

THE SME SECTOR IN THE CARDS COUNTRIES:

A Panorama at Country and Regional Level

AMS/451 Lot N°10 – N°2003/75117

FINAL REPORT

14th May 2004

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Annex 1: Terms of Reference for the Project

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Glossary

AEP	Agency for Entrepreneurship Performance
ASMEE	Republican Agency for the Development of SMEs and Entrepreneurship
BAC	Business Advisory Council
BEEPS	Business Environment and Enterprise Performance Survey
BiH	Bosnia and Herzegovina
BSC	Business Support Services
CARDS	Community Assistance for Reconstruction, Development and Stabilisation
CEE	Central and East Europe
Charter	European Charter for Small Enterprises
CIT	Corporate Income Tax
CoC	Chamber of Commerce
CSP	Country Strategy Paper
DB	District of Brcko
DfID	Department for International Development
EAR	European Agency for Reconstruction
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EIB	European Investment Bank
ESA	Enterprise Support Agencies
EU	European Union
F BiH	Federation of BiH
FDI	Foreign Direct Investment
FIAS	Foreign Investments Advisory Service
FINCA	Foundation for International Community Assistance
fYR Macedonia	Former Yugoslav Republic of Macedonia
GDP	Gross Domestic Product
GNP	Gross National Product
GTZ	Gesellschaft für Technische Zusammenarbeit
HAMAG	Croatian Agency for Small Business
HBOR	Croatian Bank for Reconstruction and Development
IFC	International Financial Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
INSEAT	Albanian Institute of National Statistics
KFOR	Kosovo Force
KfW	Kreditanstalt für Wiederaufbau
KTA	Kosovo Trust Agency
MBA	Montenegro Business Alliance
MCSME	Ministry for Crafts, Small and Medium Enterprises
MoE	Ministry of Economy
MoEP	Ministry of Economy and Privatisation
MSME	Micro, Small and Medium Enterprises
MTI	Ministry of Trade and Industry
NATO	North Atlantic Treaty Organisation

NEPA	National Enterprise Promotion Agency
NGO	Non Governmental Organisation
OECD	Organisation for Economic Co-operation and Development
OHR	Office of the High Representative BiH
PCA	Pohl Consulting & Associates
PHARE	Poland Hungary Assistance for Reconstruction of the Economy
PIT	Personal Income Tax
PREDA	Prilep Region Enterprise Development Agency
RDA	Regional Development Agency
RESC	Regional Enterprise Support Centre
RIA	Regulatory Impact Assessment
RS	Republika Srpska
SEE	South East Europe
SAA	Stability and Association Agreement
SAP	Stabilisation and Association Process
SEED	Southeast Europe Enterprise Development
SIDA	Swedish International Development Co-operation Agency
SMEDA	Agency for Small and Medium Enterprises Development (Montenegro)
SMEDA	SME Development Agency (Albania)
SMEs	Small and Medium-sized Enterprises
TDC	Tirana District Court
UNDP	United Nations Development Programme
UNMIK	United Nations Interim Administration in Kosovo
USAID	United States Agency for International Development
VAT	Value Added Tax

1. Introduction and Approach

1.1 Introduction

The contract for the provision of “SME Sector in the CARDS Countries: A Panorama at Country and Regional Level” was signed with Pohl Consulting & Associates in December 2003 and the team was mobilised in January 2004. Following submission and acceptance of the Inception Report in January 2004, the field research was undertaken, with a deadline of March 22nd 2004 for submission of the draft Report.

The overall objective of the project is to provide input to the process of strategic programming of the Community Assistance for Reconstruction, Development and Stabilisation (CARDS) assistance for the South East Europe (SEE) region during the period 2005-2006. This document is the draft Report for the above project, to be referred to as the “SME Panorama” project.

The structure of the report follows closely the suggested report structure presented in the Inception Report. The following key issues are addressed:

- The assignment and the organisation of the research.
- Presentation of the SME Panorama and country specific recommendations for:
 - Albania.
 - Bosnia and Herzegovina.
 - Croatia.
 - former Yugoslav Republic of Macedonia.
 - Serbia (Serbia and Montenegro).
 - Montenegro (Serbia and Montenegro).
 - Kosovo (Serbia and Montenegro).
- Presentation of recommendations for the SEE region.

1.2 Background

Albania, Bosnia and Herzegovina (BiH), Croatia, the Former Yugoslav Republic of Macedonia (fYR Macedonia) and Serbia and Montenegro are potential candidates for European Union (EU) membership. A key element of the process of converting this potential into reality is the Stabilisation and Association Process (SAP), encouraging country-specific reforms, as well as regional (Western Balkan) co-operation. Although only fYR Macedonia and Croatia are currently signatories to the SAP, the other countries are expected to follow suit in due course.

The SAP consists of three main components: trade measures to encourage import and export, thus stimulating economic growth in the region; contractual links, expected to result in signed Stability and Association Agreements (SAA) with all Western Balkan countries; and significant financial assistance designed to reinforce the aims of the SAP, focusing on supporting reforms and institution building.

This assistance amounts to about €4.6 billion to be delivered between 2000 and 2006 through the Country Strategy Papers (CSPs) and associated National Indicative

Programmes. The CSPs have been prepared for the period 2002-2006; National Indicative Programmes already exist for the period 2002-2004; and are in the process of being prepared for the period 2005-2006.

The EU-Western Balkans summit in Tessaaloniki (June 2003) reemphasised the importance of Small and Medium-sized Enterprises (SMEs) and invited the above countries to sign-up to the principles enshrined in the European Charter for Small Enterprises (Charter), thus bringing them in line with EU and Candidate Countries in following and sharing good practice in small enterprise policy. €200 million is allocated to the Western Balkans for economic reform and development measures; and in 2003, a programme dedicated to enhancing the competitiveness of SMEs in border regions was launched. Other donors and International Financial Institutions (IFIs) also have their own programmes of activity, not least the World Bank, EBRD, USAID, DfID, SIDA, etc.

1.3 Project Focus

The National Indicative Programmes for the period 2005-2006 are in the process of being prepared. The CARDS country EC Delegations and European Agency for Reconstruction (EAR) offices have been contacted by DG Relex for information and ideas for the 2005-2006 programming period. The SME Panorama project is an important element in this process, in that it separately provides input to DG Relex for the process of preparing the 2005-2006 strategic programming for the CARDS assistance to the Western Balkans.

A number of specific tasks are allocated of the SME Panorama project, as discussed in more detail in the Inception Report (PCA, 2004):

- Estimate the importance of SMEs in each of the countries: it was stressed that it would be difficult to obtain information on the key indicators of SMEs' contribution (volume of production, share of employment and share of GDP) due to the lack of SME definitions, lack of compatibility with the EU's definition and poor systems for enterprise data collection and analysis.
- Prepare a panorama of existing entrepreneurial associations: the SME situation in the Western Balkans is complex and dynamic, thus the focus of this report is on highlighting the key national SME institutions, as well as the Chambers of Commerce and other Business Associations which have become established in the region.
- Prepare a panorama of existing SME support services: the Inception Report emphasised the need to focus on the business support services, as well as business incubators and technology parks. The Inception Report also recommended a separate focus on Access to Finance, as presented in this report.
- Prepare a panorama of the regulatory/administrative/tax framework: significant progress is being made in the SEE region in relation to regulations and tax reform. The Inception Report recommended that these issues be treated separately and accordingly this report highlights the key trends in the Western Balkans region.

The key outcome of the SME Panorama project is that recommendations are to be presented focusing on potential measures to facilitate an environment conducive to the SME sector in the individual countries, as well as the region, using CARDS assistance.

1.4 Organisation of Work and Report

The background SME Panorama research was carried out during January – March 2004. To initiate the process, an introductory letter was sent to the various EC Heads of Delegation in the CARDS countries by the Task Manager, Ms Bodil Persson. Following this, PCA approached the various contacts provided by the EC Delegations and initiated the research.

The research was undertaken by the team comprising an EU Team Leader and lead author (Dr. Ricardo Pinto) and five local experts each based in one of the countries of the CARDS region (Ms. Elida Recic, Albania; Ms. Senada Keserovic, Bosnia and Herzegovina; Dr. Nevenka Cuckovic, Croatia, Mr. Zivko Dimov, FYR Macedonia; and Mr. Petar Ivanovic, Serbia and Montenegro (including Kosovo).

The principal sources of secondary SME information used in this project were:

- European Charter for Small Enterprises (National Reports, 2003).
- OECD-EBRD Enterprise Policy Performance Assessments (Country and Regional Reports, partly funded by DG Enterprise, 2003).
- Relevant reports and material collected in country.

A key feature of the SME policy environment in CARDS countries is that it is fast-changing. In such a situation, it was essential to combine the above secondary materials with up-to-date information collected in the field by our network of local consultants. In particular, interviews were conducted with the relevant staff at the European Agency for Reconstruction / Delegation offices, Ministry / Department / Agency for SMEs, other relevant public bodies and key international donors, IFIs and research institutions active in the SME policy area in the countries in question. On the basis of these sources of information, strategic recommendations were prepared for the countries and the wider region.

The rest of this report focuses on presenting the SME Panorama for each country. At the end of each SME Panorama, are presented the country specific recommendations for the CARDS system for the period 2005-2006. The final chapter presents the regional recommendations. Annex 1 sets out the Terms of Reference for the project and Annex 2 highlights an overview of key organisations involved in supporting private sector development in the CARDS countries.

2. Albania SME Panorama

This SME panorama draws on a variety of sources, such as the EC Charter for Small Enterprises National Report (2003), the OECD-EBRD Enterprise Policy Performance Assessment (2003b) and other materials collected locally, not least interviews with a variety of organisations conducted as part of the research in Albania.

2.1 Definitions and Statistics

Definition

Albania has not yet established an official definition for small and medium-sized enterprises (SMEs). The consequence is that different administrative bodies use somewhat different definitions. The state statistical body, the Albanian Institute of National Statistics (INSEAT), uses the following employment criteria in classifying firms:

- Small firms: 1 employee.
- Medium-sized firms: 2-10 employees.
- Large firms: more than 10 employees.

The Ministry of Economy is preparing a law on SMEs where an official definition of SMEs is to be introduced using employment and turnover criteria. This will bring the Albanian situation closer to EU norms, but the two definitions are a long way from being compatible, as illustrated by the new EU SME definition (below).

Enterprise category	Headcount	Turnover	or	Balance sheet total
medium-sized	< 250	≤ € 50 million		≤ € 43 million
small	< 50	≤ € 10 million		≤ € 10 million
micro	< 10	≤ € 2 million		≤ € 2 million

Source: DG Enterprise web site.

Estimates

There were 61,900 active registered enterprises in 2001 – more up-to-date information was not available. The vast majority of Albanian businesses are micro-enterprises, with few small and medium-sized enterprises being generated. About 79% of all Albanian enterprises have just one employee, and most of these (52%) are in the trade sector, where barriers to entry and the requirement for investment capital are low.

It is hard to estimate SMEs' importance, due to problems with definitions and data collection. It is not possible to estimate the volume of production or the share of employment with any degree of confidence, but it is thought that the SMEs' share of GDP is about 62% (2000).

Analysis

The lack of a single definition means that SME policy-making currently operates on a very unclear basis in Albania. Policies are determined on the basis of inaccurate information. Similarly, any evaluation of impact of policy reforms is flawed, since the baseline is not accurate to start with. In recognition of these difficulties, a twinning programme funded by the CARDS programme is being implemented by a team of statisticians. The experts are also working with INSEAT to ensure that there is greater compatibility in the SMEs definitions.

2.2 Institutions

Background

The Ministry of Economy is responsible for the SME policy in Albania. Within the Ministry, the Business Promotion Department designs, reviews and implements SME policies and strategies such as the National SME Strategy, which was approved in 2001.

The SME strategy is ambitious in its aims:

- Development of SME policy and programmes.
- Delivery of SME support services via intermediary institutions.
- Creation of a transparent legal / fiscal framework for SME development.
- Enhancing management of SMEs through training programmes.
- Access to finance by diversifying the range of tools available to small enterprises.
- Balanced regional and sectoral development by focusing on deprived regions.

The SME Law (2002) created the basis for the establishment of the SME Development Agency (SMEDA) as a not-for-profit entity with local offices to assist the implementation of the SME strategy. Its key functions are to:

- Implement policies, strategies and programmes in support of SME development.
- Propose amendments to laws, regulations and policies affecting SMEs.
- Work closely with the Council of Ministers through the Supervisory Board.
- Co-ordinate SME development activities and programmes.
- Undertake studies, market research, surveys and training on SME issues.
- Collect and disseminate SME information to relevant stakeholders.
- Formulate proposals to improve finance for SMEs.

SMEDA was created in mid-2003, so it has had little time to establish itself. Institutional capacity building for SMEDA is a top priority to ensure that the seven staff are fully trained, Agency and regional structures are effective, mechanisms for dialogue are developed, etc. Albania has had a mixed history in relation to SME institutions. A previous SME Agency existed with EU funding for a while, before disappearing completely. Therefore, it is important to ensure that SMEDA becomes an effective and sustainable institution.

SME Resources

SMEDA is financed from the state budget. However, Decision No. 56/2002 provided for very limited funding and its operating budget in 2004 is a mere €27,000. SMEDA is able to obtain additional funding from local and international donors, subject to approval from its Supervisory Board.

Consultation and Co-ordination

Attempts have been made by Government to engage businesses in policy dialogue and input. The Business Advisory Council (BAC) was established in 2000 by special order of the Prime Minister (No. 55/2000) and consists of representatives of public institutions and heads of different business organisations, including foreign business associations. BAC is chaired by the Minister of Economy and aims to ensure dialogue between the business community and the Government concerning the review and implementation of legislation impacting on the development of business. It is unclear how representative it is of the wider business community, how well resourced it is, and the extent to which SMEDA is involved in representing the interests of the SME sector. SMEDA is also looking to establish other channels of communication, such as an annual SME conference, an electronic business forum, etc.

Analysis

With the creation of SMEDA, a key missing institutional piece of the jig-saw is now in place. SMEDA will play a key role in generating a greater degree of co-ordination, co-operation and implementation of the SME strategy. It is too soon to assess its impact, but it will require significant levels of technical assistance in the coming years to ensure that it performs its demanding role effectively.

Chambers of Commerce

The Chamber of Commerce (CoC) system consists of the Union of Chambers of Commerce and 35 operational chambers in the various districts in Albania. By law, they represent the Albanian businesses vis-à-vis Governments and other partners. The supervisory body of the CoC and the Union of CoC is the Ministry of Economy. The leading bodies of CoC are the Representing Assembly and its President, the Council, the Chairman and the Secretary General. The members of the Representing Assembly and the President are elected every four years through the votes of the members of the CoC, while the Leading Council and the Chairman of the Chamber are elected by the Representing Assembly every two years. The Secretary General is appointed by the Ministry of Economy.

Functions

The CoC's activities are principally focused on trade promotion, providing information and business linkages.

Membership

Membership is obligatory for all public enterprises, businessmen and registered companies. In addition, foreign companies operating in Albania may register with the CoC. Each member is obliged to pay contributions or face fines.

Fees

The fees are fixed and independent of size of enterprise. Fee payments are one of the requirements for annual renewal of the tax number. The fees are as follows:

- Physical persons: ALL 10,000 (€74).
- Ltd companies: ALL 20,000 (€147).
- Joint stock companies: ALL 30,000 (€221).

Fines may be imposed if the fees are not paid, however, enforcement is poor and only about 20% of businesses pay the fees (Tirana CoC).

Funding

The compulsory membership fees make up most of the CoC funding. The CoC system also benefits from donor / project funding. A small amount of revenue is generated by charging for services, such as training, organising contacts, fairs, publications, etc.

Employees

There are 24 people employed by the Union and approximately 110 people in the 35 district offices. The Tirana CoC employs the largest number of staff in its six departments, whilst other cities have a limited number of employees.

Analysis

No surveys are available on the extent to which the services provided by the CoC system are valued by small enterprises. Experts and entrepreneurs suggest that the CoC is seen as being part of the government, rather than being a representative of SMEs (OECD-EBRD, 2003b). This is partly influenced by the fact that the CoC reports to the Ministry of Economy. Furthermore, while the membership fees are mandatory, the services provided to small enterprises are considered to be quite limited. The perception is that the CoC is politically well connected, but that the compulsory membership fee does not necessarily ensure that sufficient attention is paid to the needs of its membership. Reform is required to review the nature of the CoC, especially the fee structure; raise the quality and diversify the products offered to small enterprises; strengthen the network; and build capacities at the local level.

Business Associations

There are 30+ business associations, mostly based on sectoral activity such as construction, agriculture, meat processors, poultry, etc., however, none focus on SME issues per se. Below is a list of some of the associations and their membership.

Association	Sector	Membership
AATDA	Albanian American Trade Development Association	100
AB	Associations of Builders	N/A
AFADA	Agricultural Inputs	150
AFPA	Fishery	65
ALBAFLOR	Medicinal Herbs	70
AMCHAM	American Chamber of Commerce	150
ANBA	Beekeepers	600
ANSPA	Potato Producers	150
AOA	Edible Oil	54
AVALB	Agricultural Mechanisation	65
BKFSH	National Farmers' Union	25,000 est.
DENA	Dairy Processing	50
FF	Seeds and Saplings	124
FIAA	Foreign Investors Association	51
HABA	Horticulture	110
LEAA	Livestock	700
UAB	Union of Albanian Businessmen	N/A
UABO	Union of Albanian Business Organisations	343
UII	Union of Italian Investors	N/A

Source: American Chamber of Commerce Annual report, December 2001.

There are no crafts associations. USAID is in the process of implementing cluster projects that could focus on the garment and crafts industries. This may also lead to the establishment of crafts associations.

Analysis

Most of the business associations are run on voluntary basis and/or supported with donor funding (mainly USAID, GTZ and World Bank). Donor funding is essential for the establishment and early development of these business associations. It is likely that many will only exist for as long as they are externally funded, unless the voluntary membership fees become affordable. This in turn requires the number of members to increase.

2.3 Regulations

Business Entry

Companies are required to register at the Commercial Register, which is held exclusively at the Tirana District Court (TDC). In order to establish a company, a request must be submitted to a judge. Documents include the incorporation act; by-laws; bank deposit certificate for the start-up capital, etc. According to Law No. 7667 / 1993 “On the Commercial Register and the Procedures to be Followed”, judges have 30 days to register the company in the Commercial Register. In addition, a company must register with the Tax Department in order to engage in commercial activities.

Together with the request for registration, a number of documents are required:

- Registration with the Labour Inspectorate.
- Contract with the Institute of Social Securities.
- Registration with the Chamber of Commerce.
- Proof of payment of the registration tax.
- Proof of payment of the local taxes.
- Registration with the Commercial Register.
- Incorporation act, by-laws (if relevant).
- Self-declaration of the profit projections.
- Birth certificate of the company’s administrator and two passport photos.

Upon presentation of these documents in person, the Tax Department has five days to register the company. If the application is rejected, companies can complain and appeal against the decision. In addition, licenses are often required before enterprises may engage in economic activities.

According to the Charter National Report (2003), the cost of registration at the Commercial Register is €11. If some of the shareholders are not Albanian or national companies, it costs €37. In addition, it costs less than €1 for the Tax Department’s fee. The costs related to the licensing procedures may vary from €22 to €3,600. Other sources of information, suggest that the registration procedure is somewhat more problematic, involving 11 procedures, 62 days and €655 on average to register a public limited company (OECD-EBRD, 2003a). There is little indication that this costly and complex situation in improving in Albania.

Exit

It is not difficult to terminate enterprises as long as they are able to prove that they have paid all the obligations arising from their economic activities. The business register is known to include a proportion of dormant enterprises, but estimates could not be obtained.

Simplification

Administrative barriers pose a significant obstacle to business development in Albania. The publication of the Foreign Investments Advisory Service (FIAS) analysis of the administrative barriers to investment (2003) confirmed the point that tax administration, custom procedures, land and construction, administrative appeals system, etc. should be simplified and streamlined. As a result, an Action Plan, approved by the Albanian Government, has been determined which sets out the various investment barriers that are to be removed.

“One-stop-shops”

In order to establish their enterprises, all applicants are required to come in person and register at the Commercial Register, which is held exclusively at the Tirana District Court. This is a major barrier to registration and may have an impact on the levels of informal economy, which are known to be very high. There is no evidence that Albania is decentralising its registration system, so as to make it easier for entrepreneurs in the rest of the country.

“Silence is consent”

Silence consent is a principle that requires administrations to respond to requests by entrepreneurs (e.g. for registration, obtaining permits / licenses, etc.) within a prescribed time period, otherwise approval is automatic (silence is consent). There has been no progress in this area in Albania.

Land Registration / Cadastres

The land registration/cadastre system acts as a barrier to lending to SMEs. The main reason for this is the large number of legal cases relating to unclear property titles. Although there has been some progress, the issue of clear property titles is still not fully resolved throughout the country.

Informal Economy, Bribery and Corruption

It is estimated that the informal economy represents 33.4% of GNP in Albania (Schneider, 2002), but it is generally thought that is likely to be an underestimate of the real situation. According to the BEEP Survey (2002), 36.4% of small enterprises in Albania offer bribes frequently and the average bribe tax as a percentage of annual firm revenue amounts to 3.3%.

2.4 Tax

Tax System and Administration

The Ministry of Finance has responsibility for developing tax policy and drafting tax legislation. The tax system is administered by the General Taxation Department, which has branches in the 36 districts of Albania and by the Customs Department, both of which are divisions of the Ministry of Finance. Property taxes and other local

taxes are determined and collected by local authorities. Enforcement of the tax laws is considered to be poor, as is taxpayer compliance. For example, many enterprises conduct business transactions in cash / informal economy.

Key Tax Rates

- Corporate Income Tax (CIT): 24%, paid quarterly.
- Personal Income Tax (PIT): max. 10-20%, paid annually.
- Value Added Tax (VAT): 20%, paid monthly.
- Small business tax: fixed amount (€110 to €740) for annual gross revenues of up to €15,000. In addition, a fixed rate of 4% is paid on the annual gross revenues (€15,000 to €60,000). The tax is paid twice per annum.

Tax Prepayment

All taxes in Albania must be prepaid. This places a further strain on enterprises with limited recourse to commercial banks for working / investment capital.

Tax Incentives

Small enterprises whose annual turnover does not exceed 8 million leks (about €60,000) are not subject to VAT or corporate income tax. Instead, they pay a simplified tax (Law No. 8978 / 2002 “On Local Tax on Small Business”), which is a fixed annual payment that varies according to the types of business and its location. The tax is paid in two instalments (March 31 and September 30), with a 10% reduction for payment in full.

The Income Tax Law (No. 8438 / 1998) applies a simplified tax (turnover tax) to any business which is not required to be VAT registered. It applies to small business at a rate of 4% on annual gross income up to 8 million leks. Above this amount, VAT registration is obligatory.

In addition, small businesses benefit from a simplified accounting system. They maintain a record of daily turnover and submit the final annual turnover declaration in March of the following year.

Stability and Transparency

A recent OECD-EBRD report (2003b) argues that the Albanian tax system is characterised by the following features:

- Unpredictability because taxes and rates change frequently, with little warning.
- Prepayment of taxes, rather than payment after realisation of profits.
- Lack of transparency and poor availability of tax information.
- Lack of independent dispute settlement in case of complaints.
- Lack of effective consultation on proposed tax changes.

Advance Warning

Little or no advance warning is normally given before new taxes or rates are introduced in Albania. This imposes even greater compliance costs on firms, especially the ones with limited capacity and resources, such as small enterprises.

Tax Consultation Mechanisms

None exists are present.

2.5 Support Services

Business Support Centres (BSCs)

There are around 50 business support centres in Albania, of which the key ones are:

- 10 Regional Development Agencies or RDAs (7 founded by the EU; 2 by UNDP; 1 by GTZ) have been formed as independent foundations (NGOs) able to charge for the services they provide as the means of covering their cost.
- 1 Local Economic Development Agency in Shkodra (UNOPS is planning to create others in Vlora and Durres). These agencies promote local economic development and have access to credit lines operated via local banks.
- Agro-Business Management Centre in Tirana offers services such as technical assistance and business support services to agricultural associations and their members.

BSCs promote economic / enterprise development, focusing on start-ups and early growth enterprises. Now that mainstream donor funds have been largely terminated, they tend to rely on project funds from international donors (about two thirds of their income) and fees charged to local businesses (balance of their income) in order to keep operating. Achieving long-term financial sustainability is a challenge which has not yet been resolved. For this reason, the RDAs have created a national network to co-ordinate their activities and co-operate in obtaining project and commercial funding.

Technology Parks

None exist at present.

Business Incubators

Two business incubators exist in Tirana (formed in 1998) and Shkodra (1999). They were created by the World Bank Training, Enterprise and Employment Fund, which began in 1993 and is managed by the Ministry of Labour and Social Affairs. The business incubators were financed for three years, after which they became self-financing.

All tenants must be start-up businesses and can remain for three years, after which they are expected to pay commercial rents. Services offered include:

- Office services (telephone, fax, receptionist, etc.)
- Training (start-your-own-business, improve-you-business, etc.).
- Legal advice, etc.

The business incubators have limited funding, other than rent free premises until 2005. There is no strategy in place as to how they are to become sustainable. There is also a degree of institutional fragmentation in Albania: the Ministry of Economy is responsible for SME development, while the Ministry of Labour and Social Affairs is responsible for establishing and implementing business incubators. This reflects uncertainty about whether business incubators are employment/income generators or hi-tec / high growth generators; as well as the fact that there are no policies, strategies and resources in place for business incubator development in Albania.

2.6 Access to Finance

Development Bank

Albania does not yet have a national development bank. Although there have been discussions about the possibility of establishing such a bank, no concrete developments have occurred so far.

Micro Finance Bank

The Foundation for Enterprise Finance and Development (FEFAD) was established in 1996 as a fully-fledged bank, offering services such as payments, current accounts and savings facilities. The initial shareholders were KfW, EBRD, IFC and Internationale Micro Investitionen AG (IMI), followed by Commerzbank AG in 2002. In 2003, it was renamed the ProCredit Bank, the corporate identity adopted by all IMI banks in the region.

In five years, ProCredit Bank has been able to develop a large (25,000) client base, operating through a national network of 11 branches. By the end of 2003, customers had opened more than 36,000 deposit accounts with a total volume of €80 million. ProCredit has an outstanding portfolio of about 9,000 loans with a combined volume of some €47 million (December 2003). Its core target group is micro entrepreneurs - more than 88% of the disbursed loans are worth less than €10,000.

A number of other micro finance institutions are also present in Albania such as PSHM, the Rural Development Fund and the Besa Foundation, but they are not able collect deposits and provide loans. The Central Bank of Albania is redrafting the supervisory rules and regulations affecting micro finance/credit institutions to enabling them to make the transition from credit institutions to micro finance banks.

Credit Guarantee Schemes

Some small credit guarantee schemes exist such as:

- Albania Guarantee Agency (AGA): established with World Bank support to cover political risk. The World Bank no longer supports AGA, but the Government is exploring options, such as extending export risk coverage.
- Land O'Lakes: runs a small USAID-funded loan guarantee covering lending risk to small dairy farmers and food processors.
- IFC Loan guarantee risk sharing agreement: has a total of US\$ 2,5 million but no projects have been approved to date.

The main initiative of this nature is expected to be a new credit guarantee scheme to be financed with a soft loan from the Italian government. Further details do not exist at present.

Mutual Credit Guarantee Schemes

None exist at present.

SME Credit Lines

14 commercial banks operate in Albania. Of these, four provide SME credit lines:

- National Commercial Bank.
- ProCredit Bank.

- Italian Albanian Bank.
- American Bank of Albania.

The experience of both the National Commercial Bank and the ProCredit Bank has demonstrated that it is possible to have high rates of return and rapidly increasing numbers of business clients. The long delayed privatisation of the Savings Bank has finally resulted in the lifting of the crediting restrictions on the bank. Since it is the largest bank in terms of deposits in the country, this should lead to positive developments for SMEs in due course.

Leasing

Albania lacks a leasing law, but a draft law is being prepared. It is expected to be discussed among stakeholders, before being sent in Parliament in 2004.

Other

There are two equity funds operating in Albania:

- Albanian Restructuring Enterprise Fund (AREF): this investment fund worth \$14 million was established by the EBRD with financial support from the Italian government. AREF provides equity and quasi-equity financing to SMEs active in the manufacturing and services sectors. AREF operates on a strictly commercial basis, seeking returns commensurate to risks.
- Albanian-American Enterprise Fund (AAEF): promotes private sector development by providing a wide range of finance, including equity investments, loans, and guarantees. Financing is typically in the \$300,000 to \$1,000,000 range.

2.7 Country Specific Recommendations: 2005 - 2006

Definition and Statistics

The current situation in relation to SME definitions and statistics is inadequate and may result in inappropriate policy responses by Government. A number of reforms could be implemented with CARDS assistance, as they are directly linked to the agenda established by the EC Charter:

- There is a need for a single definition for SMEs, which all state bodies employ, and which is as compatible as possible with the EU's new definition. This would enable the Albanian government to determine policy and assess impact, partly by benchmarking itself against other transition economies, as well as EU countries.
- Further technical assistance is required to ensure that the key state organs, not just INSEAT, utilise the new definition and collect business statistics in a systematic and efficient manner, utilising best practice from EU member countries.

