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Signed:.....



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ABSTRACT

Background:

Phare support to SME development has mainly consisted of technical assistance and advisory services to national institutions, support to SME policy and legislative development and financial support for SME development. Progress has been made in tackling problems inherited from the past, as well as in developing a favourable environment for the creation of new companies. However, formation and survival rates of SME are still well below the EU average and as such there are a number of challenges to be faced at both the enterprise and government levels.

The Present Status of SME Development within the Candidate Countries:

Each Candidate Country has a ministry responsible for the implementation of an SME development strategy, but this responsibility is often shared with other ministries. The absence of clear lines of accountability increases the risk of poor co-ordination and over-lapping responsibilities, multiple implementation platforms and low administrative efficiency. SME strategy is still not well embedded in regional development strategy, and broad economic and social policies are often not supportive of effective SME development. Institutions supporting SME suffer from overlapping responsibilities and an unclear division of tasks. Providers are generally not part of a national network, and assist SME in isolation from existing national strategies. The development of *one-stop shops*, capable of assisting SMEs is urgently needed.

The administrative framework facing SMEs is often incoherent as well as excessively complex and constitutes a major barrier to the development of the sector. In addition, compliance with new regulation is costly and difficult because of the volume of laws being passed or amended. Access to finance is another key factor affecting the development of the SME sector, and there are numerous non-banking and subsidised loan schemes. However, the level of demand means that only a very small proportion of SME actually benefit from these facilities.

Effects of Phare Funding on the SME Sector:

Overall, the most significant effects of the Phare assistance to the SME sector have been found in Poland, particularly in terms of the promotion of entrepreneurship at the regional and local levels, enhancement of competitiveness and internationalisation of SME and the enhancement of co-ordination of existing support structures. Positive effects have also been noted in Slovakia and, to a lesser extent, in Estonia, Hungary and in the Czech Republic; with only limited effects in Bulgaria, Latvia, Lithuania and Romania. Phare assistance in Slovenia has had no significant effects and, has actually had a negative effect in terms of the enhancement of co-ordination between existing facilities. The variation in the effectiveness of Phare funding to the SME sector between Candidate Countries is largely a result of the different administrative and regulatory frameworks in place and the differing success of Phare in helping to develop support mechanisms, which suit national SME needs.

Recommendations:

A large number of recommendations have been made, both at an overall planning level and at country level. These cover measures to address completion of structural reforms; benchmarking at a national level; multi-annual development strategies; coherent national business support systems; more supportive legal and regulatory frameworks; encouragement of innovation aimed at raising international competitiveness; better access to finance through non-banking financial and guarantee schemes; mobilisation of future Structural Funds; and human resource development to address entrepreneurial skills.

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GLOSSARY OF ACRONYMS

| | |
|--------|---|
| ASME | (Bulgarian) Agency for Small and Medium Sized Enterprises |
| BAC | Business Advisory Centre |
| BARDA | Bulgarian Association of Regional Development Agencies and Business Centres |
| BDA | Business Development Agency |
| BEST | Business Environment Simplification Task Force Initiative |
| BIC | Business Innovation Centre |
| CBC | Cross Border Co-operation (Programme) |
| CC | Candidate Countries |
| CD | Consultation Document |
| CEA | Czech Energy Agency |
| CEEC | Central and East European Country(ies) |
| CI | CzechInvest |
| CoC | Chamber of Commerce |
| COP | Country Operational Programme |
| CIA | Czech Institute for Accreditation |
| COSMT | Czech Office for Standards, Metrology and Testing |
| CRD | Centre for Regional Development |
| DG | Directorate General |
| DIS | Decentralised Implementation System |
| EBIT | Earnings before Interest and Tax |
| EBRD | European Bank for Reconstruction and Development |
| EC | European Commission |
| ECIS | Energy Consultation and Information Centre |
| EEC | European Economic Community |
| EIA | Environmental Impact Assessment, Act No. 244/1992 (Environmental Impact Assessment Act) |
| EIB | European Investment Bank |
| EIC | Euro Info Centres |
| EMAS | Environmental Management and Audit |
| EN | European Norms |
| EU | European Union |
| EURADA | European Association of Development Agencies |
| FDI | Foreign Direct Investment |
| FM | Financing Memorandum (a) |
| FSU | Former Soviet Union |
| GDP | Gross Domestic Product |
| GF | Guarantee Funds |
| HRD | Human Resource Development |
| IFI | International Financial Institution(s) |
| IMF | International Monetary Fund |
| ISO | International Organisation for Standardisation |
| ISPA | Instrument for Structural Policies for Pre-accession |
| IT | Information Technology |
| ITDH | Hungarian Investment and Trade Development Agency |
| JEV | Joint European Venture Programme |

| | |
|----------------|--|
| KfW | Kreditanstalt für Wiederaufbau |
| KREDIT, REGION | Development programmes for SME |
| LBAC | Local Business Advisory Centre |
| M&A | Monitoring and Assessment |
| MARD | Ministry of Agriculture and Regional Development |
| MCRD | Ministry of Construction and Regional Development |
| MDP | Ministry of Development and Prognosis |
| MEA | Ministry of Economic Affairs |
| MEYS | Ministry of Education, Youth and Sports |
| M€ | Ms of € |
| MF | Ministry of Finance |
| MFA | Ministry of Foreign Affairs |
| MIMMC | (Romanian) Ministry for Small and Medium Sized Enterprises and Co-operatives |
| MIP | Multi-annual Indicative Programme |
| MIS | Management Information Systems |
| MIT | Ministry of Industry and Trade |
| MNE | Multi-National Enterprise |
| MoE | Ministry of Economy |
| MoERD | Ministry of Economic Relations and Development |
| MPSV | Ministry of Labour and Social Affairs |
| MRD | Ministry for Regional Development |
| MSE | Micro and Small Enterprises |
| MSKK | Ms of Slovak Crowns |
| MU | Monitoring Unit |
| NAC | National Aid Co-ordinator |
| NACE | Classification of Economic Activities |
| NADSME | National Agency for the Development of SME |
| NEF | National Educational Fund |
| NDP | National Development Plan |
| NGO | Non-Governmental Organisation |
| NPAA | National Programme for the Adoption of the Acquis |
| NPC/MC - ESC | National Programming and Monitoring Committee for Economic and Social Cohesion |
| NEDP | (Bulgarian) National Economic Development Plan |
| NPF | National Property Fund |
| NPPA | National Plan for Preparation for Accession (CZ) |
| NSI | (Bulgarian) National Statistical Institute |
| NUTS | Nomenclature of Statistical Territorial Units |
| OECD | Organisation for Economic Co-operation and Development |
| PAO | Programme Authorising Officer |
| PFI | Participating Financial Institutions |
| PIU | Programme Implementation Unit |
| PMU | Programme Management Unit |
| PPS | Purchasing Power Standard |
| QMS | Quality Management System |
| R&D | Research and Development |
| RAIC | Regional Advisory Information Centre |

| | |
|---------------|---|
| RBDC | Regional Business Development Centre |
| RDA | Regional Development Association |
| RDB | Regional Development Board |
| RIC | Regional Information Centre |
| ROP | Regional Operational Programme |
| SAPARD | Special Accession Programme for Agriculture and Rural Development |
| SBDC | Small Business Development Centre |
| SBDF | Small Business Development Fund |
| SF | Structural Funds |
| SME | Small and Medium-sized Enterprise(s) |
| SMMC | Sectoral Management and Monitoring Committee |
| SOP | Sectoral Operational Programme |
| SP | Strategic Plan |
| SPP | Special Preparatory Programme |
| SWOT | Strengths, Weaknesses, Opportunities and Threats Analysis |
| SZRB | Slovak Guarantee and Development Bank |
| TA | Technical Assistance |
| TA | Tangible Assets |
| TECHNOS, PARK | Programmes for SME |
| ToR | Terms of Reference |
| TPO | Trade Promotion Organisation |
| TPO - ICEP | Programme for the modernisation of the Portuguese economy |
| TQM | Total Quality Management |
| UNDP | United Nations Development Programme |
| UNIDO | United Nations Industrial Development Organisation |
| USAID | United States Agency for International Development |
| USD | United States Dollars |
| VAT | Value-added Tax |
| WP | Work Programme |
| WTO | World Trade Organisation |

EXECUTIVE SUMMARY

The principal objective of this Report is to identify lessons and make recommendations for the design of future SME programmes, based on a desk analysis of the conclusions and findings of Phare Programme Monitoring and Assessment Reports, Country Assessment Reviews, other monitoring data and strategic planning documents produced within the Candidate countries, and interviews with key stakeholders.

Background

Since the beginning of the transition process towards democracy and the market economy in the Candidate countries, the EU has attached great importance to effective SME development. Progress has been made by the Candidate countries in tackling the problems inherited from the past, as well as in developing a favourable environment for the creation of new and innovative companies able to withstand the competitive pressures of the single market. However, the formation and survival rate of SME in the Candidate countries, and their degree of internationalisation, are still well below the EU average, and more progress is needed to increase their international competitiveness in order to cope with an enlarged Internal Market.

The EU has supported SME development in all ten Candidate countries through the Phare Programme since its commencement, mainly through provision of technical assistance and advisory services to national institutions, support to SME policy and legislative development and financial support for SME start-up and development. The BEST exercise carried out by DG Enterprise is an important tool for the transfer of Best practices. SME development will also be a key priority for the utilisation of Structural Funds, and it is essential that the Candidate countries develop effective mechanisms for their implementation as a crucial tool to ensure vital economic and social cohesion.

The present status of SME development within the Candidate countries

Analysing the development of the SME sector at the macro level was difficult due to the general lack of adequate statistical data. This is partially explained by the recently established and fast-growing nature of the SME sector, for which the National Statistical Offices have not yet introduced a suitable methodology, collected data or established a trend able to take in consideration also the size of the *grey economy*, so relevant in a significant number of Candidate Countries.

From a benchmarking point of view, an important indicator is the number of active SME per 1,000 inhabitants. Poland and Slovenia are the only countries well aligned with the average data for the 15 EU Member States. The other countries either exceed this average (the Czech Republic, Hungary and Slovakia), or are dramatically below it (Bulgaria, Estonia, Latvia, Lithuania and Romania). Data on the share of exports confirms the importance of the relationship between population and exports, with the Estonian SME sector clearly focusing on exporting whilst the remaining countries lag behind. Overall, the share of local added value linked with the export activities of the CC remains very low and a narrow number of multinationals companies is controlling the largest share of export leaving to local companies (and, more specifically, to the local SME) only a very small share of export. With the exception of Estonia and Latvia, the SME share of total employment is below the EU average, and there is a continuing need to support the sector as an instrument of job creation, in the context of strategies aimed at achieving sustainable social cohesion. The overall picture is one of a sector still evolving, and requiring further support, particularly as far as the upgrading of

the existing SME - in terms of management, manufacturing and commercialisation - is concerned.

At policy level, each Candidate country government has identified a ministry responsible for the implementation of an SME development strategy, but, with the exception of Slovenia, this responsibility is shared with other ministries, typically national ministries for regional development, which also bear some responsibilities for the SME sector. This absence of clear lines of accountability increases the risk of poor co-ordination and over-lapping responsibilities, multiple implementation platforms and low administrative efficiency. All Candidate countries have produced National Development Plans. Generally, the impression is that on-going SME strategy is still not well embedded in regional development strategy, and that the Candidate countries' broad economic and social policies are only partially supportive of, or incidental to, effective SME development.

Compliance with new regulation is costly and difficult because of the volume of laws being passed or amended. The successful development and upgrading of small businesses requires a predictable environment but this is missing in the Candidate countries. A number of changes to the existing regulatory framework have been implemented without a specific *ex-ante* analysis of their likely impact on the SME sector. Governments have, for different purposes, identified the main administrative and legal burdens affecting SME development; but this has not generally been translated into well-defined and prioritised action plans to implement the necessary changes.

Access to finance is a key factor affecting the development, upgrading and performance of SME, and most Candidate country governments have defined a wide range of non-banking and subsidised loan schemes to support the temporary financial weakness of the sector. These schemes have been effective in supporting SME but demand is strong, and consequently, only a very small proportion of SME can benefit from these facilities. Poland has developed the most complete network of institutions supporting SME, with regional funds, a credit guarantee fund, micro-funds, etc. The commercial banks are not always the best agents to overcome the lack of financial support, so Governments are supporting establishment of non-banking and subsidised loan and guarantee schemes. Phare has also provided a multi-country SME Facility, managed by the EBRD, KfW/CEB and EIB whereby Phare committed 161 MEUR (end of 2001), and the EBRD 450 MEUR, the CEB/KfW 263 MEUR and EIB expected to contribute for 30 MEUR. However, it alone is unlikely to ease the access to credit for micro and small enterprises, still considered extremely risky by the banking system, and policy orientation will need to move towards innovative financial schemes to ensure improved access.

Institutions supporting SME suffer from overlapping responsibilities and an unclear division of tasks. The range of services is generally not divided between the needs of micro, small and medium enterprises under start-up, embryonic or development stages. With the exception of Poland and to some extent Slovenia, the providers in most Candidate countries are not part of a national network, and assist SME in isolation from existing national strategies. The development of one-stop SME shops, capable of providing information regarding all of the services available, as well as all of the rules and regulations relevant at national level, is urgently needed.

As regards readiness for the utilisation of Structural Funds, much remains to be done, integrated approaches have not been developed, and there are as yet no agencies capable of performing the Managing Authority role in the Candidate countries.

There are a number of common challenges to be faced by the SME sector, both at enterprise level and at the level of government. At enterprise level, they include the ability to face single market competitive pressures; upgrade managerial and entrepreneurial skills; form effective integrated supply chains; lobby government effectively; adjust to rapid legal changes; find credit and access high quality support services. At government level, the challenges will be: the completion of structural reforms and enterprise restructuring; the promotion of enterprise upgrading to boost international competitiveness and to effectively support the creation of a dynamic SME sector; the organisation and implementation of systematic international benchmarking to learn from more advanced countries; using the sector to boost economic and social cohesion; providing a rational, well co-ordinated and supportive institutional framework and business support system; boosting start-up rates; encouraging innovation as a tool of competitiveness; mobilising structural funds effectively; and eliminating national and regional differences in skill levels.

The contribution of Phare to SME Development

Overall, the most significant effects of the Phare assistance to the SME sector have been found in Poland. Positive effects have also been noted in Slovakia and, to a lesser extent, in Estonia, Hungary and in the Czech Republic; with only limited effects in Bulgaria, Latvia, Lithuania and Romania. Phare assistance in Slovenia has had no significant effects and, as far as the enhancement of co-ordination between existing facilities is concerned, negative effects.

Significant effects have been found in respect of the promotion of entrepreneurship at the regional and local level, as well as the enhancement of competitiveness and internationalisation of SME (but limited to the Phare activities addressing foreign direct investment and export promotion). Limited effects have been found regarding the enhancement of the co-ordination of the existing facilities. Although significant effects were found in Poland and, to a lesser extent, Slovakia, hardly any effect was found in Bulgaria, Hungary, Czech Republic, Estonia or Romania. Adverse effects were observed in Slovenia. Very limited, or no effects were noted regarding the improvement in business and financial environment conditions. The financial environment has improved to a limited extent with Phare support in the Czech Republic, Hungary and Slovakia, but remains unchanged in Bulgaria, Estonia, Romania, Slovenia and Poland. The institutional framework in Bulgaria, Latvia and Lithuania remains unsatisfactory.

Recommendations

A large number of recommendations have been made, both at overall planning level and at country level. The overall recommendations cover measures to address completion of structural reforms. These measures are addressed (i) at CC governments and include the need to speed up the design and implementation of such reforms as well as the need to adjust Stock Exchange systems and address the competitiveness of SME at political level.; (ii) at Commission Services, which should follow developments and if necessary support CC governments efforts with specific technical or financial assistance. The overall recommendations also include benchmarking of the sector at national level; multi-annual development strategies; coherent national business support systems; more supportive legal and regulatory frameworks; encouragement of innovation in a framework of enterprises' upgrading aimed at raising international competitiveness; better access to finance through non-banking financial and guarantee schemes; mobilisation of future structural funds; and human resource development to address entrepreneurial skills.

Country-specific recommendations are dealt with in an Annex to the Report.

PREFACE

The European Commission requested the OMAS Consortium to produce a review of SME development in the Candidate Countries of Eastern and Central Europe, based on experience gained in the preparation of Monitoring and Assessment of the Phare Programme. Preliminary terms of reference were produced which envisaged a short desk study, but were then modified following a kick-off meeting in June 2001 with concerned Enlargement DG Task Managers and Country Co-ordinators. A consensus was subsequently reached on the value of a considerably enlarged study, incorporating an analysis of the status of SME development and support within the Candidate Countries, and the approach adopted by the Enterprise DG in support of SME development. The study would also focus on the effects of the Phare Programme on SME development, and the readiness of the Candidate Countries to utilise European Union Structural Funds to support SME development.

A second Kick-off meeting was held in July 2001 to confirm the extended scope of the Report, to confirm the increased resources to be deployed and to agree an extended time schedule for the production of the Report.

A Final Version of the report, excluding both Bulgaria and Romania, was published in November 2001. The study, following a debriefing meeting held at CSHQ's on January 15th, 2002 has subsequently been expanded to cover the two missing countries, both of which are included in this revised draft final report.

The resulting Report¹ has drawn heavily on information already available, supplemented by a more detailed study of the ten countries (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia).

The factual basis for this Report is:

- Interviews with key stakeholders in the European Commission and within Candidate Countries' national programmes;
- A desk analysis of the conclusions and findings of Monitoring and Assessment Reports, additional monitoring data and strategic planning documents produced within Candidate Countries;
- The definition and deployment of effectiveness criteria to identify the effects of the Phare Programme on SME development.

As a basis for the assessment of the contribution of the Phare Programme to SME development and subsequent recommendations, the Report includes three main analyses: an analysis of problems identified by European Commission officials; a strategic analysis of current national SME development and support; and an analysis of the Phare support. The Report overviews experience and lessons learned, and makes recommendations designed to improve the planning of future measures supporting SME development and upgrading in the accession context.

This Report has been prepared through funding provided by the Commission of the European Union. The views expressed herein are those of the OMAS and EMS Consortia, and do not reflect any official view of the Commission Services.

¹ The authors of this report are Sophie Papalexidou, Raffaele Boldracchi and David Smith, assisted by short term specialist input from Aiden Geraghty.

I. THE REPORT

1. BACKGROUND

1.1 The Small and Medium-sized Enterprise (SME) sector has been identified as an important factor for positive growth and employment within an enlarged European Union, and a dynamic and sound SME sector is essential for the sustainable development required for economic and social cohesion in existing and future Member States. The European Commission consequently gives high priority to policies and mechanisms for the promotion of SME and the fostering of a more entrepreneurial Europe.

1.2 Since the beginning of the transition process towards democracy and the market economy in the Candidate Countries (CC), the EC has attached great importance to effective SME development. However, Agenda 2000 (1997) concluded that *SME in candidate countries are still a long way from having the level of support and resources that exist in the EU, for example in support services, policy co-ordination, or in development of appropriate legal and regulatory frameworks. Access to finance remains a key bottleneck.* Consequently, enterprise (particularly SME) development continues to be a priority in pre-accession strategy.

1.3 The Regular Report adopted by the EC on 8 November 2000 underlined the progress made by the CCs in tackling the problems inherited from the past, as well as in developing a favourable environment for the creation of new and innovative companies able to withstand the competitive pressures of the Single Market. However, their formation and survival rate, and their internationalisation, were still reported as well below the EU average, and more progress was needed.

1.4 Enterprise development is a common medium-term priority for the CC under the Accession Partnerships, which stress the need *to improve the conditions for the creation and development of private enterprises, with particular attention to SME.* Several Chapters of the *acquis communautaire* focus on enterprise development. The two most relevant are Chapter 15: Industrial Policy and Chapter 16: SME².

1.5 The EU has supported SME development in all ten CCs through the Phare Programme since its commencement, mainly through three sets of actions:

- Provision of technical assistance and advisory services to national institutions responsible for SME development;
- Support to SME policy and legislative development;
- Provision of financial support for SME start-up and development, in collaboration with local financial intermediaries.

² Annex 9 describes the key requirements of Chapter 16. Other Chapters of relevance are Free Movement of Goods (1); Company Law (5); Competition Policy (6); Environment (22) and Consumer and Health Protection (23).

1.6 Following the approval of the European Charter for SME by the EU Council in Santa Maria da Feira (June 2000), the European Council approved a Decision on 20 December 2000 for a Multi-Annual Programme for Enterprise and Entrepreneurship, and, in Particular, for SME Support for the Period 2001-2005.³ The programme is also open to CCs, in accordance with the conditions established in their EU Agreements, after approval by the respective Association Council. The programme is expected to address a number of objectives:

- Enhancement of the growth and competitiveness of business in a knowledge-based internationalised economy;
- Promotion of entrepreneurship;
- Simplification and improvement of the administrative and regulatory framework;
- Improvement of the financial environment for business, especially SME;
- To give business easier access to Community support services and programmes and to improve co-ordination of these facilities.

1.7 The multi-annual programme is intended to build on, inter alia, the findings and the recommendations produced under the Business Environment Simplification Task-Force (BEST) initiative, as well as under the Fourth Round Table of Bankers. These initiatives have contributed to the development of a better business environment, and to improvements in the dialogue with bankers on issues related to access to finance for SME. These two initiatives have been recently extended to the CCs.

1.8 SME development will also be a key priority for the utilisation of EU Structural Funds (SF), and it is essential that the CC develop effective mechanisms to ensure smooth implementation of SF-related measures. The mechanisms planned by the EC to enable the CCs to manage the SF effectively upon accession are set out in Annex 2. The programming period 2000-2006 focuses on job creation through the implementation of an integrated development plan for urban and rural areas, addressing (a) strengthening regional competitiveness, and (b) upgrading skills in the labour market. Assistance for SME development is the cornerstone of this development plan.

1.9 In February 2000, an Evaluation Report examined the effect of the Phare support provided to the SME sector during the period 1990-1998. Based on the findings of the report, four main recommendations were defined to provide guidelines for the programming of future Phare interventions:

- Phare funds should mainly address the long-run SME development process (i.e.: networking, sub-contracting, technology transfer, education and training. Phare funding should be based on the principle of subsidiarity, and not be used to substitute for the basic forms of government spending on business support, or to support activities that could have been undertaken by the private sector;
- Phare should support radical changes to the national sectoral legislation;
- New special financial schemes should be designed to improve the economic effect of direct financial support to SME; and
- The strengthening of the local and regional administrative capacities in order to support local economic and business development, also in expectation of the utilisation of SF.

³ Council Decision 2000/819/EC published in the Official Journal on 29th December 2000.

1.10 In order to tackle the new challenges, a number of guiding principles for future Phare interventions have been defined:

- Differentiation between CCs;
- Flexibility, to take account of different rates of progress in CCs and regions;
- Strong links between projects and national strategies;
- Ensuring the additionality of projects and the maximum aid leverage;
- Setting rules for co-financing and grant aid;
- Identifying good practice;
- Supporting the exchange of experience between CCs and Member States.

2. OBJECTIVES and SCOPE OF WORK

2.1 The principal objective of this Report is to identify lessons, and make recommendations, for the design of future SME programmes, based on a desk analysis of the conclusions and findings of Phare Programme Monitoring and Assessment Reports, and Country Assessment Reviews, other monitoring data and strategic planning documents produced within the CCs, and interviews with key stakeholders.

2.2 The following key activities were carried out:

- Definition of issues to be addressed: fact-finding meetings with Phare Country Co-ordinators to identify priorities to be addressed at the country level.
- Problem Situation Analysis at country level: fact-finding missions in the CCs to review national policy frameworks for support to the SME sector and eventual utilisation of SF, followed by definition of the main challenges to be faced.
- Contribution of the Phare Programme to SME development: criteria were developed and defined, on the basis of the existing programming documents and interviews carried out with the representatives of the Enlargement and Enterprise DGs, to identify the effect of the funded measures. These criteria were:
 - Simplification and improvement of the business environment;
 - Improved financial environment for SME;
 - Enhancement of SME competitiveness and internationalisation through research, innovation, training and information services;
 - Enhancement of co-ordination of existing facilities to give business easier access to supporting services, programmes and networking; and
 - Promotion of entrepreneurship at regional and local level.

An effect analysis of the measures was prepared in the form of a Thematic Assessment Matrix, linking them to the criteria upon which the different measures should have had an effect.

2.3 On the basis of the findings of the Problem Situation Analysis, recommendations were produced to address the challenges to be faced by SME in the near future. Overall Recommendations are given in Chapter 6, and at the individual CC level, in Annex 8.

3. THE PRESENT STATUS OF SME DEVELOPMENT WITHIN THE CANDIDATE COUNTRIES

The findings of a country level Problem Situation Analysis

3.1 The Analysis

3.1.1 In order to represent the existing situation of SME development within the CCs, a Problem Situation Analysis was carried out, and the findings are presented in Annex 1. An in-depth analysis has been carried out for the ten CCs (see Annex 8). The findings are presented in Annex 3. On the basis of the findings the issues affecting SME Development within the CCs are examined below.

3.1.2 In order to answer questions raised during interviews with the Commission Services, a number of issues (such as the implementation of a benchmark analysis, the performance of the institutional support network and access to finance) have been addressed in a more comprehensive manner. The findings of the analysis have led to the definition of the main challenges to be faced by CCs in the near future. The Problem Situation Analysis focused on the following aspects:

- General overview;
- Status of the SME sector;
- Broad economic and social policies;
- Regulatory policy;
- Access to finance;
- Institutions supporting SME, and their rationale; and
- Readiness to utilise Structural Funds.

General Overview

3.1.3 Among the CCs, foreign direct investment (FDI) inflows for the year 2000 were forecast to be \$8.5 billion for Poland, \$5.5 billion for the Czech Republic, \$1.5 billion for Slovakia and \$1.4 billion for Hungary, but only \$50 M for Slovenia⁴. Poland and the Czech Republic are currently well ahead of other CC in attracting FDI. The performance of Slovakia has been particularly impressive but Slovenia continues to lag behind other CC in relations to its capability to attract FDI. Bulgaria and Romania have the worst record in terms of per capita receipt of FDI.

3.1.4 All the CCs achieved positive GDP growth in 2000. However, only Poland and Hungary have managed to increase their industrial outputs over 1990 levels. Over the past ten years there has been a growing industrial specialisation among the CC and, on average, in each CC five majors sectors account for between 60 and 70% of industrial output.

⁴Business in Central Europe – The Annual, 2001. Sources: EBRD, EIU, national statistics.

3.1.5 Hungary has achieved a level of productivity amounting to 50% of the EU average, making it the best performing CC in this respect. In contrast, Bulgaria and Romania have only reached 25% of Hungary's level. There is a great deal of variation between different industrial sectors in terms of productivity levels. Across the 10 CCs, four sectors have registered positive productivity growth: electronics, optical equipment, transport equipment and furniture. On the other hand, there are five sectors which have registered decreases in productivity: food & beverages, tobacco, textile, leather and chemicals. The sectors enjoying productivity gains have been able to further improve their comparative advantage vis-à-vis EU enterprises. On the other hand, the sectors in which productivity has fallen have incurred cost problems and risk having ULCs (Unit Labour Costs) greater than Member States levels.

3.1.6 Table 1 shows a number of macroeconomic indicators:

Table 1 Macro economic indicators (EUROSTAT 2000)

| | BG | CZ | ES | HU | LV | LIT | PL | RO | SK | SL |
|--|-----------|-----------|-----------|-----------|-----------|------------|-----------|-----------|-----------|-----------|
| GDP per capita (% of EU-15) | 24 | 60 | 38 | 52 | 29 | 29 | 39 | 27 | 48 | 72 |
| GDP (% GROWTH IN 2000) | 5.8 | 2.9 | 6.9 | 5.2 | 6.6 | 3.3 | 4.0 | 1.6 | 2.2 | 4.6 |
| Inflation | 10.3 | 3.9 | 3.9 | 10.0 | 2.6 | 0.9 | 10.1 | 45.7 | 12.1 | 8.9 |
| Unemployment Rate (%) | 16.4 | 8.8 | 13.7 | 6.4 | 14.6 | 16.0 | 16.1 | 7.1 | 18.6 | 7.0 |
| Commercial balance (Import vs export) | 74.1 | 90.1 | 74.5 | 87.6 | 58.5 | 69.8 | 64.7 | 78.8 | 92.8 | 86.4 |
| FDI PER CAPITA (€) | 239 | 2213 | 1980 | 1790 | 943 | 683 | 671 | 317 | 1000 | 1348 |
| NET INFLOW - FDI AS % OF GNP | | | | | | | | | | |
| In 1999: | 6.5 | 9.3 | 4.3 | 2.9 | 5.0 | 4.5 | 4.1 | 3.1 | 3.6 | 0.7 |
| In 2000: | 7.1 | 9.0 | 8.0 | 2.9 | 5.7 | 3.4 | 5.3 | 2.8 | 10.8 | 1.0 |

3.1.7 In 2000, the Deutsch Bank Research Institute carried out a study to define a convergence indicator for the CCs, describing the level of alignment of a number of macroeconomic indicators with the EU average. Five indicators were selected: real economy, growth, political and economic institutions, foreign trade, and monetary and fiscal policy. The findings of the study indicate that Slovenia has the highest level of convergence (71.3%), followed by Hungary (70.3%), the Czech Republic (69.4%), Estonia (66.3%), Poland (62.9%), Slovakia (61.7%), Latvia (61.3%), Lithuania (56.6%), Bulgaria (56.4%) and Romania (50.6%).

3.1.8 According to the EBRD Transition Report 2000, the progress registered by CCs in the implementation of economic reforms has not yet led to a situation fully compatible with that in the EU (see Table 2). The Report focuses on three main topics: Enterprises, Trade and Competitiveness, and Financial Institutions. On this basis, full harmonisation with EU standards has been achieved in the fields of small-scale privatisation and foreign trade liberalization, although the Western Balkans Countries are still facing regulatory problems. Overall, the best reforming CC is Hungary, followed by Estonia. The Czech Republic, Slovenia, Lithuania, Slovakia and, particularly, Latvia and Bulgaria, still lag behind in the pace of economic reform. Romania is the CC where the need for economic reform is the greatest. The general overview indicates that a relatively large proportion of reforms have still to be implemented, and that special attention should be given to issues such as Governance and Restructuring, Competitiveness, Stock Exchange and Non-Financial Institutes and Large-scale Privatisation. The EBRD has recently ranked the CC as well as other former planned economies of Europe and Former Soviet Union (FSU). On this basis, Hungary is the best performing CC and Bulgaria and Romania are the ones where reforms are most needed in the spheres of institutional development and economic liberalisation.

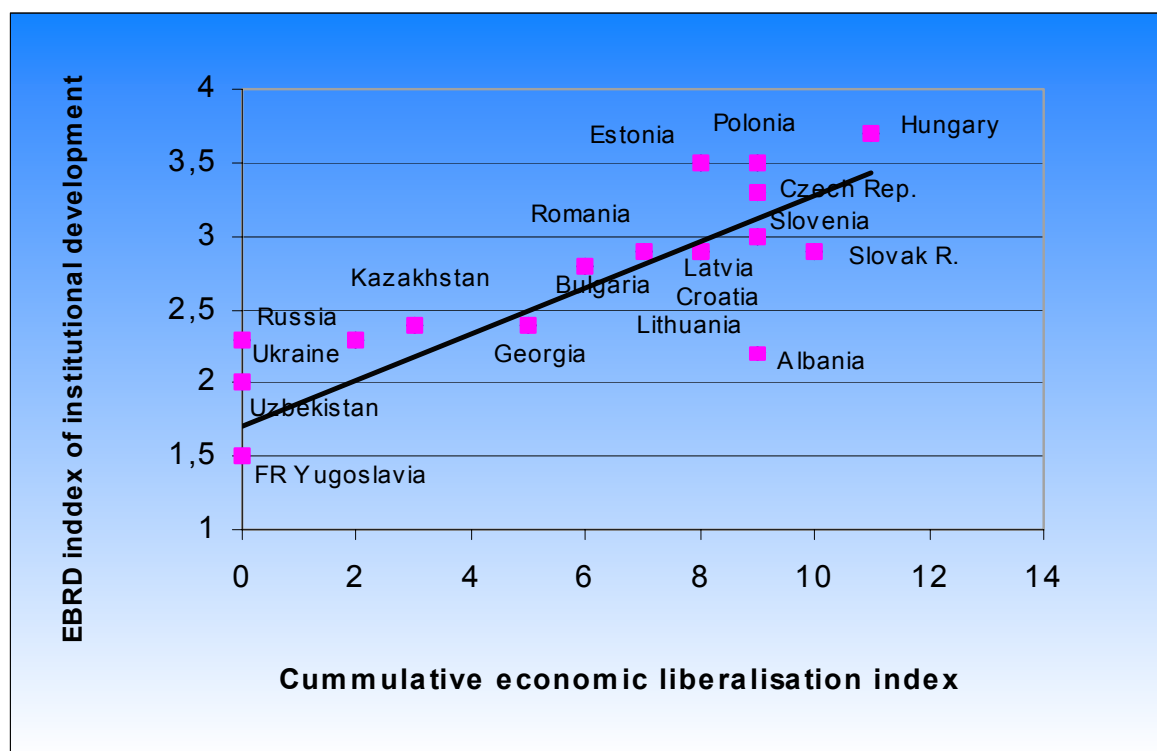
Table 2: Implementation of economic reforms

| Candidate Country | Large-scale Privatisation | Small-scale Privatisation | Governance and Restructuring | Price Liberalisation | Foreign Trade | Competitiveness policy | Reform of Banking System | Stock Exchange & Non-fin. Inst. | Total |
|-------------------|---------------------------|---------------------------|------------------------------|----------------------|---------------|------------------------|--------------------------|---------------------------------|-------|
| BG | 4- | 4- | 2+ | 3 | 4+ | 2+ | 3 | 2 | 24+ |
| CZ | 4 | 4+ | 3+ | 3 | 4+ | 3 | 3+ | 3 | 26+ |
| ES | 4 | 4+ | 3 | 3 | 4+ | 3- | 4- | 3 | 28 |
| HU | 4 | 4+ | 3+ | 3+ | 4+ | 3 | 4 | 4- | 29+ |
| LE | 3 | 4+ | 3- | 3 | 4+ | 2+ | 3 | 2+ | 24+ |
| LI | 3 | 4+ | 3- | 3 | 4 | 3- | 3 | 3 | 26 |
| PO | 3+ | 4+ | 3 | 3+ | 4+ | 3 | 3+ | 4- | 27+ |
| RO | 3 | 4- | 2 | 3 | 4 | 2+ | 3 | 2 | 23- |
| SL | 3 | 4+ | 3- | 3+ | 4+ | 3- | 3+ | 3- | 26+ |
| SR | 4 | 4+ | 3 | 3 | 4+ | 3 | 3 | 2+ | 26+ |

Note: The rating ranges from 1 (for sectors not having registered any progress in transition towards a market economy) to 4+ (for those sectors where the CC have reached the EU standards). Source: EBRD Transition Report.

