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COMPETITIVENESS AS A FUNCTION OF LOCAL AND REGIONAL GROWTH AND DEVELOPMENT*

Abstract

Each economic entity, institution and individual has the responsibility of contributing to the economic development in its region. Creating conditions for the development and empowerment of the business sector are activities that in the long run lead to the strengthening of not only certain economic sectors, but the entire region. In the recent period sources from EU funds for co-financing of capital projects have become available to investors. Given the uncertainty in business conditions, investors' poor capitalization, lack of business profitability and, in terms of profitability and risk, lack of high-quality capital projects, the benefits of these resources are insufficient and/or inadequately used. The aim of this paper is to analyse the strength and capabilities of Croatian companies for financing and implementation of high-quality capital projects. For this purpose, this paper will present the results of research of financial position of selected companies in 2012. Also, it presents the results of research from 2011 that examined the reality of projections of later activated investment projects. These results are the basis for a conclusion about the ability of management, in the analysed region, to make realistic plans and carry out high-quality capital projects.

Keywords: capital projects, financial position of the company, growth and development of the region

1. Introduction

This paper aims to present the dynamics of growth and development in the local and regional environment. In this case the concept of growth and development of small and medium-sized enterprises is comparable to the success of implementation of the development strategy of the regulator. This analysis can be conducted using the criterion of competitiveness. For the purpose of this research, an analysis of the financial position of small, medium and large enterprises has been carried out. The research included SMEs, operating in 2012 on Croatian territory. The sample covers 5,957 companies with turnover between 25,000 to 370,000 euros and employing an average of 55 people. This paper explores strategies for local and regional development and growth at the national level on the example of the Republic of Croatia and Europe 2020 strategy. The main focus of this paper is the framework of the activities that are planned to be implemented until 2020. Improvement of the competitive framework of all EU member states, which should have a strong influence on local and regional development, together with examples of the analysed SMEs in Croatia, will provide more specific conclusions regarding the implementation of the strategies.

2. Strategy of local and regional development and growth - with emphasis on capital projects

Conceptually, the primary strategy of growth and development, since the Republic of Croatia became a member of the European Union, arises from guidelines and strategies defined by the European Union at the level of all member states. In the context of Europe 2020 all member states should put the emphasis on the economy, with an effort to achieve a synergistic effect and impact on improving results in the field of employment and productivity. The same problem and need is recognised in Slavonia, where according to all economically comparable criteria this region is ranked very low compared to other regions in Croatia. It is clear that the problems of local and regional development and growth are identical to those that occur at the national and supra national level, especially in terms of growth and development. It is certain that inequality between countries, within countries and between regions is more and more pronounced. In simple terms, globalization affects countries and regions in different ways. For less powerful countries in the region, globalization is a process that is happening to them and to which they must react. To a certain extent, less powerful countries will have to decide whether or not to accept the rules of more powerful countries, although in today's global economy they have little choice but to accept them (Hurrell, Woods, 2000). In accordance with the defined priorities, the emphasis is on achieving cohesion growth, which is based on smart, sustainable and inclusive growth (Europe 2020, A strategy for smart, sustainable and inclusive growth, 2010). Each component stands for the economy that, through knowledge and innovation, is trying to use resources and potential that would geographically link less and more developed areas and thus set the foundations for more competitive market and influence employment growth. Europe as a global participant has to use the potential and capacity to adapt to the weakened environment in terms of increased age of the population and the increasing competitiveness of other global actors. The EU gave specific recommendations on economic activities that have to be undertaken at the national level in the next period. Above all, necessity to improve the stability of the business environment was recognised, with the focus on small and medium-sized enterprises that should be more innovative in comparison to other companies. This recommendation is initially aimed at improving the conditions regarding the intellectual property and the ownership of promising business ideas. On the other hand, the need for reduced administrative burdens imposed on companies implies the need for improving the quality of business legislation. The improvement of inter-sectoral cooperation (enhancing the position of the industry) would improve the position of EU member states by making them leaders of global sustainable development. The Republic of Croatia has, in line with strategies and recommendations defined by Europe 2020, strived to define the plan of investment and capital projects in order to follow the trends that are in accordance with the EU recommendations. The Investment Plan envisages the growth of gross investment of public state and the general government, the growth of investment of public sector, increased absorption of EU funds, increased foreign capital inflows through FDI, maintaining the current level of public spending with a tendency of slight increase and an increase of exports with the improvement of competitiveness of the domestic economy (Investment Plan of the Republic of Croatia for 2014, 2013).