Institutional Issues

SMEDA is the key organisation responsible for implementing the SME policy and strategy. However, it has limited funds, was only created in mid-2003 and has yet to establish itself fully. Moreover the prehistory associated with SME institutions in Albania, means that it faces high expectations and will be closely observed by SMEs, business associations and the wider SME stakeholders. A priority for CARDS support during 2005 – 2006 could be to ensure the institutional strengthening and sustainability of this institution, focusing on the following elements:

- Undertake a thorough review and up-date of the SME strategy to ensure that SMEDA takes ownership the strategy and that it is up-to-date and capable of being implemented. This is particularly important now that the Albanian government is committed to the EC Charter agenda.
- Based on the new strategy, ensure that the SMEDA's resources (budget, programmes, staffing, etc.) are consistent with the task that it is responsible for.
- Develop a detailed programme of capacity building to ensure that the SMEDA personnel have the knowledge, resources and policy tools to implement their remit.
- Assist SMEDA to work effectively with the regional business support centres that it will be increasingly co-operating with in the future.
- Ensure that financially sustainable is a key goal of the organisation and that there is a medium to long term strategy for achieving this, built around core funding from the state budget.

Business Government Dialogue

Albania recognises the importance of business government dialogue. The Business Advisory Council (BAC) has been established, however, but it is not an effective tool. CARDS assistance could:

- Establish a representative, regular and effective mechanism for government-business dialogue and representation. Now that SMEDA has been created, there is a need to establish a representative consultative body focusing specifically on small enterprise issues. SMEDA could act as the secretariat for such a mechanism.

Business Associations

There is a need to improve services provided by business associations in Albania, with the support of the CARDS programme:

- Review the Chamber of Commerce legislation and system, dealing with issues such as the nature of the relationship between the Ministry of Economy and the Chamber of Commerce (should it be a representative of businesses or government?), the continuing necessity for compulsory membership, the effectiveness of the national and regional structures, the range of services and the degree of focus on small enterprises and their needs.
- Intensive training programmes on issues such as customer orientation, marketing, business planning, lobbying, certification, IT skills, marketing, fund raising, etc. so as to enhance their capacities to meet the needs of their clients by providing a range of quality, customised services.
- Better IT skills and equipment, not least databases and web sites to facilitate contact with members and provide better quality information and services.
- Networking of business associations, not only in terms of IT networks but also information sharing, co-operation and co-ordination of activities.

Regulatory Issues

Unlike most other countries in the SEE region, there is little evidence that Albania is simplifying the complex and costly business entry (registration and licensing) process. The CARDS programme could prioritise the need to simplify business entry, using the extensive experience which has built up in the region. The focus could be on the following issues in 2005 and 2006:

- Technical assistance in order to implement the Action Plan to Simplify the Business Environment, approved by Government in 2003.
- Examine options for simplifying the registration procedures, including removing the courts from the process of registration, as in Serbia, Kosovo, etc.
- The registration process is highly centralised in the Tirana District Court and imposes major compliance costs on enterprises. Consideration could be given to introducing a regional one-stop-shop system of registration (and licensing), perhaps located in the key urban areas.
- In conjunction with the above, the scope for on-line registration (and payment of taxes) could be prioritised, especially if the system is to remain centralised.
- The licensing regime is non transparent and represents a major barrier to doing business. Technical assistance is required to simplify the licensing and permit regime, in conjunction with introducing the principle of “silent consent”, so as to accelerate the process.

Diversification of Finance

Albania has traditionally relied very heavily on remittances and family capital to finance enterprise development. The banking sector is becoming more stable, the rules are being revised in favour of micro finance institutions and the privatisation of the Savings Bank offers greater prospects for mobilising capital to assist the growth and development of small enterprises. CARDS assistance could be used to help diversify the range of financial products available to small enterprises:

- The leasing law is in the process of being prepared in Albania. CARDS assistance could be mobilised to demonstrate, through pilot initiatives, that leasing is both a feasible and profitable area of business activity for financial institutes.
- Other areas of possible activity include factoring, supplier credit, etc. in partnership with the International Financial Institutions active in Albania.

Entrepreneurship

CARDS technical assistance could be used to assist help develop a greater culture of entrepreneurship in Albania during 2005 to 2006:

- Develop strategies in relation to business incubators, technology parks, technology transfer, clusters, business networks, etc.
- There is a need to further develop the entrepreneurial spirit and new skills throughout the education system (secondary school level, colleges and universities), promote the entrepreneurial efforts of young to-be entrepreneurs and develop training schemes for managers in small enterprises.
- The size and impact of the informal economy is significant in Albania. There is a need to develop a palette of policy tools and responses, based on EU experience, to reduce the costs of non-registration, increase voice, increase the costs of non-compliance and increase access to finance, as recommended by good practice in this area (this is the subject of a separate PCA report to the EC that is in the process of being finalised).

3. Bosnia and Herzegovina SME Panorama

This SME panorama draws on a variety of sources, such as the EC Charter for Small Enterprises National Report (2003), the OECD-EBRD Enterprise Policy Performance Assessment (2003c) and other materials collected locally, not least interviews with a variety of organisations conducted as part of the research in Bosnia and Herzegovina (BiH). Due to its complexity, the information for BiH refers to the state of BiH unless otherwise specified. The following abbreviations are applied in this chapter: Federation of BiH (F BiH), Republika Srpska (RS) and District of Brcko (DB).

3.1 Definitions and Statistics

Definition

There is a lack of SME definitions in BiH. Only the Republika Srpska (RS) has implemented a definition for SMEs, which is as follows:

Micro enterprises:

- Average annual number of employees: less than 10.
- Annual total turnover €200,000.
- Assets value €100,000.

Small enterprises:

- Average annual number of employees: 10 – 49.
- Annual total turnover €200,000.
- Assets value €100,000.

Medium-sized enterprises:

- Average annual number of employees: 50 – 250.
- Annual total turnover €10 million.
- Assets value €5 million.

Estimates

In 2001, there were about 30,000 registered SMEs (99.3% of all enterprises). SMEs' importance can be gauged by the following broad statistical estimates:

- Volume of production = N/A.
- Employment = 63% (2001).
- Share of GDP = 36% (2002).

Analysis

The lack of SME definitions means that policy making operates largely in the dark in BiH. Even where there is a definition, as in the RS, this is incompatible with that of the EU. Despite the existence of Statistical Agencies at BiH and entities/cantons level, there is a significant degree of inconsistency in the systems for business data collection and processing. The RS uses the former Yugoslav Republic's methodology for data collection and processing, but in the F BiH a modified model of EU's statistical system is in use. Both systems operate using outdated hardware and software, making the situation more complicated. There is a need to overhaul the definitions and associated statistical systems in all parts of the BiH, using compatible methods and definitions.

3.2 Institutions

Background

The institutional framework to support SMEs is complex and under-developed but is improving over time mainly due to the efforts of international community. Since the situation differs dramatically, the following discussion differentiates between the BiH State (BiH), Federation of BiH (F BiH), Republic of Srpska (RS) and District of Brcko (DB) whenever possible.

BiH State: The Ministry of Foreign Trade and Economic Relations of BiH deals with economic development, including enterprise development at state level. A Division for Development and Entrepreneurship was created in 2003 which has a Promotion and Development of Entrepreneurship Unit. This unit has 12 staff members and is in the process of developing a law on SMEs. The resources available are limited, covering salaries and office costs, leaving limited scope for programme funding. There is no SME strategy at present, however, the Poverty Reduction Strategy Programme (PRSP) was approved by BiH Council of Ministers in February 2004 and is going through the parliamentary procedures. The PRSP covers a wide range of issues, including creating an enabling environment for investments and SME development.

Federation of BiH: The Federal Ministry for the Development of Entrepreneurship and Craftsmanship is responsible for developing the SME sector. This is in recognition of the importance of the SME sector and the necessity for effective co-ordination in the F BiH. The F BiH lacks an SME strategy at present.

Republic of Srpska: The Ministry of Economy, Energy and Development has established a Department of Private Entrepreneurship, which has prepared and adopted an SME strategy (Programme of Development of SMEs 2002-2005) in 2001. The strategy defines SMEs using a similar definition to that of the EC. Furthermore, an Agency for SMEs was created in 2003 to implement the SME strategy. Although it was expected to have a budget of €75,000 in 2003 and eventually a staff complement of 14, it is not yet established due to a lack of sufficient state funds. The same applies to the Fund for SME Development. Both Agency and Fund are planned to be implemented as they are key parts of the economic policy of RS Government in 2004.

District of Brcko: The Department of Economy of the Government of DB deals with SME development. In the last three years the broad legislative framework for economic activity has been the priority. Since 2001, the key focus has been on establishing the Regional Development Agency (RDA) of Brcko District as the implementing agent, targeted by the framework provided by the approved Regional Development Strategy (2002-2006). The RDA has developed a “one-stop-shop” for business registration; delivers business support services; deals with trade and investment promotion, etc.

SME Resources

The organisations operating at state, F BiH and RS level have created institutions to support SME development, but they lack the funds to implement programmes to underpin their SME strategies (where these exist). In DB, the RDA is based on a broad regional partnership and the budget comes partly from the Government of the

DB. This means that it has greater financial means at its disposal than its counterparts elsewhere in BiH. Much of the funding in the area of private sector development comes from the IFIs and donors active in the country.

Consultation and Co-ordination

Ensuring effective government - business dialogue has not been a priority in BiH. In the Federation of BiH a Social and Economic Council was created in 2002 consisting of Government, Employers and Trade Unions. The Council co-ordinates social dialogue and focuses on collective bargaining agreements. Other than this, dialogue and consultation at all levels is restricted to ad hoc arrangements through the Chamber of Commerce and Employers' Associations.

In September 2003 the Federation of BiH passed a regulation for the establishment of the Co-ordinating Body (competent Federal Ministries, Cantons and municipalities in the Federation of BiH) for development. The Federal Ministry for Development of Entrepreneurship and Craftsmanship will implement, through the Co-ordinating Body, SME support projects for the Federation, approved by the Government of the Federation and manage both domestic and foreign means for realising these projects. Such Co-ordinating Bodies were also established in RS and DB in 2003.

Analysis

The system is highly fragmented and functions poorly. The institutional infrastructure is being put in place, however, there is a serious lack of funds, the institutions are generally weak and unsustainable, the policies and strategies are underdeveloped, the various institutions rarely communicate and co-ordinate effectively with the SME stakeholders within their territory, let alone between the State, Federation of BiH, Republic of Srpska and District levels. One of the causes of this is the very low level of knowledge and skills of employees in the relevant institutions, as well as a lack of information needed to successfully create and implement projects which would provide stronger support for SME development.

Chambers of Commerce

There are 19 Chambers of Commerce (CoC) in BiH comprising: 1 BiH Foreign Trade Chamber, 2 entity CoCs, 1 CoC of Brcko District, 10 Cantonal CoCs in F BiH and 5 regional CoCs in RS.

Functions

The Foreign Trade Chamber represents the interests of the members abroad through diplomatic and consular networks; co-operates with other Chambers in the country and abroad; promotes and implements educational programmes; develops business and computer systems; develops favourable conditions for foreign investments and joint-ventures; collects and elaborates economic data and market analyses within the framework of foreign economic relations; promotes the BiH economy and presents the products of BiH companies at international fairs; supplies information on the legal system, economic legislation, including legal services, to foreign and local economic entities, etc. A similar set of activities is performed by the entities and cantonal/regional CoC. The activities of the Chambers of Crafts are mainly focused on helping with registration procedures and lobbying at entity / cantonal levels.

Membership

Members of the Foreign Trade Chamber of BiH are legal and natural persons operating in various businesses, banking and finance, public utilities and other activities. Membership is mandatory. There are about 40,000 members in various import and export activities.

Membership of the CoCs in the Federation of BiH and Republic Srpska is no longer obligatory, as of 1st January 2004. Membership of the CoC in Brcko District has been on a voluntary basis since its establishment on 2000.

The principle of voluntary membership also applies to the newly formed Chambers of Crafts created in 2002. There are 3 of these in whole country.

Fees

As from January 2004, membership fees vary according to the decision of each cantonal/regional CoC assembly. The basis for calculation of the voluntary membership fee is the sum of gross salaries. For example, the membership fee of the Sarajevo Canton CoC (1,700 members) and Zenica-Doboj Canton CoC (400 members), both of which had about 10 times more members whilst membership was mandatory, is about 4% (this depends on the size of the SME). The membership fee is mandatory for CoC of Federation BiH (3%) and for CoC of RS. Membership of the Foreign Trade Chamber of BiH is mandatory only for SMEs which are registered for import/export activities and amounts to 2% of their gross salaries. In addition, SMEs pay 1% on the value of imported goods and services and 0,5% on the value of exported goods and services. The membership fee cannot exceed 40.000 KM (€20,450) per year.

Funding

The key source of funding for most CoCs is the membership fee. There are very few, such as CoC of Sarajevo Canton in the FBiH, which have significant levels of other sources of income, such as training fees, etc.

Employees

Number of employees varies very significantly from two (in case of some Chambers of Crafts) to 20-30 in case of some Cantonal and CoCs. There are up to 50 employees in the case of few Cantonal CoCs, entity CoCs and the Foreign Trade Chamber.

Analysis

The 19 ex state-owned CoCs are generally considered to be fairly ineffective as far as SMEs are concerned, with notable exceptions such as the Sarajevo Canton CoC. It is generally argued that whilst membership was mandatory, the majority of CoCs were insufficiently attuned to the needs of the small enterprises. Since January 2004, when membership became voluntary, the situation has reportedly changed dramatically, resulting in more diverse and higher quality services. This appears to be driven by a collapse in membership and thus the necessity to deliver services which are in tune with the needs of clients.

The Chambers of Crafts are mainly focused on micro and small enterprises, and sole traders. Their limited financial muscle (because of the nature of their members), combined with the fact that they are still relatively new, means that they are at a

relative disadvantage vis-à-vis more established business associations at this point in time and require support in the early phase of development. There is a notable lack of co-operation and networking within the CoC system itself, as well as with other business associations active in the country.

Business Associations

There are certain professional associations such as: the association of taxi-drivers, bakers' association, butchers' association, hairdressers' association, wood processing workers' association, textile workers' association, metalworkers' association, catering workers' association, trade association, etc. There is also the association of employers at different levels (state, entity, cantons, and municipalities).

Analysis

Although these business associations started to appear from 1999/2000 onwards and a significant number of such associations have become established, they lack the capacity to significantly influence the business environment in the interest of their members. By contrast, the professional associations which fall within the umbrella of the Chambers of Commerce have greater capacity and are more influential. Some of the business associations are supported by donors, such as the 14 municipal business associations formed by Community Habitat Finance in Central BiH.

3.3 Regulations

There are no laws regulating policy and support to the SME sector. The "BiH SME Development Strategy" is under preparation and the "Poverty Reduction Strategy Paper", which will regulate support to the SME policy development, has been adopted by the Council of Ministers of BiH and is passing through parliamentary procedures. In March 2004, the "Strategy, Policy and Programme of Employment in BiH and Entities" was presented by the Employment Bureaux, Trade Unions and Chambers of Commerce. Until recently, BiH was one of the few European countries without an employment programme, despite the fact that more than 450,000 persons are officially registered as unemployed. In June 2003, Bosnia and Herzegovina endorsed the principles contained in the European Charter for Small Enterprises, which creates a framework for SME development activity.

Business Entry

The F BiH, the RS and DB have their own company legislation. According to the BiH Small Enterprise Charter National Report (2003), the time and costs needed to register a company in the Court Register vary: 15 days / €1,650 in District of Brcko; 30 days / €1,400 in Federation BiH; and 31 days / €1,650 in Republic of Srpska. In the case of the two entities, the company registration procedure involves a large number of complex steps which can discourage business start-up and expansion. The entry of a new firm involves an average of 12 steps; an average period of 74 days; and costs €656 (OECD-EBRD, 2003a).

There are developments underway which should improve matters. The District of Brcko has set itself a target of registering all enterprises within eight days. In 2002, the High Representative created the Bulldozer Committee (see below), composed of

OHR, WB, EC, IMF, and USAID, to cut as much red tape as possible, thus stimulating economic growth. One of the Bulldozer Committee's main goals is to reduce the number of days to register a company to 15 days.

Exit

Business exit is not an expensive affair in the case of BiH, however, the procedure remains bureaucratic and there are numerous steps involved in terminating enterprises. Exit in the case of bankruptcy is regulated by new Laws on Bankruptcy (passed in RS and DB, and in the parliamentary procedure in FBiH) and the Liquidation Law.

The business exit conditions impact on the proportion of active / non-active enterprises. For example, the exit procedures mean that numerous enterprises continue to be registered even though they may be dormant for several years. Fear of controls by the tax and financial police is another reason why inactive companies remain registered.

Simplification

A report by the Foreign Investment Advisory Services (FIAS, 2001) on administrative barriers to investment in BiH led directly to the BiH Council of Ministers and the Entity Governments approving an Action Plan on the Removal of Administrative Barriers for Investments in 2002. Simultaneously, the Office of the High Representative (OHR) published a "Jobs and Justice" reform agenda (OHR, 2002), involving five pledges around the themes of economy and justice. These two documents represent the framework to streamline the regulatory and legal environment.

In November 2002, the Bulldozer Committee was created to implement the business simplification agenda involving 50 economic reforms. By February 2004, the Bulldozer Committee had implemented all the reforms. The Bulldozer process is led by five Regional Bulldozer Committees and a BiH-wide Agricultural Bulldozer Committee. In Phase II, an additional 50 reforms are being formulated and are in various stages of government procedure. These new reforms are expected to be enacted by the summer of 2004. Phase III will be launched in March 2004. An important reason for the progress being made is that the State, Entity and Brcko governments agreed to establish Emergency Reform Units made up of highly-motivated civil servants who have direct access to the heads of government and who are tasked with steering Bulldozer reforms through the relevant ministries and government departments.

"One-stop-shops"

There are about 20 Information Centres in municipalities throughout the country. Their purpose is to provide administrative services to citizens, sole traders and SMEs in one location, but they provide only a part of the documentation required to register businesses.

The creation of one-stop-shops is not being pursued in BiH at the present time except in the District of Brcko, where the Regional Development Agency has introduced a one-stop-shop on a commercial basis. It is expected that this method of facilitating

administrative procedures will be established in BiH with the support on international donors.

“Silence is consent”

The 15 day rule amounts to silent consent as far as company registration is concerned. No other developments are planned at the present time.

Land Registration / Cadastres

The obsolete land registration / cadastre system inhibits lending to SMEs. There are numerous cases where the ownership cannot be proved beyond doubt due to such issues as lack of effective updating of information and double registration of ownership. This applies especially to property obtained by SMEs via the privatisation process or bought from privatised companies. Since banks experience problems selling real estate used as collateral due to unclear title, this adds to the cautious lending behaviour by commercial banks. GTZ is supporting land registration and cadastral reform, but this is a long term process.

Informal Economy, Bribery and Corruption

It is estimated that the informal economy represents 34.1% of GNP in BiH (Schneider, 2002). According to the BEEP Survey (2002), 22.4% of BiH small enterprises offer bribes frequently and the average bribe tax as a percentage of annual firm revenue amounts to 0.9%. In March 2004, the BiH Council of Ministers discussed a draft money laundering law, which is expected to enter the parliamentary procedure in the near future; the same applies to the draft law on Reviewing Privatisation Contracts concluded so far, as well as the draft law on the Revision of the Privatisation Process. These developments should impact on the scope for bribery and corruption.

3.4 Tax

Tax System and Administration

Tax policy and tax administration is the exclusive competence of the Federation, Republic of Srpska and the District of Brcko. In order to develop a meaningful single economic space, the business community strongly supports the necessity to harmonise tax policies and rates, resulting ultimately in a unitary tax policy and administration system. There have been some developments towards harmonising the tax system between the two entities and Brcko District. For example, in August 2002, an agreement was signed between the entities and DB on avoiding double taxation with regard to excise duties. Much greater harmonisation is required in relation to excise duties, the sales tax, etc. as these are key barriers to doing business in BiH.

In December 2003, the BiH Council of Ministers appointed the Director of the Indirect Tax Authority and the BiH state parliament passed a law to merge the country's three separate customs administrations into a single, state-wide Value-Added Tax (VAT) system, which will be introduced and administered at state level. The Law on Indirect Taxation represents a significant step toward the creation of a single economic space in BiH and a key move forward in the country's hopes of joining the EU. It is anticipated that VAT Authority will be fully operational in January 2005 and that implementation of the VAT system will start in January 2006.

Key Tax Rates

- Profit Tax: 30% FBIH, 10% RS, 20% DB, paid monthly.
- Sales Tax: 20%, 10% FBIH, 18%, 8% RS, 18%, 8% DB, paid monthly.
- Value Added Tax (VAT): expected to be introduced in January 2006.

Prepayment

Profit tax must be prepaid.

Incentives

The existing laws for the whole territory of BiH (both Entities and Brcko District), provide for the following CIT tax exemption: enterprises are 100% exempt in the first year of operation, 70 % in the second year, and 30% in the third year. According to the programme of the Federation of BiH, there is a plan to create a Law on Incentives for Small Business Development. Enterprises are exempted from the income tax if 50% of employees are disabled persons. There is also a set of incentives for SMEs which are founded fully or partially with foreign capital.

Stability and Transparency

The tax system is highly fragmented, with each part of BiH pursuing its own policies, rates and changing these as they see fit. The result is a highly unstable and non transparent system, as far as enterprises are concerned. As always in these situations, small enterprises in particular face severe compliance difficulties and costs. The recent developments in respect to indirect tax (VAT) offer the prospect of some improvement in the future.

Advance Warning

The fragmentary nature of the tax system means also that there is limited advance warning for enterprises. There is also little training provision of both the tax administrations and entrepreneurs. An exception is likely to be the introduction of VAT, since this tax has been anticipated for some time.

Consultation Mechanisms

None exist at present.

3.5 Support Services

Business Support Centres (BSCs)

There are about 40 business centres and agencies primarily providing support and services to the SME sector, the majority involving donor support:

- Enterprise Development Agencies established by UNDP/ILO in Banja Luka and Bihać (Mostar and Livno closed down due to lack of financial sustainability).
- Regional Business Development Centres established by UNDP/UNIDO in Zenica and Banja Luka (Bihać closed down due to lack of financial sustainability).
- Chambers of Commerce business support departments (Sarajevo, Tuzla, Banja Luka, Zenica, BiH Chamber of Foreign Trade, Chamber of FBiH, etc.).
- Business Support Centre Brcko (part of Brcko District Regional Development Agency - BDDA).

- Business Centre in Srebrenica (support for sustainable return of refugees).
- Agency for Local Development Initiatives (ALDI Gorazde).
- Tuzla Agency for Local Development Initiatives (TALDI).
- Central Bosnian Economic Development Agency (CeBeda).
- Development of Women Entrepreneurship Programme, Tuzla.
- Others including EG Tuzla, LINK Mostar.
- Independent Bureau for Development, Gradacac
- Forma-F Mostar.
- Economic institutes (mainly linked to the Faculties of Economy).

An important country-wide development is that five supra-Regional Development Agencies (RDAs) are in process of being establishment with CARDS assistance under the Regional Development Programme (EURED programme). They cover five consolidated economic regions, with the founders being municipalities, Cantons, business associations, international organisations (in the case of Central BiH), etc. The North-East (NERDA), Herzegovina (HERDA) and Sarajevo (SERDA) RDAs are already registered, while the Central (REZ-RDA) and North-West (DARNW) RDAs are expected to do so in April 2004. All RDAs are in the process of preparing regional development strategies, and in addition, the BiH Regional Economic Development Forum became establishment in February 2004. The Forum will lobby for effective regional development policies, and to ensure that regional policy is integrated into the overall economic framework in BiH. In addition there is also a number of sub-Regional Development Agencies (DA) in Brcko District DA, Tuzla Canton DA, Semberija DA (RAS), Banja Luka Economic Region DA (BLERDA), Middle Bosnia Canton DA (CEBEDA), Upper Drina Valley DA (REDRIN), Herzegovina DA (HERDA), Posavina DA, Bihac DA.

In addition, some new BSCs were established in 2003:

- Business Service Centre of the Government of Zenica-Doboj Canton.
- Business Centres within the 14 municipal business associations formed by CHF in Central BiH.

Despite the large number of BSCs in BiH, the great majority are in need of additional capacity building (human resources, IT literacy, foreign languages skills, etc.). The issue of achieving financial sustainability remains pressing and BSCs continue to close down once donor funding is terminated. There would appear to be an ongoing need to maintain this activity.

Technology Parks

None have been implemented in BiH but there is a plan to establish a technology Park in Zenica based on the infrastructure and the skilled and educated workers of “Kemal Kapetanovic” (metallurgy institute). This institute was a distinguished scientific research institute, linked to the steel factory in Zenica (the biggest in the former Yugoslav Republic) and the Faculties of Metallurgy and Machinery. There also appears to be scope for establishing technology parks in university towns such as Sarajevo, Banja Luka, Mostar and Tuzla, however, much more research and analysis is required before this becomes a reality.

Business Incubators

The only active Business Incubators in BiH are based in Gradacac (formed in 1998), Modrica-Tarevci (2002) and Mostar (2003). Two projects have been approved by the EU Quick Impact Facilities 2 (EC programme) in Zenica and Žepce at the end of 2003. Each project will receive €40.000 worth of support to help establish the incubators using exist infrastructure and buildings. During 2003, feasibility studies were undertaken to create incubators with an Information Communication Technology focus in Bugojno and Sarajevo. Donors may finance these projects.

There is a lack of policy with respect to business incubators in BiH; the responsibility for implementation is unclear; and the national and international resources to promote them effectively are missing. More generally, there is still a lack of awareness of what they are on the part of entrepreneurs, ministries, business associations, etc.

3.6 Access to Finance

Development Bank

There are two banks in Federation of BiH: the Bank for Development and Reconstruction, Sarajevo and the Investment Bank of FBiH, Sarajevo. Both disburse loans to SMEs, but they do not fully play the role of a development bank.

Micro Finance Bank

ProCredit Bank (Micro Enterprise Bank until 2003) is the only micro finance bank present in BiH. Along with numerous commercial banks, it provides micro credit lines. The ProCredit Bank specialises in providing MSMEs and rural and urban households with suitable facilities for deposits, micro and housing loans, as well as payments services. As of December 2003, it had 18,000 active clients, indicating that the services offered by the bank enjoy the confidence of the public; the outstanding loan portfolio stood at €44 million; total assets amounted to €51 million; and it had a high quality loan portfolio, with only 0.6% of loans more than 30 days in arrears.

There are also a number of organisations providing micro- credit schemes to SMEs and sole traders such as:

- MCO REZ-FUND - Zenica
- MCO BENEFIT - Lukavica
- MCO EKI Mikro - Sarajevo
- MCO LOK Micro - Sarajevo
- MCO BOSVITA - Tuzla
- MCO MIKRA - Sarajevo
- MCO SUNRISE - Sarajevo
- MCO MI BOSPO - Tuzla
- Mikro ALDI - Gorazde
- MCO Mikrofin - Banja Luka
- Mikro WOMEN for WOMEN International - Sarajevo
- MCO MELAHA - Sarajevo
- MCO WORLD-VISION - Zenica
- PARTNER MCO - Tuzla
- MCO PRIZMA Mikro - Mostar

- MCO SINERGIJA PLUS - Banja Luka

The Association of Micro Financial Institutions was established in 1999 and strives to improve the conditions and business environment faced by micro finance institutions through networking and support to micro and small entrepreneurship in BiH.

Credit Guarantee Schemes

Credit Guarantee Schemes have recently been introduced as a tool in the BiH financial market. International donors created two projects in 2003:

- Mostar (funded by Cooperation of Italy, managed by the “LINK” NGO), supporting start-up enterprises.
- Brcko District (funded by UNDP), supporting start-up agriculture producers.

The EU Regional Development Programme (EURED) provided technical assistance for the establishment of the Loan Guarantee Funds. It is too soon to assess the impact of these schemes. A third loan guarantee fund is in the early phase of being establishing in Central BiH, to be funded by Cantonal governments, municipalities and business associations.

Mutual Credit Guarantee Schemes

None developed so far.

SME Credit Lines

In the last two years, following significant new FDI in the financial sector, the range of SME credit lines has expanded dramatically. Competition among foreign owned banks (such as Raiffeisen, Volksbank, HVB bank, Hypo-Alpe-Adria, Zagrebacka banka), as well as among the stronger domestic banks (such as ABS banka, Central Profit Bank, Nova banjalucka banka) has led to a reduction of interest rates for loans. The interest rates for SME credit vary from 8%-12% in the majority of credit lines; the period of maturity varies from 1-5 years; and the focus includes agriculture, production, export activities, purchase of equipment, etc.

Some credit lines are offered to SMEs through local banks by bilateral donors (e.g. Italian government, Turkish government, etc.). These offer better terms and conditions (5-8%) but tend to be restricted to the purchase of equipment or goods from their producers (tied “commercial loans”).

Leasing

Leasing is not currently an important form of financing SMEs activities. Only a subset of commercial banks (e.g. Raiffeisen Bank, ProCredit Bank, etc.) offer this option. The BiH law on financial leasing is still under parliamentary procedure.

3.7 Country Specific Recommendations: 2005 - 2006

Definitions and Statistics

Only the Republic of Srpska has created an SME definition, albeit one which is not compatible with the EU's. This, together with the obsolete data and statistical information systems which exist at state, entity, canton, etc. level, means that there is an urgent need to obtain CARDS assistance with respect to the following:

- Establish a single SME definition, compatible with the EU's.
- Establish a modern and effective data collection system throughout the country, especially regarding the SME sector.
- Utilise EU member country and EUROSTAT input to achieve the above.

