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# MANUAL FOR INVESTORS

FOREIGN DIRECT INVESTMENT,  
ENVIRONMENT AND INTERESTED PUBLIC

March, 2014



**Environmental movement “OZON”**

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## **PREFACE**

Years of experience and the results that we've achieved in cooperation of government institutions and NGOs in the environmental field, gives me the right to assert that, among other things, it was one of the key preconditions for successful implementation of standards in the field of environmental protection, strengthening the capacities of our institutions, transparency of work and access to information in the field of environment, as well as participation of citizens in decision making.

We realize that procedures for obtaining environmental approvals are interpreted as barriers to business, but the practice in the implementation of laws in this area shows that those are good mechanisms to overcome all the problems that could be an obstacle for successful implementation of major investment projects.

That is why this manual is a 'visa' for successful preparation of projects and guidance that does not leave a possibility for error. I recommend it wholeheartedly as a result of expert analysis and engagement of our institutional capacities and capacities of non-governmental organizations on its inspirational content.

With respect to the initiators, Environmental movement „Ozon“, our partners, I wish a lot of „readers and users“ and very few barriers.

With respect,

***Ms Daliborka Pejović, Secretary of State, Ministry of sustainable development and tourism***

## INTRODUCTION

Montenegro as an ecological state, declared by Constitution, must access every process with special sensibility and responsibility to future generations, especially in part of attracting foreign investment as one of the most important assumptions for further development.

Previous experience with foreign investors, mostly negative, as evidenced by examples of privatizations of large systems like Kombinat aluminijuma Podgorica (KAP), should raise the level of caution in the whole society, especially since the consequences of accumulated debts and given guarantees are influencing the quality of the environment, where the citizens of Montenegro live and work.

Recognizing the responsibility of civil society organisations in decision making related to the environment, which is linked with economic development, foreign investments and privatizations, the Environmental movement „OZON“ wants with this Manual to contribute to creation of positive business environment for attracting of serious investors, who will see the ecological country not as an obstacle but rather as a vision towards which they will adjust their interests and long-term strategic goals.

Another reason that we can not and do not want to skip, is blaming NGOs, as most active and dominantly most critical segment of civil society, for „chasing away“ the foreign investors. In that way some centers of power were trying to justify their wrong decisions, which had negatively affected the quality of life and environment in Montenegro which they deliberately don't want to show to the public precisely expressed in ecological and economic parameters.

The great challenge that we are taking with a sincere wish to use our knowledge and experience for human cause, should affect the stimulation of argumentative public dialogue, or more accurately the wide consultations and involvement of expert and lay public in all future

development projects or privatizations that will have an impact on the environment.

As an association that publicly advocates the model of proactive institutions that will offer their services to users, rather than create obstacles with procedural and administrative barriers, we hope that this approach will be recognized by decision makers but also by potential foreign investors who want to invest in Montenegro.

The recommendations given in this Manual will provide guidance to all those who really want to listen to the needs of local communities and to make them the first and most important strategic partner, which is for us an undeniable evidence of serious and long-term interest, as well as the sustainability of investments.

Potential investors have a great responsibility and they need to understand the caution that interested public has, especially civil society organisations that protect public interest, because the long period of transition and economic crisis as well as bad experiences do not leave a room for unconditional optimism.

Montenegro has an unused potential but also significant environmental problems that need to be solved for which we need significant foreign investment, and we believe that joint observation of these two factors should be applied in all future projections and planning.

We hope that this Manual will help create a positive climate for investment, particularly in the area of environment, but that will also reduce the space for various abuses and irregularities, which is also essential for the whole society.

**Mr Aleksandar Perović**, *director of Environmental movement „OZON“*





## 1. FOREIGN DIRECT INVESTMENT (FDI) AS A WAY OF ENTERING THE FOREIGN MARKET

Montenegro as one of transition countries, as the rest of our region, is a space that really needs foreign direct investment.

International business engagement is a precondition for survival in global economy, and less one of the alternatives which companies have in modern economic environment.

There are four basic modes of entry into international market: export, contractual transfers, joint ventures and strategic alliances, and FDI.

