

NECESSARY BANK GUARANTEES FOR THE INTERNATIONAL PROJECTS IMPLEMENTATION IN CONSTRUCTION

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Abstract: Construction industry is an activity connected to a large number of other activities and it influences their development significantly. Construction in Serbia has a long and successful tradition in the international markets, but currently, there is little participation of our companies in the international markets and it is far from the available possibilities. Following the collapse of the largest construction companies during the transition process, new companies are developed and they need institutional and financial help and support to appear in demanding international market. This paper emphasizes the necessity to provide bank guarantees required by investors in the implementation of the international projects, with the aim of securing work quality and contractual deadlines. One of the solutions is to create a Development Bank with the appropriate support for the construction companies in acquiring business in the international market.

Keywords: *the international projects, construction, bank guarantees*

Introduction

In the process of transition, the construction companies experienced the fate of the most industrial companies in the economy of Serbia, and that is the loss of capital and market, a large reduction of the staff, lack in terms of technology, etc. New companies take the place of the large construction companies, trying to acquire international competitiveness with far less capital and compete for the implementation of big international projects. There are many obstacles on the

way, the biggest among them strict investor requirements, i. e., the requirements of those who invest in business in terms of work quality and deadlines.

Construction companies in Serbia possess nothing of their own financial strength for competing with foreign companies which are often assisted by their governments in order to secure international contracts. Therefore, financial institutions should provide stronger financial support for the construction sector with the aim of regaining the place in the large international markets. As our companies have a long and successful tradition in international project execution, appropriate skills and workforce, it is necessary to complete their competitiveness in terms of international markets through stronger financial support.

Macroeconomic aspect of business in construction industry

The characteristics of the economy in Serbia in recent years has been relative macroeconomic stability, along with low inflation, stable exchange rate, employment increase and stable financial system. There is also an increase in real GDP and investments in fixed assets, which is favorable for the development of economic activities.

The risks that slow down the economic growth in Serbia are reflected in energy products price and interest rate increase, more intensive protectionism in the international trade, slowdown in economic growth in key foreign trade partners, slowdown in the European integration process in the region, etc.

According to the Serbian Chamber of Commerce data (2019), there was an increase in industrial production in 2018 in comparison to the previous year of only 1.3%, indicating the need for a faster development in this industry with the aim of backlog reduction in comparison to the developed countries. The total foreign trade exchange of goods in Serbia in 2018 increased by 10.9% compared to the previous year, although imports increased faster than exports (13.0% compared to 8.1%).

According to the World Bank, business environment in Serbia is not very favorable for the people engaged in some economic activities. In fact, the Republic of Serbia is in the 40th place out of 190 countries in the research on business environment for economic activity performance. As far as the construction licence issuing is concerned, Serbia has made considerable progress recently, and it takes the 11th place. The other identified weak points are tax collection in the 79th place, bankruptcy solutions in the 49th place and contract application in the 65th place (The World Bank, 2019).

The National Bank of Serbia supports economic activities by maintaining a relative low reference interest rate, currently around three percent, with low inflationary pressure and the European Central Bank extensive policy that

maintains the reference interest rate at zero in the Eurozone. Such a policy allows companies to plan their growth and development for a longer period because they provide stability and predictability of economic trends in future. In a modern business environment, there is a chance of survival and growth only for the companies with the ability to adjust to the new environment conditions.

Most of the companies in Serbia have been faced with a number of problems in the transition period, such as: insolvency, insufficient investments, unfavorable conditions for loan acquisition, slow process of adjustment to the European standards and technical regulations, illegal work and 'grey' economy, poor market regulation, etc. All of these problems are also present in construction industry. In addition, there are specific problems in construction industry, and their solutions depend mainly on the government. Not only more significant investments in infrastructure are a necessity, but it is also necessary to reduce the existing extensive bureaucratic procedures that make the entire economy and market more difficult to develop.

Company flexibility is its capacity to avoid threats and use the chances quickly, with minimum costs, and financial flexibility management is in the function of company value maximization. Therefore, the companies show a tendency for the creation of optimal financing structure as a combination of debt and the company capital, whereby achieving maximum company value. According to Volberda (1998), there are two perspectives of financial flexibility: internal and external.