3.1.9 A further confirmation of the trend is revealed in an analysis of the EBRD index of institutional development and economic liberalisation. Once again, Hungary is the best performing CC and Bulgaria and Romania are lagging behind. Improvement vis-à-vis other EU Member States and FSU Transition Countries is however impressive in all ten CCs. This is shown in the following chart:

Figure 1: The EBRD Index of Institutional Development and Economic Liberalisation



Source: EBRD Transition Report

3.1.10 Analysing the development of the SME sector in the CC (at the macro level) is a difficult task, largely due to the lack of adequate statistical data. This is partially explained by the recently established and fast-growing nature of the SME sector, for which the National Statistical Offices have not yet introduced a suitable methodology, collected data and established a trend. In addition, in several CCs, the size of the *grey economy* limits the accuracy of statistics on the SME sector. The available data are therefore not complete, or fully comparable, or suitable for the purpose of an exhaustive benchmarking analysis: however, a tentative comparison between selected countries is shown in Table 3.

Table 3: Statistical Analysis – SME in Selected Candidate Countries

| Countries | Population (000) | No of active SME (000) | No of active SME per 1,000 inhabitants | Share of Exports % | Share of total employment % | Total unemployment % |
|--------------|------------------|------------------------|--|--------------------|-----------------------------|----------------------|
| Bulgaria | 8,200 | 207 | 25.2 | NA | 59.1 | 16.2 |
| Czech R. | 10,300 | 760 | 73.7 | 36.1 | 59.1 | 9.8 |
| Estonia | 1,450 | 30 | 21.5 | 66.8 | 75 | 9.6 |
| Latvia | 2,400 | 38 | 15.7 | na | 70 | 9.7 |
| Lithuania | 3,700 | 52 | 14.0 | na | na | 8.1 |
| Hungary | 10,200 | 801 | 78.2 | 35 | 59.4 | 7.5 |
| Poland | 38,600 | 1,816 | 47.0 | 47.6 | 64.3 | 11.4 |
| Romania | 22,460 | 622 | 28 | NA | 40.2 | 7.1 |
| Slovakia | 5,400 | 350* | 64.8 | 30.5 | 56 | 18.6 |
| Slovenia | 2,000 | 99* | 49.5 | 20** | 63.8 | 10.5 |
| EU-15 | | | 48 | | 65.9 | |

(*) The data do not specify if the number is referred to registered or active

(**) The data only refer to the performances of Micro & Small enterprises.

3.1.11 The number and performance of the SME sector varies significantly on the basis of a large number of factors. Generally, the role and status of SME is linked to the population, so whilst SME in large countries, with more than 20 M population (Poland and Romania), can focus on their internal market, countries having less 6 M or fewer inhabitants need to penetrate foreign markets, and also be able to resist competitive pressures associated with their entrance into the Single Market. SME in Bulgaria, Hungary and the Czech Republic, with a population of 10-15 M, need to pursue a dual strategy aimed at both penetrating new markets and consolidating their presence within their existing local market. The implication is that SME in CC should choose one or more of the following strategies:

- Remain in the local market offering the same products and services;
- Remain in the local market offering new products and services;
- Penetrate a (new) foreign market offering the same products and services; and
- Penetrate a (new) foreign market offering new products and services.

From a benchmarking point of view, an important indicator is the number of active SME per 1,000 inhabitants. Poland and Slovenia are the only countries well aligned with the average data existing within the 15 Member States. The other countries either exceed this average (the Czech Republic, Hungary and Slovakia), or are dramatically below it (Bulgaria, Estonia, Latvia, Lithuania and Romania). This data may in part be explained by the size of the grey economy but there is nevertheless a considerable level of difference.

The data on the share of exports confirms the importance of the relationship between population and exports, i.e. reliance on exports is inversely proportional to a country's size. The Estonian SME sector clearly focuses on exporting, whilst the remaining countries lag behind. In the absence of more data for Slovenia, the only observation possible is that it appears to be under-performing compared with other CCs. No information is available concerning the performances of Bulgaria and Romania SME in terms of their export share. In any case, with the noticeable exception of Estonia, the SME sector has still to considerably improve its export performances. This is a crucial point to be addressed because a large proportion of export share is controlled, within the CC, by a relatively small number of large multinational companies that, at any moment, can turn their activities towards more competitive countries. The problem is linked with the lack of international competitiveness within the sector and considerably efforts have to be place in upgrading the sector up the international standards.

3.1.12 The data available on unemployment demonstrates the role of the SME sector in terms of social cohesion. Only in Poland and Slovenia is the share of employment in the sector well aligned with the EU-15 average. In Estonia and Latvia it slightly exceeds the average. Bulgaria, the Czech Republic, Hungary and Slovakia are below average. Romania is dramatically below average.

3.1.13 The overall picture is one of a sector still evolving, and requiring further support.

Broad economic and social policies

3.1.14 Each CC government has identified a ministry responsible for the implementation of an SME development strategy, but, with the exception of Slovenia and Romania, this responsibility is shared with other ministries, typically national ministries for regional development, which also bear some responsibilities for the SME sector. This situation has not led to effective co-ordination of policy and actions, and, in most countries, the absence of clear lines of accountability increases the risk of poor co-ordination and over-lapping responsibilities, multiple implementation platforms and low administrative efficiency. The Government of Slovenia has recently developed an integrated structure that brings under the Ministry of Economy (MoE) both SME related activities and regional development activities. This is a positive development, particularly in view of the future utilisation of EU SF. A National Strategy to support SME up to 2004-2005 has been approved by both the Czech and the Hungarian Governments. The Bulgarian Council of Ministers has approved a national strategy but it has not yet been ratified by the Parliament. Slovenia has developed a draft version of a strategy, but other countries have not.

3.1.15 All CC have produced National Development Plans, but none had been approved by the Regional Policy DG at the time of drafting this Report. The Czech government has also developed a draft Sectoral Operating Programme (SOP) - Industry, but no documents are readily available for implementation. Generally, the impression is that on-going SME strategy formulation is still not well embedded within regional development policy.

3.1.16 The overall impression is that the CCs' broad economic and social policies are only partially supportive of, or incidental to, effective SME development and, in any case, very little efforts have been made to identify suitable approaches to ensure the upgrading of the sector, particularly as far as the manufacturing aspects are concerned. The responsibility for the provision of support to the sector is still affected by poor co-ordination and lack of clear accountability. The future development of the SME sector is not generally supported by an approved multi-year policy document and the activities presently carried out to support the sector are ad hoc, rather than a keystone for regional development strategy.

Regulatory policy

3.1.17 Overall, all CC governments are committed to the improvement of their legal and administrative systems, but the pace of change in the regulatory environment presents a key challenge to the sector, especially as governments are developing a legal framework compatible with the *acquis communautaire*. Compliance with new regulation is costly and difficult because of the volume of laws being passed or amended. The successful development of small businesses in accordance with economic policy objectives requires, above all, a predictable environment and this is missing in the CC. A number of changes to the existing regulatory framework have been implemented without a specific *ex-ante* analysis of their likely impact on the SME sector. Governments have, for different purposes, identified the main administrative and legal burdens affecting SME development: but this has not been translated into well-defined and prioritised action plans to implement the necessary changes. The only exception is the Government of Slovenia, which has launched an ambitious and highly innovative "*Anti-Bureaucracy Action Plan*", which specifies the main measures to be taken, with a tentative time-schedule. Regulatory policies are not yet adequate or appropriate for the SME sector. Moreover, the weakness of representative business associations as interlocutor

has been an obstacle to the participation of the sectors into the development of the regulatory framework.

Access to finance

3.1.18 Access to finance is a key factor affecting the development and performance of SME. Under market economy conditions, and in the presence of fast growing globalisation, the commercial banks active in the CC are on the whole introducing loan criteria similar to those applicable in Member States, including a thorough risk appraisal. In this framework, the request for a track record and substantial collateral are unavoidable requirements for lending money for start-ups, or for enterprises in their embryonic phase. High collateral levels (100 – 200%) are linked with inefficient bankruptcy laws, which make it extremely difficult to foreclose mortgages and convert the collateral into liquid assets in case of payment default. CC governments have defined a wide range of non-banking and heavily subsidised loan schemes to support the temporary financial weakness of the sector. These schemes have been effective in supporting SME but demand is strong, and consequently, only a very small proportion of SME can benefit from these facilities. A number of guarantee schemes have been launched by the CC. For example, the Czech-Moravian Guarantee Bank has implemented a range of guarantees and other financial schemes for the benefit of Czech SME. The Bank currently plays the *role* of a development bank, and there are argument in favour of transformation to a true development bank capable of providing a complete range of services to SME. One of the most challenging and ambitious government plans supporting SME is the Széchenyi Plan developed by the Hungarian Government. No other CC has developed such a comprehensive plan to boost the economy, building on the SME sector. Poland has developed the most complete network of institutions supporting SME, with regional funds, a credit guarantee fund, micro-funds, etc.

3.1.19 The commercial banks are not always the best agents to overcome the lack of financial support for SME. Governments, fully aware of this situation, are supporting the sector by the establishment of non-banking and subsidised loan and guarantee funds. This is a viable solution for CC where the number of SME per 1,000 inhabitants is below the EU average, as well as for those CC showing an SME share of total employment lower than the EU average.

3.1.20 EU Phare Programme managers have collaborated with the EBRD to form the Phare-EBRD SME Facility. The Facility was conceived to provide loans and equity to enterprises. Currently, the Facility is supported by a Phare contribution of 161 M€, blended with an additional 450 M€ provided by the EBRD, 263 by the Council of Europe Development Bank in association with the Kreditanstalt für Wiederaufbau (KfW))⁵, and 30 plus 300 to be provided by the European Investment Bank. The implementation of the Facility has been delegated to the respective IFI, which have to identify eligible local financial intermediaries to manage the funds under a Loan and Guarantee Window and an Equity Window. The overall objective is not the direct provision of financial support to the SME sector but *to induce financial intermediaries in the ten applicant Countries to expand and maintain, in the long term, their debt and equity financing of SME operations*. Funds are considered as disbursed when an agreement is reached between the EBRD and the local financial intermediary, rather than when funds are actually lent to SME. Awareness of the Facility is poor in the EC Delegations in the CCs. Currently, the Facility has succeeded in establishing agreements with a number of financial intermediaries for managing the Loan and Equity Windows (see Annex 10). As the

⁵ See OMAS Consortium Annual Assessment Report R/ZZ/SME/00088, issued 21 December 2000.

funds are managed by local commercial banks, the Facility is unlikely to ease the access to credit for micro and small enterprises, still considered extremely risky by the banking system. Moreover, the EBRD itself has set guidelines for financial intermediaries, which reiterate the need for a cautious approach to lending to SME.

3.1.21 In almost all industrialised countries, governments have implemented a range of programmes promoting SME. Governments generally consider financial support as the major component of promotion policies for the development of entrepreneurship and SME, and direct support and long-term loans are provided under favourable conditions, thus permitting the financing of businesses, which would otherwise be frustrated due to lack of financial support. In the majority of the OECD countries, loan guarantee schemes and mutual guarantee schemes exist for financing start-up businesses, which would otherwise be unable to obtain funding. Loan guarantees seek to overcome the high risk faced by financial institutions when lending to micro- and small businesses⁶. Under the new guidelines for programming Structural Funds, the provision of assistance to the SME sector is one of the key points in combating unemployment. The policy orientation is to organise innovative financial schemes to ensure better access to finance for SME. More specifically, *in practice this will mean: fewer direct aid payments, and more assistance provided in the form of easier access to financial markets, risk capital or through private-public partnership.*⁷

Institutions supporting SME

3.1.22 An extremely wide variety of institutions, organisations and associations support the SME sector, more often than not in an uncoordinated way. In Slovakia, Poland and Slovenia, the national business support network is relatively well co-ordinated, and national institutions (NADSME, the SME Development Agency, and the Small Business Development Centre) effectively co-ordinate the national network for information and counselling services to SME at the regional and local level. In the Czech Republic and Estonia the situation is considerably more complex, particularly after the establishment of entirely new structures (Czech Industry, and Estonia Enterprise), which are expected to play a crucial role in SME development, but without a role being defined. Moreover, in the Czech Republic, the Centre for Regional Development (CRD) is very active and needs to find a role in the national SME development strategy (the CRD hosts the Euro Info Centre). In Hungary, a new institution has been established to manage the SME-related activities of the Széchenyi Plan (the MVF), but the future role of the institutions currently co-ordinating the SME related support programmes (for example, the MVA) is unclear. Overall, the outreach capacity of the national networks is very low. In the Czech Republic, the national network of RAIC and BIC barely assists 1% of the active SME. The Slovak network supports less than 5% of the active SME, and in Slovenia, the SBDC serves the needs of a maximum of 10% of the active SME. In Bulgaria and Romania, the institutional support to SME is still confused, incoherent and in need of a fundamental overhaul.

⁶ State guarantee schemes are available in Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, the Netherlands, Sweden, the United Kingdom and the USA. Spain has created some restricted credit lines aiming to encourage co-operation among SME groups. *Mutual guarantee schemes* operate in Belgium, France, Greece, Germany, Italy, Luxembourg, Portugal and Spain.

⁷ "Reform of the structural funds and draft new guidelines for programming" – Speech by the Commissioner at the meeting of the EU Parliament's Committee on Regional Policy, 28 February 1999.

3.1.23 Overall, institutions supporting SME suffer from overlapping responsibilities and an unclear division of tasks. The range of services is generally not divided between the needs of micro, small and medium enterprises under start-up, embryonic or development stages. With the exception of Poland and to some extent Slovenia, the providers in most CCs (for example, the BIC and RAIC) are not part of a national network, and assist SME in isolation from existing national strategies. The development of a one-stop SME shop, capable of providing information regarding all of the services available at national level, is urgently needed. In this respect, the Euro Info Centres are not being fully utilised and the outreach capability of the information and counselling networks is very low.

3.1.24 In comparison with EU Member States, the development of institutions such as Business Angels is still underdeveloped. Business Angel networks are a very special form of business service, which provide a means of introduction between investors and SME. Business Angels invest in SME and provide finance and expertise or business skills. A small number of Business Angel networks operate on a commercial basis or are sponsored by banks, venture capital funds or industry associations. The majority is publicly funded. There are already a great variety of Business Angel networks operating in the United States and in Europe⁸.

Readiness to utilise Structural Funds for SME development

3.1.25 An integrated approach, with actions selected to contribute to a common objective, such as combating industrial decline (in particular with SF measures), linked with interventions to promote the business environment, has not yet been developed and approved by most CC. Geographical coverage at the level deemed most appropriate by the CC, but with the NUTS II level as the minimum, has been established by the countries analysed, with the exception of Slovenia. No Managing Authorities, capable of compliance with SF requirements, have yet been established in the CCs.

The main challenges to be faced by the SME sector

3.1.26 Overall, a number of common challenges have been identified during the examination of the Problem Situation Analysis. SME development is a complex process, requiring a mix of interventions to be implemented at different levels - a Strategic Level (higher), an Institutional Level (middle), and an Enterprise Level (lower). The three key actors are consequently the policy makers, the national business support network, and the SME themselves. Only through co-ordinated action at all three levels will effective SME development be possible. Under market economy rules, government should not interfere in the management of individual enterprises, and it should allow the market to differentiate between them. The government's task is therefore to create the right conditions for a flourishing and effective SME sector, capable of pursuing economic and social cohesion.

3.1.27 The nature of some of the key challenges we have identified through the activities carried out in drafting this Report is presented below in Table 4.

⁸ Business Angel networks, being a tool for stimulating the creation of new enterprises and thus employment growth in Europe, are one of the European Commission's priorities. **The European Business Angel Network** (EBAN) has already had one year's experience. EBAN has two categories of members: full members and associated members. Several National Business Angel Networks are partly funded by the European Regional Development Fund. National Business Angel Networks started to increase rapidly in the United Kingdom from 1991. They have been working in the Netherlands since 1995 and in Finland since 1996.

Table 3: Challenges to be faced

| Challenges to be faced by the CC at Enterprise Level. | Challenges to be faced by the CC at Government Level. |
|---|---|
| <ul style="list-style-type: none"> • Ability to face competitive pressures in the single market. Implies the definition of measures aimed at improving, inter alia: <ul style="list-style-type: none"> - productivity; - definition of product/market strategy; - R&D activities as a tool to develop innovation; - readiness for the e-business economy. • Upgrading managerial and entrepreneurial skills. • Integrating supply chain networks as a tool to effectively support company matching activities, aimed at the establishment of co-production and/or co-marketing activities with EU based partners. • Making their voices heard by authorities bearing responsibility for the definition of a new legal and regulatory framework. • Coping with a fast changing legal environment, meeting the requirement of the <i>acquis communautaire</i>. • Coping with a financial environment that cannot offer credit to the weakest SME (i.e. micro enterprises, start-up and/or small and micro enterprises in their embryonic development). • Gaining access to information and high quality support services in a more co-ordinated and diversified way than at present. • Accessing foreign (particularly EU Member State) markets. | <ul style="list-style-type: none"> • Completing structural reforms necessary to further restructure enterprises and to create a dynamic SME sector. • Effectively benchmark the National SME sector with other EU and/or CC in order to define best practice and understand the actual needs of the sector. • Define multi-annual strategies and measures to effectively support SME development and upgrading, in order to boost economic and social cohesion through employment generated by a dynamic SME sector. • Defining a rational and well co-ordinated institutional framework capable to define and implement the broad economic and social policies defined by the multi-year strategy. • Ensuring the commitment of all necessary institutions to further improve the business environment. • Contributing to the definition of a coherent national business support system to effectively support the needs of the SME sector. • Boosting start-up rates and improving the chances for newly established enterprises of surviving and growing, taking the opportunity offered by the access to an enlarged Internal Market. • Improving conditions for competitiveness: <ul style="list-style-type: none"> - better access to finance; - definition of a legal and regulatory framework addressing SME needs; - human resource programmes specifically addressing the upgrading and strengthening of entrepreneurial skills. • The definition of specific measures to support and encourage innovative approaches, including via the existing network of BIC and Business Incubators, promoting closer ties between enterprises and universities. • Utilising the unique opportunity offered by SF to focus on the necessity for a clear and effective structure, able to mobilise these funds for the benefit of the sector. • Eliminating the gap between national and regional skills in planning development programmes. |

4. THE CONTRIBUTION OF THE PHARE PROGRAMME TO SME DEVELOPMENT

4.1 Phare support to the SME Sector

4.1.1 Phare assistance has mainly been delivered through the following instruments and frameworks:

- National SME sectoral programmes, providing support for installing proper legislation and structures, and taking actions to stimulate SME development. (Other measures, funded by Phare, support the SME sector indirectly: for example, Trade Development, Foreign Direct Investment Promotion, Enterprise Restructuring, Energy, Environment, Education, Social Development, Approximation of Legislation, etc.).
- Economic and Social Cohesion programmes that contain a variety of actions aiming at stimulating economic activity as a tool to narrow the economic development gap.
- Cross Border Co-operation programme components addressing SME development issues at cross border level.
- The Multi-Country Business Support Programme aimed at strengthening the business representative organisations in the CCs through projects aimed at developing partnership contacts and co-operation with their counterparts within the EU. The total Phare budget for this programme totals 26 M€.
- The Multi-Country Technical Assistance Information Exchange Office (TAIEX) Programme that provides the CCs with technical assistance for national administrations and business associations on the approximation of legislation.
- The Phare SME Facility in co-operation with IFI (EBRD, CEB/KFW, EIB), conceived to provide loans and equity to enterprises.

4.1.2 This Report focuses upon the Phare national programmes addressing SME development issues.

4.2 Phare National Programmes

4.2.1 In order to analyse the contribution of the Programmes to SME development, a number of criteria have been defined to assist in identifying the effects of the funded measures. The criteria are:

- Simplification and improvement of the business environment;
- Improved financial environment for SME;
- Enhancement of SME competitiveness and internationalisation through research, innovation, training and information services;
- Enhancement of co-ordination of existing facilities to give business easier access to supporting services, programmes and networking; and
- Promotion of entrepreneurship at regional and local level.

These criteria form the basis of the Thematic Assessment Matrix shown in Annex 3.

4.2.2 The four measures used in the Thematic Assessment Matrix are groups or types of assistance commonly found in the Phare national programmes:

- Institution Building;
- SME Policy Development;
- Direct non-financial support to SME; and
- Direct financial support to SME.

4.2.3 The criteria ratings used in the Matrix are derived from the series of Monitoring and Assessment Reports prepared by the OMAS Consortium during the period April 1996 to April 2001, and the related Country Assessment Reviews. On the basis of the Thematic Assessment Matrix, the following conclusions are drawn.

4.2.4 The simplification and improvement of the business environment has received only limited benefits from the assistance delivered by Phare. With the notable exception of Poland and, to a lesser extent, Estonia, the assistance has not been designed to support this extremely important aspect of SME Development. The establishment of three key institutions at the beginning of Phare activities in Poland ensured the existence of the local skills required to maintain a business environment adequate to the needs of the sector. In this respect the assistance delivered by Phare to the Polish Government should be considered as a success story, which could be replicated elsewhere. The important lesson is that at the start of any plan for private sector development, priority should be given to the provision of support to the national government for the definition of an appropriate and adequate business environment. The main consequence of a lack of support for this strategic aspect is the present situation, in which practically all CCs face serious business environment problems that will hamper further development of the sector.

4.2.5 The financial environment for SME has received little significant benefit from the assistance provided by Phare. The banking systems in CCs, as in the member states, are extremely reluctant to support companies financially without a proven track record and collateral to cover the loans. The problem is not the availability of funds, but the high risk associated with lending money. In this respect, the financial environment can only be improved through the organisation of non-banking financial schemes specifically addressing the needs of both the start-up and of the micro/small enterprises, and the development of effective bank guarantee schemes. The latter, subsidised by State funds if necessary, could support the SME in obtaining loans from the commercial banks. Phare should concentrate on the organisation of financial support for the weak but viable enterprises. Phare assistance has had a positive effect only within those CCs (Czech Republic, Slovakia and Hungary) where Phare funds have been merged with national funds to launch non-banking or subsidised financial schemes in collaboration with local banks.

4.2.6 When Phare has embarked on pure banking financial schemes, the effects have been negligible. In this respect, the financial schemes funded by Phare in Slovakia and the Czech Republic can be considered as an example of good practice, particularly the non-banking financial schemes. In some cases, like Slovenia, the financial support has been very limited and managed in isolation from the existing national structures. Furthermore, the interest rate offered to SME was not aligned with (as favourable as) similar initiatives taken by other institutions. Very little has been achieved in Lithuania and Latvia.

4.2.7 Enhancement of competitiveness and internationalisation of the SME sector through better access to research, innovation, training and information services has received limited benefits from the assistance delivered by Phare Programmes. Poland and Slovakia have benefited from assistance specifically conceived to support the SME sector, where the two national agencies proved to be particularly effective in designing projects focusing on both internationalisation and competitiveness. In other CCs, no specific assistance was designed under the Phare SME Development programmes. In Hungary and the Czech Republic, a positive effect on the internationalisation of the sector has been achieved through the performances of ITDH and CzechTrade/ CzechInvest. The main adverse aspect is that, until

the last programming cycle, the issue of internationalisation and competitiveness had not been tackled by the SME development programmes: or, if addressed; only very limited resources were made available (Estonia). In this respect, the assistance delivered to Polish SME through the National SME Development Agency and the assistance delivered to the Hungarian SME through ITDH under the FDI and Export Promotion Programmes has been very successful. However, the Latvian Development Agency has performed poorly in comparison in respect of SME promotion and foreign trade promotion financed through Phare.

4.2.8 Phare assistance has had a very limited impact on improved co-ordination of the existing facilities to provide business easier access to support services, programmes and networks. Only in Poland and Slovakia has the co-ordination of the existing facilities supporting SME been enhanced. The business support network established by the two national SME development agencies exhaustively covers the facilities available to the sector. The national network of information and counselling centres provides the sector with easier access to support services and networks. Less positive results have been achieved in the Czech Republic, and in Hungary and Estonia, the sector has had no benefit from the Phare assistance in enhancing the overall co-ordination. The situation in Latvia and Lithuania is similar, where the lack of sustainability of the national support network reflects the limited commitment to SME development by the governments concerned.

4.2.9 In Slovenia, the Phare support has had a negative effect, with provision of support unrelated to the existing national network. In Poland the business network created by the SME Agency effectively co-ordinates a large number of initiatives at both national and local level. Through the Department of Craft and SME, the Agency acts as an interlocutor between the national government and the sector. The main lesson learned is that before starting any initiative it is essential to have a full understanding of the national support networks to avoid wasting resources.

4.2.10 A positive effect has been registered for the Phare assistance aimed at supporting the promotion of entrepreneurship at regional and local level, although significant beneficial effects have only been observed for Poland. The 150 RBPC and the 20 BIN effectively support the promotion of entrepreneurship at regional and local level. To a lesser extent, a positive effect has also been noticed in Slovakia, Hungary and the Czech Republic, although the outreach capability of the existing network is very limited. Limited effects have been linked with the implementation of the SME Phare programmes in Estonia and Slovenia. The success story is linked with the activities of the National Service System established by the Polish SME Development Agency. Any external assistance aimed at developing entrepreneurship at regional and local level cannot avoid operating in the framework of an effective national framework and, consequently, the first objective for external assistance should be the strengthening of the existing business support network. Effective co-operation between SME development agencies and regional development agencies is essential, and this is not always the case.

4.2.11 Overall, the most significant effects of the Phare assistance to the SME sector have been found in Poland. Positive effects have also been noticed in Slovakia and, to a lesser extent, in Estonia, Hungary and in the Czech Republic. Only limited effects have been noticed in Latvia and Lithuania. Phare assistance in Slovenia has delivered no significant effects and, as far as the enhancement of co-ordination of the existing facilities is concerned, negative effects. The effects of Phare assistance in Bulgaria and Romania have also been negligible.

4.2.12 In certain CCs (such as Hungary), significant effects have been found in respect of the promotion of entrepreneurship at regional and local level, as well as the enhancement of competitiveness and internationalisation of SME (but limited to the Phare activities addressing FDI and export promotion). However, few positive benefits in this regard have been yielded in Bulgaria or Romania. Limited effects have been found regarding the enhancement of the co-ordination of the existing facilities. Although significant effects were found in Poland and, to a lesser extent, Slovakia, hardly any effect was found in Hungary, Czech Republic and Estonia. Adverse effects have been observed in Slovenia. Overall, very limited or no effects have been found regarding the improvement of both the business and financial environment conditions. Although Poland has benefited from the Phare assistance for the improvement of business environment, limited results have been noticed in Estonia for both the improvement of financial and business environment. The financial environment has improved with Phare support in Czech Republic, Hungary and Slovakia, but remains unchanged in Bulgaria, Estonia, Slovenia, Poland and Romania. The institutional framework in Romania, Latvia, Lithuania and Romania is unsatisfactory.

5. RECOMMENDATIONS

The following recommendations address the challenges defined in the Problem Situation Analysis. They are set out in a manner designed to assist planning. More specific country recommendations are incorporated within Annex 8 on a country-by-country basis.

5.1 Completing structural reforms

5.1.1 CC governments should:

- (a) Speed up the design and implementation of the urgently required reforms concerning the introduction of effective mechanisms for corporate governance and enterprise restructuring;
- (b) Commit themselves to the alignment of Stock Exchange systems with those of the EU, as a tool to ease the constraints on access to credit for SME;
- (c) Address the competitiveness of SME at policy level focusing on the identification of fully fledged programmes aimed at upgrading managerial and manufacturing skills; and
- (d) For each of the above steps, define a detailed action plan, capable of being monitored and followed up by the responsible bodies.

5.1.2 The Commission Services should follow developments, supporting, if necessary, the CC governments' efforts with specific technical and/or financial assistance.

5.2 Benchmarking the SME sector at national level

5.2.1 Before embarking on any benchmarking activity, CC governments should verify the effectiveness of the National Statistics Offices in developing and collecting statistical data relative to the SME sector. If deemed necessary, specific support should be designed by the Commission Services in co-operation with EUROSTAT.

5.2.2 The Commission Services should explore with the CC the possibility of launching a CC benchmarking analysis to build upon the positive results of the CC BEST initiative. The findings of the analysis should be discussed by the representatives of the CC and the Commission Services in the frame of ad hoc seminars and/or workshops, to identify examples of good practice that could be replicated successfully within the CC. The analysis should be extended to include a representative sample of EU Member States.

5.2.3 The benchmarking analysis should be carried out by the CC addressing two main themes: Entrepreneurship Development and SME Dynamics (see Annex 5)

5.3 Definition and approval of multi-annual SME Development Strategies

5.3.1 CC governments should develop a medium-term multi-annual SME Development Strategy, addressing the needs of the sector up to 2006. Such a strategy should address the following:

- (a) Promoting entrepreneurship as a tool to support enterprise creation and reduction of unemployment, placing particular stress on achieving results more aligned with the EU average in terms of numbers of SME per 1,000 inhabitants and share of employment covered by the SME sector;

- (b) Boosting the start-up rate and the chances for newly established enterprises to survive and grow;
- (c) Stimulating the development of the regulatory and business environment taking account of sustainable development, to encourage research, innovation and entrepreneurship to meet the needs of the sector;
- (d) Improvement of access to finance for SME, especially for start-up and early stage financial schemes;
- (e) Enhancing the competitiveness of the SME sector and further developing internationalisation in the context of globalisation and a knowledge-based economy;
- (f) Implementing ad hoc upgrade programmes addressing the existing SME in order to carry up internal reorganisations addressing, booth, the implementation of “materials” (i.e.: purchase of equipment, machinery, etc.) and “immaterials” (implementation of management, manufacturing, financial management, etc) actions with the financial support of state budget;
- (g) Ensuring that the National Business Support Networks and Services to SME are provided in an effective, well co-ordinated and rational way;
- (h) Defining specific measures to support and encourage innovative approaches, through the existing network of BIC and Business Incubators in collaboration with universities and other research centres; and
- (i) Defining fully-fledged human resources development programmes, specifically addressing the development/strengthening of entrepreneurial skills.
- (j) Promote the development of Business Associations as key interlocutors both at policy level and vector of best practice transfer;

5.3.2 In order to produce effective strategic and policy development documents, CC governments should adopt a methodological approach based on the following aspects:

- (a) Ensure that the needs of SME are fully taken into account. In this respect it is essential to carry out an in-depth SME Survey in each CC, informed by the benchmarking analysis referred to above, which should lead to a statistical and technical understanding of SME needs.
- (b) Support policy development through the identification, exchange and implementation of good practice. The findings of the benchmarking analysis, and the supporting seminars and workshops organised to exchange views and experience, should allow the CC governments to identify measures capable of effectively supporting SME development and upgrading.
- (c) Carefully review the existing regional development strategies to ensure that the SME strategy is well embedded into the regional development strategies.

5.3.3 The CC governments should define a rational and well co-ordinated institutional framework, capable of defining and implementing the broad economic and social policies defined by the multi-annual SME Development Strategy. Clear lines of responsibility and accountability should be set by the Government, which should provide the Ministry responsible for the implementation of the strategy with the necessary authority.

5.3.4 The Enterprise DG should closely follow the CC efforts to produce, approve and implement the multi-annual SME Development Strategy.

5.4 Contribute to the development of a coherent National Business Support System

5.4.1 CC governments should organise an operational and management review - carried out by independent external evaluators - of the existing national business support network, in order to increase its effectiveness and efficiency, to reduce duplication and ensure a rationalisation of the services provided.

5.4.2 In order to ensure a greater coherence in the provision of support services, CC governments should establish a network of SME one-stop shops to ensure that SME can readily obtain information on all the support services they need. The Euro Information and Correspondence Centres and/or the National Chambers of Commerce should have a considerably bigger role to play in the provision of information. The Enterprise DG should explore the possibility of providing specific support to setting up this network, taking advantage of existing resources.

5.4.3 Each CC has a unique SME sector and macro-economic environment that should be carefully considered when rationalisation is conceived. A number of concerted actions are presently on going within the EU and the CC governments should explore, in collaboration with the Enterprise DG, the possibility of receiving specific support from EURADA (European Association of Development Agencies). EURADA has recently conducted a benchmarking exercise on development activities in general, and specifically on support services, and could advise on the organisation of a benchmarking exercise, focusing on the various national business support networks, as a tool to define good practice⁹ in respect of the rationalisation of the services provided to SME in CCs.