**Table 1: Foreign market entry modes**

<b>Export:</b> indirect export, associated export arrangements, direct export, export consortium, Lohn business, leasing	<b>Joint ventures and strategic alliances:</b> distribution alliances, manufacturers alliances, research and development alliances
<b>International cooperation agreements:</b> contract management, contract manufacturing, assembly production, long-term production cooperation, business and technical cooperation, license, franchising	<b>FDI:</b> acquisitions, mergers, greenfield investments

Source: based on Branko Rakita, "Međunarodni biznis i menadžment", 2006

FDI is considered to be the highest level of engagement in the international market. Foreign company through FDI becomes the owner of the entire business or majority of the company, therefore the level of control on international market is higher than in all other methods of international engagement.

There is a difference between FDI, which has control and development function and is therefore always preferable in terms of society and portfolio investment abroad, which has the sole function of

achieving return on invested capital, without control of business of the local target company.

FDI is carried out through acquisition or takeover of local company (brownfield investment), merger or amalgamation with local company, or through the creation of entirely new company (greenfield investment).

The factors used for analysis of four modes of market entry that are listed in the table above (export, international cooperation agreements, strategic alliances and joint ventures and FDI) are: control, agent costs, initial investments, market share, technology ownership, imitation risk and political & cultural risk.

**Table 2: Factors for analysis international market entry modes**

Factor/International mode	EXPORT	International cooperation agreements	SA/JV <sup>1</sup>	FDI <sup>2</sup>
CONTROL	Minimum	Minimum/Contract	Medium/Significant	Maximum
AGENT COSTS <sup>3</sup>	Significant	Maximum	Limited	Minimum
INITIAL INVESTMENTS	Minimum	Minimum	Limited/Significant	Significant
MARKET SHARE	Minimum/Medium	Minimum/Medium	Medium/Significant	Significant
TECHNOLOGY OWNERSHIP	Own	In own country/Contract	Transferred to	Own

<sup>1</sup> SA-Strategic alliances, JV-Joint Ventures

<sup>2</sup> FDI-Foreign Direct Investments

<sup>3</sup> Agent costs arise when the interests of agents are in conflict with the interests of principals.

			JV/defined in contract	
IMITATION RISK	Limited	Significant	Limited/Significant	Minimum
POLITICAL AND CULTURAL RISK	Minimum	Minimum	Limited/Significant	Significant

We will explain below each of the above terms. The control that manufacturer has in international market is being increased by transformation from export to FDI. Also, the higher return on investment that is associated with higher risk is expected with the increase of the control. Therefore, it becomes clear why the companies choose FDI abroad: more control brings higher yields. However, as noted, higher risk that is associated with higher yields means that the company has to be very careful in risk management in order to realize benefits from an increased degree of control in the international market.

Agent costs are related to the costs that arise when the interests of the agent (agent, distributor, etc...) are in conflict with the interests of principal, i.e. company that hired an agent (e.g. an exporter). Agent costs are decreasing as we move to more complex forms of international engagement. The reason is very simple: the company is increasing the scope of activities that are carried out internally within their own system, and then by increasing control over the business it reduces the risk of conflict of interest by external parties that are not part of the company (like agents).<sup>4</sup>

Since each control is connected to specific investments, the level of investments increases with greater control, i.e. from less to more complex international market entry modes. Investments are lowest

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<sup>4</sup> Agent costs are a very complex area, not only in business literature but also in finance literature, so we believe that those who are interested for this concept should further investigate both sources: business and finances (especially the area of international finances)

when the company exports or rents technology (license) and the highest when it decides to manage their own company abroad. Investments are not limited to necessary manufacturing investments but also investments in marketing and personnel.<sup>5</sup>

Market share as one of primary motives for greater engagement abroad, should be accompanied by an increase in the degree of complexity of the international market methods. It is necessary to conclude that market share is a parameter of success, not a goal in itself. If larger market share does not bring an increase in profit, the strategy that relies only on this parameter does not bring long-term benefits. Market share is limited when the firm exports and increases through investing in sales or production operative division abroad, because the company becomes more flexible and better equipped to meet the challenges of local market and cultural environment.

Technology ownership is an important factor because it opens the field of imitation risk of a particular technology. Risk is the lowest when the company controls technology within its enterprise. It is interesting to note that license agreement is considered to be the most risky in terms of imitation, because it involves transfer of technology information. Therefore, it is particularly challenging to properly define the contract and prevent the possibility of potential theft of technology.