Institutional Issues

The institutional framework for SME development is highly fragmented at the State, Federation of BiH, Republic of Srpska and District of Brcko levels. CARDS technical assistance in 2005 and 2006 could focus on the development of a sound framework for SME policy making and implementation, as required for the successful delivery of the Charter principles that BiH has recently committed itself to.

The key components of such a programme would focus on the following:

- A capacity building programme targeted at the SME support institutions is urgently needed, focusing especially on the state level Ministries, including training, field visits, secondments, etc.
- Development of web sites for the key SME institutions, since the business environment is highly complex and none of relevant ministries, agencies, etc. offer this (excluding RDAs such as Brcko District, Sarajevo, Tuzla Canton and Zenica-Doboj Canton).
- Assessment of the possibility of creating an SME co-ordinating body at State level to ensure a systematic approach to the development of a business friendly environment through the creation of an SME policy and implementation strategy.
- The Republika of Srpska and the District of Brcko have set up their own SME implementation arrangements; and the Federation is planning its own mechanism. Whilst recognising that the District of Brcko RDA functions well, there is a need to build up the capacities of these institutions and to ensure that they undertake effective SME co-ordination both within their territories as well as at State level. Particular attention needs to be placed on the issue of achieving financial sustainability.
- The EU Regional Development Programme has initiated the process of creating five supra-Regional Development Agencies and the establishment of a network of all local and regional development agencies. This is a positive development which could be expanded to as to ensure that the network becomes an effective mechanism for exchange of information, ideas and best practice, including application for funding and implementation of projects.
- There is a need to evaluate the possibility of creating a representative body for business advisory services and business consultants as a means of strengthening the support and services to small enterprises; ensuring co-ordination of activity for the benefit of the enterprises; as well as introducing a system of international certification and accreditation so as to set minimum quality standards and improve confidence in the benefits of services. This would be a useful step towards raising standards and assisting the process of financial sustainability.

Business Government Dialogue

There is almost no business-government dialogue to ensure the creation of a better business environment in BiH:

- An exception is the Socio-Economic Council in F BiH, but it needs to be strengthened so as to increase its usefulness.

- Depending on how effective this proves, a similar mechanism may need to be established at the state level, as well as in RS and BD for consistency. This is unlikely to happen on its own.

Business Associations

Most of the Chamber of Commerce system has become voluntary since January 2004 and is having to compete vigorously for members. The Crafts Chambers became established in 2002; and various business associations have been created since 1999. There is a need to support these institutions to become more professional, broaden the range of services on offer and achieve financial sustainability. Key issues include:

- Intensive training programmes on issues such as customer orientation, marketing, business planning, lobbying, certification, IT skills, marketing, fund raising, etc. so as to enhance their capacities to meet the needs of their clients by providing a range of quality, customised services.
- Better IT skills and equipment, not least databases and web sites to facilitate contact with members and provide better quality information and services.
- Networking of business associations, not only in terms of IT networks but also information sharing, co-operation and co-ordinations of activities.

Regulatory Issues

In parallel with the efforts of the Bulldozer Committee, there is a need for CARDS to support the continuing process of business simplification. The focus of the technical assistance could be on the following issues:

- Review of the procedures for registration, re-registration and termination of firms, so as to simplify the process; and publication of all the procedures, subject to how much of this work is completed by Bannock Consulting in the current DfID financed project.
- Implement an electronic firm registration system in the Courts covering the whole country and consider mechanisms for removing the Courts from the registration process, so as to enable them to focus on their priority role.
- Reduce the time and cost associated with business entry by establishing a single registration system and developing a “One-Stop-Shop” system throughout the country.
- Pilot the possibility of on-line registration and tax payment.

Diversification of Finance

Despite the large number of commercial banks in BiH, the strongest of which are those with foreign participation, banking intermediation remains low. Legal and judicial reforms are a prerequisite to increase intermediation, since creditors are unclear about their ability to use the court system in the exercise of collateral rights and contract disputes:

- This is an area where CARDS assistance could focus on in 2005, including accelerating the implementation of options for quick resolution of commercial disputes through “out of court settlements.”
- There is also a need to promote the broadening of financial products (through demonstration projects and seed capital) offered by the commercial banks to small enterprises, such as:
 - Leasing schemes.
 - Mutual Credit Guarantee Schemes.

Entrepreneurship

Promotion of entrepreneurship is a key element of the Charter. Whilst recognising that the CARDS system will fund continuing work in relation to vocational education and training, more could be done in this field in BiH. CARDS technical assistance could be used in 2005 and 2006 to assist the development a greater culture of entrepreneurship, focusing on the following elements:

- Develop strategies in relation to business incubators, technology parks, technology transfer, etc. building on the existing activities and programmes (EU RED, USAID, Southeast Europe Enterprise Development - SEED, etc.)
- Campaign on the informal economy: the informal economy appears to be growing in significance to the point where it affects the legitimacy of the state and results in unfair competition vis-à-vis registered enterprises. EU best practice needs to be harnessed to assist the Ministry of Economy to develop appropriate policy tools to tackle this issue.
- There is a need for a wider programme focusing on fostering a culture of entrepreneurship in BiH. Examples include:
 - Develop the entrepreneurial spirit throughout the education system and promote the entrepreneurial efforts of young to-be entrepreneurs.
 - Campaign on self-employment: this could be supported at the national level through a broad campaign so as to raise awareness among the general public and the media of the importance of self-employment in counteracting the very high unemployment levels.
 - Establishment of an Annual Awards for Entrepreneurship: this could make a contribution to improving the image of entrepreneurs and raising the profile of successful businesses, especially if it is backed up international organisations and the government.

4. Croatia SME Panorama

This SME panorama draws on a variety of sources, such as the EC Charter for Small Enterprises National Report (2003), the OECD-EBRD Enterprise Policy Performance Assessment (2003d) and other materials collected locally, not least interviews with a variety of organisations conducted as part of the research in Croatia.

4.1 Definitions and Statistics

Definition

The definition of small and medium-sized enterprises (SMEs) is regulated by the Law on Enhancing the Development of Small Entrepreneurship (March 2002):

Micro enterprise:

- Annual average number of employees: below 10.

Small enterprise:

- Annual average number of employees: below 50.
- Annual turnover below HRK 16 million (€2.1 million), or long-term assets below HRK 8 million (€1.0 million).

Medium-sized enterprise:

- Annual average number of employees: below 250.
- Annual turnover is below HRK 60 million (€ 7.9), or long-term assets below HRK 30 million (€3.9 million).

Estimates

In 2002, there were about 57,000 registered SMEs (99% of all enterprises). SMEs' importance can be gauged by the following broad statistical estimates:

- Production = N/A.
- Employment = 54% (2002).
- SME share of GDP = 55% (2002).

In the last decade, the SME sector has been an employment generator and, therefore, an important factor counteracting the rising levels of unemployment. By contrast, large enterprises have experienced a shakeout in employment levels since 1991.

Analysis

The definition of SMEs is compatible with new EC SME definition only with regard to the number of employees. However, the turnover and fixed capital requirements are much lower, reflecting differences in the general levels of economic development. The SME definitions could be synchronised over time, especially if Croatia obtains Candidate Country status.

Precise statistics with regard to the size of the enterprises exist only from the Financial Agency's (FINA, the ex-State Bureau for Payment Settlements and the only agency with a complete database on enterprises' financial reports) records. The State Statistical Office does not categorise enterprises in relation to the EU definitions of size. It would be advantageous to introduce standards that would make it possible to

compare Croatian data with that of EU and accession countries. These are potential areas for CARDS technical assistance in future.

4.2 Institutions

Background

The institutional framework for the development of the SME sector is fairly comprehensive in Croatia. At the state level, in recognition of the importance of SME development to the economy, a Ministry for Crafts, Small and Medium Enterprises (MCSME) was responsible for setting SME policy. Entrepreneurship and SME development were singled out as priorities for 2002-2004 (Developmental Priorities of the Republic of Croatia, 2002-2004, 2001, p.11).

A new Government took office at the beginning of 2004 which intends to continue strengthening the SME sector as one of its priorities. However, within the programme to reduce of number of ministries, the MCSME was abolished as a Ministry and reverted to reporting to the Ministry of Economy, Labour Entrepreneurship. A new Directorate for SMEs was formed within the Ministry of Economy, Labour Entrepreneurship, which is in charge of SME development.

The Law on Stimulating Development of Small Entrepreneurship (2002) is based on the Programme for Development of Small Entrepreneurship in Croatia, 2001-2004 which sets out the country's main strategic goals:

- Increase the share of small business in total economic output to the level of EU.
- Increase the share of small businesses in industry, tourism and services.
- Enhance financial stability and provide more sources of finance.
- Accelerate technological development, competitiveness and open-up new markets.
- Increase the number of small businesses and the number of employees of SMEs.
- Support the small business development institutions and create entrepreneurial support infrastructure (business centres, business incubators, business zones, etc.).
- Educate and train entrepreneurs through focused educational programmes.
- Form networks and clusters of small business organisations.
- Develop contacts with neighbouring countries to exchange experience.

In 2003 the MCSME prepared the Programme of Small Entrepreneurship Development, 2003-2006. It was adopted in the autumn of 2003 and retained the same priorities but presents a more precise account of the incentive programmes and how they will be implemented in the medium term.

The Croatian Agency for Small Business (HAMAG) funded by the state budget and international sources, and is expected to play the crucial role of implementing the short and medium term plans for the development of small business, however, it appears to be mainly focusing on and co-ordinating financial incentives to SMEs. It is expected that HAMAG's role could be further strengthened with regard to funding (providing incentives, subsidies, guarantees and capital assistance to the SME sector), as well as staffing, since the MCSME merged with the Ministry of Economy, Labour Entrepreneurship in January 2004.

Local authorities and counties play an important economic and enterprise development role. Most of the 21 counties in Croatia operate their own regional business support centre and local authorities host 35 local business support centres. They are important partners in implementing the Programme of Small Business Development. Lack of funding is not as important an issue as elsewhere in the CARDS region, but counties and municipalities lack the expertise and skills to develop a more entrepreneurial dynamic in their localities.

SME Resources

The financial support to SMEs through the MCSME (such as SME incentives, subsidized loans and other capital assistance) amounted to €10.2m in 2003. However, there was significant additional financial support available for SME sector from the state budget via the other ministries (Ministry of Tourism, Ministry of Public Works, Reconstruction and Construction Industry; Croatian Bank for Reconstruction and Development) which comes up to €68 million according to the Ministry of Finance's budget plan for 2003. Unlike other countries in the region, there is a correlation between the ambitions set out in the SME strategy (in this case the Programme for Development of Small Entrepreneurship in Croatia) and the funds that the state allocates to achieve that strategy. The budget plan for 2004, presently in preparation, may further increase the level of resources ring-fenced for SME development, despite the pressures exerted by the fiscal deficit.

Consultation and Co-ordination

No dedicated mechanism for SME – government dialogue exists at the present time in Croatia. The main means of involving business community in the legislative process is via the participation of the Croatian Chamber of Commerce, the Croatian Chamber of Crafts and Crafts and the Croatian Employers' Association. These institutions are asked for feedback on documents and legislation (interestingly, the CoC may actually participate in Parliamentary Working Groups on relevant issues). In addition, the Croatian Employers' Association participates in the Tripartite Council and both chambers have signed a "Partnership for Development" which means that they participate as the recognised partners in the official dialogue between the Government, employers and Trade Unions, with the aim of reaching consensus on key economic reform policies and legislation.

Analysis

In pursuit of its SME policy goal, until January 2004 the MCSME co-ordinated with a range of institutions such as HAMAG, Croatian Bank for Reconstruction and Development, SME business development centres, regional development agencies, business incubators, free business zones, business associations, regional and local administration, etc. in dealing with SME development. From January 2004 this task has been transferred to the newly formed Directorate for SMEs within the Ministry of Economy, Labour Entrepreneurship. Its work is backed-up by the initiatives of other ministries. Overall the system functions fairly well, although the role of HAMAG (and the new Directorate for SMEs) needs to be further strengthened within the context of recent abolishment of MCSME, both in terms of funding and the capacity of the staff.

Chambers of Commerce

There are two chambers in Croatia:

- Chamber of Commerce.
- Chamber of Crafts.

Functions

The Croatian Chamber of Commerce (HGK) represents the interests of its members before government authorities and policy makers. HGK gives opinions on legislative solutions and law proposals, participates in different policy making bodies and in Parliamentary committees. HGK also promotes the Croatian economy abroad. Other tasks include facilitation of economic restructuring, development of the entrepreneurship, research and innovation support, business training and development of information systems. HGK also issues and authenticates export-import business documents (certificates of origin, export permits, etc.).

The Croatian Chamber of Trades and Crafts (HOK) promotes the interests of tradesmen. HOK co-operates with the Government in passing regulations and creating economic policies for the development of trades and crafts. Membership is organised into tradesmen associations, county chambers and vocational organisations, through which they conduct their activities and promote their interests. The HOK also represents and promotes the Croatian crafts abroad by supporting the participation of Croatian tradesmen at international trade fairs.

Membership

Membership is compulsory in both cases.

Fees

The Chamber of Commerce collects a monthly fee of €7 for small firms, €200 for medium firms, plus 0,01% of annual income. Companies starting-up in the current or previous year pay €7 per month. The Chamber of Crafts collects a monthly fee of €2 plus up to €15 (for the local chamber and crafts association), plus 0,4% of annual income/profit.

Funding

The sources of income are mainly membership fees. Income is also generated for fees charged for the provision of services such as training, consultancy, certification fees and permits, as well as the management of the Chamber's assets and property.

Employees

The Croatian Chamber of Commerce (HGK) has 20 regional/county chambers. The Zagreb Chamber is responsible for both the city of Zagreb and Zagreb County. The work of HGK is organised into 12 sectors representing the main branches of economic activity. The membership is also organized into 36 professional organisations. The number of HGK employees is not publicly disclosed.

The Croatian Chamber of Trades and Crafts (HOK) has 20 regional/county offices and 114 offices at the level of different cities and municipalities. It has about 91,000 members. The number of employees is not publicly disclosed.

Analysis

Both the Chamber of Commerce and the Croatian Employers' Association are more geared towards meeting the needs of the large and medium-sized rather than small enterprises. The range of services offered is indicative of such an inclination, although it should be noted that both institutions have departments supporting SME development.

The survey information that is available (Croatia Enterprise Policy Performance Assessment, OECD-EBRD, 2003d; European Charter for Small Enterprises, 2003; Croatia National Report, 2003; Business Association Development in Croatia, CIPE, 2004; Surveys of HGK and HUP, etc.) indicates that the small business community is not satisfied with the present levels of service and support provided to them. There is much scope for improvement in this area. This particularly relates to the service provided at the regional and local levels, where the Chamber of Commerce's offices are too understaffed and under-skilled to respond to the SMEs needs. Awareness of the priorities of the small business community needs to be increased, services diversified and quality raised.

Business Associations

The major business associations are:

- Croatian Employers' Association (HUP): 5,000 members that employ about 300,000 employees. Membership is voluntarily and is organised into 24 branch associations covering different economic activities (e.g. chemical industry, financial intermediation, transport, trade, tourism, etc.). It has a special branch that deals with SME support. Its headquarters is in Zagreb, but there are regional offices in Rijeka, Osijek and Split.
- Croatian Managers' and Entrepreneurs' Association (CROMA): members include managers, entrepreneurs, members of supervisory boards, directors of company units, heads of departments, heads of other business associations and institutions, as well as the entrepreneurs and owners of companies. Membership is voluntary but the size of the membership is not disclosed.
- Croatian Banking Association (HUB): its members are the 15 most important banks in Croatia holding about 85% of total assets in the banking industry. It is an independent institution promoting the interests of the banking industry as a whole.
- Association of Management Consultants (UPS): a voluntary association of individuals and companies which promotes professional management and business consulting services by qualified practitioners.
- Business Association of Croatian Woman (KRUG): a voluntarily association seeking to improve the position of businesswomen through the education, networking and promotion of businesswomen's achievements by supporting women's entrepreneurship, business culture and business ethics. The association has nine branches and over 100 members.

Analysis

Surveys identify about 80 business associations (Business Associations Development in Croatia", IMO for Centre for International Private Enterprise, 2004). 22 operate in the field of services, reflecting the prevalence of this sector in the Croatian economy. There are also associations in other sectors such as manufacturing, transport and communication, trade, tourism, agriculture, etc. Some business associations are more

influential than others, depending on the strength of their membership. This is difficult to determine, as this is often privileged information restricted to members.

Most of the business associations are voluntary. The quality of services provided to members varies considerably and there is scope for improvement:

- A number would benefit from greater specialisation and customised around the needs of their membership, as well as a focus on raising the quality of services in order to avoid overlapping with others.
- Sectoral business associations need to define more precisely the specific needs of their membership and, in particular, assist in the process of Croatian integration with the EU (standards, accreditation, import/export, networking services, etc).
- Improve dialogue with government in order to better represent and voice the interest of their membership in policy-making and adopting new legislation.

4.3 Regulations

Business Entry

The legislative procedures concerning company registration are broadly in line with EU practices and are not considered to present legal or administrative barriers to business start-ups (FIAS, 2002). However, due to an overburdened commercial court system, registration is still a much more time-consuming process than in EU countries, as well as in the most advanced transition countries. The FIAS study on administrative barriers to foreign investment (2002) found out that the total time taken for all procedures for registering a company is 45 days; and that obtaining building and location permits for building new business premises takes a minimum of three months. Through the Action Plan for Reducing Business Barriers (see below), the previous Government recommended a time limit of 30 days for company registration, after which the registration is automatic. This time limit has not been stipulated by law as an obligation and is not being implemented. The Government is also seeking to reduce the costs of various procedures of company registration, especially for small business and crafts start-ups. According to its public statements, the new government seems to be even more ambitious with regard the time limit for company registration, but it remains to be seen whether this will be legislated for.

The procedures for registering a start-up can be both time consuming and costly. For example, to establish a plc, the Companies Act (Official Gazette No. 111/1993, 34/1999 and 52/2000) identifies the following steps for registration:

- Statement on the start-up and certification of the signature by a public notary.
- Deposit initial capital.
- Announce in the Official Gazette.
- Register in the Commercial Court (Register of Companies).
- Make a seal.
- Obtain company identification number from the Croatian Bureau of Statistics.
- Register at the Tax Administration and obtain tax number.
- Obtain customs number from the Customs Administration (if relevant).
- Notify the start of business (Croatian Pension Insurance Fund and the Croatian Health Insurance Fund).

According to the Charter National Report (2003), it can be quite costly to register a firm in Croatia: it costs €2,500 to register a plc (€15,000 in the case of joint stock companies), but it is cheaper to register crafts (€160 plus up to €67 for Certificate of Crafts plus €10 – €147 additional fees for technical issues). A key issue is that obtaining permits and licences can be extremely problematic and it is not unusual for this process alone to last up to six months.

Exit

The termination of firm is a slow process due to inefficient procedures of the bankruptcy courts. Enforcement of bankruptcy regulations is also weak. For this reason many of registered companies exist only “on paper” and are not active. According to FINA data (2002) less than 40% of registered enterprises are active firms and the State Statistical Bureau reports that 48% of all registered enterprises were active in 2002. Either way, this is one of the highest proportions in the CARDS countries.

Simplification

According to the last FIAS study (2002), land acquisition, registration and site development are amongst the most problematic aspects of starting a business in Croatia and are considered to be major impediments to both domestic and foreign investment. As a result, an Inter-Ministerial Task Force on Removing Administrative Barriers to investment was created in 2001 focusing on simplifying barriers and reducing costs to start-ups. It is headed by the Vice-Prime Minister of Economy, Labour Entrepreneurship, whose Ministry co-ordinates the work of the Task Force. Some progress has been made, for instance in the field of land and cadastre registers reform, where electronic books are being prepared with the support of World Bank and EU loans. The beneficial results of the reform will be first felt in capital city, while the rest of the country is expected to be completed by 2008. The Task Force has also proposed that the principle of “silence is consent” should be introduced, as well as the possibility for on-line registration of firms. The e-Government project aims to make registration and other administrative services on-line and pilot programmes are expected to be initiated in selected municipalities in the near future.

“One-stop-shops”

This issue is not being pursued in Croatia at the present time, although the idea has been examined in government programmes and strategic documents.

“Silence is Consent”

See “Business Simplification” above.

Land Registration / Cadastres

The land registration system presently hinders faster SME development in Croatia. The World Bank and EU have provided \$37.5 million worth of loans to the Croatian Government for the introduction of electronic books / registers during the period 2003-2008, when it is hoped the system will comply with international standards.

Informal Economy, Bribery and Corruption

It is estimated that the informal economy represents 33.4% of GNP in Croatia (Schneider, 2002). According to the BEEP Survey (2002), 12.9% of Croatian small enterprises offer bribes frequently and the average bribe tax as a percentage of annual

firm revenue amounts to 0.6%. Other estimates (Institute of Public Finance, 1997, 2002) suggest that the informal economy is both far lower and actually decreasing in the case of Croatia (from 25% in 1996 to about 10% in 2001). The main contributory factors appear to be economic growth, improvements in statistics, introduction of VAT, etc. (Ott, 2002).

4.4 Tax

Tax System and Administration

The Ministry of Finance is responsible for setting tax policy. Within the Ministry of Finance, the Tax Administration is tasked with implementing tax regulations and regulations concerning the payment of contributions, which all residents are obliged to pay. The Tax Administration performs administrative and other professional duties relating to the following:

- Receiving tax returns, collecting and refunding taxes.
- Establishing tax base and tax liability.
- Carrying out inspection supervision.
- Pursuing cases at the misdemeanour courts due to violations of tax regulations.
- International legal assistance in tax matters.
- Development and use of the tax information system.
- Seizure of assets in order to collect public taxes upon the request of government bodies and courts and in line with special laws, etc.

Key Tax Rates

- Corporate Income Tax (CIT): 20%, paid annually.
- Personal Income Tax (CIT): 15, 25, 35 and 45%, paid monthly.
- Value Added Tax (VAT): 22%, paid monthly.

Prepayment

Three taxes are prepaid: CIT, PIT and VAT.

Incentives

Tax system is tax neutral but there are opportunities for new enterprises to reduce their tax obligations:

- Accelerated or one-off amortization.
- Reduction of tax base for new employees' salaries.
- Reduction of tax rate to 0% in areas of special state concern.

The law allows micro enterprises (craftsmen and freelancers) to pay lump-sum income tax and surtax instead of keeping business records. In this way, income taxes are reduced and business record keeping is simplified.

Stability and Transparency

The tax system is considered to be generally stable and transparent. There have not been significant conceptual redesigns and reforms since 1998. Changes have been made but only to the rates of CIT and PIT, and the new Government plans to reduce VAT to 20% from January 2005.

Advance Warning

Experts consider that there has generally been sufficient time for enterprises to prepare for new legislation, but research (OECD-EBRD, 2003d) points out that small companies need more information and assistance from the support institutions in that regard.

Consultation Mechanisms

No dedicated consultation mechanisms for tax issues exist. A Professional Association of Certified Tax Consultants was established in 2003, which may engage with government in relation to tax reforms and changes.

4.5 Support Services

Business Support Centres (BSCs)

The number of business support centres (BSCs) has been growing steadily. It is thought that there are now around 40 BSCs providing a variety of advisory services for SMEs. Most of the BSCs were founded by local/county authorities, backed-up with private sector and donor support.

They were usually founded as centres for enterprise development at the local level (cities and municipalities); as regional or local economic development agencies; or technology development / transfer centres. They are highly dependent on public financial assistance and offer a highly diverse range of products and services. The lack of institutional financial sustainability remains a concern, leading to problems with continuity of services provision. Sustainability could be enhanced by introducing high quality services on a fee paying basis.

The ex Ministry of Crafts and Small and Medium Enterprises (MCSME) attempted to enhance BSCs by providing funding via the Support Programme for SME Development. It is thought that this Programme will be continued by the Ministry of Economy, Labour Entrepreneurship. BSCs continue to be a focus of interest for international assistance programmes such as UNDP, EC, SIDA, USAID, etc.

Technology Parks

There are two technology parks located in Zagreb and Rijeka. Their mission is to support business start-ups, advise entrepreneurs, provide business education and training, and deliver project management to introduce quality certifications such as ISO 9000. They also promote new technologies and innovations and provide support to SMEs to develop new products, introduce know-how and new technologies, product prototypes and market preliminary products. These technology parks also provide a potential structure for business incubation oriented towards hi-tec companies (see below).

There is scope to upgrade/develop technology parks within the context of raising the competitiveness of the Croatian industry vis-à-vis the EU. Potential is thought to exist in business software, information and communication technologies, process automation, system and design optimisation, etc. The framework for this potential to be realised (such as policies, strategies, resources, etc.) is largely missing.

Business Incubators

There are presently 12 business incubators in Croatia, the newest of which opened in Bjelovar in 2003. The best established incubators are located in Labin, Rijeka and Split. Their premises and services are partially subsidised by the municipalities where they are located. The tenancy duration is a maximum of 60 months compared to the standard of 36 months in the SEE region, but they sometimes exceed this limit.

Business incubators offer their tenants office and workshop place at preferential rates; use of office, computer and communication equipment; meeting room facilities and related services. Assessments (OECD-EBRD, 2003d; MSCME surveys) have indicated a positive impact on the rate of business start-ups, especially with regard to access of office or production space needed in the early years of newly established firms. Business incubators could be deployed in the war affected and economically depressed regions as a job creation instruments. Greater progress could be made by learning from the experience of the SEE region, but also the new EU member countries. The lack of financial sustainability is an on-going problem.

4.6 Access to Finance

Development Bank

The Croatian Bank for Reconstruction and Development (HBOR) is a state-owned bank tasked with stimulating economic development. HBOR provides SME loans via commercial banks for on-lending. HBOR also operates two direct-lending SME loan programmes:

- **Development of Private SMEs:** this programme provides long-term loans for modernisation and expansion of existing enterprises, handicrafts and other types of entrepreneurial activities. Loans can be used for investment into the fixed assets (business premises, equipment, etc.) and working capital (up to 30% of the loan amount) and refinancing of existing financial obligations. The funds are administered through commercial banks. Eligible sectors include manufacturing industry, crafts, tourism, agriculture, transport and other services. Up to 70% of investments are financed from the HBOR loan. The loan amount ranges from €10,000-€1,000,000; the repayment term is up to 8 years, with a grace period of up to 2 years; and the interest rates charged are 5.5%-7%.
- **Incentives to Start-ups:** this programme assists businesses start-ups and handicrafts, thus creating scope for new employment. It prioritises export and production projects, investments in new technology and joint investments with foreign partners. Business start-ups require 30% of the investment amount in assets. The loan ranges from €10,000-€500,000; the repayment term is up to 12 years, with a grace period of up to 2-3 years; and interest rates vary from 5% (in special state concern areas and islands) to 7%. Up to 70% of eligible investments are financed from the HBOR loan.

HBOR also provides loans for business start-ups via on-lending ranging from €10,000-€250,000. It finances up to 70% of the investment amount for a 12 year term with interest ranging from 5-7%, depending on the region.

Micro Finance Bank

A micro finance bank does not exist at present, but several micro credit initiatives are being implemented by NGOs, with the support of international organisations:

- Microcredit Savings and Loans Co-operative (NOA): was established by the SOROS Foundation and Opportunity International in 1996. It has offices in Central, Western and Eastern Slavonia and in Southern Croatia, including Beli-Manastir, Vukovar, Pakrac, Dubrovnik and Osijek. It provides group loans, loans for agriculture and security for individual loans. Loans are provided for equipment, raw material and working capital. The terms and conditions are: 1% interest per month; 6 month maturity, 90 day grace period; and an administrative fee of 2%. Security derives from groups of three to five members who guarantee for each other, based on the “graduation principle.”
- The Soros Foundation / Open Society Institute: activities started in 1991 and the Centre for Entrepreneurs (CEPOR), Osijek is being supported. CEPOR also manages a \$200,000 credit line with NOA.

Credit Guarantee Schemes

One of the tasks of the Croatian Agency for Small Business or HAMAG (previously the Croatian Guarantee Agency) is to issue guarantees to SMEs according to the guarantee programme adopted by the Government. Since 1995, 3,400 guarantees have been approved (€ 87 million; default rate 1,6%). During the same period, the Croatian Agency for SMEs also awarded 3,100 grants reducing credit costs (€ 2,7 million).

Mutual Credit Guarantee Schemes

None exist at present.

SME Credit Lines

Most of the favourable SME credit lines are provided by HBOR through on-lending contracts with about 30 commercial banks. These credit lines are used to support private entrepreneurship by providing long-term loans for the modernisation and expansion of existing enterprises, handicrafts and other entrepreneurial activities. The borrowers are domestic enterprises in with a maximum of 250 employees, and entrepreneurs in the manufacturing industry, crafts, tourism, agriculture, transport and other services. The maximum loan is HRK 8 million and HBOR finances up to 75% of the investment costs. Repayment terms are between 4-10 years and interest rates of 5.5%-7.5% are charged.

Government also plays an active role in stimulating SME credit by providing loan guarantees through HMAG and loan subsidies for special programmes, such as export-oriented SMEs and those in tourism sector. Special subsidies and guarantee schemes are also offered to the war affected regions and islands in order to stimulate job creation through SME development.