Accordingly, some legislative (Act on Investment Promotion and Development of Investment Climate, 2012) and implementative activities for attracting the investments have been introduced, enabling formulation of the prospective framework of regional growth and development - incentive taxes and duties, incentives for employment and other types of expenditure associated with capital and labour-intensive investment projects, with special emphasis on strategic projects attempting to directly influence the increase of the employability, which would contribute to the development of production and services, implementation of new technologies and creation of a competitive environment at the micro and macro level. This criterion is focused on specific major capital investment expenditure that derives from individual investments or those co-financed by the EU funds. The criteria clearly specify what is considered as a capital project and investment, and also what is considered to be an increase of added value in terms of the employability, or development of industry in some less developed regions. Major benefits in terms of capital investments in less developed regions in the Republic of Croatia have been defined (Act on Strategic Investment Projects of the Republic of Croatia, 2013):

- the value of total capital investment expenditure is HRK 150,000,000.00 or higher;
- possibility of co-financing from the funds and programs of the European Union, with the total capital expenditure of the project amounting to HRK 75,000,000.00 or higher;
- undeveloped areas (mainly areas of the ASSC) where the total value of capital investment expenditure is HRK 20,000,000.00 or higher;
- on the islands, where the total value of capital investment expenditure is HRK 20,000,000.00 or higher;
- for projects in agriculture and fisheries, where the total value of capital investment expenditure is HRK 20,000,000.00 or higher.

Capital investments have certain specifics regarding the financing, stressing the necessity of overall financial planning. The most common sources of financing capital investments are associated with borrowing or issuing bonds, but it can also be associated with co-financing through EU funds or other specific financial institutions. Capital investments in the conditions of uncertain economic environment require a broader view of the analysis of investment flows, where critical variables can significantly affect the viability of investment. Frequent critical variables depend on the amount of investment costs, cost of materials, selling price, correlation of production volume and sales, and timescale of construction and start of operation. Justification and feasibility of a capital project can be determined with elimination criteria, functional criteria and descriptive criteria. The definition of capital projects (Budget Guide for Citizens, 2003) gives a more direct definition of capital project and is associated with investment companies both in public and private sectors. The definition is focused on the fact that capital projects include all projects whose design or construction takes longer than one year, with expected return in the years following the execution or construction.

In terms of volume, capital projects are infrastructure facilities with social benefit, and most of them are: schools, hospitals, highways, bridges and similar structures. The role of capital projects within the regional and local government, as well as private companies, is extremely important since they represent a model of financing with a significant impact on the local and regional development. The regional development policy in the Republic of Croatia (Regional Development Strategy of the Croatia 2011 - 2013, 2010) defines three objectives: development concepts of counties and statistical regions, development of the supported regions and the development of the border regions in terms of development of competitiveness. These strategic objectives do not include anything more than interconnection of regional and territorial framework, either with harmonization of the development needs with national interests, or with the concept of connecting with all institutional stakeholders at all territorial levels. This model of defining the regional development strategy is not promising, because it is not focused on real implementation activities. The utility of this strategy is best reflected in the shortcomings and weaknesses that are present in certain local and regional areas. Development difficulties in the regional and local public sector are slowing down socio-economic development and at the same time influence the perspective of SMEs. Factors that have an adverse impact on the status of SMEs in Slavonia are: underdevelopment of basic and business infrastructure, high unemployment, slow process of restructuring, low tech production and low level of use of new technologies, high level of gray economy, low levels of income of local government units (Regional Development Strategy of the Republic of Croatia 2011 - 2013, 2010). In the Republic of Croatia, integrated planning of development projects at regional and local levels is still not sufficiently accepted.