5.4.4 A scheme of rationalisation of the services provided by the National Business Support network could be approached, if appropriate with the support of the Enterprise DG, in accordance with the measures suggested in Annex 6.

5.4.5 Client orientation is a crucial principle in support service provision and the Business Support networks should take account of the differing needs of various types of SME. These should be met through the development of distinct packages of services for different target groups, ranging (besides the obvious size ceiling) from start-ups and enterprises in an embryonic phase, to more mature enterprises in the development phase. Coherent pricing policies should be developed for the various categories of services, and clear policies developed for the relationship between public and private provision.

5.4.6 In accordance with the EU principle of subsidiarity, services are most effective when they are brought close to the small-scale entrepreneurs. Government institutions should use local support structures wherever possible to ensure outreach services have a viable number of clients.

5.4.7 Consistent and effective promotion of support services offered by the network should be planned, and the development of new products and services to meet market requirements should be a priority for the business support networks. The transfer of technology and know-how from advanced market economies is an important part of developing research and development capacity in CC. (Successful examples include the organisation of sub-contracting

⁹ Recently, important restructuring processes have been carried out in a number of EU Member States. Examples of good practice are in Ireland (with the establishment of Enterprise Ireland), Sweden (with its ALMI amalgamation) and Finland (Finnish TE Centres).

exchanges and/ or supply chain development programmes, similar to the ones developed by ITDH in Hungary, and by CzechInvest).

5.4.8 Specific attention should however be placed on the development of adequate advisory services run by private SME.

5.5 Improving the business environment

5.5.1 Cutting red tape is a key challenge for the CC. This implies making existing and future regulations as simple as possible. In accordance with the Commission Services proposals¹⁰ *the EU must 'think small first' to avoid undue burdens on business...the regulation, which is right for small firms, can be handled by all firms, but the reverse is not true.* This is a highly relevant recommendation for CC governments in formulating their policies.

5.5.2 When new measures are proposed, CC governments should carry out a preliminary business impact assessment.

5.5.3 CC governments should regularly monitor the opinion of SME on the business environment in order to verify the effectiveness of the existing regulatory policy.

5.5.4 The adoption of the *acquis communautaire* is a costly exercise for micro-and small enterprises, and CC governments should carry out an analysis of its impact. On the basis of the findings CC governments should explore the possibility of providing financial and technical support for the application of the new regulations linked with the *acquis*.

5.6 Specific measures to support and encourage innovative approaches

5.6.1 In order to strengthen the role of Incubators in supporting SME development with specific attention to innovation, the CC governments should consider a number of measures, including finance and good practice in incubator infrastructure and innovation support (see Annex 7).

5.6.2 CC governments should explore with the Enterprise DG the possibility of launching a joint Action Plan to strengthen the existing network of business Incubators, including cross-border provision.

5.7 Promoting better access to finance

5.7.1 In order to support requests for collateral from SME, CC governments should allocate adequate financial resources to support Bank Guarantee Schemes.

5.7.2 In order to support start ups and the early stages of their development, CC governments should develop non-banking loans schemes, and organise equity and/or venture capital schemes.

5.7.3 The Business Angels concept is still significantly underdeveloped. CC governments should define, with the support of the Enterprise DG, a plan to introduce this concept in a more systematic way.

¹⁰ DG Enterprise – “Proposal for a Council Decision on a multi-annual programme for enterprise and entrepreneurship (2001-2005)

5.8 Addressing the future utilisation of Structural Funds

5.8.1 The Regional Policy DG should analyse the soundness of the institutional frameworks established within CC for the eventual utilisation of SF in relation to SME Development.

5.8.2 In order to avoid overlapping and an inefficient use of the funds, clear levels of accountability must be defined between Ministries involved, to ensure the smooth and effective implementation of the measures funded after accession and aimed at further strengthening of SME.

5.8.3 The gap between national and regional skills in planning development programmes needs to be narrowed in CC to produce a coherent approach to SF. The absorption capacity of regional and local development agencies in the CC is generally limited.

5.9 Human resources development programmes to strengthen entrepreneurial skills

5.9.1 Governments should invest in human resource development and set up special programmes for support for business start-ups and for the early stages of development for Micro- and Small enterprises.

5.9.2 Governments should promote and provide information about the business environment, business start-up, planning and management in vocational and secondary schools.

5.9.3 Governments are in the better position to co-ordinate the existing governmental and non-governmental institutions and organisations that are active in the provision of training in the SME sector. A special effort should be made to co-ordinate and publish templates and examples for human resource development.

II ANNEXES

Annex 1. Fact-finding meetings with Phare Country Co-ordinators and identification of priorities to be addressed at Country level.

| Issues/ Meeting | Relevant Findings | Suggested Report Focus |
|---|--|---|
| Mr. Bardo Gavazzoli DG Enlargement 08-06-01 | <ul style="list-style-type: none"> • A review of the orientations of Phare support to enterprise sector has been recently carried out. • In February 2000 an overall evaluation of Phare support covering period 1990-1998 has been presented defining a number of recommendations. Phare has accepted the recommendations and has been reoriented consequently. • Further support needed for the joint Phare EBRD SME Facility • A number of guiding principles have been set by the Commission to foster SME development: <ul style="list-style-type: none"> - differentiation between CC; - flexibility to take into account progress in CC and regions; - stronger links between projects and national strategies; - ensuring additionality of projects and the maximum aid leverage; - setting rules for co-financing and aid rates; - identifying goods practices and favouring the exchange of experience between CC. • For the future, Phare is planning to support projects under one or several of three main orientations: <ul style="list-style-type: none"> - the general needs for improvement of the business environment; - preparation of SME for competing in the Single Market; - integration of EU policies in supporting the enterprise sector. | <ul style="list-style-type: none"> • How the enterprises within the CC are tackling a number of perceived challenges (list provided) • How the Governments within the CC are tackling a number of perceived challenges. (list provided) |
| Mr. Gigliotti – Mr. Serri DG Enlargement Slovak Republic Team 12-07-01 | <ul style="list-style-type: none"> • Only partially aware of the Multi annual programme on SME; • Unclear situation of BIC/RAIC vis-a-vis their statute. • On going restructuring of banking sector could have caused some problems in committing the Phare SME support programme for establishment of financial schemes; • Unclear about the behaviour of NADSME in managing funds. • SARIO is suffering from sustainability problems. | <ul style="list-style-type: none"> • Financial Schemes: <ul style="list-style-type: none"> - SME EBRD/Phare Facility; - Financial management of the schemes (Financial audit of NADSME) • Sustainability of BIC/RAIC; |
| Mr. Declerck DG Enlargement Deputy Head of Unit 12-07-01 | <ul style="list-style-type: none"> • Crucial not to provide enterprises with subsidies. • Main challenges of SME: Production & Creation of Added value. • The Business Associations are the ideal instruments to provide adequate support and services to the SME. • The problem of access to credit is not any longer a general issue. The problem is the effectiveness of the regulations affecting the banking system vis-a-vis the credit conditions (i.e.; the bankruptcy law that should allow adequate mechanism to | <ul style="list-style-type: none"> • Business Environment: <ul style="list-style-type: none"> - Legislation; - Corruption; - Best Practices; - Regulations. • Financial schemes: <ul style="list-style-type: none"> - Role of SME EBRD/Phare Facility; |

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| | <p>execute mortgages).</p> <ul style="list-style-type: none"> • The main aim of the financial scheme is to stimulate access for SME to credit. • Enterprise privatisation / restructuring issues are not really focusing on SME. • Importance of having ensured at least 25 % of co-financing. | <ul style="list-style-type: none"> • Role of Business Associations |
| <p>Ms. Scheffer DG Enlargement Latvia Team 12-07-01</p> | <ul style="list-style-type: none"> • In LATVIA the interest rate is still too high, for SME, in comparison with macro economic indicators. • Late start of Guarantee Fund. • Ineffective implementation (adoption) of relevant legislation. • Policy advice of Phare not translated into concrete action. • Lack of transparency • Very weak institutional framework. • Weak Latvian Development Agency: lack of adequate skills and Business Associations • No interest in being registered as an SME. • Ethnic problems between Russians and Latvians. Russian SME not transparent. • No actions to support export / promote FDI. • Money available but not easily accessible to SME.. • EBRD TAM successful in Latvia • Free Port and Free Economic Zones have been established but are not on line with EU regulations | <ul style="list-style-type: none"> • Institutional framework: <ul style="list-style-type: none"> - Role of Latvian Development Agency. |
| <p>Mr. Singh – Mr. Avigdor DG Enlargement Estonia Team 12-07-01</p> | <ul style="list-style-type: none"> • NDP produced • SME development is under umbrella of Ministry of economic affairs • The MEA is co-ordinating the implementation of programmes through RDA and BDA. • The Ministry of Finance is the overall “co-ordinating Ministry”, is co-ordinating the NDP and the (eventual) structural funds. • Reach web site of Estonia • Estonia is a small country and SME are a large part of the enterprises. • A certain regional imbalance is causing problems at regional level. • Access to credit is not a topical issue. • Estonia is mainly a trader • SME focus on three sectors: <ul style="list-style-type: none"> - High tech - Agro-industry - Wood industry - Tourism. • No need to focus on <i>acquis</i> related issues. | <ul style="list-style-type: none"> • Institutional framework: <ul style="list-style-type: none"> - What are the most effective measures in terms of reduction of unemployment, access to credit, and entrepreneurship development? - Which are the main weakness to be addressed by Phare? |

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| <p>Mr. Canciani DG Enlargement Hungary Team 13-07-01</p> | <ul style="list-style-type: none"> • The Szecheny Plan is co-ordinated by the MVF and not by the MVA. • There are different actors involved in regional development: Ministry of Agriculture and rural development – Ministry of Economic Affairs. • Phare has launched, for the first time ever, a project supporting E-Commerce. | <ul style="list-style-type: none"> • Business Environment • Access to credit (SME EBRD/Phare Facility in primis) • Business Incubators |
| <p>Mr. Sparkes DG Enlargement Bulgaria Team 13-07-01</p> | <ul style="list-style-type: none"> • Bulgaria is supporting SME through a network of Business advisory services co-ordinate by a SME Development Agency. • Regional development is not an issue. • The Ministry of Economy is responsible for programming; implementation and evaluation of SME related programmes. | <ul style="list-style-type: none"> • Financial Schemes (specific reference made to the Phare/EBRD SME Facility). • Advisory services. • Business Incubators. |
| <p>Mr. McClay DG Enlargement Romania Team 13-07-01</p> | <ul style="list-style-type: none"> • The institutional framework is not very clear. • There is a Ministry for SME since the beginning of 2001. • The ministry is co-ordinating its activities with the “Ministry of Development and Prognosis (MDP)”. • The Operational responsibility lies with the MoSME. The SME Development Agency is acting under this umbrella. • The overall co-ordination for the economic and social cohesion programmes lie with the MDP. The Regional development agency is acting under this umbrella. • For 1999-2000-2001, the Phare programme is mainly supporting Grant Schemes (implemented by the 8 regional development Agencies). On this basis, the SME are not expected to reimburse the funds but they have to co-finance the project and to present a business plan. The Grant Scheme could also be utilised for the provision of services. It could generate a conflict with the EBRD/Phare SME Facility. • The banking sector is still under privatisation. • The year 2000 has been a lost year. | <ul style="list-style-type: none"> • Management of Grant Scheme. • Institutional Framework |
| <p>Mr. Claeýé DG Enlargement Poland Team 16-07-01</p> | <ul style="list-style-type: none"> • Considerable improvements since OMAS last report. • Since 01-01-2001 an SME Development Agency has been established following the approval (2000) of a Law on SME. Big problem: how to deal with government? How to find a role in the market? What role the Agency should play regarding EU Structural Funds? • The new Agency for Entrepreneurship Development has replaced the previously existing Foundation for SME. The staff and the local network is the same as the Foundation. Now the Agency is entitled to receive subsidies from the Government. Its running costs are partially covered by USAID. • The Development Agency is competing with this Agency for the utilisation/planning of EU SF. • How to be ready for utilising EU SF between 2004 and 2006? | <ul style="list-style-type: none"> • Complex financial schemes (e.g.: Equity scheme, Guarantee loan Scheme). |

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| | <ul style="list-style-type: none"> • No National Development Plan has been produced yet. • The Banking sector is very competitive, and 90% of the sector is owned by foreigners. • The EBRD/Phare SME Facility has not yet delivered any results. It's at the starting phase | |
| <p>Mr. Hodjik – Ms. Moran</p> <p>CSD Czech Republic 25-07-01</p> | <ul style="list-style-type: none"> • The time is too short to produce a valid report. • The co-ordination with DG Enterprise has to improve. • A twinning project is addressing the improvement of legal and institutional environment. Need to see it. • The CSD is not following up the EBRD/Phare SME Facility. Apparently, three agreements has been reached with Ceska Sporitelna and with the Czech-Slovak SME Fund. No info on the conditions set by the facility to SME. • Need to see the private banks active in supporting SME • So far, Phare concentrated in institutional Building activities: little has been done to provide direct financial support to SME. | <ul style="list-style-type: none"> • Institutional Framework. <ul style="list-style-type: none"> - Not yet clear how many Managing Authorities will be appointed for the eventual utilisation of SF. - For each programme there should be need for an MA. - Role of CRD vis-avis BDA for the management of Grant Scheme. - The MIT has recently established a new body: Czech industry. Their role is unclear - Conflict of responsibility between MREGDEV and MIT re SF - Technical & financial sustainability of BDA • Business environment <ul style="list-style-type: none"> - How many months to set up a company? Unclear - The existing legislation is valid but the problem is how to implement it - Problem: access to medium-long term credit • Existing Association network <ul style="list-style-type: none"> - Too large a number of association is assisting SME. - The ASMEC has been selected for the Business support programme. Was it the right choice? |

Annex 2. Investment Support from Structural Funds

1. Under Regulation 1260/99 and the Vade Mecum for Structural Funds Plans and Programming Documents, CCs need to:
 - a) adopt an integrated approach, with actions selected to contribute to a common objective, such as combating industrial decline, in particular with SF type measures, linked with interventions to promote the business environment. Ex-ante evaluation (as referred to in Article 41 of 1260/99) should be started.
 - b) establish geographical coverage at the geographical level deemed most appropriate by the CC, but with the NUTS II level as the minimum, with the possibility of focusing on areas with specific and severe problems (in accordance with Article 13 of 1260/99).
2. Countries are expected to provide revised NDPs or NDPs in the middle of 2001 that will underpin both multi-annual programming for ESC projects financed from Phare 2002-06 and the preparations for Structural Funds.

ANNEX 3. Thematic Assessment Matrix defining Evaluation Criteria for selected Measures

| CRITERIA ¹¹ MEASURES | Simplification and improvement of business environment. | Improved financial environment for SME. | Enhancement of SME Competitiveness and internationalisation through better access to research, innovation, training and information services. | Enhanced co-ordination of existing facilities to give business easier access to support services, programmes and networks. | Promotion of entrepreneurship at regional and local level. |
|--|--|--|---|--|--|
| <ul style="list-style-type: none"> • Institutional Building. - TA to SME Dev.Ag. - TA to RDA - Information & Counselling Networks¹². - TA to Businesses representations. - TA To Trade Organisations | BG 1 CZ 1 ES 2 HU 1 LA 1 LI 1 PO 3 RO 1 SL 1 SK 1 | BG 2 CZ 2 ES 1 HU 2 LA 1 LI 1 PO 1 RO 2 SL 1 SK 2 | BG 1 CZ 2 ES 1 HU 2 LA 1 LI 1 PO 3 RO 1 SL 1 SK 2 | BG 1 CZ 1 ES 1 HU 1 LA 2 LI 1 PO 3 RO 1 SL 0 SK 3 | BG 1 CZ 2 ES 1 HU 2 LA 2 LI 1 PO 3 RO 1 SL 1 SK 2 |
| <ul style="list-style-type: none"> • SME Policy Development¹³. - TA for the development of National SME Strategy. - Approximation of legislation. | BG 1 CZ 1 ES 2 HU 1 LA 1 LI 0 PO 3 RO 1 SL 1 SK 1 | BG 1 CZ 2 ES 1 HU 1 LA 1 LI 1 PO 1 RO 1 SL 1 SK 1 | BG 1 CZ 1 ES 2 HU 2 LA 1 LI 1 PO 2 RO 1 SL 1 SK 1 | BG 1 CZ 1 ES 1 HU 1 LA 1 LI 1 PO 3 RO 1 SL 1 SK 2 | BG 1 CZ 2 ES 1 HU 2 LA 2 LI 1 PO 3 RO 1 SL 1 SK 1 |

¹¹ Criteria Rating: 0=Negative effect; 1= No significant effect; 2= Limited effect; 3= Significant beneficial effect.

¹² Business Information centres – Regional Advisory and Counselling Services – Euro Information Centres.

¹³ TA has also been provided under the TAIEX Scheme.

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|--|---|--|--|--|
| <ul style="list-style-type: none"> • Direct non-financial support to SME. - Advisory Services. BG 1 - Promotion of co-operation between SME. CZ 1 ES 2 HU 1 - Business incubators LA 1 - Sub-contracting Exchange Office. LI 1 PO 3 RO 1 SL 1 SK 2 | <ul style="list-style-type: none"> BG 2 CZ 2 ES 1 HU 2 LA 1 LI 1 PO 1 RO 1 SL 1 SK 2 | <ul style="list-style-type: none"> BG 1 CZ 2 ES 1 HU 2 LA 1 LI 1 PO 3 RO 1 SL 2 SK 3 | <ul style="list-style-type: none"> BG 1 CZ 1 ES 1 HU 1 LA 2 LI 1 PO 3 RO 1 SL 0 SK 2 | <ul style="list-style-type: none"> BG 1 CZ 2 ES 1 HU 2 LA 1 LI 1 PO 3 RO 1 SL 1 SK 2 |
| <ul style="list-style-type: none"> • Direct Financial Support to SME - Grants in combination with National Bank Loans. BG 1 - Guarantees Schemes. CZ 1 ES 1 HU 1 - Start-up Schemes. LA 1 LI 1 - Micro-credit Schemes. PO 1 RO 1 - Equity Schemes. SL 1 SK 1 | <ul style="list-style-type: none"> BG 2 CZ 2 ES 2 HU 2 LA 2 LI 1 PO 1 RO 2 SL 1 SK 2 | <ul style="list-style-type: none"> BG 1 CZ 2 ES 1 HU 2 LA 1 LI 1 PO 1 RO 1 SL 1 SK 2 | <ul style="list-style-type: none"> BG 1 CZ 1 ES 1 HU 1 LA 1 LI 1 PO 1 RO 1 SL 1 SK 2 | <ul style="list-style-type: none"> BG 1 CZ 2 ES 1 HU 2 LA 2 LI 1 PO 1 RO 1 SL 1 SK 2 |
| <ul style="list-style-type: none"> • TOTALS | <ul style="list-style-type: none"> BG 1 CZ 1 ES 1.85 HU 1 LA 1 LI 0.85 PO 2.5 RO 1 SL 1 SK 1.25 | <ul style="list-style-type: none"> BG 1 CZ 2 ES 1.25 HU 1.85 LA 1.25 LI 1 PO 1 RO 1 SL 1 SK 1.85 | <ul style="list-style-type: none"> BG 1 CZ 1.85 ES 1.25 HU 2 LA 1 LI 1 PO 2.25 RO 1 SL 1.25 SK 2.0 | <ul style="list-style-type: none"> BG 1 CZ 1.85 ES 1.25 HU 1 LA 1.25 LI 1 PO 2.5 RO 1 SL 0.5 SK 2.25 |

Annex 4. Policy, Regulatory, Support and Institutional issues to be addressed at Country level

Policy Issues

1. Existing economic and social policies, in order to provide an overview of policy towards the private sector and an evaluation of the degree to which is sympathetic to SME.
2. Which Government and Ministries and Departments have prime policy responsibility. 3. Comment on existing co-ordination between government departments.
4. Is there a clearly defined National Strategy on SME? Is it well embedded with the regional development strategies?
5. How is the Government defining sector needs?
6. Is there adequate understanding of the international competitiveness attained by the local SME?

Regulatory Issues

1. Is Regulatory policy adequate for the further development of the SME sector in the Country?
2. Is there any clear statement of priorities in updating the SME regulatory environment vis-a-vis registrations, licenses, labour law, health and safety at work, company law, product liability, bankruptcy law, etc?
3. Is there any research/studies addressing the need to improve the regulatory environment to EU standards?
4. What are the main shortcomings of the existing regulatory framework for SME?

Support Issues

1. Which aspects of SME Development are presently covered by the Government and/or by donors other than Phare?
2. Identify success stories that can be replicated by Phare in other Countries.
3. Financial support schemes – tax incentives – Incubators – training programme – information and counselling schemes – etc.

Institutional Issues

1. Key institutions and associations involved in the national SME development framework.
2. Type and effectiveness of the services provided to SME
3. Type of assistance received by National and donors different from Phare including Business and Advisory Centres active in the Country.

Annex 5. Recommendations for an SME benchmark analysis

1. Entrepreneurship Development

a) Entrepreneurial Dynamism

This indicator is focusing on the capacity to adapt to changing market conditions. In this respect, the creation of new enterprises is one of the main mechanisms of adjustment to new market conditions. This is an indicator of specific relevance for those Countries for which the number of SME per 1,000 inhabitants is (considerably) below EU-15 average. It is recommended to utilise the number of start-ups of enterprises as an indicator, as a percentage of total enterprise stock. In the EU, the data ranges from 8% in Portugal and 6% in Ireland, to 1% in Belgium and Italy. This type of data is not yet easily available within the CC.

The enterprise survival rate after three years is a relevant data to assess the level of competitiveness. The data is the number of new enterprises created in year “n-3” still surviving in year “n” as a percentage of total number of start-ups of enterprises in year “n-3”. The data in the EU ranges between 70% in Belgium, Netherlands and Finland and 55% in Denmark. Information on survival rates after 36 months is not yet available in CC, similarly no information is available concerning the survival rate after 12, 18 or 24 months. The only exception is Estonia, for which data is available for the survival rate after 12 months of enterprises established in 1997, and which is considerably below EU average (i.e. lower than 40%).

The added value per employee is a useful indicator for productivity and, consequently, the competitiveness of the sector. Although data are not available for all CC, what is available gives cause for concern. Against an average added value of €45,000 for the EU, Slovenia has registered a performance of €17,000. Even this is considerable better than the Czech Republic (€10,000) or Slovakia (€4,300).

b) Regulatory and Business Constraints

Concerning regulatory constraints, relevant data are the time requirement and costs necessary for company registration. The data indicates the overall administrative and regulatory environment in which enterprises will have to operate. In order to establish a preliminary benchmark, within the EU the time involved in setting up a company ranged, in 1997, from 24 weeks in Spain to 1-5 weeks in Belgium, Ireland, Sweden and UK. The costs involved in setting up a company ranged, in 1997, from €2,000 in Austria, to a few hundred € in Spain, Ireland, Italy, Finland, Sweden and UK.

Concerning business constraints, survey a representative sample of micro- small- and medium-enterprises in order to identify the policy areas where improvement is needed. A tentative list of possible business constraints to be investigated would include (a) lack of skilled labour force; (b) access to finance; (c) technology change; (d) Government regulation; (e) infrastructure).

c) Capital markets / financial conditions

Availability of early stage venture capital is instrumental in the provision of effective support to SME in their start-up and/or embryonic phase. The professional services that normally accompany the provisions of early stage capital increase the chances of success. In this respect,

a very useful indicator is the total venture capital and early stage financing as a percentage of GDP¹⁴. The Netherlands (0.31 %), Belgium (0.28%), the UK (0.2%) and Sweden (0.19%) are well ahead of the rest of the EU, although they are all far behind the USA (0.38%).

Over the past few years, the activity of Business Angels has considerably increased. Business Angels are private informal investors that fund projects that are generally too small for venture capital institutions. They are an alternative to bank financing or to funds provided by family and/or friends. They often play a monitor role as well. Organised networks of business angels (BAN) make it easier for fund seekers to establish contacts with them. In terms of benchmarking is recommended to concentrate on the number of active BAN and on number of deals initiated by BAN. In 1999, there were 109 active BAN (48 in UK, none in Spain or Portugal) having initiated 400 deals (234 in UK, none in Denmark, Spain, Italy or Portugal).

d) Enterprise Dynamics

Innovative Capacity

The capacity to innovate is an important component of competitiveness. In this respect, public expenditure on R&D as percentage of GDP is very important benchmark data. For 1998, Sweden (0.95%), Finland and France (0.90%), Germany and Netherlands (0.80%), Austria and Denmark (0.70%) devoted, in 1998, a larger proportion of their GDP to the R&D than the USA and EU average.

The share of innovative SME in total (%) is an excellent benchmark for innovation. An enterprise is defined as innovative if it reported having introduced new or improved products on the market or new or improved processes. Data available for 1997 show that, on average, 42% of the EU SME are innovative. Ireland (62%), Austria (59%), Germany (59%), Denmark (59%), the Netherlands (50%), Sweden (43%) and Italy (43%) are above average.

Knowledge based economy:

The knowledge-based economy is considered *from the point of view of new, fast growing markets in which the sooner enterprises engage the better off they should be*¹⁵. A useful indicator to measure the adaptation of SME to new market conditions is the number of SME using Internet for commercial purposes. As far as 1999 is concerned, the EU average was 20%. Germany, Sweden and Austria (32%), and Luxembourg (28%) are showing performances above EU average.

¹⁴ Venture capital investment can be distinguished according to the stage of development of the beneficiary enterprises. The sum of seed and start up capital constitutes the early stage capital. Moreover, Seed capital is aimed at financing research, assessment and development of an initial concept. Start up capital is the capital provided to companies for product development and initial marketing.

¹⁵ DG Enterprise – Commission Staff Working Document – “Benchmarking enterprise policy” October 2000 (SEC(2000) 1841).

Annex 6. Recommendations for an approach to the rationalisation of the Business Support Networks.

Means of Co-ordination

- Merger of existing agencies / institutions at National, regional or local level.
- Restructuring of services to provide a comprehensive solution approach to the client's needs.
- Development of integrated service of high-specialised centres.
- Common umbrella for different Agencies or services, which will keep their autonomy under a common overall strategy.
- National Agency with regional offices or with specialised services providing integrated services in co-ordination with other support services.

Conditions for effective support services

- Diagnosis of SME needs. Measurement of the degree of satisfaction with the services delivered. Differentiate between Micro-Small-Medium size enterprises as well as between services to start-up, early stage and development services.
- Strategic planning of the network. Definition of measurable indicators of achievement with a specific attention on the expected outreaching capability (i.e.: which percentage of active SME should be assisted).
- Definition of standards procedures of service delivery and communication between support services of the network. Eventual compulsory ISO 9001 certification requirement for the Centres belonging to the Business Support network.
- Benchmarking of support services aiming at improving their performance on the basis of good practice.
- Establishment of a networks of "SME-One-Stop-Shops"

Practical problems in the co-ordination process

- Willingness of the (independent) Agencies to be co-ordinated.
- Effective communication system between the members of the network.
- Avoiding risk of duplication and overlapping.

Annex 7. Recommendations for the strengthening of the Business Incubator networks.

Finance for Incubator infrastructure and innovation support

- Government of the CC to provide, if necessary in collaboration with the EU, public funding for incubator projects.
- There is a need to facilitate the development of networks of individual incubator projects, with the aim of achieving critical mass sufficient to attract the private sector, particularly in the development of training and support services.
- Explore the possibility to define tax incentives to attract greater private sector funding of incubator projects, recognising that such funding may not deliver benefits until the project is fully developed and mature.

Good practice in Incubator Infrastructure and Innovative Support

- The governments of the CC are recommended to organise an impact study on existing incubators focusing, inter alia, on the number of businesses started, their survival rate after 12, 18, 36 months, the the number of jobs created and the exports generated.
- A benchmarking exercise should be organised and carried out, utilising as many managers of EU Incubators as possible, in order to define a good practice. Based on the findings of the analysis, a manual could be prepared and made available on the internet to anyone running and/or starting an incubator.
- Establish a financial scheme to support the preparation of feasibility studies and business plan development for new companies.
- The existing business Incubators are recommended to establish cross-border partnerships.
- There is need to ensure an effective partnership between business incubators and large industrial companies.

Annex 8. Country Studies Statistical Summary

Country Overview

| Country Overview | BG | CZ | HU | SK | PL | EE | SL | LV | RO | LT |
|---|--------|--------|--------|--------|---------|--------|--------|--------|--------|--------|
| Population (Ms) (2000) | 8.2 | 10.3 | 10 | 5.4 | 38.65 | 1.4 | 2 | 2.4 | 22.5 | 3.7 |
| Population Growth (per 1000 people) | -4.8 | -1.1 | -4.8 | 1 | -0.3 | -4.4 | 4.8 | -6.3 | -1.5 | -0.6 |
| GDP (M €) | 13,000 | 51,200 | 45,100 | 18,500 | 145,500 | 4,900 | 18,800 | 6,400 | 40,000 | 10,000 |
| Real Economic Growth (GDP Growth Over previous year, 2000) | 5.8% | 2.50% | 5.20% | 2.20% | 4.10% | 6.90% | 4.60% | 6.60% | 1.6% | 3.30% |
| GDP per capita in PPP (€) (2000) (EU-15= 22,530 €) | 5,400 | 13,500 | 11,700 | 10,800 | 8,700 | 8,500 | 16,100 | 6,600 | 6,000 | 6,600 |
| GDP per capita PPP as % of EU-15 (2000) | 24.0% | 59.00% | 52.00% | 47.90% | 38.60% | 37.70% | 71.40% | 29.30% | 26.6% | 29.30% |
| Inflation (%) (2000) | 10.3% | 3.90% | 10.00% | 12.70% | 10.10% | 3.90% | 8.90% | 2.60% | 45.7% | 0.90% |
| Rate of Unemployment (%) (2000) | 16.2% | 8.80% | 6.60% | 19.10% | 16.30% | 13.20% | 6.90% | 14.20% | 7.0% | 15.60% |
| Inward Foreign Direct (FDI) Investment (M €) | | 4,792 | 1,849 | 306 | 6,821 | 284 | 170 | 456 | | 317 |
| Inward FDI per Capita (€) | | 465 | 185 | 57 | 176 | 203 | 85 | 190 | | 86 |
| Outward FDI (M €) | | -185 | -237 | 354 | -15 | -79 | -35 | -15 | | -8 |
| Outward FDI per Capita (€) | | -17.96 | -23.70 | 65.56 | -0.39 | -56.43 | -17.50 | -6.25 | | -2.16 |
| Trade Balance (M €) | -1,833 | -1,932 | -2,059 | -1,035 | -14,142 | -827 | -1,168 | -936 | -3,055 | -1,318 |
| Trade Balance as % of GDP | -4.1% | -4% | -5% | -6% | -10% | -17% | -6% | -15% | -4% | -13% |
| Gross Foreign Debt as % of GDP | | 22.80% | 56.10% | 42.10% | 31.10% | 48.50% | 24.20% | 26.50% | | 25.20% |

Notes: All Figures 1999 unless stated

Sources: Eurostat- Statistical yearbook on Candidate Countries (Eurostat, 2001);

Key data on Candidate countries (Eurostat, 129/2001)

European Parliament (http://www.europarl.eu.int/enlargement/briefings/index2_en.htm)

Summary of the Status of the SME Sector:

| Status of SME Sector | CZ | HU | SK | PL | EE | SI | LV | BG | RO | LT |
|--|---------|-----------------------------|-------------|-----------|-------------|--------|--------|---------|---------|----------------------|
| Number of active SME's | 760,000 | 808,100 | 350,000 | 1,816,000 | >30,100 | 99,700 | 37,860 | 210,590 | 622,000 | 52000 and Decreasing |
| SME's as % of Total Enterprises | 42.62% | 99.30% | N/A | 61.00% | 99.30% | 99.70% | 99.00% | 99.6% | 97.7% | 95.60% |
| Share of GDP | 59.40% | N/A | 39.5% (GNP) | 48.00% | N/A | N/A | >60% | | 55% | N/A |
| Share of Employment | 59.10% | 59.40% | 56% | 64.30% | Approx. 50% | 63.80% | >70% | 60% | 40% | N/A |
| Share of Exports | 36.10% | Weak- mainly service sector | 30.50% | 47.60% | Approx. 10% | <20% | N/A | 32.3% | | Decreasing |
| Share of Imports | 49.40% | N/A | 44.70% | 65.40% | N/A | N/A | N/A | | | N/A |

Annex 9. Country Studies

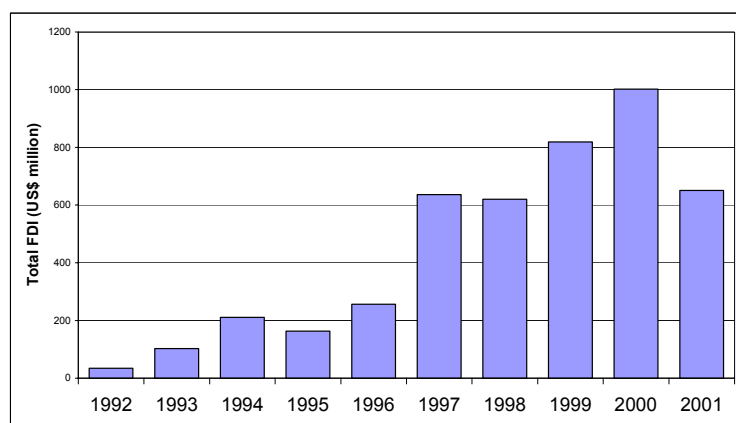
BULGARIA

General Overview

Bulgaria has a population of 8.2 M of which 1.22 M reside in the capital Sofia. Over the period 1995-1999 Bulgaria's economy contracted in size, with GDP shrinking at an average annual rate (at constant prices) of 1.8% (GDP shrank by 10.1% in 1996 and by 7.0% in 1997). Bulgaria's GDP per capita adjusted to PPS was €5,400 in 2000 (i.e. the lowest of all the CCs) and amounted to only 24% of the EU average. GDP did however grow at a rate of 5.8% in constant prices in 2000, which was among the highest of all the CCs. The unemployment rate was 17.6% at the end of May 2001 and had increased dramatically as a result of the privatisation process and restructuring in the manufacturing sector. Consumer price inflation stood at 10.3% in 2000, which represents a major stabilisation of price inflation since the collapse of the country's financial system in 1997 when price inflation stood at 1,045%. The introduction of an IMF-backed currency board on 1 July 1997 pegged the value of the Lev to the Deutschmark on a one-to-one basis and has managed to achieve rapid monetary stability.