Political risks are related to the risk of war, terrorism, nationalization, anti-globalization movements etc. Cultural risk is observed primarily in relations among the employees who belong to different cultures, as well as in the role that company wants to have in local community. Political and cultural risk increases with the transition to more complex forms of international engagement. The lowest risk is when company indirectly exports, and the highest when the company has a direct ownership of assets abroad (foreign direct investment). With increasing cultural risk it is necessary to include the cultural specificities in every management decision related to business

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<sup>5</sup> Personnel problem is becoming more complicated depending on whether the enterprise has to transfer existing staff from headquarters or it may hire local staff. Knowledge on local culture is a necessary element of solution to this problem.

in the international market. It is especially important to understand the specificities of the cultural milieu in the country where FDI is placed.

### **1.1. THE CHALLENGES OF INTERNATIONAL ACQUISITIONS**

As one of the FDI methods, it is very important to talk about acquisitions or takeover. Acquisition is a process of buying and selling of economic entities. On the other hand, international acquisition is specific because of change of ownership over the target company (target company or the subject of the acquisition) in favor of the foreign buyer's company. Stages in acquisition process have a number of characteristics. Each international acquisition process has following stages with reference problems:<sup>6</sup>

- **Stage 1:**
- Strategic review
- Constituent search
- Access
  
- **Stage 2:**
- Draft conditions
- Diagnostic study (due diligence)
  
- **Stage 3:**
- Negotiations on buying and selling
- Conclusion
  
- **Stage 4:**
- Procedures after the conclusion

Stage 1 should define the goal of the acquisition. Basically, any idea for the acquisition is the desire to increase the value of buyer's company, risk dispersion or management challenge. Acquisition is an instrument to achieve the strategic goals of the company. On this basis,

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<sup>6</sup> Peter Howson, "Due diligence", Masmedia, Zagreb, Croatia, 2006, p. 12.

the acquisition proposal should be directed to the basic reason for the existence of company, which is an increase of the capital for the joint-stock companies. That is why the so-called strategic review should explain the relationship between potential acquisition and realization of strategic goals of company. This is followed by a search for the 'ideal' target company, ie. subject to acquisition. The search is impossible without pre-defined selection criteria, which, in their own way, contribute to the achievement of the strategic goals of buyer's company. After the criteria are defined, it is necessary to 'filter' every potential target company by certain criteria and rank it in relation to other acquisition candidates. The essence is that only those companies whose purchase increases the value of buyer's company have a strategic logic. Accessing a potential target is possible after perceiving mutual interests, which can often last a long period of time.

Stage 2 of international acquisition consists of defining the draft conditions and the subsequent 'due diligence' of potential target company. It is important to point out that the draft conditions is a non-binding document that aims to define the basis of common interests. Diagnostic study or 'due diligence' is assessment of acquisition's quality of all areas listed in the table below<sup>7</sup>:

**Table 3. Areas of “due diligence” (diagnostic study)**

Subject	Examination field	Required results
Environment	Obligations arising from headquarters of customer and process, compliance with regulations	Potential obligations, the nature and expense of actions to limit such obligations
Finance	Verification of historical data, review of management and composition	Confirm existing profit. Provide a basis for evaluation
Law	Contracts, spotting problems	Guarantees and compensations, verification of all existing agreements and purchase contracts

<sup>7</sup> Peter Howson, "Due diligence", Masmedia, Zagreb, Hrvatska, 2006, p.p. 19 – 20.

Commercial	Market dynamics, competitive position of target company, commercial odds of target company	Future profit, development of integrated business strategy, input for assessing
Human resources and culture	Composition of the labor force, employment conditions, degree of responsibility and motivation, organization	Detection of obligations in employing, assessment of potential costs of human resources and risks at conclusion of work, emphasis on human resources issues that need to be solved during the integration, culture evaluation, costs and planning of personnel changes after the deal
Management	Quality of management, organizational structure	Identify key issues in the integration, display of new organizational structure after the integration
Pensions	Different pension plans and assessment of plans	Reducing the risk of lack of money
Tax	Existing taxes, duties and arrangements	Avoid any unanticipated tax liabilities, optimal position of integrated business
Information technologies and systems	Business, ownership and appropriateness of technology	The possibility of system integration and related costs. Plans for operational efficiency and competitiveness
Technology	Business, ownership and appropriateness of technology	Value and sustainability of production technology
Production	Production techniques, validity of existing technology	Technical threats, maintaining the existing methods, the possibility of improving, necessary investments

