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ESTIMATING THE BILATERAL FOREIGN DIRECT INVESTMENT FLOWS IN TRANSITION ECONOMIES

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ABSTRACT

The paper employs a gravity model augmented with institutional related factors to study the determinants of bilateral FDI flows between South East European Countries (SEE-5) and Central East European Countries (CEE-10) on one hand, and European Union Countries (EU-14) on the other hand, on a yearly time span 1994-2010. The study applies different linear estimation technique like GLS and non-linear estimation techniques, like Random Effect Tobit and Poisson-Pseudo Maximum Likelihood. The findings of the paper suggest that the bilateral flow of FDI between countries is determined by market size factors of both host and source countries and transaction cost factors between countries, as well as by the institutional performance of host countries.

KEYWORDS

FOREIGN DIRECT INVESTMENT, TRANSITION COUNTRIES, PANEL ECONOMETRICS, GRAVITY MODEL

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1. INTRODUCTION

Foreign Direct Investments (FDI) are considered as the main source of foreign capital for transition economies of South East European Countries (SEECs) and New European Member States (EU-NMS), (UNCTAD, 2013). This development occurred with the process of transition from socialism to capitalism and the integration of the economies of SEECs and EU-NMS into the international economic structures through trade and capital flows. (Dauti, 2015a, 2015b; Buch *et al*, 2003). Moreover, FDI in transition economies of SEECs and EU-NMS can accelerate growth, institutional reforms, technological developments and infrastructure reforms, in addition to providing capital account relief (Damijan *et al*, 2002; Bevan and Estrin, 2004).

The aim of this paper is using panel data on bilateral FDI flows from individual developed source economies to transition developing host economies between 1994 and 2010, to analyse empirically the

determinants of inward FDI flows to host economies ofSEEC-5[1] and EU-NMS-10[2], by focusing on market size, transaction cost and government policies as the determinants of FDI. Therefore, the empirical strategy of the paper will be focused on advantages of location FDI, denoted by market size factors of source and host countries and ownership and internalization advantages of FDI, denoted by distance, host country institutional factors, and transition progress (Dunning, 2007). These FDI flows are mainly coming from continental Europe and therefore several major global economies like the USA and Japan are under-represented in this study. Hence, EU-14 countries[3] will be considered as the main source countries of FDI due to their main importance in terms of FDI in the SEE and CEE regions.

The empirical approach follows the models of Buch *et al* (2004) and Bevan and Estrin (2004), which are based on the theoretical models of Helpman (1984), which largely explains FDI flows by factor endowment considerations (including institutions and by viewing FDI flows, as determined by gravity factors, like market size factors represented by Gross Domestic Product (GDPs) of source and host countries and transaction factors represented by country distances). Hence, the basic gravity model of FDI, in this study, is augmented by considering also host country institutional related factors and transition progress. Based on this, the study draws on policy recommendations for promoting FDI inflows in the host countries. This study will enrich the empirical literature on FDI determinants, using bilateral data at country level, by considering also institutional and transition-related factors as crucial ones that largely determine the size of FDI inflow into transition economies. Moreover, the empirical study finds that FDI between the developed EU-14 countries and the transitional SEE-5 and EU-NMS-10 countries is determined by gravity factors, host country institutional factors, and transition progress.

The paper is organized as follows. The next section presents the theoretical background of the gravity model applied to studies of FDI flows. The following section presents the methodology and the empirical model and describes data used. The subsequent section presents the results obtained by estimating the augmented gravity model. The last section summarizes the results and concludes.

2. THEORETICAL BACKGROUND OF THE GRAVITY MODEL APPLIED TO FDI STUDIES

In the last two decades, gravity model analysis has been widely used in empirical studies of trade flows and foreign direct investments (Eichengreen and Irwin, 1998). The model is based on Newton's law of universal gravitation. The law states that all objects attract each other with a force of gravitational attraction. This force of gravitational attraction is directly dependent upon the masses of both objects and is inversely proportional to the square of the distance, which separates their centres. In economic terms, with respect to foreign investments, this model means that investment flows between two countries (gravitational attraction) is determined by the countries' GDPs (their masses) and inversely related to the distance between the two countries (generally their capital cities). A simple version of the gravity model is typically specified as:

$$f_{ij} = a\frac{y_i y_j}{d_{ij}} \quad (1)$$

where f_{ij} stands for the value of FDI from country i to country j, the y_i and y_j are the respective national income values of country i and j, d_{ij} is a measure of distance between them. Distance can be taken as a

[1]Albania, Bosnia and Herzegovina, Croatia, North Macedonia and Serbia
[2]Bulgaria, Romania, Slovenia, Slovak Republic, Czech Republic, Hungary, Poland, Latvia, Lithuania and Estonia
[3]Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherland, Portugal, Spain, Sweden, and United Kingdom

measure of the transaction and physical costs of foreign investments. These costs generally include: the transportation and communication costs, the cost of language and cultural barriers, the cost of movement of personnel, as well as the information costs of institutional and legal factors, like local property rights, domestic regulations and tax systems, which are assumed to increase with distance (Bevan and Estrin, 2004). Besides physical distance, the extended gravity model applied in this study identifies the flows of FDI from the core 14 EU investing countries to 5 SEE countries and 10 EU New Member States (NMS). This analysis can be explained by the supply side of investing partners, demand conditions of host countries, and other economic factors (such as institutional factors), which can either assist or resist the movements of investment flows.

3. METHODOLOGY, EMPIRICAL APPROACH AND DATA

In line with theoretical framework of FDI determinants, we consider the role of geography in explaining FDI pattern among SEE and CEE countries and other policy factors either resisting or promoting FDI by using the conceptual framework of the gravity model. To capture the geographical relevance in explaining FDI patterns among SEE and CEE countries, we will consider distance as a proximity determinant of FDI, including regional grouping dummy variables, like World Trade Organization membership and bilateral FDI agreement. These integration variables are included in the model to consider the competitive advantage of host countries by gaining economies of scale and reducing investment barriers between SEE countries and CEE member states. The explanatory variables denoting market size, such as GDP for both home and host countries are included in the model to measure the effect of economic size on FDI flows. This perception is derived from the eclectic paradigm theory of FDI to consider the motivations of FDI either efficiency or market seeking (Dunning *et al*, 2001). Other institutions-related determinants, such as corruption perception index, world governance indicators on control of corruption, regulatory quality, government effectiveness, rule of law, political risk, and voice and accountability, are in the model in line with the perceptions of efficiency seeking considerations of FDI. The variable of schooling is considered in the model to account for host country human capital development and resource-seeking considerations of FDI. To explain the pattern and effects of inflows of FDI to SEECs and new member states of CEECs, each explanatory variable is considered independently. The reduced form of the model including related selected variables is given below:

$$lnfdi_{ij,t} = \alpha_{ij} + \mu_t + \beta_0 lngdp_{i,t-1} + \beta_1 lngdp_{j,t-1} + \beta_2 ln|gdpc_{i,t-1} - gdpc_{j,t-1}| + \beta_3 lnx_{jt} + \beta_4 lnfdi_{ij,t-1} \times lny_{jt} + \gamma + \delta + \varepsilon_{ij,t} \quad (2)$$

Where fdi_{ijt} is a bilateral gross FDI inflows from source country *i* to host country *j* at time *t*, in millions of US dollars. gdp_{ijt-1} represents market size variables denoting the gross domestic product, in millions of US dollar in source and host country, respectively. Both variables are lagged by 1-time period, in order to control for endogeneity problems between FDI and GDP. We use the absolute difference of GDP per capita variable between source country and host country at time *t* *dif* $\left|gdpc_{it-1} - gdpc_{jt-1}\right|$ as measures of income. The absolute difference of GDP per capita, between source and host country, will allow us to control for serial correlation between GDP and GDP per capita variable (Greene, 2013). The country-pair specific effects, a_{ij} captures all the time invariant factors, such as distance, common land border, common language etc, while u_t is a time dummy, γ is host country dummy and δ is source country dummy, x_{jt} represent the vector of host country explanatory variables and y_{jt} stands for host country institutional related variables interacted with lagged dependent variable. The interaction terms are lagged by 1 period to avoid possible endogeneity concerns. ε_{ijt} is the standard error term.

3.1 EMPIRICAL MODEL

Following the work of Altomonte (1998), Bevan and Estrin (2004), Boss and De Lar (2006) Johnson (2006) and Mateev (2008) applied to OLI framework, we employ the gravity model for explaining FDI patterns, among countries that have invested in the SEE-5 countries and EU-NMS-10. For estimation purposes, the extended gravity equation for FDI inflows in SEE and CEE countries is specified in the equation (3):

$$\begin{aligned} lnfdi_{ij,t} = {} & \alpha_{ij} + \mu_t + \beta_0 lngdp_{i,t-1} + \beta_1 lngdp_{j,t-1} + \beta_2 lnd_{ij} + \beta_3 ln|gdpc_{i,t-1} - gdpc_{j,t-1}| \\ & + \beta_4 smctry_{ij} + \beta_5 wto_{jt} + \beta_6 bfdia_{jt} + \beta_7 lnop_{jt-1} + \beta_8 lnbex_{ij,t-1} + \beta_9 lnsch_{jt} \\ & + \beta_{10} lntrans_{jt} + \beta_{11} lncpi_{jt} + \beta_{12} lnfdi_{ij,t-1} \times lncc_{jt} + \beta_{13} lnfdi_{ij,t-1} \times lnrq_{jt} \\ & + \beta_{14} lnfdi_{ij,t-1} \times lngov_{jt} + \beta_{15} lnfdi_{ij,t-1} \times lnrl_{jt} + \beta_{16} lnfdi_{ij,t-1} \times lnpr_{jt} \\ & + \beta_{17} lnfdi_{ij,t-1} \times lnva_{jt} + \beta_{18} seed_{ij} + \gamma + \delta + \varepsilon_{ij,t} \quad (3) \end{aligned}$$

Where *i* denotes individual source countries, *j* denotes individual SEE and CEE receipt countries; *t* denotes the years from 1994 to 2010. The empirical model assumes that bilateral FDI in SEE and CEE countries is a function of GDP, distance, language, cultural and border similarities, world trade organization membership of host economy, bilateral FDI agreement, trade openness, bilateral exports from country *j* to country *i*, schooling, transition progress, corruption perception index and world governance indicators like control of corruption, regulatory quality, government effectiveness, rule of law, political risk and voice and accountability.

3.2 DATA DESCRIPTION AND HYPOTHESIS

Along the lines of previous research, the dependent variable fdi_{ijt} is defined as the bilateral flows of FDI from source country *i* to host country *j* at time *t*. The source of this data is the OECD. In the empirical model we include the variables of gdp_{it} and gdp_{jt} sourced from UNCTAD, to consider the market size of host and source country. The empirical literature suggests positive relationship between market size factors and the size of FDI flows (Bevan and Estrin, 2004; Johnson, 2006; Mateev, 2008; Dauti, 2015a; Dauti, 2015b). The source of this data is UNCTAD. In the empirical model, we also include the variable of the absolute difference of GDP per capita between countries to capture the market size differentials between countries, as well as factor endowments differentials between countries. The empirical literature suggests both, positive and negative relationship between factor cost differentials and FDI. The positive (negative) sign of this variable may also be due to the fact that differences in wage levels are compensated (not compensated) by productivity (Bergstrand, 1985, 1989).The source of the data for this variable is UNCTAD.

The transaction cost variable in this study is represented by the distance between source and host country. The variable of distance lnd_{ijt} represents gravity factor. Distance between source and host country is expected to have a negative effect on the size of FDI flows, due to costly adoptions of goods to local preferences (Johnson, 2006) and high transportation cost (Bevan and Estrin, 2000; Resmini, 2000). The variable of distance is measured by the actual route distance from the economic centres (generally, capital cities) between source and host countries, in kilometres[4]. According to Resmini (2000), greater distance presents weaker trade ties between the FDI source country and the host country, thus providing for lower FDI flow levels. Typically, empirical studies proxy trade costs with bilateral distance.

However, a number of additional variables are also customarily used. In this regard, the model includes also additional gravity factors through dummy variables, like $smctry_{ij}$ which is a dummy variable that takes value one when two countries share a border, a language or were the same country in the past,

[4]The source of this variable is http://www,geobytes,com.

correspondingly. In all the cases, the coefficient is expected to be positive. This variable is used to capture information costs and search costs, which are probably lower for foreign investors whose business practices, competitiveness and delivery reliability are well known to one another. The source of the data for $smctry_{ij}$ is CEPII.

The variable of openness, measured by the sum of exports and imports over GDP, sourced from UNCTAD, denoted by $lnop_{ijt}$ is included in the model to account for the openness level of the SEE countries (Bos and De Laar, 2004). The variable of openness is used to capture the liberalization of trade and foreign exchange transactions. The fewer restrictions a host country imposes on trade the higher will be the FDI attracted by this country. Therefore, a positive relationship between openness and FDI flow is expected.

The variable $lbex_{ijt-1}$ is considered in the model to account for bilateral exports from host country *j* to source country *i*. This variable is lagged by one time to allow the bilateral exports the grace period before it starts affecting host country's inflow of FDI. Bilateral exports are included as explanatory variable because of the higher export propensity of foreign firms to the international market. It is expected that host country bilateral exports to encourage more FDI flows, meaning that exports will come before FDI flows. Hence, export oriented economies may be more successful in encouraging FDI flows. Therefore, it is expected positive relationship between lagged bilateral exports and FDI flows. The source of the data for $lbex_{ijt}$ is OECD.

The variable of schooling $lnsch_{jt}$ sourced from World Bank database on education, measured by tertiary school enrolment as a per cent of gross school enrolment of the host country population is included in the model to account for efficiency-seeking motives of FDI, capturing the human capital developments in the host country (Borensztein, De Gregorioand Lee, 1998). According to the research literature, there is a strong positive relationship between FDI and the level of educational attainment in the domestic economy. In line with Borensztein, De Gregorio, and Lee (1998), this variable is expected to present a positive relation to FDI flows: the more educated the workforce, the greater the incentive for investment, since a better-educated workforce yields higher returns.

We augment the gravity model by institutional related factors having regard the importance of the institutional quality with respect to promoting the country to foreign investors. We proxy for the quality of institutions in the host country through the World Bank's Worldwide Governance Indicators (WGI), which include six relevant measures, on per centile rank values, like control of corruption, regulatory quality, rule of law, government effectiveness, political risk and voice and accountability. These measures are included in the model as interaction terms with lagged dependent variable fdi_{ijt-1}. Moreover, the inclusion of one year lagged FDI flows interacted with institutional related determinants of FDI, allows us to test whether the relationship between past and current FDI differ according to quality of host country institutional system. Methodologically, the lagged dependent variable is introduced in the model to correct for serial correlation problems.

The index of control of corruption $lncc_{jt}$ captures perceptions of the extent to which elites and private interests exercise public power for private gain, including both petty and grand forms of corruption, as well as "capture" of the state. It is expected that control of corruption will be negatively associated with bilateral FDI flow. The index of regulatory quality $lnrq_{jt}$ measures perception of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. It is expected that regulatory quality index will be positively related to bilateral FDI flow. The index of rule of law $lnrl_{jt}$ measures the perceptions of the extent to which economic agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police and the courts, as well as the likelihood of crime and violence. It is expected that economic agents' confidence in host country institutional system, represented by quality of contract enforcement and property rights, will be positively related to bilateral FDI flow. The index of voice and accountability $lnva_{jt}$ captures perception of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media. The political stability index $lnps_{jt}$ captures the perception of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically – motivated violence and terrorism. The government effectiveness index $lngov_{jt}$ captures perception of the quality of public

services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation and the credibility of the government's commitment to such policies. In general, it is expected that bilateral FDI flow from source to host country will increase as the overall institutional conditions in the SEE-5 and EU-NMS-10 host countries improve. Therefore, a positive relationship between FDI and host country governance indicators is expected.

The variable $lntrans_{jt}$ is included in the model to capture the transition progress of host country institutions. Following Johnson (2006), this variable is constructed by the sum of four EBRD transition specific indexes, i.e. the indexes denoting overall infrastructure reform, banking reforms, trade and foreign exchange rate reforms and the reforms in the securities and non – bank financial institutions. It is expected that the transition progress will be positively associated to bilateral FDI flow. The source of the data for this variable is European Bank of Reconstruction and Development (EBRD).

Additionally, Transparency International Corruption Perception Index, (CPI) is included in the study to address the level of perceived corruption and to capture the investment climate in the host countries. The variable $lncpi_{jt}$ is measured by perceived corruption on a continuous scale from one to 10. In the model, we account for the effects of corruption as an institutionally related determinant. The data is collected from the Transparency International's website. The variable is expected to have a positive relationship with the FDI flow, since a higher value of the corruption index indicates a less corrupt business environment in the host country.

However, in the study there are also other institutional dummy variables included. The dummy variables, such as wto_{jt}, $bfdia_{ijt}$ are included in the model in line with the business network theory of FDI flows, to denote institutional factors affecting FDI flows into SEE countries. In this regard, wto_{jt} is included in the model to denote the membership of the receipt country of FDI into the World Trade Organization (WTO). The source of this data is the WTO database. The variable $bfdia_{ijt}$ is included in the model to denote bilateral investment treaties between country *i* and *j* at time *t.* The source of the data for bilateral investment treaties is UNCTAD.

Finally, to address the question of whether the main determinants of FDI are different across the two group of countries (SEE countries versus EU New Member States), in the estimated model, we introduce the host country dummy variable, denoted by the SEE dummy variable. This variable is included in order to differentiate between the overall potential for FDI inflows between the SEE-5 and EU-NMS-10 countries. It is expected that inflows of FDI may, to a certain extent, be independent of the above country-specific determinants and will be related to the geographic region of SEE that has been plagued by political instability and war for the important part of the time period under consideration. In addition, the SEE-5 countries have been less integrated in the regional free trade agreements and may hence be considered as less attractive locations for export platform-based FDI.

3.3 ECONOMETRIC ISSUES

The non - linear estimation techniques are considered in the study, in order to deal with the problem of zero observations in the dependent variable. Therefore, due to the presence of zero FDI flows in the FDI data matrix, we rely on the results from Poisson Pseudo Maximum Likelihood Estimation technique (PPMLE) and Random Effects Tobit (RET) estimation technique. (Santos and Silva, 2011). In this regard, to solve the problem of zero and negative observations in the dependent variable, following Eichengreen and Irwin (1998) and Wei (2000), we transform the dependent variable, by taking the logarithm of the absolute value of FDI increased by one. By this transformation, we take care of zero observations, and negative values are retained and the coefficients from an OLS regression can still be interpreted as elasticity's for large values of the dependent variable. The advantages of using PPMLE and RET is that

they deal with the problem of zero FDI flows, provide unbiased and consistent estimates in the presence of heteroscedasticity, all observations are weighted equally and the mean is always positive[5].

Additionally, due to the presence of heterogeneity in the data, which is more likely to be present in the case of transition economies, in the form of the country differences with respect to macroeconomic performances and structural country specific reforms, other specifications might be preferred for this purpose. Furthermore, simple panel estimation techniques, like fixed effects and random effects exhibit group - wise heteroscedastic, contemporaneously and serially correlated residuals, and therefore, we use the Parks - Kmenta method and Beck - Katz method. The Parks - Kmenta method performs estimation by using the Generalized Least Squares (GLS) estimation technique and applies two sequential transformations. The first transformation removes the serial correlation, while second corrects for contemporaneous correlation and heteroscedasticity (Beck and Katz, 1996). On the other hand, Beck and Katz (1996) proposed a less complex method, retaining OLS parameter estimates and replacing OLS standard errors with panel - corrected standard errors (PCSE).

4. DISCUSSION OF THE RESULTS

In all estimates, the gravity coefficients appear to show the same effect on the flow of FDI from EU-14 source countries to SEE-5 and EU-NMS-10 countries. Hence, the results are consistent with a transaction cost analysis of FDI in which FDI flows are attracted between relatively large economies, but the gains from overseas production diminish with distance from the source country. Host country GDP and source country GDP is positive and significant almost in all specifications (1-4). This suggests that the income level and the size of host country market is an important determinant for foreign investors. A negative and significant coefficient of distance indicates that FDI flows are determined by gravity factors as expected. On the other hand, the positive coefficient of host country GDP and negative coefficient of distance support the market – seeking hypothesis of FDI. Focusing on estimates from columns 1, the estimated gravity coefficients can be interpreted as follows. Source and host country GDP has a positive and significant impact on bilateral FDI, with an elasticity of 0.449 and 0.459 respectively. An increase in source and host country GDP by 10 per cent, increases bilateral FDI flow from source to host country, on average by 4.4 and 4.5 per cent, respectively. An increase in the road distance between capital cities of source and host country by 10 per cent will decrease bilateral FDI flows from source to host countries, on average, by 11.3 per cent. The variable accounting for the degree of openness of the respective SEE -5 and EU-NMS-10 countries is positive and significant in the relevant fixed effect specifications (see 1-5). This result confirms the importance of trade liberalization policies and foreign exchange transactions for the size of bilateral FDI flows into SEE-5 and EU-NMS-10, originated from EU-14 countries. Focusing on column 1, as the openness degree of host countries increases by 10 per cent, FDI into SEE-5 and EU-NMS-10, will increase, on average by 5.8 per cent, holding other variables constant. The coefficient of bilateral exports is significant and positive in almost all estimates (1-5). Focusing on column 1, this indicates that an increase of bilateral export from exporting SEE-5 and EU-NMS-10 to importing EU-14 countries, by 10 per cent improves the inflows of FDI from source EU-14 to host SEE-5 and EU-NMS-10 countries by 0.9 per cent. Hence, it is confirmed that bilateral exports come before bilateral FDI flows. In other words, foreign firms located in SEE-5 and EU-NMS-10 countries have high export propensity to their domestic markets. This result suggests that the increase of bilateral exports of host SEE-5 and EU-NMS-10 countries serves as a channel through which FDI activity in the exporting countries expand. The positive relationship between bilateral exports and bilateral FDI flow, on the other hand, confirms the complementarities between bilateral exports and bilateral FDI flows.

[5] Westerlund and Wilhelmsson, 2009; Silva and Tenreyro, 2008.

Referring to the same estimates (see column 1-3 and 5), we find significant coefficients of schooling. The estimated elasticity of schooling is 0.62 indicating that a 10 per cent increase in tertiary school enrolment will increase bilateral FDI flow, from EU-14 to SEE-5 and EU-NMS-10 countries, by 6.2 per cent. This result supports efficiency seeking considerations, that foreign investors are likely to locate their investments in countries with high potentials of efficient human resources and a well-educated labour force. Among institutional related determinants, referring to specifications 1-4, the results are showing that lagged bilateral FDI flow interacted with regulatory quality is significant and positively related to agglomeration patterns, as expected. This interaction tests whether the relationship between past and current FDI differ according to quality of host country governments policies that promote private sector developments. This is an indication that FDI decisions rely on past information of host country perceptions toward governmental abilities to formulate and implement sound policies and regulations that promote private sector developments. This means that the relationship between past and current FDI differ according to governmental regulation policies. The reason why this index is significant in lagged form may be because this index does not vary too much from year to year, and the real effect cannot be captured by this estimation. In addition, the world governance indicator denoted by control of corruption interacted with agglomeration effect of FDI, is positive and significant in almost all estimates, contrary to expectations. The results indicate that the relationship between past and current FDI depends upon perceptions of the extent to which public power is exercised for private gains as well as the capture of the state by private interest. We find that as these perceptions increase by 10 per cent, the agglomeration effect of FDI on further FDI flows from EU-14 to SEE-5 and EU-NMS - 10, increases, on average, by 2.4 per cent. In addition, contrary to expectations, higher perceived corruption in the host countries, denoted by CPI index, appears to decrease the level of FDI flow into host SEE -5 and EU-NMS-10, originated form EU-14 countries, indicating that as the business environment in the host country is perceived to be less corrupt, by the perceptions of the host country population, the size of bilateral FDI flow into host countries decreases, since higher values of CPI index are associated with less corrupted business environments. This result is confirmed in column 3 and 4. Referring to relevant a 10 per cent increase in the corruption perception index is associated with average decrease of FDI flow into host countries, by 7.8 per cent. The variable of voice and accountability interacted with the agglomeration effect of FDI, contrary to expectations, shows a negative impact on further FDI flows, indicating that as the perceptions of host country citizens for empowering the democratic processes with regard to implementing democratic standards on governments selections through free elections campaigns increases, the agglomeration effect of FDI on further FDI flows decreases (see columns 1-4).