The internal flexibility refers to the company's capability to adjust to the requirements of the environment (reactive and preventive aspect), while the external flexibility denotes its capability to influence the environment through rapid capitalization of investment opportunities. The optimal structure of financing is a combination of debt and equity, where the maximum value of the company is achieved. Decisions on the financing structure cannot be made independently of strategic investment plans, disinvestment, acquisitions, etc., since the financial strategy must be consistent with the business strategy. According to Brigham and Daves (2007), the structure of company financing depends on: business risk, tax position, the need for financial flexibility, the tendency to risk management and opportunities for growth.

The financing structure of a company is under a great influence of numerous internal and external factors. The most important internal factors are company size, profitability, solvency, growth possibilities, property structure, earnings volatility, etc. The external factors influencing the structure of financing could be divided into industry and macroeconomic factors. Among the macroeconomic factors, the most important ones are certainly GDP growth rate, inflation rate, tax rates movement, reference interest rate, etc. Construction project financing is specific in many ways, since this industry largely differs from other fields of economy.

Domestic savings is by far the most important source of investment financing in almost every country in the world. Its scope depends on gross domestic product

per capita as well as national savings rate; it can be asserted with reliability that these two macro aggregates are directly correlated. High level of national income per capita also implies high savings rate and vice versa, low level of this indicator corresponds with low savings rates. Industrially advanced countries, as a rule, base their development on the investments financed through domestic savings. On the contrary, the biggest problem of economic development financing by far is insufficient domestic savings. This causes insufficient investment in production capital necessary for rapid economic progress.

Developing countries finance their investments largely from the additional savings from other countries. The national savings rate is partly determined by the national income per capita size, therefore it is logical that this rate is low in the countries where the national income size per capita is hardly enough to satisfy the existential needs of the population. Consequently, their development depends on the foreign fund inflow. This situation is applicable to the Republic of Serbia to a large extent, when we speak of the construction sector. The alternative to the borrowed sources of financing are owned sources, and they are very modest in most construction companies.

It is necessary to outline a concept of a system of measures for the construction industry, in order to take this sector on the safe road to recovery. The systematic approach implies that in addition to direct incentives, the measures in the change of the institutional environment where the sector operates could have more far-reaching effects.

All these things are proof of generally accepted neo-institutional theory that market failures are the result of inefficient institutional organization. It is therefore necessary that the government take action in the adoption and application of laws in the field of property protection, contract implementation and investors' rights guarantees. Accordingly, it turns out that the less perfect the market, the role of the government and its institutions is larger, and vice versa (Leković, 2001).

Construction industry faces various challenges and problems in all the countries. In the countries with delayed transition these problems and challenges have their own specific details reflected in specific institutional environment and persistent lack of the appropriate sources of funding. A devastating impact of the great world financial crisis from 2008 should be added here because construction was among the industries most affected by the crisis. Unlike some other economy sectors, construction industry in the Republic of Serbia has not succeeded in its internalization after the year 2000, although there were favorable conditions (Mladenović, et al, 2012).

Construction project management implies goal balancing in terms of scope, time and costs. Four processes of project cost management are (PMI, 2017): cost management planning, cost evaluation, budgeting and cost control. Project costs are cash assets necessary for project implementation, and they are some of the basic factors of management (Jovanović, 2003). Having in mind the complexity of the economic environment where construction companies operate, it is obvious that more attention should be paid to the issues of investment project choice,

implementation and evaluation. This relates primarily to the financial construction part of the project due to the interest rate levels, high accompanying lending costs, currency clauses in contracts, loan mortgage securities, etc.

Construction companies have insufficient owned funds for large project financing, so they are forced to rely on the borrowed funds, often under unfavorable conditions. It particularly refers to the implementation of the international projects where construction companies face numerous and strong competition of the companies from other countries. Most of those foreign companies are supported by their own governments in various ways with the aim of achieving as favorable foreign trade position as possible.

Significant international projects are mainly managed through general terms of FIDIC contracts, which anticipate technical, commercial and legal standards in construction and other industries. These standards represent rule unification in the international construction works and thus reduce the need for company adjustment to the local laws and practices. FIDIC abbreviation stands for the International Federation of Consulting Engineers, founded with the main aim of professional interest protection in global world economy, especially in construction and industry, as well as the creation of the unique standards and practice in the fields of construction and consulting.