Intellectual property	Validity, duration and protection of patents and other intellectual property	Expiration of the deadlines, impact and expense
Property	Documents, land registry, lease agreements	Confirmation of holders of property rights, property evaluation and costs
Anti-monopoly	Differently regulated fulfilment of requirements at the state level, level of market development, exchange of information with competitors	Merger control and declaration of competence, assessment of antimonopoly risk because of the activities of target company, the evaluation of legal feasibility of the contract of target company
Insurance/risk	Present, future, and most important, pass business exposure. The structure and the expense of existing programs	Cost benefit analysis of risk retaining in relation to its transmission

Source: Peter Howson, *"Due diligence"*, Masmedia, Zagreb, Croatia, 2006, pp. 19 - 20

Stage 3 can begin only when the buyer company has understood characteristics of potential seller i.e. target company and when on basis of diagnostic study has established a critical mass of interest for further negotiations. Stage 3 is based on negotiations and conclusion of job after successful completion of negotiations.

Diagnostic study is 'filler' topic for negotiations, because in Stage 2 risks that need to be negotiated are identified. Previously well done 'homework' is certainly a basis for successful negotiations in the due diligence of potential seller, i.e. target company. Since the price is also subject of acquisition, which is the end result of negotiations, basically a result of informative preponderance of buyer or seller, it is clear why we can't affect well its level without diagnostic study. In this stage it is important to point out that the trust between buyer company and target company that was gained during the negotiations should be transferred to management teams, which will manage post-acquisition



stages. Therefore, it is positive to include management that will manage post-acquisition stage in negotiations, in order to act preventively on informative asymmetries between negotiators and those who will take the stage after the conclusion of the acquisition. Only when the negotiations are completed, a purchase contract is signed with specified conditions of transfer of property and other elements that will follow after the acquisition process.

Stage 4 deals with all procedures after the conclusion of purchase business i.e. primarily the management of target company and desired integration with buyer company. Acquisitions are much more challenging in terms of integration than mergers, which essentially involve complete merging in one organization that doesn't allow creativity in integrations. Acquired company is managed in this stage, and this leads to many challenges of post-acquisition management in all company sectors. In all operations it is necessary to make adjustments to quality control of products and services, stricter selection of buyers and suppliers, more efficient management of all resources, greater costs control, greater respect for the principles of modern marketing and information technology. It is particularly important to increase the overall business transparency and concern for employees.

## **1.2. SOCIALLY USEFUL METHODS TO INCREASE FDI IN MONTENEGRO**

How to continue or strengthen growth trends of FDI in our country? Generally, there is an agreement on important national factors to attract FDI, which are:

- Political stability and low political risk,
- Macroeconomic stability,
- High level of European integration
- Established relations with the World Trade Organization, attractive and transparent tax system,
- Reformed banking and legal system,

- Presence of international banks and companies for insurance of investments,
- Fast and efficient judicial system,
- Equal treatment for foreign and domestic investors,
- Liberalized export-import regime,
- Free transfer of goods/ services/ knowledge/ people within the region,
- Available skilled labor force and clearly defined working relations,
- Preserved environment.

All these factors with special emphasis on environmental protection are very important and they are being assessed during every investment decision for potential acquisition or a greenfield investment. Foreign investor should see his presence in Montenegro as a long-term thing and respect the environment, in order to be considered as socially responsible and welcome to our community.

## **2. SOCIO-ECONOMIC IMPACT OF INVESTMENT IN THE LOCAL COMMUNITY**

Transition countries at the beginning of 80s and 90s of the twentieth century entered the privatization and reforms whose ultimate goal was creation of the market economy with full economic and social efficiency, respect for private initiative and free market principles. Due to the lack of own funds transition countries are forced to rely on different types of foreign investment, and at the same time to fulfill a number of conditions in order to attract investors.

Among the many effects that foreign direct investment (FDI) is causing, certainly the most important for us is their development potential. It is, without any doubt, important and empirically confirmed. More significant question is its utilization. We also must bear in mind that not all effects of FDI in the host country have to be positive. This leads us to necessity of knowing the effects of FDI, as well as the need for measured and selective state policy and development strategies of local companies.