Table 1: Results from different estimations

	(1)	(2)	(3)	(4)	(5)	(6)
VARIABLES	FE with DKSE	FGLS	PCSE	Random Effect Tobit	Poisson Random Effect	Poisson Fixed Effect
Log of GDP in source country (-1)	0.449**	0.449**	0.091**	0.136*	0.076	-0.045
	[2.61]	[2.61]	[2.46]	[1.87]	[1.27]	[-0.34]
Log of GDP in host country (-1)	0.459***	0.459***	0.570***	0.691***	0.417***	0.421***
	[3.55]	[3.55]	[12.54]	[9.83]	[7.44]	[4.27]
Log absolute difference of GDP capita (-1)	0.002	0.002	0.001	0.003	0.006	0.005
	[0.17]	[0.17]	[0.11]	[0.30]	[0.82]	[0.77]
Log of distance	-1.696***	-.696***	-.833***	-1.159***	-1.170***	
	[-4.99]	[-4.99]	[-6.51]	[-7.03]	[-6.33]	
Same country			0.086	0.027	-1.320**	
			[0.27]	[0.05]	[-2.40]	
WTO membership.	0.044	0.044	0.503***	0.165**	0.472***	0.415***
	[0.38]	[0.38]	[5.31]	[2.06]	[6.56]	[5.43]
Bilateral FDI agreement	-0.236***	-.236***	0.393***	-0.101	0.232***	0.105
	[-3.68]	[-3.68]	[4.59]	[-1.27]	[3.01]	[1.29]

Log of openness (-1)	0.585**	0.585**	0.530***	0.639***	0.160	0.225*
	[2.34]	[2.34]	[3.34]	[4.13]	[1.42]	[1.77]
Log of bilateral exports (-1)	0.090***	0.090***	0.381***	0.136***	0.053***	0.020
	[6.59]	[6.59]	[9.97]	[7.45]	[3.49]	[1.33]
Log of schooling	0.622***	0.622***	0.074	0.410***	-0.086	-0.016
	[3.69]	[3.69]	[0.96]	[3.49]	[-1.01]	[-0.17]
Log of transition progress	0.652	0.652	-.222***	0.154	1.203***	2.008***
	[1.17]	[1.17]	[-4.22]	[0.47]	[3.70]	[5.57]
Log of corruption perception index	-0.600	-0.600	-.860***	-0.788***	0.063	0.210
	[-1.60]	[-1.60]	[-3.86]	[-4.14]	[0.46]	[1.42]
Log of control of corruption * FDI (-1)	0.242***	0.242***	0.254***	0.244***	0.094	0.070
	[3.46]	[3.46]	[3.31]	[2.91]	[1.62]	[1.18]
Log of regulatory quality * FDI (-1)	0.362***	0.362***	0.278**	0.356***	-0.065	-0.073
	[3.02]	[3.02]	[2.21]	[3.35]	[-1.00]	[-1.08]
Log of government effectiveness * FDI (-1)	-0.149	-0.149	-.326***	-0.200**	-0.030	0.023
	[-1.35]	[-1.35]	[-5.09]	[-2.34]	[-0.55]	[0.40]
Log of rule of law * FDI (-1)	-0.044	-0.044	0.170*	-0.039	-0.073	-0.069
	[-0.41]	[-0.41]	[1.77]	[-0.39]	[-1.01]	[-0.93]
Log of political risk * FDI (-1)	-0.010	-0.010	-0.144**	-0.009	-0.076***	-0.072**
	[-0.12]	[-0.12]	[-2.03]	[-0.17]	[-2.65]	[-2.49]
Log of voice and accountability * FDI (-1)	-0.376***	-0.376***	-0.226	-0.330***	0.150**	0.123*
	[-3.42]	[-3.42]	[-1.62]	[-3.06]	[2.26]	[1.78]
SEE Dummy Variable	0.000		-0.110	-0.213	-0.193	
	[.]		[-1.12]	[-1.11]	0.076	
Constant	0.000		2.824*	-0.056		
	[.]		[1.75]	[-0.03]		
Observations	3,173	3,173	3,173	3,173	3,173	3,173
Number of groups	196	196	196	196	196	164
Year dummy		YES	YES	YES	YES	YES
Log – Likelihood				-5278.42	-4081.67	-3291.44
Wald Test (χ^2)				1727.29	1105.75	956.21
Prob> χ^2				0,000	0.000	0.000
Observations				3,173	3,173	2,682

Notes: Dependent variable is log bilateral FDI flow. T-statistics in brackets, ***, ** and * indicate significance of coefficients at 1, 5 and 10 per cent, respectively.

The robust fixed effect estimates are confirming that the elasticity of voice and accountability, with respect to FDI, is -0.376, indicating that as the index of voice and accountability increases, by 10 per cent, the effect of agglomeration effect on further FDI flows, decreases, on average by 3 per cent, ceteris paribus. Hence, these results indicate that the early presence of foreign investors could not prove a positive spillover effect on host country democratic processes. The results shows that a 10 per cent increase of government effectiveness index, on a per centile rank, is associated with a decrease of the agglomeration effect of FDI on further bilateral FDI flows, from source to host countries, on average by 2 per cent, ceteris paribus (see column 4). On the other hand, the results from column 3 show that rule of law coefficient interacted with lagged FDI is significant and positively associated to bilateral FDI flow. This means that as the economic agent's confidence in host country institutions increases by 10 per cent, the agglomeration effect of FDI activity on further bilateral FDI flows in host countries increases by 1.7 per cent. The variable accounting for host country transition progress is shown to be statistically significant and positively associated to bilateral FDI flow in all relevant fixed effect estimates (columns 5 and 6). This result is particularly important for SEE countries, considering the effort of host SEE country institutions for advancing their transition reforms, like overall infrastructure reform, banking reforms, trade and foreign exchange rate reforms and the reforms in the securities and non – bank financial institutions.

Focusing on PPMLE with random effects, we find that the coefficient of *same country*, indicating common border, common language or cultural similarities between source and host country at the same time, are negatively associated to bilateral FDI flow. The explanation of this result is that countries in the sample that are close to each other do not have bilateral FDI flow. The argument holds, since there is not bilateral FDI flow between close countries of SEE-5 and EU-NMS-10. Considering Tobit random effect estimates and Poisson estimates, the estimated results are significant (the likelihood-ratio test (χ^2) reported in the last row of each table is a test of the significance of the random-effect estimates and Poisson estimates).

5. CONCLUSIONS

This paper has identified significant determinants of FDI flows into the SEE-5 transition economies and 10-New Members of European Union Countries, and highlighted theimplications of different institutional factors for FDI flows. Using an augmented gravity model, we focused the research mainly on the importance of market-seeking factors, resource-seeking factors, efficiency-seeking factors and institutional factors as primary determinants of FDI in these countries. As expected, all of these determinants play an important role in determining firms' foreign market entry decision. Moreover, SEE-5 and EU-NMS-10 host country institutional-related factors appeared to significantly determine bilateral FDI flow from the EU-14 countries. Guided by the economic theory and empirical investigation, we specify static, non - linear and dynamic models. From all the estimates, we found that gravity factors, like market size of the host and source country, are an important determinant for foreign investors. Negative and significant coefficient of distance indicates that FDI is determined by gravity factors, as expected. Based on a cross-section panel data analysis we have foundthat FDI flows are significantly influenced by both gravity factors (distance, GDP) and non-gravity factors (openness, schooling, transition progress, the corruption perception index and interaction terms between governance indicators with bilateral FDI). The positive and significant coefficients of market size factors (GDP) for both source and host country indicates that FDI is determined by host and source country market seeking considerations. In addition, the positive and significant coefficients of schooling, and host country openness is a signal that foreign investors are considering efficiency - seeking considerations for positive FDI decisions. The interaction terms of institutional related variables (control of corruption, regulatory quality, government effectiveness, rule of law, voice and accountability and political risk), with agglomeration effect of FDI, however, have showed high significance. The significant coefficients of interaction terms between lagged FDI and institutional related variables indicate that further FDI decisions are depend by past information's of host country perceptions toward host country institutional progress. The economic importance of the findings of this chapter is on providing an analytical foundation for the evaluation of country policies and institutions aimed atmaking South East European Countries and New EU member states more attractive to foreign investors. In line with this finding, the chapter provides guidance on which major macroeconomic and institutional determinants of FDI a strong emphasis should be placed by policymakers in these countries.

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COMPETITIVE STRATEGIES IN THE CONTEXT OF THE OIL INDUSTRY

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ABSTRACT

Formally or informally, rationally or intuitively, oil companies are forced to adopt advance practices in order to compete equally with other companies on the market. The pressure to remain competitive in an environment with great price variation has stimulated companies' in the oil industry to ignore the conventional methods in order to explore new ways to overcome its rivals on the market. Competitive strategies are widely used throughout entire oil industry and whether one will be successful depends on the economic value one is ready to produce to gain competitive edge over its rivals. The effect of competitive strategies is relatively different for each industry and its essence is often visible in the way how managers cope with the uprising trends on the market. Thus understanding the basic structure of the oil industry and its revolving nature is de facto a fundamental step in formulating the competitive strategy.

The aim of this paper is to discuss the importance of competitive strategies in the context of the oil industry, by identifying those strategies which are crucial for oil companies' success. The primary part of the research is aimed toward reviewing the theoretical framework of the concept of strategy. The secondary part is focused on importance of competitive strategies for the oil industry and on identifying the type of competitive strategies oil companies need to apply specifically in the context of the oil industry by identifying the potential sources of competitive advantage. According to the author's findings, competitive strategies are in fact an essential component of modern oil business and without clear strategic context oil companies cannot create a value to sustain its market power.

KEYWORDS
COMPETITION; STRATEGY; COMPETITIVE STRATEGIES; COMPETITIVE ADVANTAGE; OIL INDUSTRY

JEL CLASSIFICATION
M10; Q40;

1. INTRODUCTION

Competition is the fundamental challenge of business strategy and a key determinant for the successful operation of any modern company. The subject of competition is closely incorporated in the work of history's most renowned scientists such as Adam Smith, Karl Marx, David Ricardo and Edward Chamberlin.

Nowadays, there is no industry in the world that imposes more diversified set of human, mechanical, and technological capacities than the oil industry. What is symptomatic though is that the oil industry is most often portrayed as monolithic, where in fact there is an evident variation in terms of size and roles of companies. Crude oil is the primary resource for the successful functioning of the world. It does not belong to the group of renewable energy sources hence it is very difficult to find. Thus access to oil does not only affect governments and countries around the world, but is also a crucial element for

companies itself, because it defines the basis for companies' production activities. The oil industry is grounded on the principle of competition. Competition is one of the major drivers of economic and social development in countries around the world. From ancient times, when competition played a key role in a foreign trade, to this very day, competition has been central to the functioning of global oil markets. Strong competition on the market – driven by the entry of new oil companies – and the impact of the macroeconomic factors – the variability of supply and demand and oil price fluctuations – are just some of the elements that makes the oil industry so uncertain and vulnerable to change. Thus oil companies are forced to constantly reinforce its competitive strategies in terms of securing strong competitive position on the market. The authentic character of competitive strategies is in fact the one that provides value to consumers. However, value alone is not enough for oil companies to maintain its leadership position on the market. This process is time consuming and entails not only a huge investment but also a shift in upper management priorities toward creating a more differentiated offer within the value chain. Essentially, this shift has emerged as a result of the recent projections that oil demand will continue to grow and that high oil prices will have long term impact on the overall marginal costs in terms of supply. These calculations in the oil industry are often treated as speculative due to the dynamic nature of the oil business itself.

It is necessary for oil companies to strategically differentiate those areas which are important for their economic growth. Hence, the clearer the trajectory of future competitive activities, the easier is to face upcoming challenges in real business scenario. The pressure to be competitive in an environment where there is great price variation has forced companies in the oil industry to find new ways to overcome its market rivals. The emphasized focus in the upward segment and the growth of oil reserves are just some of the elements that encourage greater competitiveness on the market. The impact of competition on oil businesses is not universal and depends on the industry itself and the legislative policy of the country. Therefore, the aim of this research paper is to identify specific strategies which will be based on the industry itself and in accordance with long-term policies of oil companies.

2. AN OVERVIEW OF THE CONCEPT OF STRATEGY

The theoretical concept of strategy is under a constant revision by the global academic community. Within the strategy and management research, no single concept has ever been prone to change as strategies are in the business. Therefore, the debate concerning the concept of strategy is quite versatile and includes rather different perception regarding this phenomenon. Forming guide lines for choosing the right strategic decisions to ensure company's competitiveness is one of the most difficult tasks in the strategic management process. When it comes to the essence of this concept, the scientific development of strategy has always been followed by different interpretations. Through a generic review of the most influential studies in the field of strategy, we have presented only those which are considered pivotal when it comes to the competitive nature of this concept. First, we have review strategy from the aspect of competition. Second, we have evaluated strategy from the context of the industry structure. Third, we have review strategy from the aspect of competitive advantage.

2.1 STRATEGY AS A MEANS FOR CONFRONTING COMPETITION

To remain relevant in today's business world, it is necessary for companies to have a clear goal and strategy that will strengthen their position in relation to other rivals on the market (Chandler, 1962). Regardless of the industry, competition is always a motivational factor for companies to advance its innovations, diversity of supply, and competitive prices for its consumers. Competition stimulates strategic action and enables clear distinction between leading companies (Ansoff, 1965). If managers do not understand the competitive landscape of their market, they cannot successfully compete in a given industry.

Therefore, the importance of strategy is primarily driven by market competition, and without market competition there is no need for strategy (Rugman and Verbeke, 1994). Thus competition and strategy are interrelated. Strategy stems from competition and the more concentrated a particular market is the more difficult is for companies' to differentiate its product attributes. According to Thompson (1982) strategy can affect both competition and market in a positive manner and stimulate further economic growth. High competition on the market reduces companies' odds to generate profit thus pushing companies to maintain its sustainability by increasing operational performance (Schmidt, 1997). According to Chen and Miller (2013) companies' interaction is a corn stone of strategy and competition and its intensity depends on the market concentration and resource profile. Hence strategy is a set of competitive activities which includes actions and consequences as a result of the interaction between market rivals (Miller and Chen, 1996). In essence, strategy lays the foundation of long-term functioning through the effective use of techniques to overcome market competition (McGahan, 1999). If strategy is not based on competition and the external environment, it will not produce the desired effect in the context of creating a competitive edge.

2.2 STRATEGY AS MEANS OF COMPLYING WITH INDUSTRY STRUCTURE

There is no universal strategy that will match the shape and structure of each industry. When defining a competitive strategy, companies must always take into account the structure of the industry and its external environment (Porter, 1980). Strategy, as the highest business act of a company, is something that is created internally within the company itself and that can be changed overtime, whereas the structure of industry is created within the system of the external environment. Industry structure is a key determinant for a company's successful performance. In essence, the structure of the industry must always be aligned with the driving forces of competition on the market. A more profound overview of the industry structure might disclose a detailed image of the industry's profitability by generating a suitable framework for predicting changes in industry's competition (McGahan and Porter, 1997). As the structure of the industry changes, companies are forced to change and adjust their strategies because their profitability is solely determined by the profitability of the industry itself (Raza *et al*., 2011).

According Roure and Keeley (1989) it is company's management, who chooses the right industry and strategy whereas structure of the industry can indirectly influence strategy as well. Depending on its complexity, a particular industry may in fact be a main driver or a repressor of company's operating processes. For instance, the crude oil industry structure has complex regulations regarding new competition on the market due to high entry barriers. Therefore, managers tend to stick with the industry type they are most familiar with by inheriting specific industry characteristics and choosing strategies to utilize advantage of those characteristics. Once managers evaluate the profile of competing companies, they begin to identify an appropriate strategic position through which they will build a competitive advantage (Kim and Mauborgne, 2009). Based on the applied competitive strategy, companies adjust all activities within the value chain by defining its targets and budget.

2.3 STRATEGY AS A MEANS FOR CREATING COMPETITIVE ADVANTAGE

One of the most eminent strategy scholars in the world, Michael Porter, has differently examined this conception and its applicable nature. According to Porter (1980) competitive strategies reflect companies' differentiating characteristics through the selection of different actions aimed toward realization of a unique combination of values. In a nutshell, companies can improve its business operations by either applying the low cost or differentiation strategy. Porter (1980) emphasized that every industry has a distinctive structure, which actually shapes the character of the competitive interaction that develops among companies over time. Through adequate implementation of competitive strategies, certain companies can more easily define their position relative to the competition, which essentially leads to the creation of sustainable competitive advantage (Pisano and Hitt, 2012).

Competitive advantage is acquired when the company possesses unique attributes that will enable to outperform its competitors (Wang, 2014). In other words, competitive advantage reflects the difference between the values created by the company versus value created by competitors. A company with a competitive advantage is able to create higher economic value for its shareholders, customers, and suppliers than its competitors (Porter, 1987). As concluded by Hunt (2000), a company's superior financial performance can solely be achieved by sustaining a strong competitive advantage on the market. However, the company strives to maintain its competitive advantage through continual innovation in production processes, product characteristics and trade methods.

Overall, competitive advantage is the basic principle of competitive strategies and its only relevant driver of generating above average profitability (Porter, 1991). To succeed in attaining its goals, companies must perform better than its rivals and identify a competitive advantage that distinguishes the business from its competitors. In order to show the difference between companies, Barney (1991) studied the relationship between company's internal resources and sustained competitive advantage, based on four empirical indicators: value, rareness, imitability and substitutability. These indicators reveal how heterogonous and immobile companies' resources are and to what extent they are useful for creating sustainable competitive advantage. As other scholars confirmed, it is more effective when companies use its internal resource base to overcome external opportunities and challenges (Wernerfelt, 1984; Prahalad and Hamel; 1990). Thus companies will be able to better understand their strengths in terms of allocation of resources by using its internal capacity as a competitive advantage.

3. THE IMPORTANCE OF COMPETITIVE STRATEGIES FOR THE OIL INDUSTRY

The importance of competitive strategies for the oil industry is caused by the fact that oil companies operate in an environment of deterministic chaos hence it has become necessary to adapt to challenges produced by the environment. Crude oil is a homogenous product and as such differs in quality and price. In order to generate bigger income, oil companies need to distinguish their products and services different than the competition. Hence competitive strategies can assist oil companies to better comprehend and analyze the competitive environment by identifying new areas for competitive growth. The structure of the crude oil market consists of three leading segments: upstream (exploration and production); midstream (transportation and storage); and downstream (refining, distribution and marketing).

From the value chain perspective, there are a number of oil companies that participate only in one segment (upstream) while there are integrated oil companies which are involved within the entire value chain operations (upstream, midstream, downstream) of the business. In that regard, the competitive strategies in the oil industry, having in mind the structure of the industry itself, are more related with those operational activities which consist the oil industry value chain. The intensity of competitive activities depends on the relevance of the segment and how attractive is for oil companies. Highly profitable oil companies are precisely those who know how to look ahead and identify key areas for building and sustaining competitive advantage.

3.1 TYPES OF COMPETITIVE STRATEGIES IN THE OIL INDUSTRY

There are number of competitive strategies that are characteristic for the oil industry and which oil companies use them as a basis for creating competitive advantage. An important element in the formulation of competitive strategies is of course the structure of the industry and the specific segments that affect the profitability of the industry itself. According to the study performed by Singh (2010) there are two types of strategies which are common for the oil industry. The non-differentiating strategies - which are the most common industry wide strategies – and differentiating strategies – which are only applicable for certain oil companies.

Table 1: Competitive strategies in the oil industry

1. Non-differentiating	2. Differentiating
Portfolio management	*Asset based differentiation*
Operational efficiency	*Enhanced oil recovery*
Financial management	*Development of hard-to-produce reserves*
Sustainability	*Evolved sustainability strategies*

Source: Singh (2010)

3.1.1 Non-differentiating strategies in the oil industry

3.1.1.1 *Portfolio management*

The *Portfolio management* strategies refer to the balanced portfolio of assets related to the diversity of geological and geographical risks. Each successful oil company evaluates the risk of its assets so it can effectively optimize the overall performance of their property portfolio. Within the oil industry, the essence of the portfolio management strategy lies within the diversified business unit which encompasses the portfolio of assets and projects and portfolio of technology and competences (Skaf, 1999). Hence it is important to emphasize that the production of oil reserves is what actually characterizes a particular region and what makes it competitive. Managing oil reserves is a complex process and requires knowledge and advanced geological expertise. There are a number of geological sites that provide an appropriate combination of reserve capacity, which manifest the equilibrium and the duration of the return on investment. Given that the oil industry managing economy is slowly beginning to shift its focus – from cost reduction to adopting new type of asset management practices – portfolio optimization is another effective way to analyze and enhance the overall value of assets (Adams *et al*., 2001).

3.1.1.2 Operational efficiency

The *Operational efficiency* strategies are closely related to implementing a cost effective strategies and cost coordination in terms of finding new oil fields and maintaining production levels by controlling operating costs. In practice, operational efficiency measures the generated profit as a function of operating cost. The higher the operational efficiency, the more profitable a company or an investment is. Operational efficiency strategies allow oil companies to prove that they are capable of managing their assets in a way that is reliable, sustainable and profitable. Key activities that stimulate the operational efficiency of oil companies are related to adequate interpretation of seismic data, dynamic management of oil reservoirs by extending their lifespan, as well as effective production optimization by consolidating operational databases. Operational efficiency allows oil companies to save much of their operating profit. Given that in the last decade, the cost of extracting oil has rose significantly has put even more pressure on how to remain profitable in a situation when oil prices are falling and costs are rising (Eller *et al.,* 2011). Therefore, it is necessary to establish a balance between optimizing existing assets and developing new assets. If oil companies fail to improve the level of operational efficiency and economy, they can have a negative effect on future long-term growth.

3.1.1.3 Financial management

The *Financial management* strategies include the financial flexibility achieved by maximizing revenues and cash flows while controlling costs, sustainable capital expenditures, business growth and high shareholder return, expressed in dividends and repurchasing stocks. It is important to note that the amount of revenue and net profit of oil companies is primarily conditioned by global prices of consumer goods. Oil

corporations, on the other hand, are forced to postpone further exploration and extraction when oil prices fall due to weak demand or overproduction, in order to avoid negative cash inflows (Agostinho and Weijermars, 2017). These variables are constantly fluctuating and are mainly drive by factors whose nature is uncontrollable, such as global supply and demand, political stability, market forces and government market regulations. What determines the level of future investments in the oil industry is mainly conditioned by the future expected profitability. Since profitability and production are highly correlated, the investment outlook is also improving due to a higher oil prices. Over the past year, investments within the upstream segment has declined significantly whereas the same trend is expected to continue in 2021, demand for oil is expected to increase in the near future. Reduced investments and supply could cause market volatility and rising oil prices, which could further jeopardize energy stability and international politics.

3.1.1.4 Sustainability

The *Sustainability* strategies support the paradigm associated with corporate social responsibility. In that context, some of the corporate social responsibility strategies in the oil industry include the following elements: a) Employee strategies which are related with the quality of life, safety and diversity; b) Climate change strategies which are aimed at reducing the greenhouse gas emissions carbon storage and improving process energy efficiency; c) Environmental strategies whose goal is replace the fossil fuels with different sources of renewable energy thus reducing the impact on air, water, and soil quality. Key principles for environmental sustainability are most often associated with maintaining a healthy natural environment by increasing awareness for more responsible environmental behavior (Anis and Siddiqui, 2015). In order to do so, it is vital to design more advanced models of oil production and consumption and a full transition toward green economy in order to sustain a clean energy with a decreased level of carbon oxide thus mitigating climate change.

