operate on the basis of allocation of excess savings of the population toward the most profitable activities of the company [4, p. 48].

Foreign direct investment inflows to the Western Balkans

Observing the individual countries of the Western Balkans, we can point out that Bosnia and Herzegovina realized FDI in the amount of EUR 5.856 million in the 2005-2013 period [3]. According to the Central Bank's data, an increase in foreign direct investment was registered in 2010 and 2011. The inflow of FDI in 2010 was increased by EUR 307 million or 70.5% compared to 2009. FDI inflows in 2011 amounted to EUR 355 million, which represented 2.7% of GDP and an increase of 15.7% compared to 2010. Unfortunately, besides promising forecasts, foreign direct investment in 2012 amounted to EUR 285 million, which represented a decrease of 2.2% of GDP or 19.6% compared to 2011. Significant decline in FDI inflows continued during 2013, amounting to EUR 252 million.

Albania realized FDI inflows of USD 1.051 billion in 2010. A slight decrease of FDI was recorded in 2011, totaling USD 1.036 billion. A downward trend continued in 2012, when the total FDI amounted to USD 957 million. In 2013, there was a significant increase in FDI inflow, which amounted to USD 1.35 billion (2). Montenegro achieved total FDI inflows in the amount of EUR 1.066 billion in 2009. That year was followed by a decline in FDI inflows in 2010 (EUR 552.107 million). In 2011, a downward trend continued and FDI was EUR 389.104 million. A slight increase in FDI inflows was recorded in 2012, amounting to EUR 461.59 million, followed by another fall in the inflow of FDI in 2013 to EUR 323 million [5, p. 13].

In the period from 1993 to 2013, Croatia achieved total FDI inflows in the amount of EUR 26.865 billion. A record year was 2008, because the FDI inflow amounted to EUR 4.053 billion. This year was followed by a decline in FDI inflows in 2009 (EUR 2.408 billion) and also in 2010 (EUR 370 million), which is linked to the recession in the Eurozone and Croatia itself. During 2011 and 2012, FDI in Croatia recorded a significant increase and amounted to EUR 1.091 and 1.055 billion, respectively. In 2013, a significant decline in FDI inflows was recorded, which at the time amounted to EUR 436 million [13, p. 9]. In the period from 2005 to 2012, Serbia recorded a net inflow of FDI of EUR 12.5 billion. In 2006, Serbia achieved a record in net inflow of FDI in the amount of EUR 3.322 billion. This year was followed by a significant decrease in the inflow of FDI. During the 2010 and 2011, FDI amounted to EUR 860 million and EUR 1.826 billion, respectively. In 2012, a drastic decline in FDI occurred, which totaled only EUR 241 million. In 2013, a significant increase in FDI inflows was recorded, which amounted to EUR 768.534 million. In the period from 2003 to 2013, Macedonia achieved a total net FDI inflows amounting to EUR 2.938 billion. A record year in the inflow of FDI to Macedonia was 2007, when FDI stood at EUR 506 million. In 2010, FDI amounted to EUR 160 million. In 2011, FDI was EUR 336.8 million. In 2012 and 2013, FDI amounted to EUR 72 million and EUR 251.5 million, respectively [19].

In this paper we analyzed the impact of variables on the net inflow of FDI (15), such as GDP, growth rate of gross domestic product, the share of trade in GDP and inflation rate. We found that GDP and the share of trade in GDP had a significant effect on the net inflow of FDI in the Western Balkans, while the effect of GDP growth and inflation rate on FDI was insignificant or even negative. The positive effect of GDP per capita on the net inflow of FDI in the Western Balkans countries can be explained by the fact that these countries as a whole represent an important market in terms of size and future market potential. In the early 1990s and during the transition period, GDP per capita in the Western Balkans countries was low, but in the early 2000s there was a significant increase due to the inflows of FDI, which together with the process of transition and privatization played a critical role. These processes did not take place in the same manner in all the countries (3, 4, 5). In particular, this process was delayed in Bosnia and Serbia. In the case of a share of trade in GDP, we found a significant effect of the given variable on the net inflow of FDI. First of all, this is a result of the policy of openness and liberalization of economies of those countries. In particular, this effect was enhanced at the moment when the majority of countries signed an agreement on accession and candidate status. Besides this, these countries became members of the trade agreements, such as CEFTA, EFTA, etc. All this resulted in increased inflow of FDI.