Rates of foreign direct investment (FDI) are low in comparison to other CCs and, according to EUROSTAT (2000), Bulgaria has the lowest per capita rate of FDI among the ten CC (i.e. €239). FDI has however increased since the introduction of the currency board in 1997, although provisional estimates of levels for 2001 were lower than for the year 2000 and 1999 (see graph below). Low labour productivity and poor product quality from Bulgarian companies (needed as sub-contractors and/or co-production partners), land ownership problems,¹⁶ widespread corruption within the public administration, the complexity of the Bulgarian fiscal and administrative system and, finally, a less than optimal judicial system all continue to discourage many MNEs from setting up in the country.

Rates of FDI in Bulgaria, 1992-2001 (US\$ M)



Source: Bulgarian Foreign Investment Agency; the value for 2001 is provisional.

The process of privatisation proceeded at a relatively fast pace over recent years and the private sector share of GDP reached 56.7% in 1998, 65.3 % in 1999 and 70% in 2000.

¹⁶ The absence of a cadastre means that land ownership is often unclear and foreign nationals are restricted in their ability to acquire land. They can only purchase land if they set up a registered company and it is the Bulgarian company and not the foreign subsidiary which is the technical owner of the land.

Bulgaria foreign trade position is slowly improving and its exports grew by 20% in 2000 (\$4,812 M versus \$4,006 M in 1999), while imports grew by 17% for the same period. Moreover, 2000 witnessed a 24% rise in exports of electric machinery and apparatus. This group includes high tech industries.

Status of SME Sector

It is difficult to make a precise assessment of the number, size and activities of SME in Bulgaria. This is due to the fact that statistics on the SME sector are generally very poor with particular problems in identifying the number of “active” SME as well as SME “survival rates”. The unfriendly regulatory and fiscal environment mean many small businesses choose to operate in the so-called ‘Grey Economy’, thereby falling outside of the scope of basic data gathering exercises and normal statistical surveys.

According to the “SME Report 2000” published (in 2001) by the Agency for SME (ASME), it is estimated that there are 210 590 SME. The Report does not however specify if the data refer to “active” SME. There are 25 SME per 1,000 inhabitants, which is a very low rate in comparison to the EU-15 average (48 SME per 1,000 inhabitants), but can be partially explained by the size of the grey economy (see below).

The Number of SME in Bulgaria (by Size Classification)

| Enterprise size | 1996 | 1997 | 1998 | 1999 |
|-----------------|----------------|----------------|----------------|----------------|
| 0 - 9 | 164,092 | 175,101 | 190,008 | 195,313 |
| 10 - 49 | 9,109 | 9,825 | 11,129 | 11,761 |
| 50 - 249 | 3,862 | 3,666 | 3,708 | 3,516 |
| Total SME | 177,063 | 188,592 | 204,845 | 210,590 |
| > 250 | 937 | 775 | 798 | 739 |
| Total | 178,000 | 189,367 | 205,643 | 211,329 |

Source: “SME Report 2000” - NSI - in house elaboration (re. EU classification)

The vast majority of Bulgarian SME are small and micro-sized ones, whose combined share has remained constant in recent years at around 98% of the total number of active firms in the economy. Around 43% of micro-sized enterprises are engaged in either wholesale and retail trade or in the repair of motor vehicles or personal and household goods. This grouping also accounts for the largest proportion (31.2%) of small enterprises. In the size categories 51-250 employees, the manufacturing sector predominates, accounting for 33.5% (50-100) and 49.2% (100 - 250) of all businesses.

The sectors hotels and restaurants, transport and communications, real estate, renting and business activities, education, health and social services are all dominated by micro-sized enterprises. The sectors agriculture, fishing and forestry; mining; manufacturing; electricity, gas and water supply; and construction are proportionally over-represented with enterprises employing 11 to 50 people.

In terms of the contribution to total employment, the largest proportion of people is employed in large enterprises with more than 250 employees. Having said that, the importance of larger enterprises diminished somewhat over the period 1997-99 (see table below) and the relative importance of businesses employing 0-100 people grew over the same period. The size class dominance (in 1999) is the large one, and the percentage (39.8%) is greater than the EU-15 average (34.1%). Together with medium-sized enterprises, large enterprises ensure 62.4% of the jobs in the country.

Employment in Bulgarian Enterprises According to their Size Class (in Percent, %)

| Size of Enterprise ¹⁷ | 1997 | 1998 | 1999 |
|----------------------------------|------|------|------|
| 0-10 | 19 | 20.5 | 22.0 |
| 11-50 | 13.2 | 14.5 | 15.6 |
| 51-250 | 24.0 | 23.3 | 22.6 |
| 251+ | 43.8 | 41.8 | 39.8 |

Source: NSI - "SME Report 2000" - NSI - in house elaboration (re.: EU classification)

The largest absolute numbers of SME are unsurprisingly found in the major population centres such as Sofia, Plovdiv, Bourgas, Varna and Stara Zagora. However, in most rural and semi-rural parts of the country SME are proportionately more important with nearly all private businesses being either small or micro-sized. There are quite dramatic variations between regions in terms of the density of SME.¹⁸

In 1998, value-added per employee¹⁹ in micro-sized enterprises stood at €1,100 compared with €30,000 in the EU. In small enterprises in Bulgaria the value was €1,800 (versus €50,000 in the EU) and in medium-sized ones €4,900 (versus €95,000 in the EU).²⁰

Labour productivity in SME is much lower than in larger enterprises, with micro-sized enterprises having the lowest productivity of all. According to ASME,²¹ this tendency is widely confirmed with the exception of State-owned micro-enterprises, which have higher productivity in comparison with the large enterprises. The principal reason for this is that SME are often compelled to use equipment, which is obsolete because they lack the means of financing an upgrade of their capital stock. According to ASME, 23.7% of SME use equipment of more than 10 years of age, while only 2.9% of the companies possesses equipment that was less than one year old. Anecdotal evidence also suggests that SME suffer from higher rates of staff turnover and that MNEs are often able to attract better calibre staff, to the detriment of SME, by offering higher wages and better working conditions. There is however some evidence of convergence of productivity amongst different enterprise size groups in recent years (see table below).

¹⁷ Bulgaria has a different definition of an SME than the EU one. Micro enterprises have between 0 and 10 employees, small enterprises between 11 and 50 employees and medium-sized enterprises between 51 and 100 employees. All businesses with more than 100 employees are said to be large. To allow comparison with data for other CEEC, we use the EU classification.

¹⁸ The South-East (around Bourgas) contains the highest density of SME (per 1000 inhabitants), with the South-West (around Sofia) and North-Central (around Rousse) both also having density rates above the national average of 25.5 SME per 1000 inhabitants. On the other hand, the North-West (around Vidin) has a much lower density (16.2 SME per 1000 inhabitants).

¹⁹ Defined as the sum of the operating profit of the enterprises, the compensations of employees (including gross wages and all other payments such as social contributions, unemployment insurance etc.) and the expenditures on depreciation all of which are then averaged out on a per employee basis.

²⁰ Source: The European Observatory for SME, Sixth Report, European Commission (2000) and NSI (2000).

²¹ SME Report 2000, published in 2001 by ASME

Labour productivity in Bulgarian enterprise size classes (micro enterprises = 100)

| Enterprise Size | 1997 | 1998 | 1999 |
|---------------------|-------|-------|-------|
| (0-10 employees) | 100.0 | 100.0 | 100.0 |
| (11-50 employees) | 213.9 | 148.8 | 114.5 |
| (51-100 employees) | 215.3 | 157.0 | 118.3 |
| (101-250 employees) | 238.5 | 195.3 | 146.7 |
| (251+ employees) | 439.8 | 339.0 | 235.1 |
| All enterprises | 295.3 | 225.9 | 164.3 |

Source: NSI, reprinted in the report 'Review and Analysis of the External Assistance for Small and Medium-sized Enterprise (SME) Development in Bulgaria', commissioned by the World Bank and published in June 2001.

In terms of the contribution of SME to foreign trade, it is worth noting that the SME share of total exports has always been lower than its share of total imports. Over the years, there has however been an increase in the share of exports linked to SME (see table below).

The Contribution of SME to Exports (%)

| Year | Size | | | |
|------|----------------|-----------------|------------------|-----------------|
| | 0-10 employees | 10-50 employees | 50-250 employees | > 250 employees |
| 1997 | 8.82 | 6.50 | 11.86 | 72.82 |
| 1998 | 9.53 | 7.85 | 15.77 | 66.85 |
| 1999 | 9.17 | 7.30 | 15.84 | 67.69 |

Broad Economic and Social Policies

The Ministry of Economy is responsible for developing and implementing industrial policy. Industrial policy is conducted within the framework of the "Strategy for Improvement of the Productive Sector", a crucial part of the "National Economic Development Plan 2000–2006" (NEDP). A revised version was submitted, by the Ministry of Regional Development and Public Works, to the European Commission in May 2001. According to the Regular Report (November 2001) "(...) *The Economic Development Plan states clearly the priorities in this field but needs to be finalised and fully embedded in national decision-making to ensure that it plays an operational role in guiding policy.*"

The Ministry of Economy and the Agency for SME (ASME) in the Council of Ministers are responsible for developing and implementing SME policy. Other ministries are however also important to the SME sector. The Ministry of Regional Development and Public Works has responsibility for implementing regional development policy, and the Ministry of Labour and Social Policy has responsibility for job creation schemes, many of which are based implicitly or explicitly on the involvement of SME. Finally, the Ministry of Finance has responsibility for fiscal policy which impacts on all actors within society, including SME.

The SME sector is perceived as a tool for achieving the priorities of the regional development policy. Article 19 of the SME Act promulgated by the State Gazette 84 from 24.09.1999, contains explicit references to the functions of the local authorities (i.e. elaboration and implementation of programmes for the promotion of SME).

Current economic and social policies (particularly in the regulatory and fiscal sphere) are not yet conducive to the optimal development of the SME sector. There is however increasingly a recognition of this within the Bulgarian Government and steps are gradually being taken to

improve the situation. Bulgaria's SME policy is in line with the principles and objectives of the EC enterprise policy,²² though the definition of SME still differs (particularly in terms of medium-sized enterprises) from the EU definition.

Intra-ministry co-ordination appears to be reasonably strong but severe difficulties exist in terms of co-operation and collaboration between ministries and other stakeholder bodies. There are several reasons for this. Firstly, several ministries and other bodies have only recently been established and their specific roles are as yet not perfectly clear. This has also led to 'turf' issues with ministries/bodies competing for control of certain areas. The intensity of workloads, staffing shortages and the lack of a clear structure for joint-working also restrict the extent to which effective inter-ministry and inter-agency consultation and collaborations can take place.

ASME recently published a *National Strategy for the Development of the SME Sector for the Period 2002-2006*. The principal objective of the Strategy is to establish a favourable institutional, regulatory, administrative and financial environment to stimulate the development of SME. The Strategy has recently been approved by the Council of Ministers and is a follow-on from an earlier strategy, the *National Strategy For Stimulating The Development Of Small And Medium-Sized Enterprises* (covering the period 1998-2001).²³ A problem encountered with the 1998-2001 Strategy was that there was no means of monitoring progress with its implementation. The new strategy therefore contains short-, medium-, and long-term objectives. ASME also produces an annual report on the state of the SME sector. Other strategies, which are relevant for the SME sector, include the Bulgarian National Plan for Economic Development (NPED), which has been revised for the period 2000-2006, and the Ministry of Labour and Social Policy's Strategy for Employment Creation.

Current government priorities include the simplification of administrative procedures, the improvement of the tax system, the effective implementation of the "National Strategy for SME Development" by designing concrete programmes, and strengthening the dialogue with the business community on the refinement of existing legislation.

Regulatory Policy

According to ASME's "SME Report 2000" there are six major problems facing the SME sector in 2000. The most serious problem is reduced demand for goods and services, followed by strong competition and the State bureaucracy. Unfair competition, limited capital and high tax rates are the other three key issues.

Tax Policy

A large amount of the tax burden falls on SME. Furthermore, as tax evasion is such a common occurrence in Bulgaria, taxes have been introduced which are extremely high (based on the assumption that only a proportion of those liable will actually pay them) and are very easy to levy (but are applied in a very indiscriminate manner). A key tax in this regard is the *Patent Tax* which was introduced as a replacement for the more difficult to collect Capital-Gains Tax. The Patent Tax is, broadly speaking, levied on the amount of space which a business occupies and in no way reflects their profitability or turnover. The rate at which it is levied has recently

²² Regular Report, Nov. 2001

²³ The Strategy has two key approaches: creation of a favourable business environment, and support to start-up and SME development via effective direct support to SME.

been increased dramatically (3 or 4 fold in the case of some types of business). It is already causing many SME (particularly micro-sized ones) to collapse or to disappear into the grey economy.

Social security and VAT

Social security contributions are extremely high and this leads to several problems. Firstly, it is common-practice for SME to officially pay their staff only a basic wage with additional (untaxed) remuneration being provided on an informal basis. In more extreme cases, people working for many SME are not officially even employees of the company and are paid entirely on an unregistered, untaxed basis. It is also important to remember that a large proportion of micro-sized enterprises only employ family members (and pay them either informally or 'in-kind'). The Government has however started to modify the regulatory system. The "Mandatory Social Insurance Code" came into force at the beginning of 2000 allowing a reduction of the insurance burden for employers and the insurance allocations were allocated according to the ratio 80 (employers) - 20 (employees). The ratio is expected to reach 50:50 by 2007.

VAT in Bulgaria is levied at a rate of 20% on all products. For enterprises to gain an exemption from paying VAT on intermediate inputs they have to make purchases of at least 75,000 Lev (€38,427) per year. This is outside of the operating range of many SME, leaving them at further competitive disadvantage vis-à-vis larger enterprises. In 2000, the VAT Act provide for a reduction in the period for reimbursement of VAT paid from 6 to 4 months.

Bureaucracy

Current regulatory policy is a key barrier to the development of the SME sector. The complexity and incoherence of Government legislation affecting SME as well as associated corruption, is a key reason why many SME choose to operate in the grey economy. It has been estimated that the costs of operating in the grey economy (vis-à-vis being formally registered) are 2.4 times lower in cash terms and 3.4-times lower in terms of man-days.²⁴ There is now however a broad acknowledgement within the Government that regulatory policy needs to be reformed to make it more conducive to the development of the SME sector. Accordingly, some actions have already been taken and others are planned for the future, especially within the framework of the National Strategy for the Development of the SME Sector.

The 1999 SME Act included *inter alia* provisions designed to favour SME. For example, when real estate owned by municipalities or by state-owned companies is being sold by tender, the Act stipulated that if the SME and a large enterprise had equal offers then the SME would receive preference, and it could pay only 50% of the sum and the other 50% in installments over a two year period. However, this advantage for SME has failed to materialize as municipalities have preferred to sell to larger enterprises offering immediate full payment and so have not complied with the law, which has not been enforced by the authorities. In addition, to be eligible for such benefits enterprises have to be on the official register of SME established by the SME Act. However, the register was not successfully developed and there are currently only a total of around 500 businesses on it. It is suspected that part of the reason for this is the reluctance of SME to disclose any information, which they believe, could be passed on to other bodies and then used to determine their full tax liability.

²⁴ Source: Gancheva, Y. and L. Bogdanov (2001), *Microeconomic Environment for Business in Bulgaria*, Institute for Market Economics, Sofia.

In 2000, the Government undertook a detailed review of the existing licensing, permit and registration arrangements. By December 2000, a total of 121 regulations have been revoked or alleviated.²⁵ At the beginning of 2001 a new regime was introduced - following the Council of Ministers Decree 233/08.11.2000 on export trade - for obtaining the necessary permits and registration for export transactions.

In order to further reduce the administrative and regulatory barriers facing SME a Working Group was set up in 2001 under the Chairmanship of the Vice-Prime Minister. It is conducting an inventory of all the licensing and permitting regimes, which SME have to face. The Working Group will then make an assessment as to whether parts can be slimmed down or else eliminated entirely.

In a parallel action, a new law -“Act of Principles” - has been drafted to regulate future additional legislative developments in the SME sector and provide definitions of all the key terms to ensure uniformity. This act is expected to pass through Parliament in June 2002. Another initiative is aiming to introduce ‘one-stop shops’ for SME to comply with administrative procedures as well as accessing information sources at the regional and municipal level.²⁶ In addition, the Euro Info Centre Sofia has published a guide to the services provided to SME by all governmental and non-governmental organisations. The Guide includes contact information and aims to improve and simplify the business environment.

Registration, Licensing and Permitting

Despite some efforts to simplify administrative requirements and create an operating environment more supportive of the SME sector, many problems still remain. Whilst it is not difficult to establish an SME per se, the steps required afterwards in terms of meeting the requirements of a range of different agencies (e.g. the Hygiene and Epidemiological Service, State Veterinary and Sanitary Control Inspection and Fire Service) in terms of licensing and permitting are extremely time-consuming. Furthermore, in recent years, in an attempt to ensure compliance with the *acquis communautaire*, primary legislation affecting the SME sector has changed at a rapid rate. This has caused several major problems. Firstly, the lack of continuity with the legal and fiscal framework has made it impossible for SME to conduct effective long-term planning because of a constantly changing operating environment. Secondly, when primary legislation has been changed, the associated secondary legislation often has not been updated on time. This has led to a situation where primary and secondary legislation affecting SME is often contradictory and leaves SME unclear about what their actual legislative obligations are.

Unfair Competition

One of the key reasons why the regulatory and fiscal framework has not been designed to be supportive to SME is because they do not have an effective lobbying voice in Bulgaria. Instead the system appears to have been set up in favour of large, mainly former state-owned enterprises, which continue to wield considerable political influence. Such businesses enjoy an unfair competitive position vis-à-vis SME. They frequently do not pay taxes, social security contributions, utility bills and sub-contractors (many of whom are SME) and frequently disregard environmental and health and safety regulations.

²⁵ ASME’s “SME Report 2000” published in 2001.

²⁶ ‘One-stop shops’ are being piloted in 6 different regions (Sofia, the Sofia Region, Smolyan, Pazardjik, Veliko Tarnovo and Blagoevrad).

Corruption

Although in theory the legal framework is designed to allow enterprises to enforce contractual obligations, in reality it is practically impossible to ensure adherence to contracts through the legal system. Suing over non-adherence to a contract is a laborious and expensive process, which can take years to resolve. Furthermore, as corruption in the judiciary is still widespread there is no guarantee of a just outcome.

Access to Finance

The financial crisis in 1996-97 was in part due to uncontrolled and risky lending on the part of commercial banks (although most of this lending was to large enterprises and illicit 'front' companies, not to SME). The effects of this, as well as the resulting Government legislation, have left banks extremely risk adverse and as such many prefer to invest mainly just in Government-backed bonds. On this basis, access to finance is a key problem facing the SME sector. It is a particularly severe problem for start-ups and micro-sized enterprises, as most banks adopt a very cautious risk appraisal and carry out restrictive policy vis-à-vis the financing of SME. Reasons for this include problems with the identification of ownership, the lack of bookkeeping in some SME and the fact that international accounting standards are not applied. In addition, the majority of SME are not able to provide collateral on loans required by the Banks (sometimes more than 200%), to cover the credit risk.²⁷ Land and property is generally the only significant potential source of collateral that potential borrowers have. However, land ownership disputes and the resulting absence of a functioning land market means that large tracts of land have absolutely no value – and consequently cannot be used as collateral.

The Banking Law also stipulated that Bank Managers could be prosecuted if they were presiding over a certain level of bad debt. This Article has since been repealed but Bank Managers and their loan officers remain extremely risk adverse. Interest rates are also extremely high – they currently stand at around 14-16% or up to 20% when the associated loan application charges are included.

The fact that a large proportion of SME do not officially even exist means that many are in any case automatically excluded from accessing sources of finance and interacting in a normal manner with commercial banks. In fact various bodies have estimated that around one third of all Bulgarian SME do not even have a bank account. Lack of access to normal commercial credit facilities means that many SME, particularly start-ups and micro-sized enterprises, are obliged to access money from other sources, such as from family members or from informal lenders (loan sharks). Many SME find finance from these informal sources an acceptable means of solving their credit needs, especially as it can often be obtained at much cheaper rates and because their principal motivation behind seeking finance is generally not to implement longer term growth or capital renewal strategies, but is rather simply to overcome short term difficulties (such as cash-flow problems).

Another problem with access to finance is the length of time it takes to process loan applications. It can take several months or more for a decision to be reached on an application. In many cases the potential commercial opportunity on which the loan application was based can have passed by. A key reason for such slow processing rates for loan applications is the fact that banks do not generally have sufficiently qualified loan evaluators. As such the EBRD-supported loan facility operated by Union Bank and Evrobank is regarded as a success. It has

²⁷ The Law on Banking, which was enacted in 1997, stipulates that borrowers have to be able to provide a minimum of 125% collateral for a loan.

moved ahead of those credit lines operating without international support, because Phare-funded training is being provided to the staff of Union Bank and Evrobank on how to evaluate SME loan applications. The loan facility offers credits up to 200,000 lev (€102,357).

It is also almost impossible for the many (mainly agricultural) SME in rural areas of Bulgaria to access commercial credits, both because of the practical difficulties of being far-removed from population centres where banks are located and also because financial institutions are particularly reluctant to lend to agricultural enterprises, because of the perceived risk involved. There is a State Fund for Agriculture, which provides financial subsidies and preferential credit lines for producers in agricultural areas, but its impact is unclear. Other sources of SME finance found in mature economies are not yet present in Bulgaria. For example, there is no venture capital market. This is largely for two reasons. Firstly, the lack of a functioning equities market means that potential venture capitalists do not have the option of easily withdrawing their stake in an enterprise at a point in the future. Secondly, Bulgarian entrepreneurs generally lack the ability to put together credible business plans for initiatives which venture capitalists would be willing to invest in.

Despite the fact that access to finance remains a very serious problem for SME in Bulgaria, there are some signs that the situation is improving. For example, long-term credits as a share of total lending were five times higher in 2000 than in 1999. Bulgarian commercial banks are slowly starting to see SME-lending as a key area of future business growth.

Several financial initiatives have been taken by the Government to support SME. The “Encouragement Bank” was created in 1999, with the Bulgarian Government as the principal shareholder. It provides investment credits for SME for a period of 4 years and up to €200,000 and export credits up to €500,000. The bank offers three programmes for investment crediting: export crediting, long-term investment crediting and investment crediting of SME. The long-term investment credits are provided with the support of the EIB that provided a \$10 M credit line for a 12 years period. In addition, in 2001 the Encouragement Bank launched a programme ‘Increasing the Competitiveness of the Bulgarian Production’. Credits from €20,000 to €1,000,000 (provided a personal contribution of 25% is made) are offered for periods between 4 and 10 years and are available for the introduction of new technologies and for the production of eco-products. In 2000, 58 loans have been granted to SME by the Bank for a total amount of BGN 6.5 M (3.2 M€).²⁸

The activities of foreign lending institutions are also having a positive ‘demonstration effect’. For instance, ProCredit Bank, with branches in six major population centres, has been set up by a consortium of five foreign banks.²⁹ It offers funding specifically to SME and boasts simplified application procedures (it aims to be able to process a loan application in as little as 48 hours).

A 4.25 M€ “Promotion of SME” credit line is run by the KfW, Evrobank and Union Bank to offer credits to micro- and small-sized enterprises. Up to 2000, 553 loans have been granted under this scheme (492 by Eurobank) for a total amount of BGN10.3 M.

²⁸ Investment crediting: 36 loans – BGN 3.4m; Export financing: 3 loans – BGN 0.1 m; micro-crediting: 7 loans – BGN 0.3m; Long term investing: 12 loans – BGN 2.6m.

²⁹ The International Finance Corporation (a member of the World Bank Group), the EBRD, the Deutsche Investitions- und Entwicklungsgesellschaft GmbH, Commerzbank and the Internationale Micro Investitiones Aktiengesellschaft.

Another example is a guarantee scheme of the United Bulgarian Bank (UBB) supported by USAID. Guarantees are provided for 5.5 M€ of credits to SME until 2004 and 5.5 M€ for credits for energy-saving projects for the period until 2006. USAID guarantees up to 50% of the credit portfolio of UBB and covers up to 50% of the credit provided to SME.

The Institutions Supporting SME and their Rationale

A large number different institutions and organisations provide support to SME in Bulgaria:

The Agency for Small and Medium Sized Enterprises (ASME) is responsible for carrying out state policy for the promotion and support of the development of Bulgaria's SME. Set up in 1998, it was originally an executive agency attached to the Ministry of Industry, but the SME Act passed in 1999 turned it into a State Agency subordinated to the Council of Ministers. ASME has a head office in Sofia (with a staff of 21 employees) and offices in the centres of the six (NUTS II-equivalent) planning regions (Bourgas, Varna, Vidin, Plovdiv, Rousse and Sofia).

The Advisory Board for Small and Medium Enterprises chaired by the President of ASME is a consultative body for discussion of policy for the support and development of the SME sector. The Foreign Investments Agency (FIA) is a state body subordinated to the Council of Ministers and is responsible for coordination of foreign investment activities. It provides assistance with promotion, attraction and support of foreign investment and priority investment projects. FIA also maintains a database of Bulgarian SME which are seeking foreign partners. The Bulgarian Trade Promotion Agency (BTPA) was established on January 1st 2002 and is an agency of the Ministry of Economy. It is responsible for export promotion. The Bulgarian Agency for Export Insurance (BAEI) was created through the adoption, in 1998, of the Export Insurance Act. Its objective is to support Bulgarian exporters, including SME, in international markets, through balancing risk and protection from financial losses as a result of non-payment from foreign clients. The National Employment Service (NES) is the implementing agency of projects supported by the Ministry of Labour and Social Policy. NES organises vocational and qualification training courses, offers advisory activities for unemployed people wishing to start their own business and works together with employers to define their labour requirements. The National Statistical Institute (NSI) produces statistics on the SME sector.

Numerous NGOs are also involved with SME development in Bulgaria. The Bulgarian Association of Regional Development Agencies and Business Centres (BARDA) is a non-governmental umbrella organisation of independent regional development agencies and business centres whose activities have a regional development and SME-support focus. It was established in 1997 and now consists of 33 member organisations (either full members or associate members). The member organisations offer a range of different business-support activities (as far as their funding and staffing levels allow), including information services for SME, helping to develop business plans, assisting with the attraction of FDI into the region and training for both local SME and for the unemployed. BARDA has three employees in Sofia and its member organisations have between two and seven members of permanent staff. In addition, they hire contractors as consultancy and training staff depending on the particular activities underway at any given time. The Bulgarian Chamber of Commerce and Industry (BCCI) offers the usual range of services provided by CoCs. The Bulgarian Industrial Association (BIA) was founded in 1980 and now acts as a lobbying body for the business

community. The Bulgarian Chamber of Skilled Crafts (BCSC) supports the small crafts sector through training and representation. It was founded in 1998 and represents 20 different craft Branch Associations for particular craft sectors as well as the (soon to be established) six Regional Crafts Chambers. The National Union of the Small and Medium Business (NUSMB) was established in 2000. The goals of the union are to ensure representation of SME within state organisations with a view to improving the business environment. There are also numerous different branch associations which represent member businesses in specific industrial sectors.

The Euro info Centres offer services information, advice and assistance concerning EU enlargement and legislation issues. DG Enterprise is attaching specific importance to the EIC concerning the implementation of SME Development strategy and, consequently, have to be considered as a key player of SME policy implementation. Three business incubators have been recently set up to support innovation among SME.

There are several problems with the institutional set-up designed to assist SME in Bulgaria. Firstly, there are too many bodies trying to do too similar things: nine separate organisations (either governmental or NGO) have as their aim the nationwide provision of support services to SME. This leads to individual providers having a low profile and being under-resourced as well as confusion on the part of potential SME beneficiaries and duplication of activities. Certain institutions also appear to exist more as a means of collecting international donor support than to meet genuine SME needs in a coherent and credible manner. Furthermore, although there are numerous organisations operating at both the national and local levels, there is a lack of effective provision at the regional level. ASME's offices in the six planning regions do provide some level of provision at this level but they are much too understaffed to offer a significant service (they have a combined full time staffing level of ten persons). There is a strong likelihood however that there will be a *de facto* move towards a more regionalised structure of SME support as it seems probable that several of the stronger and more active members of BARDA's network will subsume the weaker ones. This will probably occur on an ad hoc basis however and it is currently unclear whether the end result will be six RDAs each covering one of the six planning regions.

Given this confused and incoherent picture of institutional support to the SME sector, it is unsurprising that there are significant problems with engaging SME with support services in certain areas of Bulgaria. Indeed there are parts of certain regions (often rural areas) where there is no absolutely no practical or advisory support to SME whatsoever. In general the outreach capacity of SME support mechanisms is extremely variable across the country and is very often 'personality-driven' (i.e. there are good provincial governors or mayors who are reasonably pro-active and able to build partnerships with the business sector, but others who do very little at all). There is therefore an urgent need to both deepen and expand the level of support service-outreach to SME across Bulgaria as well as make the support on offer more visible and understandable to the SME community.

The Implementation of the Phare Programme

Over the period 1990-1999, the Phare 'SME' cluster received 42.5 M€ of funding. In addition, the 'Private Sector Development and Restructuring' sector received 53.7 M€ and included many activities which directly or indirectly benefited SME. Phare support to the SME sector in

Bulgaria has taken several different forms. There have been projects focussed on institution-building within (governmental and NGO) bodies responsible for supporting SME (such as BG-9105 which established RDAs in Smolyan and Bourgas and three business support centres, or BG-9704 which *inter alia* helped with the establishment of ASME). In addition, BG-9908-02³⁰ is aimed at enhancing the capacity of both ASME and BARDA. There have also been various innovative actions designed to assist with specific aspects of SME development. Examples in this respect are the QMS grant scheme or investments in business incubators in areas of industrial decline in two target regions by assisting entrepreneurs to set up in business and by supporting existing small businesses.³¹ In addition, Strategic Restructuring and Financial Advisory Services (SRAFAS - BG-9812.02.02.02) which provided consultancy services to 37 enterprises in the areas of general management, financial management, marketing and operational improvement.

SME have also benefited from various grant and revolving credit schemes. The funds from these schemes are generally disbursed by Bulgarian commercial banks in an attempt to build up the capacity and willingness of the domestic banking sector to work with SME. A key SME-finance project, funded in part through BG-9704 and BG-9805 is the Bulgarian Post-Privatisation Fund (BPPF). Phare has provided funding for the operating expenses of the BPPF management team, pre-investment due diligence and preparation of business plans, and post-investment advice and restructuring. The actual capital of the fund (40 M€) is provided by the EBRD. Since 1998 it has disbursed a total of 1.256 M€ for 53 pre and post-investment consulting assignments for the benefit of six existing investees, and a seventh company, in which the BPPF plans to invest. There were 24 pre-investment assignments amounting to 0.352 M€ (incl. legal due diligence, financial reviews, and drafting of investment agreements) and 29 post-investment assignments amounting to 0.904 M€ (incl. audits, marketing support, development of management information systems and industrial and management reviews). The Fund has however been criticised (for instance by the Ministry of Economy) for being too expensive, spending too much on TA, rejecting too many good potential investments, and for not having made more investments sooner.

On the whole, implementation of Phare-supported SME programmes has proved to be difficult given their complexity, current levels of administrative capacity in Bulgaria and the difficult operating environment for SME. Some stakeholders (such as for instance the European Commission Delegation) feel that the level of complexity and innovative nature of some Phare-funded programmes is over and above the capabilities of Bulgarian implementing authorities at both the national, regional and local levels. This has led to a lack of suitable project ideas and consequent delays in the tendering processes. In the case of some Phare Programmes this has led to Phare funding being lost due to the passing of the disbursement deadlines.

The Effect of the Phare Programme on SME Development

Relatively little Phare funding has been provided to institution-building and that which has been offered has only enjoyed limited success. For example, the institution-building element of BG-9908 (see above), which is designed to develop the capacity of both ASME and BARDA, now looks unlikely to achieve the desired level of long-term, sustained benefits as originally

³⁰ Capacity Building for the Accelerated Growth of the Small and Medium-sized Enterprise Sector in Bulgaria.

³¹ These two projects were funded through BG-0004 and at the time of EMS's interim evaluation (January 2002) had not recorded any effects.

envisaged because of a lack of certainty over the future role of ASME and because of internal staffing difficulties at BARDA.

The assistance delivered to SME to provide support to the internationalisation of activities has been negligible and no effect has been noticed. No Phare assistance has specifically addressed the need to ensure adequate co-ordination of the existing bodies. There has been little impact on the need to enhance co-ordination of existing facilities assisting SME. In a similar way, also the promotion of entrepreneurship at regional and local level has realised no positive effect in relation to Phare assistance.