With integrated planning, based on strategic goals and strategic priorities, an action plan has to be adopted, with appropriate measures for achieving clearly defined priorities, including planning and funding sources. (Evaluation of the system of strategic planning and financing possibilities of counties and local government units in the context of the implementation of regional development policy of the Republic of Croatia, 2012). The region of Slavonia, with its geographical potential and potential businesses, compared to other geographical and administrative parts of Croatia, is least competitive. It is important to determine the framework of regional development that will generate a series of competitive activities (not competitiveness strategies) towards other regions, especially in the segment of small and medium enterprises, the development of business infrastructure and encouragement of investments since companies lack technological development and pursue traditional industrial activities which are primarily based on agriculture. Lack of orientation towards research and development is one of the problems, given that companies in the segment of industry, business and financial services are oriented towards more attractive geographic and administrative areas. The lack of key competencies (Prahalad et al., 1994) in the form of quality management of complex business processes, integration of differential technology and cohesion of learning and knowledge in the vertical structure of enterprises are potential weaknesses in the functioning of the companies in Slavonia. In accordance with this, there is no indication of feasible solutions concerning improvements in the growth and development of regional areas, as well as creating competitive environment of the analysed company. The strategic framework for regional development and the development of enterprises are one-dimensional and focused on institutional activities. The methodology shows the current situation, the real dynamics of the functioning of local and regional environment, but only in the sphere of the public sector. All the above is a good strategic framework that defines the functioning of activities of the public sector, however, the Regional Development Strategy of the Republic of Croatia gives very little information about the activities related to private sector. The strategy shows us that too many government entities are involved in the development of the economy: state agencies, funds, institutes and agencies. It is evident that there is no clear terminology and strategic guidelines that would impact the private sector companies.

The reasonable man adapts himself to the world; the unreasonable one persists in trying to adapt the world to himself. Therefore all progress depends on the unreasonable man. (George Bernard Shaw)

Growth and regional development strategy should have a different approach. There is no clear implication on the positioning of companies in Slavonia, especially because all strategic aspects related to the regional and competitive development in the Republic of Croatia aim to generate legal, regional and administrative changes. Whether this derives from miscalculation in understanding which leads to an increased risk for excessive emphasis (Kourdi, 2004), which is based on the lack of competence, presents a problem of the approach and understanding of the economy in general. As visible from this Strategy, from the very beginning there was no clear analysis of other possibilities and variations, no proper information collected, and no precise definition of expenditures and income. Nowadays it is increasingly difficult to plan capital projects in terms of overcoming new challenges (Hamel, Breen, 2007: 10) and creating competitive advantage. It is increasingly clear that the future does not destroy only companies, but also entire industries. Implementation and sustainability of strategies is decreased since companies develop faster, they enter the peak phase and the decline stage faster. The life cycle of enterprises in the modern environment has changed greatly, and unpredictability regarding the maturation and aging of the company is in strong correlation with the capital and investment projects. This aspect is reflected in the research part of this paper.

3. Results of the research

A prerequisite of raising regional development is to increase its competitiveness in the area of business conditions from the viewpoint of investors. The goal of almost every capital investment is to increase labour productivity and production capacities, to reduce costs etc. In other words, the goal is to increase competitiveness and profitability of the investor's business. Given the fact that the economic empowerment of each company indirectly strengthens the very region, regional state institutions should create conditions for the development of business activities. In doing so, companies become more socially responsible and encourage the development of other sectors, but only under the condition that their business is prosperous.

The authors conducted a research with the aim to analyse the strength and capabilities of Croatian companies to be leaders of economic growth. Capital projects are essential to the processes of company modernization, increase of profitability and competitiveness that are prerequisites of economic growth. For that reason, in the research whose results are presented in this paper, the authors analysed the strength and capability of Croatian companies for financing and implementation of their capital projects. The research sample consists of companies whose financial position in the year 2012 was analysed trough this research. The companies were sampled by the method of random sampling, with which 5,957 companies were selected. The sample consisted of profit companies that are registered in the Register of the Commercial Court of the Republic of Croatia regardless of their business activity. In the analysed period, the selected companies had a turnover from 25,000.00 EUR to 370,000.00 EUR, so the sample consisted of companies with characteristics of micro to large companies. The average income of the sample achieved in year 2012 was 5 million EUR, with the average number of employees in the same year of 55 employees. The source of information based on which the financial position of companies from the sample was assessed, are annual financial statements published by the Financial Agency - FINA. The sample does not include financial institutions and non-profit organizations. As this base sample includes all the companies, including the companies that are in account blockade, are in bankruptcy or liquidation, or whose losses exceed the value of the share capital, another "better quality" sample was created. The purpose of the secondary sample was to compare it with the results of the "primary sample" analysis and making higher quality conclusions, based on more inputs.

The "better quality" sample consists of companies extracted from the "primary sample", but:

- are not under bankruptcy or liquidation
- are not in account blockade
- have a positive ER.

In this way, the 20% of the "primary sample", or 1,182 of companies were excluded leaving 4,775 companies in the "better quality" sample for comparison of the results with the analysis of the "primary sample".