In our analysis, a high correlation between the observed variables within the initial value was not observed. It is generally known that a high correlation can lead to a problem of multicollinearity. This means that it is difficult to assess the correlation of one variable while the correlation of other variables is constant. All this leads to a less reliable conclusion. The problem of multicollinearity is present if two regression variables (or more) are linearly dependent or nearly linearly dependent (including variable $x_0=1$, which generates a constant member). Much more common and serious is the problem of approximate multicollinearity or nearly linear dependence of regression variables, which exists if two or more regression variables are highly correlated. When the observed variables are highly correlated, it is difficult to separate their individual effects on the dependent variable. If the objective of forecasting is the future value of the dependent variable on the basis of the established regression model, multicollinearity problem is ignored, but in other cases, the problem is more rigorously approached. In the Table 2 we can see that a high correlation does not exist, and therefore conclusion can be more reliable.

Table 2: Correlation of variables

	GDP	_GG	FDI	_TRA	_CPI
GDP	1.000.000	-0.167026	0.764458	0.099721	-0.075895
_GG	-0.167026	1.000.000	-0.103533	0.163760	-0.076216
FDI	0.764458	-0.103533	1.000.000	0.156032	-0.101126
_TRA	0.099721	0.163760	0.156032	1.000.000	-0.252533
_CPI	-0.075895	-0.076216	-0.101126	-0.252533	1.000.000

Source: Authors

Note: ***, **, and * represent statistical significance at the 1%, 5%, and 10% level, respectively.

Remark: GDP - Gross domestic product per capita; _GG - Growth rate of gross domestic product; FDI - Foreign direct investment; _TRA - Share of trade in GDP; _CPI - Consumer price index.

In our analysis, we started from H_0 hypothesis that these variables have negative impact on FDI inflows. Based on our panel analysis of the lowest squares, we found the following results based on four independent analyzed variables that affect the dependent variable FDI. Based on findings of p-values, we can present the probability that the estimated $\beta = 0$. We selected a level of significance in the range of $\beta < 1\%$, $\beta < 5\%$ and $\beta < 10\%$. Based on the observed p-values, we can conclude that GDP per capita has a value that is less than $\beta < 1\%$, which means that it has a significant and positive impact on FDI inflows, and we rejected the null hypothesis ($\beta \neq 0$). In the case of GDP growth or _GG, the p-value is 0.8711%, which represents a value above the chosen level of significance $\beta < 5\%$, which means that it is insignificant or has no impact on FDI inflows. Based on the share of trade in GDP or _TRA, the p-value is 0.2093%, which means that it is significant, and that it has a positive impact on FDI in the Western Balkans. Finally, the rate of inflation _CPI is 0.6990%, which is above the rate of 5%, and presents the negative significance (see Table 3).

The data used in this research were taken from the database of the World Bank. We selected a sample of six Western Balkans countries. We analyzed the time period from 1994 to 2012. It is the period in which most of the Western Balkans countries were in a transition phase. In this analysis, a dependent variable is net FDI inflows, while independent variables are GDP per capita, GDP growth, the share of trade in GDP and the inflation rate. Their value is above the threshold of 5%. If the growth rate of gross domestic product is observed, a high value represents values that exceed the determined amount of 5%, which indicates that it is insignificant, and that it does not affect FDI inflow. This is explained by the fact that the observed countries in the analyzed period recorded most of the time the low rates of growth, which had a negative impact on FDI inflows. The rate of inflation or _CPI is also insignificant, indicating that inflation does

Table 3: Panel EGLS (Cross-section random effects)