The Phare Programme has in places made a contribution to an improved operating environment for Bulgarian SME, although its overall effect has been extremely limited by both administrative upheavals in the key agencies targeted by institution-building projects and insufficient capacity to benefit from innovative, Structural Funds-type projects and revolving credit facilities. There is therefore a strong argument that Phare Programmes should be simplified so that Bulgaria is better able to benefit from the funding on offer.

Phare-supported credit lines such as those mentioned above have had only very limited effect, with low disbursement rates and only a tiny fraction of SME benefiting from assistance. The application of these schemes has however been overwhelmingly concentrated in a small part of the country, predominantly the five or six largest population centres. Consequently, large swathes of Bulgaria do not have any access to Phare-supported credit and grant schemes. In fact, SME support of any nature is almost completely absent in most rural areas of Bulgaria.³² As a result, little overall effect has been noticed on the improvement of the financial environment. Phare has however realised some positive effects through the 'demonstration effect', which its credit lines have had on the domestic lending sector.

The Readiness in Utilising the Structural Funds for SME Development

There is currently almost no capacity to utilise the Structural Funds (SF) in the SME area. Implementation of initial grant schemes is slow and very problematic and there appears to be a continuing lack of co-ordination between the SME policy and aid co-ordination sphere. The quality of project monitoring in this sector is among the worst of all Phare sectors. On the basis of current performance, it is hard to see how BG can be ready to implement extended DIS, let alone the SF by 2007 in this area.

The 33 RDAs which belong to BARDA are currently too fragmented and institutionally weak to have a major role in SF implementation and in any case do not appear to enjoy support at a national political level for such a role. Equally, the Ministry of Economy has rejected a proposal made by ASME that a Phare funded project be launched to develop capacity in its regional offices with a view to them becoming SF implementation bodies. It seems likely that either an existing body will have to have its current role dramatically changed or a completely new body will have to be established.

Aside from the practical implementation difficulties, which threaten the effective disbursement of the SF, there are also attitudinal difficulties and problems of ignorance, which need to be overcome. Apart from a group of civil servants and wider stakeholders operating at the national level, very few people are actually aware of the funding opportunities available, especially amongst the types of groups (such as SME) which are often beneficiaries of such support. Furthermore, there is a view amongst those Government practitioners which are aware of the

³² An exception in this regard is the UNDP-supported JOBS Project, which supports rural SME through the creation of business centres and through subsidised leasing of equipment for business owners.

SF that they are simply another version of Phare (and other aid programmes such as ISPA and SAPARD) but that the levels of funding available are significantly larger. There is little understanding of the highly decentralised system, which underpins the SF and the practical difficulties, which this poses in terms of project and programme design, partnership building, implementation, monitoring and evaluation.

Certain activities have though been carried out to increase the readiness to implement the SF. Geographical coverage has nominally been established through the creation - in July 2000 and in accordance with the Council of Ministers Decree N° 145/2000 and Decree N° 3/2000 - of six separate planning regions (comparable to EU NUTS II regions).

A recent decision by the Council of Ministers stated that the Ministry of Finance will be responsible for handling SF resources. The assumption thus far is that the Ministry of Finance will also be responsible for managing pre-accession funds, although this is still not clear.

In order to ensure an effective management of the “Special Preparatory Programme - SPP”, the Council of Ministers adopted Decree N° 3/2000 which defined the obligations of the newly established “Central Coordination Unit” that, under the Ministry of Regional Development and Public Works, shall implement the SPP and be in charge for the preparations of projects to apply for financing support from EU funds.

According to the “SME Report 2000” (ASME - 2001), following decree N°145/2000, ad hoc committees have been created for the implementation of projects and programmes co-funded by the EU programmes in the field of regional development and economic and social cohesion as well as to ensure interrelation with the Districts Councils for Regional Development, the Council for regional development under the Council of Ministers and the central bodies of the Government.

Nevertheless, unless more time and effort is given in the near future to establishing an administrative structure for the SF and associated capacity for their implementation which is suitable to Bulgaria’s needs many of the same problems which are currently being encountered with Phare programme implementation are likely to be replicated on a much greater extent when the SF first arrive in Bulgaria and the net result will be an inability to benefit from the funding on offer.

The Main Challenges to be faced in the Near Future by the SME Sector in Bulgaria

| Challenges to be faced by Bulgaria at the enterprise level | Challenges to be faced by Bulgaria at the Government level |
|---|---|
| <ul style="list-style-type: none"> • Coping with an administrative system, which is extremely complex, fragmented and incoherent as well as subject to corruption. • Adjusting to a fast-changing legal system where the requirements of primary and secondary legislation is sometimes incompatible. • Being able to access sources of finance, which is particularly difficult for start-ups and micro-sized businesses and those enterprises located outside of major population centres. • Gaining access to better quality and more widespread information and support services (especially outside of | <ul style="list-style-type: none"> • Reducing the number and complexity of administrative procedures so as to reduce the cost of doing business for SME. • Reducing the level of corruption in both the public administration and judiciary so as to allow better treatment of SME and fairer outcomes following litigation. • Introducing a taxation system, which is more equitable for SME and where revenues can be collected more effectively so as to allow lower rates of tax evasion and therefore lower marginal rates of taxation. |

| | |
|---|--|
| <p>the major population centres).</p> <ul style="list-style-type: none"> • Developing suitable representation and lobbying capacity at the national Government-level, so as to improve the suitability of Government policy towards the SME sector. • Improving productivity and value added. • Improving the quality of products and services produced, especially so as to make them acceptable in international export markets. • Upgrading management skills to allow better business planning both by established enterprises and start-ups (especially in terms of business plan formulation). • Upgrading HRD policies to facilitate more productive and settled employees within SME | <ul style="list-style-type: none"> • Introducing a more coherent system of support-mechanisms for SME at both the national, regional and local levels (especially in rural areas) where the relevant institutions complement, rather than work against, each other. • Giving adequate financial support and legislative powers to such SME-support bodies. • Ensuring that the various fiscal incentives aimed at boosting the SME sector and contained within the 1998 SME Act are actually implemented. • Ensuring that the legislative environment is as conducive as possible to widespread (but prudent) loans to the SME sector. |
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Recommendations

1. The administrative framework within which SME have to work should be overhauled to make it less expensive and time-consuming and more coherent and integrated. The work of the Working Group headed by the Vice-Prime Minister which is designed to audit current procedures and propose potential simplifications to the systems in place should therefore be strongly supported and the implementation of any recommendations it makes strongly considered. In particular, the implementation of a 'one-stop shop' system for SME permitting and licensing should be considered.
2. The government must define an SME Policy focusing on creation of new enterprises as a tool to support job creation and increase the number of SME per 1,000 inhabitants.
3. Attempts should be made to address the problems caused by corruption both in the judiciary and wider public administration at the national, regional and local levels. This should involve careful implementation of the provisions contained within the National Anti-Corruption Strategy and, longer term, attempts to eliminate the reasons for corruption brought about by low public sector salaries and low morale within the public administration.
4. The fiscal environment facing SME should be made more equitable for SME. This needs to include measures designed to increase the rate of collection of business taxes (especially amongst larger enterprises) and income tax so that marginal rates of taxation for both individual businesses and employees can fall. Specific aspects of taxation policy discriminating against micro-sized businesses (such as the high VAT-rebate thresholds) should also be removed.
5. Prior to introducing any new legislative change, the Bulgarian Government should conduct *ex ante* evaluation in order to forecast the likely impact on SME.
6. The Bulgarian Government should encourage the application at the municipal level of the various fiscal benefits for SME contained within the 1999 SME Act.
7. The Government must develop, as a matter of urgency, new and effective mechanisms to ensure the collection of reliable data concerning the number of active SME and their survival rate after 12 - 18 - 24 and 36 months.

8. Attempts should be made by all stakeholders (i.e. the Bulgarian Government and financial sector as well as by Phare) to make it easier for SME to access finance. Initiatives designed to develop the capacity (such as the training of loan evaluation officers) and willingness of the commercial banking sector to loan to SME should be a priority in this respect. Alternative sources of financing and support to the financing sector such as co-operative/mutual loans, venture capitalists or credit guarantee schemes should also be supported. SME should also be targeted, especially in terms of developing their capacity to develop credible business plans.
9. The Government should identify and promote non-banking finance schemes addressing the needs of start-ups and SME in their embryonic phase. Specific attention should be placed on the development of an effective National Guarantee Scheme
10. The Government should promote innovation through the establishment of network of incubators and technology parks.
11. Attempts should be made to increase the level of SME support offered outside of major population centres (particularly to rural SME in more disadvantaged regions).
12. Phare support should give greater recognition to administrative weaknesses present in Bulgaria (at the national, regional and local levels). Accordingly, it should instigate the development of institution-building measures to improve support to the sector.
13. For its part, the Bulgarian Government should reach clear decisions on the future role of key agencies involved with the conception and implementation of policies designed to assist the SME sector (such as ASME and the RDAs). Moreover, the analysis of the future role of individual bodies should not be conducted in isolation but rather should address how different bodies will interact and complement one another.
14. Once a credible organisational structure for SME support institutions within both the public administration and SME sector has been established, these bodies must receive an adequate level of financial resources and know-how transfer to allow them to be able to support the SME sector in an effective manner.
15. Attention should urgently be given to how future SF support should be implemented. Crucially, the Bulgarian Government needs to confirm which organisations will be responsible for implementation of the SF and then take steps to provide the necessary financial support and training for them to be able to discharge their roles.

CZECH REPUBLIC

General Overview

The Czech Republic has a population of 10.3M. Its economy has recovered from the crisis that lasted until 1999, and in 2000, the economy registered real growth of 2.5 %. The inflation rate was reduced to 3.9% in 2000, against expectations of a reduction to 2.5 %. The GDP per capita on purchasing power parity (PPP) basis is around 59% of the EU-15 average (13,500 €), ranking second after Slovenia amongst the CCs. The unemployment rate is 8.8%. The most positive news is the significant growth of Foreign Direct Investment (FDI). It is the preferred country amongst the CC's to invest in. In 1999 the FDI inflow was 4,792 M€, which is equivalent to 465 € per capita. The Czech economy can be described as a market economy. The GDP share of the non-State sector has increased by 15.9% since 1994, and reached 77.2% in 1999. Both imports and exports are high and the trade deficit (as a share of its GDP) is the lowest amongst the CC's at 4%. Foreign debt is also at a reasonable level compared to other CC's at 22.80% of GDP. The Czech Republic devotes the biggest share (65% of EU average) of GDP to Research and Development (R&D) amongst CC.

Status of SME sector

According to the enterprise register in 2000, a total of 1,783,000 business entities (99.8% of total) have been issued with a trade licence, an increase of 4.1% in respect to 1999. The number of active SME is about 760,000 (658,000 being natural persons). In 1999, the sector contributed 53.5% to the GDP (53% of total added value), and in 2000, 59.4%. SME provided 36.1 % of total exports in 2000, a decrease, in respect to 1999, of 1.0 % (Medium-sized enterprises account for the 21.8% of total exports and Small enterprises account for 14.3 %). SME share of imports was 49.4% in 2000, a decrease of 2.37% compared with 1999. The structure of SME in number and size corresponds closely to the EU average. The most relevant differences are the lower employment share, 59.1% (EU - 65.9%), and the added value per employee, which is below the EU average at 10,100 € (EU - 45,000 €). No information is available concerning the survival rate of SME after 12, 18, 36 months following start-up.

Broad Economic & Social Policies

The broad economic and social policies are partially supportive of effective SME development. The Ministry of Industry and Trade (MIT) has been given the responsibility of SME development, although two other ministries support the sector: the Ministry of Regional Development (MRD) and the Ministry of Labour and Social Affairs (MOLSA). Co-ordination among the various ministries/ departments sharing responsibilities for SME Development exists only on paper, and no clear division of accountabilities has been defined. This raises questions about the effectiveness of the co-ordination and implementation mechanism for policies. A National Strategy for SME has been developed to cover the period 2001-2004. The National Development Plan (NDP), approved in July 2001 by the Czech government has also been approved and DG REGIO, who were expected to comment before the end of September 2001. The NDP is linked to the Sector Operational Programme (SOP) "Industry", which defines well the priorities for the SME sector. However, the SME development strategy is not embedded in the national regional development strategy.

Regulatory policy

The regulatory policy is not yet adequate for further development of the SME sector. The government is fully aware of this shortcoming and has prioritised measures to improve the legal and administrative system. A specific programme has not been defined. A new law on SME has been approved by the Czech government and is scheduled to enter into force on 01/01/2003. Overall, the pace of change in the regulatory environment presents a serious

challenge to the sector, as the government is developing a legal framework fully compatible with the *acquis*. The requirement to conform the newly defined regulations is costly and difficult because of the volume of laws being passed or amended. Micro and small enterprises consider the existing legislation particularly unfriendly, for example, taxation, and the rigid regulations relating to the payment of social security and health insurance costs. The process of starting-up a business still requires a considerable amount of bureaucratic activity. In order to simplify the procedures, the government is committed to amend the Trade Authority Act by the year 2003. Small enterprises face serious problems with secondary insolvency, and it is necessary to provide consistent protection from creditors and to accelerate the collection of accounts. Urgent modifications to the existing legislation are required in at least four fields, and the government, with support from Phare 2000, has taken the first steps, but nothing is likely to happen until the end of 2002.³³

Access to finance

Access to finance is an extremely difficult task for SME. Overall, the problem is not related with the lack of liquidity within the system, but associated with the unfavourable conditions set by the banking system for the SME sector. The commercial banks link the authorisation of loans to high collateral (up to 150-180%) and a proven track-record. This approach is a consequence of the extremely difficult process (up to 4-5 years) of enforcing a mortgage in case of default, and transform the collateral into cash. According to the Association of Banks, the realisation of collateral was very close to 0% until the end of 2000³⁴. The process of obtaining loans is a time-consuming exercise that can take up to 4-6 months. The interest rate is still well above the inflation rate. The “Policy on Support to SME in the years 2001-2004” reiterates the government’s commitment to maintain its State Budget subsidised financial support for SME development. The Czech-Moravian Guarantee and Development Bank (CMGDB) will act as Fund Manager for six financial support Programmes that will come into operation with the approval of the new Law on SME. Of particular relevance is the almost total absence of mechanisms addressing the setting-up of venture capital funds, seed capital schemes, equity, etc. Funds available under the State Budget scheme are small in comparison with demand, and alternative mechanisms to support SME financially are needed.

The Institutions supporting SME and their rationale

SME are mainly supported through the network of Regional Advisory and Information Centres (RAIC) and the Business Innovation Centres (BIC) co-ordinated by the Business Development Agency (BDA) under the direct supervision of the MIT. Assistance is provided under “preliminary consultation and advisory services” and the implementation of “non-banking financial schemes” through the network of RAIC and BIC. Available data for 2000 raise concern about the outreaching capability of the network co-ordinated by the BDA. The network serves less than 2% (or less than 0.5% if the preliminary consultation are not considered) of the active SME, with a budget of 450,000 € of Phare funds, and 30 M CZK (800,000 €) from the State budget³⁵. The activities of BDA are still heavily dependant on

³³ (1) Preparation of a new Bankruptcy legislation. (2) Solution of issues related to the functioning of the Commercial and Business Register. (3) Application of *Acquis Communautaire*, with respect to the freedom of the establishment and freedom to provide services for physical and juridical persons acting in sectors not covered by specific legislation (i.e. banking; insurance; investment services and securities market, etc). (4) Simplification of State administration as regards registrations, licences and authorisation to businesses.

³⁴ After the approval of the new law in April 2000, the situation has considerably changed and commercial banks have succeeded in realising 100 out of the 600 pending cases. Nevertheless, the execution of a real estate mortgage outside Prague is still a difficult operation.

³⁵ In 2000, the BDA provided 10,808 preliminary consultation and advisory services to SME through its network of RAIC and BIC³⁵. The number is very low in comparison to the active SME (760,000) and negligible if only the number of special advisory services to SME is considered (i.e.: 1,683).

Phare support (which is due to end by 2003). The CMGDB plays an important role in the provision of the financial support to SME. However, the bank only has 5 branches nationwide and therefore it is questionable whether they have the geographic spread necessary to provide a reasonable service to SME's, particularly small enterprises. In principle, the financial institution should be allowed to provide other forms of non-financial assistance, especially counselling and training, which would strengthen its "Development Bank" vocation. There are a few examples of Business Incubators and, from September 1999 up to November 2000, 130 companies were placed in the five BIC Incubators. Potentially, there is a great demand for this kind of service but the space available is very limited, and the government is not fully supportive. The CzechTrade Agency, whose role it is to promote Czech exports provides market information, consultancy and the services to SME. The CzechInvest Agency, the institution to promote FDI, supports SME through the "Czech Supplier Development Programme". This programme is a 1999 Phare twinning project (1.2 M€) complemented by a Business Audit project (0.3M€). The programme is expected to be extended until at least 2002 but also with the remit of widening the recipient sectors. A feasibility study has recently been undertaken financed by Czech Invest, to identify business sectors to be supported. The MRD is the co-ordinating body for the implementation of the EU Social and Cohesion Fund. Under the MRD, the Centre for Regional Development (CRD) has been established to act as the implementing agency of programme administered by the MRD, such as the Phare CBC Programme, the Regional Development Fund and programmes for the preparation for Structural Funds. In this context, the CRD has had (and will have) a role to play in the activities addressing SME development. Indeed the CRD has been designated the role of implementing the Productive Sector Investment Fund with 4 M€ of Phare funding. This scheme is aimed at increasing SME competitiveness, in particular to assist the development of enterprises, which use the results of R&D in their production processes and introduce quality standards into companies and obtain creditation. The CRD also hosts the activities of the Euro Information and Counselling Centre. Under MOLSA, the National Training Fund manages a large number of training programmes specifically focusing on the development of entrepreneurship, and support to SME development in respect of the strengthening of the managerial skills. Furthermore, a National Discussion Group has been established as a consultancy body of the MIT in the area of SME. The Group meets 3-4 times a year to discuss issues relevant to SME. The group consists of representatives from the Chamber of Economy, business and employers associations, entrepreneurs and government officials. There are several business membership organisations (e.g.: Economic Chamber, Entrepreneurs Association, Industry Confederation, Association of SME of the Czech Republic which undertake similar activities and have comparable goals in the SME development. There are too many SME associations and thus have little negotiating power, along with financial assistance being too splintered. Steps however, have been taken to consolidate these associations with the merger of the association of medium-sized enterprises (AMSP) and The association of small and medium-sized enterprises (ASMEC). With more than 15,000 members and connection with BC-NET, BRE, World Trade Centre, and its regional network of 60 active local economic chambers, the Economic Chamber of the Czech Republic is potentially a key actor supporting SME development.³⁶ The Association of Czech Trade mainly represents the interests of commercial SME, and is a member of Euro Commerce. The Association is a partner of both MIT and MRD in designing strategies to the benefits of its members. The activities funded by the State Budget overlap and duplicate the services provided by other associations and

³⁶ Among the services provided by the Chamber the "Support for SME". The Chamber has 70 staff and a turnover of 140 Ms CZK without subsidy. Of particular relevance is its register of bad debtors that should be considered by any serious attempt to improve the bankruptcy law (the National Central Bank do not have such a register). CzechTrade is in the process of starting co-operation agreements with the regional chambers.)

institutions. The next stage appears to be a rationalisation of the activities carried out to advise SME, and the establishment of an “SME one-stop-shop”.

The Implementation of the Phare Programme.

Phare assistance to the SME sector started in 1991, with an allocation of 20 M€, which resulted principally in the establishment of a Small Loan Guarantee Scheme. It also supported the creation of the first RPIC and BIC, and a Project Management Unit (PMU) at the Centre for Support to SME at the MIT³⁷. Since June 1994, Phare has provided further support to SME development within the framework of a component of the 1993 Private Sector Development Programme. The Wider Objective of this Programme was the promotion of sustainable economic development through the development of the private sector. The Immediate Objectives were to continue both easing and expanding the access of SME to credit, and to assist with the creation and development of SME by strengthening the network of regional advisory centres and business innovation centres. Although the Programme was implemented prior to the preparation of the Accession Partnership and NPAA, support to research and development, if implemented successfully, would have met a short-term priority. The activities for institutional support, business support network, financing schemes, training and running costs, and research and development matched the medium-term priorities for Economic Criteria of the Accession Partnership and NPAA for promoting competitiveness. Despite initial delays, Phare assistance to SME was rated satisfactory. The main achievements included the development of new independent institutions for co-ordination of SME support, provision of direct support mechanisms, and the replenishment and development of innovative financial schemes. Although the Programme design was adequate, the decision not to provide sector policy advice may have caused some of the difficulties of implementation. The Wider Objectives of the assistance provided under FM 97 and FM99 were to enhance economic and social cohesion, competitiveness, enterprise development, economic reforms, regional industrial development, manufacturing investment and economic integration into the EU. The Immediate Objectives were to develop strategies, strengthen skills and upgrade systems of the agencies supporting regional foreign direct investment, exporting and SME, in order to improve the economic competitiveness of Czech businesses. . The slow pace of implementation has meant that the independent evaluators were not able to make an adequate assessment (05/1998).

The effect of Phare programme on SME development

Under the Measures addressing Institutional Building, no Phare assistance was conceived to support the simplification and improvement of the business environment through the strengthening of the existing structure(s) or by the setting-up of institutions specifically dealing with this important aspect of SME Development. As a consequence, there has been no effect concerning the simplification of business environment. The financial schemes developed by Phare since 1993 to support SME financially, have had a positive effect by providing financial support to SME at a time when access to credit was a key factor affecting SME development. Less positive has been the effect on the development of equity and risk capital mechanisms. The assistance delivered to SME to provide support to the internationalisation of activities has been positive, mainly through the activities carried out by CzechTrade. The effect of the activities managed by the network of RAIC and BIC has been very limited as regards the enhancement of SME Competitiveness and internationalisation through better access to research, innovation, training and Information Services. The assistance was however effective in raising the interest of government, which through co-financing schemes, confirmed its commitment toward the provision of technical assistance to the sector. No Phare assistance has

³⁷ At that time it was the Ministry of Economy.

specifically addressed the need to ensure adequate co-ordination of the existing facilities. The implementation of Phare support programme has been spread over a wide numbers of actors and projects. It is difficult for individual SME and SME support organisations to get information about the areas supported by Phare, the assistance available, and the methodology to obtain this support. Besides the assistance provided to BDA, other agencies and organisation benefited from Phare assistance, but in an uncoordinated way (e.g.: the National Training Fund, CzechTrade, CzechInvest, the Economic Chamber, the Confederation of Industry, the CRD, the Regional Development Agencies (RDA) network, etc). This has had an adverse impact on the need to enhance co-ordination of existing facilities assisting SME. The assistance provided to the network of RAIC and BIC, to the local institutions implementing CBC Programme related measures, and to the RDA has generated a positive effect on the promotion of entrepreneurship at regional and local level. Some improvements are however still needed.

The readiness in utilising SF for SME development

An integrated approach, with actions selected to contribute to a common objective (such as combating industrial decline), in particular with SF type measures linked with interventions to promote the business environment, has been developed. The NDP includes an “Industry” section that exhaustively defines the government strategy. A SOP for Industry that specifically defines measures to support SME also features in the NDP. Geographical coverage deemed most appropriate has been defined in terms of the NUTS II level. The country will be split into eight regions, one of which, Prague, will [probably] not qualify as an Objective 1 region. In January 2000, the NUTS III regions were also defined, but the related administrative elections were only held in November 2000. As a consequence, the NUTS III regions are not yet ready to play their intended role. The MRD will be the main co-ordinating body for the implementation of the SF. The MIT has established (November 2000) CzechIndustry, which it will co-finance. CzechIndustry is expected to play the role of implementation agency for the SOP and will become the implementation agency for the MIT, with the full extent of its functions operational from the year 2002. Different executive agencies as CzechTrade, the BDA, CzechInvest and/or regional agencies will follow-up the activities of the implementation agency. Although the basic conditions for the eventual utilisation of the SF are in place, there is still a need to better define the distribution of responsibilities among the various actors (particularly CzechIndustry) involved in the utilisation of SME-related SF.

The main challenges to be faced, in the near future, by the SME sector in the Czech Republic.

| Challenges to be faced by the Czech R. at enterprises level. | Challenges to be faced by the Czech R. at Government level. |
|--|---|
| <ul style="list-style-type: none"> • Being able to face the competitive pressures in the single market, particularly in relation to the present very low labour productivity and added value per employee in comparison with the average EU, and CC like Slovenia. • Coping with a fast changing legal environment, meeting the requirement of the <i>Acquis Communautaire</i>. • Gaining better access to information and high quality support services. • Upgrading management skills in order to increase efficiency and promote entrepreneurship. • Enhancement of the growth and competitiveness of the sector in a “knowledge-based” internationalised economy. | <ul style="list-style-type: none"> • Better understand the actual needs of the SME sector, also with the support of more reliable statistical data. • Development and implementation of specific programme addressing the simplification and improvement of the administrative and regulatory framework. • Complete the structural reforms necessary to further restructure enterprises and to create a dynamic SME sector. • To give businesses easier access to EU support services, programmes and to improve co-ordination of these facilities. • Ensuring the commitment of all existing institutions supporting SME in a joint effort to |

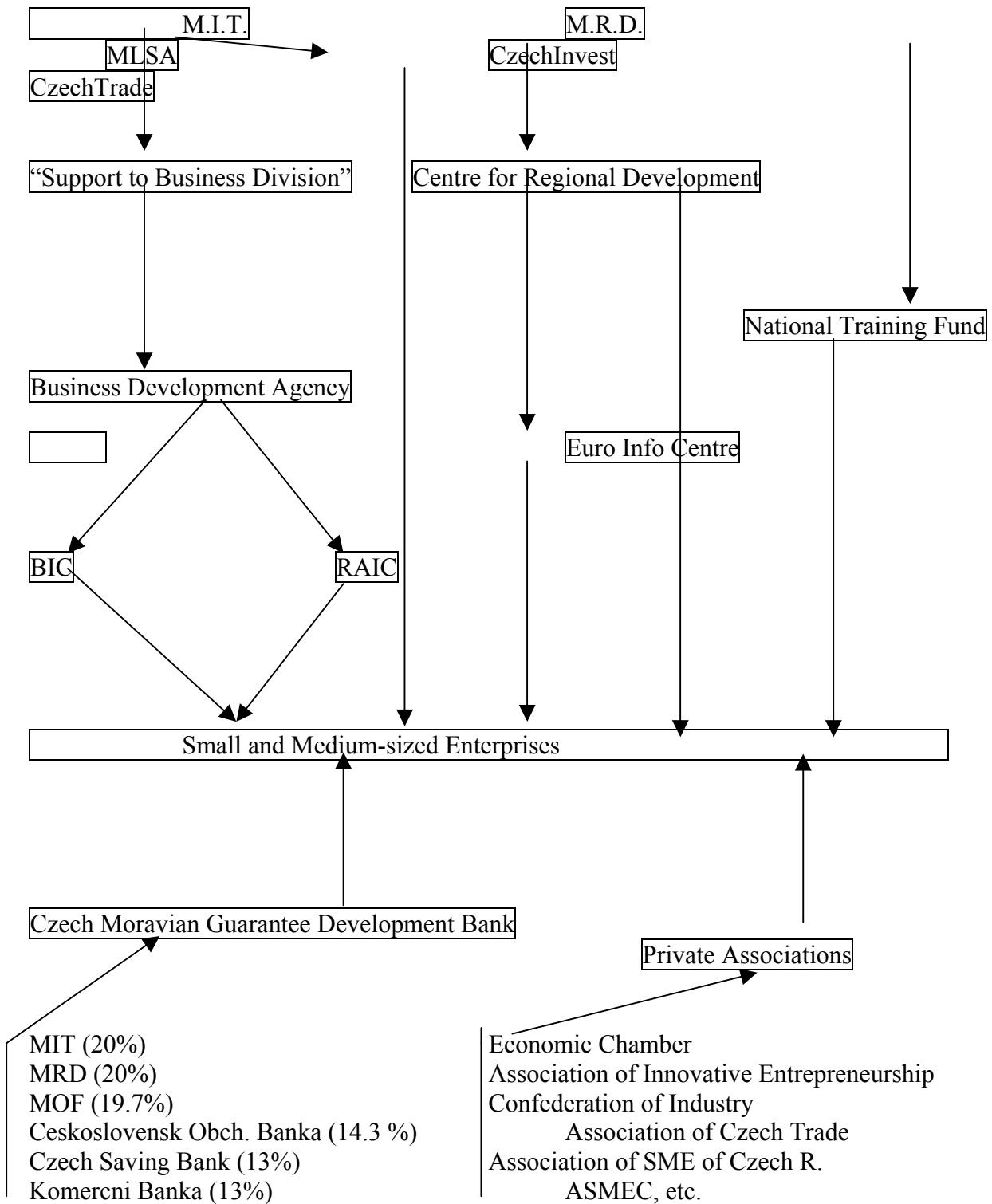
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| <ul style="list-style-type: none"> • Integrating ‘Supply chain’ networks and improving export related marketing and product quality related skills. • Making their voice heard by authorities through the development of more effective business associations better representing the interests of entrepreneurs through a more effective lobbying activity. | <p>ensure more effective co-ordination in order to provide a better service to SME.</p> <ul style="list-style-type: none"> • Defining clear accountability role for the implementation of SME development measures. • Improving horizontal factors of competitiveness, such as entrepreneurship and management education, or the development of a more friendly taxation system for SME. • Eliminating the gap between national and regional skills in planning development programmes, with a specific attention placed on the readiness in utilising SF upon accession. • Ensuring adequate planning skills development at NUTS III level, and defining financial support mechanisms to support this enhancement process. • To enhance the capacity of the MIT and to create appropriate structures for efficient planning, development, management, control and monitoring of the material and financial sources which use funding from the SF in industry. • Improvement of the financial environment for SME, granting better access to credit for SME development and/or start-up or innovation through the development of non-banking schemes. • Further support the SME sector in order to reach for the SME sector a level of employment share similar to the EU one (i.e. 65.9 %) |
|--|--|

Recommendations

1. The Government should establish a more effective system to ensure adequate co-ordination and accountability between the MIT and the other two ministries having responsibility for the provision of SME support (MRD and MOLSA).
2. The MIT should carry out a Needs Analysis to plan SME support in a more effective and exhaustive way. Based on the findings a dual strategy should be developed, keeping the needs of micro/small enterprises support separate from the medium-sized enterprises. The Analysis should also give a better appreciation of the financial requirements, as well as of the type of financial support needed.
3. The Needs Analysis should allow a differentiation between the needs of micro and small enterprises in their start-up and/or embryonic phase from SME that have already gained their place in the market, and for which access to credit should not be a problem.
4. Urgent attention should be given to the development of non-banking financial mechanisms, such as Seed Capital Scheme, Risk Capital Schemes, Start-up Schemes, etc, mainly addressing equity intervention that are needed by the sector. Equity schemes should be conceived in support of the activities of the Business Incubators.
5. A programme to speed up the simplification of the public administration and the improvement of the existing legislation should be developed by the MIT, preferably in the context of the on-going Phare twinning project specifically addressing these issues.
6. In order to ensure an effective utilisation of the SF addressing SME development, the MIT and the MRD should explicitly define the Institution(s) playing the roles of overall co-ordinator, Implementing Agency and Executing Agency. There is an urgent need to clarify the roles of the CRD, Czech Industry and the BDA.
7. The existing SOP does not pay sufficient attention to the regional dimension of industry development problems. A regional dimension is needed, particularly as far as SME development is concerned.

8. The MIT should define, in collaboration with the MOLSA, adequate indicators of achievement addressing the need to raise the employment share of SME up to EU levels.
9. The role and performance of BDA should be reviewed and assessed by the MIT, with special regard to its national profile in the SME sector. In the same way, the assessment of RAIC must be completed as a matter of urgency, in order to review formally the outreaching capability of the network.
10. The role of the CMGDB should be further strengthened as a development bank. In this respect, the MIT should explore the possibility of enlarging the scope of the CMGDB's activities beyond the provision of financial support.
11. The MIT should consider involving the Economic Chamber and the Czech Association of Trade in more direct way in their programmes for SME development. The two organisations already play an important role in SME support and, as a recent development, the Czech Trade Agency prefers to collaborate with the local network of the Economic Chamber, rather than the RAIC network.
12. The MIT and the MRD should define a new and enlarged role for the Euro Information Centre hosted by the CRD. It should be possible, on the basis of the activities carried out by the Centre, to plan the establishment of an "SME one-stop-shop" so urgently needed.
13. Better co-ordination between the activities managed by CzechTrade, CzechInvest and by the Entrepreneurs Association, to promote export and sub-contracting development is needed. A focal point should be established, co-ordinating all the existing activities which support the export/ sub-contracting activities of SME.
14. Further consolidation of SME associations needs to be pushed, in order to strengthen negotiating positions and so that financial assistance can be more focused.

The Sme Business Support For The Czech Republic



ESTONIA

General Overview

Estonia has a population of 1.4 m with 45% of the population are located in the four cities of Tallinn, Tartu, Narva and Parnu. The rest of the population is scattered among 15 counties and the islands of Hiiumaa and Saaremaa. In 1998, Estonia registered an annual GDP growth of 4.0% and by 2000 it had reached 6.9%. In PPP per capita terms this amounts to 8,500 € which is 37.7%. The rate of inflation in 2000 was 3.9% coming down from 19.8% in 1996. Unemployment has reached 13.2% by 2000 and there is a strong regional imbalance. The inflow of FDI in 1999 was 284 M€, which is equivalent to 203 € per capita. . The trade balance for the country is the highest for the countries studied in this report (17% of GDP). Foreign debt is about ½ of the GDP, which is one of the highest of all CC's.

