

Diversification Strategies of Business Groups in Bosnia and Herzegovina

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Abstract

A business group has recently become one of the popular topics in the literature. Although some countries such as South Korea, India, China and Turkey have widely focused, still many countries along the world has been neglected in the English literature. Bosnia and Herzegovina is a country which became one part of the former Socialist Federal Republic of Yugoslavia and encountered brutal ethnic conflict. It has been in the restructuring process after Dayton Agreement which ended the conflict. In this period, the role of business groups with diversification strategies is indisputable. The purpose of this study is to focus on diversification strategies of business groups in B&H. According to this purpose, business groups in BIH were investigated in terms of diversification levels and ways, new entered sectors and internationalization levels.

Key words: Business groups, Diversification strategies, Bosnia and Herzegovina

Introduction

In simplest terms, a business group is defined as “a collection of firms bound together in some formal and/or informal ways (Granovetter, 1994)”. It is a rather stable organizational structure, common to many countries that underwent industrial development relatively late (Kock and Guillén, 2001). There are many well-known examples of business groups throughout the world. *Keiretsu* in Japan, *qiye jituan* in China, *business houses* in India, *grupos economicos* in Latin American countries, *grupos* in Spain, *chaebol* in South Korea, *guanxi qiye* in Taiwan, and *family holdings* in Turkey (Granovetter, 1994). Their exact features differ from country to country because of distinct economic, social, and cultural environments (Chang, 2006). Due to these differences, there is no ‘clear framework for business groups’ according to Yiu and others (2007). They also have important similarities. Most notably, business groups pursue unrelated product diversification under centralized control (Chang, 2006). Business groups have tended to grow very quickly through diversification (Kock and Guillén, 2001). ‘Diversification’ is entrance of an organization to different sectors like new product and services by developing business or buying other organizations (Ramanujam and Varadarajan, 1989). If new sectors have direct relationship with current business activities of organization in terms of basic capabilities and resources, it is called ‘related diversification’, if they do not have direct relationship, it is known as ‘unrelated diversification’ (Rumelt, 1982).

Business groups emerged in former socialist countries during the privatization process. During the rapid privatization in Czechoslovakia, various forms of cross ownership among banks and investment trust funds were formed, and many of those investment trust companies turned themselves into holding companies (Coffee, 1999). Similarly, Stark

(1996) showed how previously state-owned firms in Hungary purchased small firms and formed groups. Like Czechoslovakia and Hungary which were the former socialist countries in Eastern Europe, Bosnia and Herzegovina was one of the six constituent republics of the former Socialist Federal Republic of Yugoslavia. Though transition started with significant delays compared to other countries in southeast Europe, privatization has been an important part of this process. The institutional and legislative framework for privatization was completed in 1998 and a voucher privatization has also finished. According to an EU feasibility study, 70 percent of companies in FBiH and 47 percent in RS had been sold by 2002 (European Commission, 2004). By this way, the number of business groups in BiH has increased. Strategies, structures and different characteristics of these business groups have awakened curiosity in this post conflict country. The purpose of this study is to reveal business groups in BiH and to focus on diversification strategies of business groups in BiH after war.

Literature Review

Cuervo-Cazurra (2006) combining sociology and economics-based definitions of business groups defined business groups as a set of legally-separate firms operating in multiple strategically-unrelated activities that are under common ownership and control and argued that there are different types of business groups based on their ownership: family-owned, widely-held, and state-owned. Each type has different actors who own, control, and manage it. According to Cuervo-Cazurra (2006), while in a widely-held business group, the ultimate ownership of the business group is widely dispersed among multiple shareholders and managers are the ones in control, politicians and civil servants are the ones who exercise control and they manage the firm either directly or indirectly, through the control of appointed managers in state-owned business groups. On the other hand, in a family-owned business group, an individual or family are involved in the ownership, control, and management of the business group.

Different theoretical frameworks have been beneficial to explain formation of business groups (Chung, 2001). One of these approaches is thesis of late industrialization (Ozkara, Kurt and Karayormuk, 2008). Literature that belongs to late developing countries put the state in the centre of economic activities (Buğra, 1994). According to this approach, the state which provides supports to accelerate economic improvement because of late development affects the birth and growth of a certain organizational form by regulations in money and capital market at the same time (Chung, 2001). At this point, local institutions and institutional systems create their own organizational forms. Foreign trade and investment policies of governments and their encouragements to invest different sectors or export played role in transformation of firms which want to take advantage of opportunities into a diversified business group (Chang ve Choi, 1988; Guillén, 2000).