Dependent variable: FDI
Method: Panel EGLS (Cross-section random effects)
Date: 06/01/14 Time: 18:56
Sample: 1994 : 2012
Periods included: 19
Cross-sections included: 6
Total panel (balanced) observations: 114
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.163981	0.192724	-0.850859	0.3967
GDP	0.050375	0.004049	12.43977	0.0000
_GG	0.001017	0.006874	0.147950	0.8827
_TRA	0.002437	0.002089	1.166795	0.2458
_CPI	-0.001207	0.003017	-0.399881	0.6900
Effects specification				
			S.D.	**Rho**
Cross-section random			0.000000	0.0000
Idiosyncratic random			0.684137	1.0000
Weighted statistics				
R-squared	0.591489	Mean dependent var		0.750038
Adjusted R-squared	0.576498	S.D. dependent var		1.084160
S.E. of regression	0.705539	Sum squared resid		54.25859
F-statistic	39.45570	Durbin-Watson stat		0.840969
Prob (F-statistic)	0.000000			
Unweighted statistics				
R-squared	0.591489	Mean dependent var		0.750038
Sum squared resid	54.25859	Durbin-Watson stat		0.840969

Source: Authors
Note: ***, **, and * represent statistical significance at the 1%, 5%, and 10% level, respectively.

not affect the net inflow of FDI. The random effects model analyzes individual variables with respect to the overall appearance, while the fixed effects model analyzes the difference between each variable. Fixed effects is otherwise called Least Squares Dummy Variables model – LSDV (see Table 4), and it allows different amounts for each group (section), and dummy variables for each section. The usefulness of the fixed effects is reflected in the fact that certain disturbances in the inflow of FDI may occur in the observed period due to recessionary trends, so that without fixed effects a panel regression would not be able to explain a given phenomenon. In addition, the fixed effects includes omitted variables in certain countries, and increases the accuracy of the regression. On the other hand, the use of a random effects model has some advantages in terms of estimating the less data than a fixed model, providing further explanation of the variables.

In Table 5, on the basis of the unit root test, the variables _GG, _CPI have a stable stationarity. In case of _TRA, FDI and GDP, a significant unsteadiness is noticed. On the basis of the observed p-values, i.e. on the basis of the observed value $\beta < 1\%$, it is noticed that _GG and _CPI variables have a lower value, which means that we can reject the null hypothesis that they are significant. In the case of $\beta = 1$, then it is a perfect autocorrelation. However, if we assume that the p-value is $\beta < 5\%$, then we can say for variables _TRA and FDI that they are significant. Finally, in the case of GDP p-value being above 5%, it indicates that it is insignificant. After we make the correction of data based on non-stationary distribution of the t-statistic, the conclusion will be reliable. In addition, there are other problems that can lead to inconsistent conclusions.

In our analysis, we applied the LSDV or fixed model and the random model. Fixed or LSDV model allows heterogeneity and individual differences between countries. Based on the fixed effect or LSDV, we can conclude that the observed variable GDP has low p-values that are less than 1% and 5%, which means that we reject the null hypothesis and consider it as not significant (see Table 6).

This means that there is a strong connection between FDI inflows and GDP in the Western Balkans countries. Higher GDP per capita can be a sign of a larger market and the improvement of the business climate. Equally, in the case that _TRA or the trade share of GDP p-value is less than 5% of the eligible amount, it means that we reject the null hypothesis and we consider that the given variable is significant. The main reason why the share of trade in GDP is significant has been explained by the increased openness in terms of imports and exports of selected countries and their presence in a number of trade and customs agreements,

Table 4: Panel Least Squares

Dependent variable: FDI
Method: Panel Least Squares
Date: 06/01/14 Time: 18:25
Sample: 1994 : 2012
Periods included: 19
Cross-sections included: 6
Total panel (balanced) observations: 114

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.163981	0.198753	-0.825048	0.4111
GDP	0.050375	0.004176	12.06242	0.0000
_GG	0.001017	0.007089	0.143462	0.8862
_TRA	0.002437	0.002154	1.131401	0.2604
_CPI	-0.001207	0.003112	-0.387750	0.6990

R-squared	0.591489	Mean dependent var	0.750038
Adjusted R-squared	0.576498	S.D. dependent var	1.084160
S.E. of regression	0.705539	Akaike info criterion	2.183159
Sum squared resid	54.25859	Schwarz criterion	2.303168
Log likelihood	-119.4401	Hannan-Quinn criter.	2.231864
F-statistic	39.45570	Durbin-Watson stat	0.840969
Prob (F-statistic)	0.000000		

Source: Authors
Note: ***, **, and * represent statistical significance at the 1%, 5%, and 10% level, respectively.