Status of SME sector

More than 30,000 enterprises were operating in Estonia in January 2000. In comparison with the number of inhabitants, Estonia has 21.5 SME per 1,000 inhabitants, which is not only considerably below EU average (48), but well below other CC. The SME sector in Estonia is characterised by a preponderance of micro enterprises (75%), Small enterprises account for 20.6% and Medium-size enterprises are 3.7%. SME contribute to nearly half of Estonian employment and their share in the overall employment has increased steadily. Of the total employment in commercial enterprises (418,991 in 2000), about three-quarters are employed by SME. However, the fall in overall employment in the last few years has included a fall in the number of SME employees, mainly in the large and medium-sized enterprises. The distribution of employed people is as follows:

| Number of People Employed | 1999 | 2000 |
|---------------------------|----------------|----------------|
| Micro – enterprises | 74,650 | 78,233 |
| Small enterprises | 127,566 | 124,886 |
| Medium enterprises | 115,443 | 109,594 |
| Large enterprises | 111,381 | 106,278 |
| Total | 429,040 | 418,991 |

*Source Central Office of the Tax Board.

The size/class dominance³⁸ is the Small one (29.8%). The share of employees accounted for by the Small and Micro-enterprises (< 50 employees) is lower than EU average (i.e.: 48.4 % compared with 52.5%). Large and Medium enterprises account for 51.6% of the total employment. The Small and micro-enterprises form the core of the working population and produced almost 50% of the total value of exports in the year 2000. Between 3,000 and 4,000 SME were involved in exporting at the end of 2000 (Micro enterprises 11.8%, small enterprises 33.5% and medium enterprises accounting for 54.7% of exports). Approximately 50% of SME are involved in subcontracting or sub-supply to foreign companies located outside Estonia. Almost all the SME in the metal and clothing industries are involved in sub-contracting. Estonia currently has the strategic advantage of low labour costs, which makes it attractive to foreign companies not only to locate here but also to enter into sub-supply contracts with Estonian SME. This subcontracting has been very beneficial to the SME in providing them with growth potential; good export order books and has assisted them to develop quality in product and manufacturing processes. However this dependency on foreign companies makes SME very vulnerable to any downturn in business by their contractors. This situation will change over time in particular with accession to the EU when increased regulatory, social and

³⁸ A country is said to be micro- small- medium- sized or large scaled if either micro, small, medium or large-scale enterprises have the largest share in total employment.

wage costs together with wider competition will begin to impact on business profitability, growth and confidence. There is a need for an exit strategy from the vulnerability of sub-contracting over the longer term. They need to consider the development of their own products and markets, and will require assistance to do this. The share of SME business activity varies in different sectors of the economy. Trade, lodgings and catering, business services, forestry and construction are largely dependent on SME, since more than 90% of the workers in these sectors are employed by SME. In 1998, approximately 40% of all SME were involved in trade, with 14% in manufacturing and business services. Agricultural undertakings constituted 4%, building enterprises 8%, and transportation/communications 7% of all SME. Most of the workers employed by SME are involved in trade (26%) and manufacturing (23%). Other sectors of the economy: construction (11%), business services (11%), transportation/communication (8%), and agriculture (6%) are also characterised by relatively high employment levels. In comparison to January 1995, employment in agricultural SME has seen the greatest decrease, going from 11% to 6%. Of the business ventures established in 1997, 39% were still operating in 1998. By the end of 1998, each new enterprise had created 8.9 new jobs on average. Some 40% of the companies established in 1997 and still functioning in 1998 were involved in trade, approximately 15% provided business services and 10% were in manufacturing. The government is actively encouraging the development of the Information Technology sector. This is evidenced by the multiplicity of internet sites available on the world wide web providing information on all aspects of Estonian business and development, the development of the Technology Agency and its linkages with Tartu and Tallinn Universities. A population of only 1.4 M people provides SME with a very small and scattered home market. This fact impacts on the development of SME in that growth of the home market is severely limited. For SME to grow into medium sized businesses employing substantial numbers of people consideration must be given to exporting products almost from the start-up of their operations.

Broad economic & Social Policies

The government views the SME sector as very important for new job creation and the general development of the Estonian economy. The Ministry of Economic Affairs is responsible for the SME development through the Department of Economic Development – SME Unit. The Ministry co-ordinates the activities of Regional Development Agencies that are the main provider of support to the SME under the regional development programmes and the government subsidised schemes. The Ministry of Finance is responsible for co-ordination at inter-ministerial level and for the co-ordination of SF activities. A Working Group for SME policy was established in January 1999 to produce a report as a basis for the “National policy for SME” as well as to support the MEA in preparing the SME Policy Chapter in the NDP. There was no official SME policy document until the publication of the National policy for the development of SME’s in 2001/2002. The support of small enterprises has been one of the Government main priorities in order to make the transition period as easy and painless as possible for both entrepreneurs and all of society. The basis for classification of Estonian SME is the number of employees as set out by the EU, while the turnover limit has been omitted. The law does not regulate the aid provided according to the principles of regional policy. Certain exceptions are made for loans provided by the Agriculture and Rural Life Credit Foundation. An NDP has been produced and there is need to incorporate comment from DG Regio before the full endorsement and approval of the Plan by the European Commission. An exhaustive national strategy for SME covering the period up to 2006 has not been developed. This hampers an understanding of the financial/ technical requirements needed for the further development of the sector, in a way that embraces emerging regional imbalances.

Regulatory policy

Recently, and especially since the start of Accession negotiations, the Estonian Government has recognised the importance of the SME sector for economic and social development, and the need for a well-structured SME policy. The most important and complex piece of legislation affecting the overall business community is the Commercial Code, adopted by the Parliament on 15 February 1995 and enforced on 1 September 1995. The Code follows the German model. The legal forms of general partnership, limited partnership, limited liability company and joint stock company were regulated in more detail, and a legal form of self-employment was introduced. Supervisory councils were added to the administration of a joint stock company, being subject to a general meeting of shareholders and having the right to elect the board, which makes the key decisions affecting the activities of the enterprise³⁹. The Commercial Code sometimes makes the bureaucracy complicated for small businesses, but it does ensure effective control over companies and makes them more reliable as business partners. VAT was introduced for the first time in 1990 by a decree of the Government, when most goods were covered but services were exempt. The sales/VAT tax rate now is 18% - applied equally to both goods and services. Businesses with a turnover less than 250,000 EEK per year are exempt from VAT, unless they wish to register for it. The current tax legislation is based on the principle of proportional taxation and the corporate and personal tax rate is equal and fixed at 26%. For businesses outside the capital of Tallinn and part of the surrounding Harjumaa there is a tax exemption on re-invested profits. There are no special tax provisions for SME. The situation of SME in Estonia is greatly influenced by the labour-related legislation (including laws on health and social insurance, employment contracts, safety at work etc.). While the economic policy in the Estonian Republic has been liberal and therefore favourable to SME, the labour law is more employee-friendly. There are no noteworthy exceptions made for SME and small companies sometimes have problems performing all the duties. The level of minimum wages is subject to tripartite negotiations. According to the Health Care System Law, employers have to pay to the National Health Insurance Fund (13% of all payments made to employees (only certain exceptions)). SME pay the social tax to the State Pension Fund of 20% of all payments made to employees. This, together with the compulsory health insurance is a heavy tax burden on the employer. As these taxes are directly related to salary costs, they appear to be one of the major factors hindering job creation. Public discussion has started regarding the need to share this burden between employers and employees as a possible incentive to create more jobs. The Accountancy Law introduced the principle of accrual bookkeeping in 1992, which was implemented at the beginning of 1995. Accountancy regulations in Estonia are now compatible with those of Western Europe. The development of a normal business climate has been assisted by the enforcement of the Copyright Law in 1992, the Property Law in 1993, and the General Terms of the Civil Code in 1994. In view of the lack of Anti-Trust legislation, the Competition Law, adopted in 1998, has a special importance for SME. The principles of contracts are contained in the general part of the Civil Code of the Estonian SSR that is partially still in force and does not conflict with modern regulations. A new Contracts Law will be adopted soon. Successive governments have moved towards creating a market economy and have created a benign regime for the development of the business sector in Estonia. With its encouraging tax regime, low cost and skilled labour, Estonia is an attractive country for inward investment and for sub-contracting activities. Current very high tariff barriers for export to Russia have substantially hindered exports to that country. Discussions currently in process between the Russian and Estonian,

³⁹ The Code established Commercial Registers under city and county courts. The Register includes the main data about companies and is public. Documents presented to the Register require notary verification. There is a general register of business names which prevents duplication of the names of enterprises.

Latvian and Lithuanian authorities may bring some relief in this area. A well-defined Action Plan to eliminate the administrative burden and improve the regulatory framework does not exist. The business environment is subject to many changes carried out in isolation from a strategic SME, but no ex ante review of the likely impact on the performances of the SME has been carried out.

Access to finance

Access to credit is not perceived as a major factor hampering the further development of the sector. The legal act that comes closest to SME-specific legislation is the Law on State Support to Enterprise adopted on 10 May 1994. This Law regulates the process of providing financial support to the self-employed, and companies with less than 80 employees, an annual net turnover less than EEK 100 M, and which have no subsidiary companies. Financing can be in the form of a loan, guarantee or capital grant; the support is delivered by State-owned foundations that have no income tax obligation. At least 70% of the share capital of the supported enterprises must belong to Estonian residents. The general maximum period of the loan or guarantee is 10 years. The total amount of the loan or collateral should be not more than 75% of the total cost of the assisted business project. The applicant must offer collateral, which can be property, securities, existing contracts, a guarantee by a third party, or facilities or materials bought using the loan. Guarantee support for SME and businesses generally has been combined under the KREDEX Agency (Kredit and Export Guarantee Foundation), which provides the following facilities: Export guarantees, SME guarantees, Housing Foundation Mortgage guarantees. The conditions and regulations for guarantees vary. The micro-credit enterprises are adversely affected by the conditions set by the commercial banks, particularly as far as the request for collateral and a track-record is concerned. This may also be reflected in the relatively small number of SME per 1,000 inhabitants.

The Institutions supporting SME and their rationale

A large number of institutions and organisations are active in providing services to the SME sector. In 2001, the government established a new umbrella foundation, Enterprise Estonia, is intended to encompass the following agencies/foundations: Regional Development Agency (responsible for regional development), Technology Development Agency (responsible for technical development and liaison with universities), Trade Development Foundation (responsible for trade development), Tourist Board (responsible for the development of tourism in Estonia), the Estonian Investment Agency (responsible for foreign direct investment, a division of the Trade Development Foundation). Enterprise Estonia has only just been established and its operational mandate has yet to be defined. The Regional Development Agency is by far the most important Agency currently involved in the support and promotion of SME in Estonia. The RDA has two main functions (1) Phare programming and co-ordination of Phare inputs to Tourism and Technology development and (2) the business support system for SME. The Business Support System of the Regional Development Agency supports micro and medium-sized businesses, and the formation of new viable businesses throughout Estonia, in order to contribute to long-term stable economic growth of Estonia, following at the same time the principles of sustainable development. It supports 15 Business Advisory and Service Centres (BASCS) which are now State-funded to the amount of 200,000 EEK each, per annum. The Business Support System provides commercial services that are in accordance with the needs of the target group businesses and that are not provided by the enterprises/ firms operating in the market. The Business Support System organises co-operation with various organisations and offers efficient partnerships with institutions engaged in regional and local development activities. The Business Support System is also an executive structure for the implementation of the national policy directed to the support of enterprises in the SME sector. It is a channel for the submission of proposals to ministries for designing

policies directed to business development. The Business Support System is available and flexible for all enterprises included in its target group⁴⁰. The support system consists of the central institutions: the Estonian Regional Development Agency and the Regional Policy Loan Foundation, business development centres operating in all counties and providing minimum services on the basis of contracts, and the business consultants included in the list of Estonian Business Consultants. The Regional Development Agency operates two regional offices, one in the south and one in the north-east. A third may be established in the west. These offices are not part of the Business Support System but rather are regional extensions of the Head Office in Tallinn. Support is also offered to SME by the following foundations established by the government: the Credit and Export Guarantees Foundation, the Enterprise Credit Agency, the Estonian Investment and Trade Development Foundation, the Estonian Innovation Fund, the Rural Loans Guarantee Agency and the Agriculture and Rural Life Credit Fund. Estonian SME that participate in international fairs receive compensation. Special regional development programmes have been defined to support regional advancement and State budget aid is assigned through these programmes to county governments, projects presented by local authorities and non-profit organisations. The aid is directed towards developing regional target industries according to official regional policy. In order to promote the export of Estonian goods and services, support is given to programmes associated with the development of export activities. These include participation in international fairs, studies done on external markets, the training of exporters, and the application of international export standards. At the beginning of 1999, the government passed a law establishing a state guarantee scheme for exports. This law provides guarantees to banks and insurance companies providing finance to exporting companies. Under bilateral agreements, Business Promotion Centres are managed by the Swedish NUTEK Programme and the Nordic Council of Ministers supports SME through the Business Advisory Services. Under the Phare Programme, four Business Advisory centres assist SME in Tallinn, Narva, Tartu and Johvi. The implementation of the support programmes has been dispersed over a wide numbers of actors and projects. It is difficult for individual SME and support organisations to get information about the areas supported, the possible assistance obtainable and the methodology to obtain this support.

The implementation of the Phare Programme

Initially, the Phare approach to the SME sector aimed at complementing the reform policies of the Government of Estonia. Assistance fell into two main categories: (1) Technical Assistance, including policy advice, to the creation of BASCS, the Euro-Info Centres (in Tallinn and Narva), assistance to the SME Fund (Small Business Loan Fund) and (2) Financial Assistance to the Estonian SME loan scheme. The wider objectives of the more recent Programmes did not directly refer to SME but addressed general issues relating to increased competitiveness of the Estonian economy, the viability of the securities market, the suitability of Estonia for inward assessment, and the creation of the necessary basis for private sector development. The immediate objectives were to support the development of the entrepreneurial sector and to assist the development of SME through BASCS and special financial and promotion schemes. Estonia's aspirations to establish a well-functioning SME sector in an appropriate policy framework has not changed over the years that Phare funds have been available to the sector and progress has been made in developing policies in line with the principles and objectives of the EU enterprise policy. The main lines of Estonia's policy towards SME revolve around internationalisation, creation of a system of regional business support and the development of innovation and technological development. SME represent 99% of Estonian enterprise and by

⁴⁰ Micro-enterprises, small and medium-sized enterprises with up to 80 employees (Estonian definition), but it is also allowed to work with enterprises with less than 250 employees (EU definition of medium-sized enterprises).

the end of 1998 accounted for 47% of the workforce. However, their development continues to be hampered by the difficulties of access to finance (although this is no longer perceived as a major obstacle) and employing skilled labour. Efforts in this direction need to be continued.

The effect of Phare programme on SME development

The initial support for the establishment of four Business Advisory and Support Centres proved very useful, however with the cessation of Phare support the levels of service have been curtailed, although they continue to be supported by the government through the Regional Development Agency. The support by Phare for the establishment of the Small Business Loan Fund proved valuable and was instrumental in encouraging the government to invest in the fund. Support to the government, particularly the Ministry of Economic Affairs, in the area of institutional building was beneficial, however due to staff turnover the long-term benefit of the input remains doubtful. However the government has not fully committed itself to these initiatives partly because the lack of commitment to SME development and partly because of scarcity of funding.

The readiness in utilising SF for SME development

Currently, the readiness for utilising SF for SME Development is limited. An integrated approach, with actions selected to contribute to a common objective, such as combating industrial decline, in particular with SF type measures, linked with interventions to promote the business environment has not been developed yet. Geographical coverage has been partially established at NUTS II level. A Managing Authority, to comply with Structural Funds requirements has not been selected yet. The Regional Development Agency plays a relevant role in SME development. The new "Enterprise Estonia" should play the role of the umbrella organisation for business and regional development in Estonia, including SME development. At present it is unclear what the role of Enterprise Estonia is, and how it will relate to the Agencies and Foundations that come under its ambit. The government needs to set out policy objectives and a strategy for this organisation and its subsidiary bodies. So far, an integrated network of regional development agencies does not exist and even the strengthening and/or the development of adequate administrative capacity of the institutions responsible for the implementation of, at least, the pre-structural funds, has not taken place. The NDP which underpins both the multi-annual programming for SF projects financed from Phare 2002-06 and the preparations for Structural Funds has not been approved by the Commission Services. Despite actions by the government to create a market economy and develop support for business activities there are a number of factors which impact on its capability to build a strong SME and business sector. The ability of the existing institutions to benefit from structural funds is limited. The existing capacity to develop, manage, implement and monitor complex development programmes in ministries, agencies and regional institutions is weak. There is a regular turnover of staff in these institutions resulting in a shortage of staff with experience and commitment to implement policies, strategies and programmes. The lack of institutional memory at national and regional levels will be a substantial handicap during the implementation of Structural Funds.

The main challenges to be faced, in the near future by the SME sector in Estonia.

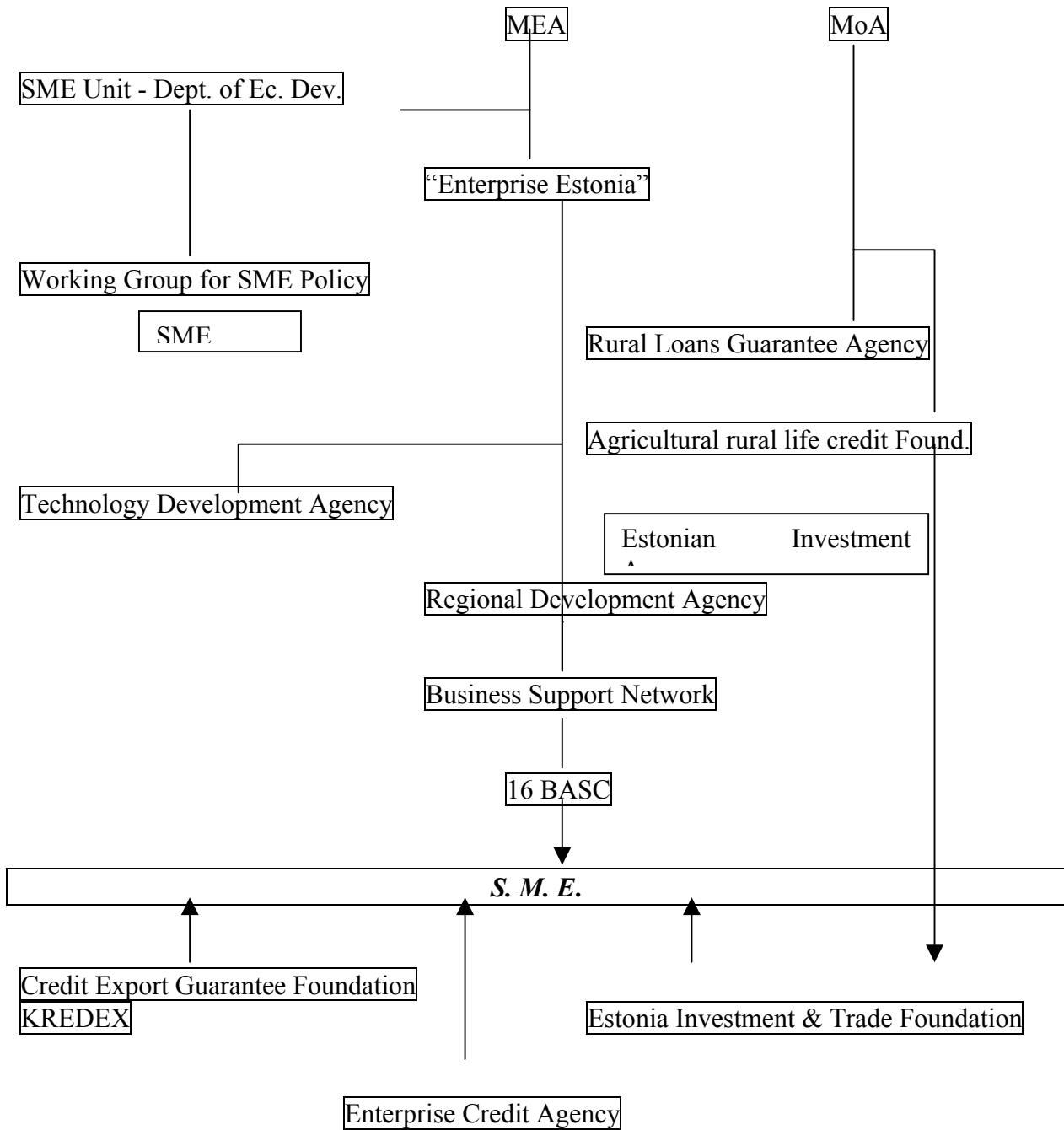
| Challenges to be faced by Estonia at enterprises level. | Challenges to be faced by Estonia at Government level. |
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| <ul style="list-style-type: none"> • Being able to face the competitive pressures in the single market, particularly for those SME heavily relying on sub-contracting relationships with FDI. • Coping with a fast changing legal environment, meeting the requirement of the <i>Acquis</i> | <ul style="list-style-type: none"> • Development of a multi-year Strategy for SME Development (up to 2006) addressing the major weakness of having a small number of SME per 1,000 inhabitants. • Identification of the most effective way to develop an SME strategy well-embedded into a |

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| <p><i>Communautaire.</i></p> <ul style="list-style-type: none"> • Gaining better and more co-ordinated access to information and high quality support services. • Upgrading management skills in order to increase efficiency and promote entrepreneurship. • Further enhancement of the growth and competitiveness of the sector in a “knowledge-based” internationalised economy. • Improving export related marketing and product quality related skills. • Making their voice heard by authorities through the development of more effective business associations capable of representing the interests of the entrepreneurs through effective lobbying activity, particularly with the adoption of a new regulatory system affecting Labour Law and Social Costs. | <ul style="list-style-type: none"> • regional development strategy adequate to solve the regional imbalance issue. • Development and implementation of specific “Action Plan” addressing the simplification and improvement of the administrative and regulatory framework in such a way to duly consider the likely effect of any new Act on the performances of the SME. • Complete structural reforms necessary to further restructure enterprises and to create a dynamic SME sector to support, inter alia, sustainable Social Cohesion. • To give business easier access to Community/National support services, programmes and to improve co-ordination of these facilities. • Ensuring the commitment of all the existing institutions supporting SME in joint efforts to ensure more effective co-ordination to provide a better service to SME. • Defining clear accountability role for the implementation of SME development measures. • Improving horizontal factors of competitiveness, such as entrepreneurship and management education or development of a more friendly Labour Law system for the sector. • Clearing the gap between national and regional skills in planning development programmes, with specific attention placed on the readiness in utilising SF. • Ensuring adequate planning skills development at the NUTS II & III level and defining financial support mechanism to support this enhancement process. • To enhance the capacity of the Ministry of Economic Affairs and to create appropriate structures for efficient planning, development, management, control and monitoring of the material and financial sources which use funding from the EU Structural Funds in industry. This needs the availability of skilled staff for an adequate time. • Improvement of the financial environment for SME, granting better access to credit for start up of micro and small enterprises, particularly within the lesser developed regions. • Further SME development and/or start-up or innovation through the development of non-banking schemes. • Further support the SME sector in order to reach for the Micro and Small enterprises a level of employment share similar to the EU one (i.e. 52 %) from the existing one (48%). • Reducing the very high tariff barriers for exports to Russia have substantially hindered exports to that country. |
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Recommendations

1. The Government should define an Action Plan aimed at reducing the administrative burden on SME. The Plan should include a timetable for implementation. Before adopting any new legal standards affecting SME, the government should carry out an ex-ante analysis in order to identify the impact on the performance of SME.
2. The Government should find solutions to the presently unfavourable environment regarding the flexibility of the labour law, as well as the procedures behind the application of the social security costs.
3. The Government should endeavour to reduce the effects of the existing tariff barriers for export to the Russian Federation.
4. The Government should produce a Strategic Plan for SME development up to 2006. The document should be embedded in a regional development strategy addressing, inter alia, the existing regional imbalance. The Strategic Plan should cover the development of all business sectors in which SME plays a major role. The Strategic Plan should build on a careful analysis of the reasons for the low number of SME per inhabitant, as well as the lower contribution to employment offered by the micro and small enterprises.
5. When analysis is available, the Government should define measures addressing the following aspects:
 - Increasing the number of SME per 1,000 inhabitants from the present 21 to at least the EU average of 48.
 - Increasing the contribution of micro and small enterprises to the total employment, by incorporating an active employment strategy.
 - Developing a detailed strategy to encourage those SME currently totally dependent on supply foreign companies and competing on a low cost basis, to develop their own brand and quality standards, so that in the longer term they will not be dependent on foreign companies for their continued existence.
 - Further supporting the development of initiatives among the SME in relation to Tourism development.
6. The Strategic Plan should clearly define roles, mandates, and structures for the institutions involved, paying a specific attention to the definition of the role of "Estonia Enterprise".
7. The Government should include the following aspects:
 - The establishment of a Micro-credit schemes for the provision of small credits for start ups and micro business development purposes.
 - The development of a guarantee fund to support the requirements of growing companies to access funds, to ensure their continued growth and development of export markets. This could be done by further developing the activities of the KREDEX Agency through adaptation, and/ or the expansion of existing guarantee schemes.
8. The Government should develop an institutional framework that is well co-ordinated, transparent and accountable. In order to simplify the access to the services for SME, a regional system of "SME one-stop-shops" should be established to allow entrepreneurs more efficient access to the services available.

Estonia Business Support Network



HUNGARY

General Overview

Hungary has a population of 10 M. The implementation of economic reform led to increases in Hungary's GDP by 4.4% in 1997, 4.9% in 1998, 4.5% in 1999 and 5.2% in 2000. In 2000 GDP per capita in PPP was 11,700 €, 51.9% of the EU-15 average. The Unemployment rate was 6.6% in 2000, whilst the inflation rate still remains above 10%, a considerable improvement on 1997 (18.5%). As much as 85 % of the GDP is now generated by the private sector, and the number of State assets available for sale is diminishing rapidly. Both in absolute terms, and on per capita basis, Hungary has been one of the preferred destinations within eastern European countries for FDI. In 1999 FDI was 1,849 M€, equivalent to 185 € per capita. There is a health trade balance with a deficit of only 5% of GDP. Foreign debt however is a burden, with mounting debt equivalent to 56.10% of GDP.

Hungary is currently characterised by a strong economic duality, with a large proportion of GDP produced by foreign owned (and highly export-oriented) large multinational corporations, but also a large number of domestically owned SME, whose contribution to the economy is relatively small in terms of GDP, although they employ higher numbers of employees. Hungary has a good reputation in the development of economic reforms. The first round of reforms took place in 1968. Since 1985, systematic reforms have been implemented and some parts of institutional and judicial infrastructure of a market economy have been in place for more than ten years. Therefore, the number of SME in 1990 was considerably higher than in other CEEC, and the legislative and regulatory environment are more geared towards enterprise development. In Hungary, almost 20% of enterprises were established before 1990.

Status of SME sector

The SME sector is dynamic and, in comparison with 1996, the number of registered enterprises in 2000 reaching 1,500,000. In the same period, the number of active SME increased from 698,045 to 808,087. In 1999, the SME sector accounted for 99.3 % of companies and 59.4% of employment. No data are available about the survival rate of SME. The structure of SME in number and size only partially fits the EU average. Medium and Large enterprises are aligned to the EU average, and the percent of micro enterprises (96.8% compared with 93%) is bigger in Hungary than in the EU, to the detriment of the number of Small enterprises, which is 2.8% compared with 5.9% EU average. In Hungary there are 78 active enterprises per 1,000 inhabitants, while EU has 48. The size/ class dominance⁴¹ in Hungary is the large one (40.6 %), which is bigger than the EU average (34.1 %). This difference is more exceptional when compared with EU Countries of micro size class dominance (e.g.: Italy, France, Spain and Greece), but not in comparison with EU Countries of large size dominance (e.g.: Germany, Belgium, Ireland, Netherlands and UK). The average number of employees per SME ranges between 5.8 and 6.1. This is slightly larger than the EU average (4 employees per SME). The share of sole proprietors in the sector (58%) underlines the importance of the self-employed companies. More than 66% of the SME have no employees, against 52% for the EU SME. The SME mainly concentrate on the Service Sector, where there are 679,896 active SME (84.8% of active SME). The manufacturing sector amounts to 10.3%. The exporting capacity of the SME is quite weak. The big multinational companies generated the largest part of export in 1998 (65% of total export). Also, due to low financial capacity, the SME sector is weak in manufacturing and innovation. Poor production quality hinders its capability of establishing sub-contracting agreements with the multinational enterprises active in the

⁴¹ A country is said to be micro- small- medium- sized or large scaled if either micro, small, medium or large scale enterprises have the largest share in total employment.

Hungary. Marketing, business knowledge and management abilities are areas requiring considerable improvement for SME development purposes.

Broad Economic & Social Policies

The broad economic and social policies are partially supportive of effective SME development. The Ministry of Economic Affairs (MEA) has been given responsibility for SME development, although the Ministry of Agriculture and Regional Development (MARD) also has a role in supporting the sector. The Ministry of Foreign Affairs (MFA) is also involved, through the Hungarian Investment and Trade Development Agency (ITDH), in the promotion of exports and FDI. Effective co-ordination between the various Ministries/ department sharing responsibilities for SME Development only exists on paper, and no clear division of responsibility has been defined, raising concerns about the effectiveness of the co-ordination and implementation mechanism of the defined policies. A National Strategy for SME has been developed to cover the period 1998-2002. In 2000, the government launched an ambitious medium-term economic development programme called the "Szechenyi Plan"⁴² which includes an enterprise part. The Plan is mainly aimed at ensuring a rapid and sustainable economic growth, and will be implemented and followed up by the MEA. The Plan covers the period 2001-2006 and, for the first two years, 625 billion HUF (3 billion M€) have been allocated to support, inter alia, the SME sector. The Plan is a challenging development plan showing the strong commitment of the government towards economic development. The government has produced an NDP, but DG REGIO has not approved the document. MARD has not yet clearly defined how the regional development strategies will address SME development and the SOP Industry has not been approved yet. The SME council, under the auspices of the MEA, gives political guidance.

Regulatory policy

In their attempts to promote the SME sector, previous governments have tended to over-regulate it, smothering initiative and discouraging prospective entrepreneurs. Since 1998, the incoming government accepted the need to redress the balance in favour of small businesses, and passed an SME Act in September 1999 which classified enterprises in EU terms as far as size is concerned, setting down priorities and committing resources to implement it. The available legal forms⁴³ for operating an enterprise are basically in conformity with EU forms and serve the present needs of the SME sector well. Fast and cheap transformations from one form to another are available. The registration procedures are adequate and the changes implemented since 1998 are a considerable improvement in terms of reduction of the administrative burden. The process of starting-up a business has been simplified. However, the regulatory policy is not yet adequate to the further development of the SME sector. The administrative burden in reporting different kinds of taxes has been rationalised, and some deregulation started in cases of smaller turnover (e.g.: smaller SME). The deregulation in frequent reporting has been however associated with a request for a more detailed determination of costs. The system of local taxes is generating uncertainty and disparities among SME operating in different regions. Administrative burdens caused by the social security system have been enlarged since the beginning of 1998, as all the entrepreneurs (all kinds of SME) have to report each month (instead of yearly) employment changes and entrepreneurial withdrawals. Overall, the pace of change in the regulatory environment presents a key challenge to the sector, as the government develops a legal framework fully compatible with the acquis. The legal requirement to conform to the newly defined regulation

⁴² <http://www.gm.hu/english/economy/szechenyi.htm>

⁴³ Sole proprietor, unlimited partnership, limited partnership, joint enterprise, limited liability company, and company limited by shares.

is costly and difficult because of the new number of laws being passed and refined. The government is fully aware of this shortcoming and its medium-term strategy builds on the reduction of taxes on labour, and cut backs on administrative obligations. Currently, one of the main challenges of the government is the implementation of its strategy for the regulatory policy. In this respect, an Action Plan to address the implementation of the reform has not been prepared.

Access to finance

Access to finance is still extremely difficult for SME. Overall, the problem is not related with the lack of liquidity within the system, but is associated with the unfavourable conditions set by the banking system for the SME sector. The commercial banks adopt a very cautious approach, and the amount of collateral required often exceeds 150%. The on-going privatisation of the banks (presently, 70% of the Hungarian banks are controlled by foreign organisations) has not signalled any change in this cautious approach. Most Hungarian SME consist of micro and small enterprises, whose assets can hardly be separated from those of the individual entrepreneurs' personal assets. These SME rely on a combination of family assets and support provided by relatives, which is important for the start-up phases, but is clearly inadequate for development needs. The existing "Credit Guarantee Ltd" (one of the few institutions active in the guarantee sector) is pursuing a risk adverse approach, and is pulling out of guarantees loans for the small business and start-ups which are the most in need of this type of support. Both the Micro Credit Scheme (MCS) and the Phare Loans Schemes managed by the Local Enterprises Agency (LEA) networks, mainly address the need of start-up businesses. A significant proportion of the MCS has supported the financial needs of newly established micro and small enterprises (at the end of 1998, the MCS financially supported 20,696 applications). The Phare Loans Scheme (PLS) failed to encourage commercial bank participation in funding SME⁴⁴ as the banks do not consider the maximum ceiling of 10 M HUF (20,000 €) adequate. There is also a tendency to consider the PLS as the "last resort" in the event of failing to obtain credit through other financial sources. Reserving 50% of the funds available for start-up activities has made the involvement of commercial banks more difficult. In order to support the sector in overcoming the difficult access to credit, the Széchenyi Plan is to devote specific assistance to the provision of funds to financially support, on co-financing basis, the SME sector. In accordance with the 1999 SME Act, starting in 2000, a special budgetary appropriation has been established to grant subsidies to the SME sector. The "Budgetary Appropriation for SME (KKC)" totals 5.23 billion HUF. The application of the SME appropriation, including professional, accountancy and administrative activities, has been managed by the Hungarian Enterprise Promotion Public Utility Company (MVF), but the funds available under the State Budget scheme are small in comparison with demand, and alternative mechanisms to support SME financially are needed.