Local communities must take into account the negative consequences of the process of internationalization of business. Antiglobalists cited exploitation of labor as an argument against influx of foreign investments. Transnational companies engaged in labor-intensive industries, as a rule, decide to invest the capital in countries with the lowest wages, where labor law is not regulated or applied. *„Under the influence of foreign capital, especially when it comes to direct investment, the economy evolves according to the needs and interests of foreigners, and no account is taken of the national objectives of economic and social development“<sup>8</sup>*. Because of these concerns, policymakers are required to prevent distortion of domestic economic structure with appropriate decisions and to direct activities of multinational companies towards the achievement of national macroeconomic objectives.

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<sup>8</sup> Jovanović Gavrilović, P., *Međunarodno poslovno finansiranje*, Belgrade, Faculty of Economics, 2004, p. 161.

Investments affect transition processes in country towards a market economy directly and indirectly. Those investments that are related to economic growth in key industries, market and the development of trade relations and technology transfer have a direct influence. Indirect impact is reflected in the construction of institutional systems of these countries, encouraging the privatization process and creating conditions of competition.

The impact that FDI has on development potential in the community is great. Whether and to what extent it will be used, depends on many factors, but also on the skills of host country. Some of impacts that FDI has, are:

- Building and maintaining the general level of business activity and thus preventing stagnation or recession;<sup>9</sup>
- Development of certain industries or maintenance of their production level and development of less developed regions. Foreign direct investment usually initiates development of new economic activities that were not present in the host country, which encourages further economic development of the country.
- Gaining new knowledge and technologies. Foreign investment involves launching of brand new business abroad, and in order to achieve this it is necessary to transfer technology to a country where they decide to invest.<sup>10</sup>

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<sup>9</sup> By hiring local labor in branches the unemployment rate is being reduced and income of households is being increased. A better inflow in health and pension funds as well as in the budget of local community is achieved by calculation and payment of taxes and contributions on wages of new employees.

<sup>10</sup> It is technical knowledge and skills in marketing and management, which ultimately improves the business of entire national economy, because domestic economic entities are trying to look up to their rivals.

- Connecting and involving of local companies in international technological, manufacturing and distribution networks. Countries with small and underdeveloped markets are not able to start production marked by significant fixed costs, so foreign investment allows the host country to put its economy on trial in industries with high level of production and high fixed costs.
- The newly built capacities provide immediate and better supply of the domestic market. Surpluses are exported, and in this way the image of the host country is improved.
- Growth in production due to the inflow of FDI often leads to an increase of employment. However, the long-term impact on the formation of human capital is much more important and it is achieved by adopting of new skills and knowledge, new forms of organization and management.
- FDI may lead to modification of the technological base of country and reduction of the technological gap in regard to developed countries. At the same time, the government's policy of attracting FDI can significantly affect the intensification of industrialization of the country and raising the technological level of production.

It is necessary to make our country attractive as ultimate destination for foreign capital which would be a significant source of economic development, modernization, growth in production, employment and income. They also have great political and economic importance because they give a signal to others that the country has specific performances and economic future, and that investment can prove to be profitable. At the same time, every investment increases the chance for new ones and improves the image of the country. It should be noted that investors first decide in which specific country they will invest their capital and then they choose the local community where they will start the production, build a distribution center or other facility.

## 2.1. MOTIVES FOR INVESTING AND THEIR DIRECTING

Determinants of FDI trends are numerous and can be viewed from two perspectives: from the perspective of investors' interest and from the standpoint of the beneficiary country.

Generally speaking, to realize the investment there should be a rational connection i.e. strategic fit between the investor and investee in the receptive country. Although the following list can not cover all the motives for investing in our region, motives can be grouped:

- I. Market motives
- II. Efficiency motives
- III. Financial acquisition motives

I. Within the market motives, which are the most common<sup>11</sup>, it could be performed the following division:

1. One of the motives for investing in our region is unique CEFTA market, which includes all the countries of the former Yugoslavia, except Slovenia and Croatia, which are members of the European Union, with the addition of Moldova. CEFTA is Central Europe Free Trade Agreement, and all the EU members in this area, as Bulgaria, Romania, Croatia (up to 01.07.2013.) and Slovenia belonged to it. Entering the region market through acquisition, the most efficient way to export to other states in the region is without paying customs, provided that the location of production is chosen in an optimal way. It is particularly important for international companies to „win“ this region prior to competition.