Direct provision of government finance in providing credit lines to the SMEs should, in time, be replaced with funds from commercial banks, mutual guarantee schemes and other sources of short and long-term funding for SMEs, such as venture funds, business angels, equity financing, etc. The lack of long-term finance for SME development is an issue which the EBRD and other IFIs are seeking to tackle.

Leasing

On the initiative of the Croatian Chamber of Commerce, an association of 14 leading leasing institutions was formed (Debies Leasing Hrvatska, Erste & Steiermaerkisches-Leasing, Gama Beta Leasing, Euroleasing, HVB Leasing Croatia, Hypo Leasing Kroatien, Korotan Leasing, PBZ Leasing, Porsche Leasing, Raiffeisen Leasing, S Immorent International Holding, i VB Leasing) in 2002. Banks offering leasing products for entrepreneurs undertook a series of promotional activities to introduce the advantages of leasing in providing equipment and rolling stock. The Government has requested technical assistance from the IFC to further develop the leasing industry by improving its regulations.

Other

The Croatia financial market is fairly advanced compared to other countries in the CARDS region. For example, there are four venture capital funds: Capital Croatia Partnership Ltd, SEAF, Alpe Adria Venture Fond (Horizonte Venture Management) and Copernicus Adriatic. These are financed through EBRD, IFC, pension and other funds and commercial banks, but they are not used extensively. Business Angels do not exist in an organised manner.

4.7 Country Specific Recommendations: 2005 - 2006

Institutional Issues

- There is a range of different support institutions available for SME sector in Croatia, however, their capacities, expertise and impact vary considerably, particularly at the local and regional levels. Technical assistance delivered through CARDS should continue to strengthen the capacities of regional and local administration, as well as business support centres and business associations, to provide better support services for SME development.
- In addition to further enhancing the capacity of specialised business advisory, consulting and related support institutions, there is a need to introduce internationally recognised standards and certification for business advisory services. This should result in higher quality services, as well as a greater willingness on the part of small firms to buy such services, thus assisting the process of attaining financial sustainability, one the main problems in Croatia.
- There is a lack of instruments for regular, timely monitoring and evaluation of the performance and impact on the development of the SME Sector in Croatia. This applies to all levels, but is particularly important in relation to central government (now the Ministry of Economy, Labour Entrepreneurship) and the SME implementation agency (HAMAG). Likewise, it is necessary to measure the impact of the different international technical assistance programmes, so as to better target activities in the future. Allied to this, the SME environment would benefit from a mechanism for co-ordinating technical assistance, preferably led jointly by the Ministry of Economy, Labour Entrepreneurship and the Ministry of European Integration.
- The staff at the Ministry of Economy, Labour Entrepreneurship (new Directorate for SMEs) have been mainly inherited from the ex MCSME. An assessment needs to be made as to whether the Directorate for SMEs is adequately equipped to perform its demanding role, especially as the new government appears to be even more committed to SME development than its predecessor.

- There is a need to strengthen the capacity, sustainability and human resources of regional and local administration, as well as Regional Development Agencies to better cope with most important economic problems such as unemployment, restructuring and increasing competitiveness in the enterprise sector. A special focus would be to encourage micro and small enterprises creation in war affected and economically depressed regions. CARDS assistance should continue to link up with other donors active in these areas such as UNDP.

Business Government Dialogue

- Given the importance that the Government attaches to small enterprise development, there is a need to introduce mechanisms for regular and effective dialogue between Government and business community, especially small enterprises. CARDS technical assistance could be provided to develop such a mechanism, using internationally accepted good practice.
- Allied to the above, there is a need to include a wider range of stakeholders (local community, donors, etc.) in that dialogue, so that representatives of the SME sector may influence draft legislation and policy in an effective and timely manner. This could link up with the National Competitiveness Council's recommendations (2004) to establish a Task Force to better co-ordinate policies, legislation and, instruments and programmes for enhancing entrepreneurship. Technical assistance would be needed in the start-up stage.

Business Associations

The services provided by business associations are generally rated higher than those delivered by Chamber of Commerce, especially the HGK. This raises a number of possibilities for CARDS assistance to business associations during 2005 to 2006:

- Technical assistance to the CoCs in order to train staff and review the range of services provided and customise to the needs of the small enterprise community.
- Technical assistance to assess the costs and benefits to the Chambers and the wider business associations of introducing voluntarily membership (the others have introduced voluntarily membership); and whether such a change might act as a catalyst for the delivery of a wider and more effective range of business-oriented services to members.
- Technical assistance to business associations to introduce quality standards, monitoring and evaluation of the services, customer orientation, etc.
- Technical assistance to strengthen the capacity and expertise within of the business associations in order to better meet the current needs of the SME community at the local and regional levels.

Regulatory Issues

- Croatia is one of the few countries in SEE that is not yet considering the possibility of introducing a one-stop-shop system for the registration of businesses. CARDS funded feasibility studies for the implementation of such a system in Croatia (in 2005), followed by resources and know-how for effective implementation (in 2006) would represent a timely development. Other partners include the World Bank and SIDA.
- Furthermore, CARDS could assist by developing the scope for E-businesses and assessing the possibility of creating on-line registration of enterprises by initiating pilot projects in dynamic municipalities such as Zagreb, Rijeka, Osijek, Cakovec,

Pula, and Split. Since this is a Charter priority, it could be followed up with implementation assistance in 2006.

Diversification of Finance

Croatia has the most sophisticated financial system in the CARDS countries. However, there is a need for CARDS assistance to further develop the capital markets in Croatia by introducing new instruments for SME finance:

- For instance, since Croatia's situation is more advanced, it may be appropriate seek to develop the venture capital market, seed capital funds, as well as Business Angels, as is happening in certain new EU members such as Slovenia, Hungary, Czech Republic, Poland, etc.
- There is a need to promote good practice in EU and accession countries in relation to leasing and mutual credit guarantee schemes. Neither is established in Croatia, but both are known to be effective mechanisms in enabling small enterprises to accessing finance.
- Pilot initiatives in relation to the above, perhaps targeted at the more disadvantaged regions, could lead to an important demonstration effect which may encourage mainstream financial institutions to begin offering these financial products to small enterprises.

Entrepreneurship and Competitiveness

Entrepreneurship and competitiveness are two essential components for Croatia to focus on in the future, with CARDS assistance:

- The National Competitiveness Council has identified 55 priority recommendations for improvement of competitiveness of the Croatian economy. Comprehensive support and know-how to implement this agenda can only be provided with CARDS assistance. Priority areas include:
 - Development of enterprises operating in the knowledge economy with emphasis on technology and innovation.
 - Support of firms applying ISO norms and standards.
 - Support fast growing export-oriented enterprises.
 - Identification of EU benchmarks (costs and financial indicators), etc.
- Further development of a culture of entrepreneurship is required (campaigns, competitions, education at school, college and university, vocational training, etc.). Special attention will need to focus on promoting entrepreneurial skills for starting businesses among young people and woman entrepreneurs.
- Assistance to raise the levels of productivity and competitiveness (international standards and certification, quality control, etc); as well as increase support to export-oriented enterprises. This could be done in collaboration with the World Bank and USAID.

Privatisation

- CARDS should continue to provide assistance in relation to the privatisation, competition and regulation of public utilities (oil and gas, energy production and distribution, transport, etc.) and communication industries in order to improve the general market environment and competitiveness of the utilities sector, especially by opening the possibility of market entry for new providers.
- CARDS could support further strengthening the skills and capacities of independent regulatory agencies such as the Energy Regulatory Council, Telecommunication Regulatory Council, etc.

- There is a need to simplify firm's exit and bankruptcy procedures. Only 40% of registered enterprises are actually active. This means that national policy making and evaluation is not being carried out on a sound basis and there is a need to reform the process of exit. CARDS assistance in collaboration with the World Bank and EBRD would be valuable in dealing effectively with this issue.

5. FYR Macedonia SME Panorama

This SME panorama draws on a variety of sources, such as the EC Charter for Small Enterprises National Report (2003), the OECD-EBRD Enterprise Policy Performance Assessment (2003e) and other materials collected locally, not least interviews with a variety of organisations conducted as part of the research in FYR Macedonia.

5.1 Definitions and Statistics

Definition

The definition of SMEs is incorporated in the Law on Accountancy (Official Journal No. 39/99 and No. 70/2001). Article 4 states the following:

- Small enterprises fulfil one of the following criteria:
 - Less than 50 employees.
 - Annual turnover less than MKD 8,000 average monthly gross salary (€200).
- Medium-sized enterprises fulfil one of the following criteria:
 - Less than 250 employees.
 - Annual turnover less than MKD 40,000 average monthly gross salaries.

The law makes no mention of micro or large enterprises. However, the final draft of the new Company Law (Article 465) states that businesses are defined as: large, medium, small and micro, based on the financial statements of the previous two years. The likely new definition, according to this draft law is:

Law on Trade Companies	Micro employees	Micro turnover	Small employees	Small turnover	Medium employees	Medium turnover	Large
Definition	1-9	<0.5M €	10-49	< 2M €	50-250	< 10M €	over 250

Source: Draft Company Law, Feb 2004.

Estimates

Reliable, accurate information does not exist on these issues. Below are a series of estimates of the current situation in FYR Macedonia:

- Volume of production = 45% of GDP (2003).
- Employment = 39% (2003).
- Share of GDP = 40% (2003).

Analysis

Experts consider the future SME definition (as per the draft Company Law) to be sufficiently compatible with the EU definition; and that it is appropriate to set lower financial boundaries for FYR Macedonian enterprises because of the much lower productivity and competitiveness of their SMEs.

Apart from the issue of definitions, a major problem in SME policy-making is that only a part of the registered SMEs are actually active and contribute to the production, employment, GDP, taxes, etc. Active enterprises are those that submitted balance sheets and profit and loss statements to the tax authorities in the previous year. The number of registered SMEs is 67,737 firms (Court Register and State Statistical

Office), however, only 32,800 are actually active (48%). In order to make policy relevant decisions, Government must develop accurate enterprise data.

5.2 Institutions

Background

The Ministry of Economy (MoE) is responsible for SME policy making. Within the MoE, the SME Department focus on the following priorities:

- Development of the institutions to support entrepreneurship and competitiveness.
- Optimisation of the business environment to encourage start-up businesses.
- Promotion of entrepreneurship and delivery of support to entrepreneurs.
- Maximisation of SMEs' access to financial support.

The SME Department has four staff members but significant responsibilities. In the last two years, it has been operating without its implementation arm (National Enterprise Promotion Agency or NEPA – see below) and it was not very active until the arrival of the new Government in FYR Macedonia in 2003.

NEPA was established in 1997 with EU PHARE programme support. Its objective was to promote the SME sector across a broad range of government activities, including working with the international donor community. NEPA has been semi-operational and is expected to be replaced with the Agency for Entrepreneurship Promotion (AEP) in the near future.

AEP will implement the SME strategy. It has a Board of Directors and will shortly (May 2004) have a Director and about 10 professional staff. AEP will also co-ordinate the broad network of SME supporting centres consisting of 5 Regional Enterprise Support Centres (RESCs), 3 Enterprise Support Agencies (ESAs), the Prilep Region Enterprise Development Agency (PREDA), 4 Technology Transfer Centres, and the five existing Business Incubators and Euro Info Correspondence Centre.

Under the terms of the Ohrid Framework Agreement that ended the political crisis in 2001, the municipalities soon will be granted powers to receive part of taxes generated on their territory. They will be able to undertake urban planning and manage their own local economic development, including supporting SMEs and measures for fostering entrepreneurship. Local authorities do not yet have the resources or know-how to undertake this role in a meaningful manner, with the possible exception of the large municipalities.

The latest SME strategy (“Programme of Measures and Activities to Promote Entrepreneurship and the Competitiveness of SMEs”) was adopted in April 2003. It is more sophisticated than its predecessors and focuses on such issues as competitiveness, industrial clusters, innovation, etc. It is not clear whether the process of development, consultation and approval was as thorough as it might have been.

SME Resources

A key problem remains that the Governments lacks the resources to implement the strategy commitments. For example, although the SME Agency is state funded, it receives little resource from the state budget (€50,000). €15,000 is earmarked for staff costs, with the remainder destined to support SME projects. This budget is not

commensurate with the activities identified in the SME Strategy. FYR Macedonia will continue to depend on the international community for resources to promote small enterprise development. The MoE relies heavily on the EC, USAID, UNDP and World Bank to support SME activities.

Consultation and Co-ordination

Traditionally, there has been limited consultation between the private and Government. Dialogue was mainly informal in nature, but in June 2003 the Ministry of Economy established a National Competitiveness and Entrepreneurship Council whose members are mainly drawn from the private sector. Meetings are held every three months and the MoE acts as the secretariat to the Council. This Council is already a more effective channel of communication between Government and the private sector than what previously existed, but it is too early to assess its impact.

Analysis

Other than the establishment of the Agency for Entrepreneurship Promotion, which has been delayed by two years, the most important institutional components are already in place in FYR Macedonia. However, there is relatively little horizontal co-operation and communication. As a rule the various institutions are not adequately resourced, there is limited sustainability of the regional network of business support centres and there continues to be a lack of co-operation and synergy between ministries, agencies, NGOs, business centres, local authorities and the private sector in the development and implementation of SME policy.

Chambers of Commerce

Functions

The Economic Chamber of Macedonia (CoC) is a business oriented NGO governed by the Law of the Economic Chamber of Macedonia (Official Gazette No. 38/90) from 1990. The CoC's functions include:

- Representing the interests of the members of the CoC in relation to government.
- Developing information systems.
- Establishing good business practices and business ethics.

Membership

Membership is still compulsory, but a new CoC Law is being drafted. In its present form, it is recommending that membership should be voluntary in future.

Fees

The annual membership fees depend of the gross wages of employees (0.12% for CoC and 0.09% for Regional CoC, which amounts to a total of 0.21%). This is approximately €7-€20 per employee, per annum.

Funding

In addition to the membership fees, which constitute its main source of funding, the CoC earns additional income from the application of Macedonian EU Article Numbering (EAN Mac), ISO certification services, consultancy, promotional activities, etc.

Employees

The Macedonian CoC has 90 staff; the Skopje Regional CoC has 15 staff; the other regional offices typically employ a couple of people. In total there are about 120 employees operating from eight regional chambers.

Analysis

SMEs are very critical of the CoC (OECD-EBRD, 2003e) and view it as being old fashioned, bureaucratic and not particularly SME-oriented. They typically call for voluntary membership, a more SME-friendly orientation, promotion of corporate governance and good business practice and ethics and partnership with Government and other important stakeholders.

Business Associations

There are 15-20 business associations, but none focuses specifically on SMEs. Business associations tend to be specific in nature: wine production, organic food, milk and dairy products, meat, IT, textile, tourism, etc. Craft associations also have a long tradition in fYR Macedonia and focus their activities on sole proprietors such as handicrafts. Membership is voluntary and a minimum of 50 such organisations exist, many with regional branches.

Analysis

Small enterprises have little tradition of being supported by entrepreneurial institutions such as the Chamber of Commerce and NEPA, the previous SME Agency. Few business associations have well-defined services such as: market information and support, lobbying, networking, training, etc. Donors such as GTZ have sought to build-up the capacities of business associations and NGOs. The main constraints to further development include:

- Legislation forbidding companies from being members of professional associations, except as physical persons.
- Restrictions excluding associations from engaging in profit-generating activities.

5.3 Regulations

Business Entry

The registration procedures to start-up new enterprises remain a noteworthy problem in fYR Macedonia. While handicrafts benefit from a relatively easy registration process, this cannot be said of other enterprises. According to the Ministry of Economy's Charter National Report (2003), there are seven steps for registering enterprises. The taxes and legal service fees for registration amount to €100 - €300 (licences another €10). Research carried out independently comes up with a slightly different scenario: 7 steps, 48 days, €240 register a plc (see OECD-EBRD, 2003a).

Reforms are underway to the Company Law, Handicrafts Law and Trade Law, which should result in improvements to the registration process. Proposed solutions include rapid entry in the Trade Register, enabling start-ups to begin operating prior to obtaining other permits, licenses, etc.

Exit

If firms have met their normal financial and tax obligations, the process of terminating companies is not considered to be overly complex or long. However, if the company has liabilities in relation to the pension and health funds, unpaid salaries, etc. the assets must be sold in order to recover those debts. This process can last for years.

The bankruptcy process is complex and inefficient. The law requires the creation of a Bankruptcy Council consisting of two judges and an accountant, and experts argue that there is scope for non transparent activities to occur. As in several other CARDS countries, the Company Register is not an accurate reflection of the companies that are actively operating and paying taxes.

Simplification

fYR Macedonia is making determined efforts to simplify the business environment. In 2003, a second FIAS report (2003) assessed the environment for investment and concluded that much additional work was required to improve the investment climate. The Government established Working Groups to prioritise the required reforms, resulting in the publication of its “Programme for Stimulating Investment in Macedonia” (MoE, 2003). This programme involved a detailed action plan for achieving the desired reform. Although it is a comprehensive programme, the MoE lacks the resources (financial, know-how, etc.) to implement it according to the projected timescale.

“One-stop-shops”

Business entry and exit remains a major problem in fYR Macedonia, which is why stress continues to be placed on the establishment of a national network of one-stop-shops for registration. However, although a rudimentary form of one-stop-shop appears to have developed within the Ministry of Economy’s offices for the registration of handicrafts, a solution remains illusive in the case of the mainstream enterprises. The Ministry of Economy is committed to the establishment of a one-stop-shop, but there is little evidence of progress being made.

“Silence is Consent”

Article 16 of the Draft new Handicrafts Law, which is expected to be submitted to Parliament soon, requires that once a request for registration is submitted, the authorities must respond within 8 days otherwise the handicraft is considered to be registered. This represents a step in the right direction.

Land Registration / Cadastres

The land registration / cadastre system inhibit lending to SMEs. Without a reliable and efficient cadastre system, banks either refuse to lend or insist on higher levels of collateral to cover perceptions of risk. These barriers have a negative impact on both Foreign Direct Investments (FDI) and potential domestic investors.

In recognition of the necessity to create an efficient register of property, as well as an effective cadastre system, the Government of fYR Macedonia has negotiated a grant with the Japanese Government to digitise maps, thus improving land registration and the cadastre. This project is expected to be completed by 2005.

Informal Economy, Bribery and Corruption

The overall business environment is over-regulated, complex and rapidly changing. Such a situation, common throughout the SEE region, offers scope for operating on the margins of legality and for non-transparent activity. It is estimated that the informal economy represents 45.1% of GNP in FYR Macedonia (Schneider, 2002). According to the BEEP Survey (2002), 22.7% of small enterprises offer bribes frequently and the average bribe tax as a percentage of annual firm revenue amounts to 0.8%.

5.4 Tax

Tax System and Administration

The Ministry of Finance is responsible for setting tax policy, legislation and administration. Lower levels of government do not yet have tax-raising powers, but this is expected to change soon. The new territorial division of FYR Macedonia will empower local authorities to collect a part of the VAT as well as the full property tax. The law is expected to be approved in spring 2004. The State Audit Bureau undertakes internal ministry audits and examines the use of state expenditures. Taxpayers are audited at random. Fines may be imposed and tax evasion may be punished by imprisonment for up to five years.

Key Tax Rates

FYR Macedonia has a relatively low tax regime, albeit a complex one:

- Corporate Income Tax (CIT): 15%, paid annually (a new tax law is being drafted which will streamline the tax system and reduce uncertainties).
- Personal Income Tax (CIT): 15% and 18%, paid monthly.
- Value Added Tax (VAT): 18% and 5%, paid quarterly, 3 month refund period.

Prepayment

Five taxes must be prepaid in FYR Macedonia: property tax, VAT and profit tax.

Incentives

There are no tax incentives and instruments for the support of SMEs in FYR Macedonia.

Stability and Transparency

The tax system in FYR Macedonia continues to experience numerous changes. The result is that the tax system is highly unstable, thus imposing major compliance costs on enterprises, especially small ones. Although the situation has improved, there is limited circulation of advance rulings and/or interpretations to enterprises and tax experts are rarely aware of the latest changes and developments. The administration of VAT returns is considered to be particularly problematic, resulting in serious delays and costs for enterprises.

Advance Warning

Changes to tax laws, rates and regulations are rarely made with sufficient advance warning. There is a constant lack of sufficient information and preparation in the form of training and publicity.

Consultation Mechanisms

No formal mechanisms exist for consulting with enterprises. The new CIT law being prepared by the Ministry of Finance is known to have been developed with the active involvement of some enterprises. However, this has been done on an ad hoc basis, rather than through some form of regular consultation with businesses.

5.5 Support Services

Business Support Centres (BSCs)

There are nine BSCs in FYR Macedonia:

- **Regional Enterprise Support Centres (RESCs):** five RESCs were established in 1999 and received EU funding until October 2002. The RESCs have a chequered history, with major disruptions in support. RESCs were established as Foundations and are not allowed to charge for their services. This contributes to the difficulties in attaining financial sustainability.
- **Enterprise Support Agencies (ESAs):** with the support of DfID (UK) three ESAs were created in Tetovo, Gostivar and Ohrid. Core services include business start-up, improving skills and business advisory services. Funding has now terminated.
- **Prilep Region Enterprise Development Agency (PREDA):** With the support of the Swiss government, PREDA was established in Prilep and started operating in 2001. PREDA is registered as a Foundation, but is also registered as a private limited company, thus enabling it to generate income and work under the VAT Law. PREDA does not provide direct business advisory services directly to SMEs, but assists local business service providers to develop. There are plans to increase the range of activities performed by PREDA.

None of the business support centres have attained financial sustainability and are struggling to continue operating. They tend to survive on the basis of project funding from the government, international donors and IFIs. As previously discussed, the MoE plans to better integrate the BSCs network (as well as the Technology Transfer Centres, Business Incubators, etc.) with the new Agency for Entrepreneurship Promotion. The Ministry of Economy plans to sub-contract a range of activities with the business support centres, via the Agency for SMEs, which should improve matters.

Overall, the SME support infrastructure remains weak and there is a need to assist local authorities to fulfil their new economic and enterprise development responsibilities. Certain donors, such as UNDP, are active in providing assistance to municipalities.

Technology Parks

The main activity in this area is being undertaken through GTZ's technology transfer project. Four Technology Transfer Centres have been established, linked to the University of Skopje (3) and University of Bitola (1). GTZ provides a package of support including:

- Direct financial support for the infrastructure and part of the operating costs.
- Capacity building for the professional staff.

- Indirect financial support for co-financing technology transfer projects leading to the introduction of innovative technology and launching high-tech start-ups.
- Business advisory services and assistance (training, study tours, networking, partnership development, etc.).

GTZ funding is about to terminate in February 2004, which will leave a gap in terms of a focus on technology / science parks and similar initiatives. FYR Macedonia lacks a strategy for the development of these enterprise development tools at the moment. There is a need to further unlock the knowledge and expertise held in universities so as to generate start-ups, spin-offs, etc., however, universities suffer from continuing perceptions that it is inappropriate for academic institutions to engage in commercial ventures.

Business Incubators

The World Bank was the first to establish business incubators in FYR Macedonia, in co-operation with the Agency for Privatization. The Social Support Project enabled five business incubators to become established in 1997. Three other incubators were established, resulting in 7 Business Incubators (Biljana–Prilep, Turtel–Stip, Sasa–Makedonska Kamenica, Delcevo, Tisk–Krusevo and Deni–Veles). Only 5 continue to operate.

These incubators were established as non-for-profit limited liability companies. FYR Macedonian business incubators have a Founder, a Supervisory Board and Management (one full-time staff member, plus part-time staff and consultants). The services offered include: accommodation, technical assistance, management, accounting, reception, legal and business advisory services. They also offer micro loans (average loan is USD 6,000 for working capital, with a 10% annual interest rate). The business incubators operate largely independently and the degree of coordination with other SME stakeholders is limited.

The MoE plans to develop a further five business incubators, although there is currently neither a strategy nor a feasibility study for their establishment. No state funding has been allocated to these activities and donors expected to fill the funding gap.

5.6 Access to Finance

Development Bank

The Macedonian Bank for Development Promotion (MBDP) was established 1998 with capital worth €15 million and works through the other 11 registered commercial banks. It targets priority industries, job creation, technological development, introduction of new technologies, domestic equipment, compliance with environment legislation, use of domestic raw materials, start-ups, etc.

The key focus of activities is export promotion and export insurance. Loans for SMEs range from €50,000 - €400,000 at an interest rate of 11% over 5 years, with a grace period of one year. Below are some typical SME loans.

Institution	Interest (%)	Repayment	Grace period	Collateral	Loan (€)
Loans for SMEs & start-ups through MBDP- KfW line	11-13	< 5 years	1 year	mortgage on real estate, fixed assets, bills of exchange	50,000 - 400,000
MBDP export promotion	11 plus premium risk	< 1.5 years	< 6 m	mortgage on real estate, fixed assets, acceptance order, bills of exchange	3 million per foreign buyer
MBDP Credit line for Micro enterprises & entrepreneurs	variable 12-18	2-3 years	< 6 m	mortgage on real estate, fixed assets, personal guarantees	15,000 - 50,000

Micro Finance Banks

In July 2003, ProCredit Bank was established by KfW, EBRD, IFC, and Internationale Micro Investitionen AG. Its mission is to provide services to Micro, Small and Medium Enterprises (MSME), thereby playing an important role in the development of businesses as well as the banking sector more generally. Management is provided by IPC, a German consulting firm specialising in micro finance. ProCredit Bank operates through branches in Skopje, Tetovo, Bitola, Kumanovo and Gostivar. The ProCredit Bank provides loans to MSEs in all sectors of economic activity, with loans ranging from €1000 - €100,000. All loans are provided on a commercial basis and require minimal collateral.

In addition, there are a couple of micro lending programmes:

- Opportunity International operates as a micro lending institution through a locally established NGO (Moznosti) providing loans, business training and assistance to MSEs. Individual loans up to \$17,000 are available, as are group loans. Moznosti has branch offices in Kocani, Kicevo, Kumanovo, Strumica, Bitola, and Ohrid. In order to become sustainable Moznosti obtained accreditation from the National Bank of Macedonia to become a financial institution. It is now licensed to take deposits, thus enabling portfolio growth and expanding the potential sources of financing for entrepreneurs. Since 1995, 8,323 loans have been disbursed by Moznosti totalling €22,5 million. The average loan size is approximately \$2,600.

Institution	Interest (%)	Repayment	Grace period	Collateral	Loan (€)
Moznosti start-ups	variable 18-24%	< 3 years	1-6 m	mortgage tangible assets	2,000- 17,000
Moznosti working capital	16-22 %	< 2 years	1-6 m	mortgage on real estate	1,000 - 12,000

- The SME Commercial Finance Fund (SME Fund) is a project to provide short-term working capital through the use of innovative trade finance products such as purchase order financing, pre-export financing, factoring and other asset-based products to SMEs. The SME Fund is capitalized with a \$1.5 million loan and it provides financing for the purchase of raw materials and the production of manufactured goods for domestic and export markets.

Credit Guarantee Schemes

The Ministry of Economy prepared a draft law for a Credit Guarantee Fund in July 2003, but is it taking time to receive Parliamentary approval, primarily because of a lack of funds to capitalise the Fund. It is expected that the draft will become law in May/June 2004 and that the funds will be provided by the state budget, supplemented by donations and other revenues surpluses. The Fund will apply to small enterprises with less than 50 employees and priority will be given to new job creation, exports, increase value added, new technology, expanding business, etc.

Mutual Credit Guarantee Schemes

None exist at present.

SME Credit Lines

The key finance gap is for credit in the \$600 - \$20,000 range. Loans of this size enable businesses to move from focusing on economic survival to developing sustainable business ventures. Moznosti (Opportunity) was the first organisation to start operating in this range, but more needs to be done to meet the needs of SMEs.

Institution	Interest (%)	Repayment	Grace period	Collateral	Loan (€)
ProCredit Bank	11-15	< 5 years	1 year	personal guarantee mortgage on real estate and fixed assets	2,000- 5,000 10,000 to 100,000
MBDP Credit line for Micro enterprises & entrepreneurs	variable 12-18	2-3 years	0.5	mortgage on real estate, fixed assets, personal guarantees	15,000 to 50,000
Italian Government credit line	9-12%	3 y	1	mortgage on real estate, fixed assets, personal guarantees	100,000 – 300,000
Moznosti, Agribusiness micro loans	16%	< 36 m	6 m	mortgage on real estate	5,000 – 12,000
Moznosti group loans for all purposes	14 %	< 12 m	1 m	group loan insurance	1,000 – 2,000
Horizonti (CRS & Caritas)	2% per month	< 6 m	0		300 –1,000
MEDF (MCIC)	8-12 %	< 4 y	1 y	fixed assets	10,000- 50,000
MEDF (for individual farmers)	7.3%	< 4 y	1 y	real estate	10,000 per farmer

Leasing

A new leasing law (2002) was developed with the support of IFC/SEED, which enabled the creation of new leasing companies with minimum capital of €100,000. SMEs qualify for leasing on the strength of their cash flow, rather than credit history, collateral or capital base, as typically required by banks. Some amendments were made to the law in 2003 and it is expected that the financing options for small businesses in FYR Macedonia will improve considerably as a result, especially those that require plant and equipment. Anecdotal information suggests that several companies are already licensed or have applied for licenses for leasing operations.