The Institutions supporting SME and their rationale

Up to 1999, the main institution to provide support to the SME sector was the Hungarian Foundation for Enterprise Promotion (MVA), supervised by the MEA. The MVA is currently the co-ordinating body for advisory and information counselling activities carried out by the national network of Local Enterprises Agencies (LEA). In 1999, a new institution, the MVF was established by the Hungarian Government (supervised by the MEA), with equity of 50 M HUF. The role of the MVF has been fixed as the provision of support for the emergence and development of the Hungarian SME, and is of great relevance in the context of the new government strategy for SME development⁴⁵. ITDH effectively assists SME in developing

⁴⁴ The PLS is operated through financial intermediaries selected on competitive basis.

⁴⁵ From 2001, the mission of MVF has been enlarged to the contribution to the successful implementation of the Széchenyi

international trade. A specific set of measures has been defined to support regional development activities in Eastern Hungary. ITDH has hosted the Euro Information and Communication Centre (EICC) since 1994. The EICC mainly assists SME, and provides them with a wide range of information. In addition to the support provided by the LEA Network, other services and support programmes are available to SME. The development of industrial parks began in Hungary in the early 1990s, initiated by local government and businesses relying on the direction of development and experience in the advanced west European countries⁴⁶. To date, 37 industrial parks have obtained support through the infrastructure development tenders jointly issued by the Economy Development and Regional Development/Rural Development Funds (where only industrial parks were eligible bidders). Through this, investments in infrastructure totalling HUF 8 billion will be implemented by 2001, with central support of HUF 3 billion (HUF 1.7 billion from the Economy Development Fund and HUF 1.3 billion from the Regional and Rural Development Fund). A Subcontracting Programme was launched in 1998 under the direction of the MEA for support to enterprises wanting to act as suppliers, in order that they could establish EU style business relations with Hungarian large enterprises and multinational concerns. The MEA has placed the MVA in charge of performing the tasks to be executed under this Programme. Under the supervision of MARD, the Regional Development Programmes are managed through a system inclusive of the Regional Development Councils (decision making bodies) and Regional Development Agencies (implementing bodies). The provision of support to SME is characterised by overlap and unclear division of tasks. Furthermore, the focus on enterprises is not present in all organisations, and unnecessary competition exists between institutions, such as the LEA and the Chambers. The broad range of services and support provided to SME does not separate the needs of micro- small and medium enterprises, and does not address international competitiveness of Hungarian SME. The existing institutional framework has not yet developed an adequate level of co-ordination with clear co-ordination and accountability lines. The relationships between the MEA and the MARD have still to be clarified in terms of accountability and/or share of responsibility for SME development. Regional Development Councils, RDA, Chambers MVF, MVA, LEA, all operate locally without a clear and mutually recognised division of tasks. Individual LEA do not work as a member of a National SME Development network, but work as an independent private company. In summary, there is no movement towards the provision of an “SME one-stop-shop”.

The implementation of the Phare Programme.

Phare has been active in the SME Sector since 1991, and more than 50 M€ has been allocated to support SME Development in Hungary. Other measures, such as the support to the establishment and development of technological parks, are funded under other Phare Programmes (CBC). The main areas addressed have been national and regional support for the establishment and maintenance of a nation-wide Local Enterprise Network, through the Hungarian Foundation for Enterprise Promotion, and Loan Schemes for micro enterprises and start-up businesses. The 1996 Programme was to be transitional, and informed by a mid-term Strategic Study, which would identify a viable exit strategy for Phare assistance by 1999. The Wider Objectives of the Programmes were to contribute to the development of the private sector, to assist the socio-economic transformation of Hungary, to facilitate accession to the European Union and to improve the environment for the SME Sector. The Immediate Objectives were to develop national and regional services for the SME Sector, to ensure the

Plan, being responsible for the management of the applications of the Plan.

⁴⁶ By the end of 2000, 112 applicants (28 in 1997, 47 in 1998 and 37 in 1999) won the title “Industrial Park”. In 88 industrial parks, more than 90 enterprises generated products to a value in excess of Ft1,400 billion with productive investments of Ft357 billion and a labour force of 81,000 in 1999. About 80 per cent of this was exported.

sustainability of the Local Enterprise Agency Network to service the needs of SME, to develop new strategies for the Sector, and to consolidate credit lines for SME businesses. Under 1997 and 1999 Programmes, Immediate Objectives have been further refined to prepare SME for Accession, by providing credit, improving their environment and establishing partnerships, and also to improve services to the sector and the survival rate of start-up businesses, to promote growth, job creation and maintenance. The latest Programmes reflected the priorities from the NPAA: (i) modernisation of the Micro-credit Scheme Programme, (ii) support the government strategy assisting SME and the national four-year SME Programme, and (iii) the development of the business information system for SME. The 1997 SME Development Programme did not make any significant contribution to the Wider Objectives at the time of the last OMAS Consortium assessment (April 2000). Phare has contributed to SME development priorities included in AP and NPAA through the establishment of a business advisory network for local SME, the creation of a coherent SME policy to support the sector, and through the provision of lending programmes. At the time of the third Assessment (August 2001), the Phare Programmes had only limited impact on the systematic problems facing the SME Sector. The LEA Network had not benefited from the assistance planned under Programme 1997 and outputs were not delivered at the cut off date of the Assessment. The revised Micro-Credit Scheme was not yet operational and the implementation of the Programme 1999 was behind schedule.

The effect of Phare programme on SME development

Under the Measures addressing Institutional Building issues, no relevant Phare assistance has been specifically conceived to support the simplification and improvement of the business environment through the strengthening of the existing structure(s) or by the setting-up of institutions specifically dealing with this important aspect of SME Development. As a consequence there has been no effect on the simplification of business environment. The financial schemes developed by Phare since 1991 to financially support SME, have had a positive effect on the financial environment when access to credit was even more problematic than now. No Phare assistance has directly addressed the implementation of Guarantee Schemes (with the exception of HU-9001). The assistance delivered by Phare has not specifically addressed the important issue of competitiveness, which, since 1998, is one of the key priorities of the Government. No specific assistance has been conceived to provide a fully-fledged assistance to the existing network of business incubators. The internationalisation of SME has benefited from the assistance delivered by Phare through the ITDH. The institutional environment in Hungary is based on a broad range of organisations and institutions addressing the SME needs, but no Phare assistance has been designed to addressing adequate co-ordination of the existing facilities, in order to provide SME easier access to support services, programmes and network. It remains confusing and difficult for individual SME and support organisations to get information about the areas supported by Phare, not just under SME programmes, but also under other related programmes, detailing the assistance available and how to obtain this support. Ignoring this issue has resulted in an adverse effect on of co-ordination of the existing facilities to assist SME. The assistance provided to the national network of LEA, and to the local institutions implementing CBC Programme measures and Regional Development Agencies, has only had a marginally positive effect on the promotion of entrepreneurship at regional and local level.

The readiness in utilising SF for SME development

An integrated approach, with actions selected to contribute to a common objective, such as combating industrial decline linked with interventions to promote the business environment has not been developed yet. The NDP has not been approved and, most likely, there it will be March 2002 before an integrated approach is ready for implementation. Coverage at the

geographical level deemed most appropriate has been defined in terms of NUTS II level. The Country will be split into seven regions. The NUTS III regions have not been defined. MARD will be the main co-ordinating body for the implementation of the SF. With the support of the Phare Programme, in the frame of the Phare 2000, a Regional Preparatory Programme has been launched to prepare the Hungarian regional authorities for the implementation of SF, but it is not clear how SME development will be addressed. It is also not clear how responsibilities are divided between the MARD and the MEA, and secondly, which body within the MEA, will be responsible for managing the funds addressing SME development. A number of related questions arise, for example, the roles of MVA and MVF, and how they will interface with MARD. The regional development institution system in Hungary is in place but the system has not yet developed adequate skills to design and implement SF measures addressing SME development.

The main challenges to be faced, in the near future, by the SME sector in Hungary.

| Challenges to be faced by the Hungarian SME. | Challenges to be faced by Hungary at Government level. |
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| <ul style="list-style-type: none"> • Being able to face the competitive pressures in the single market, particularly in relation to the presently poor skills in manufacturing and innovation. Poor production quality hinders the sector capability to establish sub-contracting agreement with the multinational enterprises active in the Country. • Marketing, business knowledge and management abilities are areas requiring considerable improvement for SME development purposes: <ul style="list-style-type: none"> • Coping with a fast changing legal environment, meeting the requirement of the <i>Acquis Communautaire</i>. • Gaining better access to information and high quality support services. • Upgrading management skills in order to increase efficiency and promote entrepreneurship. • Enhancement of the growth and competitiveness of the sector in a “knowledge-based” internationalised economy. • Integrating “Supply chain” networks and improving export-related marketing and product quality related skills. • Making their voice heard in authorities through the development of more effective business associations capable of representing the interests of the entrepreneurs through a more effective lobbying activity. | <ul style="list-style-type: none"> • Better understand the actual needs of the SME sector, also with the support of more reliable statistical data adequate to the implementation of benchmarking analysis. • Development and implementation of a specific programme addressing the simplification and improvement of the administrative and regulatory framework. • Development of a more friendly taxation system for the sector. • Complete structural reforms necessary to further restructuring enterprises and to create a dynamic SME sector able to reach a level of employment share similar to the EU one (i.e. 65.9 %). • Develop adequate planning and management skills in order to ensure the smooth implementation of the Szechenyi Plan with a specific attention to the following aspects: <ul style="list-style-type: none"> • Improving horizontal factors of competitiveness, like entrepreneurship and management education. • Improvement of the financial environment for SME, granting better access to credit for SME development and/or start-up or innovation. • Specific attention should be paid to ensuring adequate development of small and medium size enterprises keeping in mind the high number of micro enterprise in comparison to the EU average. • The activities of SME mainly concentrate on the Service Sector (i.e.: 84.8% of active SME). The manufacturing sector only covers 10.3% and there is need to increase the involvement of SME in this sector. • The export capacity of the SME is quite weak. The big multinational companies generated the largest part of export in 1998 (i.e.: 65% of total export) and the government should strongly support the international competitiveness of SME. • To give business easier access to Community support services and programmes, and to improve |

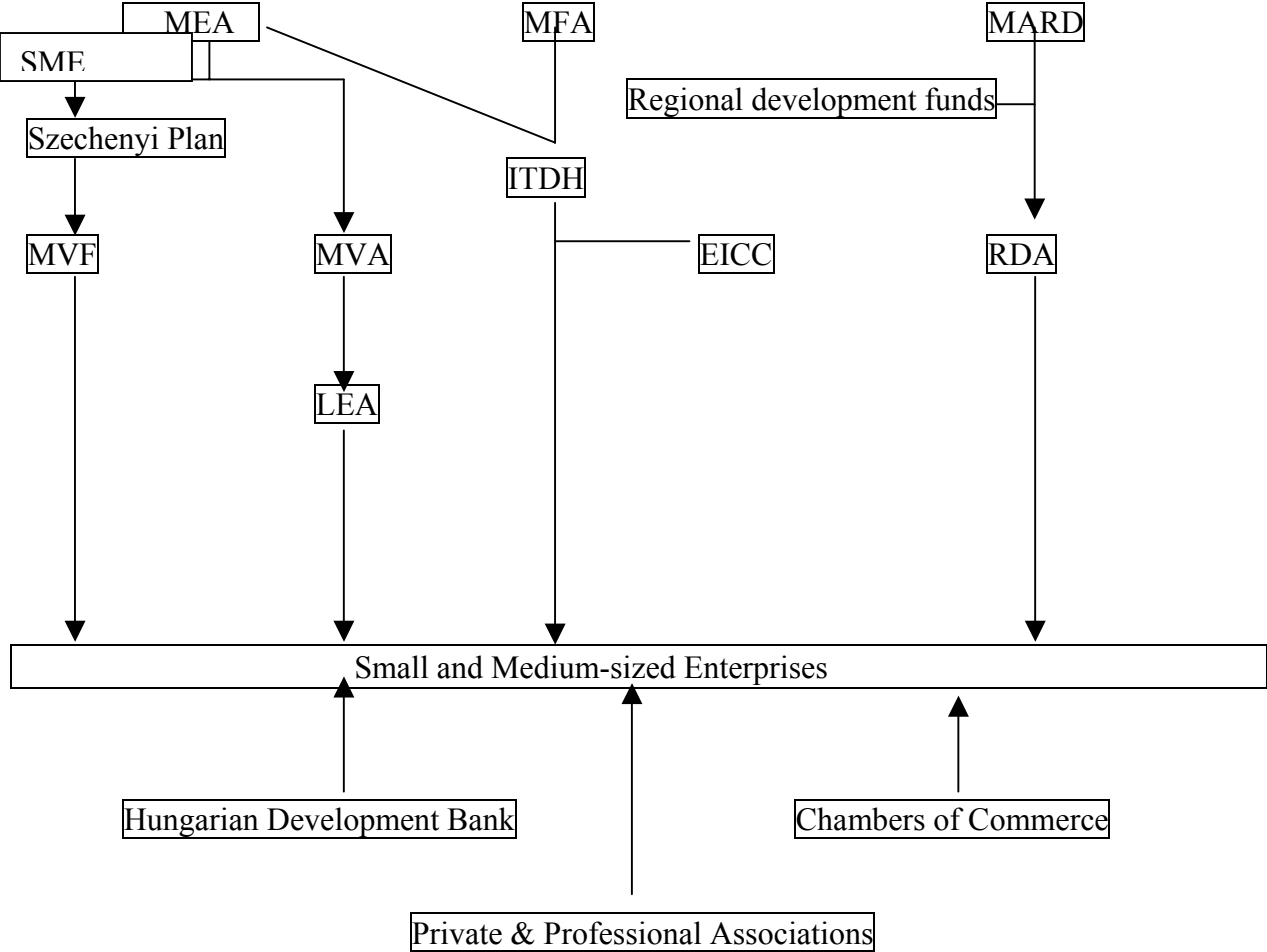
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| | <p>co-ordination of these facilities.</p> <ul style="list-style-type: none"> • Ensure the commitment of all existing institutions supporting SME to ensure more effective co-ordination in order to provide a better service to SME. • Defining clear accountability level vis-a-vis the implementation of SME development measures. • Clearing the gap between national and regional skills in planning development programmes, with specific attention placed on the readiness in utilising SF upon accession. • Ensuring adequate planning skills development at NUTS III level and defining financial support mechanism to support this enhancement process. |
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Recommendations

1. The MEA should carry out a Needs Analysis to plan SME support in a more effective and exhaustive way. Based on the findings, a dual strategy should be developed, separating the needs of micro/small enterprises from the medium ones. On this basis, the government should launch a fully-fledged programme to reduce the bureaucratic burden, and to simplify the administrative and regulatory framework.
2. The MEA should organise an impact analysis in order to appreciate the actual impact on SME of the harmonisation of the legal system with the acquis. The analysis should also focus on the costs incurred by the sector in coping with the new legislation and, if deemed necessary, to propose specific financial support.
3. The government should establish a more effective system to ensure adequate co-ordination and accountability between the MEA and the MARD as far as the SME development activities are concerned.
4. The government should clarify the role of the two organisations bearing responsibility for SME development (MVA and MVF) also specifying the future role of LEA. In this respect, the government should consider the possibility of guaranteeing the financial sustainability of the LEA Network following the termination of Phare support.
5. The Government should carry out an organisational and management review of the MEA in order to be informed about the availability of adequate skills to manage the highly innovative and challenging Szechenyi Plan. In order to develop effective management tools, valid indicators of success should be defined, if necessary in collaboration with the Phare Programme and/or DG Enterprise.
6. The government should attribute to existing organisations and institutions assisting the SME sector clear and non-duplicating tasks.
7. The MEA should consider involving Economic Chambers in a more direct way in their programme of SME development. Their Association already plays an important role in SME support, but there is a need to better co-ordinate the activities carried out by the Economic Chambers, with the forthcoming activities linked with the Szechenyi Plan.
8. The MEA should define a new and enlarged role for the Euro Information and Communication Centre hosted by the ITDH. It should be possible, on the basis of the activities already carried out, to plan the establishment of an “SME one-stop-shop” urgently needed by SME.
9. MARD should launch an organisational and management review in order to understand the strengths and weaknesses of the existing structures existing at regional level (both NUTS II and III), in order to better define the strategy for the eventual utilisation of structural funds.
10. MEA and MARD should consider the best way to ensure the development of adequate synergies between the Szechenyi Plan and the eventual utilisation of SF.

11. In order to support innovation, the existing network of Industrial Parks should be considered a strength to be utilised in implementing the Szechenyi Plan.
12. The existing Sub-contracting programme is a valuable tool to support international competitiveness, and should receive further financial and technical support under State and EU funded support programmes.

Hungarian “Small Business Support Network”



LATVIA

Overview

Latvia has a population of 2.4 M inhabitants and at present indeed has a declining population. In 2000, GDP growth was 6.6%, a big improvement on 1999's negative growth (-3.9%). However over the period 1995-1999 average growth was a healthy 3.2%. Per capita, in terms of PPP the GDP was 6,600 € (29.30% of EU-15 total). Unemployment in the last few years has steadied at 14.2% in 2000. Inflation in the past has been a problem with rates as high as 24.7% in 1996 but by 2000 was at 2.6%. Latvia is attracting good amounts of FDI at present having one of the highest per capita rates at 190 €. As a % of GDP, the trade balance (-16%) and amount of foreign debt (26.50%) are in line with other CC's.

Administratively, Latvia is divided into 33 regional units: 26 districts and 7 major cities, which perform the functions of both local authorities and district self-governments. Significant social and economic differences exist between the regions at present. The majority of economic activity has been concentrated in Riga. The gap in social and economic condition and GDP-ratios has been continuously widening between the richest and poorest parts of the country. This process of regional differentiation is not only causes significant social and economic problems within Latvia, but also may have an adverse impact on Latvia's progress towards Accession. Ethnic problems are still adversely affecting the social cohesion and the functioning of SME still lacks transparency.

Status of SME

The Law on Control of State and Municipal Support Provided to Business Activity⁴⁷ contains the applicable definition of SME, largely in accordance with the EU definition. In September 2000, there were 37,860 SME operating in Latvia (the data do not differentiate between registered and active SME). Approximately 76% of all enterprises are micro enterprises (less than nine persons employed), 19% are small enterprises (10-49 persons employed) and approximately 5% of all enterprises are medium sized (50-249 persons employed). The SME sector accounts for more than 99% of the total number of existing enterprises (39,753 in 1999), and employs more than 70% of workforce, covering more than 60% of GDP. In comparison to EU and other CC, the number of enterprises per 1,000 residents in Latvia is extremely small (15 enterprises versus 48). Typically, the sector dominates in the area of services, although in the last few years there has been a tendency of growth in the manufacturing-oriented SME. In order to boost export activities, a number of "Free Port" and "Free Economic Zones" have been established, but their status is not in line with EU regulations.

Broad economic and social policies

The Ministry of Economy is responsible for the design and implementation of the National SME Development Policy, through the "SME Development Policy Division" of its Entrepreneurship Department (4 staff work on Entrepreneur policy). The basis for SME state support measures is the "National Program for the Development of Small and Medium-Sized enterprises. SME are a priority also in a number of official documents⁴⁷. The Multi-annual strategy to address sector development over the next four-five years is under development. The main objective of the business development policy in Latvia has been to create a favourable environment for entrepreneurship and attract domestic and foreign investment.

⁴⁷ National Program for Integration into the EU - Medium term economic development strategy - Concept of state support to business activity - Rural Development Program - Drafts of the National Development Plan for the attraction of the EU Pre-Structural Funds.

Increase of competitiveness of Latvian industry cannot be contemplated without support to innovative activity. In 2000, the National Innovation Concept was developed to organise state support system to innovation. The aim of the Concept is to promote the economy open to innovation, and it contains a set of activities to stimulate a more effective link between research and business, for the development of innovative and knowledge-based business. The activities relate to the development of all components of the National Innovation System, including education and research business, investment and legislation. The next step, after the approval of the National Innovation Concept in the Cabinet of Ministers is the development of the National Innovation Programme. To implement all the activities mentioned it is planned to open a new budgetary programme “Support to Innovative Activity”. State support to SME is regulated by the Law of 1998 on Control of State and Municipal Support to Entrepreneurial Activity, developed in line with the state support principles accepted in the European Union. While Latvia has an extensive legislative framework for regional development policy, institutional responsibility and the instruments to support regional development were dispersed throughout a number of ministries. An effort to regulate the central government sector is underway and several ministries have been involved.

Regulatory Policy

The government considers that a helpful business environment is necessary for smooth SME development, and a number of relevant actions have been already undertaken. An important step has been the adoption of the Commercial Law in the parliament in April 2000, which brings together regulations previously contained in several legislative documents, and revokes series of outdated provisions, typical of a transition period. Once fully implemented, the Law will allow a reduction of the types of enterprises, from the existing 13 types to five types⁴⁸. The adoption of the Commercial Law is substantially simplifying business legislation in Latvia by replacing the present 20 legal documents and consolidating them in one law with a unique legal terminology. The main changes for entrepreneurs will be: (1) re-registration in the Commercial register, (2) adaptation of the company charter and management to the requirements of the Commercial Law, (3) change of the type of enterprise if the existing type is no longer possible according to the Commercial Law. There are expectations that the Commercial Law should contribute to the improvement of legal and investment environment in Latvia, despite the potential problems and additional costs that may appear during the re-registration of enterprises in the Commercial Register. The problems are mostly linked with the capability of the public administration to ensure a smooth implementation of the newly adopted legislation. State support to small enterprises is mainly linked with tax exemptions provided in the Law on Company Income Tax⁴⁹. Overall, the regulatory environment is not yet adequate to the needs of the sector. New legislation has been adopted but not yet implemented. Under the area of Regional Development Policy the government supports economic development in the less-developed parts of the country (‘assisted’ regions) by providing small-scale support for entrepreneurial activities. An action plan to improve business environment is under preparation.

Access to Finance

Latvian SME’s have difficulty in accessing embryo/ start-up credit through the commercial bank system. Start-up and early stage credits are associated to very tough conditions set by the commercial banks that request high collateral, offer high interest rate and require a proven

⁴⁸Sole proprietorship; company with full liability; limited partnership; limited liability company; joint stock company.

⁴⁹ Companies employing less than 25 employees with the balance sheet value less than LVL 70 000 and where turnover is under LVL 200 000 may benefit from these exemptions.

track-record. In order to support the SME sector financially, a broad range of initiatives exist including public and/ or public mix financing. The Hipoteku Bank is a State Guarantee Bank jointly funded by the government and the German Development Bank (KfW), and during 2000, the Hipoteku Bank started to implement a “Programme of Lending for the Development of Small and Medium-sized Enterprises (SME) in Latvia”. The Programme, approved by the Cabinet of Ministers on 15 November 1999, aimed at supporting two groups of enterprises: SME providing new jobs, and start-ups. A State Guarantee amounting to LVL 10 M was allocated to implement the Programme during the years 2000 to 2002. Agreements with the German development bank Kreditanstalt für Wiederaufbau were signed in 2000 attracting a total of 23 M€ (LVL 13 M) for financing the Programme⁵⁰. During 2000, “Hipoteku Bank” started a micro-credit scheme in co-operation with Latvia’s savings and credit unions. Within the framework of this project, the Bank signed agreements with the Co-operative Association of Savings and Credit Unions of Latvia, and the savings and credit unions of Līgatne, Rauna, Taurene and Veselava, which extended sub-loans to their members. The Guarantee Agency was set up in January 1998 by the Latvian Development Agency (LDA) (25%), the Latvian Export Credit (State Corporation for promoting export of Latvian goods, 50%) and the Chamber of Commerce and Industry (25%). The purpose of the Guarantee Agency is to offer guarantees to companies fulfilling eligibility criteria⁵¹ to secure credit. The appraisal and selection of the projects are made by the commercial banks: 13 banks have been selected covering the whole country. It is proposed to cover the cost of the guarantee by charging a 24% premium, but it has not yet been decided what proportions the bank and SME should pay. The Agency has to date issued guarantees for 10 projects at an average level of 300,000 €. This low up-take is linked to the fact that the Fund is undercapitalised (1.5 M€) and cannot fulfil all the requests. Overall, access to credit is still a big problem for the SME, and there is need to rationalise the existing schemes in the framework of a well-conceived strategy linked with a regional development strategy.

The Institutions supporting SME and their rationale

Latvia has not yet developed an effective business support network, at least comparable with other CC. The main problems hindering and restricting the efficient implementation of business support measures are the lack of a clear strategy on how to address, at national level, the needs of the SME sector, and a shortage of financial and human resources. The Latvian Development Agency (LDA) should be the key actor for the implementation of the national SME strategy. It is a non-profit State owned joint stock-company established by the government at the end of 1993 to attract foreign direct investment and to promote exports⁵². However, the LDA plays a passive role towards the provision of support to SME. A network of 13 Business Advisory and Support Centres (BASC) has been set up since 1993 with the support of the EU Phare Programme. During the past few years, the government has provided co-financing through the Privatisation Fund. The main activities of BASC are business training and consulting activity (business planning, credit arrangement, business practices, marketing, financial management, sales, and customer care), and information and office services. However with the ending of the Phare funding their situation has become precarious and they have either closed or embarked upon purely commercial operations. Four technology centres and parks provide incubation space to stimulate and support the setting up of

⁵⁰ The implementation of the Programme started in March, 2000, achieving considerable results by the end of the year. Loans totalling to LVL 4.1 M were extended within the framework of the Programme and about LVL 10 M, including the co-financing of companies, were invested in the national economy of Latvia. Within this programme the bank has funded 89 projects and created approximately 300 new jobs.

⁵¹ Up to 150 employees, assets up to LVL 200,000 (€ 300,000) of assets and a turnover of up to LVL 1 M (€ 1.5 M).

⁵² The major services offered are: services for foreign investors, export related services for local and foreign companies, sector studies.

technology-based enterprises under the supervision of the LDA. Since 2001, the LDA has been authorised to run an EICC in Latvia and operate a non-profit company providing services to local enterprises on a fee basis, except for the provision of information received by EIC free of charge. Overall, the institutional network established to support the SME development is extremely weak.

The implementation of the Phare Programme

Between 1990 and 1997 a total of 174 M€ was allocated to Latvia by Phare, of which 5.91 M€ was directly attributed to SME development. After 1997, no direct support was allocated to SME development, although, further amounts were allocated to projects supporting indirectly SME development through programmes such as regional development and Financial Sector Development. One of the purposes of the Phare Programmes has been to improve the availability of finance to SME through the provision of loans, grants, loan guarantees and equity. Phare funds allocated for this purpose have been however very limited (1 M€ for an SME Loan Scheme). A small allocation (€ 80,000) was provided from the 1995 Financial Memorandum to undertake the initial development of a Loan Guarantee Institution. A consultant was retained to undertake a feasibility study, prepare an outline design and draw up the legal framework for a Loan Guarantee Agency. The Fund was established in January 1998. Institutional programmes were introduced to assist the Government to develop an effective institutional framework for SME development. There have been two components: to assist the Ministry of Economy in the development of an appropriate policy framework and the development of an institutional development programme for SME support organisations and to co-ordinate overall programme implementation. In the early phase (1993-5), progress on the development of policy was limited, due to frequent of staff. The most significant output was the completion of a major survey of SME through 260 face-to-face interviews. This was used to draw up a rather ambitious (in view of resources available) Draft SME Development Programme

The effect of Phare programme on SME development

A low portion compared to the bulk of the SME loan Scheme is put into projects for support of the LDA to implement, plan and improve business services. Although some assistance has been designed to address the weaknesses of the financial environment in Latvia in respect of SME under SME policy development, its effect has been limited. As a consequence, Phare assistance has had no effect on the improvement of the financial environment for SME. Overall, no significant effect has been observed for the enhancement of competitiveness and internationalisation as a consequence of Phare support. The enhancement of co-ordination of bodies and organisation supporting the SME development has received only very small benefits from the Phare assistance. Too little has been designed to promote entrepreneurship at regional or local level. Overall, the impact of Phare has been negligible and the result is the extremely poor level of effectiveness attained at institutional network level.

The readiness in utilising Structural Funds for SME development

An integrated approach, with actions selected to contribute to a common objective, such as combating industrial decline, in particular with SF type measures, linked with interventions to promote the business environment has not been developed yet. Geographical coverage at the level deemed most appropriate for the CC, but with the NUTS II level as the minimum, with the possibility of focusing on areas with specific and severe problems, has not been established. A Managing Authority, to comply with SF requirements has not been selected yet. The appropriate organisations in the ministries and the development agencies suffer from a rapid turnover of staff and, as a result, operate with staff who have not developed enough experience to deal with the complex programming management and monitoring which Structural Funds

will require. A National Development Plan is expected to be approved in December 2001, which could underpin both multi-annual programming for ESC projects financed from Phare 2002-06 and the preparations for SF. At present the administration is not in a position to manage SF's.

The main challenges to be faced, in the near future, by the SME sector in Latvia.

| Challenges to be faced by Latvia at enterprises level. | Challenges to be faced by the Latvia Government. |
|--|--|
| <ul style="list-style-type: none"> • Being able to face the competitive pressures in the single market, particularly in relation to the productivity and to the development of new product/services. • Coping with a fast changing legal environment, meeting the requirement of the <i>Acquis Communautaire</i>. • Gaining better access to information and high quality support services. • Upgrading management skills in order to increase efficiency and promote entrepreneurship. • Enhancement of the growth and competitiveness of the sector in a "knowledge-based" internationalised economy. • Integrating 'supply chain' networks and improving export related marketing skills. • Making their voice heard by authorities through the development effective business associations capable of representing the interests of entrepreneurs through effective lobbying. | <ul style="list-style-type: none"> • Developing a Multi annual SME Development strategy addressing, inter alia, the need to considerably increase the number of SME per 1,000 inhabitants as a tool to reduce, inter alia, regional imbalance. • Simplification and improvement of the administrative and regulatory framework through the definition of comprehensive Action Plan clearly defining the time schedule and the responsible institutions for the implementation. • Complete structural reforms necessary to further restructuring enterprises and to create a dynamic SME sector. In this respect specific attention should be paid to Enterprise Restructuring, Competitiveness, Governance and Bank System. • To give business the possibility of accessing national and community support through the services provided by a more effective business support network. • Ensuring the commitment of all the existing institutions supporting SME in joint efforts to ensure a more effective provision of services to SME. • Improving horizontal factors of competitiveness, such as entrepreneurship and management education. • Closing the gap between national and regional skills in planning development programmes, with specific attention on the readiness in utilising SF upon accession. • Improvement of the financial environment for SME, granting better access to credit for SME development and/or start-up or innovation. |

Recommendations

1. The Latvian Government should urgently prepare a Multi-annual strategy for SME Development. Learning from the experience of other CC, Phare Programme support should instigate, support and closely follow-up the development of such the strategy.
2. The Strategy should address the development of measures aimed at increasing the number of SME per 1,000 inhabitants. This would have positive implication on the reduction of the existing regional imbalance. Moreover, the strategy should redesign the structure of the National Business Support Network based, so far, on the activities of the Latvian Development Agency.
3. The Latvian Government should carry out, with the support from the Phare Programme, an operational and management review of the institutions having a key role in the provision of support to the SME sector. On this basis, concerted actions should be conceived in order to create pro-active and development-orientated entities, which would form the backbone of those structures necessary for the future development of the business sector. This action

particularly applies to: The Latvian Development Agency, the Loan Guarantee Agency, and the Development Policy Division of the Department of Industrial Policy in the Ministry of Economy.

4. In order to ensure sustainability to the Phare support so far delivered, the strategy should include an important role for the network of BAC established with the support of Phare and presently not sustainable without public money.
5. In advance of the strategy, the Government should commit himself to provide adequate staff, in number and skills, to the Latvian Development Agency and the ministerial departments dealing with the SME sector.
6. In parallel to this operational and management review, a detailed survey of the Latvian SME should be carried out in order to better understand the needs of the SME. The Government needs to become much more active in its support of the SME sector and, with upgraded and motivated institutions, begin to address the challenges outlined above. It must also lead the process and improve its consultation with the entities concerned. There is a need for a government unit engaged in market research, evaluation and monitoring.
7. In order to improve access to credit for SME, the Government should embark on the definition of a non-banking subsidised scheme to support start-up. Micro-credit and early stage financial support are starting to exist.
8. In order to effectively reform the business environment, any new measure should be passed only upon the submission of a business impact analysis of the impact of the new legislation on the sector.
9. The government should carry out an impact analysis on the SME sector of the adoption of the acquis and, building on the findings of this analysis, consider the possibility of supporting, technically as well as financially, the SME in adopting the new regulations.

LITHUANIA

Overview

Lithuania has a population of 3.7 M. In 2000, its GDP growth was by 3.3% compared with 1.1% in 1999. The country is in a classic economic problem with a low inflation rate (0.9%) and high unemployment is (15.6%). The GDP per capita in terms of PPP is 6,600 €. By 1997, 70% of GDP came from the private sector. According to the Lithuanian Department of Statistics, 67.9% of the working population was employed in the private sector in the third quarter of 1997. The International Monetary Fund estimated that in 1997 the shadow sector accounted for 25 percent of the economy. Independent experts put this figure at about 30%. Inward FDI is amongst the lowest of the CC's at 86 € per capita, whilst the trade balance (-13% of GDP) and foreign debt (25% of GDP) is in line with that of other CC's.