Financial preconditions for company sustainability, financing and implementation of capital projects that are essential to the processes of modernization, increase of profitability and competitiveness are the following:

- Positive net working capital
- Equity ratio – minimum 35% of total assets financing
- net profit margin > 15%
- days payables outstanding aligned with days sales outstanding
- collectible receivables
- Net financial debt / cash flow < 4
- Debt-service coverage ratio (DSCR) > 1.25
- realistic business targets
- investing in the assets in the function of business activity.

Since the number of companies in the sample was large, the information available from the annual financial statements was analysed. In particular, the parameters of net working capital, equity ratio, net profit margin, and net financial debt compared to cash flow were analysed trough this research. Along with the analysis of the financial position, the results of the research of reality of projections of planned investment projects will be presented. This research was conducted by one of the authors in year 2011 and presented in the doctoral dissertation. The results of research of the financial position and management ability to plan realistic projections of capital investments are the basis for a conclusion about the ability of management in the analysed region to make realistic plans and carry out high-quality capital projects.

Analysis of net working capital

By analysing the structure of assets of the firms included in the sample, it can be seen that long term assets are on average 62% of total assets of the sample. At the same time the equity together with the long term liabilities are, on average below 50% of total assets financing. The inadequate structure of financing long term assets leads to negative net working capital of the analysed "basic sample":

Table 1 Analysis of the net working capital (in '000 HRK)

Sample description	Value	Working capital	
		2012	2011
basic sample	Maximum	496,465	417,015
	Minimum	-1,953.291	-1,953.646
	Average	-913,109	43,438
„better quality sample"	Maximum	496,465	417,015
	Minimum	-1,953.291	-1,953.646
	Average	2,102	2,427

Source: author's calculation

On the other hand, the "better quality" sample has a positive average net working capital, and from this standpoint, complies with the above mentioned precondition for sustainability of the financial position of the company and conducting the capital investments. It is indicative that the net working capital of both samples in the year 2012 decreased, which can be expected in an even larger amount in the next two years.

Analysis of equity

By this precondition it was assumed that minimum equity ratio should be at the level of 35% of total financing of the company to ensure a sustainability of the financial position and lower vulnerability to negative market conditions. By analysing both samples it was found that average equity ratio of the basic sample is negative with 23%. That means that a significant portion of companies from the sample have accumulated losses that exceed their share capital. That refers to more than 16% of the companies in the basic sample, which have a negative equity ratio, thus affecting the average size of the entire sample. On the other hand, the "better quality" sample, which consists of companies that have a positive equity ratio, that are not in account blockade or under bankruptcy or liquidation, has an average equity ratio of satisfactory 39%, which is above the defined minimum of 35% of own capital invested in the company. Another issue is the actual quality of the documented equity and whether its value is realistically determined and recorded in the business books of the analysed companies.

Analysis of net profit margin

By this precondition it was assumed that minimum net profit margin should be over 15% to ensure sustainability of the financial position. The average net profit margin of the basic sample in the year 2012 was 22%, which includes all companies of the sample together with extreme results with net profit margin of 100%, or multiple negative values. In the "better quality" sample the achieved net profit margin in the year 2012 was also negative with -2%. The reason for the negative profitability is a long term crises in Croatia that evolved into depression, with continuous drop in employment and consumption. In such an environment, companies are reducing their margins with the aim of maintaining the minimum sales, and keeping of business.

Analysis of gap between days payables outstanding and days sales outstanding

By this precondition it was assumed that at least a minimum positive GAP of days payables outstanding and days sales outstanding should be maintained for preserving the liquidity. Clearly, without dividing the sample by the industries, it is questionable what the recommended levels for this precondition are. Regardless of the above, every company must take into account the dynamics of debt collection and payment of obligations towards its suppliers, with the objective of maintaining a minimum liquidity. By the analysis of the results of calculating the average gap between days payables outstanding and days sales outstanding, it was determined that the basic sample in the year 2012 had a negative average GAP of -35 days. In the same year the "better quality" sample achieved a positive GAP of 38 days, which leaves, depending on the concrete industry, a rather sound period and to finance inventories.

Analysis of net financial debt / cash flow

By this precondition it was assumed that net financial debt in comparison of cash flow of the analysed company should not be higher than 4 in order to ensure sustainability of the financial position of the company. By analysing the basic sample it was determined that average indicator of net financial debt compared to cash flow is significantly higher than the minimum standard, and is on the level of 30.39%. More than 45% of the sample had an unsatisfactory level of this indicator, and the rest of 55% had an indicator of net financial debt compared to cash flow of less than 4. The "better quality" sample in the same time had a much better position, though still above the minimum required parameters, with 5.46%. In this sample, 62% of the companies have an acceptable level of this indicator. From these results it can be concluded that the basic sample has a high volatility of the results of this indicator, and that a small number of companies recorded extreme values that affect the average size. The standard deviation of the basic sample is a high 573.5, and the standard deviation of the "better quality" sample is 11.1.