5.7 Country Specific Recommendations: 2005 - 2006

Technical Assistance to the Ministry of Economy (MoE)

There is currently a CARDS technical assistance programme targeted at the needs of the MoE, including the Department for SMEs. There is a need to continue the process of institutional capacity building, so as to strengthen the Department for SMEs. There are serious pressures on this Department to perform on behalf of the SME sector, however, its capacities are limited (four staff; limited skill base). In particular, now that FYR Macedonia has signed up to the principles enshrined in the Charter, the SME Department must develop the capacity to implement a demanding agenda, which the Government is committed to. Specifically:

- There is a need to review the staff numbers and skill base, and whether these are consistent with the role that the SME Department is now expected to perform, bearing in mind the fact that the AEP is about to be created.
- There is a need to review the SME Strategy in light of the new institutional arrangements (including local government decentralisation) and the 10 Charter principles which are to be prioritised by Government.
- There is a need to introduce performance monitoring and evaluation, possibly measured against the SME strategy and the EU Charter.

Technical Assistance to the Agency for Entrepreneurship Promotion (AEP)

Following the long drawn out demise of the previous SME Agency (National Enterprise Promotion Agency), there is a need to ensure that the EAP is an effective institution for implementing the SME strategy, linked to the Charter. CARDS technical assistance is already being provided to the MoE to set-up the EAP, however, a key priority for 2005 and 2006 will be to build-up the capacity of the new institution itself and its staff such as:

- Customised training on the key aspects of its role.
- Liaison with MoE, regional network, SME stakeholders, small enterprises, etc.
- Mechanisms for dialogue and consultation on key SME issues, since this is not a priority of the National Competitiveness and Entrepreneurship Council.
- Implementation of the SME strategy.
- Strategies in relation to business incubators, technology parks, technology transfer, etc. building on the work of existing programmes (such as GTZ) that are coming to an end.

Technical Assistance for the integration of the Regional Network

- The SME regional institutional framework includes the business support centres (RESCs, ESAs, Technology Transfer Centres, Business Incubators, etc.). Given the history of these institutions, it will be difficult for the EAP to co-ordinate this network. Technical assistance is needed in order to adopt best practice, based on similar SME support networks in EU countries. Key issues include:
 - What is the purpose of the network?
 - How is it to be funded?
 - How is effective co-ordination to be achieved by APE?
 - How is performance to be monitoring and measured?
- Allied to the above, there is a need to raise the quality and standards of the services provide by BSCs to small enterprises. Various donor projects have

introduced programmes to improve the capacity of local trainers and consultants to supply quality services. What is now required is a greater focus on international standards and accreditation for business advisory services (such as the International Council of Management Consulting Institutes). This should raise standards across the country and, therefore, the willingness on the part of entrepreneurs to use these services.

Local Government and Local Economic Development

The new local government legislation will lead to a new administrative division involving 80 municipalities and result in new rights and obligations including tax raising powers, economic and enterprise development, etc. Much effort is going in to the process of preparing for decentralisation:

- In parallel, it is necessary to build up the local economic development (LED) capabilities of municipalities. Some initiatives are being carried out for example, by UNDP in Kicevo and Stip, however, much more effort is needed in this area, linking up with the regional network of BSCs. The CARDS programme could create a project to establish Public Private Partnerships for SME development and job creation between the BSCs in the SME support network and local authorities. A pilot project could be initiated in 2005 to build up such partnerships (APE/BSC on one side and local authorities and local business communities on the other).

Reduction in Legal and Administrative Barriers for Start-ups

fYR Macedonia has made some progress in improving its legislative base; various draft laws are in the process of being approved and implemented, but the barriers to registration of enterprises remain significant. CARDS could assist in several areas:

- Build up the capacity of the MoE to implement the detailed priorities established and approved in the Programme for Stimulating Investment in the Republic of Macedonia (2003).
- Undertake feasibility and implementation work necessary to establish a one-stop-shop system for company registration and re-registration in 2005-2006.
- Build on the “E-Government” initiative to improve SMEs’ on-line access to information, registration, tax payment, etc. in relation to public, as set out in the EU Charter.

Financial Support Measures

Consideration could be given to establishing demonstration projects with CARDS funding to assess the feasibility of diversifying the sources of finance available to small enterprises. The focus of the demonstration project could be:

- Mutual Guarantee Schemes: the banking system in fYR Macedonia is impaired in its dealings with the small enterprise sector by the lack of information on potential borrowers. One way of improving the banks’ knowledge of the enterprise sector would be to promote mutual guarantee schemes along the lines of the German and Italian model. These have the benefit of reducing the risk associated with SMEs by pooling information on the enterprises to a single institution (the guarantee fund) which provides an alternative to collateral in loan application to banks. Local banks can participate in the fund by having a seat on the Board of Directors, which allows them to gain important information. The reduction of asymmetry of information and the presence of a pool of funds that can be used instead of collateral can facilitate SMEs’ access to finance by reducing the perceived risk linked to enterprises, as well as easing the collateral requirement for borrowers.

- Leasing: leasing can be used to assist start-up businesses and existing small businesses in the production and/or services sectors to finance the acquisition of commercial machinery and equipment. The Leasing Law is being improved, opening up the prospect of providing greater assistance to small enterprises.

Entrepreneurship

Promotion of entrepreneurship is a key element of the Charter, but relatively little has been done in this area in FYR Macedonia. CARDS technical assistance could be used in 2006 to assist the development of a greater culture of entrepreneurship, focusing on the following elements:

- Develop a culture of entrepreneurship throughout the education system (secondary school level, colleges and universities) and develop training schemes for managers in small enterprises.
- Campaign on the informal economy: the informal economy appears to be growing in significance to the point where it may affect the legitimacy of the state. EU best practice needs to be harnessed to assist the Ministry of Economy to develop appropriate policy tools to tackle this issue.
- Campaign on self-employment: this could be supported at the national level through a broad campaign so as to raise awareness of the importance of self-employment in helping to deal with the extremely high levels of unemployment.
- Establishment of Annual Awards for Entrepreneurship: this could make a contribution to improving the image of entrepreneurs and raising the profile of successful businesses.

6. Serbia (Serbia and Montenegro) SME Panorama

This SME panorama draws on a variety of sources, such as the EC Charter for Small Enterprises National Report (2003), the OECD-EBRD Enterprise Policy Performance Assessment (2003f) and other materials collected locally, not least interviews with a variety of organisations conducted as part of the research in Belgrade. Reference to Serbia in this Chapter is in the context of the Republic of Serbia (Serbia and Montenegro).

6.1 Definitions and Statistics

Definition

There is an SME definition in Serbia (Law on Accounting and Auditing, FRY Official Gazette No. 71/02), which is related to the number of employees, total income and value of assets. The definition is set out below.

Small enterprises fulfilled at least two of the following criteria in the last year:

- Average number of employees: up to 50.
- Total annual income less than €2,5 million.
- Average value of assets less than €1 million.

Medium-sized enterprises fulfilled at least two of the following criteria on the day of financial reporting in the last year:

- Average number of employees: 50 to 250.
- Total annual income from €2,5 to €10 million.
- Average value of assets from €1 to €5 million.

Large enterprises are those with higher values of at least two of the indicators relating to medium-sized enterprises. The law on private entrepreneurs defines a private entrepreneur (sole trader) as a physical person establishing a business and working independently for the purpose of gaining an income.

Estimates

It is estimated that there are 239,270 registered SMEs (2003), of which 67,700 are active SMEs (99% of all enterprises). SMEs' importance can be gauged by the following broad statistical estimates:

- Volume of production: n/a.
- Employment = 54% (2002).
- Share of GDP = 45% (2002).

Analysis

A workshop held in January 2004 on business statistics in Serbia concluded that the "existing available data in relation to the SME sector were insufficient, unreliable and did not prove to be a sound basis for the analysis of current and the creation of new economic policy." (Louis Berger, 2004). It argued that it was necessary to organise a statistical Business Register, starting with the introduction of a unique identifier for the sake of comparability and usage of available databases. The current EAR SME

project and the forthcoming 2004 CARDS project will continue to focus on developing the business statistical base in Serbia.

6.2 Institutions

Background

The Ministry of Economy and Privatisation (MoEP) is responsible for SME policy-making. Within the MoEP, responsibility is distributed between the Department for Development of SMEs, which focuses on national policy and strategy for SMEs, and the Department for Private Entrepreneurship, which deals with sole-traders. The MoEP was the driving force behind the creation of the National Strategy for the Development of SMEs and Entrepreneurship (January 2003). The Department for the Development of SMEs has four staff plus a significant degree of international technical assistance (EAR Non Financial Assistance to SMEs), and focuses on:

- Developing an SME strategy.
- Improving access to finance.
- Developing a network of regional enterprise support agencies.
- Improving the SMEs statistics.

The Republican Agency for the Development of SMEs and Entrepreneurship (ASMEE) was established in 2001 with state funding and donor support (including the EU). It operates within the framework of the SME strategy to promote the SME sector. ASMEE receives €170,000 from the state for its operational budget, but this covered only 20% of projected expenses in 2003. The difference is made up by project and donor funding, as well as commercial revenue.

Although ASMEE has gone through a period of seven months without a Director, it has taken the opportunity to restructure and refocus its activities, with the effect that it has become a stronger institution. ASMEE has been particularly active in developing its institutional base. It has established a network of 12 business support centres (about five staff each), with a further 30 sub-centres (a couple of staff each). Seven of the business support centres have been established by EAR; two by GTZ; one by the Swiss; and a further two by the government. ASMEE hopes to expand the regional network by a further five centres in 2004. ASMEE has driven a well-intended proliferation of regional centres and sub-regional centres, but there are major concerns about the sustainability of such a large network in a relatively small republic, especially once donor funding declines. The MoEP is expected to provide limited state support for the EAR-supported centres, but this is unlikely to be extended to the non EAR-assisted part of the network.

Both the regional state bodies and local authorities have local economic and enterprise development powers, but the funding and human capital do not yet exist to maximise this potential.

The SME strategy was adopted in January 2003 was called the “National Strategy for the Development of SMEs and Entrepreneurship” and covered the period up to 2008. This document sets out a comprehensive range of priorities such as key sectors, support and advocacy for SMEs, a process of regulatory and legal simplification, access to finance, etc. Two key commitments of the strategy include:

- Increasing the number of SMEs from 240,000 to 400,000.
- Creating more than 1 million jobs in SMEs.

SME Resources

The Government has not committed significant resources to implement the strategy commitments. Serbia will continue to rely heavily on the international community for resources to promote small enterprise development, not least the EU, World Bank, Germany, etc.

Consultation and Co-ordination

There are few mechanisms for consultation between the private sector and Government. The main one is that SME Advisory Board, consisting of business people appointed by the Minister of Economy and reporting to the MoEP. The SME Advisory Board met twice in 2003 but cannot be considered an effective channel of government - business communication. Major reform is required in this area, possibly resulting in ASMEE acting as the secretariat to this forum.

Analysis

Having started social, economic and democratic transition relatively late compared with the rest of the CARDS countries, Serbia has made rapid progress in the last couple of years in relation to SME issues. Not only are the national, agency and regional structures in place, but they are increasingly working well together. The on-going political instability of the last six months or so has held back even greater progress. Key concerns remain about the adequacy or otherwise of the resource base for SME development, the sustainability of the SME institutions and the legislative logjam in Parliament, which is hindering further reform.

Chambers of Commerce

There are three sets of Chambers of Commerce in Serbia:

- Serbian Chamber of Commerce.
- 17 Regional Chambers of Commerce.
- 2 City Chambers of Commerce (Belgrade and Vojvodina).

Functions

The Serbian CoC's functions include a very broad range of activities such as: advocacy, economic policy measures, improvement of business conditions and operations, exchange of experience, business contacts and networks, information provision, project development, regional development, strengthening business ethics, certificates, approvals and permits for foreign transactions, business databases, etc.

Membership

The three sets of CoC are compulsory in nature. Theoretically, enterprises based in Vojvodina and Belgrade may have to pay three different sets of CoC membership fee.

Fees

The fees vary from Chamber to Chamber. In the case of the Serbian CoC, these are:

- 3,000 Dinars (€42) for enterprises with up to 10 employees.
- 0.12% of the gross wages of employees for enterprises with 10+ employees.

Funding

All CoCs offer information, advice and business-to-business services and training. CoCs also try to obtain project funding from the EU and other donors.

Employees

The number of employees is not available for the Serbian CoC and the 17 regional CoCs. To give an indication, 100 people are employed by the Belgrade Chamber of Commerce alone.

Analysis

Small enterprises are generally dissatisfied with CoC services, according to the people that were contacted (see OECD-EBRD, 2003f). Theoretically, firms may have to pay one or more membership fees for a service that they do not perceive that they benefit from. Experts believe that this is fuelling an increase in voluntary business associations, as entrepreneurs look for alternatives that do meet their business needs.

Business Associations

There has been a rapid growth of business associations in Serbia. These are known to be extensive but no records could be obtained of how many exist, their focus, membership, etc. To give an example, the following have been created in Belgrade: Belgrade Association of Entrepreneurs plus a network of five related associations in Grocka, Zemun, Rakovica, Vozpovac and Vracas. Numerous sector-specific business associations have been created in Belgrade. Donors such as USAID and SEED support the development of business associations. SEED has created the Vrsac Business Association and is in the process of establishing associations for beekeepers and herb pickers.

Analysis

These business associations differ from the Chambers of Commerce system in that they are voluntary in nature. They generally appear to have limited resources and capacity. With the continuing existence of compulsory Chambers of Commerce, they are finding it difficult to develop and fulfil their potential and become sustainable without domestic and international assistance.

6.3 Regulations

Business Entry

The registration procedures to start-up enterprises remain very complicated in Serbia and requires registration in the commercial courts, Statistics Bureau, etc: "The feedback from Serbian small businesses is that there is a perception that the process is too bureaucratic, takes too long, and costs too much" (OECD-EBRD, 2003f).

The situation for sole traders has improved dramatically. They are now able to register their enterprises within 3-7 days, according the Small Enterprise Charter National Report (2003). The same report indicates that the costs for registering a plc have come down from €203 to €176 in 2003. Research carried out independently comes up with a slightly different scenario, namely: 16 steps, 71 days and €194 to register a plc (World Bank, 2002).

The Law on Business Registration and the Law on the Business Registration Agency have been submitted to Parliament. They should result in major time and cost reductions for enterprises as they will remove the necessity for court involvement in the process of registration and establish 16 one-stop-shop registration offices. The legislation has been awaiting Parliamentary approval for six months, as have other laws which should improve matters in future such as: law on bankruptcy, VAT, public procurement, company law (start-up capital for a plc will be reduced significantly to €10), enforcement procedures, etc. Ultimately, however, both republics should be aiming for a single registration system, using the most effective approach available.

Exit

Although 211,668 SMEs were registered in 2002, it is estimated that only a third of the enterprises are actually active firms. Reasons for this includes the cost of deregistration (minimum of €100), the bureaucracy involved in the process of exiting, as well as a desire to maintain company registrations “just in case”. Many firms meet the legal requirement of terminating the company if it is not operating for two years continuously by submitting balance sheets showing zero activity.

Simplification

In June 2001 the Government formed the Inter-ministry Working Group for Deregulation to draft recommendations concerning deregulation. The Working Group comprised deputy heads of the relevant ministries, supported by the Ministry of Economy and Privatisation. In April 2003, the Working Group became the Council for Economic Regulatory Reforms and its terms of reference expanded to:

- Survey all ministries’ plans in connection with regulatory reform.
- Obtain activity plans of all working groups focusing on new laws or amendments to existing laws.
- Consider draft regulations in terms of their impact on the economic system.
- Promote greater transparency of legislative reforms and encourage greater involvement of all interest groups.
- Harmonise new regulations with Regulatory Impact Assessments (RIA).

Some progress has been made on issues such as business registration, inspection, ombudsmen and other obstacles to doing business. The Council should make more rapid regulatory progress, now that it is supported by the World Bank.

“One-stop-shops”

The concept of one-stop-shops is expected to be implemented in Serbia via 16 local offices. The main issue is when the laws on Business Registration and the Business Registration Agency will be approved by Parliament, and whether international good practice (such as in Romania) will be used in the process of implementation.

“Silence is consent”

No policy and reform efforts have been made on this front.

Land Registration / Cadastres

The state of the land register continues to impede the use of mortgage finance for businesses. There is the property register covering about 50% of the territory of Serbia (the whole of Vojvodina and towns in Serbia). There is also the so-called Tappi

system, the original property register, applying to a small proportion of the territory in southern Serbia. A cadastre also covers the whole territory of the Republic. The system creates land ownership uncertainties and slows down the privatization process, inhibits investment and the development of an effective mortgage market.

The Law on Planning and Construction has improved matters. The Ministry of Urban Planning and Construction is working on the development of a sound and reliable Land Register, however, this will take some time. It is also very difficult to obtain building and renovation permits, as well as the necessary operating licenses. This acts as a brake on investment.

Informal Economy, Bribery and Corruption

The overall business environment confronting small businesses is over-regulated, complex and rapidly changing. Such a situation, common in much of the SEE region, offers scope for operating on the margins of legality and for non-transparent activity. It is estimated that the informal economy represents 29.1% of GNP in Serbia and Montenegro (Schneider, 2002). According to the BEEP Survey (2002), 15.9% of small enterprises in Serbia and Montenegro offer bribes frequently and the average bribe tax as a percentage of annual firm revenue amounts to 1.5%.

6.4 Tax

Tax System and Administration

Tax collection, regulation and compliance are the responsibility of the republics. Since 2001, Serb tax policy has focused on broadening the tax base and ensuring greater neutrality and transparency. Certain taxes operate at the federal level (such as sales tax, excise duty, customs duty etc.), whereas many operate at the republic level (such as personal income taxes and corporate taxes, social security contributions and property tax).

The law on Tax Procedures and Administration is particularly noteworthy since it:

- Terminated the Bureau for Clearing and Payments in January 2003 and transferred this responsibility to commercial banks.
- Created the Republic Tax Administration within the Ministry of Finance and Economy to co-ordinate activities.
- Established the Tax Police and defined a number of tax-related criminal activities.

Key Tax Rates

- Corporate Income Tax (CIT): 20%, paid monthly.
- Personal Income Tax (CIT): max. 10-20%, paid annually.
- Sales tax: 14%, paid monthly.
- VAT was to be introduced in January 2004. Although the legislation is before Parliament, it is unlikely to be introduced before the second half of 2004, or possibly January 2005.

Prepayment

No taxes are prepaid in Serbia.

Incentives

Under Article 50 of the Enterprise Profit Tax Law, small enterprises are entitled to a 40% tax credit for investment in fixed assets. The exemption from profit tax is limited to 70% of the profit tax charged in that year. Article 48 entitles enterprises to a tax credit of up to 20% when buying a fixed asset and exemption from profit tax amounting up to 50% of the charged tax. Enterprises may carry over the unused portion of the tax credit in the current year to account for future profit tax in the next 10 years. Lastly, Article 49 states that that the profit tax payable by firms employing new workers for an unspecified period of time is reduced by an amount equal to 100% of the gross wages and/or salaries paid to such employees (including the taxes and contributions payable by the employer) over a period of two years.

Stability and Transparency

The tax system has improved greatly since 2001. However, the numerous reforms and new laws required by the transition to a market economy results in complaints from small enterprises about the pace of change, as well as the compliance burden.

Advance Warning

Changes to tax laws, rates and regulations are not considered by small enterprises to be made with sufficient advance warning. Recent tax changes include: Amendments to the Law on Enterprise Property Tax, Law on Turnover Tax, Excise Duties Law, Property Tax Law, Law on Property, Personal Income Tax Law, Tax Procedures and Administration. Further laws have also been submitted to Parliament: VAT, social security law, social insurance contributions, voluntary pension funds, property tax law, etc.

Consultation Mechanisms

No formal mechanisms exist for consulting with enterprises.

6.5 Support Services

Business Support Centres (BSCs)

The Government of the Republic of Serbia has created, in partnership with donors (e.g. EAR, GTZ and SDC), the following BSCs:

- 10 regional agencies/centres (Belgrade, Kragujevac, Krusevac, Nis, Novi Pazar, Novi Sad, Subotica, Uzice, Zajecar and Zrenjanin).
- 2 government-operated centres.
- 30 local sub-centres.

More than 70% of the territory of Serbia (excluding Kosovo and Metohija) is covered by the BSCs. The regional centres/agencies provide support to entrepreneurs in the various phases of their operation, expansion and development. The services (information, consulting and advice) are directed at linking local entrepreneurs with local and international specialists, and local service provider networks (lecturers, consultants, web designers, marketing agencies, local media, etc.). ASMEE is looking to fund another five centres in 2004; and possibly more sub-centres.

A Euro Information Correspondence Centre has been established and is based at the Belgrade Chamber of Commerce. Some local authorities and Chambers of Commerce

also provide business support services in Serbia. Finally, the number of private consultancies, auditors, bookkeepers, lawyers, etc., has increased rapidly. One of the main obstacles to wider use of business services by small enterprises is the lack of international quality standards and accreditation schemes for business consultants.

Technology Parks

No technology parks, business parks, industrial zones, etc. exist at present. The Hellas Fund has €7.2 million available to stimulate technology parks along corridor 10. A careful strategy is required before such a development can occur effectively.

Business Incubators

ASMEE has produced a manual on good practice in implementing business incubators, but none exist at present. A business incubator and/or managed work space strategy is similarly lacking, as are the resources to implement such initiatives.

6.6 Access to Finance

Development Bank

No such bank exists at present and is not likely to in the near future. There is an oversupply (48) of banks in Serbia relative to the size of the market. Further rationalisation is certain to follow in the coming years.

Micro Finance Bank

The Micro Finance Bank (MFB) was founded in April 2001 by EBRD, KfW, IFC, Commerzbank, IMI and FMO to promote the development of MSEs (up to 100 employees) through loans and general banking services (accounts, money transfers, etc.). The MFB also offers general banking services to private customers. MFB became the ProCredit bank in 2003 and has established 10 branch offices and a further 10 credit outlets throughout Serbia.

The credit terms and conditions are fairly expensive (up to €10,000, interest rate of 2% per month for a term of 18-24 months; for small enterprises (loans of €10,000-€50,000) the rate is up to 1.75% per month; and for medium-sized firms the interest rate is up to 12% p.a., the maximum term being 36 months. In addition to the interest rate charged, ProCredit Bank also levies a commission of up to 2% per loan.

As of September 2003, the outstanding credit portfolio stood at €55 million, comprising almost 10,000 loans. Loans in arrears represent less than 1% of the portfolio volume. In retail banking, ProCredit Bank has a total of 78,000 clients have deposited almost €52 million in savings accounts. The Serbian banking sector is still considered to be highly regulated, leading to high administrative costs and restrictions on banking services.

Credit Guarantee Schemes

Two credit guarantee schemes have been created:

- The Guarantee Fund Law was adopted in May 2003 and the Fund, Director, Supervisory Board and the Statute are in place. The staff has been recruited and a tender published inviting banks to work with the Guarantee Fund. The Guarantee Fund was expected to issue guarantees in October 2003, but has yet to do so.

- The Development Fund of Vojvodina has been operating since 2002 and finances SMEs and small farmers. Since 2003 it has been possible for loans to be guaranteed by the Fund directly and borrowers may mortgage their property as security for debt owed to the Fund.

Mutual Credit Guarantee Schemes

None exist at present.

SME Credit Lines

There are 48 registered banks, many of which provide credit form small enterprises. In its 2002 annual report, ASMEE estimated that there were twenty banks providing SME credit lines, with many providing more than one product for this target market. EAR, EIB, KfW and others provide international credit lines through local banks amounting to about €40 million; as well as €37 million worth of soft loans from the Italian government. Current credit lines include the following:

Source	Banks Participating	Credit Line	Sub-loan Ceiling	Max. Term	Max. Grace Period	Interest Rate
EAR	Eksimbanka Novosadska B Zepter Banka Cacanska B Komercijalna B	€ 15 million, of which: € 4.5 million € 4.5 million € 3.0 million € 1.5 million € 1.5 million	€ 200,000	5 years	12 months	LIBOR + 6% (current rate = 8.30% app.)
EIB	Eksimbanka Komercijalna B	€ 20 million, of which: € 10 million € 10 million	€ 200,000 – € 4,000,000	12 years	12-36 months	LIBOR + 0.3% for lending banks + 3% margin
EFS (1)	Zepter Banka		€ 100,000	3 years	3 months	9.5-12%
EFS (2)	Komercijalna B	€ 2 million	€ 50,000	3 years	6 months	9.5-12%
EFS (3)	Kulska Banka		€ 50,000	4 years	12 months	9.5-12%
KfW (1)	Micro Finance B (see section 7b below)		> € 10,000 €10,000- 50,000 < € 50,000	2 years 3 years 3 years	1 month 6 months 6 month	24% 16.8-21% 9.5-12%
KfW (2)	Eksimbanka	€ 2 million	> € 50,000	3 years	6 months	9.5-12%
Komercijalna Banka	Komercijalna B (own resources)	N/A	€ 125,000	5 years	6-12 months	9.95%
State Budget	Fund for Serbia Development	N/A	Up to 40% of project	5 years	12 months	9%
Raiffeisen	Raiffeisen Bank (own resources)	€ 2.1 million	€ 500,000	3 years		9-11%
Jubanka	Jubanka (own resources)	N/A	€ 200,000	3 years	12 months	7.95%-9.95%

Source: EAR Office, from DFC report (2003).

Leasing

A leasing Law was approved in 2003, following support by SEED and the World Bank. Seven leasing companies, including Raiffeisen, have established leasing operations. It is too early to assess whether there are any problems with the law. There may be some scope for assisting the diversification of finance for small enterprises by experimenting with the use of micro leasing, if the financial organisations active in the market currently fail to fully exploit this opportunity.

6.7 Country Specific Recommendations: 2005 - 2006

The CARDS assistance for SME development is pretty comprehensive in of Serbia, covering SME development, privatisation, export promotion, foreign direct investment, entrepreneurial education etc. The project “Non-Financial Support to SMEs” will be extended and deal with various issues identified in the SME Panorama. A number of recommendations are worth highlighting for the period 2005 and 2006.

Institutional Issues

Most of the CARDS technical assistance support has been delivered to the Ministry of Economy and Privatisation, with some support directed at the Republican Agency for SMEs (ASMEE). This support needs to be maintained. A capacity building technical assistance programme is required based specifically on ASMEE and the regional network, so as to strengthen their capacity further and work towards financial sustainability. Key issues to cover include:

- Securing long-term financial support from the state budget. An annual budget of €200,000 is insufficient to deal with the priorities in the SME strategy.
- Improving the accountability structures between the Ministry of Economy and Privatisation and ASMEE.
- Developing strategies in relation to important aspects of SME development such as: industrial / science parks / industrial zones and business incubators / managed workspace. This needs to be done jointly with the Ministry of Economy.
- Rationalisation of the burgeoning range of business centres and sub-centres, so as to secure the sustainability of the network. This could focus on the (future) NUTS II level, positioning the network to obtain future pre-accession / structural funds.
- Establish international quality standards and accreditation for BSCs, based on an independent organisation.

Business Government Dialogue

The SME Advisory Board is not an effective channel for government - business communication:

- Reform is required to generate such a mechanism for dialogue, based on good practice experience in EU countries. Since ASMEE is responsible for implementing the SME strategy and for reflecting the needs and priorities of the small business sector, it might be appropriate for the Agency to act as the secretariat for such a mechanism.

Business Associations

The existence of a national CoC, two city CoCs and 17 regional CoC's, all of which are compulsory in nature, appears to be excessive for a relatively small country:

- CARDS could establish a project to assess whether there is a need to improve and rationalise the system of CoC, including the membership fees currently demanded. This is required in view of the proliferation of voluntary organisations in Serbia, and the need to secure choice, competition and quality for small enterprises.

Regulatory Issues

The legislation currently before Parliament should result in significant improvements to the business environment, but CARDS assistance could be deployed to ensure that implementation is carried out in an effective manner:

- When approved by Parliament, registration through one-stop-shops will be implemented in 16 locations. CARDS assistance could be used to ensure that international good practice (in Romania and in EU member countries) is employed and that this complex process is effectively implemented in Serbia.
- Linking up with the agenda set out by the Charter, CARDS assistance could ensure that relates aspects are implemented in the course of 2005 and 2006, such as on-line registration.

Diversification of Finance

The commercial banking sector is relatively crowded in Serbia. The next few years should see further improvements in SME products, partly as a result of the intense competition. In this context, CARDS assistance could focus on diversification of the financial products available in the market:

- The Leasing Law has recently been approved, following support by SEED and the World Bank. Seven leasing companies have established leasing operations but it is unclear whether leasing will indeed be of interest to the key financial institutions. CARDS assistance could be mobilised to demonstrate, via seed capital in pilot initiatives, that leasing is both a feasible and profitable area of financial activity.
- No mutual credit guarantee schemes exist in Serbia. A demonstration project in this field could be useful in stimulating the commercial banking sector and others to follow this path, rather than relying exclusively on state credit guarantee schemes. Where the latter exist, CARDS technical assistance could be deployed to ensure that international best practice is utilised, so as to maximise their impact.
- Other possible demonstration projects include factoring and venture capital, possibly in partnership with SEED.

Entrepreneurship and Competitiveness

Building on the EU Charter's priorities, further attention could focus on the following themes through CARDS assistance:

- Further developing a culture of entrepreneurship in Serbia (campaigns, competitions, education at all levels, vocational training, etc.).
- Increasing the levels of productivity and competitiveness (international standards and certification, quality control, etc).
- Reducing the levels of informal economy (reducing unfair competition for registered firms, developing appropriate policy responses, etc.).