3.1.2 Differentiating strategies in the oil industry

3.1.2.1 Asset based differentiation

The *Asset based differentiation* strategy is widely used in the oil industry. It is an essential element of structural empiricism due to the fact that oil companies are forced to differentiate their products in order to avoid destructive competition. Differentiation emphasizes the authenticity of the product while authenticity is the basis for creating competitive advantage. The number of crude oil grades traded on the international market has increased significantly in recent years due to the strong desire to differ sources. Although the prices of these different grades move along on the market, it is important to emphasize two different characteristics (Bacon and Tordo, 2005). First, the price differentials among different crude oils are quite large. The price of crude oil (wholesale and retail) is not the same everywhere and it differs primarily in terms of price and quality. The higher the quality, the higher the price. Second, the size of the differentials between given grades appears to increase along with the rise of the general price of crude oil. In addition, oil companies can differentiate their products based on physical attributes, such as innovation, consistency, durability and reliability. This type of differentiation is more present in the downward segment, especially within the gasoline market, where consumers can make a clear distinction when choosing the right retailer.

3.1.2.2 Enhanced oil recovery

The *Enhanced oil recovery* strategy is equally important for creating a distinctive position in the oil industry. The amount of crude oil concentrated in a particular area is always uncertain. In pursuing fossil and non – conventional energy sources, oil companies are obliged to simultaneously utilize as much oil as

possible from the existing energy sources. By effectively applying this strategy, oil companies can identify themselves as leaders in technology by stimulating production from mature oil fields. But what is important for oil companies is certainly the percentage of oil that can be recovered (produced). Adequate application of the enhanced oil recovery method can result in 30% to 60% more oil than the estimated tank volume, compared to 20% and 40% when using primary or secondary techniques. The process of crude oil recovery is influenced either by the producers of crude oil or as a reaction of nature itself. Recent improvements in technology and the current economic climate indicate that the future growth of the enhanced oil recovery will depend on the degree of innovation in the drilling segment, the cost of crude oil, including capital and human resources, which are essential to the success of enhanced oil recovery strategy.

3.1.2.3 Development of hard-to-produce reserves

The strategy of *Developing – hard – to – produce reserves* is one of the most challenging strategies oil companies face today. Large conventional fields are gradually being emptied and entering a phase of decline. As the rate of oil reserves decreases, the world oil demand increases. These events are forcing oil companies to start developing more complex fields which impose the application of more advanced technology for the production of hydrocarbons and refining. The process of developing hard renewable assets includes the following characteristics: low oil recovery factors in a situation where conventional technology is used for the development of oil fields; high financial costs for new labor force; high reservoir temperature (1000 degrees Celsius); reserves that can be located in a surface deeper than 4 km; presence of high viscosity oil in oil basins; and the need to use non-traditional technologies with specially designed equipment. Many of the reserves that are extracted from unconventional sources belong to the group of hard-to-produce reserves (bituminous oil, shale oil, gas hydrate etc.). Through this strategy, oil companies actually demonstrate their distinctive position on the market by consciously focus on the exploration of unconventional sources which are crucial for the global oil industry.

3.1.2.4 Evolved sustainability

The *Evolved sustainability* strategy represents the sustainability of human existence through the careful balance of economic, social and environmental capital. The main goal of this strategy is to meet the oil needs of the global society at moderate cost, safely, and with minimal impact on the environment, until adequate alternative energy sources are available. In past years, oil companies have integrated sustainability as an important segment of their governance policies and continue to create programs based on the principles of ethics, human health and safety. Hence it is essential for oil companies to implement a change in the overall management paradigm, which in turn indicates the need for systemic solutions to the problem of sustainability. On this way, oil companies will change the current image they project as conglomerates, concerned only with revenue growth and profits, while ignoring the importance of the concept of ecological and sustainable development.

3.2 SOURCES OF COMPETITIVE ADVANTAGE IN THE OIL INDUSTRY

Building a competitive advantage within the commodity industry such as the crude oil is rather a complex task for managers worldwide. The global oil industry is composed of a set of key parameters within which oil companies can build a competitive advantage. The relevance of these parameters solely depends on those specific areas that are considered as a leading driver of long term profitability. Competitive advantage must be something sustainable, something that will enable oil companies to survive on a long run. How oil companies will position within the value chain is crucial when building a competitive advantage. Identifying the sources of competitive advantage in the oil industry is extremely important for both scientists and practitioners. Thus there are three crucial areas where oil companies can create

sustainable competitive advantage: technology and innovation; costs and production growth; alternative energy sources.

3.2.1 Technology and innovation

Technology is one of the key drivers of competitive advantage in the oil industry. The reason why the importance of technology in the energy world is increasingly emphasized is primarily due to the growing deregulation of the market, globalization and rapid technological processes. In the oil industry, technology is not only a key factor in differentiation, but it also improves the economy of business performance. Hence competitive companies in the oil industry define access to technology itself as a source of competitive advantage. The more effective the technology of an oil company, the greater its competitive advantage. However, the process of adapting to new technology is considered risky because of the high cost and the variable final results. The financial return on technology investment can be huge, both for oil companies and for nation's energy security. Development and application of advanced technology is vital for today's oil industry especially in the context of discovery and development of oil resources. Oil tanks are covered with thick layer of stone, which further complicates the visibility of the quantity of deposits located underground. But advances in three-dimensional (3D) seismic studies have made it possible for oil companies to develop accurate models that measure the depth and size of underground capacities. New technology improves the economy for developing large offshore oil deposits. Drilling oil at great depths significantly enhances the complexity, costs, and potential risks of carrying out the entire process. Recent technological innovations have enabled oil companies to meet these challenges by introducing the horizontal method of drilling and hydraulic fracturing thus enabling oil companies to build competitive advantage by exploiting unconventional resources (shale oil) which many considered redundant in terms of profit. Rapid digitalization and automation of processes has changed the course of information technology in the oil industry enabling companies to manage large data and drive efficiency in order to decrease carbon emissions. As the energy industry reshapes, technology and innovation will be crucial for oil companies to meet demand with less impact on the environment.

3.2.2 Costs and production growth

In the oil industry, each company who manages to extract a sufficient amount of oil reserves while maintaining low operating costs is considered to have competitive advantage. Nowadays, the cost reduction strategy is being used as core strategy by oil companies worldwide. This occurs as a consequence of the global economic recession which positions costs as pivotal for long-term sustainability. In order for oil companies to produce affordable oil products, they are obliged to carefully manage their costs within various projects, by optimizing their portfolio in a cost effective way. Oil companies can maintain a competitive edge over its rivals through sound investment flow and planned production which will be aligned with the global demand. When oil prices sharply declined as a consequence of COVID – 19 pandemics, increased production has actually proved contra productive because oil companies were unable to neither store it nor sell it at appropriate prices. When oil extraction costs rise, oil companies prefer higher crude oil prices in order to make profit. Otherwise, when extraction and production costs are rising and crude oil prices are declining, oil companies will lose money or struggle to break even. These unpredictable price shocks are always followed by excess supply and profit decline. In order to remain competitive, it is important for oil companies to cut costs in a way that will not harm its current production and will boost the rate of economic recovery.

3.2.3 Alternative energy sources

The future of the global energy industry lies within the alternative energy sources. They are vital for the future successful operation of the global economy. Although projections for oil reserves are

increasing every year, it is the non-renewable capacity of crude oil that leads oil companies to invest in the development of renewable sources that are expected to be the main driving force of the new energy world. The use of alternative sources has a key role in operation of CO2 emissions that are released in large quantities in the atmosphere when using conventional fuels. Global practices in the energy industry indicate a growing trend of de-carbonization and complete transformation toward green energy economy. This means changing the strategic vision of oil companies by identifying new areas of competitive advantage. As they transit toward cleaner energy sources, oil companies are launching solar and wind projects through the special development of the state-of-the-art technology that is considered more profitable on the long run. Growing concerns about climate change makes the need for renewables even more relevant especially given the low tolerance of investors toward excessive carbon emissions. Even though, the return on oil companies' investments in alternative sources has not been satisfactory as that of oil and gas, it is necessary to maintain competitiveness in this segment due to its growing potential. In the energy sector, things are changing rapidly, and lagging behind competition also means losing market power.

4. CONCLUSION

Achieving the desired performance is one of the biggest preoccupations of managers in rapidly growing markets such as the oil industry. In attaining their goals, oil companies face a series of challenges that they need to overcome in order to keep up with the developed energy world. For oil companies, to be competitive means to be sustainable economically. In order to do so, a strong degree of competitive advantage is required for oil companies to generate profit. Therefore, it is necessary to change the generic approach to oil commercialization and emphasize the differential attributes of it.

The results of this research indicate that competition and competitive strategies have strong impact in the oil industry, which is evident throughout each stage of the value chain. Competitive strategies are the driving force of oil company's economic activities. They enable oil companies to grow and create sustainable value within different stages of the value chain. Implementation of advanced technology, cost management, and continuous innovation are the key areas for creating a distinctive market position. As a process, creating a competitive advantage in the oil industry is relatively hard, but maintaining it is even harder. That is why many oil companies fail to secure a long-term edge over its market rivals.

Given that new market trends are changing priorities in the energy sector, it is crucial for oil companies to change their focus on developing cleaner energy sources with renewable capacity. The new competitive challenge of oil companies will certainly be how to transform oil into energy. Thus development of alternative energy sources is the new competitive advantage in the oil industry. The fore coming transformation in the oil industry is expected to be slow, considering the large share of fossil fuels within the overall energy consumption. Nonetheless, the future of alternative energy sources is bright and its long-term implications are crucial in creating more competitive, healthier, and greener energy economy for nations.

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ADVANTAGE AND DISADVANTAGE OF THE NEW FRAMEWORK FOR DOING BANKING BUSINESS IN AN INFORMATION ECONOMY

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ABSTRACT

Modern technology related to products and services based on knowledge reduce the distance between clients and banks which results with focusing on offering of new electronic (online) banking products and services. Today, more and more the question is raised: At what stage each of the electronic or physical market model is more appropriate for banking operation as a function derived from the characteristics of the transaction? The Internet, the quick communication, the coordination and the collaboration help banks to cut transaction costs through virtual integration with their clients. Contemporary information and communication technology (ICT) leads towards reduction of transaction chains and separation of some of the operational activities of the banks, i.e. towards more efficient ways models of banking operation.

The paper deals with the challenges that the banking sector is faced as a consequence of the latest developments of ICT. The possibility of making numerous transactions with just one click, the facilitated access of the clients to the internet, the reckless pace and the new way of living, especially due to the Covid-19 pandemic, further accelerated the development and the implementation of electronic banking (e-banking). In this regard, the goal of the paper is to explore the new business model that banks need to apply in the contemporary banking operations as well as to point out the advantages and disadvantages of increased e-products and e-service development in the banking operation in an information economy.

KEYWORDS
E-BANKING, INFORMATION AND COMMUNICATIONS TECHNOLOGY

JEL CLASSIFICATION CODES
G210, G32, O33

1. GOALS OF THE WORK, MATERIALS AND METHODS

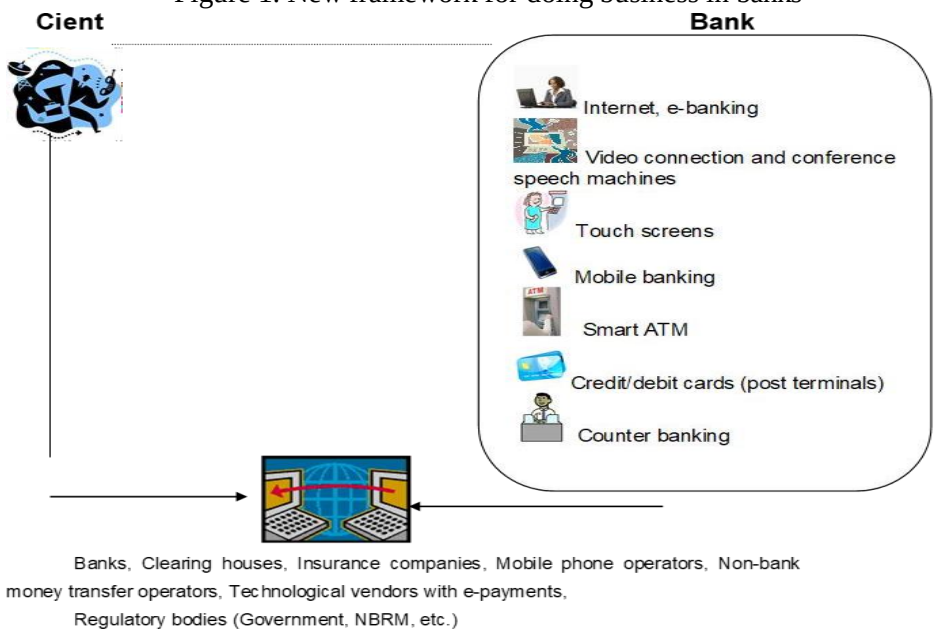
Primary goal of the paper is to demonstrate the new business model that traditional commercial banks need to apply in the contemporary banking operations, as well as positive and negative aspects of fintech products implementation. Namely, as a results of the new ICT, the new fintech products and especially due to the Covid-19 pandemic, commercial banks will prefer electronic versus physical offers of financial products and services and shall try to separate their basic business activities, i.e. utilize services from external operators. For the preparation of this paper, secondary data for analytic and field research have been used whereas surveying, inductive and deductive methods as well as analysis and synthesis methods have been applied. Internet was used as a major tool to approach data and literature. Figures and graphical methods have been employed for visual presentations during the research.

2. NEW BUSINESS MODEL IN THE BANKING SECTOR

ICT, as information-intensive, transforms the market by changing the models for commercial banks, forming links between market actors and contributing to changes in the market structure. It changes the market structure by expanding transactions and suppliers in the market, thus opening the possibility for new models of organizing services and running the business. In the presence of the activities of ATM machines, e-banking, m-banking, as a result of the change in the way the value is generated and the profit gained and with the significant modification of the service and supply chains, a new type of business banking model emerges. In the new model, the profit is not gained as before from the difference between the marginal costs of the services, i.e. the differences between the active and passive interest rates, but is gained by integrating service and supply chains. In the presence of e-banking, instead of loans, revenues are increasingly generated from indirect sources such as generating new types of financial products and their good presentation on the market. In addition to the direct economic benefits of e-banking, such as reduced costs of taking over transactions in the electronic marketplace, other indirect benefits may also arise, such as better information processing and changes in organizational form. The Internet is changing the organization, and thus the process of risk management in banking: new channels will be opened for the distribution of knowledge and human interactivity.

The assumptions of the new framework for doing business in banks presented below are: each bank has Internet access, the subject of the transaction are electronically delivered products and services, the connection will be sufficient to ensure the implementation of interactive multimedia transaction, there will be no favoritism market access and cheap and fast computerization will be available[6]. Based on these assumptions, the new banking framework will be as shown:

Figure 1. New framework for doing business in banks



Source: Summarized by the author

The new framework consists of horizontal transactions and a network of partners or vertical transactions. Horizontal transactions describe the various business processes in the global transaction chain, while vertical transactions denote the number of independent participants – a network of partners. In

[6]Material goods (statements, contracts) can also be sold online, but their delivery to the consumer requires certain transport costs.

contrast to the functional components of the traditional banking model known in the literature as brick and mortar, in the new model the client can access financial products and services with just one click, i.e. the new model will be: click-click (click- click). From the point of view of the supply chain, the new ICT transmits power from the client bank, where the next sale is just a mouse click and freely distributing a huge amont of information about prices, products and services. As can be seen from the figure 1 above, ICT changes the cost structure of the bank in terms of costs required for communication/customer support and execution of financial transactions. As a result, distance is reduced, contributing to a reduction in communication costs in two of three possible ways: by reducing the cost of remote communication methods, by reducing communication delays, but also by reducing the volume of regular face-to-face meetings in person. Reducing costs in each of the horizontal transaction processes in the model will provide visible benefits not only in terms of improving financial services but will also contribute to maximum benefits within the bank itself. Namely, the new model of full automation at all levels and processes will enable the growth of efficiency, enhancing profitability and providing services that did not previously exist.

The vertical definition of the new business model, in addition to banks, insurers and other actors in the network economy, includes regulatory and governmental bodies that will have to make strategic choices and create an appropriate environment for the development of the information society. The only thing that can increase the complexity of the new model is the number of independent participants involved in the execution of the transaction and additionally, the technological heterogeneity and technological knowledge of each of them. It is obvious that before starting to exchange information, network partners need to know the way each of them runs the business. Therefore, as Simon (1991) has emphasized, The claim that markets allow every firm to run its business with little knowledge of its partner's business is more of a fiction than a statement. The organization must redefine its scope of influence through the active cooperation of all participants in the overall transaction chain. In order to analyze the network of partners, which is actually outside the scope of this study, it is necessary to focus on management, on optimizing the connection between them, as well as on the external organizational environment.

As a result of e-banking, e-payment and their potential to reduce the costs of imperfect information, there is a significant shortening of the supply and delivery chains of financial services, which changes the organizational structure of banks and reduces the need for traditional branches. Traditionally, easy access to information is provided through intermediaries. Therefore, in the new framework, any financial product that can take digital form can easily disrupt the traditional distribution channels for such a product. Thus, in addition to banks and payment card issuers as the main agents of e-banking and e-payment, new players are emerging in the new framework. Namely, recently there emerged many non-bank money transfer operators, mobile phone operators, sellers of new e-payment technology who are trying to take over some of the value-added operations of the main agents or at least to enter into cooperative agreements with them.Lately, instead of referring customers to bank branches, they get easy and fast access to banking services through ATM's cash deposit, cash withdrawals and other types of transactions. As Wiegand and Benjamin have pointed out, over time, the e-market place will evolve from a single source of electronic sales channels through biased markets[7] to personalized markets where the consumer (customer) can use help in making a choice. Thus in the network economy, opportunities are opened for the creation of a third party, the so-called "info-intermediaries"[8] or "new market founders". The effect of market founders is a new phenomenon that is very good for consumers (customers), while suppliers (banks) lose part of their profit margin, and market founders get the rest of the profit. If the founders of the market are owners or have a significant interest in a supplier, they can turn the market in their favor and as a result, put consumers and other suppliers at a disadvantage. Given that the effects of market founders can be a threat to markets, competitive market founders are needed to prevent market distortions.

Today, the largest online payment provider, PayPal, which belongs to e-Bay, has a growing role in the online auction market. Customers have PayPal accounts with which they make e-payments. They

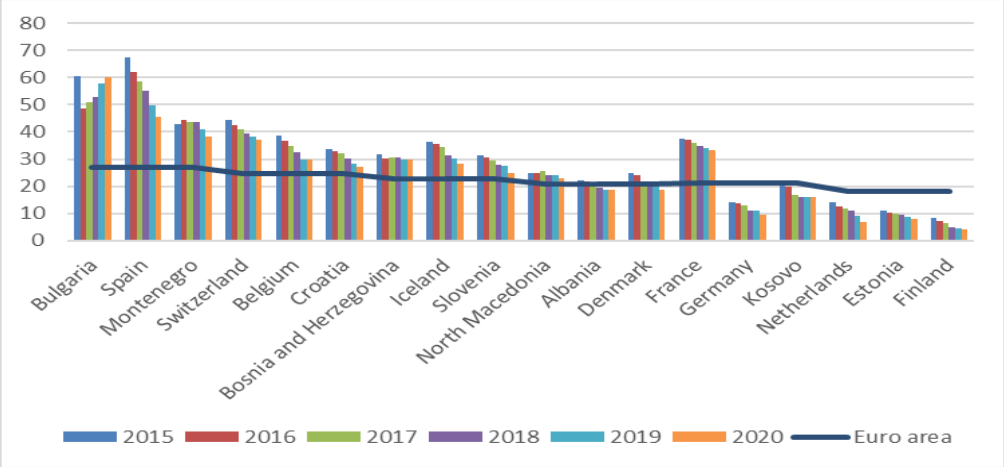
[7] Prejudice markets are markets where the founders of a market that is one of the suppliers, use the mechanisms of market transaction to their advantage.

[8]Info Intermediaries is an interactive agent who would research products that are in demand by the consumer and would take care of individuals around their privacy and secure payment.

replenish their accounts directly by transfer from bank accounts or by means of credit cards and checks. In just two years, PayPal accounts have doubled, with 143 million accounts in 190 countries (35 million of which are in Europe) (UNCTAD 2007-2008). While in 2011, more than 232 million accounts were registered, of which over 100 million were active, in 2021 PayPal operates in 202 markets and has 377 million active, registered accounts. It allows customers to send, receive, and hold funds in 25 currencies worldwide whereas from 2021 it will allow customers to use cryptocurrencies to shop at 26 million merchants on the network.[9] PayPal offers services not only to individuals (B2C markets) but also to legal entities (B2B markets). New potential players in the market are Google and especially Microsoft, with the introduction of an online micro-payment service. Additionally, large companies for telecommunications, energy, etc. are increasingly introducing their own systems for electronic payment of monthly bills for electricity, telephony, internet, television, etc. With the opening of this type of online payment portals by larger corporations, the need for over-the-counter operations and the commissions that the bank charges for this type of service are increasingly reduced. According to a research conducted at Macedonian banks, the cost for one banking transaction implemented via Internet payment (classic payment via PP30 order implemented through KIBS) varies from 5 to maximum 20 MKD whereas at least 20 up to maximum 45 MKD are needed for the same transaction implemented via the counter.

The research, coordination and monitoring costs that banks and other institutions have with the exchange of financial documents, services or ideas are increasingly reduced with the online transactions. Through cutting of transactions and processing cost, the number of branch offices required for serving the same number of clients is reduced. It is assessed that the implementation of one transaction is several times higher in a traditional branch office than the cost for the implementation of the same transaction by using the Internet.

Chart 1: Number of commercial bank branches (per 100,000 adults)



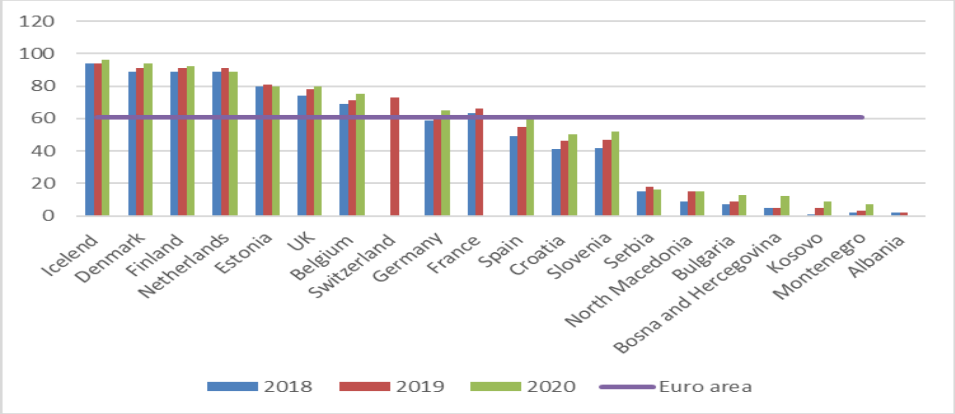
Source: World Development Indicators -http: //data.worldbank.org/indicators

The number of branches of commercial banks in Europe has been declining significantly in recent years. A slight increase was observed only in Bulgaria. Namely, according to the data of the European Central Bank in 2011, banks in Europe have closed 7,200 branches, i.e. their number has decreased by about 20,000 compared to the number before the financial crisis in 2008.(Utrinski Vesnik, 2013). This decreasing trend continue from 2015 to 2020. In an effort to reduce operating expenses and increase profits, banks are increasingly closing their branches. Easy replacement of their functions with the application of electronic, in particular Internet banking only further facilitates and encourages that process. Reduced transaction costs will lead to reduced branch visits, reduced volume of high-frequency routine transactions, i.e. the need to redesign their role or close them. The advantage of the cyber branch office over physical

[9] http://en.wikipedia.org/wiki/PayPal

branch office is the fact that it is open for 24 hours, it covers the global market and its variable costs continuously fall (UNCTAD 2007-2008). In Switzerland, UBS Bank, one of the largest global banks, in its branches, with ATMs, has installed the so-called Multimat machines with screens that allow customers to use them for transactions similar to those offered by internet banking. As a result, the employees of the branches of this bank are becoming more and more financial advisors who help the clients in making decisions about the source of the various financial instruments offered by the bank. Taking into account this and many other similar examples in practice, branches will modify their appearance and role in the future, i.e. they will look more like shops, salons, service centers that will present their new financial products and offer financial advice. Additionally, with the development of technology and its increasing application by customers, these functions of the branches will be easily replaced by new so-called video terminals.