Table 5: Unit Root tests for variables _GG, _CPI, GDP, FDI, _TRA

Null Hypothesis: Unit root (individual unit root process)
Sample: 1994 : 2012
Exogenous variables: Individual effects
User specified lags at: 1
Total number of observations: 114
Cross-sections included: 6

_GG (Growth rate of gross domestic product)

Method	Statistic	Prob.**	Cross-Sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-4.73131	0.0000	6	102
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-3.60898	0.0002	6	102
ADF – Fisher Chi-square	34.7411	0.0005	6	102
PP – Fisher Chi-square	43.2670	0.0000	6	108

_CPI (Consumer Price Index)

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	21.4905	1.0000	6	102
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-2.63585	0.0042	6	102
ADF – Fisher Chi-square	27.5607	0.0064	6	102
PP – Fisher Chi-square	548.104	0.0000	6	108

GDP (Gross domestic product)

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-0.04977	0.4802	6	102
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	2.23199	0.9872	6	102
ADF – Fisher Chi-square	2.47456	0.9983	6	102
PP – Fisher Chi-square	2.25818	0.9989	6	108

FDI (Foreign Direct Investment)

Method	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-0.82796	0.2038	6	102
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-0.27968	0.3899	6	102
ADF – Fisher Chi-square	11.8911	0.4545	6	102
PP – Fisher Chi-square	10.5184	0.5706	6	108

_TRA (Share of Trade in GDP)

Method	Statistic	Prob.**	sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t*	-1.55991	0.0594	6	102
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-0.63401	0.2630	6	102
ADF – Fisher Chi-square	12.4084	0.4135	6	102
PP – Fisher Chi-square	11.7335	0.4673	6	108

Source: Authors
Note: ***, **, and * represent statistical significance at the 1%, 5%, and 10% level, respectively.

such as the EU, CEFTA, EFTA, etc. Regarding the growth rate of gross domestic product or _GG and inflation rate _ CPI, we can say that they are insignificant, or that they do not have a significant impact on FDI inflows. Their value is above the threshold of 5%. If a high value of the growth rate of gross domestic product that exceeds the determined amount of 5% was observed, which indicates that it is insignificant, it means that it does not affect the inflow of FDI. This is explained by the fact that the observed countries in the analyzed period had for the most part a low rate of growth, which had a negative impact on FDI inflows. The rate of inflation or _CPI is also insignificant, indicating

Table 6: Fixed effects – Least Squares Dummy Variables (LSDV)

Dependent variable: FDI
Method: Panel Least Squares
Date: 06/01/14 Time: 18:58
Sample: 1994 : 2012
Periods included: 19
Cross-sections included: 6
Total panel (balanced) observations: 114

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.528534	0.224580	-2.353429	0.0205
GDP	0.056259	0.007485	7.515996	0.0000
_GG	0.003236	0.007402	0.437149	0.6629
_TRA	0.005785	0.002553	2.265475	0.0256
_CPI	-0.001283	0.003539	-0.362479	0.7177

Effects specification

Cross-section fixed (dummy variables)

R-squared	0.633517	Mean dependent var	0.750038
Adjusted R-squared	0.601802	S.D. dependent var	1.084160
S.E. of regression	0.684137	Akaike info criterion	2.162313
Sum squared resid	48.67649	Schwarz criterion	2.402331
Log likelihood	-113.2519	Hannan-Quinn criter.	2.259723
F-statistic	19.97536	Durbin-Watson stat	0.913473
Prob (F-statistic)	0.000000		

Source: Authors
Note: ***, **, and * represent statistical significance at the 1%, 5%, and 10% level, respectively.

that inflation does not affect the net inflow of FDI. This statement is identical to the previously conducted research.

On the basis of the Hausman test, we got a high statistical and low p-values of 0.0192%, which is less than 5% and we rejected the null hypothesis. Based on this information, we decided to use a fixed effect model, because we believe that it is better for assessment of the analyzed phenomenon (see Table 7).