Privatisation

Serbia has an ambitious programme to privatise 4,500 State Owned Enterprises (SOEs) by 2006 through tender and auction. Of these, about 150 – 200 are very large enterprises, involving complex privatisations. By contrast, significant progress has been made in privatising small enterprises, mainly to local buyers:

- CARDS could continue to assist the privatisation process, focusing on pre-privatisation activities and turn around management for large SOEs.
- Consideration could be given to post-privatisation assistance to some of the privatised small enterprises with growth potential, as a means of assisting them to

adjust to the new market realities and act as models of the potential offered by Serb enterprises.

7. Montenegro (Serbia and Montenegro) SME Panorama

This SME panorama draws on a variety of sources, such as the EC Charter for Small Enterprises National Report (2003), the OECD-EBRD Enterprise Policy Performance Assessment (2003g) and other materials collected locally, not least interviews with a variety of organisations conducted as part of the research in Podgorica. Reference to Montenegro in this Chapter is in the context of the Republic of Montenegro (Serbia and Montenegro).

7.1 Definitions and Statistics

Definition

There is no official definition of SMEs in any recently adopted law. Nevertheless, the Statistical Office of Montenegro uses an SME definition stemming from the previous FR of Yugoslavia Law on Accounting and Auditing (Official Gazette No. 71/02):

Micro enterprises: employ less than ten employees.

Small enterprises fulfilled at least two of the following criteria in the last year:

- Average number of employees: up to 50.
- Total annual income less than €2,5 million.
- Average value of assets less than €1 million.

Medium-sized enterprises fulfilled at least two of the following criteria on the day of financial reporting in the last year:

- Average number of employees: 50 to 250.
- Total annual income from €2,5 to €10 million.
- Average value of assets from €1 to €5 million.

Estimates

In 2003 there were 22,500 legal entities, out of which 10,500 were registered as entrepreneurs, 10,900 as limited liability companies, 350 as shareholders companies and the remaining 750 as partnerships. Out of the total number of enterprises registered in Montenegro, over 98% are SMEs.

SMEs' importance can be gauged by the following broad estimates:

- Volume of production: N/A.
- Employment = 40%.
- Share of GDP = 52%.

Analysis

The SME data in Montenegro are inadequate. The problems include:

- Enterprises were obliged to submit balance sheets and income statements to the Bureau for Clearing and Payments, but are no longer required to do so, as commercial banks have taken over this function. This results in a gap in information.
- The Statistical Office in Montenegro lacks statistical skills and capacity.

- There is a lack of co-operation between institutions responsible for collecting SME data (Employment Fund, Pension Fund, Commercial Court and Public Revenue Office).

In order to improve SME policy making and evaluation, it would be advantageous to develop more efficient business data and statistics, starting with the introduction of a unique identifier for the sake of comparability and usage of available databases.

7.2 Institutions

Background

The Agency for Small and Medium Enterprises Development (SMEDA), established in 2000, is responsible for SME policy making. SMEDA co-ordinates SME policy so as to create a more conducive business environment. It aims to co-operate and co-ordinate with relevant ministries in the preparation of draft laws, regulations, etc., working principally through working groups.

SMEDA reports directly to the Prime Minister, rather than to a Ministry. SMEDA is financed from the state budget (€3 million per annum), supplemented by significant international support. This resource covers the operating costs of the Agency, maintains a regional network and funds various SME projects, including provision of financial support to SMEs. SMEDA has 4 regional offices in Bar, Bijelo Polje, Rozaje and Podgorica, and plans additional offices. It boasts 25 staff (7 based in the Euro Information Correspondence Centre in Podgorica) and various international advisors.

SMEDA has drafted a succinct SME strategy “policy Strategy to Support the Development of Small and Medium Sized Enterprises” (2002), which received Governmental approval and focuses on the following priorities:

- Promoting entrepreneurship.
- Promoting business skills.
- Ensuring fair competition.
- Reducing regulatory and administrative barriers to business development.
- Simplifying the business taxation system.
- Encouraging the formation of private business associations.
- Increasing access to business information.
- Increasing supply of business services.
- Facilitating access to affordable finance.

Legislation regulates the role of local authorities and, following decentralisation in 2002, municipalities have acquired economic development powers, including enterprise development. Municipalities are in a position to influence some of the major remaining administrative barriers relating to licensing procedures, which are in need of simplification.

SME Resources

Unlike many other similar agencies in the CARDS region, SMEDA is relatively well funded. The direct state budget is a relatively generous sum and is supplemented by significant international resources for technical assistance and finance for SMEs.

SMEDA is also relatively well staffed and has benefited from the intense presence of international advisors over the last few years. Given the capacity available to SMEDA, small enterprises wonder about the extent to which it is implementing its defined priorities effectively (OECD-EBRD, 2003).

Consultation and Co-ordination

Ad hoc consultations take place via the Chamber of Commerce (see below), but no regular government-business consultative body exists. The Montenegro Business Alliance Recently, an independent voluntary business association, recently started providing a framework for public-private debates (see below).

Analysis

SMEDA is well funded, has good capacity and is well connected through direct access to the Prime Minister. The Agency is making steady progress, however, there does not appear to be much communication, co-operation and co-ordination with the wider SME stakeholders in the country. There also appears to be very little regular dialogue between the Government and the business sector, especially SMEs.

Chambers of Commerce

There is one Chamber of Commerce (CoC). It is a trade and business association of manufacturing, trade, and service companies such as banks, insurance companies and research institutes.

Functions

The activities of the CoC include the following:

- Improvement of business operations.
- Stimulation of research and development.
- Provision of business information.
- Organisation of international activities and relations.
- Improvement of business operations in the field of entrepreneurship.
- Representation vis-à-vis republic authorities, Federal Chamber of Economy, federal authorities and other relevant organisations.
- Development policy and economic policy.
- Encouragement of good practice and business ethics.
- Other activities in the interest of its members.

Membership

Membership is mandatory.

Fees

Each registered firm is obliged to pay 0.32% of its gross wages.

Funding

It is 100% financed through mandatory membership fees.

Employees

The CoC employs 45 staff. It does not have regional offices.

Analysis

The CoC is not considered to be active in supporting SMEs. According to research (e.g. OECD-EBRD, 2003) SMEs are not satisfied with the services obtained from the CoC. They question the necessity for mandatory membership and would prefer to be free to join business associations on a voluntary basis.

Business Associations

There are several business associations representing SMEs at the national level:

- Montenegro Business Alliance (MBA), with 350 members (including all foreign investors and 10 associations).
- Beekeepers' Association, with 270 members.
- Union of Employers, with 200 members.

The Montenegro Business Alliance (MBA) aims to partner the public and private sector, as well as international organisations, to promote stability and sustainability in relation to the Montenegrin economy. MBA is based on voluntary membership and is considered to be the leading voice of business in Montenegro. It has over 350 members (if one considers the associations' own members, which employ over 10,000 workers and contribute about 25% to the GDP in Montenegro) and is financially sustainable from the membership fees.

Analysis

There has been a rapid growth of business associations in Montenegro since 2002. These are fairly extensive but no data is available as to how many exist, their focus, membership, etc. In addition, some sector-specific business associations have been created. Donors, such as USAID and EAR, support the development of business associations.

7.3 Regulations

Business Entry

Montenegro is by far the best performer in the SEE region, in terms of business entry. The Enterprise Law (2001) streamlined the procedures of creating and registering enterprises, so as to stimulate entrepreneurship and business development. The consequence is that a Limited Liability Company (LLC) can be formed with founding capital of €1 and a further €10 for the Commercial Court fee. The Central Registry of the Commercial Court has four working days to issue the registration, otherwise firms are deemed to be automatically registered. The total costs of the necessary formal procedures for registration come to about €35. The fact that the procedure is quick and affordable has reportedly resulted in a significant increase in the number of businesses registered in Montenegro.

The key remaining problems are not related to registration per se. They have more to do with obtaining operating licence at municipal level. These costs can vary from €350 - €900.

Exit

The Enterprise Law (2001) requires annual re-registration through a simple procedure: firms approach the Commercial Court, submit the request to renew the licence and a new one is issued within a day. The first phase of re-registration occurred in 2002 and the procedure is considered to be effective. This means that the problem of active as opposed to dormant enterprises, so common elsewhere in the region, does not exist in Montenegro. That said, the procedure for voluntary termination of a company is difficult, complex and involves a large number of steps.

Simplification

Montenegro has made significant progress with business registration, but further efforts are required to simplify the business environment. In particular, although licences and permits seek to protect the public interest, they can also act as unnecessary barriers, as in the case of Montenegro. There is no national forum for business simplification, but the Centre for Entrepreneurship and Economic Development established a Working Group in January 2004 with the aim of simplifying licensing procedures, permissions and the registration regime. The Working Group is actively working in the municipality of Bar to pilot initiatives with a view to enabling good practice experience to be transferred to other municipalities. In February 2004, FIAS undertook a Diagnostic Study of the Investment Environment, which sets out some of the key barriers to investment.

“One-stop-shops”

The Business Register is now based in Podgorica, which means that all enterprises must travel to the capital city to be registered. There is a need to assist local authorities to develop one-stop-shops for registration, certification, information, etc.

“Silence is consent”

Other than the introduction of silent consent for Commercial Court registration, no other policy reforms are being pursued.

Land Registration/Cadastral

The Cadastral Office is responsible for dealing with all immovable property rights. Registering of land titles is computerised and is not considered to be overly time consuming or costly. The law established a time limit of 30 days for registration but in practice it takes about half the time. Montenegro is one of the few countries in the SEE region to have national treatment of foreigners as far as property is concerned.

Nevertheless, the Cadastral Office does not have reliable information. There is no requirement that the land be surveyed before registration. Uncertainty about ownership rights means that commercial banks hesitate in accepting property as collateral, which drives up interest rates to compensate for the risk. A new Restitution Law was adopted in February 2004, but the Cadastral Office still does not register claims for restitution. Possible improvements would include (FIAS, 2004):

- Enacting workable land restitution laws and procedures, and reviewing options requiring time-bound registration of claims.
- Reviewing land title requirements and procedures to improve land title transparency and requiring surveys of registered land.

Informal Economy, Bribery and Corruption

It is estimated that the informal economy represents 29.1% of GNP in Serbia and Montenegro (Schneider, 2002). The Institute for Strategic Studies and Prognoses estimates that the informal economy represents 30% of GDP; and that 27% of the workforce is employed in the informal economy (ISSP / World Bank: Household Survey). According to the BEEP Survey (2002), 15.9% of small enterprises in Serbia and Montenegro offer bribes frequently and the average bribe tax as a percentage of annual firm revenue amounts to 1.5%.

7.4 Tax

Tax System and Administration

The Ministry of Finance determines tax policy and is in charge of tax legislation and regulation. While it is responsible for the overall taxes, municipalities have been allocated the task of dealing with local taxes and administer numerous communal taxes and fees. The Department of Public Revenue is in charge for tax collection, including VAT, personal income tax and corporate tax.

The total tax burden in Montenegro is about 34% of GDP, which is neither high by regional standards (the equivalent is 53% in Hungary, 44% in Czech Republic and 44% in Poland - Economist, 2003), nor a cause for policy concern. Nevertheless, the public sector is over-staffed and in need of major restructuring - 37,000 people are employed in the public sector, accounting for a third of the workforce.

Key Tax Rates

- Corporate Income Tax (CIT): 15% (profits up to €300,000); 20% (profits over €300,000), paid annually.
- Personal Income Tax (CIT): 17%, 21% and 25%, paid annually.
- Value Added Tax (VAT) 17%, paid monthly (immediately in the case of imports).

Prepayment

No taxes are prepaid in Montenegro except in the case of imports, where VAT is paid immediately, together with customs duties.

Incentives

There are no tax exceptions and instruments for SMEs, but there are various features that small enterprises can avail themselves of:

- Newly established legal entities performing production activities in undeveloped municipalities are not required to pay profit for the first three years.
- NGOs do not pay taxes for profits below €4,000.
- Small entrepreneurs with yearly incomes of less than €18,000 may pay tax in approximate amounts (depending on business activity and amount of income).
- A 25% tax deduction is possible for investment in new assets.

Stability and Transparency

The tax system has undergone intense reform. Since December 2001, the Government of Montenegro has undertaken a radical overhaul of the tax system, resulting in six new tax laws. The aim has been to improve tax collection, broaden the tax base, reduce tax rates and simplify tax administration procedures. This means that all

enterprises, especially smaller ones, have faced substantial compliance costs. Corporate and personal income tax administration is improving but is not yet very effective. Further improvements in tax administration should increase the tax yield.

Advance Warning

Changes to tax laws, rates and regulations are not considered by small enterprises to be made with sufficient advance warning. Nevertheless, in March 2004 the Parliament of Montenegro signed a Memorandum of Understanding with two independent business associations (Montenegro Business Alliance and Union of Employers) and two NGOs (Centre for Entrepreneurship and Economic Development and Institute for Strategic Studies and Prognoses) to open up the legislative process to debate within the Parliamentary Commission, which is in charge for proposing new legislation before it is formally submitted to Parliament.

Consultation Mechanisms

No formal mechanism exists for consulting entrepreneurs, but in February 2004 Montenegro Business Alliance signed a Memorandum of Understanding with Department of Public Revenue of the Ministry of Finance to enable consultations to take place between public authorities and the private sector.

7.5 Support Services

Business Support Centres (BSCs)

In partnership with donors (such as EAR and GTZ), SMEDA has created:

- 4 regional agencies/centres (Podgorica, Bar, Rozaje and Bijelo Polje).
- 7 local sub-centres.
- 1 Euro Information Correspondence Centre.

More than 70% of the territory of Montenegro is now covered by these regional centres, which provide support to entrepreneurs during the various phases of their operation, expansion and development. The services include: consulting, business plan development, Internet support, marketing, etc.

A number of other organisations are active in Montenegro, such as GTZ, Urban Institute, Firm Level Assistance Group (USAID programme) and the Centre for Entrepreneurship and Economic Development (with five offices). In addition, private bookkeepers, lawyers, auditors, etc. have also become established in Montenegro. Most BSCs have developed on an ad hoc basis, with different donors and international organisations typically taking the lead in developing their own models and approaches. None of them have achieved financial sustainability and are not likely to do so in the near future.

Technology Parks

No technology parks, business parks, industrial zones, etc. exist at present. GTZ is working on a survey in order to identify the levels of knowledge among the SME stakeholders of technology parks and similar. A strategy is lacking in Montenegro.

Business Incubators

There are no business incubators, although there are some initiatives to create one soon. A strategy is lacking, as are the resources to implement such initiatives.

7.6 Access to Finance

Development Bank

A development bank existed in Montenegro for several years, but was closed down. None is planned for the future, not least because there are already 12 registered commercial banks. Further reductions in the number of banks are anticipated.

Micro Finance Bank

A micro finance bank is yet to be established in Montenegro, but there are several micro credit lines operating through commercial banks. In 2002 the Micro-Credit Montenegro (MCM) was established with USAID support. MCM has meanwhile been transformed into Opportunity Bank and is providing small loans to the farmers. Interest rates are fairly high at 12-18% per annum.

Credit Guarantee Schemes

No credit guarantee schemes have been created, but the Central Bank anticipates developing a state credit guarantee law this year. If such a scheme is to be implemented, international good practice in this area should be employed to ensure that it is structured effectively.

Mutual Credit Guarantee Schemes

None exist at present.

SME Credit Lines

The registered commercial banks operate credit lines supporting SME development. Most of the SME support is delivered through international credit lines provided by EAR, EIB, KfW, etc. The latter operate through local banks and amount to about €15 million. Interest rates have been reduced by about half over last three years, but are still high (12-18%). In 2002 European Fund for Montenegro was created (donors include the European Union, Austria, Switzerland and Germany) with the aims of providing financial support to SMEs, including agricultural development. In addition, certain state funds target entrepreneurs and SMEs:

- Fund for Development: provides the cheapest loans (interest rates range from 6%-10%) mainly for exporters, business start-ups and general business development.
- Employment Bureau: has implementing a programme to stimulate employment and entrepreneurship since 1999, focusing on self-employment and offering small loans of €5,000-€10,000.
- New government credit lines: in February 2004 the government made €12 million available through 14 credit lines focusing on increasing employment and support development of agriculture and tourism in co-operation with six banks.

Leasing

There is only one leasing company, Montenegro Leasing & Finance (MLF), which started operating in 2003. There may be scope for assisting the diversification of finance for small enterprises by experimenting with the use of micro leasing.

7.7 Country Specific Recommendations: 2005 - 2006

Institutional Issues

A key problem is the “implementation gap”. Many of the new laws are not yet fully applied by the SME institutions, administration, judiciary and municipalities. Much of the technical assistance support from various donors has focused on the SME Development Agency of Montenegro (SMEDA), and CARDS could continue to prioritise capacity building and ensuring institutional sustainability:

- Focus on securing the effectiveness and sustainability of the network of business support centres. A large number of sub-centres may not be compatible with the need for achieving sustainability once donor funding begins to be reduced.
- Support the development of effective strategies in relation to specific aspects of SME development such as: business incubators, technological parks, industrial zones, high-tech corridors, clusters etc. This could be done in the partnership with other public institutions as well as the private sector.
- Provide the necessary support to SMEDA in order to position it to obtain future pre-accession and structural funds.
- Support for the development of appropriate business statistical information, systematic data collection (including data sharing between the relevant institutions) and building the human and institutional capacities through collaborations with EUROSTAT and other EU country statistical institutions.

Business Barriers

Montenegro’s business registration process has improved significantly, but there is scope for further reform with CARDS support:

- Establish a high-level, public-private committee to drive a comprehensive approach to reducing specific administrative barriers to business development.
- Support the activities of bodies active in the process of business simplification, especially in the area of licensing and permits.
- Develop a country-wide, one-stop-shop registration network by the end of 2006.
- Develop an on-line registration system.

Business Government Dialogue

No country in SEE has been able to generate an effective business – government mechanism for dialogue. Montenegro is no different in this respect:

- Reform is required to generate a mechanism for dialogue either via SMEDA and/or the Ministry for Economy. The CARDS programme could help establish such a mechanism, with a view to providing a model for other countries.

Privatisation and FDI

Over 60% of the state owned firms have been privatised and preparation is underway for several large companies. Organisations such as USAID and EAR continue to assist this process, for example in relation to the aluminium plant (Kombinat aluminijuma Podgorica), Niksic Steel Company (Zeljezara Niksic) and the remaining state owned bank (Podgoricka banka). Further assistance is required to complete the process:

- Further post-privatisation support could be delivered through the CARDS system to assist the Privatisation Council to stimulate small enterprise development following privatisation.

- CARDS could target post-privatisation assistance for restructuring and retraining key management personnel, so as to increase the competitiveness of the firms.
- An Investment Promotion Agency (IPA) is planned for this year, an important precondition for enabling Montenegro to attract higher levels of FDI. Previous experience demonstrates that a significant degree of capacity building is essential in order to assist the IPA to become an effective tool for FDI promotion.

Business Associations

The existence of a national Chamber of Commerce with mandatory membership is currently considered to be a burden to the SME sector, as the services are not considered to be adequate. CARDS could develop a project to:

- Evaluate the value of introducing voluntary membership for the Chamber of Commerce, thus creating a level playing field in relation to business associations.
- Support regional programmes focusing on business-to-business events, conferences, trade initiatives, etc. in the SEE region and the EU.
- Support programmes to develop the businesses sector by focusing on standards such as ISO, IAS, EU exports, etc.

Diversification of Finance

Significant changes are taking place in the banking sector, including entry of foreign banks, establishment of the Montenegro Central Bank, privatisation of state-owned banks, transfer of the clearing house function from the Bureau for Clearing and Payments to commercial banks, liberalisation of the foreign exchange regime, etc. This, combined with the intense bank competition, should result in new and better SME products. In this context, CARDS assistance focus on helping to diversify of the financial products available through the financial market:

- Help to establish and strengthen leasing, since there is currently only one leasing company with low levels of capitalisation. This could be done in co-operation with the SEED programme.
- No export support schemes exist in Montenegro, so a demonstration project could be useful in stimulating the financial sector to deliver this option in future.
- The Central Bank is developing a state credit guarantee law to be implementing in 2005. CARDS assistance could ensure that international best practice is utilised in the creating the fund; and that alternatives, such as mutual credit guarantee schemes, are developed.

Entrepreneurship and Competitiveness

Much effort is required to build on the agenda and priorities established by the EU Charter. CARDS assistance could focus on:

- Introducing international standards such as ISO, quality control and international certification in specific sectors with export potential.
- Developing a culture of entrepreneurship through campaigns, education and vocational training at all levels, including schools, competitions, etc.
- Providing assistance to develop tools to influence the levels of informal economy.

8. Kosovo SME Panorama

This SME panorama draws on a variety of sources, such as the EC Charter for Small Enterprises National Report (2003), the Trade and Investment Guide to Kosovo (2004) and other materials collected locally, not least interviews with a variety of organisations conducted as part of the research in Pristina.

8.1 Definitions and Statistics

Definition

There is currently no definition for SMEs. The draft Company Law being prepared by the Prime Minister's office may incorporate the new EU SME definition. This cannot be confirmed at this stage.

Estimates

It is not possible to estimate the importance of SMEs in Kosovo at present. There are various reasons for this: a definition of SMEs does not exist; it is considered that effectively all enterprises are SMEs in the case of Kosovo; and all the enterprises in Kosovo are in the process of being reregistered, making accurate statistical information hard to obtain. Although 50,000 enterprises were registered provisionally, not more than about 28,000 firms are expected to be registered in 2004 according to the Ministry of Trade and Industry.

Analysis

Efforts could be made to interact with the Prime Minister's office and MTI to include the EC SME definition in the new Company Law. Substantial assistance will be required to develop appropriate definitions, databases and statistical analyses. An option could be to develop an SME Observatory, as planned by the Ministry of Trade and Industry (MTI). A more effective long-term approach might be to engage with the Kosovo Statistical Office to develop its general statistical capacity, including that of information collection on enterprises.

8.2 Institutions

Background

UN Security Council Resolution 1224/99 established a United Nations Interim Administration in Kosovo (UNMIK), tasked with generating substantial autonomous and self governing institutions. The same resolution also provided for a security umbrella under the responsibility of Kosovo Force (KFOR) and a multinational military force led by the North Atlantic Treaty Organisation (NATO).

UNMIK promoted a Constitutional Framework for Provisional Self-Government Institutions in 2001. This framework led to the creation of relevant institutions and substantial autonomy for Kosovo via the 120-elected member Assembly of Kosovo. One of the key new institutions is the Ministry of Trade and Industry (MTI), which controls SME policy. UNMIK retains responsibilities relating to trade issues.

MTI is responsible for determining SME policy in Kosovo. In doing so, it has established a Private Sector Development and Investment Department (PSDI Department), which focuses on attracting domestic and international investment, as well as developing the institutional infrastructure for entrepreneurship and improving the business environment in Kosovo.

The PSDI Department has 23 staff members and is expected to expand to 30 in 2004. 10 of these are based in the five MTI regional offices, with the remainder located in Pristina. The majority focus on investment issues and most of the 7 new staff members will be allocated to the new Investment Agency, which is expected to be established in 2004. Relatively few staff deal with small enterprise issues and capacity building is required.

In its plans for 2004 – 2006, MTI is committed to establish an SME Agency. This was originally expected to be created in 2004, but severe budgetary constraints (see below) mean that implementation has now been deferred to 2005. The SME Agency is expected to have a regional structure, possibly involving 10 state owned regional offices. The five existing MTI regional offices are expected to be upgraded; and the five Regional Enterprise Agencies (REAs – initiated with CARDS support) are expected to make up the rest of the network. MTI anticipates that they will all become state institutions.

Under the decentralisation process, local authorities have received local economic development powers, including enterprise development functions. Local authorities appear to have some resources, however, lack the staff and know-how to undertake enterprise development in an effective manner.

MTI is still a relatively new and fragile institution. It has not yet developed an SME strategy, action plan for implementation or developed structured policies in relation to such issues as: business incubators, industrial parks, raising competitiveness and exports, etc. but these are expected to be put into place during the period 2004-2006. Various draft laws are in the making, such as the law on Business Organisations (initiated by the Prime Minister's office), Credit Guarantee Scheme, etc., all of which will also stretch MTI's limited enterprise development capacity.

SME Resources

MTI requested a budget of €930,000 for 2004, so as to implement the activities of the PSDI Department, but none of these resources will be available. Some of the funding from the rest of MTI (amounting to €2 million in 2004) will be vired so as to undertake some PSDI activities, but the majority of this is likely to be directed at funding staff costs, as well as the investment activities. Very little funding is likely to be available for enterprise development in 2004; the situation in 2005 and 2006 cannot be predicted. This means that MTI will rely even more heavily than elsewhere in the SEE region on the international community for resources and technical assistance to promote small enterprise development. CARDS will be the key programme in this respect.

Consultation and Co-ordination

A Consultative Council was established by MTI in May 2003 and has met three times under the Chairmanship of the Minister of Trade and Industry. The exact focus of the

Consultative Council is not yet clear, however, it represents an attempt to initiate a dialogue with a range of non-government players. The members include:

- 4 representatives of MTI.
- 1 representative of a State Owned Enterprise.
- 4 representatives of private businesses.
- 1 representative of the Chamber of Commerce.
- 1 representative of commercial banks.
- 1 representative of UNMIK.
- 1 representative of Kosovo Business Support (USAID, ending in Sept. 2004).
- 2 representatives of minorities.

There are issues about the degree of representativeness of this group, its mission and whether it is adequately supported with a secretariat, so as to maximise its potential and input in terms of policy making. Nevertheless, it represents a positive step forward with scope for improvement.

Analysis

It is too early to assess the extent to which the system works effectively. MTI has been created, it has responsibility for private sector development and has prioritised small enterprise development in the form of a Department, albeit it with a focus on investment. The PSDI Department has plans to establish further institutional support for SME development at national (SME Agency) and regional level (10 regional offices). However, it has no state funding in 2004 and there are many issues which will need to be tackled, such as the lack of SME strategy, action plans and specific policies and resources to support the development of entrepreneurship and competitiveness. The approach thus far appears to be broadly on the right track, such as the establishment of a Consultative Council, however, the resources are extremely limited and the human capital needs to be upgraded. The SME policies and institutions would benefit from making the most of the extensive good practice that has been built up in the SEE region and beyond.

Chambers of Commerce

Functions

The Kosovo Chamber of Commerce undertakes the following functions:

- International services.
- Information provision.
- Consultancy.
- Executive services.
- Training.
- Relations with international organisations, including other Chambers.

It is hard to assess whether its services are geared to the needs of the SME sector. To the extent that almost all enterprises in Kosovo are SMEs, this is likely to be the case.

Membership

Membership is compulsory. A new law is before Parliament which proposes that the current compulsory system is maintained. Early indications are that there is a lack of political consensus on this issue.

Fees

The membership fees are €50-500 annually, depending on the size of the firm. In reality, the fees have been more voluntary than mandatory in nature for the last four years. This is reflected in the fact that there are currently 3,000-3,500 firms registered in Kosovo Chamber of Commerce, but about 28,000 registered firms in all.

Funding

Membership fees comprise an estimated 50% of the Chamber of Commerce's funding. Other services, such as information, consulting, advice, fairs, etc. make up the difference, according to the Kosovo Chamber of Commerce.

Employees

60 staff members work in the Chamber of Commerce. 35-40 are located in Pristina and the remainder in its seven regional offices.

Analysis

The vast majority of enterprises are SMEs. About 10% of the registered enterprises are paying regular fees to the Chamber of Commerce despite the fact that the membership fees have been effectively on a voluntary basis since the end of the war. This suggests that a certain proportion of enterprises obtain services that they value. That said, the latest Riinvest survey of SMEs indicates that 80% of the surveyed enterprises believe that membership of the Chamber of Commerce should be voluntary (Riinvest, 2002, p.11). Despite this, the law that has been submitted to Parliament will reinforce the mandatory nature of the Kosovo Chamber of Commerce. It is unclear what will happen, since early indications (situation as of February 2004) are that Parliament is unlikely to approve the bill in its current form.

Business Associations

A few other business associations, mainly USAID inspired, exist:

- Alliance of Kosovo Businesses (AKA): 5,000 members and 23 associations.
- Alliance of Kosovo Agribusiness (ABK): 3,000 members.
- Kosovo Exporters' Association (KEA): 23 members.
- Kosovo Business Women Network (KBWN): membership unknown.

Analysis

These business associations have all been formed on a voluntary basis. They appear to have been largely developed on a "top-down" basis by donors and continue to receive substantial technical support for their development. It is not clear whether these associations will be sustainable once donor funding runs out. Their future would be clearer if they were able to compete with the Chamber of Commerce system on an equal footing.

8.3 Regulations

Business Entry

The registration procedures to start-up new enterprises have recently been streamlined. According the Charter National Report (2003), Executive Order 2002/22

states that so long as documents are delivered which satisfy the requirements of UNMIK Regulation 2001/6, registration of companies must be follow within five working days in the form of a written confirmation of receipt of the application and an application filing number. Within seven days, the authority must issue the Certificate of Business Registration. This simplification has been possible to achieve, mainly because the commercial courts are no longer part of the registration process.