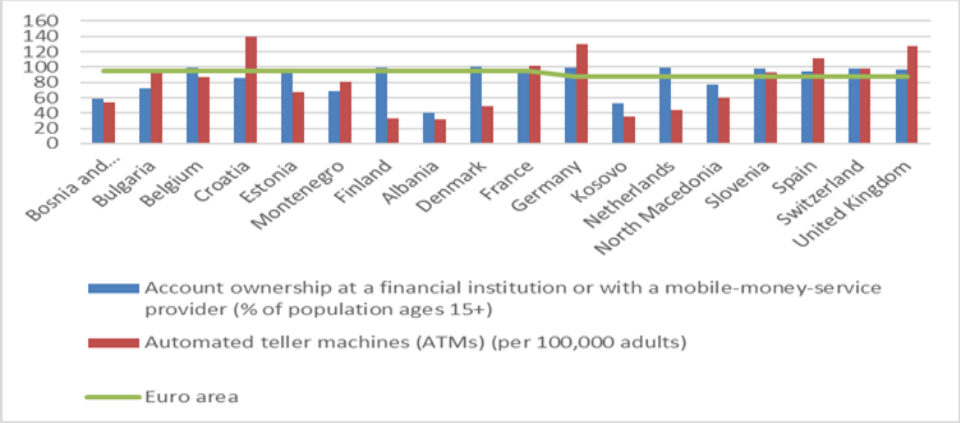
Chart 2: Individuals using Internet for internet banking (% of individuals)



Source: Eurostat

However, as statistics show, although e-banking, online or mobile payment lead to changes, they will still not eliminate the role of banks and their branches. Developing countries, especially Balkan countries are far from the average of the Euro area of 61 percent usage of the internet banking. Except for Croatia and Slovenia that are slightly better at using this category of Internet services. According to the United Nations International Telecommunication Union (ITU) nearly three billion people or 37 percent of the world's population have never used the Internet even though due to the coronavirus pandemic the number of Internet users has increased from 4.1 billion people in 2019 to 4.9 billion in 2021.

Chart 3: Using of ATMs and a mobile-money-service provider in 2017



Source: World Development Indicators -http: //data.worldbank.org/indicators

Given the growing penetration of mobile smartphones, it is very likely that they will become the main channel for the transfer of online payments, especially in those countries and regions where there are few branches and ATM networks.

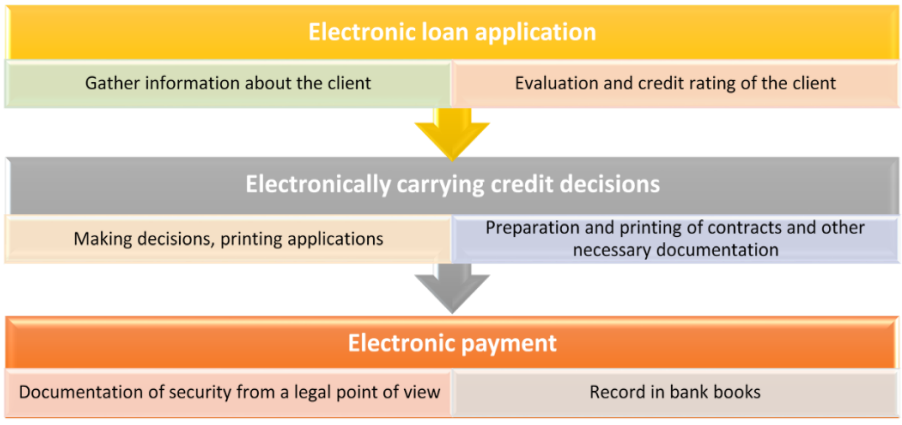
3. ELECTRONIC LENDING

Electronic lending (e-lending) or also known as web lending (CreditOnWeb) is a modular system that automates the entire lending process. It is loan or lending software that automates and manages the loan lifecycle from origination to collection. It is a holistic view of borrower transactions on a single platform, regardless of the type of loan, size of business, or industry regulations. Automation includes: collecting data and information about the client, evaluating his rating, detailed definitions of credit applications (type of loan, type of collateral), as well as monitoring the entire work process up to the approval phase. Additionally, e-lending supports activities related to disbursement of already approved credit lines and the daily obligations of monitoring, including loan refinancing, restructuring, activating, writing off already approved loans, activating collateral, as well as continuous updating of data and information. Its application is possible for all clients of the bank (population, small, medium and large corporations), where there are special modules for economic group assessment and analysis of economic sectors. The introduction of automated instruments to support the overall lending process enables easier monitoring of the life cycles of the agreed processes, as well as overcoming the operational risks from the manual activities.

Namely, the advantages of electronic lending are in the direction of:

- saving time (reducing the time required to go to the bank, preparing contracts and other documents in the lending process);
- lower operating costs and increased efficiency;
- eliminate a paper workflow, as well as minimizes error and effort when tracking and reconciling loans across enterprises and stockholders (reduction of operational risks);
- to control credit risk, better customer interaction, configure loan products, provide analytics, and create dashboards and reports
- standardization of business processes;
- greater opportunities to support and monitor increased volume and growth of lending.

Figure 2: Schematic presentation of the main e-lending activities



Source: Exprivia Spa,Italy, http://www.exprivia.it/en/media/comunicati-stampa

The new e-lending system implies the possibility for banks to evaluate their customers for all their products from a single credit application. Namely, with the help of the system, the analysis and assessment of the credit risk at the level of each client would be performed, taking into account all the products of the bank (credit cards, consumer loans, mortgage, etc.). Based on the initial application of the client and analysis of the additional amount of credit that he / she can submit, an analysis of the products that would be appropriate for the client is performed, ie the system would suggest the best instructions. The new system would set credit limits, offer products that the client could use, and make final decisions about approving or rejecting the loan application. With the introduction of an individual customer management system, which means setting pre-approval limits for each product, banks have managed to increase profitability by 9% and reduce the chances of bad placements in almost all products by more than 60% (Gordon, FICO 2012). Namely, the new electronic approach to decision-making improves the risk management process, by reducing application and processing costs and by increasing banks' profits from the influx of new customers.

Electronic lending can be easily integrated with the legal system, i.e. it has the opportunity to apply a wide range of stages of legal procedures in order to integrate the data and avoid unnecessary information and functions. Namely, there is a special software tool Acalled CONTMAN, which enables the automatic preparation of standard contracts (contracts defined by the legal service), as well as the management of texts in a working version if negotiated with the client. Also, with a special module for creating reminder messages, it is possible to enter and record some future obligations that the client has to fulfill. (www.exprivia.it)

4. ADVANTAGES AND DISADVANTAGES FROM THE DEVELOPMENT OF E-PRODUCTS AND E-SERVICES IN BANKING OPERATIONS

Today, under the pressure of digitalization, increasing financial liberalization, globalization and increasing competition, banks tend to increasingly use more sophisticated information methods and technologies, in order to reduce risks, increase efficiency, productivity and profitability in operations. New fintech products such as Internet e-banking, mobile phones-mobile banking, plastic money-plastic cards, are becoming increasingly crucial in the banking industry. The Internet penetration today is stronger than ever. According to the EU agenda, 9.2 billion Euros are expected to be invested in the key digital technologies between 2021-2027. The goal of the new investment Digital Europe Program is to ensure that all Europeans possess the skills and the necessary infrastructure to meet a full range of digital challenges. (European Commission, 2020) If we consider the global growing tendency of the Internet penetration, the application of mobile and wireless communication and uncertainties caused by Covid-19, it can be concluded that the innovative tools in banking sector are predestined for further even greater growth and development.

Technology is often seen as a mechanism for improving productivity and efficiency in banking. E-news in banking reduces transactional, ie coordination costs, intensifies and modifies traditional risks, cause changes in the organization of banking operations, as well as increase the efficiency of operations. The gains from the increased banking efficiency are followed by the qualitative improvements of the existing banking services and the creation of constantly new products. However, e-innovations in banking need to be analyzed from both sides of the equation: positive changes and new opportunities on the one hand, and challenges and dangers on the other. As a modern method of identifying customers, e-banking contributes to the erosion of economic and geographical boundaries by allowing people to communicate and do business anywhere and anytime. Namely, with the electronic transmission, the transactions are performed without movements by the clients. Therefore, by removing geographical boundaries and allowing customers to conduct transactions around time and space, e-banking significantly reduces the importance of time and contributes to huge time and cost savings. The Internet, as a means of electronic payment, reduces communication costs and expands the limits of banking capacity. It unites banks and customers all over the world, generates different pricing mechanisms, ie enables comparison of financial products and services. The Internet, leads to redistribution of resources and consequently to improved competitiveness.

With its use, financial products can be easily converted into a digitized information stream with zero transport costs.The speed and low transaction costs of e-banking and e-payment are the strongest driving force for the exponential growth of the Internet in the financial sector. Thus e-banking sè more becoming internet banking or online banking.

The advantages of the development of e-products and e-services in the banking business can be summarized primarily in: a) the possibility of presence everywhere; b) faster and greater access to new types of banking transactions; c) increasing ability to consolidate operations in financial operations and improve overall efficiency; d) drastic reduction of transaction costs; e) increased competitiveness, flexibility and responsibility to customers. E-banking has the potential to accelerate existing trends and introduce new ways of doing business, organizing work and networking in society. Lower transaction costs, network effects created by increased returns and larger economies of scale, which can be achieved through the use of e-services online.

From the point of view of the clients, the advantages from the development of ICT, especially from the appearance of online e-banking are: a) opportunity and possibility for payment from anywhere in the world; b) improved quality of services; c) personalized banking products and services; d) rapid response; e) low fees and commissions; f) new banking e-products and e-services. Namely, the advantage of electronic banking is that before the transaction is completed even in the traditional way, by posting the necessary information in an available form online, customers are a priori in a position to know which financial product they want and can use.

Today, e-banking and other fintech products takes a swings in economic terms and their potential are growing. There are a number of challenges that need to be overcome in order to take full advantage. In addition to non-proprietary standards and the open nature of electronic operations will lead towards increased transparency and competition (positive effects) will also lead and potential invasions of privacy (adverse effects). Limitations, shortcomings of e-news in banking can be identified as:

1. Overflow of information syndrome. Namely, the average users, individuals or companies, especially small and medium-sized ones, may be confused and do not know how to work and research with an obvious definite list of information services.

2. Need for certain new costs for physical installation and maintenance of the new ICT (websites, hardware, software programs). The entry fee can be quite high, not only in terms of the capital costs required to introduce the technology, but also in terms of understanding the technology, especially how to make full use of it. However, despite the fact that some websites, hardware and software programs cost thousands of millions of dollars in the markets, there are of course cheap and simpler ones that can be more easily designed and upgraded.

3. Restraint in the application of web-based strategies due to the observed "uncertainty" about the use of the Internet as a business environment and as a basis for contact. The basic business needs and goals in banking are for transactions to be private, secured, guaranteed and timely. Not all of them can be filled with online e-banking. Fintech product are sensitive to external attacks. Without adequate collateral technology in banking, incalculable financial damage (high operating risks) as well damage to its reputation (high reputation risk). Namely, a confidential document may be made public or pass into the hands of competitors. Additionally, misuse of credit cards or banking information may compromise the client, or in addition to simple theft, financial documents may be altered and illegal transactions may be conducted - high operational risks. Risk of using e-news in banking is created by providers, while insecurity claims are created by end users. Therefore, while the new ICT may drastically reduce some transactional, distribution costs, new costs associated with building trust and reducing risks will arise.

4. Internet e-banking reduces the volume of face-to-face meetings. Given that preferences for an alternative variant of the product are often explained more easily by the use of gestures and intonations than by grammatical sentences, we can really argue that e-banking has its limitations. When transactions are performed online, customers are faced with asymmetric information. With inability to physically verify the information being exchanged. By making the information in a richer electronic (digital) form, an attempt is made to overcome the problem with the asymmetry of the information. However, Internet information very often has a commercial motivation and value, thus the accuracy of such information is often questioned.

Given that at the current stage of development there is a lack of statistics that can measure the level, growth and composition of e-products and e-services in banking, it is still unclear whether fintecks is the key that will help banks simplify and improve business processes in their operations. Through capital increase, technological change leads to changes in capital and labor, to an increase in capital productivity, which in turn leads to growth and development. In the long run, the combination of new banking products, expanded market research, income gains and reduced fees and commissions as a result of increased productivity will lead to increased net profits. Namely, in the long run, every bank probably will have more advantages than disadvantages of increased volume and facilitated access to information, products and services. Banks that will be the first to be able in their strategies to implement e-innovations in banking, will also be leaders and first beneficiaries of finteck gains.

5. CONCLUSION

At the current level of development, although there are more and more network (electronic) bank branches, neobanks, it is still too early to talk about massive switching of all clients to full use of online electronic financial services, especially considering the conservative behavior and their habits to link to existing services. Although in the last decade there is increasing number of neobank as Chriss Britt (CEO of CHIME biobank) has said that they're "more like a consumer software company than a bank," i.e. they mostly make money when customers swipe their debit and credit cards in contrast to the big banks who make most of their money on fees, penalties, and loans. (Volenik, 2021) Large European banks are actively joining each other in technology groups in order to further develop security in payment systems. They have prepared plans to develop an integrated approach to the inclusion of electronic services in all their branches and affiliates. Today, banks in Europe and the United States are increasingly embracing the click and mortar model or the brick and click approach. They combine the benefits of traditional banking (face-to-face interactions) with the speed, 24/7 availability and lower costs of e-banking. However, the innovation of the click approach, ie the innovations in ICT continue to continuously transform the business banking model. Whether the traditional commercial banks will fully apply the new ICT features depends on the flexibility of the employees and the existing efforts of the bank to innovate. The first step that every bank should think of in terms of application of e-products and e-services is to contemplate and determine its position with regards to:

- The position that it has on the banking and financial market,
- Current and planned developments of the other players on the market,
- The nature of the services that it delivers compared with the services of its major competitors,
- The type and the size of risks it will be faced with and can manage during each operation,
- The type of clients it attracts and supports (especially whether or not they have an opportunity to be connected with the Internet).

Generally, as the fintech products develops and due to the increase of transactional costs for the organization of the physical market banks fail to take the advantages offered by the e-market and in doing so to make best use of the production factors. Thus, it is more efficient to perform the transaction on the physical market up to the level where the losses and the costs are equal with the marketing costs spent if the transaction is performed via the electronic market. The lower adaptation costs (easier organizational implementation) as well as the high value changes are significant factors for early acceptance of the new architecture. (Bresnahan 2001).

With the growing reduction of the corporate structure of the banks, expansion of the subcontractors and the new founders of the markets will contribute to increasing the number of participants in both domestic and international payment operations. New players of the financial markets (non banking operators for money transfers, techno sellers with e-payment, neobank, operators with mobile phones) will increase competition and reduce the profitability of the traditional commercial banks. The success and profitability of the banks will be largely determined by their ability and skills to allocate every saved capital in sufficiently flexible multiple instruments which will be repeatedly applied and will reduce the risk level

in the decision-making process. Economy of Scale will be prerequisite for the long-term profitability and sustainability of the banks. Some banks will be able to independently access the organic growth by exploring the available cost-effective solutions; others are likely to decide to be merged with or taken over by other banks.

Internet e-banking and other fintech products increases the number of new users entering exponentially, i.e. it creates a cycle of self-empowerment, as customers reduce their costs and increase their efficiency by doing business online, so they are increasingly convincing their business partners to do the same. Therefore, it is very likely that there is an asymmetry in the ability of banks to control the entry into the electronic market. Cyber attacks remains highest threats in the informational economy. Proposing new and secure online payment systems solutions will still be one of the challenges for banks and regulators in the 21st century.

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STORRYTELLING MARKETING ONCE UPON A TIME….

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ABSTRACT

The 21st century has brought a complete transformation of the marketing that is practiced in companies. 2020 really changed the face of marketing. Marketers less talk about traditional marketing, and more about experiential, societal, interactive, humanized, personalized, inclusive, content, omnichannel marketing. Traditional marketing uses the „one to many" approach where radio, TV, newspaper campaigns broadcast to a passive and unified audience. The plot lays in the hands of corporate narrators. The new marketing model uses „multi-way communication" approach where consumers are in control of what they see and how they respond to company's commercials. They are active, involved, interactive, empowered in the process of buying. The new marketing tries to be more humanized and „come closer" emotionally to the consumers. The most suitable way to make people believe in companies' promises is storytelling.

Storytelling as a part of content marketing, that aims through stories, fables, folklore, tales, short interesting events to touch the senses of consumers, to reach their soul, to involve them in the buying process and to encourage them to buy products and services. Everyone loves stories. Everyone has a story. Everyone believes in stories. Marketers use storytelling to give life to brands and motivate consumers emotionally to react to brands. People easely understand stories, memorize them, retail them, spread them.

However, this sales technique is not a new concept, but it is a new opportunity to commnucaite marketing initiatives. Many factors and circumstances have led companies to use this technique. People all over the world face uncertainty, poverty, pandemics, economic crisis, isolation, quarantines. In this cruel time, everyone needs warmth, love, joy, a little happiness, friendship, kind words, comfort. It is these feelings that companies „use" to get closer to consumers, and sell them their products and services. Storytelling is the process of making a connection with the customer first, and selling a product second. Storytelling is a powerful marketing strategy that creates an emotional link between producer and consumer.

KEYWORDS

Storytelling, Content marketing, traditional marketing, emotional connection, stories

JEL CLASSIFICATION CODES

M31, M37

1. INTRODUCTION

For the importance of stories today, the best illustration gives тhe movie director Steven Spielberg: "Once upon a time it was a small gathering of people around a fire listening to the storyteller with his tales

of magic and fantasy. And now it's the whole world. In Japan and in Finland, in the heartland of America, in Italy and Spain, in Singapore and France . . . still they gather to hear the stories. But now they gather in multiplexes in Britain, Germany, Spain, Australia . . . or giant movie places in Mexico. That's what has thrilled me most about Jurassic Park phenomenon. It's not "domination" by American cinema. It's just the magic of storytelling, and it unites the world. And that is truly gratifying (Woodside A, Sood S, Miller K,2008).

People really love stories! People love great stories! (Bet-David, 2019). That is why people go to movies, read books, watch TV, visit friends and gather in the family. They do this because they enjoy in listening, talking about, and sharing stories. Stories are us! Everyone has heard the stories from his/her parents or grandparents. And the time of storytelling is a magical, presenting a world without pain, sorrow, sadness and full with fun, entertainment, love, joy, happiness and excitement. Stories are magic, they can create other worlds, emotions, ideas and make the everyday seem incredible. Stories are in our blood! They talk about our tradition, culture, habits, language, and learn us about the difference between good and bad, sadness and happiness, darkness and light. They can teach us empathy and take us on terrific journeys. According to David there are several types of stories, such as: stories that inspire, stories that persuade, stories that launch revolutions and movements, those who tap into the people's potential and those who manipulate.

But, when people start to tell stories? People are telling stories from the same beginning, but things were changed in:

- 1450 – when the printing press was invented and stories were written and distributed more quickly,
- 1890 – when camera was born and motion picture was there,
- 1925 – when TV came and later radio appeared and especially
- Today – when there are social media, blogs, Internet where people everyday shares stories.

Story is an **emotional investment**. Stories are about emotions of people that are an integral and indispensable part of the daily organization of life. People, on a daily basis, have different feelings, like sadness, joy, commitment, fear, thrill, excitement, and so on. There is no fix formula for creating an ideal story. But stories play a great part in people's life. Gottschall (2012) rightly points out that humans have the need to tell stories, to explain themselves and make sense in the world around them. Stories are basic in all human cultures and because of their structure, content, share and understanding people build common experiences. Telling a story makes information way more **memorable.** Psychologist Jerome Bruner found that "we are 22 times more likely to remember a fact when it has been wrapped in a story". (Attest blog, 2019) This feature of stories is used by companies to sell their products and services to people. Today brands have modified the way they interact and communicate with their customers. Companies find out that a good story creates a positive emotion that inspires people to take an action, i.e. to be interested and to buy their goods and services.

In simple words, storytelling marketing means using a narrative to communicate a message. The aim is to make the viewer/ listener feel something – enough that it'll inspire them to take action. Storytelling in marketing helps consumers to understand why they should care about something, and it works to humanize the brands. Storytelling in marketing is not limited to film, stories can be told in pictures, verbally or in written form. And they can be told across all channels – from social media to billboards.

Dan Lok (2019) talks about the importance of storytelling in marketing. He believes that the future of marketing lays in storytelling. He shares three secrets to brilliant storytelling that companies need to have in mind in order to attract more audience:

- **Setting the stage, time and location**: the best way to draw people in the company's story is not to tell them what to do, what to buy, whom to listen to, but to transfer them into the fairytale that starts as every story with "once upon a time, once upon a time…". Companies need to touch the imagination of people and visualize the better place, timing and scene they want to be. Companies need to set the stage, the mental image that people can visualize and forget the reality for few minutes.
- **Specific story**: Companies need to be specific about their stories. They can use the dialogues with the audience and put them in the middle of the stage, or the action.

- **Moral of the story:** Why companies are telling the stories? What is the moral of the story? What is at least one take away that audience want to have out of stories? What people need to do to feel the magic of the transformation? Companies need to teach them how to become better by using their goods and services. Companies need to persuade consumers that only their products will help them to live in a magic world.

Storytelling is the key to win the hearts of the customers and clients and is the future of the marketing. Storytelling is the art and science of using a fictions or non-fictions narrative, characters and plot to convey a message indirectly to consumers to buy a product. Storytelling is an important pillar in the content marketing because it makes the content more engaging and compelling as opposed to traditional marketing communication that is based strictly on facts and figures.

2. LITERATURE REVIEW

Stories are the oldest form of passing knowledge from one to the other generation. They learnt us a lessons about our identity, traditions, culture, folklore, and also the differences between good and bad, positive and negative, right and wrong, about heroes and villains.

The Cambridge dictionary defines stories as: "a description, either true or imagined, of a connected series of events". Google gives a similar definition that story is "an account of imaginary or real people and events told for entertainment". The Oxford dictionary says that "story is a description of events and people that the writer or speaker has invented in order to entertain people". The more precise definition is given by McKee (2018), in his book "Storynomics", that" a story is a dynamic escalation of conflict-driven events that cause meaningful change in a character's life". In this definition two things are important, **change and conflict**. Without them there is no story. Meaningful change is what happens when the core value at stake changes from negative to positive, from failure to success. Conflict is about intentions and obstacles that a character needs to overcome in order to obtain their object of desire. The bigger the obstacle, the more heroic the action to overcome.

There are also lot of **definitions for storytelling**. Storytelling is generally defined as the art of telling stories, although it can be said that it is a technique that manages to convey much more than just story. It is also about creating and taking advantage of a fantastic world to connect emotionally with the receiver through the story (David, 2019). Storytelling is the interactive art of using words and actions to reveal the elements and images of a story while encouraging the listener's imagination. (National Storytelling Network). Storytelling is the act of sharing a tale or a series of events.

Story marketing is a marketing technique in which writers use journalist-style storytelling techniques on behalf of a company to attract customers through relative and helpful information. Storytelling marketing allows you to present your brand narrative in story form — allowing you to resonate with customers. (Carter, 2020). Storytelling marketing is using narrative techniques to engage with an audience and shape a brand's identity beyond traditional marketing approaches. Storytelling gives businesses a valuable opportunity to connect with customers and promote their values and beliefs without using overtly sales-driven techniques. Storytelling is an essential element in an ambitious marketer's tool belt in an age where consumers demand authenticity.