The market for corporate control

The market for corporate control requires more or less organized market or, in the narrow sense, that it is characterized by efficiency [5, pp. 13-18] and transparency [9, pp. 650-655]. The financial market [23, p. 264] can be seen in a broad and a narrow sense. In a broader sense, it implies any market place where financial transactions are performed; in a narrow sense, it can be characterized as an organized market in which financial assets are traded.

Investor protection is defined as the first priority and as being above the national rules of the regulation (IOSCO)[3] [4, p. 11]. The level of investor protection and the financial market development are closely linked, which means that the development of regulatory institutions determines the level of protection, which is increased after every crisis faced by external owners.

A significant impulse for trading on organized markets is a fiscal treatment of securities. Previous solutions on the markets in the Balkan region created the fiscal environment which can be considered reasonable, including comparison with successful emerging markets, whereby the same status is given to domestic and foreign investors.

Table 7: Hausman test

Correlated random effects – Hausman test
Equation: Untitled
Test: Cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	11.766089	4	0.0192

Source: Authors
Note: ***, **, and * represent statistical significance at the 1%, 5%, and 10% level, respectively.

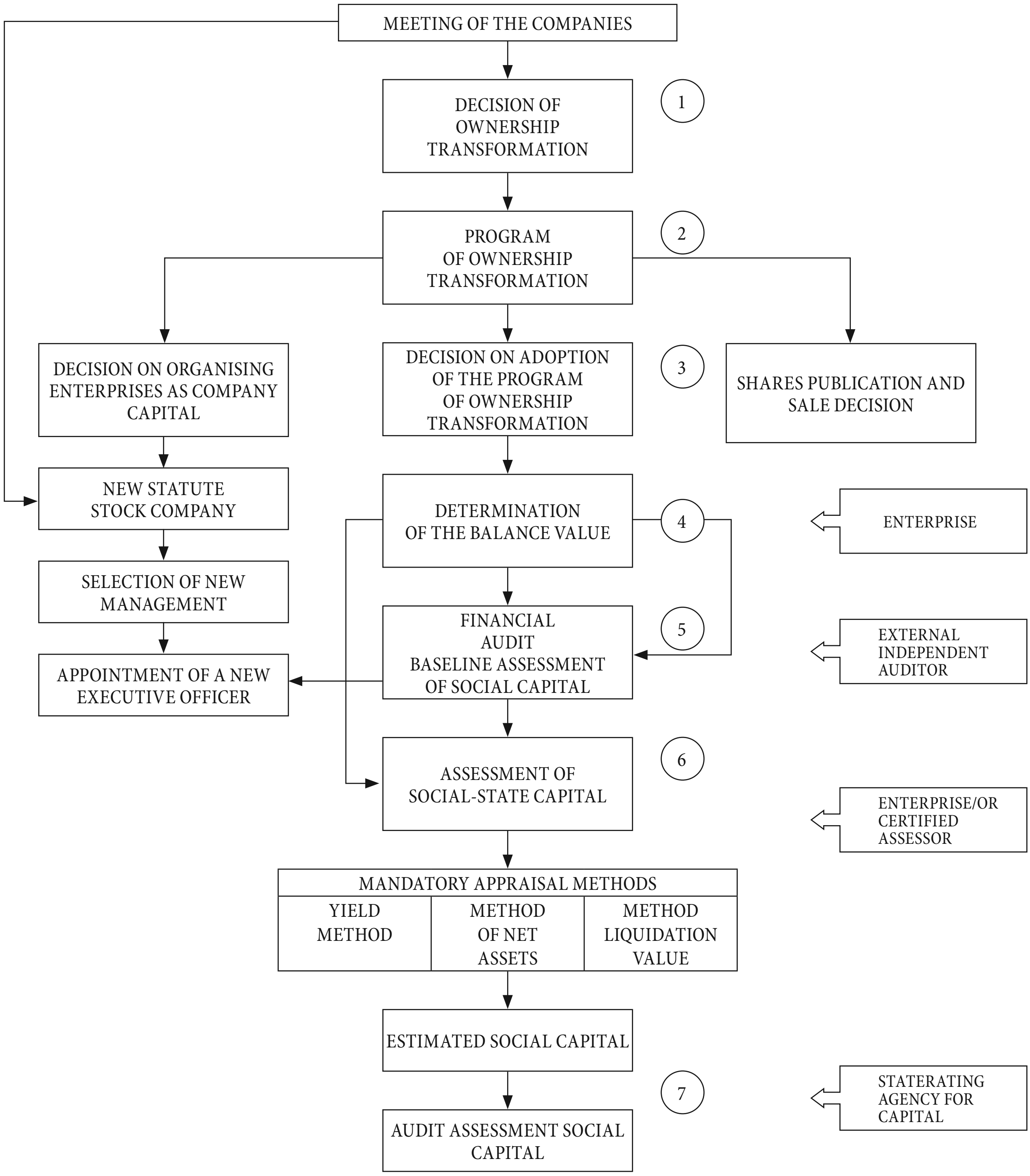
3 International Organization of Securities Commissions