It is able to claim that the changes of government policies in economic development process and the change in socio-economic structure affect business groups (Ozkara, Kurt and Karayormuk, 2008). For example, through Kock and Guillén (2001)' s evolutionary view, the selection environment in the late-developing countries changes systematically as (i) firms within the country gain more experience and (ii) the country's infrastructure (education, labor and financial financial markets, etc.) develops at a slower speed than the demand for such services from the business community. According to Kock and Guillén (2001), at the first stage, some locals create firms based on contact capabilities. At the second stage, entrepreneurial survival and growth in the country shift to effectiveness and

efficiency at executing projects and running plants as well as to finding ways to cope with inefficient local factor markets. A third stage may start if local firms develop organizational and technological capabilities that allow them to engage in advanced product and process innovation on their own.

In addition, there have been some arguments that economic crises have also evolutionary effect on business groups. (Ozkara, Kurt and Karayormuk, 2008). For example, Chang (2006) pointed out that East Asian business groups face an uncertain future. Since the 1980s, foreign creditors and investors have become more important to East Asian economies. The sudden outflow of foreign capital out of the region in 1997, known as the Asian Crisis, significantly affected business groups in this region. According to Chang (2006), prior to the crisis, there were many structural weaknesses in the financial sector. Ineffective bank regulation and supervision and poor accounting and disclosure diminished transparency. For example, many family-controlled business groups in Indonesia and Malaysia owned banks. They used the banks' reserves as if these funds belonged to them and extended credit to their own affiliates. Non-bank financial institutions, especially in Korea and Thailand, often lacked adequate discipline. Right after the crisis, many financial institutions in Indonesia, Korea, Malaysia, and Thailand were severely distressed or insolvent. Many banks were closed and others were placed under government supervision. In another example, Choe ve Pattnaik (2007) who examined the evolution of Korean business groups after the Asian economic crisis claimed that in the wake of Korean economic crisis in 1997, the efficacy of these business groups was called into question. To facilitate the transformation, the Korean government implemented a series of corporate reform programs. Korean business groups have undergone significant change since the crisis.

Unlike other examples above, Bosnia and Herzegovina represent very small business environment. BiH was a part of the former Socialist Federal Republic of Yugoslavia. Yugoslavia's post-World War 2 planned economy took shape in the 1970s with the introduction of autonomous workers' councils, although they were effectively controlled by the political elite. State control reduced production and competition while workers' councils directed most of their subsidies to payroll, neglecting investment in research and development. Economic breakdown was inevitable and the disintegration that arguably led to the war began with Yugoslavia's debt crisis in 1979 and the subsequent stagnation in GDP growth, which converged with the rise of nationalism in the 1990s (Divjak, 2006). After Yugoslavia's disintegration, BiH declared its independency like other five republics. This declaration caused the Serb-controlled Yugoslav People's Army surround hills of Sarajevo and invade Bosnian cities in 1992. This ethnic conflict 'between the three constituent nations of BiH was Europe's bloodiest since World War 2 (Divjak, 2006)' lasted until the Dayton Peace Agreement was signed on 21 November 1995. During the ethnic conflict, transportation, power and communications infrastructure were almost completely obliterated. Various estimates put the cost of direct and indirect damage at over \$50 billion. By 1995, GDP had shrunk to \$2.1 billion, less than a third of its pre-war level, and per capita GDP to \$500. Industrial production fell by more than 90 percent (World Bank, 1997). Table 1 illustrates the state of the economy at the beginning and immediately after the conflict.

Table 1 – Economic indicators before and after the war

	1991	1995
GDP (\$ million)	8,670	2,105
Per capita income (\$)	1,979	501
Non-agricultural unemployment rate (%)	27	53
Average monthly net wages (\$)	400	57

Source: World Bank (1997) *Bosnia and Herzegovina: From Recovery to Sustainable Growth* (Washington DC, US: World Bank).