The advantage of closing standard type contracts are multiple: price reduction in the process of contract closure, contractor trust increase, reduction in the number of unforeseen situations, solution predictions for a large number of controversial situations that might arise in the course of the specific project implementation.

On the other hand, the disadvantage of these general terms of contract relates to the fact that it is an access agreement which, thanks to the bidding procedure mechanisms, foresees that the specific edition of FIDIC is an integral part of the contract documents, without the possibility of significant modifications or amendments by potential bidders.

The importance of financial guarantees and support to construction in the international market

Construction is very important economic industry in the functioning of the entire economy because it relates to over thirty industries, using their products as equipment or material for installation and construction of buildings. This branch of the economy includes design and engineering, building construction, civil engineering construction and hydraulic engineering, finishing works and building materials industry. Construction used to be one of the most successful economic branches, with a high share in GDP and construction works around the world. The companies such as Energoprojekt, Mostogradnja, 'Ratko Mitrovic' and others left significant marks in complex construction project implementation around the world.

All large and developed countries take care of supporting their companies when they perform in the world markets. Serbian companies have no appropriate financial support for international market appearance; it refers particularly to construction because it experienced a real collapse in the transition period so that large construction companies, which have performed large-scale construction works around the world for decades, have

collapsed completely or they have been fighting for survival through bankruptcy proceedings. New construction companies are still not ready or competitive to appear in the international market, although there are renowned scientific and educational institutions, institutes, associations in Serbia, capable to produce high-quality work force and support the implementation of large international projects.

One of the key problems arises at the moment when a construction company from Serbia needs to provide bank guarantees for high-quality business performance or an advance paid by investors. National banks are not prepared to follow companies when they appear in the foreign markets, although we speak of large, high-quality business projects. What are the reasons for such attitude in banks? It is primarily a great difference between active and passive interest rates as well as oligopolistic position of the banking sector in Serbia. Another reason is a possibility to purchase government bonds or state loans to cover budget deficit under very favorable conditions for the banks.

The unpleasant position of the domestic construction companies can be understood in the best way through construction projects where the government is the employer or investor, such as Corridor 10, Corridor 11, and other big projects in infrastructure, with the Serbian companies as subcontractors and foreign construction companies as main contractors. The requirements of the tenders are often out of reach for domestic companies; therefore foreign competition wins large-scale works in infrastructure. Naturally, other works are also conditions for these, such as loans from the countries whose companies carry out the works, etc.

Throughout the transition period, the economy was struggling with insolvency and losses, while the banks achieved positive business results. The attribute of banking sector in Serbia is that interest rates and bank commissions are much higher than in the countries the banks are from. This is true for the economy sector as well as retail banking, which indicates the need for much larger influence of the National Bank on the business policy of the banks, and it must be in the best interest of the economy and consumers, not only in order to achieve as much profit for the banks as possible.

One of the solutions is to establish the Development Bank with the government owned control package that would neutralize obvious existing defects at the expense of its own economy and population. Among other things, this bank could offer guarantees to the construction companies and enable them to participate in high financial value project implementation on equal terms in the international tenders. The effects of this type of support would be positive in multiple ways, for the company development itself, new knowledge and experience acquisition as well as export increase and foreign trade deficit reduction for the whole country.

Conclusion

Construction project financing is specific in many ways, since this industry differs from other areas of the economy to a great extent. The length of the construction projects, their high monetary value and numerous risks accompanying this industry represent complex problems for the companies, especially if we consider strong competition in both domestic and

international market. Considering the impact of the construction on the development of the other branches of the economy, it is necessary to provide all forms of support for the revitalization of this sector as well as the competition increase in the international conditions.

It is beyond doubt that the construction companies from Serbia need stronger banking support in order to gain large international projects in the developed markets where there is strong foreign company competition. It refers to more favorable credit conditions (lower interest rates, longer terms of credit) as well as bank guarantees provision for high-quality work performance within the contracted deadlines. In case of disinterested commercial banks for this type of support, it is necessary to establish the Development Bank as soon as possible, in order to support the breakthrough of the construction sector in new international markets and their return to the markets they operated in before the breakup of Yugoslavia.

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