Presentation of the results of the research of reality of projections of planned investment projects

Table 2 Reality of projections of planned investment projects

	Av. operating income (in 000 EUR)	Av. EBITDA (in 000 EUR)	Average net profit margin
Average planned values	2,247	859	40.15%
Realized values	2,307	706	27.15%
Variations in average planned value from the realized values	**+2.60%**	**-21.70%**	**-47.90%**

Source: unpublished doctoral dissertation; Bestvina Bukvić, I. (2012). „Utjecaj rizika na ocjenu opravdanosti investicijskih projekata u poljoprivredi"

From the presented results, it can be concluded that investors in their project proposals projected the level of operating income fairly well, but significant differences were visible in the projections of profitability. The realized EBITDA was 21.7% lower than planned. Also, net profit margin is 47.9% lower than planned by the capital project proposals.

4. Conclusion

BThis paper is based on the multidimensional overview of the potentials of SMEs in the regional environment, emphasizing the collision with the Croatian legislation and strategic investment concepts. In the investment strategies there is no category for regional development that reflects the economy, although in the meantime new law on regional development has been adopted. There is a lack of economic and investment framework of a wider scope, rather than the current one, focusing solely on the activities of the public sector. The fact is that management structures in Croatia generally have a problem with crisis management. The question remains whether competitiveness management in the current environment should be the task only of companies, or if positive investment climate should be managed by the regulator.

In the period of long term economic crisis that can be characterized by depression, it was shown that the introduction of the current state measures in accordance with direct and indirect interventions further weakened the power of the private and business sector. As a result of long term crisis, the majority of companies became too weak for implementing high quality capital projects.

Companies that rationally managed the generated net profit in a period of prosperity, mainly still have a solid balance sheet structure, but generally the profitability of business is decreasing. On the example of Slavonia, it was shown that capital project proposals have been too optimistic in terms of expected profitability of the planned projects. On the other hand, with regard to the improvement and further development of the economic environment and competitiveness of SMEs in Croatia, our research indicates that strategic frameworks should be more strongly directed towards the SMEs. Particularly, strategic decisions should be focused on strengthening of the business sector, in terms of specific legislation, strategic documents and the improvement of the effectiveness of financial management. Investment projects impact company development and profitability, indirectly boosting the productivity, employment, and living standard, which is of special interest of any government. The real and the public sectors, as well as the academic structures should be involved in finding adequate measures to improve both the entrepreneurial environment and managerial skills in companies.

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(Endnotes)

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Konkurentnost u funkciji lokalnog i regionalnog rasta i razvoja

Sažetak

Svaki gospodarski subjekt, institucija i građanin imaju obvezu sudjelovanja u razvoju svoje regije. Stvaranje uvjeta za razvoj i osnaživanje poslovnoga sektora aktivnosti su koje u dugom roku vode jačanju ne samo pojedinihe ekonomskih sektora, već i cijele regije. U posljednje su vrijeme za sufinanciranje kapitalnih projekata, investitorima dostupna sredstva iz fondova Europske unije. Međutim, s obzirom na neizvjesnost u uvjetima poslovanja gospodarskih subjekata, neprimjerenu kapializaciju investitora, nedostatak profitabilnosti osnovnog posla, i u okvirima prihvatljive profitabilnosti s obzirom na rizik, nedostatak kvalitetnih kapitalnih projekata, efekti ovih sredstava su nedovoljno i/ili neprimjereno korišteni. Cilj ovog rada je analizirati snagu i mogućnosti hrvatskih tvrtki da financiraju i provedu kvalitetne projekte. U ovome radu prezentirati će se rezultati financijske pozicije odabranih tvrtki u 2012. Rad prezentira i rezultate istraživanja iz 2011 kojim je ispitana realnost projekcija, kasnije aktiviranih investicijskih projekata. Rezultati su osnova za donošenje zaključka o mogućnostima menadžmenta u analiziranoj regiji, kako bi formirala realistične planove i provela visoko kvalitetne projekte.

Ključne riječi: kapitalni projekti, financijska pozicija, rast i razvoj regije