Positive and high dependence degree of ownership dispersion (see Figure 1) and the level of investor protection are present in all transition economies.

Timely and accurate information disclosure of all material facts relating to the company's operations, including issues relating to financial situation, performance, ownership structure and the management of the company [2, p. 21] should be made, wherein special attention should be paid to the following material information essential for shareholders and protection of their management rights:

- The financial and operating results of the company;
- The objectives of the company;
- Data on majority shareholders and their voting rights;
- Information on the members of the management body, on key executives and their income;
- Information about foreseeable material risk factors;

Figure 1: Process chart of ownership transformation



Source: Authors

- Data on substantive issues, concerning employees and other third parties;
- Data on the management structure and business policy.

Contemporary trends of corporate governance: Lessons for the future

OECD Principles of Corporate Governance represent a framework of corporate governance which should protect shareholders' rights. Those rules are not binding but are recommended, especially in the part relating to the shareholders' rights, equal treatment of shareholders, disclosure and transparency of information, where their application is provided through statutory provisions of national legislation. In this regard, the rules and procedures on the acquisition of corporate control in the capital markets, and extraordinary transactions such as the takeover and sale of a controlling stake, should be clearly specified and made public, so that investors understand their rights and are able to protect them.

A wide circle of international organizations, bodies and associations [22, p. 310], in cooperation with transnational organizations [4, p. 13], holds annual meetings to discuss very meticulously corporate governance system and finding of ways for permanent and continuous improvement.

International organizations that are dealing with and promoting standards of corporate governance [8, pp. 17-21] are OECD, World Bank, MIGA, IFC [23, p. 45], International Chamber of Commerce, European Commission, UNIDO and UNCTAD.

They do not have a primary activity in the projects and in ensuring the elements of corporate governance. Therefore, the study of various aspects of corporate governance is in the initial stages of development, with no single international organization covering the area of corporate governance with a clear vision in all its segments.

Conclusion

The current extremely difficult economic conditions, the global economic and financial crisis, financial illiquidity, declines in economic activity and consequent decrease in the collection of value added tax and other public revenues have severely affected the regular functioning of the public sector. Therefore, it is necessary to intensify the efforts aimed at introduction of the institution of internal audit in the public sector in order to ensure rigorous control of public spending and streamlining of the public administration, thus contributing to a faster reduction of the budget deficit. Preserving the integrity of the market is imperative for all participants, institutions, capital markets, economy, various occupations and professions.

During the transition period, GDP per capita in the Western Balkans countries was low, but in the early 2000s there was a significant increase due to the inflow of FDI, which together with the process of transition and privatization played a critical role. These processes are not taking place equally well in all countries (3, 4, 5). In particular, this process is delayed in Bosnia and Serbia [24, p. 61]. First of all, this is the result of a policy of openness and liberalization of economies of those countries. In particular, this effect was enhanced at the moment when the majority of countries signed an agreement on accession and candidate status. Besides this, these countries became members of the trade agreements, such as CEFTA, EFTA, etc. All this resulted in increased inflow of FDI.

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