Storytelling contains the ability to capture the attention of the viewer and to make him/her feel an emotion towards the brand this makes it a tool that can also be applied in marketing and advertising. Consumers not only demand a product or service, but they also want to communicate and feel identified through the content and messages of the brand. That is why the implementation of storytelling is necessary, due to the emotional nature that the stories present and that can serve to connect with the client (Muller, 2016).

Neil (2019) talks about three steps of a good marketing storytelling:

- **Companies need to define their core message**: the story needs to has a point. People will not be "hooked" if they listen to a story that a company needs more money, more profit, more sales, more numbers

and facts, more conversions or requires greater number of followers. If the story has no point, people will not see a point of paying attention to the company or its products and services.

- **Companies need to decide what kind of story they will tell:** one version of storytelling is **inciting action**, i.e.to make people to want to do something, to take action, to be motivated and be involved in the process of buying. Another way of storytelling is to tell people about the company. Company has its own unique story, its ups and downs and sharing them with people can be motivational and inspirational for people to visit or follow the company on the web. **Personalized story** can be an amazing tool because when people know more about the company they are inclined to relate more and more likely they will connect with the company. **Conveying value** is another way of telling a story that gets people's attention. If people believe in the same values as company does, they are more likely to relate with the company and follow it as well. And the last way for company storytelling is to **educate people and pass on the knowledge**. People want to be engaged, to learn new things, to explore and to get new knowledge and be able to execute on it in the future.
- **Companies need to establish a call for action**: when people hear the story, they can be "hooked" to it, they are all about the company, they are all about the brand, they are all about the business, but they don't know what to do next. Companies need to tell them what to do or what they expect them to do. Companies can ask people to join their e-mail list, to follow them on the social platforms, to visit their website. And it doesn't have to be a major commitment or a "pressure" to people to buy the products right away. Sometimes doing something little, without huge effort is more appreciated by the people. By building the relationship, people in time will convert to customers.

Bhargava (2020) mentions **six things** that makes a story good for marketing:

- **Featuring a relatable protagonist**: the central character must be someone, fictions or not, that people can relate with. People have to empathize with the character. The story is simply as good as the relatability of the protagonist.
- **The story needs to be real and authentic**: the worst advice in marketing that one can give is "Fake it till you make it!". Being fake or unauthentic is absolutely not an option. Today's consumer isn't fooled by brand's that are inauthentic or unoriginal. Company has to have a fresh idea and a unique perspective. Companies need to stay true with their brand values and principles. Also, it not recommendable to use jargon, clichés and complex words in the story. It has to be short and simple to get people's attention.
- **Usage of emotions to connect with the audience**: this could be anything-fear, anger, joy, thrill, surprise or any other emotion that motivates, moves or makes people feel something to connect with company's brand. Emotions make the story real and humane.
- **Stick to the point and avoid digressing**: the story shouldn't be huge and long fairytale where consumers have to wait a lot to get the point. Storytelling in marketing works only when the story is succinct and absolutely to the point, without digressing even a bit. The audience is not supposed to lose the interest. Craft the story that simply grabs the peoples' attention, make them feel something and leave them thinking about it. In the end, company wants the people to imagine themselves in the shoes of the protagonist and think about how using goods and services could actually turn their lives around and not be left with a narrative that leaves them confused, bored or unmoved.
- **Throw some facts and figures to support the story**: when a company uses a storytelling it doesn't mean that it can completely ignore the hard facts. Data can support the story and add to its credibility.
- **Worthy cliffhanger:** After storytelling the company needs to leave people wondering and wanting more. This has to intrigue people and leave them with something to think about and to ensure they come back to find out more.

According to Patel (2019), any story has to possess **three elements**: **character(s), a conflict and resolution**. Having characters in the story allows people to see themselves in the story and be part of it. Without characters there will be a disconnect between the company and the persons who are listening to the story. Characters need to be there, in the story and be relatable. Also, without a conflict there will not be that hook that gets people in their waiting to figure out what is happening next. If everything is in a

harmony, perfect, rosy, then the story becomes boring. And finally the story needs to has a resolution. Every conflict needs the resolution to go with it.

In this line, Bhargava (2020) states that the main elements of stories are the **protagonist, a conflict** (problem that a protagonist is faced with or "pain points") and **solution** they discover (closely tied to the goods and services that company offers).

According to Truelson (2018), the marketing storytelling needs to have four elements, such as:

- **Message:** Storytelling as a branding tool is not about telling stories just for the sake of it. In marketing, stories are told in order to convey messages that reflect positively on the brand. That is why the essential for the company is to develop a clearly defined message. Without it, there is no reason to tell stories.
- **Conflict:** Conflict is the driving force of a good story. No conflict, no story. But why is this the case? The answer lies in human nature. As humans we instinctively look for balance and harmony in our lives. So, as soon as harmony is disrupted we do whatever we can to restore it. When faced with a problem – a conflict – we instinctively seek to find a solution. Conflict forces us to act. As storytellers, we get our message across through conflict and its resolution.
- **Character:** Another basic element is the character(s). We have seen how conflict marks the turning point in the story, but in order for this conflict to play out, you need a cast of interacting and compelling characters. In order to get personally involved with a story, we must be able to identify with the characters. Here it is important to keep your target audience in mind. The audience must be able to identify with both the hero and the problem. Based on our need to have balance in our lives we will usually emphasize with a person faced with a conflict.
- **Plot:** Once your message, conflict and cast of characters are all in place, it is time to think about how your story should progress. The flow of the story and its events are vital to the audience's experience. Given the fact that we can only tell one thing at a time, and that a story exists only as a progression of events within a given time span, the sequence of events needs careful consideration. It must have a precise structure to propel it forward and maintain audience interest.

Fog, Budtz, Munch and Blanchette (2010) argue that there are basic elements, such as the message, the conflict, the characters and the plot; that should not be lacking in the use of storytelling in any discipline. These elements can be varied or applied differently depending on the recipient, the context or situation in the story and its purpose. The message works as a central theme throughout the story. In the message there must be conflict, an element that is very important due to its relationship with human nature. To captivate the public, the story must not be completely chaotic nor be in complete harmony, it had to be a balance. The characters are the ones who give the story the emotion that is needed to captivate the audience. It refers to the hero, who pursues a goal and has the support of one or more characters. It also has an adversary, the traditional villain, who tries something contrary to the hero, thus establishing the conflict. The argument is the events that occur and how they progress in it are very important for the viewer's experience, that is why there must be a precise structure to boost the story and maintain the interest of the public. The fight of good against evil. Or the idea of overcoming adversity are arguments that always hook the story consumers.

Sedej (2021), in her presentation talked about the following **seven components** of a great storytelling:

1) **Detective approach to storytelling**, making a complete research on what the story will be about,
2) **Find and answer the key questions**: why should customer care about your story?
3) **Tell stories in connection to values**-positive feelings about the brand
4) **Create a conflict** – problem, enemies, no harmony and predictable events that are boring,
5) **Create a captivate characters**: powerful characters, one or more, real or imaginative,
6) **Use humor**: fun, entertainment, engaging, that makes sense and it is not offensive,
7) **Stimulate curiosity**: interesting facts, discovering unknown, making people wonder

For Godin (2006) there are some **guidelines** that every story should follow to capture the imagination and conquer a large part of the audience. The story to tell must **be true,** it does not mean that it is real, but that it is consistent and authentic. It must generate confidence, since the story will not succeed if the credibility to tell it is not worked before. **Being subtle**, you must leave room for the recipient to draw their own conclusions, so it will be more effective, a good story engages the audience from the beginning. Do not appeal to logic, but to the senses, you can say more in a second than with a long explanation. **Do not direct to anyone,** a story cannot be diluted to satisfy everyone in general, because then it will not attract anyone's attention.

3. RESEARCH METHODOLOGY

For the purpose of this paper only secondary sources are used: data and information from relevant existing literature on content marketing and storytelling, like journals, statistical data, reviews, e-books, published presentations, blogs, FB statuses and YouTube vloggers. A combination of YouTube videos on the art of storytelling from different experts, marketers, practitioners are used. Mainly online sources were used. Even though content marketing (storytelling) is not a new term, lately it is becoming a hot topic for marketers, probably because it is powerful and easily can relate to consumers. Secondary sources provide a lot of data from qualitative and quantitative research, historical reviews and method of comparisons.

4. ANALYSIS AND RESULTS

For the purpose of this paper, analysis of a case study is used. Many companies are using storytelling. The biggest mistake that companies are making nowadays related to the storytelling is that they tell stories that hardly connect to their products and services. When companies use storytelling it must relate to their goods and services and how they help people to become better, to live better, to have more qualitative life or overcome their problems.

Even though there are plenty of examples of good and bad storytelling, this paper elaborates the principles of storytelling based on one example, given in the following video:

Video 1: The Art of Business Storytelling (08:00 – 09:45 minutes)

Source: https://www.youtube.com/watch?v=77FUr6ZsWjY

In the video above, an example of storytelling is given. Namely, a blind man is sitting on the ground, with his money box and cardboard with the inscription: “I am blind, please help!” People pass by, do not pay attention to him and rare passers-by left him little money in his can. Until a lady appears who will change the inscription on the cardboard and his life literally! After that change of the cardboard, many passers-by left more money in his can. At the end of the day, the lady comes and is satisfied with the money passengers left to the blind homeless man. He recognizes her by walking and asks her what she wrote on the cardboard that made him so happy and “rich” that day. She read him "It's a beautiful day and I cannot see it”!

This example shows that the **rules and principles of storytelling** work. Namely,

1) **Companies should not use a lot of facts and figures** and point out WHAT they are doing. They should not say that THEY are the best, THEY have needs, THEY have products and services, THEY have profits, THEY require this and that, and so on.

2) **Stories should touch and connect with consumers emotionally**. Or as McKee says: “At their most basic, stories are about conflict and resolution – the basic tenets of life: man suffers difficulty and gets through it: we can all relate to this. We are attracted to the human strength to overcome”.

3) **Stories should contain conflict or build a contrast** between good and bad, poor and rich, heroes and villains. At the heart of every story is to have a contrast, a problem, a conflict, a difference between where the consumer is and where he would be by using a particular product or service.

4) **Stories should be credible, true and related to the products and services offered by companies**. They must be authentic and based on real events. Facts can also be used, but only to support the truth and objectivity of the story.

5) **Companies should use storytelling to call for action**. Calling for action means motivating people to buy their product or service. They need to convert people into their regular customers.

6) **The best stories should be retold and shared** with friends, acquaintances, colleagues, family members. Word-of-mouth marketing is the essence of a storytelling who helps companies to sell products and services.

Hence, **the important steps of each story are:**

1) **A disruption of the status quo,** ie issue or problem that needs to be solved,

2) **Conflict or struggle** between two opposing forces: good with bad, hero with willian, right or wrong, darkness and light, and

3) **Resolution**, ie return to a new normal, which is better than the previous state.

Companies need to offer resolutions and help their characters to solve problems with their products and services. In this sense Godin is saying that “Either you are going to tell stories that spread or you will become irrelevant”.

5. CONCLUSION

This paper can be concluded with the American native proverb that “Those who tell the stories rule the world”. With today’s digital technology, people are exposed to around 30.000 commercial messages per day which is huge having in mind that this number was 500 in 1970-es. There is a major shift from traditional to a new marketing model. Traditional old marketing model is based on “one to many approach” when radio, TV campaigns broadcast to a passive and unified audience. The plot lay in the hands of corporate narrators. The new marketing model is about multi-way communication. Here consumers are in control of what they view and how they respond to commercial messaging. They are active, empowered agents in the media production process. They can choose what to read, watch, share or ignore corporate messages.

Storytelling is not a new concept, but it is a new opportunity to communicate marketing initiatives. People are storytellers by nature. Storytelling is an important marketing tool for brands in order to get in touch with the main audience.

Companies are using storytelling because it is an efficient way to come closer to the audience. The main reasons are that:

- People remember stories! Stories are memorable!
- People relate to stories because stories are about beautiful experiences, not just about empty words!
- Storytelling is about coming brands back to life!
- It is a great way for brands to say…remember me, connect with me, think about me, buy me, retail about me!
- Stories inspire actions!

Storytelling is the future of the marketing because it connects emotionally with consumers. It uses the different emotions that people have, such as anger, joy, thrill, sadness, sorrow and implies goods and services that can overcome the problem and offer a solution for consumers. And it would be really good to finish this paper with the words of Steve Jobs: "The most powerful person in the world is the story teller. The storyteller sets the vision, values and agenda of an entire generation that is to come."

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REINVENTION OF NEW BANKING BUSINESS MODELS IN REPUBLIC OF NORTH MACEDONIA

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ABSTRACT

Banks represent the foundation of every financial system. However, their role as main intermediate and liquidity provider starts fading and many authors argue that "brick and mortar banks" would even disappear. The digital economy brought in rapidly changing technologies, increased knowledge intensity and led to creation of new models of businesses and service delivery channels. The financial landscape in developed countries has already started to change with the entrance of Fintech companies, challenger and neo banks, which in turn meant actual threat to incumbent players. As a response, the traditional integrated corporate banking model started shifting towards diverse digital banking ecosystem of bank and non-bank players.

This research paper identifies and analyses the key drivers that are changing the banking business model in developed countries and correspondingly describes three possible scenarios for Macedonian banking system which will imply changes in the current banking business models. Within the scenario framework, special attention is given to the opportunities and threats that banks may face in their main group of activities (services and products). Additionally, through conduction of SWOT analysis this research paper shows the advantages and weaknesses that Macedonian banks would have in the new digital banking ecosystem. The customer preferences, advanced technology, the entrance of new competitors and changes in regulation will initiate drastic changes in the banking sector where Macedonian banks must rethink their business model in order to remain competitive. Therefore, the main purpose of this research paper is to propose reinvention of bank business models in the new digital banking ecosystem.

KEYWORDS

BUSINESS MODEL, BANKING ECOSYSTEM, FINTECH COMPANIES, SCENARIO.

JEL CLASSIFICATION CODES

G21, M10

1. INTRODUCTION

The rapid spread of information and communication technologies impose digital transformation of every business sector in the economy and creation of New Economy, or digital economy. The financial sector as important part of the economy is not omitted from this digital transformation. After all, the financial sector should lead the introduction and usage of innovative digital technologies in offered services, products to clients and in internal matters regarding the financial companies' architectures, IT

infrastructures and working procedures. However, today the fastest-growing financial companies we see around the world are not the traditional "mortar and brick" banks, but FinTech companies, challenger banks and neobanks. These new financial players are changing the banking ecosystem and add full digitalization in banking products, services and activities. These new participants challenge existing incumbent banks and offer innovative solutions that allow customers to optimize many financial services, to make them easier, more accessible and cheaper.

Therefore, major banks all over the world are experiencing pressure on changing their business models. According to Teece, 2018 a business model describes an architecture for how a firm creates and delivers value to its customers and the mechanisms employed to capture a share of that value. Through business model, an organization is able to describe the nature of its business in the sense of "what it does," "what it offers" and "how the offer is made" (Ritter and Lettl, 2018) and "what is the main value created". With the integration of digital technologies into banks' business processes and procedures new bank business models were introduced, which actually meant transformation of traditional banking into digital banking. In this context, the further explanation is that ongoing transformation of economies and industries, the growing power and development of digital technologies generally, has direct impact on a bank's business model. And, for the purpose of maintaining or achieving more success on the market with the newly designed business model, banks should nevertheless analyze and explore different alternatives stories – scenarios for the future. In that manner, banks will possess a good understanding and insights about their client requirements, and clear understanding of the firm's value chain (Teece, 2018).

Many banks in Republic of North Macedonia follow the new trends in digital banking in order to maintain their competitiveness on the banking market. However, by monitoring the process of digital transformation we can say that today this process is at its beginning. Each bank uses digital technology to expand its product ranges and services to clients and attempts to focus on the specific needs of the buyer. Yet, Macedonian banking sector still lacks the competition from new entrants, such as fintech companies due to the fact that new regulatory framework is needed to be implemented in order to support them. In this context, in the second half of 2020, a study[10] was led and coordinated by the National Bank of Republic of North Macedonia for the purpose of mapping the development of the Fintech sector in North Macedonia and to assess the opportunities, barriers and challenges posed for innovation and for new market participants. According to the conducted survey, among 220 participants[11], 72% of the bank and non-bank financial institutions answered that they initiate digital transformation, where banks are further ahead in their digital transformation. In addition to that fact, 93% of banks, already have separate organization unit, or person responsible for digital transformation. This new technology, given the data in the study, banks and non-bank financial companies use for automation (60%), 40% use new technologies for introducing innovations related to payments, and around 30% use big data analytics. In other words, 58% of the incumbent banks and non-bank financial companies are developing some form of Fintech products or services, such as: innovation in credit scoring models with the aim to reach segments of the market that banks cannot or do not wish to engage with; facilitation of instant peer to peer payments; allowing businesses to sell their receivables on an online platform, without the need for paperwork, and subject to regulatory changes needed; automation of credit scoring so that customers can get instant loan application decisions and innovative finance products for loan car business and car leasing businesses. Based on responses received in the conducted survey, traditional banks and non-bank financial companies are

[10] This study was financed and technically supported by the European Fund for South East Europe's Technical Assistance Facility. The study was coordinated and led by the National Bank of the Republic of North Macedonia, with support from a United Kingdom based Fintech advisory firm Vedanvi.

[11] These participants were grouped into the following stakeholder groups:

1. Banks
2. Non-Bank Financial Institutions, such as Insurers, leasing companies and other non-bank lenders
3. Alternative Finance Firms, such as lending firms as well as Technology Providers to Financial Services
4. Accelerators, Investors and Development Partners, including Consultants
5. Regulators spanning all financial services sectors
6. Relevant Government departments.

incrementally improving their existing products by using advanced technology. However, when conducting the study there was not existence of a totally new Fintech based business models, such as equity or loan-based crowdfunding, or launch of digital only challenger banks, or Insuretech solutions.

According to this study 64% of bank respondents, while 73.33% of non-banks respondents, felt that if regulators did open the market for Fintech players, it would present an opportunity to incumbents. On the contrary, 28.57% of banks and 22.67% of non-banks financial players note that new players will pose a threat to their organization and may adversely affect their market positioning. As a remark in this study it is pointed out that often the least digitally prepared financial services firms will feel the most threatened by new Fintech entrants into their market.

By describing the impact that the digitalization trend has on global scale in the banking sector and the new surroundings that currently take place in RNM, it can be concluded that changes are starting to happen in Macedonian banking and/or financial sector. The key drivers that actually are changing the banking landscape and strive to imply creation of new digital banking ecosystem are already identified and will be further elaborated.

The purpose of this paper is to point out alternative scenarios for further development and transformation of the banking sector and the main contribution is focused on proposing appropriate business models for banks in order to respond to this new turbulent environment.

2. KEY DRIVERS THAT ARE CHANGING BANKING LANDSCAPE

The banking landscape is continuously evolving and is constantly under the influence of many trends. Today, digitalization is the most significant of the several trends that shape the banking industry. Therefore, before introducing the scenario narratives about different alternative futures, this paper will analyze and describe the key drivers in order to better understand the current conditions in which the bank operates, locally and globally. The most important factors identified here, are customer preferences, usage of advanced technology, entrance of new competitors and changes in regulation, which will determine the basis of the scenarios and their results. These factors constantly interact with each other and create complex and interesting bases for building scenarios. Important to note is that each bank should compile its own list of key driving factors. As a matter of a fact, in one industry, lists of key company factors would be similar. Hence, it can be concluded that the company has very little control over the driving factors and the only way it can use them to its advantage is if to recognize them, understand their impact and if they do not go in its favor, then it should influence into creation of new driving forces (Mason, M.K., 2015). The key factors elaborated here are called predetermined elements of scenarios because they appear in every scenario; they have high influence over the business but relatively low uncertainty. Usually scenarios elaborate and other key drivers, which are called critical uncertainties, because they have the greatest impact on the company and are the most uncertain. Critical uncertainties are closely related to predetermined elements and are found by considering the assumptions about them. They have the power to fundamentally change the business and define or significantly change the nature or direction of scenarios. However, in this research paper these types of assumptions about the predetermined elements will be omitted.

Customer preferences. Contemporary's customers have different behavior norms than before and they are looking for more aesthetically appealing, highly personalized and context aware financial services, so that the need of the moment is served quickly without bank's clerks lumbering intervention. Furthermore, millennials want to be in control of their own finances, acquire for a self-service model and want to try different financial solutions from different service providers, whether is from different banks and/or different new players such as neo banks, challenger banks, Fintech companies etc. Digital technology and the experience it offers allows customer to monitor all their balances anytime and anywhere. For example, applications in smart phones may offer advice on wealth building, spending habits and money saving tips (Ogden, 2017). What is relatively certain about this key driver is that the evolved customers' needs would be satisfied and every customer is becoming a digital customer – someone more and someone less.

Usage of advanced technology. Many authors and practitioners see the development of electronic banking as a revolutionary development, but, when broadly speaking electronic banking is another step in how banking processes, organizational structure and offered services evolve. For instance, by using advanced technology banks have different alternative channels for interaction with customers at their disposal. Online and mobile banking have already changed how customers engage with the bank. Additionally, the rise of new banks, which have digital-only models of operating, gives customers a full range of services and products on their smart phones, without accessing their bank and waiting in queues. With customer interaction through digital channels, banks may also use the generated behavioral and transactional data. By analyzing this newly available data banks may have even more meaningful ways to engage customers by developing new innovative solutions. With the pressure coming from the side of customers and regulatory authorities, banks must embrace the digital technology, which will inevitably change their business models.

Entrance of new competitors. For years, banks have competed primarily with other banks with mass branch networks, marketing campaigns, and different fixed and variable loans' and deposits' interest rates. The offering of variety of financial services meant moderate competition in which several large banks had the lead due to their large share of the market. However, although customers use deposit, payment and credit facilities offered by banks, today they are no longer the only players in the banking market. For instance, today's customers might pay with debit/credit card but they also might pay with PayPal. The payment market is quickly evolving. Not only PayPal is seen as a mean of payment. There are fintech companies which serve as examples in the process of making payments faster, simpler and more secure, such as Circle, Remitly, Stripe, Braintree, Aeropay, DailyPay, Bolt, Ripple, Affirm. If this part of the financial market is monitored on global scale it can be concluded that today's fastest-growing financial services organizations are not banks, but FinTech companies, challenger banks and neobanks. These new financial intermediaries are changing the banking landscape and add full digitalization in banking products, services and activities. In order to remain competitive, banking sectors characterized by the presence of large incumbent players may help ensure that new offerings rapidly reach a wider share of customers. In other words, banks operating in countries with high concentration rates, such as Macedonian banks, have larger incentives to be the first movers in securing partnerships with Fintech players and hence gain rapid customer adoption.

Regulations. The digital transformation of banks and the entrance of new Fintech players is impracticable without a legal framework that leads and allows usage of technology and financial innovation. Most of the laws in Republic of North Macedonia are designed to protect the incumbent players, and these laws could actually discourage new entrants in the banking market. Additionally, according to the above mentioned conducted study Macedonian regulators already acknowledged that current regulation may not always accommodate Fintech business models. Macedonian regulatory framework should consider changes and updates in the Anti-Money Laundering and Combating the Financing of Terrorism Law, Electronic Signature Law, Data Protections Laws, and Laws on Obligations in order to impose creation of new banking landscape. The main limitation in these laws is that they require physical presence for identification when opening a new account or conduct a transaction. However, aside these facts, there are strong initiatives for changing the current regulatory framework. For instance, there is an expectation of accelerated implementation of the new payment services and systems regulation transposing PSD2 (Payment Service Directive 2) and other relevant EU directives and regulation in the payment area. PSD2 is aimed to make payments safer, increase protection of consumers' data and reducing the risk of fraud for electronic transactions, foster innovation and competition while ensuring a level playing field for all players, including new ones. The biggest change that PSD2 will bring is that banks will have to open their payment services to other companies, i.e. the Third Party Providers (TPPs). This will bring revolution in banking and has multiple implications in the market of banking. These new players will have to be registered, licensed, and regulated. Barriers will be removed for these companies, therefore increasing competition, which should translate into lower costs for customers. These new players will access the customers' payment account (that's the - access to account) to make payments on their behalf (via credit transfers) and to provide them an overview of their various payment accounts, but only with the prior consent of the customers.