The registration costs are also very affordable compared with many countries in the SEE region. It costs €7 to register an individual business, including the costs of the Registration Office. Limited liability companies and stockholding companies pay €24 for the Registration Office and Registration Certificate. A €20 money back guarantee applies for delays. It is too early to assess whether this is working well, however, these developments represent significant improvements in the registration process.

Since April 2003 the MTI has been the administrative authority responsible for business registration. Attempts to work with the 30 local authorities in Kosovo were discontinued when it became apparent that the process of provisional and final registration was not happening sufficiently quickly and that additional costs were being introduced to the registration process.

Exit

Following the introduction of the new company register, about 50,000 firms registered provisionally. However, MTI anticipates that only about 28,000 enterprises will be registered in 2004. This means that the problems concerning active versus dormant enterprises do not apply to the same extent as elsewhere in the SEE region.

Simplification

No FIAS reports or similar exercises have been undertaken to assess the administrative and legal barriers to investment and set out what needs to be done to improve the investment climate. No Working Group or Action Plans exist to simplify the business environment, partly due to the fact that the system is generally considered to be quite simple. This is not to suggest that barriers do not exist. Major barriers remain, for example, in terms of land titles and ownership and the stalled privatisation (see below).

“One-stop-shops”

The Business Registry is now based in Pristina. The abortive attempt to involve the 30 municipalities resulted in the centralisation of the Business Register and it is unclear if and/or when local authorities will be involved in the process once again. Scope exists to assist local authorities (or others) to develop one-stop-shops for registration, certification, information, etc.

“Silence is consent”

Some progress is being made on this front in that company registration proceeds unless the relevant authority (MTI) raises objections.

Land Registration / Cadastres

The Kosovo Cadastral Agency (KCA) is responsible for dealing with all immovable property rights. Some progress had been made, for example, most claims and restitution issues have been clarified by the Housing and Property Development's

Commission charged with this task. However, the cadastre remains a serious barrier to investment. There have been significant delays in the development a new property register. KCA has received technical assistance from the Norwegian government, but the register remains unclear, making it difficult to enforce property rights. This affects domestic and foreign investors' willingness to engage in Kosovo and restricts small enterprises' capacity to collateralise loans through commercial banks. Efforts are needed to accelerate the process of reform.

Informal Economy, Bribery and Corruption

It is estimated that the informal economy represents 29.1% of GNP in Serbia and Montenegro (Schneider, 2002). According to the BEEP Survey (2002), 15.9% of small enterprises in Serbia and Montenegro offer bribes frequently and the average bribe tax as a percentage of annual firm revenue amounts to 1.5%.

An assessment of corruption in Kosovo in May 2003 concluded that while it exists, it is not yet pervasive or undermining the ability of the state to govern. According to this study, Kosovo scored lower than all eight of its Balkan neighbours on six out of eight corruption indices, and was comparable to the other countries on the other two indices (USAID, 2003, p.12). The latest Riinvest survey highlights unfair competition from the informal economy as being the most serious barrier to doing business, with corruption appearing in 8th place (Riinvest, 2002, p.25).

8.4 Tax

Tax System and Administration

The Ministry of Finance is responsible for setting tax policy, legislation and administration. The Taxation Authority and the Customs Services were established immediately after the war and are considered to be efficient in collecting taxes. All main taxes (such as tariffs, VAT, Excise, etc.), are collected immediately at the customs points. Other taxes, such as payroll tax, profit tax, etc., are collected at the point of sale. The procedures for payment of taxes are considered to be relatively simple, understandable and applicable to everyone.

Key Tax Rates

- Corporate Income Tax (CIT): 20%, paid quarterly.
- Presumptive tax: businesses with annual revenues of less than €100,000 or €50,000 in assets may pay this tax (7% of turnover above €7,500), paid quarterly.
- Personal Income Tax (CIT): 5%, 10% and 20%, paid monthly.
- Value Added Tax (VAT): 15%, paid monthly.

Incentives

There are no special tax incentives to support SMEs, but some general features are worth noting. Enterprises with turnover below €50,000 are not obliged to pay VAT; firms with €50,000 - €100,000 turnover are liable to pay a presumptive tax of up to 7% gross amount over €7,500; and firms with a turnover above €100,000 must pay VAT.

It is anticipated that from 2004, a number of tax changes will apply:

- Under the Presumptive Tax new facilities (representative spending, bad debt cost, related person cost, depreciation cost, capital recovery cost, etc.) will be deductible from taxable profit.
- Taxes are to be paid in advance on trimester instalments:
 - €37.5 per trimester for all taxpayers with a turnover of less than €5,000 per annum.
 - 3% per trimester turnover for all businesses related with trade, agribusiness and transport.
 - 5% per trimester turnover for all professional services, entertainment business etc., for all taxpayers with a turnover between €5,000 and €100,000, who decide not to do bookkeeping or keep statements.
 - ¼ of expected profit tax or ¼ of 110% of final tax for the next year, for taxpayers with turnover of more than €100,000 and obligation to keep a transactions trail.

(Charter National Report, 2003)

Stability and Transparency

The tax system has witnessed quite a lot of change from year to year, thus resulting in fairly significant compliance costs on all enterprises, especially small ones.

Advance Warning

It is not known whether changes to tax laws, rates and regulations are made with sufficient advance warning or whether there is sufficient information provision and preparation through training for inspectors as well as businesses.

Consultation Mechanisms

No formal mechanisms exist for consulting with enterprises.

8.5 Support Services

Business Support Centres (BSCs)

The main BSCs in Kosovo are as follows:

- 5 Regional Enterprise Agencies funded by CARDS (Pristina, Mitrovica, Peja, Prizren and Gjilan).
- Kosovo Business Support (USAID funded until September 2004).
- 5 Regional Offices of the Department of Private Sector Development and Investment (MTI).
- 1 Euro Information Correspondence Centre at the Chamber of Commerce.
- 3 UNDP Local Economic Development Centres (Decan, Skenderaj and Sthime Skenderaj).
- 1 Enterprise Development Agency (ILO project based in Pristina with an outreach unit covering the whole of Kosovo).
- Other organisations such as GTZ, Riinvest, UBO Creation, Economic Institution, Balkan Business Co-operative Network in Pristina, etc.

BSCs have largely developed on an ad hoc basis. None has achieved financial sustainability or is unlikely to do so. All rely on donor project funding to maintain their core activities.

MTI has not been active in this area so far, other than the establishment of its five regional offices. In the absence of an SME strategy, it does not have a policy position vis-à-vis business development services. This is now changing. MTI aims to develop an SME Agency to co-ordinate the implementation of SME issues, supported by a regional structure. MTI foresees a regional structure comprising 10 centres: the REA network of 5 BSCs and the existing MTI 5 regional offices. MTI anticipates that all 10 (as well as the SME agency) will be state bodies in future. There is a need to assist MTI to develop sustainable institutional structures for SME development, based on the extensive good practice that has built up in the SEE region over the last decade.

Technology Parks

No technology parks exist at present. MTI considers the development of such instruments to be a policy priority for the period 2004-2006. Policies, strategies and resources are lacking at present.

Business Incubators

No business incubators exist, but two business incubators might develop in Zvečan and Gjakova. MTI considers the development of such instruments a policy priority for the period 2004-2006 but again, policies, strategies and funds are notable for their absence. Under a new CARDS technical assistance programme for MTI, it is anticipated that a pilot business incubator will be developed in Kosovo.

Privatisation

The privatisation process was suspended in October 2003 due to flaws requiring reform. The privatisation process is yet to resume. It is thus unlikely that the Kosovo Trust Agency (KTA) can complete the process of privatisation before its mandate expires in 2005, although it should be noted that KTA's other responsibilities, particularly towards publicly-owned utility companies, are not time-bound. Many of the saleable assets may be sold by mid-2005, but the liquidation of the socially-owned enterprises and the resolution of claims on those assets will take longer.

CARDS assistance could be marshalled to accelerate the process of privatisation itself, as well as assist post-privatisation activities in 2005 and 2006. There will be newly-privatised enterprises that are owned and run by comparatively inexperienced managers searching for improvements in marketing, financial management, product development, etc. Kosovo's trade balance is highly skewed and to survive as an economic entity, it will need to develop businesses that offer potential for export. This will have to come from the establishment of new businesses, as well as the revitalisation of some of the former socially-owned enterprises.

8.6 Access to Finance

Development Bank

A development bank does not exist in Kosovo and none is planned.

Micro Finance Bank

The Micro Enterprise bank was created in 2001 and renamed the ProCredit Bank in 2003. ProCredit Bank focuses on providing financing for micro and small firms in

Kosovo and reaches a client base of 13,000 firms through its seven branches. ProCredit Bank offers business loans, agricultural loans, overdrafts and guarantees, as well as mainstream banking services such as savings and current accounts.

Credit Guarantee Schemes

No credit guarantee schemes have been created, but MTI anticipates developing such a law in 2004 or 2005. Such a scheme must not act in a distortionary manner and alternatives (see below) may be considered. If a state guarantee scheme is to be implemented, international good practice in this area should be used.

Mutual Credit Guarantee Schemes

None exist at present.

SME Credit Lines

There are seven registered commercial banks in Kosovo; and a growing number of credit lines focusing on small enterprises. The seven banks are: ProCredit Bank, Raiffeisen Bank, New Bank of Kosovo, Bank for Private Business, Banka Ekonomike, Kasabank and Banka Kreditore. In addition, there are quite a few micro finance NGOs and other non financial institutions such as the Foundation for International Community Assistance (FINCA), with 5 branches in Kosovo.

Leasing

There is no leasing law. This is recognised as something that should be developed, and the World Bank is looking to provide technical assistance in this area.

8.7 Country Specific Recommendations: 2005 - 2006

Institution Building

MTI is an important organisation, albeit institutionally weak. EAR has identified this as being an important issue to address and part of the 2004 CARDS technical assistance will target MTI. However, further assistance will be needed in 2005-2006 focusing on the following issues:

- Capacity building of the SME oriented MTI staff.
- Development of an effective and realistic SME strategy and Action Plan (covering issues such as entrepreneurship, competitiveness, business incubators, business support services, agency for SMEs and regional structure, etc.).
- Assistance to develop an SME Agency and regional structure which builds on international good practice and is sustainable.
- Assistance to develop representative and well-structured mechanisms for government – business dialogue and consultation building on the existing Consultative Council.
- Support to develop appropriate legislation, statistical information, web site and other publicity material on SME issues.

Business Simplification

The business environment should improve following recent reforms. Other CARDS actions would help improve the situation, consistent with EU Charter priorities:

- Develop one-stop-shop registration offices, possibly based in municipalities.

- Assist the relevant organisations to move towards on-line registration.
- Assist the Kosovo Cadastral Agency with the process of registering land / cadastre in co-operation with the Norwegian government.

Financial Diversification

The financial situation is steadily improving in Kosovo. CARDS assistance could usefully be deployed to help diversify the range of financial products available to for small enterprises, which financial institutions can then follow-up:

- Develop a leasing law and test it using a leasing fund. This activity could be co-ordinated with the World Bank and EBRD.
- Assist MTI to develop mutual credit guarantee schemes, preferably in place of state guarantee schemes. The latter have not proved to be very successful in the SEE region.
- If MTI insists on developing a state guarantee scheme, assistance could be provided to ensure that international good practice is incorporated into its design.

Privatisation

The Kosovo Trust Agency (KTA) is unlikely to be wound-up in mid-2005 as the privatisation process has stalled and only 27 out of 500 SOEs have been privatised:

- Further technical assistance (pre-privatisation and post-privatisation) could be delivered through CARDS to help KTA accelerate the process of privatisation and stimulate small enterprise development following privatisation.

Economically Disadvantaged Areas

The Country Strategy Paper highlights the need for harmonious regional development and attention for economically depressed regions but CARDS activities have not yet prioritised this type of support. As this report is being finalised, the situation between the Albanians and Serbs remains tense and conflicts may recur. Attention could be devoted to targeted areas and economically disadvantaged locations in relation to:

- Working with local authorities to develop their local economic development and enterprise development capacity. This should lead to employment opportunities that may help reduce some of the social, ethnic and other tensions.
- An embryonic process of regional development is taking place in Kosovo. CARDS assistance could be utilised to develop regional development partnerships, strategies, projects and implementation agencies.

Rural Development

The agricultural sector offers scope for development in Kosovo. The World Bank is developing a large pipeline project focusing on the mining and agricultural sectors. CARDS assistance could be combined with World Bank resources to deliver a more comprehensive package of assistance focusing on:

- Improvement of the operation of Municipal Courts.
- Enhancement of Accounting and Auditing standards.
- Improvement of regulations and supervisory standards for the commercial bank and insurance sectors, etc.

9. Regional Perspectives

9.1 Introduction

The individual SME Panoramas presented in this report demonstrate that there are significant differences in the respective countries' context and progress in developing an environment conducive to SME development. Notwithstanding these differences, there are a number of areas where all countries could benefit from CARDS assistance at regional level, either for the all the countries in the region simultaneously or specific countries in the region. Therefore, a number of regional recommendations are presented below according to the categories defined in the ToR. The perspective adopted was to reflect on some of the key issues of common interest and relevance, and to highlight these as possible areas for regional CARDS assistance. As in the country specific recommendations, these are strategic in nature and will require further work (such as project fiches) in order to convert them into projects to be implemented.

9.2 Institutional Recommendations

Achieving Financial Sustainability

Lack of sustainability characterises the institutional infrastructure in the CARDS countries and the wider SEE region. The government ministries tend to be 100% financed from the state budget. The lack of sustainability applies predominantly to the SME Agencies, which generally have very limited funds, and the regional network of Business Support Centres that they co-operate with, which typically just about survive once mainstream donor / government funding terminates. It is important for CARDS assistance to focus on two key issues at the regional level:

- What is the best practice in terms of SME agencies and business support centres and how can they achieve financial sustainability in the SEE region? What is the minimum period of public funding that is required? What type of commercial and other revenues can be generated in transition economies? How can the balance be funded by public bodies so as to ensure that market failure is overcome as far as start-ups and early growth firms are concerned? If institutional financial sustainability may not be attainable in the short term, under what circumstances should governments (national, regional and local) and donors develop business development services? Comprehensive policy analysis and advice in this area would be crucial in guiding future development in this area, since every country is confronting these issues.

A regional level conference would be a mechanism for awareness-raising, discussion and policy development in relation to this recurring issue, since all CARDS countries appear to be confronting this common problem, without obvious progress being made. The outcome of the conference should be the creation of a set of "golden rules" for business development services, building on the experiences of organisations such as the Committee of Donor Agencies for Small Enterprise Development (2001), as well as the EC (Phare, 2000).

Performance Monitoring

Few SME institutions conduct regular performance monitoring and assessment in the SEE region. As a result they consistently exhibit two fundamental problems:

- They are accused of not doing enough to support the SME community.
- They do not receive adequate funds to implement their demanding remit.

The time is ripe for ministries, SME agencies and business development services to begin implement performance monitoring mechanisms to enable them to demonstrate to the government, business associations and the wider SME stakeholders what they are seeking to achieve, identify appropriate performance measures and track progress being made on an annual basis. The overall framework for introducing accountable and transparent performance monitoring and assessment now exists in the SEE region, in the form of both government approved SME strategies, as well as the EU Charter:

- CARDS technical assistance could be used to implement performance monitoring and assessment at country and regional level, building on the Charter and the Investment Compact's Enterprise Policy Performance Assessment process.

Quality Standards and Certification

The individual SME Panoramas demonstrate that the business development services are not sustainable in the SEE region. A key reason for this is that small businesses are generally not willing to pay commercial rates for the services on offer. This lack of interest is because the services available through business development services are considered to be too basic (e.g. business plans, training, credit applications, etc.) whereas entrepreneurs are increasingly looking for sophisticated, value-adding services (such as quality control, EU export standards, productivity gains, etc.) that will improve profitability and which they are willing to pay for. This highlights the necessity for business development service providers to specialise, develop their skill base to higher levels and generally raise quality and standards to the point where entrepreneurs are willing to pay for their services. The CARDS programme could assist in this process in two respects:

- Develop a regional level body which would become the custodian of international quality standards and accreditation in relation to business development services. All such providers (government, NGOs, regional and local authorities, business consultancies, training organisations, etc.) would have an incentive to become accredited, service standards would be raised over time and clients would be assured of minimum quality, thus increasing their willingness to pay for business services. Such an organisation would work much more effectively at regional level, than at individual country level, but it should not necessarily restrict its activities to CARDS countries.
- Provide assistance for the development and introduction of customer charters and other quality standards, so that clients can obtain greater transparency in terms of business services, costs, standards, etc. This could also be done through the business service regional accreditation body discussed above.

Business Associations

Every country in the SEE region has an extensive network of either Chambers of Commerce and/or Chambers of Crafts. These typically predated the process of social, economic and demographic transition and often continue to be seen as institutions representing the government. With some exceptions, such as in BiH as of this year,

membership is compulsory, indeed in certain cases such as Serbia, membership of more than one Chamber of Commerce is mandatory. However, small enterprises are generally highly dissatisfied with the services on offer through these institutions. This is part of the reason why the region has experienced a significant growth of voluntary business associations, but these are generally weak, with limited memberships and financial sustainability. Therefore, unlike the situation in EU countries, the small business community is currently poorly supported by the existing network of business associations.

- CARDS assistance could be deployed to undertake a regional assessment of business associations, especially the Chamber of Commerce system, and the extent to which they are meeting small business needs. Conclusions should address whether the Chamber of Commerce system should continue to be supported through the CARDS system and how business associations generally can be developed which offer customised, high quality services that do support the rapidly changing needs of small businesses operating in volatile markets.
- The future of the compulsory Chambers of Commerce and the other, usually voluntary business associations is interrelated. Such an assessment will inevitably need to explore whether the Chambers of Commerce in the SEE region should be voluntary or compulsory in nature, as well as how best they can be reformed and restructured at national and sub-national level.

9.3 Financial Recommendations

Diversification of Finance

Reform of the financial sector, including privatisation, is proceeding rapidly in the SEE region. Various CARDS countries now have an oversupply of commercial banks, however, the levels of intermediation remain low and lending to SMEs is still restricted by the risk-averse attitude of commercial banks. Nevertheless, there is an increasing supply of credit lines, interest rates are decreasing over time and the overall terms and conditions are easing.

The focus of CARDS assistance at the regional level should be to seek to diversify the range of financial products available to small businesses. Pilot or demonstration projects need to be funded in various countries and regions, the results of which can be widely disseminated and debated in the wider region. The main focus of activity would be to encourage financial institutions to mainstream certain financial products, so that small businesses may access to a wider palette of financial options.

Key areas requiring such support include:

- Mutual guarantee schemes.
- Leasing.
- Factoring, etc.

There is a need to explore whether the SEE region is sufficiently prepared to make use of venture capital. Experience hitherto suggests that this may not be the case.

Credit Guarantee Schemes

Every country in the SEE region has either created a state credit guarantee scheme or is in the process of establishing one. In most cases, even where the legal basis exists, they are either not capitalised or have very limited funding. The region lacks expertise

in the development of effective credit guarantee schemes which make full use of international good practice in this area. This result is that such schemes are open to the criticism that the state is not in a position to select the best schemes from the pool of applications, the guarantees may be distortionary in nature and may relax bank behaviour, thus leading to inappropriate risk evaluations. The result is that SME lending may be hindered, rather than stimulated by these schemes.

- There is a need for CARDS assistance to help new and existing credit guarantee schemes throughout the SEE region to be assessed and (re)designed using best international practice in the area.

9.4 Legislative Recommendations

Business Statistics

There is poor and unreliable business information in the CARDS countries. A consistent feature of the CARDS countries is that they lack effective SME definitions, company registrations and generally data and statistics on SME issues such as business entry. Some countries are already receiving CARDS assistance to enhance this important area which is also covered by the Charter, however:

- Data and analysis are basic building blocks for effective policy making. There is a need undertake a comprehensive regional project to upgrade and harmonise statistics related to the enterprise sector, with close involvement of Eurostat and building on the recent experience of the new members countries.
- The focus of such a project would include: benchmarking business entry and exit (procedures, time, costs, etc.), recommendations for simplifying and the company registration and deregistration process, upgrading and harmonising SME definitions, upgrading of company registers, including the introduction of unique reference numbers and removal of dormant companies from the registers.

Business Simplification

CARDS countries are taking the necessity to improve the business environment seriously, but the degree of progress varies greatly from country to country. CARDS assistance could be particularly useful in making progress in two key areas:

- Registration / licensing through one one-stop-shops: in view of the complexity, cost and delay involved in the process of registration, the concept of one-stop-shops is being widely considered, but little or no progress is being made due to a lack of funds, knowledge and co-operation by the key institutions. A regional approach to this issue, driven by the CARDS programme, would enable rapid progress to be made, using established EU best practice in this field. In particular, online registration offers the technical possibility of having “virtual” one-stop-shops and countries which have already introduced e-signature legislation, such as Croatia and FYR Macedonia could be used as pilots for such an approach, using CARDS funding.
- Simplification through silent consent: the process of registration and licensing is generally complex, non transparent and involves a large compliance burden for small enterprises. CARDS assistance at the regional level could examine the scope for introducing the “silent consent” principle, which forces administrations to respond by introducing automatic approvals (silent consent) for company registration, permits and licenses within prescribed time periods.

- **Regulatory Impact Assessment (RIA):** RIA involves the systematic assessment of positive and negative impacts of regulation as a means of assisting countries to reduce regulatory costs on businesses at the same time as maximising the effectiveness of government action in protecting public interests. Because RIA helps explore alternatives and provides information with which to select the best policy options, it could be particularly useful to SEE countries undergoing major reform to their legal frameworks (see Investment Compact, 2003). CARDS assistance could usefully be deployed to assist RIA to become standard practice in the region.

Informal Economy

Although the precise size of the informal economy is often disputed in CARDS countries, there is wide agreement that it has attained proportions that could even threaten the legitimacy of the state. CARDS assistance could address this issue, which is of growing importance (see separate PCA draft report to the EC on this issue):

- There is a need for a structured, comparable, regular (annual) assessment to be made of the size of the informal economy in CARDS countries. This could enable them to move on from sterile disputes over the merits of different methodologies for assessing the real size of the informal economy, to a much-needed focus on dealing with the significant problems that arise.
- There is an urgent need for support to CARDS countries in providing effective policy responses in terms of tackling the informal economy. The activities in this respect are currently largely restricted to expert Working Groups / Committees and/or punitive measures. There is a need for research and technical assistance to develop more sophisticated policy responses, which are consistent with international best practice in this field.

9.5 Assistance Recommendations

Donor Co-ordination

The level of support for private sector development provided by the EU, international bilateral donors, International Financial Institutions, etc. to the SEE region remains impressive. However, the degree of donor co-ordination in developing and implementing such projects and programmes is not as good as it might be. There are some initiatives to co-ordinate these activities, however, these tend to be ad hoc in nature and are mainly donor-led. This results in a scope for overlapping and thus waste of finite resources. Ultimately, however, the main responsibility for co-ordination lies with national governments. If the relevant SME Agencies / Departments were adequately resourced and operating effectively, donor co-ordination would not be an issue of concern.

- The situation could be improved at regional level if all the relevant players, led by the EU and the relevant government organisation, were to meet on a regular basis to discuss and co-ordinate programmes and projects at country and regional level. Such an approach could either make use of existing instruments, such as the Investment Compact/Stability Pact for SEE or operate separately. The EU, through the CARDS programme, represents the largest donor in the region and would be well-placed to lead such donor co-ordination in relation specifically to SME development.

Charter Resource Centre

The signing of the European Charter for Small Businesses in June 2003 could generate a new political impetus in relation to SME development in the CARDS countries. The Charter effectively amounts to a framework enabling progress with enterprise development to be checked and compared across the CARDS countries. At the same time, the Charter, which was originally designed for EU countries, represent a very significant challenge which not all CARDS countries are well equipped to address.

- The CARDS programme could establish a Charter Resource Centre during the period 2005 – 2006 specifically to assist these countries to implement the 10 elements associated with the Charter. CARDS countries are looking to obtain targeted support, using best practice from EU countries. Since the issues to be dealt with are very similar in all countries, it would be efficient to establish a regional Charter Task Force that countries can draw on for support, as required. The Resource Centre would be a multi-disciplinary team of experts in transition economies and EU experience in the 10 components of the Charter.

9.6 New Instruments

A possible new instrument for 2005 and 2006 relates to the area of finance. Following from the regional analysis in section 9.3 above, there would appear to be scope to replicate the experience of the Phare-funded SME Finance Facility (EC, undated). The SME Finance Facility was established in 1999 to encourage the growth and development of SMEs by facilitating access to finance through local financial intermediaries in the Candidate Countries. The SME Finance Facility is co-managed with the EBRD, European Investment Bank (EIB) and the Council of Europe Development Bank (CEB) in co-operation with Kreditanstalt für Wiederaufbau (KfW) and its objective is to provide credit lines from IFIs, as well as Phare incentives to induce local banks, leasing companies and equity investment funds in the candidate countries to expand and maintain long-term SME finance operations. Because of the co-financed element, the IFIs have delegated authority to administer and manage the Facility, including the EC's grant contribution for a management fee. The incentive to Participating Banks is in the form of Performance Fees, Technical Assistance, Guarantees, or other tailored incentives.

The Phare programme has carried out an evaluation on the effectiveness of this instrument, which concluded that: "... out of all the initiatives designed to assist SMEs, which are supported by the Commission Services it has among the highest potential for success. However, it requires fine-tuning because at present, there are some concerns as regards its sustainability." (EMS, 2003) The instrument appears, therefore, to offer scope for replication in the CARDS countries. Several advantages could be foreseen:

- It would result in a greater level of efficiency and consistency, in that the Facility would be operated through IFIs, rather than being run through the individual EAR offices in the CARDS countries.
- It would result in a great degree of flexibility in the disbursement and funds, in that the SME Finance Facility would apply to all countries in the CARDS system, rather than individual countries, as at present.

- It would enable more effective transfer of good practice in generating greater access to finance for MSMEs, which the region would benefit from, etc.

The Phare SME Finance Facility has three products: a credit window, a leasing window and an equity window. The latter may not be appropriate to develop in the CARDS countries at this point in time since, with the possible exception of Croatia, this window is likely to be underutilised. It may be more effective for such a CARDS SME Finance Facility to deal with credit and leasing (which is beginning to develop in the SEE region) but also include other products which are currently underdeveloped:

- Factoring window.
- Supplier credit window.
- Credit guarantee window (focusing on establishing mutual credit guarantee schemes and provision of technical assistance to help existing and planned state credit guarantee schemes to become less distortionary / more effective).

This revised focus would ensure that the proposed SME Finance Facility reflects the less developed nature of the financial systems in the CARDS countries compared with the Phare countries.

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ANNEX 1

TERMS OF REFERENCE

ANNEX 2

SELECTED ASSISTANCE TO SMEs

Albania

EU

- EU CARDS technical assistance to the Albanian Customs Authorities to improve their customs services, including to the business community. This is not tailored to the specific needs of SMEs, however, the reduction in the number of customs procedures and the resulting increase in customs transparency will impact on the cost of doing business.
- EU CARDS technical assistance to the Standardization and Certification Department, which is the main institution working on these issues in Albania. The project seeks to affect all businesses by improving the business environment.
- EU CARD project (starting in July 2004 for 2 years) to further liberalize trade by strengthening of the rule of law according the international trade regulations, and based on the EU stabilization and association process.
- EU CARD capacity building project focused on the Ministry of Economy, addressing gaps in skills especially with regard to export and investment promotion, including the Directorate of Business Promotion.

USAID

- USAID's strategic priorities are the accelerated development of private enterprise; a more competitive financial sector; and increased environmental management capacity to promote sustained economic growth.
- Private Sector Agriculture Production: development of agricultural products of sufficient quality and quantity to effectively compete in Balkan and other European countries. Financing for agriculture processing and export development will be provided through combinations of trade credit, bank loans and selected guarantees.
- Small and Medium Enterprises: support market rate credit programmes for micro sized firms and increase availability of financing for a wide variety of small sized firms. Technical assistance to develop business planning, management and marketing.
- Legal and Regulatory Framework: land titling and registration systems to support land market transactions and to provide legitimacy to real property collateral. The movable property registration system will further the use of collateral for securing business credits.
- Financial Sector Responsive to Private Sector Credit Needs: the banking sector will be strengthened to gain sufficient liquidity to become a major partner in financing business development. The National Savings Bank will be privatized, improving market discipline in the financial sector.
- Agricultural Processing, Production and Export: export promotion and assistance to improve quality and quantity, especially for export.
- Business and Technical Skills: help provided to the University of Tirana MBA programme; the Association Management Centre to assist agricultural associations and enterprises; supporting Business Assistance Centres (BACs) at four universities throughout Albania.

- Collateral Law: support to develop a computerized real property registry controlled by the Ministry of Finance, to which all banks have access, thus enabling the pledging of movable property as collateral for loans by the banks.
- Laws and Regulations Governing Private Sector Registration: business registration procedures needed to be simplified and non-punitive. Programs assisted start-up businesses to become registered and other businesses operating in the informal sector to understand the advantages and disadvantages of registration.
- Financial Sector Assistance: the brokering of bank finance is a critical activity that links development of private small and medium enterprises with strengthening of the banking sector. The activity assists clients to design sound investment proposals and prepare solid business plans.

Italian Government

- Italian Cooperation (Cooperazione Italiana) has €30 million to support SME development in Albania. This project is expected to be approved in March 2004.