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<sup>11</sup> “OECD Investment Policy Reviews: Slovenia”, January 2002. framework of the OECD's centre for Co-operation with Non-Members, Secretary General of the OECD.

2. The second motive is the speed of entry into the local market, which is important in acquisition process, because the buyer company through acquisition comes on the target market relatively fast, compared to green field investment. This is especially common when buyer company does not come from the same industry as the target company.
3. The third motive is market penetration i.e. conquest of existing market with the same product category but with larger capacity. This motive is enforceable in the so-called horizontal integrations, when the buyer company and target company are in the same industry.

All the above mentioned market motives are based on future development of market/product, i.e. the assumption of investor that the potential of local and/or regional market will grow and that there will be a demand for new products/services.

II. Efficiency motive is very common, as in this way the control is increased throughout the supply chain and thus allows space for higher profit due to higher control of costs. Therefore, this type of investment is associated with the costs of resources and their more efficient management (factor cost advantages/efficiency seeking) after the investment. Efficiency in investments is based on the logic of synergies between the buyer company and target company. Therefore, the synergy comes from the joint usage and transfer of the following resources<sup>12</sup>:

- Knowledge, as the long-term factor, which is important in the area of development for high-tech industry so in integration the knowledge is transferred between the investor and all the

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<sup>12</sup> “OECD Investment Policy Reviews: Slovenia” January 2002. framework of the OECD’s centre for Co-operation with Non-Members, Secretary General of the OECD, Paris, France, 2002.

interested parties, especially the local community. Here is implied, in addition to the transfer of technological knowledge, transfer of management and marketing skills.

- Labor force, so the motive for investing could be good and/or cheap labor force that will be used for joint production.
- Material, goods and parts, that can be used in entire supply chain of investor, which would improve the whole supply chain management after the integration, which includes frequently relocating certain functions in order to rationalize the business.
- Strong brand, which is important in the investment in those industries where brand recognition is necessary ticket for new market and
- Money, as the most important factor in liquidity crisis, which is one of the main features of the current global crisis.<sup>13</sup>

III. The logic of reselling of target company in short or medium term is present in the financial acquisition motive. This motive includes the limited engagement of investor in the local market, which he will leave as soon as his targeted return on investment is met, which will occur after the resale.

On the other hand, there are beneficiary countries aimed at the economic development that can not be realized by own accumulation of resources and therefore it is necessary to hire foreign capital. Foreign investment contributes to faster technical and technological development, activating mineral and natural resources, reducing unemployment, improving the standard of living of the population, an increase in exports.

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<sup>13</sup> Nikola Perović, "Global crisis in the wine sector", Institute of Social Sciences, Belgrade, 2009, p. 387.



Investments are being directed on specific industries and to a limited area. Theoretically, this would be an area with a lower level of development. Investors with their capital are trying to locate themselves in an environment that has the tradition of that specific production. Helping investors is particularly important in the process of selecting the location. Each local community has its own characteristics, so the investments have to be moved in right direction. Investors want to go to those municipalities that are thinking in the market way. In order to bring foreign investors they have to adjust their work to the needs of investors.

In order to attract and maintain foreign investment, it is necessary to constantly work to improve general investment climate, build a favourable image of the country through marketing and promotional activities, attracting new investment and providing full support to the educational system in creating a favorable environment for foreign investment and better understanding of the role of foreign investment in economic and social development of the country.<sup>14</sup>

Among the priority needs of today's investors, which are the basis for deciding on the location of investment, are: skilled and trained labor force, the availability of a strategy of economic development of facilities and/or sites with all traffic and utility services(technical infrastructure), tax and financial incentives, the business climate of the city, which is reflected in professional and accessible behavior of public officials, the quality of services provided by local authorities, proximity to cargo transport center, highways and airports, and good cooperation with local civil sector.<sup>15</sup> From this it is clear that it is very important to constantly work on improving the quality of life and business conditions. Any successful economic development strategy should be

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<sup>14</sup> Antevski M., *Regionalna ekonomska integracija u Evropi*, Beograd, 2008, pp. 198-207.

<sup>15</sup> Begović B., Mijatović B., Paunović M., Popović D., *Grinfield strane direktne investicije*, Center for liberal-democratic Studies, Belgrade, 2008, p. 27.

based on creating of such business climate that will not only attract investments that create new jobs but also to retain existing firms and encourage the growth in number of new entrepreneurs. Particular attention should be paid to encouraging foreign investment through improvement of legislation that will be incentive for private investment and ensure transparency, non-discrimination and protection of property rights.