BiH's main post-war achievements are a stable currency, functioning central bank, sound private banking sector and on-going reforms to the tax system, although critics claim that these reforms have not yielded satisfactory results (Divjak, 2006). BiH received one of the largest per-capita assistance packages in recent history, with over \$5 billion, mostly in grants, committed in the first five years after the war (OECD Development Assistance Committee and Creditor Reporting System 'Database on Aid Activities'¹). Ten years of reform has however failed to create a favorable investment climate for private sector growth, and BiH has fallen behind most transition countries. A rough estimate of the private sector's portion in the country's GDP is around 40-44 percent (EBRD, 2003). In this post-conflict, transition and slowly developing country, diversification strategies of business groups has awakened curiosity. Our purpose in this study is to concentrate on diversification strategies of business groups in BiH after ethnic crisis.

One of defining properties of business groups is to form strategies. It can be argued that four different dimensions of strategies can show differences among business groups. These are (1) diversification level, (2) diversification ways, (3) new entered sectors and (4) internationalization degrees. *Diversification level* is related to what degree diversification of business groups is unrelated. It is important to reveal in which level business groups have diversification. *Diversification ways* is related to how they are entering new sectors. Founding new firms and purchasing them are the options from this point of view. Another important dimension of business groups strategies is possibility to enter new sectors. The last strategic dimension is internationalization. Here, it is possible to say about two different internationalization (inward – outward) according to Guillén's (2000) classification. Inward internationalization is that density of firms in BiH which were founded by business groups along with a foreign partner. Outward internationalization is density of activities of business groups in outside of BiH among their all business activities (Ozkara, Kurt and Karayormuk, 2008).

Methodology

By taking purpose and framework of this study into consideration, a methodology with three criteria was followed. First of all, through internet and business associations, a list of business groups in BiH which have at least two companies were found. From this list, it has been confirmed by business associations that nine of business groups were active. Thus, the first list of business groups was formed. The second criterion which was used to determine new business groups for the last list was the number of sectors. According to that, being active in three or more sectors for business groups was the main condition. In order to provide this criteria, official web sides and business reports of all firms which are in the structure of business groups were investigated in the first stage. Lack of information

¹www.oecd.org

about these firms was completed through calling and sending electronic mail. By this way, an information file was formed. In this file, (1) number of firms that belong to business group and their names, (2) date for foundation and purchase for each firm, (3) information about firm's sector were included. These files were sent to relevant part of all business groups and asked for confirmation or correction of information table from an official. In the second stage, the sectors of the firms which are determined to belong to business groups in the list were coded. In coding system, 'International Standard Industry Classification of All Economic Activities – ISIC Rev 3.1' of United Nations was used² to classify sectors of firms. After this process, some of the business groups were removed.

Diversification level which is from strategy dimensions was calculated by counting the number of sectors in which the firms of business groups are working. In determining diversification ways of business groups, it was found that how many firms did business groups found and purchase in the last 10 years and purchasing rate for each group was calculated. To determine new entered sectors, the number of new sectors which are entered by business groups was looked at. Internationalization dimension was calculated in terms of inward and outward sides. While the number of firms in BiH which are founded by business groups along with any foreign partner became indicator for inward internationalization, determination of whether business group has any business part in abroad or not was outward side of internationalization.

Results and Discussion

Results relevant to research question are shown on Table 1. There are values with different variables about nine business groups on the Table. The results are explained in following sections in detail.

Table1: Statistics about variables.

Variables	Mean	Standart Deviation
Number of Sectors	4,44	7,071
Number of Purchase	1,11	1,41
Number of Firms in Foreign Countries	0,77	0

Diversification Levels and Ways

According to results in this study, diversification levels of the business groups were taken into consideration. Before the ethnical crises, the former Socialist Federal Republic of Yugoslavia owned and controlled the business groups. So, diversification level in these state-owned groups was very low. Most of the business groups in BIH were founded after Dayton Agreement in 1995. But, due to some reasons like the devastating effect of ethnical crisis and post-crisis insecure economic environment, diversification level in business groups became low. So, as it is shown in Table 1, the average number of sectors in the business groups is very low in the study.