World Bank

- The World Bank intends to start providing support to the Albania government in relation to private sector development, focusing on regulatory reform, institutional reform, etc. A mission is expected in March 2004 to define the type of support to be provided.

SEED

- SEED is co-operating with the Ministry of Economy to assist with the preparation of leasing legislation and the related by-laws.
- SEED Albania is also working with sector business associations, such as the construction industry associations.

Bosnia and Herzegovina

EU

- The EU has strongly supported the development of the SME sector via financial instruments and business support projects throughout BiH. The priorities are:
 - Develop a single economic space (mutual recognition of products, quality, etc.)
 - Create a single business registration system throughout BiH.
 - Remove duplicate licenses, permits and similar authorisation requirements.
 - Implement the Law on Statistics to create a functioning system of statistics with clear lines of responsibility and co-ordination mechanisms.
 - Implementation of the recommendations of the Indirect Tax Policy Commission, including the adoption of the related enabling legislation. Establishment of the Indirect Tax Authority and the new customs authority.
 - Prepare for the introduction of VAT, to ensure that the schedule is kept to.

- Foreign trade promotion and trade policy (single economic space) and framework laws on free movement of goods.
- Establish EC-compatible certification for the export of animal products and a Phytosanitary office to promote exports and enhance standards.
- Vocational Education Training (VET).

Ongoing Projects:

- EU Quick Impact Facilities II (€3 million): is an instrument combining grant funds and technical assistance to support the economic sustainability for refugee return through job creation and local economic development activities. The main activities are technical assistance and grant fund management. The project has been prolonged until August 2004 to complete the monitoring procedures.
- EU Regional Economic Development (€7 million): EURED aims to create a framework for regional development policy in preparation for eventual accession to the EU. Key tasks include: establishment of a BiH Forum on Regional Development; establishment of five supra-RDAs; creation of regional strategies to determine the key regional economic priorities; project development through a €3 million Project Fund; and technical assistance, for example to establish Loan Guarantee Funds, etc.
- Single Economic Space II (€2 million): The project seeks to establish a single economic space consistent with the Community *Acquis* in selected areas of intervention; supporting the development of the necessary State-level institutions, which are necessary for economic integration of BiH in selected areas of intervention. The main activities are the provision of technical assistance in the following three areas: Competition, Consumer Protection and Chapter II of the White Paper - Free Movement and Safety of Industrial Products.
- European Fund Credit Lines for SMEs: the Fund has €15 million, of which €5 million has been disbursed so far.

Pipeline Projects:

- Technical Assistance to establish the Public Procurement Framework – Phase 2 (€2 million).
- Technical assistance for the Economic Policy Planning Unit (€2 million).
- Technical Assistance for the Reform and Modernisation of the Insurance Sector (€1,5 million).
- Implementation of a Comprehensive Framework for Corporate Governance (€2,5 million).
- Trade Development and Implementation of Technical Norms and Standards (€2,5 million).
- Vocational Education and Training (procurement of specialized equipment for VET schools).
- Vocational Education and Training System Reform Consolidation (€1,9 million).
- Support to policy making and co-ordination (€1 million).

World Bank

- The World Bank assists BiH in the task of undertaking and implementing a number of reforms. The key ongoing and pipeline projects are listed below.

Ongoing Projects:

- Business Enabling Environment Structural Adjustment Credit
- Community Development Project

- Local Development Pilot Project
 - Local Initiatives Project II
 - Pilot Emergency Labour Redeployment Project
 - Private Sector Credit Project
 - Privatization Technical Assistance Project
 - Small-Scale Commercial Agriculture Development Project
 - Trade and Transport Facilitation in Southeast Europe Project
- Pipeline Projects:
- Education Restructuring Project
 - Second Employment Support Project
 - Economic Management Structural Adjustment Credit Project

SEED

Services include:

- Enterprise Level Investment Services.
- Capacity Building of Enterprises and Institutions Serving SME Needs.
- Improvement of the Business Enabling Environment.

Sectors of activity:

- Agribusiness, Automotive industry, Construction Materials, Transport, General Manufacturing, Information and Communication Technologies, Medicinal Herbs and Tourism.

EBRD

- The EBRD has been initiated 15 projects focused on restructuring the financial sector, SME and infrastructure reconstruction; and will continue to support projects in these areas. Regarding enterprise development, the EBRD's first priority is to concentrate and intensify its efforts on the development and strengthening of the private sector at all levels in order to build up a track record and create a strong demonstration effect.
- The EBRD works with the authorities to accelerate the privatisation process and seeks to provide support for selected large enterprise privatisations in the form of post-privatisation financing with strategic investors. The EBRD also gives consideration to medium sized locally or regionally based private companies with a clear capacity to be successful in the regional markets, for which long term debt (including smaller size transactions) or equity (through the Bank's Direct Investment Facility) is envisaged. The TAM and multi-donor CEI BAS programmes continue to actively provide assistance to SMEs and local consultancies.

USAID

- Financial Sector Reform: aims to build the banking sector into a viable industry that merits the trust of small and large depositors alike. Activities focus on Bank Supervision, Pledge Registry, Financial Sector Business Advocacy and Training, as well as SME Development Assistance by Strengthening the Financial Sector.

- Private Enterprise Development: programmes focus on expanding access to credit, creating linkages within industries, and helping businesses to become effective lobbying organizations.
- Business Development Program (BDP): provides commercial credit in the form of loans to Bosnian businesses. The programme helps promote economic growth by assisting small and medium-sized private enterprises to expand production, creating employment opportunities, while generating income for families and communities. Loans are given directly to businesses as well as through lines of credit to five Bosnian banks. Additionally, the BDP provides six lines of credit to Bosnian Micro-Credit Organizations targeting socially vulnerable categories such as returning refugees, women and demobilized soldiers.
- Cluster Competitiveness Initiative (CCI): CCI is designed to provide technical assistance to private companies in the wood products and tourism sectors.
- Promoting Investment through Civil Society: While the BiH business community is eager to participate in the reform process, its institutions remain ill-equipped. The Centre for International Private Enterprise is developing the investment environment in BiH through strengthening of the business community.
- Linking Agricultural Markets and Producers and Processors, and World Learning Star Network, which technical assistance to the Women's Economic Network, a countrywide programme for women's economic empowerment.
- Private Sector Accounting: assistance for the accounting and auditing professions to upgrade their capabilities to European standards in preparation for integration with the European Union.
- Fostering an Investor-Friendly Legal Environment: the project deals with a number of pressing initiatives that are instrumental in removing barriers to an effective economic environment.
- Reducing Corruption by Enhancing Supreme Audit Agency Capacity: working with the Organization for Security and Cooperation in Europe (OSCE), this activity aims to reduce corruption by:
 - Performing financial reviews of selected strategic enterprises.
 - Strengthening the audit capacity of Entity Supreme Audit Institutions to audit government-owned enterprises.
 - Accelerating privatization of government-owned utility companies.

SIDA

- Sweden's development strategy for BiH involves about €30 million worth of annual support for integration with European structures and implementation of the PRSP development plan.

DFID

- DFID's principle objective is to increase the capacity of government, civil society and the private sector to achieve transition in accordance with the Dayton Peace Accords. To date DFID has funded a wide range of projects focusing on health and social policy reform, small business regeneration, media development, management training, privatisation and support for good government and civil society.
- The key elements of DFID's support for BiH are as follows:

- Privatisation and Capital Market Development (through the Post Privatisation Enterprise Restructuring Project).
- Promoting Foreign Trade and Investment.
- Trade Policy Support.
- Institutional Support to the RS Central Government.
- Support to the Ministry of Foreign and Economic Affairs in the RS.
- Small Grants Scheme.

Croatia

EU

- Regarding the SME sector in Croatia, the EC has indirectly supported key economic reforms leading to better functioning markets (such as improving investment climate, removing regulatory barriers, registration of property, etc.).
- EU CARDS Programme co-finances with the World Bank a 5 year project (2003-2008) on Real Property and Cadastre Registers Reform with total funding of €5 million.
- EC has supported several initiatives that have contributed to the quality of institutional support and business environment for the development and growth of this sector, especially in the war affected areas. One of the major initiatives that the EC supported was the operation of Local Economic Development Agencies (LEDA), together with the UNDP, with the fund worth about €5 million.
- To stimulate SME development in war affected areas, three new EU Guarantee Funds were established in 2002 jointly with the Croatian banking system totalling €3.2 million. The focus was on supporting SME development in Dalmatia, Banovina and West Slavonia.
- The EC is planning about €14 million worth of support for the economic reforms in Croatia in 2004. The focus will be on regional development, especially in the war affected areas.

World Bank

- The World Bank provides indirect support to SMEs. An example is the “Learning Innovation Loan” (LIL), which was a programme to encourage investments in IT and in other key growth sectors, including dealing with the legal environment for SMEs.
- There are also projects affecting the whole economy, but which have a particular impact on enterprise development. An example is that “Real Property Registration and Cadastre Reform Project 2003-2008”, co-financed by CARDS and SIDA. The total value of the project is \$37.2 million and aims to build an efficient land administration system with the purpose of contributing to the development of efficient property markets.
- The WB technical assistance loan (SAL) to the Croatia supports projects that strengthen the regulatory and institutional framework for market competition, such as strengthening the authorities and capacities of the Agency for Protection of Market Competition, the Croatian Securities Commission, State Statistical Bureau and Bank Rehabilitation Agency.

- Examples of projects dealing directly with the institutional environment for SME, two studies support included the Early Warning System (2003) and the FIAS Administrative Barriers to Foreign Investment in Croatia (2002).
- During 2005-2006, the World Bank will focus on: a) Structural Adjustment Loan leading to policies and measures that promote private sector development, in particular through SMEs; b) Projects that assist export oriented SMEs; c) assist science and technology oriented SMEs by promoting the development of the knowledge based economy in Croatia.

IFC

- The International Financial Corporation (IFC) focuses its support for rebuilding and modernization of war damaged manufacturing utilities in the cement, paper and pulp sectors, as well as term financing and equity for small and medium-size enterprises.
- The IFC has also financed SME appraisal technical assistance. IFC has approved \$100,000 to improve lending techniques to SMEs by Bjelovarska Banka. The full \$100,000 will be used to support SME credit lines delivered via local commercial banks.
- The IFC has provided \$US 5 million to Alpe-Adria Banka in Split, \$US 15 million to Erste Bank and \$US 3 million to Bilovska Banka for on-lending to SMEs and households.

EBRD

- European Bank for Reconstruction and Development (EBRD) has been active in SME credit matters via commercial on-lending since 1995.
- The EBRD has taken equity (€4.6 million) in Bank Austria Creditanstalt Croatia, for the expansion of corporate lending to local and international SMEs, and thus indirectly has been providing further credit to the SME sector via this bank.
- The EBRD is providing other SME support via its participation in the “Turn Around Management” (TAM) and ‘Business Advisory Services’ (BAS) programme in Croatia under which 132 individual advisory service was performed so far with total worth of €1 million.
- The Bank continues to provide longer term funding and institutional building to banks for both SMEs and retail/mortgage sector on lending, and also supporting the development of non-bank institutions such as leasing and insurance companies.
- The EBRD has so far arranged 15 SME credit lines to local banks for on-lending for the total amount of €180 million, which have enabled to finance 421 individual SME investment projects.
- The EBRD strategy for the activities in Croatia focuses on the two priority areas in the enterprise sector: a) reaching the small enterprises through credit via local banks, and b) promoting the new green-field investment opportunities and FDI inflows. Within that the special focus is on restructuring of tourism enterprises and agribusiness. The EBRD also supports the regional expansion of the Croatian companies by funding acquisitions and mergers and making equity investments in expanding companies.

USAID

- USAID launched a 5-year plan for Croatia (2001-2005) with special emphasis on economic reforms: private sector development through privatization, competition, public sector reform and SME development through training and education and through stimulating SME investment projects.
- The Croatian Enterprise Promotion Activity (CEPA) is a 3 year project worth \$7 million implemented by Deloitte Touche Thomatsu. It provides business development services to enterprises of all sizes, with emphasis on SMEs, through an independent network of trained and certified consultants operating on a fee basis.
- Future priorities in the SME sector include direct assistance to create 20,000 registered jobs in the next 4 years by establishing 1,000 new enterprises per year in the manufacturing, tourism and agriculture (private farms) sectors.

UN

- UNDP and UNOPS implemented and co-financed with the EC the programme of creation of Local Economic Development Agencies (LEDAs) as an important support structures for economic development of war affected areas. Six LEDAs were created and are operational. Phase I concerned small loans via local banks (max. \$ US 7.000) to families. The loans were based on the membership system and the UNDP guaranteed up to 50% of the loans. EU funds (€3.2 million) helped to expand and consolidate this programme. Under Phase II small credits were provided to SMEs, with an initial ceiling of €25,000.
- UNDP will continue to support the development of regional counties in the war affected areas and economically depressed regions, with a special focus on small municipality financing, funding for which has also been allocated under the regional CARDS programme.
- In 2003 the UNDP has supported a formation of association of 12 farmers-organic food producers called Eko-Dalmacija in Sibensko-kninska County, as an effort to support employment through small farming in this economically depressed region with extremely high unemployment levels.

Macedonia

EU

- Technical assistance for banking sector reform: create transparent capital market, establish a framework for lending and investment and internationally accepted accounting practices.
- Technical assistance to draft a new Trade Law: the new law should comply with Stabilization and Association agreement, as well as the WTO requirements. Simplification of company registration, central register, arbitration law, etc. Definitions for micro, small and medium-sized enterprises to be close to the new EU definition.

- Establish a Human Resource Development Fund: identify institutions for HR management selection and training of Macedonian consultants, selection of 40 SMEs to benefit from the project training courses, etc.
- Establish Euro Info Correspondence Centres: Technical assistance for establishing EICCs in the CoC.
- Policy advice to MoE: enhance the capacity of the MoE to adopt and implement the European Charter for SMEs (Lisbon Declaration 2000).
- Policy support to the MoE: to enhance its capacity to recommend and develop policies, programmes and mechanisms that will improve the current environment. To establish the Agency for Entrepreneurship Promotion.
- Vocational education and training (VET): curricula development and establishment of regional VET centres, training for VET teachers, lifelong learning system and equipment for VET schools.
- Development of Standardization, Metrology, Accreditation and Quality Validation (SMAQVa) institutes, as in EU.
- Technical assistance for Intellectual Property Rights (IPR) protection: Technical assistance for the IPR Protection Office. Installation of World Patent Organisation software is an ongoing activity.

World Bank

- Support for SMEs: new credit lines for SMEs provided through the ProCredit Bank.
- Improvement in the regulatory environment for SMEs: through the development of a new banking law and new collateral law.
- Legislative & regulatory environment for SMEs: support for the leasing law.
- Support for the Pledge Registry.

SEED

- This is a multi-donor initiative to strengthen SMEs in FYR Macedonia and the wider Balkans region by providing training for entrepreneurs and consultants; as well as improving the general business environment. The project may be extended beyond 2004.

GTZ

- Private Sector Promotion: The project involves integration of Macedonian companies in EU markets, as well as support of several NGOs and professional organizations. Assistance to Government to improve the environment for the private sector development.
- Regional development programme for eastern Macedonia: the project is being prepared and will support local authorities in East Macedonia (Shtip, Kocani, Vinica, etc).
- Technology Transfer Centres: this project sought to establish TTCs and assist them to provide technology consulting services for SMEs willing to improve the competitiveness by adopting new technologies.
- Modernization of the Macedonian agro and food sector: strengthen the sector and increase competitiveness by establishing standards for food production.

- Revolving Credit Fund: supported by the German Government (50%) and the Government of R. Macedonia (50%) through 10 other Macedonian banks.

USAID

- Macedonian Competitiveness Activity: aims to help Macedonian enterprises to become more competitive and to export more sophisticated products and services by building industrial clusters. Five industrial clusters have been chosen with the support of MCA.
- The Macedonian Financial Sector Project actively prepares laws for the financial sector, focusing on the Central Bank, other the financial institutions, accounting market, securities market, pension fund and retirement schemes, insurance, securities, FDI, etc.
- Credit Fund “Moznosti” was established in 1996 and focuses on providing loans for start-ups (small manufacturing firms, services, agro firms, trading firms, physical persons). The project has now been closed, however, “Moznosti” will continue operating as a Saving House.
- FULM is credit union which is owned by its members. It is managed by World Council of Credit Unions and USAID. It offers its members loans for: agriculture, production, trading etc.

Serbia (Serbia and Montenegro)

EU

- CARDS 2001 (€3.6 million): SME policy and strategy assistance to the Ministry of Economy and Privatisation and the Republic SME Development Agency; and the establishment of 7 regional enterprise development centres (and 10 sub-centres) in co-operation with local stakeholders.
- CARDS 2001 (€0.45 million): Funding the establishment of an European Info Correspondence Centre located in the Belgrade Chamber of Commerce
- CARDS 2003 (€1.5 million): Pre- and post-privatization restructuring and development of SMEs to be implemented through the EBRD’s Turn around Management (TAM) team.
- CARDS 2001 and 2002 (€15 million): contribution to the SME credit facility (Revolving Credit Fund)
- CARDS 2002 (€5 million): contribution to the European Fund for Serbia micro-enterprise credit facility
- CARDS 2001 and 2002 (€2 million): TA to select Revolving Credit Fund partner banks and Fund Management Unit
- CARDS 2003 (€2.5 million): export development programme with SIEPA as the main project partner
- CARDS 2004 (€4 million): contribution to provision of medium to long term financial resources to production oriented SMEs (TA for credit facility management).
- CARDS 2004 (€4.5 million): reinforce the institutional infrastructure for investment promotion, promote the country as a highly competitive investment location, stimulate the supply of “greenfield” investment sites and enable Serbian SMEs to become approved suppliers of foreign investors.

- CARDS 2004 (€4.5 million): Policy development in line with the EC Small Enterprise Charter to improve the capacity and effectiveness of the SME support structures to improve quality business development services, reinforce the institutional framework for innovation and stimulate an increase in the numbers of start-ups.

World Bank

- World Bank assistance in fostering economic growth by supporting private sector development focuses on: developing comprehensive property registration and cadastre systems; improving the efficiency of the economy through restructuring of state owned companies; restoring confidence in the banking sector; supporting improvements in the legal framework of the financial sector; improving the supervisory work of the National Bank; reducing barriers to trade and the establishment of new businesses; improving infrastructure and energy supply; and protecting the environment.
- The Second Structural Adjustment project aims to achieve the structural reforms necessary to lay the foundation for enduring growth and macroeconomic stability (US\$ 70 million).
- The Real Estate Cadastre and Registration project aims to build a more efficient real property registration and cadastre systems, with the purpose of contributing to the development of efficient real property markets. Project preparation is under way (US\$ 11 million).

EBRD

- Belgrade to Novi Sad Motorway Project: Rehabilitation and upgrading to motorway standard of a 65 km section of road from Belgrade to Novi Sad and construction of a bridge across the Danube, together with support for the transformation of the Serbian Roads Directorate to a Public Enterprise.
- EBRD: SME Credit Facility (€50 million) being prepared.

USAID

- Serbian Enterprise Development Project: is a three-year initiative to strengthen the competitiveness of Serbian enterprises and, in doing so, to stimulate economic growth, promote job creation, and improve general prosperity. It focuses on the following key components:
 - Providing technical assistance to enterprises to increase exports.
 - Developing industry “clusters” for sustainable competitive advantage.
 - Promoting foreign direct investment.
 - Providing targeted financial support via matching grants programme.
 - Building an institutional & legal environment promoting competitiveness.
 - Increasing public awareness / commitment to greater competitiveness.
- Economic Policy for Economic Efficiency: is designed to deepen and institutionalise Serbia’s economic restructuring and reform process by providing assistance in two interrelated issues/areas:
 - Commercial law and judicial reform: establishing and enforcing the rule of law in commercial transactions, thereby creating the incentives for legitimate market behaviour.

- Expand USAID's involvement into the following areas: economic policy formulation and implementation, accounting reform which is related to disclosure, transparency and therefore anti-crime/corruption, public education and information dissemination, government communications, and support for public procurement reform.
- Enterprise Restructuring & Privatization: working in close co-operation with the Privatization Agency, USAID has assisted the restructuring of Zorka Sabac, a complex holding comprising 22 subsidiary companies. USAID has also assisted in preparing seven textiles companies for auction. USAID undertakes this enterprise restructuring effort in co-operation with the World Bank, the European Union and the Department for International.

Other Donor Assistance

- GTZ, Swiss Development Corporation and SEED: business development services.
- USAID, GTZ, EBRD and World Bank: support to the legal and regulatory framework.
- GTZ: support for business linkages.
- World Bank: Export Credit Agency to provide export credit insurance, working capital loans and guarantees, export performance insurance, etc.
- MIGA: Capacity building programme for SIEPA's investment promotion capabilities.
- SIDA: FDI advisor within the Ministry of International Economic Relations on policy and strategy development.
- Hellas Fund: grant worth €7.2 million for technology parks along Corridor 10.
- USAID: Opportunity International micro credit facility.
- Italian government: SME credit line (€30-€35 million) being prepared.
- EIB: Global loan facility (€20 million, rising to €60 million).

Montenegro (Serbia and Montenegro)

EU

- Continuation of Turn around Management (TAM) and the Business Advisory Service (BAS) programme in co-operation with SMEDA.
- Programme of continuous education on business issues. Possible programmes in co-operation with schools.
- Easing access to credit for SMEs; possible formation of a guarantee fund.
- Technical assistance in implementing the agenda of economic reforms in Montenegro through hiring consultant to work with responsible government body.
- Investment promotion activities.
- Export promotion schemes.
- Activities in the privatization process through hiring consultant in privatization of the big state companies.

World Bank

- Restoring macroeconomic stability: by strengthening budget planning and execution, and improving public expenditure management and financial accountability.
- Fostering economic growth: by supporting private sector development; helping the development and modernization of comprehensive property registration and cadastre systems; improving the efficiency of the economy through restructuring of state owned companies; restoring confidence in the banking sector; supporting improvements in the legal framework of the financial sector; improving the supervisory work of the National Bank; reducing barriers to trade and the establishment of new businesses; improving infrastructure and energy supply; and protecting the environment.
- Improving the well being of the most vulnerable and building human capital: through reforms in education and health, as well as by promoting efficient social protection systems.
- Improving governance and building effective institutions: by increasing the transparency of government spending; strengthening accountability; and building the capacity of the judicial system.
- Second Structural Adjustment Loan: The objective is to support key reforms. Although the project is still being identified, it is expected that the reforms will focus on promotion of economic growth and the consolidation of fiscal sustainability and are likely to be concentrated in the areas of private and financial sector development, the energy sector, pensions and health care.

USAID

- The economic policy reform programme encompasses activities in relation to: Treasury and Pension Reform, Business Regulation & Capital Market Development, Payments System Reform, Privatization and Credit for Micro, Small and Medium Sized Enterprise.
- The industrial restructuring and SME development programme: provides assistance to industries and firms that are in need of restructuring through the Firm Level Assistance Group (FLAG).
- Strengthening the role of private enterprise: is a five-year project to promote private enterprise through determining the needs of businesses in Montenegro, developing and delivering business education programs to entrepreneurs, providing business consulting services to smaller businesses and strengthening advocacy for reforms that improve the business environment through a national alliance, the Montenegro Business Alliance.
- Economic research and advocacy for policy change: seeks to improve the quality of economic research and information in Montenegro, and to strengthen private sector advocacy.

GTZ

- Assistance to small and medium-sized enterprises to raise their competitiveness in the fields of wooden furniture manufacturing, meat processing, textile processing and mushrooms, berries, medicinal plants and herbs and spices.

- Assistance to the Montenegrin government in improving the business environment.
- Improvement of conditions for business start-ups.
- Introduction of training courses for the benefit of SMEs.

Kosovo

EU

- Institutional support to the Ministry of Trade and Industry (MTI): This €2.5 million project provides institutional capacity building support to MTI to support the development and implementation of policies, regulatory frameworks and pilot actions in a number of priority areas, including the development of an enabling environment for foreign and local investment, the economic development of disadvantaged geographical areas with high unemployment, and the development of suitable industrial space. Complementary technical support and training may also be provided to local professional institutions to support the successful implementation of the MTI's policy actions and regulations.
- Economic and other stabilisation initiatives for minority communities and return areas: This €4 million project aims to assist the integration of minority communities into mainstream economic development and to improve the conditions for sustainable returns. The project will provide a mix of business advisory services, training, credit and grants to assist disadvantaged minority communities to build sustainable livelihoods. The project expands the geographical coverage of the community stabilisation and economic development projects within the EC 2002 annual programme, particularly to those areas where there is a high potential for returns. Advisory and support services for the rural economy: this €2.2 million project aims to support the development of the rural economy and to improve food security through the strengthening of advisory support services to farmers and agri-business enterprises. Assistance will be provided to the MAFRD for the development of a comprehensive strategy on advisory support services. Training will be provided to improve the capacities of municipal agricultural/rural community advisors as well as producer organisations. The training capacity of the Agriculture Institute at Pec/Peja will also be strengthened. A small number of pilot demonstration projects for the dissemination of best-practice approaches for agriculture and non-farm rural enterprises will also be facilitated.
- Further development of Kosovo's irrigation system: this €2.2 million project will support institutional capacity building measures for the effective management and sustainability of Kosovo's irrigation system, and thereby consolidate previous EC investments that focused on rehabilitating the irrigation infrastructure. Actions will include support for the transformation of publicly owned irrigation water providers into self-sustainable enterprises, the strengthening of water user associations, and the improvement of the operation and maintenance management of the irrigation system. The key projects partners will be the Kosovo Trust Agency and the MAFRD.
- Further support for seed regulatory services: this €0.6 million project will further build the regulatory, supervision and quality assurance capacity of the MAFRD

and agriculture institutes to support the production, distribution and marketing of seed / planting materials to EU standards.

USAID

- **Kosovo Business Support:** Kosovo Business Support (KBS) programme aims to improve Kosovo's economy and revitalize the small and medium-size enterprise (SME) sector by stimulating employment and increasing investment through training, one-on-one consulting, marketing assistance, and creating linkages between Kosovar and foreign companies.
- **Kosovo Business Finance Fund:** In 2001, USAID opened the American Bank of Kosovo, (ABK) to provide a full range of banking services including deposits and international and domestic payments services. The bank's majority shareholder is a Kosovar foundation, the Kosovo Business Finance Fund, which has been providing credit to small and medium sized Kosovar enterprises since June 2001.
- **"Micro" Loans to Individuals and Small Groups:** USAID has created "village bank" micro-lending operations under the technical expertise of the Foundation for International Community Assistance (FINCA). FINCA's lending programme allows individuals and households to jumpstart income earning activities by providing loans to micro- and small and medium enterprises, along with training in basic business principles, loan repayment, and management techniques to the loan recipients.
- **Revitalizing Agriculture and Agribusiness:** Through the International Fertilizer Development Centre (IFDC), USAID is organizing a private sector network to help create agricultural commercialization networks on a sustainable basis. USAID is providing business development support designed to improve the operation of key agricultural input supply markets and improve investment and operating efficiency in selected agri-enterprises. This support is channelled through formalized associations of input dealers, poultry producers, feed processors, wheat millers, vegetable processors, and seed producers.
- **Provisional Institutions of Self Governance (PISG):** USAID provides technical assistance to elected municipal governments and the Provisional Institutions of Self Governance (PISG). USAID is assisting the PISG in institutionalizing stable macroeconomic policies and the formulation and full implementation of a market-friendly economic policy framework. Assistance covers financial sector regulation and restructuring, fiscal and tax affairs, commercial law, and private sector development, including privatization.
- **Riinvest:** In an effort to broaden Kosovar participation in economic reform, USAID supports "RIINVEST," an indigenous economic think tank that promotes policy dialogue on privatization and fiscal and economic reforms with donors, business leaders, political leaders, academics, and the media.

World Bank

- Under the Bank's first Transitional Support Strategy (TSS 1999-2001) the Trust Fund for Kosovo (TFK) of US\$60 million was committed in full to twelve projects, in addition to two post-conflict grants of US\$2 million each. More than 70 percent of the funds have been disbursed as of July 1, 2002. Through these projects, the Bank has played an important role in:

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- Assisting institution building and economic reforms, and critical budget support.
 - Promoting private sector development.
 - Contributing to the restarting of agriculture and strengthening the income generation capacity of vulnerable rural families.
 - Financing small infrastructure rehabilitation investments based on community initiative in conflict-affected areas.
 - The Bank's resources have been complemented by project co-financing amounting to US\$62 million. Under the Bank's second Transitional Support Strategy (TSS 2002-2003) the Board has approved a management proposal to provide up to US\$15 million of grants to the United Nations Interim Administration Mission in Kosovo (UNMIK). This will allow the continuation of World Bank assistance to Kosovo, with its main focus on poverty alleviation, following the recommendations of the Bank's poverty assessment report for Kosovo completed in December of 2001.
 - As part of the new programme, the Bank will finance the continuation of the successful Community Development Fund Project (US\$4 million), and a new Education Project (US\$4.5 million) aimed at increasing enrolment rates in primary and secondary education, and at enhancing access to education by girls and other vulnerable groups.
 - The Bank will also continue to provide direct fiscal support through the Economic Assistance Grant IV (US\$5 million) and to assist the authorities in the preparation of a sustainable budget framework, as well as monitoring its implementation. A small grant will be allocated to a Second Energy Sector Technical Assistance Project (US\$1.5 million).