Foreign investments can also stimulate domestic investments if there is complementarity in the manufacture of domestic companies and branches. In that case branches can establish strong links with local companies, helping them in technology and finance and at the same time presenting a stable procurement or sales market for their products. Domestic companies would have then enough motive and opportunity to invest the additional funds.

Montenegro has the advantage that it has the experience of other countries in terms of effects and inflow of foreign investment, and this experience should be used in order to exploit positive effects of FDI on the domestic economy. With this in mind it is necessary to pursue an active policy towards FDI, which involves intensive promotion of the country in targeting of investors with continuous improvement of the domestic investment climate with different measures of economic policy.

### **3. INVESTMENTS AND ENVIRONMENT**

The necessity of further development and application of latest technology achievements in different parts of economy surely is something that is not in question.

Investments in environmental protection are often considered to be a business barrier and something that reduces interest of investors, but the truth is actually the opposite. Investments in cleaner technology and production are the best guarantee of long-term strategy and competitiveness. This affects the better business image and public opinion, which is also a very important part of the business. For

example, although the introduction of ISO 14000 series of standards (Environmental management) isn't mandatory, it certainly affects the competitiveness and socially responsible business, so the significant number of business entities decide to take this step.

Bearing in mind that Montenegro is an ecological state declared by Constitution, the thesis that investors are surprised by the public's expectation for investing in environmental protection and application of modern ecological standards cannot be held. In fact it is only natural to expect that potential investments are based on precise analysis of the whole environment, which includes familiarization with current legislation, public policies and of course with current integration processes.

That is why Montenegro now has a significantly more complex starting point for foreign direct investment, than it was immediately after achieving independence in 2006. Starting a process of negotiations with the European Union (EU) and opening of Chapter 27 – Environment and Climate Change, Montenegro is for the first time faced with challenges in improving the quality of environment, which includes recovery and remediation of environmental hot spots, which are result of uncontrolled pollution over several decades. Unlike previous declarative and marketing approach, the decision makers will have to give the environment the top priority, because it is one of the most complex and expensive chapters in the process of negotiations with the EU, and only then it will be possible to meet the challenges successfully and attract interest of serious investors.

It is interesting to look back at the effect that the area of environment has on the whole integration process of Montenegro in EU. We can say that the environment that we live in is already a part of EU environment and other parts of Europe because the negative effects of different types of pollution know no boundaries. This approach brings us to the conclusion that in fact there is a mutual interest of the

citizens of Montenegro and EU citizens to achieve a unique system of environmental protection as soon as possible.

Environment significantly influences the dynamics and success of negotiations also in other related chapters (energy, transport, agriculture, fishery, free movement of goods, etc.) which is particularly important in terms of attracting foreign direct investment and other investment.

All this leads us to a conclusion that the economy through investing in environment should be the bearer and main driving force in EU integration process, for it is the only way to have an impact on better positioning in an open EU market and be ready for the implementation of the laws and standards that are applied in the international community.

In order to create a favorable environment for foreign direct investment it is necessary to ensure timely and adequate reporting on environmental protection, from companies to Environmental Protection Agency, as competent authority, and further to general public. Aarhus centers have an especially important role in this part, because they are a link between the competent authorities and interested public.

### **3.1. STRATEGIC ENVIRONMENTAL ASSESSMENT AND ENVIRONMENTAL IMPACT ASSESSMENT**

The legislative framework in the field of environmental protection and its compliance with EU law should be taken into account when making investment decision, because, as we have already said, environment in Montenegro even now must be seen as a part of international community.

Two laws that have to be interesting to potential investors in Montenegro because of their characteristics and essence are Law on Strategic Environmental Assessment and Law on Environmental Impact Assessment, which are also an important part of EU legislation in the field of environmental protection.

As it could be concluded from the name, these two laws are connected. Therefore, study on environmental impact assessment for some project is connected to Report on strategic environmental assessment for the relevant spatial planning document.

Strategic environmental assessment should be used to examine the feasibility of a project on concrete economic and environmental parameters and in that function it is important to strictly respect the guidelines provided by the Law on Strategic Environmental Assessment.

Environmental impact assessment is the last procedural mechanism for mitigating and reducing to minimum the negative impact on environment.