These discussed key drivers will be described in the alternative scenarios as predetermined elements, and they will have high influence over the business but with relatively low uncertainty, meaning Macedonian banks should expect these changes to happen. However, in which direction should these factors evolve, actually explains the differences between various scenarios.

3. SWOT ANALYSIS OF DIGITALIZED BANKING ECOSYSTEM

Sabine Lautenschläger, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB, in 2017 considered that FinTech companies will change banks and in that context: banks might team up with FinTech; FinTech might break up the value chain of banking; and FinTech could be swallowed up by big Tech companies and deeply transform the banking business. What is certain is that FinTech companies will transform banks and their business models, but whether the impact would be positive or negative depends on banks and their preparedness to respond to these changes. For instance, digital challengers and FinTech giants present a threat for banks and may reduce their share in the provision of payment services, but at the same time, the wave of innovations offers a number of opportunities for banks, who are able to move quickly (Finnegan, 2016). Due to better description and analysis of the future scenarios and the manner in which banks will react or undertake proactive activities, and how the banking landscape will sustain radical changes, this research paper presents SWOT analysis. The SWOT analysis, viewed as strategic scenario analysis tool will seek to identify the strengths and weaknesses of banks (internal environment) and opportunities and threats coming from the external environment, i.e. the new digital banking ecosystem. This analysis will allow to conduct detailed analysis of scenarios in a more transparent and systematic way.

Strengths. The usage of digital technologies in banking processes and activities allows customers to have 24/7 access to their bank account, without losing time waiting in queues and entering banks' branches. Banks have benefits from this point of view in several ways. Firstly, for internet users it would be more convenient to use internet banking and abandon traditional banks that do not offer their services via digital channels. Banks may offer automated routine branch transactions such as cash deposit and payment related activities and if digital technologies are well developed additional more complex operations from the branches' front desks may be transferred in the background. On the other hand, this manner of banks' functioning results in reduction of overhead costs of other channels such as branches and call centers, which require buildings and staff presence (Shah, M.,&Clarke, S., 2009). Furthermore, the main economic argument of internet banking is that the cost per transaction of internet banking often falls more rapidly than that of traditional banks once a critical mass of customers is achieved. So, the greatest strength that banks have from the digitalization is that the usage of digital technologies supports achievement of economies of scale, which can be seen through speeding up business processes, reducing banks' expenses and transaction costs for both, banks and customers. Additionally, established banks have excellent market access, well dispersed branch network, reliable and established products, established brands and hence customer confidence as well as the budget to bring innovations to market. As a result of the COVID 19 pandemic banks focused on developing online solutions and started implementing e-banking services as a top on their priority list. Therefore, they should use these strengths and follow or respond to the changing environment.

Weaknesses. Digital transformation of banks induces greater efficiency and agility. However, radical changes in organizational structure and processes' flows are linked to risks in low employee morale, collapse of traditional services or the customer base. Banks are faced with the challenge to maintain balance between workforce level and customer service, and they have question marks how to optimize the number of branches. Physical banking, as we know, is upheld by politeness, greeting, and desire to provide the promptest services and sophistication and ability for apologizing or expressing concerns over bank clerks' mistakes. Digital banking crosses over this border and offers full digitalization of customer services without having to physically interact with customers. Therefore, in the continuation of this process, new challenges arise. Different skills, knowledge and aptitudes are demanded from managers and employees. The current

workforce should be going through process of intensive training and further education and new employees should be recruited, both to possess wide range of skills such as: technical knowledge for Web architecture and graphic design, web development, managing web sites, internet security, content expertise for marketing or sales and IT programming, IT analysis, strategic planning, relationships management, project management, content creation/management, and process integration. For instance, bank clerks should be well educated and trained to advise customers for using digital banking services. The weaknesses that come from the area of human resources are the most crucial supportive element when transforming the banking business models and they should never be underestimated.

Another weakness comes from the fact that there is still a large population, which is not connected to the Internet. Lack of computer literacy, high cost of hardware and call charges and various other social and economic factors are some of the reasons cited for this (Walczuch et al., 2000). Additionally, there is still a large number of consumers which are reluctant to providing their banking services online, even though they have internet access or possess smart mobile phones. Factors such as security, perceived difficulties of use, perceived usefulness, functionality and lack of promotion (such as availability of cheaper products on new channels) are most commonly cited factors which are hindering the widespread adoption of new technologies (Cheng et al., 2006). Therefore, the digital banking also means an internal threat of losing existing customer base.

Opportunities. If there is anything that today's customers want that is added value of the product and services, they receive. The digital transformation enables implementing new business strategies by banks to offer a wider range of financial products, starting with personal finance management, overview of all banking accounts, investment management, advisory services and etc., which, in general, means creation of customized customer based products which give additional value to consumers. Digital banks will be able to differentiate their services and gain competitive advantage not only over other banks, but also over other traditional banks and other non-bank financial institutions. For instance, banks may benefit from using big data analytics about the needs and habits of its customers, thereby closing the information loop of feedback. In other words, if bank's client informs that has house maintaining issue, the bank can immediately recommend several contractors, arrange offers, help the client choose the most suitable one, and, finally arrange packages of financing. Thus, in addition to the financial business, the digital bank may include various non-financial entities and correspondingly non-financial services in its ecosystem. All of these services present the added value and contribute to increasing banks' profitability.

Threats. Digital banks should be the cornerstone of a larger financial ecosystem. In this new ecosystem, digital service providers, such as Robo consultants, credit card issuers, P2P lenders, insurers, brokers and asset managers are considered as important part. On global scale, these companies are already overtaking large share from the banking market and responding to the changing financial need of their customers. In this context, banks feel the threats in their main areas of functioning. In the provision of **payment services**, globally, block chain technologies and mobile money solutions already provide alternatives by rationalizing intermediation processes. These threats Macedonian banks would note in the near future, due to the fact that the monetary authority is already in the process of rolling out a significant update to the Law related to payment services and payment systems, and bringing them in line with the EU's PSD2 Directive, EMD2, PAD, SFD, IFR and some provisions from SEPA Regulation. In the area of **deposit collecting and lending**, there is already emergency of alternative lending platforms, also known as peer to peer platforms, where consumers may invest their surplus of funds/deposit and apply for a loan. These platforms have already transformed the process of credit evaluation and sourcing of capital. Related to **investment management**, Fintech companies have already launched financial innovative solutions which offer full package of user friendly platforms that provide to customer's goal-setting, planning, advisory and investing of their funds. These financial solutions cover broader customer base and empower customers to have more control over management of their wealth, in a manner in which they can build their own ETF portfolio, monitor all of their bank accounts and move funds above their monthly spending needs into investing accounts or filtering their investments based on environmental, social and corporate governance factors. Development of smarter machines which learn how to process unstructured information, for instance from news feeds in order to suggest trades and trends, contributes to **creation of**

information platforms that upgrade the information sharing among market participants. Besides Fintech companies, in this area there is emergence of regulatory companies, or RegTech companies, that combine technologies, such as artificial intelligence, big data, cloud computing, and machine learning, to facilitate compliance with increasingly complex regulations and to serve all of the users in-process monitoring in the regulations area. In other words, Regtech companies tend to centralize the management of compliance documents and to keep all employees informed about the regulatory changes. In the area of **capital raising**, alternative crowdfunding platforms widen the access to sources of capital and provide funding to greater number of companies or projects. Crowdfunding is an innovative way of sourcing funding and is most often used by startup companies or growing businesses, i.e. small and medium size companies.

The introduction of digital technologies in the financial system, and practically in the banking system has a significant impact on the overall landscape, and on the banking business models. The proposed SWOT analysis can be applied by any bank so that it can analyze its internal and external environment and how it can be effective and efficient when transforming into new digital business model. In this regard, there is a need to describe different stories about the future development of the banking system, in order for banks to choose the most appropriate and convenient business model.

4. ALTERNATIVE SCENARIOS FOR THE FUTURE OF BANKING SYSTEM AND PROPOSAL OF NEW BANKING BUSINESS MODELS

In order to make summary of the internal and external factors that digital transformation makes on the banks' core functions in the continuation of this research paper narratives of three possible scenarios will be presented. If these scenarios are well integrated into the process of business planning, they would be considered as effective test conditions of the chosen business model. In this paper they will be described as "laboratories" in which the proposed bank business models will be presented. Scenario planning allows the assessment of possible changes and outputs from various events in the environment and how they would affect the business model. In this way, new alternative creative strategies can be identified that will prepare the bank for the uncertainty in the future.

Scenario 1 – Dominations of Banks. In "Domination of Banks" regulators and the monetary authority are increasing barriers for new digital driven entrants in the banking market. In this context, the incumbent players, i.e. traditional banks keep their customer base and are not threaten by Fintech companies in their areas of functioning. Clients remain loyal to already established and trusted banks and banks maintain their business model. However, customer preferences are still changing and therefore, banks make efforts to respond to these changes and invest by themselves in creating of new digital and financial services and products that are tailored according to them. In this scenario, banks themselves invest into using advanced technology in their main areas of activities and are responsible for creating technological financial innovations in order to deliver more value to their products.

Scenario 2 - Reinvention of Banks. In this scenario, new digital entrants are even encouraged to enter into the banking market. Regulators believe that the development of the Fintech sector will provide greater opportunities and better services, primarily for consumers, but also for small and medium size companies. By increasing the financial inclusion, the financial system will be aligned with international best practices. In this scenario, customers gain trust in the new bank and non-bank players and face with attractive offerings because of the low cost for their entering. Existing banks would fail to make digital transformation quickly enough because of their decades old and lumbering systems and be at risk of being taken over by the new banking players. Traditional banks and new entrants offer their services to different marketing segments. For instance, new entrants use crowdfunding platforms for capital raising of startups, small and medium size companies, or companies/projects with higher risk, while incumbent players provide funding to companies which are in later stage of their life cycle. Additionally, incumbent players benefit from the services that new entrants offer in the area of information platforms, such as Regtech companies.

Scenario 3 – New Banking Ecosystem. In the "New Banking Ecosystem" banks cross the traditional boundaries of the banking industry and together with non-bank players operate on the same market in order to deliver to banking customers' products and services with added value. In this banking customer faced ecosystem, incumbent banks are reluctant to acknowledge the power of digital networks, and the new bank and non-bank players gain significant market share. Customers prefer new players consume tailored services where they can acquire wide range of services "under one roof". Therefore, as a last resort incumbent banks transform themselves into platforms that provide special knowledge/ expertise or know how and capabilities to the wider banking ecosystem.

In the process of digital transformation of the whole financial system, threaten by the arrival of Fintech companies and changed customer preferences, incumbent banks have their own strengths and if these strengths are properly combined with a sustainable innovation management, then these banks would survive. Major banks from all over the world have started to switch to a new business model-the digital banking model, which allows customers to perform operations via remote channels. The question remains, which are the business models that banks may develop in order to be prepared for the future.

1. Banking as integrated service. The first business model is a model in which licensed bank offers fully supported product or service on the banking market and, also integrated into to the products of the new player which is not licensed as a bank. In this manner the new player offers customers digital banking services, such as IBANs, debit cards, loans, and payment services, but without having to acquire a banking license of its own. In this way, the non-bank company/new player acts as an intermediary and is focused only on development of mobile application and its features. This mobile application communicates with the bank's system via APIs (Application Programming Interface) and Webhooks, allowing customers to manage their cards and access their accounts and transactions. Although, APIs have been used for over 20 years, nowadays is becoming attractive in banking industry, because Fintech companies and other financial institutions started implementing technology solutions for their customers. Simply defined, API is a group of tools and protocols used to build software and applications that connect to other firms' pre-existing technology. In the banking, APIs give financial institutions the ability to connect with businesses and consumers, transfer information at a more convenient pace, and expand the number, breadth of services they can offer and distribution channels.

The non-bank company/new player using APIs will have to be registered as BaaS agent (banking-as-a-service under the EU legislative), which could be accomplished faster and with less capital requirement as opposed to the requirements to obtain a license of its own. The non-bank company/new player does not directly manage the customer's accounts or money. It simply acts as an intermediary, which means it is not bound by any regulatory obligations.

This business model is built upon a standardized offering of fully supported service (conducting transactions, and providing of custody and depositary services). Therefore, banks should focus on exploiting economies of scale through partnership with the new players. With the disaggregation of the value chain bank can benefit by becoming banking platform for unlicensed new players.

2. Open Banking model – Partnership model. In general, open banking as a financial services term refers to enabling third party providers to access customer's financial information in a consented and secure manner. However, the Payment Services Directive 2 (PSD2) is European-wide regulation that requires financial institutions serving European markets to allow Third Party Providers (TPPs) access following customer consent to payments, customer transactions and account data. PSD2 is also a crucial step towards implementation of Open banking and evidence of the increasing importance that APIs are acquiring in different financial sectors. Therefore, the implementation of the Open Banking model presupposes implementation of the PSD2 Directive, where the new players will be registered, licensed, and regulated at EU/national level. Barriers will be removed for these companies, therefore increasing competition, which should translate into lower costs for customers. Additionally, with these changes in Macedonian regulative related to payment systems and services it will be addressed and the biggest concern for banks, that is reducing the risk of fraud for electronic transactions, and enhancing the protection of the customers' data.

As discussed above, with Open Banking business model, banks are legally required to provide third parties with access to their banking data. In the previous business model, non-banks/new players integrate the full breadth of financial services into their own products. In the Open Banking model, non-banking companies/new players simply use the bank's data for their products, and they are also called Third-Party Providers (TPPs). The critical thing to remember is that TPPs cannot provide banking services as they do not hold a banking license. They simply use data from bank accounts in order to provide aggregated data or to initiate transactions.

On the side of banks this model means abolishing the traditional predominantly closed and defensive way of managing customers' data and their financial positions. Banks will have to work in a more collaborative and open manner, both with other financial institutions and financial technology startups, for the benefit of end-customers. The main purpose of this model is to give third party providers (TPPs) access to customers' financial information, and indirectly offering them, especially individuals and small to medium-sized enterprises, holistic products and services, which increase customer satisfaction, loyalty, and most importantly, revenue.

Although, at first glance with this business model banks need to make more efforts to remain competitive, because the end user has opportunities to choose from more products and change providers, still this open banking model gives them an opportunity to stay ahead of the competition. Nevertheless, the banks themselves can benefit from providing access to their open banking channels or connecting to the channels of other banks by improving customer engagement; by providing end users with access to the bank's financial products, to their personal financial data and enabling them to efficiently manage their finances and to initiate payments in a secure and fully controlled manner; by using data from other banks to verify end users; by simple and automatic loan granting based on financial history received from other financial and credit institutions; by reducing time to market and increasing income through the use of products from other banks or fintech companies.

3. Platform banking, enables construction of customized faced ecosystem to meet every customer needs. Banking ecosystems operate across traditional industry boundaries, with different players working in the same space for the purpose of delivering to banking customers' services they need and value. Third-Party Fintech companies create financial products and services for bank customers, and these services are integrated with banks acting as infrastructure providers. In this banking ecosystem, banks can deliver more meaningful customer experiences and can follow customers beyond the boundaries of their traditional relationships. In other words, banks that choose this business model will have product offering across retail, private, corporate and investment banking and asset management. In this manner banks would have exceptional value proposition, i.e. flawless control over front-to back processes even if that processes are outsourced. In this constellation, banks bring their expertise in security matters, compliance, and especially in distributing financial products. The licensee remains the bank, regulated by the central bank. As to the banking services the Fintech companies offer on the platform, they partner with companies whose technology offers competitive advantages that meet customer expectations for whatever stage the customer is in.

Traditional banks often use this platform banking business model to add value to the customer experience and as an incentive to secure the customer's loyalty. By integrating fintech services into their platform, they keep their customers in the bank's network, even if it means giving a share of the revenue to the integrated Fintech companies.

5. CONCLUSION

The digital transformation in the new economy embolden fintech companies and many startups to enter the banking sector using new technologies, such as APIs, artificial intelligence, machine learning, big data analytics and introducing products and services with added value for end customer. The digital transformation is already changing banks' environment and the scenarios described in this research paper only show several paths to its further development in the future. Therefore, banks need to continuously

monitor the key drivers and signals from the external environment and consequently to make anticipated changes in the scenarios. Additionally, these proposed business models are based on assumptions about possible changes in the Macedonian banking sector by following the examples of changes in the banking landscape in Western developed countries and they need to be continuously adapted to the newly imposed conditions in the scenarios.

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INVESTIGATING THE EXISTENCE OF THE OKUN'S LAW IN NORTH MACEDONIA

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ABSTRACT

Unemployment is one of the most prominent issues being faced by developing countries such as North Macedonia. Unemployment indicates that productive resources are not being used properly, resulting in a low rate of real GDP growth. In macroeconomics, this relationship is known as the Okun's Law. The main aim of this study is to empirically examine and test the relationship between the unemployment rate and economic growth within the Macedonian economy over the period (1991-2019) using secondary data collected from the World Bank database. To examine the validity of Okun's law, which suggests a negative relationship between the unemployment rate and economic growth, The Auto-regression Distributed Lags Model is employed. The econometric analysis suggests that there is a statistically significant long-run relationship between the GDP growth and total unemployment in North Macedonia, at the 10% level of probability. In particular, the findings show that a 1% increase in the total unemployment will lead to a decrease of the GDP growth of 8.02%. This relationship in the opposite direction does not correspond since GDP growth affects total unemployment only in the short-term, with a positive sign, which is not in line with Okun's law. No long-run relationship between GDP growth and youth unemployment was detected as well, only positive short-term relationships.

KEYWORDS
OKUN'S LAW, UNEMPLOYMENT, GDP GROWTH, NORTH MACEDONIA

JEL CLASSIFICATION CODES
E24

1. INTRODUCTION

One of the key macroeconomic goals is to achieve economic growth while keeping unemployment low. Furthermore, unemployment is frequently used to assess the state and the health of the economy. The Bureau of Labor Statistics (BLS) defines unemployment as people who are without a job and have actively looked for a job in the previous four weeks. The unemployment rate is calculated by dividing the number of people who are unemployed by the total number of people in the labor force, where the labor force includes both employed and unemployed people.

The relationship between unemployment and economic growth was first investigated by Okun in 1962, which later became known as Okun's Law. The Okun's law argues that there is negative relationship between GDP growth rate and unemployment rate, which is a key theoretical and empirical concept in

macroeconomics. Theoretically, Okun's law is the link between the aggregate supply curve and labor employment. This law intends to tell us how much of output we can lose if the unemployment rate is above its natural rate (potential level of output). A lot of researchers have looked into this link. Some of them favor Okun's law, while others reject it.

2. LITERATURE REVIEW

There is a broad scientific literature that investigates the link between the total unemployment rate and the economic growth. Lee (2000) observed the link between these two variables in the OECD countries and found different level of relationship between the countries. Zagler (2003) investigated this relationship in France, United Kingdom, Germany and Italy, and found that the Okun's law is valid only at short-run, while on a long-run, the relationship between economic growth and total unemployment is positive. Javeid (2005) observed the validity of this law in Pakistan, and found that a 1% increase in GDP will lead to 2.8% decrease in the total unemployment rate. Arshad (2010) proved the existence of the Okun's law in Sweden, estimating that a 1% in GDP will lead to 2.2% decrease in the unemployment. Ting and Ling (2011) investigated the validity of the Okun's law in Malaysia and found a significant coefficient of -1.8%. Akeju and Olanipekun (2014) looked at the economic output and unemployment in Nigeria. Using the Error Correction Model, they found a weak link between the two variables: 1% change in unemployment will lead to 0.097% increase in the economic output. Dare and Hek (2016) using the ARDL model found that on a long-run, a 1% increase in the real GDP growth leads to a 2.3% decrease of unemployment rate in Curacao. On short-run, the effect is a bit smaller and leads to a 1.9% decrease in unemployment rate.

There is also literature which investigates the relationship between the youth unemployment and the economic output. Gocer and Erdal (2015) estimated the relationship between these two variables in 18 Central and Eastern European countries, and found that 1-point decrease above average economic growth rate is associated with a 1.13% decrease in youth unemployment. Zyra (2013) observed this relationship in Poland, and found out that an increase of the output growth for 1 percentage points contributes to a 0.37 percent decrease in youth unemployment rate. Furthermore, Zyra also found that the youth unemployment is closely associated to the general unemployment in Poland, and that an increase of a percentage point in the general unemployment will result in 0.46 percent higher youth unemployment.

The literature in North Macedonia offers diverse conclusions regarding the Okun's law validity in the country. For example, Unevska Andonova and Petrovska (2018) prove the existence of the link between unemployment and economic growth, however suggesting that the relationship has been somewhat weaker in the recent years, which might be related to the recent job-intensive growth in the wake of structural reforms before and during the global financial crisis and particularly the subsequent European debt crisis. Tumanoska (2019) using the ARDL model also confirms that there is a statistically significant long-run relationship between the GDP growth and total unemployment in North Macedonia, at the 1% level of probability. On the other side, studies like Sadiku at al. (2014) using quarterly data based on the VAR methodology and Engel-Granger cointegration test, show that there is no causal relationship between these two variables and a change in the growth rate of real GDP doesn't cause a change in the rate of unemployment and vice-versa. In terms of the link between youth unemployment and economic growth in North Macedonia, there seems to be a gap in the available literature.

3. PROBLEM STATEMENT

The main aim of this study is to empirically examine and test the relationship between the total unemployment rate and GDP growth in North Macedonia over the period of time (1991-2019), in order to examine the validity of the Okun's law. Moreover, the study also looks at the relationship between the youth unemployment level and the GDP growth for the same time period.

4. LIMITATIONS

Before the study dwells into deeper analysis, we should point out as limitation that it uses annual data for the empirical analysis, hence the number of observations is low. For further analysis, this empirical analysis with quarterly data is suggested to be done in order to check if the results correspond with the ones received with annual data.

The calculations of the unemployment rates have some limitations as well, considering the fact of the changes in size of informal sector and the emigration problem. To avoid such limitations, further research should also investigate the link between economic growth and the total employment level, which might reveal different conclusions.

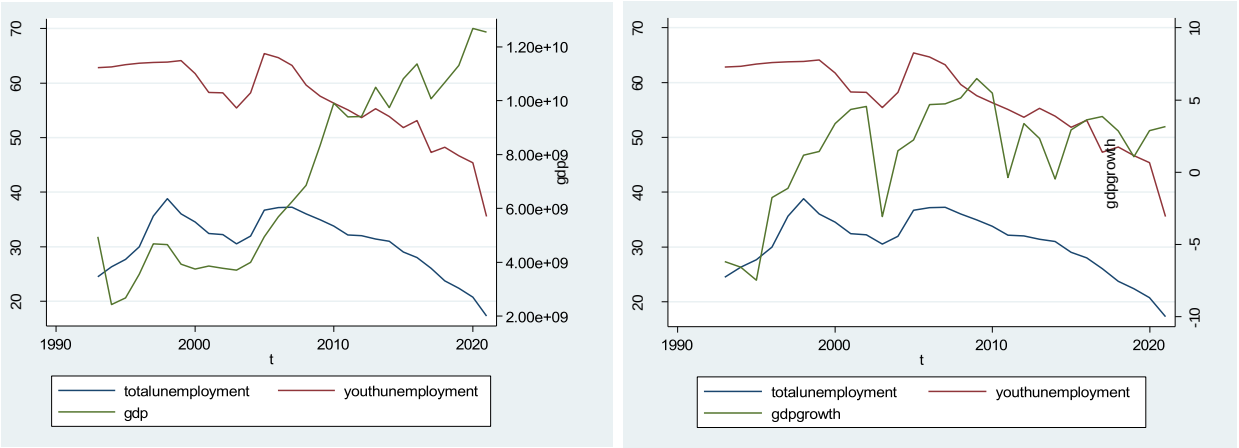
5. UNEMPLOYMENT AND ECONOMIC GROWTH IN NORTH MACEDONIA

The labor market in North Macedonia has varied significantly through the last thirty years. The total unemployment rate started with a low level of 24.5% in 1991, only to increase by 10 percentage points in the following fifteen years, reaching an all-time high level of 37.25% in 2005. The last fifteen years this situation has improved reaching an all-time low level of total unemployment of 17.26% in 2019.