²This classification is found from webside of <http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=17>

The study showed that business groups in Bosnia and Herzegovina have generally preferred the diversification way of founding the firms. Founding and purchasing ways of business groups in the last decade was investigated in the study. The number of firms which were purchased by business groups are very weak (Table 1). These firms were purchased in privatization process of state-owned companies after collapse of the former Socialist Federal Republic of Yugoslavia. The study also showed that most of the firms of the business groups in BIH were founded after the ethnical crisis.

New Entered Sectors

Another strategically dimension on which was focused in the study is new entered sectors. New sectors which business groups entered in the last 20 years were coded (Table 2). When new sectors which were entered by business groups in that period are taken into account, it is clear to say that some sectors have become prominent. Two sectors have been especially remarkable in this period. While 6 business groups entered "Manufacturing" sector, 4 of them started to work in "Financial Intermediation".

Table 2 Sectors in which business groups started to work in last decade*

Sector	Business Groups
Manufacturing	6
Financial Intermediation	4
Wholesale	1
Media	1
Construction	1

* In coding system, ' International Standard Industry Classification of All Economic Activities – ISIC Rev 3.1' of United Nations was used (This classification is found from website of <http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=17>) to classify sectors of firms.

In Table 2 relevant to "Manufacturing", the influence of restructuring of BIH post-conflict period is very important. After devastated crisis, the companies were founded in order to provide the basic needs of people. Manufacturing of food and textile products can be examples of sectors which were given importance to after conflict. Many banks and leasing companies have been founded so as to support them economically in BIH's post-conflict period. So, according to the study, "Financial Intermediation" became the second sector which business groups in BIH intensified.

Internationalization Levels

As it was explained in the literature part of the study, there are two different internationalization (inward – outward) according to Guillén's (2000) classification. While inward internationalization is density of firms in BiH which were founded by business groups along with a foreign partner, outward internationalization is an amount of activities of these groups in outside of BiH among their all business activities. The study showed that inward internationalization is more effective in BIH than outward one. Some foreign

groups have made investment in BIH with Bosnian business groups. Bosnian business groups rarely have made business activities in foreign countries.

Conclusion

Business groups have emerged in a variety of forms depending on different politic-economic environmental situations. Wars and economic crisis are some of the important factors which affect and shape strategies of business groups. According to Ozkara *at al.* (2008), especially economic crises have evolutionary effect on business groups. For example, How business groups in the East Asian countries which encountered crisis developed some strategies to overcome this situation was pointed out by Chang (2006). In this study, business groups in BIH which was devastated in ethnical conflict and their strategies were concentrated on. Four different dimensions of strategies among business groups in BIH have been investigated. These are diversification levels, diversification ways, new entered sectors and internationalization levels. According to study results, diversification levels of business groups in BIH became low. One of the most important factors for this result is economic instability in this post-conflict country. As a result of uncertainties in economic policies of the state, very powerful business groups have not emerged and current business groups have not preferred to diversify in many sectors.

In another dimension of the strategies, business groups in BIH have founded the firms instead of purchasing. Although some state-owned firms were privatized after collapse of the former Socialist Federal Republic of Yugoslavia, business groups have preferred to found different companies in especially post-conflict period. However, when new entered sectors of business groups were taken into consideration, study showed that two sectors have been remarkable in the last 20 years period: "Manufacturing" and "Financial Intermediation". In developing and transition process of post-conflict BIH, business groups' focus on the production of basic necessities of people seems normal. In internationalization level as a final dimension, when some of foreign groups have made investment in BIH, Bosnian business groups rarely have made business activities in foreign countries.

Findings and discussions in this study which focused on strategies of business groups in BIH point out that business groups in this developing country should be investigated in terms of different aspects. Differences in diversifications strategies between privatized business groups after the collapse of the former Socialist Federal Republic of Yugoslavia and business groups which were founded can be investigated.

Although this study which was concluded by depending on secondary sources tried to analyze limited number of business groups in BIH, it aimed to contribute to restricted literature about the emergence of business groups and their diversification strategies. Another study with a large number of business groups and their sectors and with recent data will be very important to support this kind of studies.

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Appendix A. Business Groups Which Were Investigated in the Research

1	ASA GROUP
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2	HIFA GROUP
3	PINK MEDIA GROUP
4	AKOVA GROUP
5	OPTIMA GROUP
6	RAIFFEISEN GROUP
7	VELBOS D.O.O. ŽEPCE
8	MIMS GROUP
9	NLB GROUP