*For example, it is an obligation to identify the so-called „zero“ state in order to avoid later any unforeseen situation. But, it often happens that this isn't done and the lack of adequate biodiversity database is often used as a reason, which causes displeasure of interested public.*

Therefore, all the obligations defined by the Law on Environmental Impact Assessment must be followed. Quality study fully complied with the law, which has passed a public debate is an important guarantor to public that they will take care of the environment and human health.

In practice we had a situation where study is put to public debate without all the necessary chapters that are defined by the Law on Environmental Impact Assessment, and it often creates unnecessary tension among interested public and members of Commission for its' evaluation.

*For example, processors of studies on environmental impact assessment often have problems with the lack of adequate alternative solutions, so they do nothing, which creates a space for resistance of interested public and also creates difficulties for investor and negatively affects the business image.*

Given the fact that large infrastructure projects such as power facilities and their impact on the environment, cause great public interest, for potential investors it is important to pay special attention to SEA and EIA.

Depending on the nature of the object, it is necessary to apply the best available techniques (BAT) and methodologies recommended by the relevant institutions.

*For example, in the case of environmental impact assessment of windfarms it is necessary to do the ornithological study. Although there is no standard methodology, NGO Centre for the Protection and Research of Birds (CZIP), a partner of BirdLife International, made some recommendations that significantly facilitate the work of document processors and investors. Treatise of CZIP „Windmills and birds – Recommendations for EIA“ is available on official website of the organization **www.birdwatchingmn.org***



### 3.2. AARHUS CONVENTION AND AARHUS CENTRES

Aarhus Convention is one of the most important international treaties, that guarantees timely public informing, participation in decision making regarding environment and the right to legal protection in case of violation of these rights.

Aarhus Convention was ratified in Montenegro with the Law on Ratification of the Convention on Access to Information, Public Participation in Decision Making and Access to Justice in Environmental Matters, adopted by the Parliament of Montenegro on 15 July 2009.

In order to create mechanism for successful implementation of this Law with the support of OSCE Mission to Montenegro the network of Aarhus Centres was established. Two of them, in Podgorica and Berane, are operating within the Environmental Protection Agency and Aarhus Centre Nikšić is an organizational unit of Environmental movement „OZON”.

This is also important for potential investors and document processors in procedures of SEA and EIA, because Aarhus centres are the right place where you can get reliable information, open dialogue with relevant authorities or local community and civil society.

Aarhus centres also have the capacity to publicly launch the current important issues, which further animates the public and increases the interest of all stakeholders of society, which should contribute to improvement of current situation.

*For example, it is necessary to point out to the public some moments that occur in practice, such as purposeful merger whose sole aim is private interest, usually financial, thus creating negative environment for investment. Similar pressure is also possible from the media workers, where financial interest stands out also as a key motive.*



### **3.3. RECOMMENDATIONS**

The key recommendations that we can give to potential investors are early consultations with interested public and transparency of the whole process.

Responsible and open approach from the very beginning has a positive effect on business image. Talking about the investment of several million of euros, implies the existence of long-term strategy and vision, so potential investors must take an adequate attitude not only towards the decision makers at the highest level but towards all interested public that seeks guarantees.

Having in mind too long period of transition and economic crisis in this region, and several bad experiences in privatization process and finally the negotiation process with the EU, it is a logical approach to give the investors information about the plans at the state and local level in preparation phase, because the development strategies must be aligned.

As we have already explained the theory that the environment in Montenegro is actually already a part of EU, which means that it enters the sphere of interest of citizens of this international community, it is clear that potential investors need to be well informed about the compliance of domestic legislation with the EU, or the dynamics in that process that is “alive”.

Also, it is very important how the media is informing the public, because potential investors often have omissions that are causing them a significant damage. For example, it is not the same if you say that the implementation of the project will “improve the quality of environment” or “during the project implementation the application of the best standards in the area of environment will be taken into account”.

Funds given to lobbyists often can be used in a more qualitative manner, in particular by informing the public of the planned investments, exploring the business environment, local communities, ordinary people and their vision and needs...

The fact that we are ecological state, defined by Constitution, is a clear message to serious investors that they have to pay attention to environmental issues from the very beginning.

In the end, noting that we are well aware that Montenegro is relatively small market, we want to highlight significant natural resources that we have, whose proper valorization could undoubtedly bring benefits to users.