The status of youth unemployment aged 15-24 followed another trend. It started out in 1991 with a seriously high level of 62.83%, reaching an all-time high level in 2004 of 64.69%, followed by a gradual decline until 2018 and reaching an all-time low level of youth unemployment in 2019 of 35.55%. Nevertheless, this rate is still high compared to the total unemployment level, and continues to be a serious societal problem. The current rate of youth unemployment is far above the EU-28 average and world-average levels of youth unemployment as well.

Another concern is the low activity rate of these persons, which deteriorated from 35.9% in 2007 by 32.8% in 2017. According to the Ministry of labor and social policy, main reasons for such situation are: increased time spent in education, reduced employment opportunities, difficulties during the school to work transition process, mismatch between the skills supply and demand at the labor market and the reluctance of the employers to cover the costs for initial on-the-job training of the young employees.

Figures 1 and 2. Trends of total unemployment, youth unemployment and GDP/GDP growth (1991 – 2019)



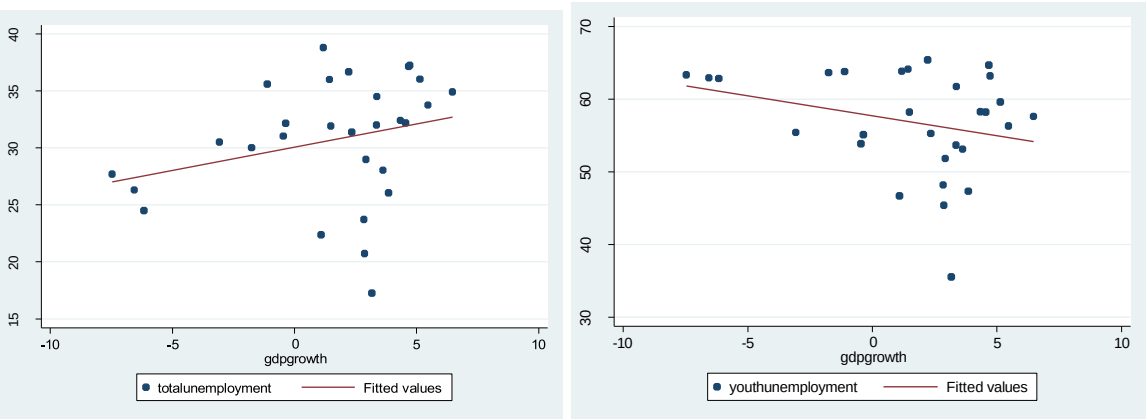
Source: World Bank database

Figures 1 and 2 represent the trends of the total unemployment rate, youth unemployment rate, GDP and GDP growth rate in the period 1991-2019. It shows that the youth unemployment is twice as the

total unemployment rate. This gap is only starting to decrease in the recent years, however the reasons behind it can be an issue of discussion as well. The trend in the GDP is witnessing a significant increase in the period 2002-2008, which is the period right after the armed conflict in 2001, and before the 2008 world financial crisis. The period which comes after 2008 is witnessing oscillations especially in the years when after effects are happening after the world financial crisis and the European debt crisis. The situation with the GDP growth also follows the political and economic crisis in the country: the ethnic conflict in 2001, the aftereffects of the global financial crisis in 2009 and the aftereffects of the European debt crisis in 2012.

Figures 3 and 4 show if there is some relationship between the variables, however no potential relationship or correlation among the variables can be detected from the scatterplot.

Figures 3 and 4. Relationship between GDP growth and unemployment rates



Source: World Bank database

6. DATA AND METHODOLOGY

This study tries to investigate the relationship between the economic growth and the unemployment rates (of total population and of youths) in Republic of North Macedonia for the period 1991 – 2019. The study uses annual data for the unemployment rate, youth unemployment rate and economic production collected from the World Bank database. Total unemployment refers to the share of the labor force that is without work but able for and seeking employment. Youth unemployment refers to the share of the labor force ages 15-24 without work but able to work and actively seeking employment. The GDP growth rate (annual %) is expressed at current US dollars' market prices.

The study employs an auto-regressive distributed lag model (ARDL) to estimate the β coefficient. There are several reasons behind the choice of ARDL instead of other techniques. First, ARDL is preferred for observations when variables are integrated of mixed orders. Second, the bounds testing procedure of the ARDL technique is more efficient for small and finite data series. Third, this technique generates unbiased estimates for the long-run model. The generalized ARDL (p, q) model is specified as:

$$Yt = \Upsilon ot + \Sigma pi=1\ \delta jYt-1 + \Sigma qi=1\ \beta jXt-1 + \varepsilon jt \quad \text{.....} (1)$$

Where Yt is a vector, β and δ are coefficients, Υ is the constant, j = 1….k, p and q are optimal lag orders where p is used for the dependent variable and q is used for independent variable, εjt is a vector of error terms. It means that the dependent variable is a function of its lagged value, the current and lagged values of the exogenous variables in the model.

The ARDL technique is a three-step process. The first step is an estimation of the optimal lag length chosen according to the Akaike Information Criteria (AIC). The second step is a bound cointegration test

where the null hypothesis being that there is no co-integration between the GDP growth and the unemployment is conducted. The estimated value is compared with the critical value from Pesaran, Shin and Smith (2001), and the null hypothesis is rejected if the test statistics is above the upper critical value. If the results suggest that there seems to be a long-run relationship, the third step uses the Error Correction Model (ECM) to provide the speed of adjustment back to long-run equilibrium after a short-run shock.

$$\Delta Yt = \alpha 1 + \Sigma \delta i \, \Delta Yt\text{-}I + \Sigma \omega \, \Delta Xt\text{-}I + \rho 1 ECTt\text{-}1 + \varepsilon t \ldots\ldots\ldots\ldots\ldots (2)$$

7. EMPRICAL RESULTS

First, the study examines the integration characteristics of the main variables, i.e. if they contain a unit root. Datasets with unit roots follow a stochastic trend, and are non-stationary. Non-stationarity implies that data series do not have constant mean, constant variance and constant co-variance over time. To test the stationarity of our variables, we are employing two stationarity tests, Augmented Dickey-Fuller and Phillips-Perron tests, which are often applied and details on them can be found, for example, in Wooldrige (2007). The null hypothesis in both tests is that the series is non-stationary, i.e. contains unit root.

Table 1. Unit roots tests

Unit root test		T statistics								
		YU	U	GDPG	YU_D1	U_D1	GDPG_D1	YU_D2	U_D2	GDPG_D2
ADF	t-stat	1.617	0.388	-2.597	-1.900	-1.455	-2.760*	-3.635**	-3.849***	-2.743*
	p-value	0.9979	0.9811	0.0936	0.3322	0.5558	0.0642	0.0051	0.0024	0.0668
PP	t-stat	1.838	0.029	-2.584	-3.137**	-1.846	-3.597**	-6.791***	-5.352***	-5.337***
	p-value	0.9984	0.9609	0.0964	0.0239	0.3580	0.0058	0.0000	0.0000	0.0000

Source: Author's calculations.

Note: *, **, *** signify that the null hypothesis (has unit root) is rejected at the 10, 5 and 1% level. The number of time lags is automatically chosen based on the Schwarz information criterion.

The results of the unit root tests are shown in Table 1. If we analyze the series of total unemployment, youth unemployment and GDP growth, the tests show that all are non-stationary, which is additionally supported with Figure 1. Since the results suggest that the series for total unemployment, youth unemployment and GDP growth are non-stationary, we conclude that variables are non-stationary in levels. After first differencing, series for total unemployment and youth unemployment stay non-stationary, while the Augmented Dickey-Fuller test rejects the null hypothesis of a unit root, but only at the 10% level of probability for the GDP growth variable. The Phillip-Perron test rejects the null hypothesis of a unit root at 5% level for both youth unemployment and GDP growth. After the second differencing, all variables become stationary, which means that they are integrated of order I (2). Under I (2), the Augmented Dickey-Fuller test rejects the null hypothesis of a unit root at the 1% level of probability for total unemployment, 5% level of probability for youth unemployment and 10% for the GDP growth. On the other side, the Phillip-Perron test rejects the null hypothesis of a unit root at 1% for all three variables.

7.1 TOTAL UNEMPLOYMENT AND GDP GROWTH

Before proceeding with the bounds test, we must specify the number of lags to include, given that the F-statistics for co-integration is sensitive to the lag length. The optimal number of lags used in the equation is the one from Akaike Information Criterion (AIC), which is 2 for the total unemployment and 1 for the GDP growth rate. It means that our model is ARDL (2, 1). Next, we proceed with the ARDL bounds test to check if there is a link between GDP growth and total unemployment.

Table 2. ARDL Bounds test (GDP growth and total unemployment)

Test statistic	Value	K
F-statistic	2.450	1
Significance level	I (0)	I (1)
10%	4.04	4.78
5%	4.94	5.73
1%	6.84	7.84

Source: Author's calculations.

The Bounds test, whose results are shown in Table 2, suggests that there is no long-run relationship between the variables, given that F value is not above the upper bound, so it means there is no cointegration among the variables. According to the finding that the variables are not co-integrated on the long run, we are proceeding with estimating of their short-run relationship, using ARDL – auto-regressive distributed lag model. The β coefficient for the short-run relationship is significant at 1% level, however the value is positive which means that it is not in correspondence with the Okun's law.

Now, we try to see if the model is invalid as well in the opposite direction, i.e. does total unemployment has any effect on the GDP growth. The results from the bounds test from this model is represented below:

Table 3. ARDL Bounds test (total unemployment and GDP growth)

Test statistic	Value	K
F-statistic	4.899	1
Significance level	I (0)	I (1)
10%	4.04	4.78
5%	4.94	5.73
1%	6.84	7.84

Source: Author's calculations.

This Bounds test, suggests that there is a long-run relationship between the variables, given that F value is above the upper bound only at 10% level of significance. To check if this correlation is valid at short and long run, we employ the ARDL including error correction model. The results are presented below.

Table 4. Results

Dependent variable GDP growth	
Speed of adjustment coefficient	-0.62 (0.005)
Short run Total unemployment	8.49 (0.123)
Long run Total unemployment	-8.02 (0.473)

Source: Author's calculations.

The results suggest that there is a negative long-run relationship between the GDP growth and total unemployment, suggesting that a 1% increase in total unemployment rate leads to 8.02% decrease in the GDP growth. On short-run, the coefficient is positive, meaning that the Okun's law is not valid for short-run. These results are in line with the Okun's law and the literature. The adjustment term is negative and statistically significant. The statistical significance of the adjustment term suggests that unemployment is driven by the economic growth, while the negative adjustment term implies that the imbalance in their relationship is balanced after a shock.

7.2 YOUTH UNEMPLOYMENT AND GDP GROWTH

Next, the study looks at the empirical relationship between the youth unemployment and GDP growth. For this test we are using an optimal lag length of 1 for youth unemployment and 1 for GDP growth, meaning that our model is ARDL (1, 1).

Table 5. ARDL Bounds test (GDP growth and youth unemployment)

Test statistic	Value	K
F-statistic	1.669	1
Significance level	I (0)	I (1)
10%	4.04	4.78
5%	4.94	5.73
1%	6.84	7.84

Source: Author's calculations.

The results of the Bounds test are shown in Table 6. Given that the F value falls below the lower values for I (0) values for all significance levels, we cannot reject the null hypothesis, meaning that there is no long-run relationship between the youth unemployment and GDP growth. According to the finding that the variables are not co-integrated on the long run, we are proceeding with estimating of their short-run relationship, using ARDL – auto-regressive distributed lag model. The β coefficient for the short-run relationship is significant at 1% level, however the value is positive which means that it is not in correspondence with the Okun's law.

To see if the model is valid in the opposite direction, i.e. if youth unemployment affects GDP growth, the study shows the results from the bounds test below:

Table 6. ARDL Bounds test (youth unemployment and GDP growth)

Test statistic	Value	K
F-statistic	3.389	1
Significance level	I (0)	I (1)
10%	4.04	4.78
5%	4.94	5.73
1%	6.84	7.84

Source: Author's calculations.

This Bounds test, suggests that F value falls below the lower values for I(0) values for all significance levels. Therefore, we cannot reject the null hypothesis, meaning that there is no long-run relationship between the youth unemployment and GDP growth.

According to the finding that the variables are not co-integrated on the long run, we are proceeding with estimating of their short-run relationship, using ARDL – auto-regressive distributed lag model. The β coefficient for the short-run relationship is significant at 1% level, however the value is positive which means that it is not in correspondence with the Okun's law.

7.3 GRANGER CAUSALITY

Even though there is no correlation on the long run level, we employ the Granger causality test to see if there is any causality among the variables.

Table 7. Granger causality test

Null Hypothesis	Obs	F-statistic	Prob.
Total unemployment does not Granger cause GDP growth	27	1.714	0.424

GDP growth does not Granger cause total unemployment	27	9.6625	0.008
Youth unemployment does not Granger cause GDP growth	28	0.00883	0.925
GDP growth does not Granger cause youth unemployment	28	1.9512	0.162

Source: Author's calculations.

From the results in the Table 7, we can conclude that only in the case GDP growth does not Granger causes total unemployment, we can reject the null hypothesis. In the remaining three cases, we cannot reject the null hypotheses since the p-values are not lower than 5%, which means that total unemployment does not Granger cause GDP growth and also youth unemployment and GDP growth do not Granger cause each other.

8. CONCLUSION

This paper investigates the relationship between unemployment rates (total and youth) and GDP growth in North Macedonia, in the context of Okun's Law, in the period 1991-2019, using the Auto-regressive Distributed Lag Model (ARDL). The research starts the unit root tests, which show that all three variables are integrated of order two I (2). The Bounds test for the relationship between total unemployment and GDP growth suggest that there is no long-run relationship between these variables. For that reason, we employ the ARDL to see if there is a short-run relationship. The results show that the β coefficient is significant at 1% level, however the value is positive which means that it is not in correspondence with the Okun's law. On the other side, the Bounds test for the opposite direction between GDP growth and total unemployment show that there is a negative long-run relationship between the GDP growth and total unemployment, suggesting that a 1% increase in total unemployment rate leads to 8.02% decrease in the GDP growth.

The Bounds tests for the relationship between the youth unemployment and GDP growth showed that there is no co-integration between the variables in both directions, which was a good ground for estimating only the short-run relationship. However, even though the coefficients for the short-run relationships are significant at 1% level, the coefficients are positive, suggesting that even on short-run, the Okun's law is not valid as well. These findings imply that more focused and youth-specific strategies and initiatives should be implemented to combat young unemployment rates.

The results from the Granger causality tests show that only GDP growth Granger causes total unemployment, while in all other cases we cannot reject the null hypothesis.

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THE EFFECTS OF PRICE AND PACKAGING ON THE CONSUMER BEHAVIOR

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ABSTRACT

This study aims to analyze the influence of price and packaging on purchase intention. Price is considered to be one of the most important attributes in consumer choice. On the other hand, consumer price knowledge tends to be not so precise. Therefore, this article aims to provide new information analyzing consumer perception or the effects that price and packaging design have on consumer behavior. Packaging design has recently become one of the most popular forms of business-to-consumer communication in terms of influencing consumer purchasing decisions. With this in mind, business organizations around the world continue to emphasize the importance of consumer opinions regarding packaging design, to obtain information that will then be used to determine the approach to use. With the growing importance of packaging design, the main purpose of this article is to provide information on the influence of packaging design on consumer purchasing decisions. One of the main findings of the study is that price and design play an important role in consumer choice, and design factors are important when deciding between two or more substitute product on the market. This research paper goes beyond and describes how numbers and illustrations are the most important element of packaging design that grabs people's attention and how price helps to change or influence people's buying behavior of certain products.

KEYWORDS

PRICE, PACKAGING, CONSUMER CHOICE, DEMAND.

JEL CLASSIFICATION CODES

D01

1. INTRODUCTION

Marketing has played a major role in the business world these days, and in fact today it is considered one of the most important factors to deal with when a company grows sales or plans something better. It is no exaggeration to say that. Achieve organizational productivity. The main goal of an organization is to build an organization that is highly effective and performs well. However, to be effective, your organization must have clear goals and appropriate strategies to achieve those goals. One of the factors to keep in mind is marketing as one of the most important tools for success these days. This research paper deals only with one element of the endless realm of marketing: the design of product packaging and the analysis of whether that design influences consumers' purchasing decisions.

Enterprises use a variety of packaging features when designing product packaging by combining

colors, designs, shapes, symbols, and text. This is Nancarrow et al. (1998) Helps to attract the attention of consumers and products through the images displayed on the packaging. The role of package design was recently appointed by market participants, but its important role is similar to other elements of marketing communications. This is probably because consumers are unlikely to ponder the product brand until they shop in the store.

The section one briefly describes the theory of demand as one of the most important element of today's business world, and the inevitable importance and role of price and packaging in the market and in the consumer choice, and its implication about their purchasing decisions. It also provides information about the analysis of this paper and the research questions addressed in this paper.

Section two reviews potential and existing literature on the impact of price and packaging on consumer choice and provides information on similar observations by various authors on this subject.

Section three consists of analytical parts and presents a model of analysis related to the research questions raised in this research paper. It also provides information about the techniques and tools used in this paper to perform the analysis.

Section four describes the methodological part of this contribution, the empirical analysis, and provides the structure of the questionnaire created and the data on its answers and respondents.

Section five of this paper contains the analysis results of this survey and lists the observations, data, and interpretations of each question in the survey.

The final section is about the conclusions made about this research paper. There will be briefly explained the meaning and results of this research paper, as well as my personal opinion about the impact and importance of price and packaging on consumer choice.

Finally, this research paper demonstrates the impact of price and packaging on consumer choice, emphasizing the inevitable importance that they play in the market, and emphasizes the need to include it in organizational strategies in order to increase the sale revenues. Moreover, it is demonstrated the important effect that price has on the consumer behavior.

2. LITERATURE REVIEW

According to Connolly and Davidson (1996) and its current research, problematic topics in package design have recently attracted the attention of many scientists and businesses, with 73% of purchase decisions at point-of-sale, or in-store. It is done in one of their papers, Rettie and Brewer (2000) pointed out the importance of package design and the increasing use of packages as a means of communication. It is important to consider the opinions of Nancarrow et al. (1998) It states that every package of a product is shaped by several package attributes, such as a combination of colors, shapes, symbols, letters and designs. In this way, you can attract the attention of consumers and identify specific products.

Price, on the other hand, is arguably one of the most influential factors in product perception in the market. According to Beneke et al. (2015), Prices are the actual guide consumers use to make purchase decisions. Price variables are always present in everyday shopping and represent the value of economic spending that consumers have to give up in order to make a particular purchase. This is what Zeithmal (1988) calls sacrificial value. Since price represents a "sacrifice", this variable is in the opposite of the purchase intent, and the higher the price, the less chance of a purchase. In some cases, Nevin e Houston (1980), Mitchell (2010), Kara et al. (2009) stated that consumers do not always view prices negatively, which represents economic costs, but is a complex variable in purchasing decisions. They suggest that price is an indicator of product quality and may represent elegance and status. These negative or positive perceptions of the role of price lead to the consumer's price image. Therefore, price perception has a strong influence on consumers' purchasing decisions. Price recognition provides information about the product and provides consumers with profound implications (Kotler and Keller, 2016). Therefore, price is an important factor in purchasing decisions for products that are purchased particularly often, and then

influences the choice of which store, product, and brand to prioritize (Faith and Agwu, 2014). Consumers are very rational when it comes to assessing the profits, they want to get from purchasing the products and services they are paying for (AlMamun and Rahman, 2014). Product prices can be divided into three dimensions: fair price, fixed price, and relative price. Reasonable price refers to adjusting the price to provide a combination of quality and reasonable service at a reasonable price (Kotler and Keller, 2016). Fixed prices are fixed prices for all buyers (Kotler and Keller, 2016). Relative prices are prices set according to the seller's quality and service (Kotler and Armstrong, 2014). According to a survey by Komaladewi and Indika (2017), most respondents, like the results of Djatmiko and Pradana (2015) and Termsnguanwong (2015), see price as an important factor influencing purchase decisions.

The majority of consumers are price sensitive, but also consider other factors such as brand image, location, service, value and quality (Tjiptono, 2008). Many consumers use price as a quality indicator, based on the general phrase "you get what you pay for" (Lien et al., 2015). Tajdar et al. (2015) Recommended that the brand should be reasonably priced. According to Tjiptono (2008), price is an important factor as it influences the brand's image and positioning strategy. Perceived high prices reflect high quality, and vice versa, as consumers tend to associate prices with product levels. In addition, Bühler and Halbherr (2017) state that price is a factor that helps improve brand image.

Another important debate related to this issue is whether consumer behavior is consistent across cultures around the world. However, while some observers believe that some of the basic issues are exactly the same across countries, certain details can be interpreted as different across cultures. Underwood et al. (2001) suggests that packaging is a symbol that effectively conveys the positive or unfavorable meaning of a product, and that the characteristics of the packaging can emphasize the originality and uniqueness of a particular product. Colors, symbols and images are important attributes of product packaging, so that all companies receive designs that serve as a strategic way to differentiate products in the market and as an important tool for market segmentation, tries to combine them. Packaging as one of the key communication elements of a product has some basic functions that define packaging according to its role in logistics and marketing, according to Pitt and Prendergast (1996). In the logistics department, the function of packaging is to protect a particular product while it is being transported through the distribution channel. In addition, it can increase the cost of the product, but reduce the possibility of damage, loss, rot, etc.

Package design consists of several elements that, when properly combined, can have a positive effect on sales. These appearance features can also be used in combination with other quality features as a powerful strategic differentiator to improve consumer awareness. One of these appearance attributes is color. It is defined as one of the nonverbal signs of a major market phenomenon (Evans et al., 1996), Belizzi et al. (1983), its importance is recognized in advertising. And packaging. Some authors, such as Danger (1987), emphasized the role of color as the primary visual indicator used to attract the attention of consumers, and color as the first element people notice in product packaging design. Is defined. Despite the importance that color may attract the attention of consumers, Kojina et al. (1996) suggest that package color preferences can influence consumer choice, and this opinion on package color is Gordon et al. (1994) was also endorsed and endorsed by the author group. Despite these opinions, many scholars, such as Schoormans and Robben (1997), say that color is an important packaging sign that draws people's attention and can actually be presented as the first sign that consumers pay attention to. Insisted. Previous study by the author Garber et al., (2000) support the opinion that it draws the attention of consumers when looking for a variety of product choices. Another packaging element that is said to play an important role in packaging design is the packaging shape of the product. This influences product ratings and consumer choices, according to Veryzer (1993). Studies by Creusen and Schoormans show that product design can be used as an important tool to determine a consumer's first impression of a particular product and to attract market segmentation and potential consumers. As the study of Schmitt and Simonson (1997) shows, there are also symbols that represent other important elements such as photographs and illustrations, as well as other visual elements that serve to attract the attention of consumers.

3. RESEARCH METHODOLOGY

There are many studies in the existing literature that highlight the impact of price and packaging on consumer choice, and its impact on product variations. In fact, some authors relate price and packaging design to the quality of products in economic models that show the impact on consumer attention and increased consumer demand. This research paper examines the relationship between price, packaging and consumer choice, and whether this relationship is positive, that is, cheap and good packaging design has a positive impact on consumer choice for a particular product. The survey should also investigate whether prices have a positive impact on consumer behavior.

Up to now, in the Balkan region, both price and package design have shown the impact on consumer choice, but there was a gap to measure. Based on this, this research paper creates two hypotheses, and with the help of them, attempts to provide answers to the questions in our research.

H1: There exist a positive relationship between the price and consumer behavior.

H2: Packaging has a positive impact on consumer choice.

Thus, previous section clarified the importance of price and packaging and discussed similar dissenting opinions and studies from various authors. The methodology section of the next section attempts to design a methodology that provides the answer to the hypothesis made.

The literature review section emphasized the importance of pricing and packaging to consumer choice, based on the available literature and analysis performed by many authors. The data analysis is one of the most important parts of the survey process, as it is necessary to design the survey and select the right tools and methods for data collection. A survey was created to collect the data needed to perform this analysis, and 144 respondents responded to this survey. Questions that participate in the questionnaire are categorized as closed-closed, and the answers are created according to a Likert scale from "strongly agree" to "strongly disagree". Descriptive statistics are used to obtain the results from this survey.

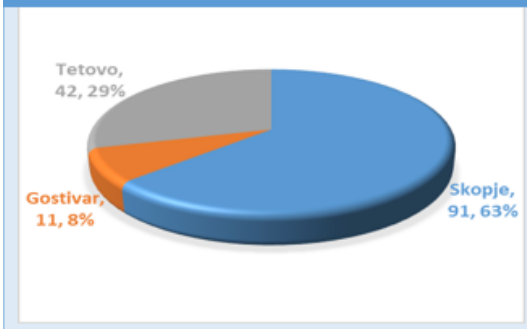
4. EMPIRICAL FINDINGS

This section reviews the answers to the hypotheses made in this research paper and presents the results of a survey conducted to individually interpret the results of each question. As mentioned earlier, this analysis is performed using a questionnaire consisting of the first three questions related to the respondent's location, gender, and age. The answerer's location question is asked as the first question in the first section of the questionnaire. It consists of three main questions used to determine the structure of the respondents. In this question, they were asked to indicate where they lived, and based on their answers, they found the following results.

Question 1: Location of the Respondents

Based on the results of the survey, 91 respondents were resident of Skopje, thus from 144 respondents approximately 64% are from the capital city. On the other side, 42 are from Tetovo. While only 11 respondents are from Gostivar.

Figure 1: Location of the Respondents



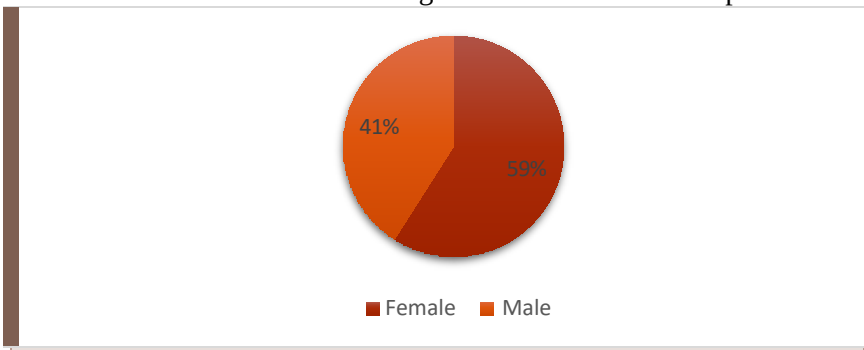
	Frequency	Percent
Skopje	91	63.19%
Gostivar	11	7.63%
Tetovo	42	29.16%
Total	144	100.00%

Source: Authors calculations

Question 2: Gender of the Respondents

As for the second question of the survey, which is intended to determine the gender of the respondents the following results have been shown in the figure 2 below. Regarding the results that have been collected from the survey we can claim that from total of 144 respondents, 85 are females, thus 59.02% females, and 59 or 40.98% in this survey are males.

Figure 2: Gender of the Respondents



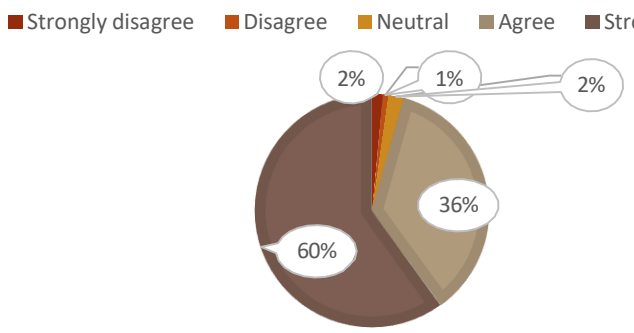
	Frequency	Percent
Female	85	59.02%
Male	59	40.98%
Total	144	100.00%

Source: Authors calculations

Question 3: Price plays a very important role in my buying behavior:

Question 3 deals with the importance of the price when consumers are buying a product. Results claim that 82 respondents strongly believe that price is an important factor that has a significant impact on consumer choice when purchasing a product. 49 only agree for the significant impact of the price on consumer choice. Five neutral respondents of the 144 claim that price doesn't affect the product consumption.

Figure 3: Importance of price in buying behavior



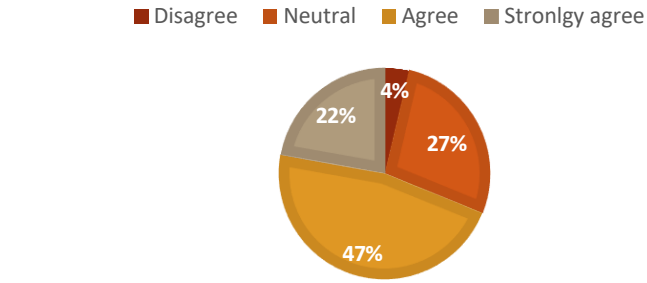
	Frequency	Percent
Strongly disagree	3	1.50%
Disagree	2	0.70%
Neutral	8	2.20%
Agree	49	35.60%
Strongly agree	82	60%
Total	144	100%

Source: Authors calculations

Question 4: Package design has a great importance and impact over my buying behavior:

As for the question 4, it is seen if the package design plays an important impact on the consumer choice, the following answers have been gathered: 46.7% claim that packaging design plays a huge role on the consumers' choice, 22.2 % strongly agree, while 38 are neutral for its importance.

Figure 4: Importance of package design in buying behavior



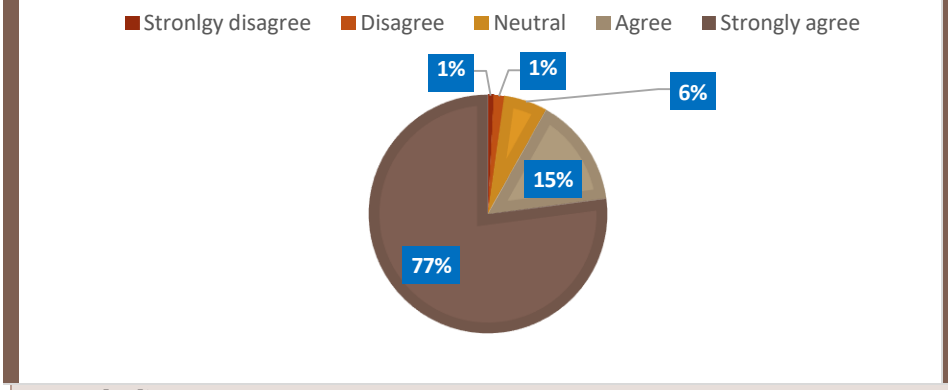
	Frequency	Percent
Disagree	6	3.7%
Neutral	38	27.4%
Agree	64	46.7%
Strongly agree	31	22.2%
Total	144	100%

Source: Authors calculations

Question 5: Expiring date of a product has an importance in my decision to buy the product:

As for the question five, the results indicate the answers in order to see whether the expiring date of a product plays a high importance on the consumers' choice. 102 of the 144 respondents strongly agree that expiration is an important factor in consumer choice, and 24 confirm this as I agree while10 are neutral. 6 disagree, but 2 respondents strongly disagree to this. This results show expiration as an important indicator that plays a very important role in consumer purchasing decisions when purchasing a particular product.

Figure 5: Importance of expiring date in consumer's choice



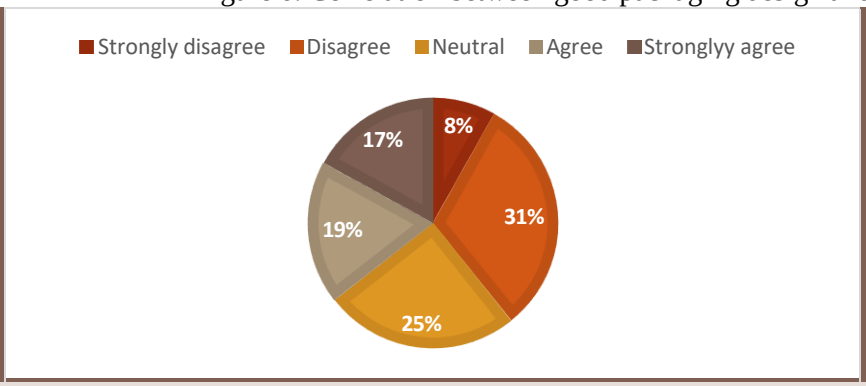
	Frequency	Percent
Strongly disagree	2	0.70%
Disagree	6	1.50%
Neutral	10	5.90%
Agree	24	14.80%
Strongly agree	102	77%
Total	144	100%

Source: Authors calculations

Question 6: Packaging design is related to high quality of the product:

The following two questions, namely question 6 and 7 are created to show if the package design correlates with the quality of the product. That is, it shows whether good packaging design is related to high quality or low quality, and the results are presented in the figure below.

Figure 6: Correlation between good packaging design and high quality



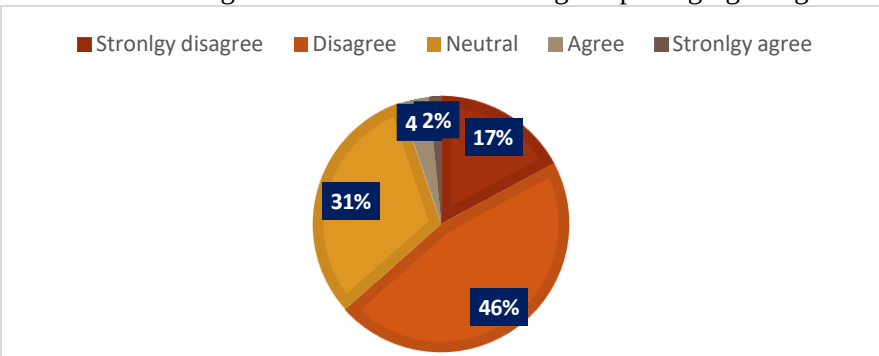
	Frequency	Percent
Strongly disagree	12	8.10%
Disagree	45	31.10%
Neutral	36	25.20%
Agree	27	18.50%
Strongly agree	24	17%
Total	144	100%

Source: Authors calculations

Question 7: Packaging design is related to low quality of the product:

The results of the seventh question, which is the opposite of the previous question, show that 46% of respondents disagree with the statement that products with good packaging design are of poor quality and 17% strongly disagree. Only 3 respondents strongly disagree while 31% are neutral.

Figure 7: Correlation between good packaging design and low quality



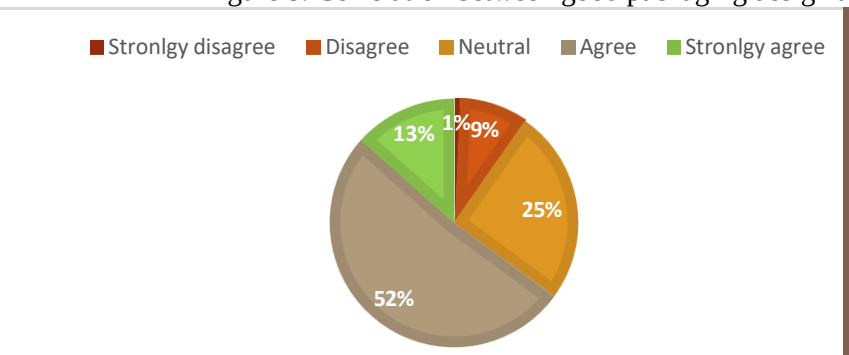
	Frequency	Percent
Strongly disagree	24	17%
Disagree	65	45.90%
Neutral	44	31.10%
Agree	7	3.70%
Strongly agree	3	1.50%
Total	143	99.30%
Missing	1	0.70%
Total	144	100%

Source: Authors calculations

Question 8: Good packaging design is related to higher price of the product:

The following results were obtained for the 8th and 9th questions of the questionnaire, which was virtually created to show the relationship between package design and price. From the tables and graphs, we can see that only one of the 144 respondents did not answer this question. Out of these, 54.8% agree that products with good packaging design are priced high on the market. 8.3% percent of respondents did not agree with this statement and marked the answer.

Figure 8: Correlation between good packaging design and high price



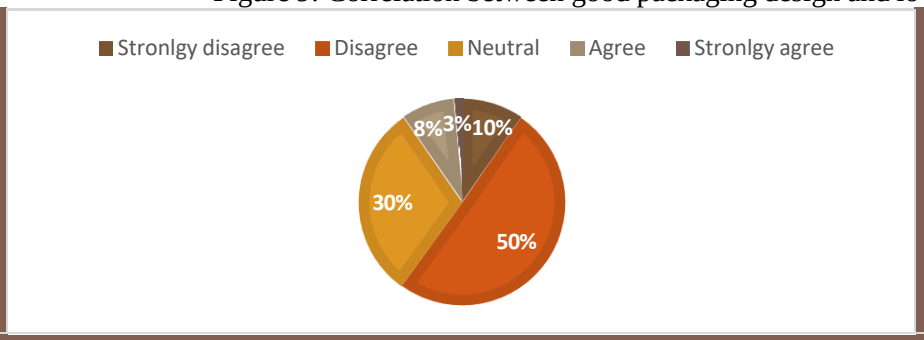
	Frequency	Percent
Strongly disagree	1	0.69%
Disagree	12	8.3%
Neutral	35	25.2%
Agree	79	54.8%
Strongly agree	17	11.8%
Total	143	99.3%
Missing System	1	0.7%
Total	144	100%

Source: Authors calculations

Question 9: Good packaging design is related to cheaper price of the product:

The results in this table only reinforce the certainty of the results of the previous question. Of the 144 respondents, 70, or 48.61.4%, say that products with good packaging design are cheap on the market. This indicates that they do not agree. By linking the answers to the previous two questions, it can be realized that there is a relationship between package design and product pricing.

Figure 9: Correlation between good packaging design and low price



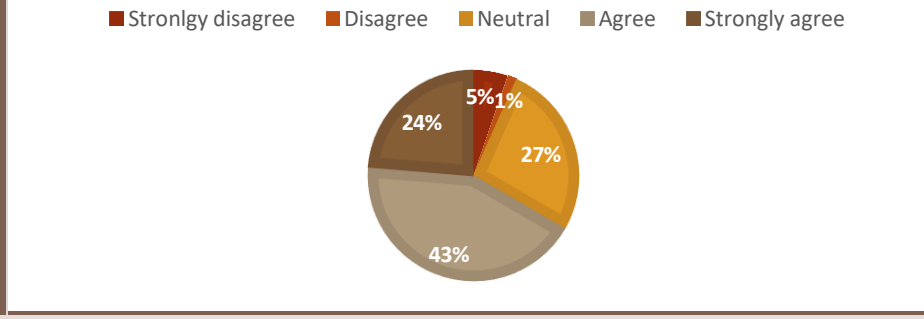
	Frequency	Percent
Strongly disagree	15	9.60%
Disagree	70	48.61%
Neutral	43	30.40%
Agree	13	8.10%
Strongly agree	3	1.50%
Total	144	100%

Source: Authors calculations

Question 10: Package design helps me as a consumer to make choices when buying products in the market:

The following question 10 is also related to the first hypothesis of our study. This shows whether package design can greatly help consumers make choices when buying products in the market. The result of the respondent is as follows. From this data, it can be said that 43% of respondents agreed that package design would be of great help to consumers when purchasing a product. 23.7%, or 32 respondents, strongly agree with this statement, but only 1.5% do not, and 5.2% do not explicitly agree.

Figure 10: Importance of packaging in helping make consumer decision

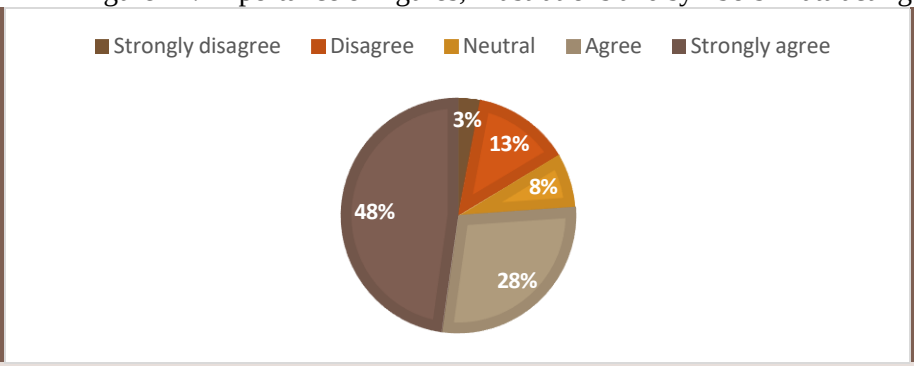


	Frequency	Percent
Strongly disagree	9	5.20%
Disagree	4	1.50%
Neutral	38	26.70%
Agree	60	43%
Strongly agree	33	23.70%
Total	144	100%

Question 11: Figures, illustrations and symbols are important to attract consumer's attention:

The results in these tables show that all the factors in the survey are important for attracting consumer attention, while figures, illustrations, and symbols show that 47.4%percentage of respondents strongly agree with this confirmation.

Figure 11: Importance of figures, illustrations and symbols in attracting consumer decision



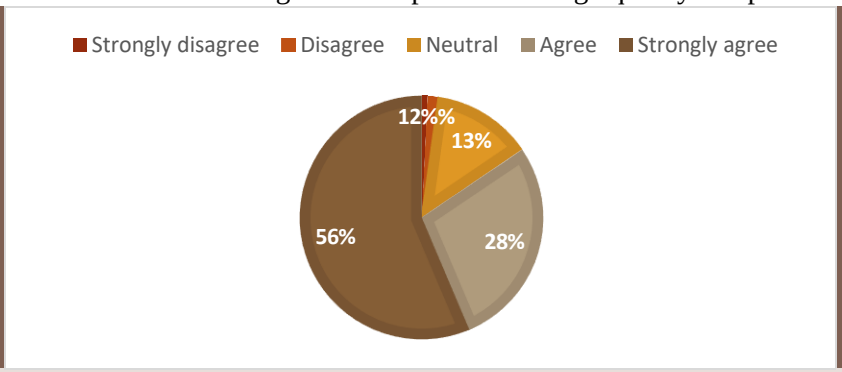
	Frequency	Percent
Strongly disagree	6	3%
Disagree	20	13.30%
Neutral	12	7.40%
Agree	40	28.10%
Strongly agree	65	47.40%
Total	143	99.30%
Missing System	1	0.70%
Total	144	100%

Source: Authors calculations

Question 12: I would stop purchasing a product with a good package design that is not of high quality in the future:

The following question 12 is provided to ask the buyer if he / she will stop purchasing a product with a good package design that is not of high quality in the future. The results are shown in the table below and in the graph. The results show that 56.3% and 80 respondents, respectively, agree with the statement that complete information greatly facilitates consumer decision-making when buying products in the market, while 0.7% or 2 persons only shows strong opposition to this statement. Respondents found that they would not buy products with good packaging design that were not of high quality. These results also show how important quality is when consuming a particular product.

Figure 12: Importance of high quality and product packaging



	Frequency	Percent
Strongly disagree	2	0.70%
Disagree	4	1.50%

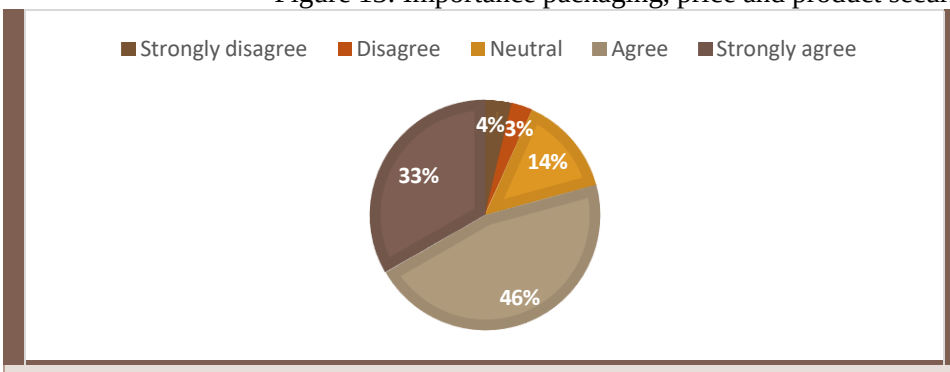
Neutral	20	13.30%
Agree	38	28.10%
Strongly agree	80	56.30%
Total	144	100%

Source: Authors calculations

Question 13: A product with a good packaging and price provides me with product security and this helps me make a purchase:

The question 13 was created to see if a product with a good packaging and price provides consumers with product security and if this helps them make a purchase. The results of this question are shown in the following table and figure.

Figure 13: Importance packaging, price and product security



	Frequency	Percent
Strongly disagree	7	3.70%
Disagree	6	3%
Neutral	21	14.10%
Agree	64	45.90%
Strongly agree	46	33.30%

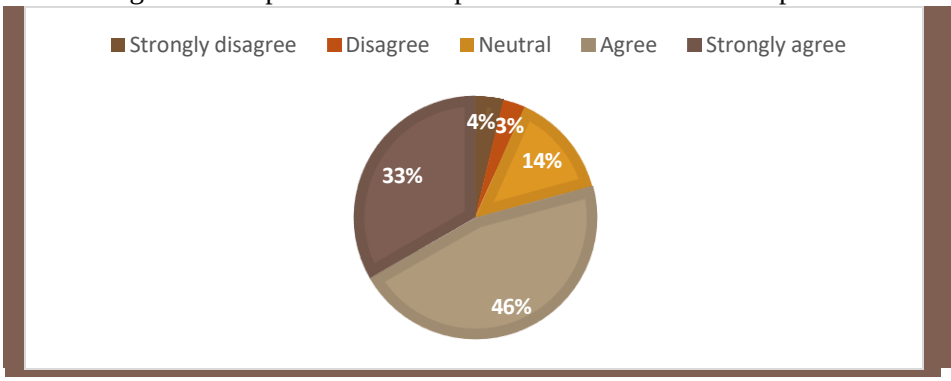
Source: Authors calculations

Question 14: Complete information about the product would help me as a consumer buy the product in the market:

The final question was intended to show if complete information about the product would help consumers buy the product in the market and collected the following results:

The data in this table show that 45.9 percent of the respondents or 66 respondents from total 144 agree that products with good packaging design give assurance to the consumers about the product and that this helps a lot in its purchasing, while only3 percent of the respondents don't agree to this affirmation.

Figure 14: Importance of complete information about the product and consumer behavior



	Frequency	Percent

Strongly disagree	7	3.70%
Disagree	5	3%
Neutral	19	14.10%
Agree	66	45.90%
Strongly agree	47	33.30%
Total	144	100%

Source: Authors calculation

5. CONCLUSION

This paper highlights the importance of the price and packaging design as factors that influence the consumer choice. Also trying to attract the consumer attention of these factors as one of the most important factors in attracting consumer attention. As a result of the research conducted, it was concluded that the design and price are important tools that can increase the consumption of a specific product and are presented as important factors that play a major role in consumer selection. The data collected from the survey provides the expected results, price and packaging design have a positive impact on consumer choice that attracts their attention. There were confirmed the hypothesis of the research paper. Finally, the analysis of the impact of price and package design on consumption can be used as useful information to help businesses maximize profits by understanding consumer preferences and reactions to product design and price policies in their near future.

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