Status of SME

The complicated economic situation, evidenced by decreasing exports and profitability, and in the purchasing power of consumers, had created unfavourable conditions for SME development by the latter part of the 1990s. According to data provided by the Lithuanian Free Market Institute, the profitability of Lithuanian enterprises decreased from 12.3 % in 1997 to 4.6 % in the first half of 2000. Data from the Vilnius Bank states that 60 % of entrepreneurs cited sales difficulties on the domestic market as being one of the major problems. Although Lithuania (in the Soviet era) was an important centre for space and defence industries, the government has not fully built on the competencies to produce world class competitive products

According to the Department of Statistics, the number of operating SME is constantly decreasing (81,600 enterprises existed at the beginning 1999, and only 52,000 at the end 2000). (The data do differentiate between registered and active SME). The data indicate a problematic survival rate related to a lack of competitiveness among the Lithuanian SME⁵³. Based on the data available for 2000, Lithuania has a very low rate of 14.0 SME per 1,000 inhabitants. In Lithuania, the share of operating SME in the total number of operating enterprises was 96.5% at the end of 1999, and 95.6% at the end of 2000. As of beginning 1999, the number of micro-enterprises accounted for 85.4% (EU average 92.9%). The number of Small enterprises accounted for 10.5% (the EU average 6%), and the number of Medium-size enterprises accounted for 3.5% of all enterprises (the EU average 0.9 %). In comparison, Lithuania shows a lower level of development of micro-enterprises, compared with medium-sized enterprises. Within the last two years, the number of micro enterprises decreased by 6%. As regards to the distribution of operating enterprises according to the sectors of activities, at the beginning of 1999 the biggest share of SME included trade enterprises 49.8% (the EU average 30.5 %). Small and medium-sized enterprises constitute the biggest share, 88.8%, of the total number of enterprises in Lithuania. According to the Department of Statistics, exports by SME decreased by 30.4% in 1999, compared with the level in 1997. This data further support the idea of an SME sector lacking competitiveness. At the beginning of 1999, the share of manufacturing enterprises accounted for 14.7% of all SME (the EU average 11.4%). The distribution of SME in terms of activity indicates that the share of trade and manufacturing enterprises decreased in particular, while the number of SME in the service sector slightly increased. In 1998, the value added in the service sector accounted for over 28%. By 2000, this difference had increased to 32.4% whilst the value added in the trade sector accounted for

⁵³ In 1999, 9,830 SME were registered, 6,156 SME were liquidated, and in 2000 the number of registered SME was 7,967, that of liquidated was 9,354.

15.1%. Though the number of enterprises providing services is increasing, the development of hotel and restaurant services is still insufficient⁵⁴.

Broad economic and social policies

The government has introduced a series of initiatives to establish the basic institutional support framework. In 1993, a new Entrepreneurship Division was set up within the Ministry of Economy (MoE) and charged with the responsibility of developing the SME Sector. The Division worked closely with the Phare Programme. In 1997, the Inter-Institutional Board for SME Problems and Adjustment of Interest (IIB) was created “*to evaluate, analyse and submit proposals to the MoE concerning additional measures for the delivery of the SME Development Programme and to provide recommendations on financing projects (...)*”. The final decision whether or not to fund support to SME is currently taken by the Business Development Council, an advisory body to the MoE established on 28 August 1998, just been re-organised. A Small and Medium Sized Enterprise Development Programme (SMEDP) was adopted by the government in February 1995 and readopted in January 1998. It defines the responsibilities of different institutions in the Sector. The latest version of the Programme is also supplemented by an Action Plan, which indicates that finance for the implementation of the SMEDP will be allotted from the SME Support Fund (SMESF). On 14 May 1998, the government approved the statutes of the SMESF. The Government has not yet developed a multi-annual strategy for SME Development covering the sector needs up to 2005/6. The NDP has not yet been finalised.

Regulatory Policy

The Business Environment is un favourable to the SME sector, as is evidenced by the continuing decrease in the number of SME, and by the concern raised by the poor survival rate of SME. Within the last few years the decreasing number of SME was influenced by a number of factors.

- Amendments to the procedures of issuance of patents (business certificates) and activities according to patents (business certificates). The government has adopted a number of resolutions⁵⁵ providing that patents (business certificates) can be issued to physical persons only;
- Increased labour costs. A recent law (29 December 1999) approved a relatively high contribution to social costs (31%) which, coupled with the rate of the state social insurance contribution for the insured (i.e. 3 %), increases the tax burden and the labour costs for SME;
- Introduction of additional taxes. The Law On the Guarantee Fund of September 2000 required all enterprises registered to pay 0.2 % of the staff remuneration before taxes to the Guarantee Fund;
- Introduction of additional bureaucratic barriers in the labour relation area (employment certificates, notification of unpaid leave of absence provided (terminated), notification of monthly insured income amounts to pensioners);
- Emergence of big trade chains in the trade sector. Big trade chains based on economising (i.e. maximising sales turnover) have minimised their costs and product prices. SME engaged in sales were not able to propose competitive prices and were forced to terminate their activities.

⁵⁴ As the beginning of 1999 only 2.3 % were engaged in this business in Lithuania (the EU average - 7.4 %), as of the end of 1999- 3.2 %, and in 2000 - 4.5 % of all SME.

⁵⁵ Resolution No. 1491 of 28 December 1999 "On Partial Amendments to Resolution No. 1398 of 30 October 1995 "On Issuance of Patents (Business Certificates)"

The unfavourable position of SME is further demonstrated by the growing numbers of liquidations. The biggest number of enterprises under liquidation was individual (personal) enterprises (IE), which were especially influenced by the amendments to the Law on State Social Insurance effective from 1 January 2000. This Law increased the costs of IE as it imposed a commitment to insure based on income received, previously, they insured for the basic pension. The regulatory framework still generates concerns among SME due to the unpredictability of the environment, and to the fact that the government is adopting legislation without thinking about the actual impact on the business. Moreover, the adoption of the acquis is also a costly exercise for the SME, further complicating the life of, particularly, the micro-enterprise sector.

Access to Finance

There is substantial demand for very small credits for start-ups asking for € 5,000 or less. Self-employed entrepreneurs' requirements tend to be similar to individuals with specific needs (e.g. tradesmen and consultants) whose needs relate to the replacement of professional equipment, plus a limited provision for working capital. The commercial banks are reluctant to support SME that are not in the position to provide high collateral and a proven track record. This implies a difficult situation for micro-and small enterprises in their start up or early stage development. Seed capital and the venture capital funds concepts are not well developed yet. An SME Credit Guarantee Fund is in the process of being established, and the possibility of creating a Venture Capital Fund has been established.

The Institutions supporting SME and their rationale

In February 1996 the Government established the National Agency - Small and Medium-sized Enterprise Development Agency (SMEDA) as the main body to support SME Development. It was founded as a non-profit organisation aimed at the provision of services to SME development at an institutional level, including policy recommendations and programme elaboration and implementation. SMEDA focuses, however, on attracting foreign direct investment dealing with a number of related factors⁵⁶. As far as SME development is concerned, SMEDA carries out research studies in business and legal environment for SME development, collect and publish information for entrepreneurs, attract additional international information and financial sources. SMEDA is the key player in the development of the SME sector in Lithuania and currently has a staff of 11 people and is involved in various activities⁵⁷. As far as the direct support to SME is concerned, six Business Advisory Service Centres (BASC) were also created with direct assistance from the Phare Programme during the period 1993-95. The BASC provide direct counselling and training to business start-ups and to the self-employed in a loosely co-ordinated way with SMEDA. One Euro-Info Correspondence Centre (EICC) was established in September 1994, but went into liquidation in 1999. Two EICs were set up in 2000, one at the Lithuanian Development Agency and the second at the Kaunas Chamber of Commerce. SME interests are represented through associations whose precise number is difficult to establish. These organisations unify their members according to the type of activity of enterprises, the common interests of entrepreneurs. Not all entrepreneurs associations are very active: some of them are well-known across the entire county, others are known in some regions of Lithuania, while some by only a certain group of entrepreneurs.

⁵⁶ Information on establishing a business in Lithuania, Information on operating costs, human resources, incentives, Information on economic zones and industrial parks, Selection of production sites and buildings, Introduction to joint venture partners, Contacts with suppliers building contractors, government institutions.

⁵⁷ Evaluating laws and regulations and preparing action plan for 2002 to 2004, Organising a conference in October with Govt ministers, reps of Business Associations, Confederations of parliamentarians etc to discuss what should be done, following which they will refresh the SME strategy. An action plan to implement the strategy will be drawn up in December 2001, Establishing 3 new information centres financed under 3rd multi annual programme.

There are five important enterprise associations and organisations active⁵⁸. Although a number of organisations represent SME interests (e.g. Rotary and Lions Clubs), entrepreneurs complain about being badly represented. The big associations represent the interests of large enterprises and the smaller associations lobbying capacity is limited. In addition, many of these organisations tend to guard their independence. There is little co-ordination and associations compete for recognition by the authorities, sometimes neglecting their mandates. The institutional network supporting SME is not effective. SME cannot count on a well-integrated support services backed by public funds. There is today no real long-term plan for the development of the SME sector, despite the many political assertions. A real synergy need to be found between all the entities concerned with SME sector development to secure a active involvement of the Lithuanian Government

The implementation of the Phare Programme

Phare assistance to the SME sector started in January 1993, and since then 14.7 M€ has been allocated to support SME development. The assistance has been delivered through a broad range of activities encompassing technical support, institutional capacity building, policy advice and training to help the Ministry of Economy, and related organisations, design and deliver small enterprise creation and development measures. Phare funds in the amount of 7 M€ were allocated to establish a revolving SME credit fund. The principal beneficiary of the earlier assistance (1993-95) was the Entrepreneurship Division within the MoE. However, at the end of 1995, the responsibility for the Programmes transferred to the newly established SMEDA. There have been a large number of recipients of Phare assistance: the BASC, the EICC, and Chambers of Commerce and Industry. The Bank of Lithuania, several commercial banks and, indirectly over 300 SME, were awarded financial support (out of 50,000 SME existing in 2000), and 15,000 enterprises, which received advice from the BASC. The Phare project team worked with the Ministry of Economy in order to: (a) improve the economic environment for SME and consider regulatory, tax and policy framework in the context of SME development, and (2) encourage new initiatives, such as supporting links between SME and educational/research institutes. The first group of BASC was set up, with Phare support, in Klaipeda, Alytus and Kaunas in 1993. The establishment of BASC in Vilnius, Panevezys and Siauliai followed in 1994. Direct financial support was granted to BASC on a permanent basis, enabling them to cover basic establishment and operational costs. BASC offered business information and counselling services, short practical training courses for small business start-ups and those considering setting up their own business. They also offered assistance in preparing business development and marketing plans. The BASC had well-established teams, the support and involvement of local municipalities, business organisations and educational institutions, however with the cessation of Phare funding, the BASC now operate as commercial enterprises. Phare has provided assistance in setting up business incubators in different regions of Lithuania, of which there are seven.

The effect of Phare programme on SME development

Phare assistance, specifically conceived to support the simplification and improvement of the business environment through the strengthening of the existing structure(s) or via the setting up of institutions specifically dealing with this important aspect of SME Development, has not had any positive effect on SME development. The number of SME is falling and the existing regulatory environment is not supportive to the sector. The assistance conceived to address the weaknesses of the financial environment in Lithuania has only had a very limited effect, if any,

⁵⁸ The National Confederation of Businessmen, The Lithuanian Entrepreneurs Employers Confederation, The Lithuanian Industrialists Confederation, The Association of Lithuanian Chambers of Commerce, Industry and Crafts, The Kaunas Regional Association of Small and Medium Sized Businesses (KRASME).

on the improvement of the financial environment for SME. Overall, no significant effect has been noticed for the enhancement of competitiveness and internationalisation as a consequence of Phare support. The enhancement of co-ordination of bodies and organisations supporting SME development has received only negligible benefits from the Phare assistance although clearly desirable given the challenging circumstances. Too little has been designed by Phare to promote entrepreneurship at regional or local level. Overall, the impact of Phare has been extremely limited, reflecting the uncertain commitment of the government to the sector. SMEDA has not yet fully defined its role and structure, the sustainability of the BASC is unlikely, and there is evidence of an extremely poor level of effectiveness at institutional network level.

The readiness in utilising SF for SME development

An integrated approach, with actions selected to contribute to a common objective, such as combating industrial decline, in particular with SF type measures, linked with interventions to promote the business environment has not been developed yet. Geographical coverage at the level deemed most appropriate for the CC, but with the NUTS II level as the minimum, with the possibility of focusing on areas with specific and severe problems, has not been established yet. A Managing Authority, to comply with SF requirements has not been selected. The main institution supporting the SME sector in Lithuania is SMEDA. This Agency, while undertaking useful activities, is insufficiently developed to play a major part in the planning and organisation of projects for structural funds support. The government has not created or developed those substantial key institutions, which will form the backbone of future competencies capable of securing and managing complex development programmes, such as those required for support under the structural funds regime. The National Development Plan, which would underpin both multi-annual programming for ESC projects financed from Phare 2002-06 and the preparations for Structural Funds has not been approved. The existing SME institutions are not in the position to benefit from SF.

The main challenges to be faced, in the near future, by the SME sector in Lithuania.

| Challenges to be faced by Lithuania at enterprises level. | Challenges to be faced by the Lithuanian Government. |
|--|---|
| <ul style="list-style-type: none"> • Being able to face the competitive pressures in the single market, particularly in relation to productivity and to the development of new product/services to compete in international markets. • Coping with a fast changing legal environment, meeting the requirement of the <i>Acquis Communautaire</i>. • Gaining better access to information and high quality support services. • Upgrading management skills in order to increase efficiency and promote entrepreneurship in a context of very low survival rate. • Enhancement of the growth and competitiveness of the sector in a “knowledge-based” internationalised economy. • Integrating ‘supply chain’ networks and improving export-related marketing skills. Placing a specific emphasis on the development of sub-contracting initiatives • Making their voice heard by authorities through the development of effective business | <ul style="list-style-type: none"> • Developing a Multi-annual SME development strategy. • Simplification and improvement of the administrative and regulatory framework through the definition of comprehensive Action Plan clearly defining the time schedule and the responsible institutions for the implementation. • Complete structural reforms necessary to further restructure enterprises and to create a dynamic SME sector. In this respect specific attention should be paid to Enterprise Restructuring, Competitiveness, Governance and Bank System. • To give businesses the possibility to access national and EU support through services provided by a more effective business support network. • Finding adequate financial resources to be devoted to the sector. Ensuring the commitment of all the existing institutions supporting SME in joint efforts to ensure a more effective provision of services to SME. • Improving horizontal factors of competitiveness, such as entrepreneurship and management |

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| <p>associations capable of representing the interests of entrepreneurs through effective lobbying.</p> | <p>education.</p> <ul style="list-style-type: none"> • Closing the gap between national and regional skills in planning development programmes, with a specific attention paid to the readiness to utilise SF upon Accession. • Improvement of the financial environment for SME, granting better access to credit for SME development and/or start-up or innovation. |
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Recommendations

1. The Government should urgently prepare a Multi-annual SME strategy for SME development. Learning from the experience of other CC, Phare Programme support should instigate, support and closely follow up the development of such a multi annual strategy.
2. The strategy should build on the structure of the “Small and Medium Sized Enterprise Development Programme (SMEDP)” and should address, principally, the development of measures aimed at increasing the number of SME per 1,000 inhabitants, as well as stopping the sharp drop in the number of SME. Moreover, the strategy should redesign the structure of the National Business Support Network currently focused on the activities of SMEDA. From a sector point of view, the strategy should explore the possibility of considerably increasing the impact of SME in the tourism sector. Additionally, the strategy should design an effective approach to link FDI with SME in order to define “Supply Chain development programmes”, like the one developed by Czech Invest.
3. The Government should carry out, with the support from the Phare Programme, an operational and management review of the institutions having a crucial role in the provision of support to the SME sector. On this basis, concerted actions has to be taken in order to create pro-active and development orientated entities, which will form the backbone for future development of the business sector. This action particularly applies to: SMEDA and its network of BASC, as well as to the Inter-Institutional Board for SME Problems and Adjustment of Interest (IIB) and the Business Development Council.
4. In order to ensure sustainability to the Phare support so far delivered, the strategy should include an important role for the network of BASC established with support of Phare, and presently not self-sustainable without public funding.
5. The Lithuanian Government should commit himself to provide adequate financial resources and staff, in number and skills, to the Agency and to the government departments dealing with the SME sector.
6. In parallel to the operational and management review, a careful survey of the Lithuanian SME should be carried out to better understand the needs of the SME. The Government needs to become much more active in its support of the SME sector and, with upgraded and motivated institutions, begin to address the challenges. It must also lead the process and improve its consultation with the entities concerned. There is a need for a unit engaged in market research, evaluation and monitoring.
7. In order to improve access to credits for SME, the Government should furtherdevelop, possibly with support from Phare, non-banking and/or banking subsidised schemes to support start-up, micro-credit and early stage financial support such as INVEGA. In this respect, special attention should be paid to the setting-up of effective guarantees schemes.
8. In order to effectively reform the business environment, any new measure should be passed only upon the submission of “Business Impact Analysis” of the new legislation vis-a-vis of the sector. This is to anticipate the SME consequences of legislation.

9. The adoption of the acquis is a costly process for the SME. The government should carried out an impact analysis of the adoption of the acquis on the SME sector and, building on the findings of this analysis, to consider the possibility to support, technically as well as financially, SME in adopting the new regulations.

POLAND

General Overview

Poland has the highest population amongst the CC's (38.65 Ms). By 1999, the GDP was growing at 4.1% but its GDP per capita in PPP was still considerably lower than other CC such as Slovenia or the Czech Republic (8,700 € against 16,100 and 13,500 € respectively). This accounts to 38.6% of the EU-15 average. However, Poland is the best performing CC in attracting FDI and has registered a very high FDI of 6,821 M€ in 1999 (176 € per Capita). The trade balance showed a deteriorating deficit from 1997 (-1.5% of GDP) to 1999 (10% of GDP). Since 1995 the unemployment rate had been falling but by 2000 was back up to 16.3%. Inflation is also a problem at 10.1% in 2000. Poland has an average level of foreign debt in comparison to the CC's (31.10% of GDP).

Status of SME sector

The number of small companies (employing up to 49 people) registered in the National Register of Economic Entities (a statistical registry) at the end of 1999 was 2,978,574 (an increase of 7.9% compared to year-end 1998). The number of Medium sized companies was 28,870 (an increase of 13.4%). The Large enterprises total 3,457. The number of *active* SME in 1999 increased by 2% and amounted to 1,816,000 at the end of the year. The growth rate of active SME in 1999 was lower than in 1998, 1997 and 1996 (18%, 18% and 9% respectively). The SME sector employed just over 7,000,000 people in 1999, accounting for 64.3% of total employment, and the size/ class dominance⁵⁹ is the large one (35.7%). When considered with the Medium-size enterprises, the large and medium enterprises account for 53.5 % of total employment⁶⁰. The data are bigger than EU average (respectively, 34.1 % and 47.4%). The share of employees accounted for by the Small and Micro-enterprises (< 50 employees) is lower than EU average (46.5 % compared with 52.5%). The share of SME gross domestic product amounted to 48.1% (38.5% by small businesses, 9.6% by medium size businesses). There are 47.4 SME per 1,000 inhabitants (EU average 48). Small and medium-size enterprises share in Poland's GDP amounted to 48%. By comparison, the share of large companies in the GDP was 22.5%. The net profits on turnover for all companies having bookkeeping standards, and employing in excess of nine people, decreased from 0.6% in 1998 to 0.1% in 1999. This drop was mainly the result of the declining profitability of small companies (a drop from 2% to 1.1%) and large companies (a drop from 0.3% to -0.8%). In the case of medium sized companies, the drop in net profitability was very small, going from 1.3% to 1.2%. Compared with the previous year, 1999 showed a drop in exports by Polish companies of 3% and imports by 2.5% (according to prices in USD). During this same period, exports by SME decreased by 3.8% and imports increased by 1%. The share of SME in overall exports went down from 48.1% to 47.6%, whereas for imports it rose from 63.2% to 65.4%. The largest proportion of SME is active in the Service sector (47%), Trade accounting for 40% and Industry for 10%. The main statistic data are available, but other important data such as the survival rate of SME after 12, 18 and 36 months are not available.

Broad Economic & Social Policies

The effective promotion of small businesses includes different components: macroeconomic environment, legal framework and fiscal policy, access to financing, business infrastructure and business climate and technical assistance. All of these problems were recognized as very important by government agencies responsible for business promotion, but not all of them have

⁵⁹ A country is said to be micro- small- medium- sized or large scaled if either micro, small, medium or large-scale enterprises have the largest share in total employment.

⁶⁰ NASMED – State of SME in 1999.

been addressed successfully in the past. The Ministry of Economy (MOE) initiates industrial policies and manages their execution, taking into particular consideration their pro-export aspects, and helping in development of small and medium sized enterprises. The Department of Crafts, Small and Medium Size Enterprises, which is responsible for creating and coordinating policies associated with development of small and medium size enterprises, was established by MOE in 1997. Since then, the range of issues, number of staff and the overall profile and its importance has increased, reflecting the growing importance of SME in the national economy. In 1999, the staff consisted of a Director, reporting to an Under Secretary of State, and 27 staff in four sections⁶¹. In addition to the SME Department, the MOE has overall responsibility for other areas of particular relevance to SME including trade policy and the promotion of exports, regional economic development, etc. In 1997, a Small and Medium Enterprises Committee was established in the Polish Parliament (the Sejm) comprising Members of Parliament from different political parties, and the Committee has played a very important role in encouraging the development of the SME sector⁶². The Committee has become permanently established in the structure of the Sejm, its basic tasks being to ensure the *friendliness* of legislation towards SME and a forum for dialogue and consultations between politicians and employers' organisations. The basis for government policies towards the sector is found in Art. 53 of the Commercial Activities Law dated 19 November 1999 (entered into force in 2001), which states that government, respecting the ideas of equality and competition, will create favourable conditions for the development and functioning of small and medium-sized enterprises. This is detailed *Government Policy Guidelines for Small and Medium-Sized Enterprises until 2002* approved by the Council of Ministers on 11 May 1999. This Document defines particular tasks and methods of implementing the above obligations⁶³. The main goal of policies up to the year 2002 is to create conditions for the full development of the potential of the SME sector. An indirect goal is increasing the competitiveness of SME, increasing export and investment in this sector. Legal, financial, organisational and informational-educational tools are being used to achieve these goals. The execution of policies regarding small and medium size enterprises is being monitored and checked. A strategy for SME development up to 2006 is in the course of development. Reports are prepared each year on the basis of information gathered by the institutions involved. These reports are then presented to both the Council of Ministers and the Parliamentary Committee on Small and Medium Size Enterprises. The Polish Agency for Regional Development (PARD) reports to the Ministry of Regional Development and Construction and is primarily responsible for its implementation in relation to regional development. The SME Agency, under the Ministry of Economy, is responsible at national level.

Regulatory policy

The SME policy is implemented through legal, financial, organisational instruments and instruments related to information/training. The bulk of program tasks in respect of legal

⁶¹ Systems Solutions: policy and regulatory issue, Sector Functioning Assessment Division: Monitoring and analysis of sector, Entrepreneurial Initiatives Development Division: initiate and support SME development initiatives including liaison with Entrepreneurs Associations and external bodies, International Relations Division: primary link with foreign donors, the SME Foundation, and work on the EU Agreement

⁶² It considers among other things such issues as: assessment of the effectiveness of aid funds used for SME development, monitoring the functioning of economic zones, assessment of the role of government in supporting the development of SME, analysing regional policy with a view to supporting SME.

⁶³ The Document also takes into account policy targets resulting from the following documents: *National Integration Strategy* - approved by the Council of Ministers on February 28, 1997, *National Program for Poland's Preparation for EU Membership* - approved by the Council of Ministers on June 23, 1998, *Social and Economic Policy Guidelines for 1999* - approved by KERM (Economic Committee of the Council of Ministers on July, 15 1998 "Support Program for the Development of Regional Institutions Acting in Support of Technology Transfer" - approved by the Council of Ministers on March 4, 1997.

instruments have been implemented. A number of laws have been recently passed⁶⁴. Their mechanisms have not yet had a full influence on the operation of business entities. Some of these laws have caused controversy, for instance the Tax Code. The draft "Law on Business Activity" (formerly known as the "Industrial Law") was approved by the Council of Ministers on October 27, 1998. The law defines the principles for undertaking and performance of business activity, small and medium-sized enterprises and the principles of business self-government. The Parliamentary procedure concerning the Business Activity Law has been finished, and the Law was passed at the end of 1999. Work has been finalised on the Law on the Acceptability and Monitoring of Public Assistance to Entrepreneurs Act of 30 June 2000 which ensures the transparency of principles for granting public assistance to entrepreneurs, including small and medium-sized entrepreneurs, as well as compliance with EU regulations. Most of those issues are addressed in the programme "Directions of the Government Activity Towards Small and Medium-Sized Enterprises till year 2002" and successful implementation of this programme will be crucial for further development of SME. In May 2001, the Parliament has approved the draft of an amendment to the Law on Guarantees and Sureties granted by the State Treasury and certain legal entities. These changes foresee the scope of guarantees being expanded to include credits for procurement of commercial goods and creation of new places of employment, as well as financing of export contracts. The draft also introduces instruments that will help strengthen the position of local and regional credit guarantee funds through a system of re-guarantees by BGK or purchase of shares by BGK. Other important recent (and draft) legislation creating the regulatory and institutional framework for entrepreneurship development in Poland and/ or impacting on SME competitiveness is shown below.

- Act of 12 May 2000 on Regional Development.
- Act of 9 November 2000 on the establishment of the Polish Agency for Enterprise Development;
- Act of 16 November 2000 changing the act on State Treasury guaranteed export contract insurance.
- Act of 15 December 2000 on the protection of competition and consumers.
- Act of 15 December 2000 on the establishment of the Trade Inspection.
- Act of 22 January 2000 on product safety.
- Act of 28 April 2000 on conformity assessment and accreditation.
- Act of 15 September 2000 - Commercial Code.
- Act of 6 July 2001 on the establishment of the Tri-partite Committee on Socio-Economic Issues and voivodship social dialogue committees.
- Act (under debate) on changing the Act on Guarantees issued by the State Treasury and selected legal persons.
- Act (under debate) on changing the Act on crafts.
- Act of 1 March 2001 on changes to the Labour Code.
- Acts of 22 June 2001 and under debate changing the act on public procurement (conformity with EU, introduction of SME specific preferences).
- Act (under debate) on changes to the act on the State Labour Inspection.
- Act (under debate) on consumer credits.
- Act (under debate) on electronic signatures.
- Act (under debate) on payment deadlines in business.

⁶⁴The Tax Code, the Banking Law, the Law on Guarantees Granted the State Budget and Certain Legal Persons, the Law on National Court Register, the Law on Pledges and Pledge Registry.

Overall, the pace of change in the regulatory environment, as the government is developing a legal framework fully compatible with the *acquis*, presents a key challenge to the sector. The legal requirement to conform the newly defined regulation is costly and difficult because of the new number of laws being passed and amended.

Access to finance

Following an intensive privatisation process, 75% of the Polish bank system is owned by foreign shareholders. The commercial banks are not keen to depart from an over-cautious approach to lending money to SME. High interest rates and high collateral are the norm and SME mainly get financial support through financial schemes funded under State budget. 1999 saw a continuing and growing interest in short-term loans by the SME sector, and the value of short-term loans taken out by SME increased in 1999 by 28.8% (to 6.875 billion €) and accounted for 45.5% of the total debt incurred by companies from this sector (long-term debt increased by 4% to 8.25 billion €). As far as the State financial instruments are concerned, the Loan Guarantee Fund established in 1995 and converted in 1997 into the National Loan Guarantee Fund could have been of major importance for the operation of the small and medium-sized enterprise sector but was not very successful. The Fund received an injection of 12.38 M€ from the State budget. In order to increase the efficiency of the Fund's operations, further modifications to guarantee principles were introduced. By the end of 1997, 80 guarantees from of the Loan Fund for the amount of 14.7 M PLN were furnished. However, the number of furnished guarantees with respect to capital held is still low. A considerable increase in BGK guarantees occurred in the first half of 1998 (by June 30, 139 guarantees for the amount of 6.35 M€ were furnished, of which 53 guarantees for the amount of 3.547 M€ were furnished in the second quarter of that year). Furthermore, at the end of 1997, there were 15 local or regional funds furnishing guarantees to the SME sector. By the end of 1997, those funds furnished 707 guarantees to the amount of 7.013 M€. According to interim data, in the first half of 1998, the number of guarantees provided by such Funds has increased. In that period, they furnished 143 guarantees totalling 3.19 M€. The short period of operation of the funds, the lack of experience in their management, insufficient information on these types of facilities and the small capital capacity of such funds, resulted in the under-utilisation of this credit guarantee instrument. The system of credit guarantees is being developed. The collateral offered by the credit guarantee funds increase the creditworthiness of the entrepreneurs in their dealings with financial institutions and hasten the process of approving funds for entrepreneurial undertakings. At the end of the year 2000, 17 local and regional credit guarantee funds were operating in Poland. In addition, one national credit guarantee fund was in operation – the BGK Credit Guarantee Fund (national credit guarantee fund operated by BGK). The local funds operate in their specific regions, usually within a few communes (*gminas*) or boroughs (*powiaty*), whereas the regional funds can guarantee credits within a voivodship. Guarantees are granted to small and medium size companies as well as to unemployed persons just starting commercial activities. The guarantees can be used for both bank credits and loans from the work offices and other institutions financing commercial activities. The funds usually guarantee 60-70% of the credit, and each fund cooperates with a few selected banks and institutions. At present, numerous new credit guarantee funds are being created in various regions of the country and are at various stages of development. The main forces behind them are local and regional governments. A capital increase from the State budget destined for about six loan institutions and 12 local and regional credit guarantee funds operating on behalf of SME is planned in the year 2001. In addition, financing is being prepared for advisory activities in 18 institutions involved in granting loans and credit

guarantees. Three mutual guarantee funds are in operation in Poland⁶⁵. The funds operate at a local level, i.e., within the region of one or a two *gminas*, to at most two/three *powiaty*. Taking into consideration their experience to date, it can be concluded that this form of guarantee institutions works. From the point of view of the banks, the means in which the funds operate is unimportant. The Fundusz Mikro (Micro Fund) was created in 1994 by the Polish-American Enterprise Fund. This Fund is directed mostly towards those small companies and those just starting activities that do not fulfil the requirements imposed by banks on borrowers. Security on loans granted by this Fund are sureties given by persons and a promissory note from the borrower. Micro-loans are also granted by local business support organisations, and these loans are above all directed towards small companies. If new activities are started in a rural area that result in new employment being created, micro-loans are granted by the Agency for Restructuring and Modernisation of Agriculture. Preferential loans facilitate the development of self-employment and increase the number of job opportunities. Preferential loans for the creation of new workplaces are available through Labour Offices under the Ministry of Labour and Social Policies (MLSP) and through local provincial banks, having subsidised interest rates (the government covers 50% of the National Bank discount rate). Loans are available either in banks (which use their own financial resources) or in Labour Offices (which manage Public Labour Fund resources). On this basis, funds are available to support SME but the problems are linked with the terms offered by the commercial banks. The conditions are not affordable to large parts of SME (micro and small) and, consequently, any new initiative needs to focus in the further development of the existing initiatives like the guarantee schemes.

The Institutions supporting SME and their rationale

The Polish Agency for Enterprise Development (SME Agency) (up to 2000, the Polish Foundation for Small and Medium Enterprise Promotion and Development) is a government institution established in 1995 with Phare support. The Agency co-ordinates SME development activities and implements SME development programmes based on foreign assistance funding which have been of major importance for the development of small and medium-sized enterprises. Its brief also includes the implementation of government programmes in support of export development and social and economic cohesion. The Agency is currently involved in implementing programmes at the total value of 400 M PLN. As set out in the Polish Government's Policy Guidelines for SME until 2002 (published in May 1999), the SME Agency will play a key role in implementing some of the tasks undertaken by government. The Polish Agency for Entrepreneurship Development will be a dedicated national SME development institution having regional "windows" implementing selected financial and other instruments conducive to the development of the SME sector. The SME Agency has established a National Services System (KSU) for small and medium-sized enterprises as a co-operative network of institutions. The KSU network includes more than 150 regional business promotion centres providing information, advisory, training and financial services. These centres provide, nation-wide, four types of services to SME: Consulting services, Training services, Information services, Financial services. These services are cheaper for SME than commercial services because of the financial support centres created by EU funds. SME have insufficient access to information about setting up businesses, business management, possible co-operation, market conditions, prices, and regulations concerning international trade and many other issues, and to improve this access, the SME Agency has decided to organise regionally disseminated centres, which provide information for SME⁶⁶.

⁶⁵ These funds are located in Dzierzgoń (Regional Investment Society S.A.), in Biłgoraj (Regional Development Agency S.A. in Biłgoraj) and Ustrzyki Dolne (Regional Development Agency S.A. in Ustrzyki Dolne).

⁶⁶ The following "information products" are available in the Business Information Network: *Fact Sheets* - database containing legal and economic reports prepared by BIN consultants, *Database* on the organisations supporting SME, *Information* about

The KSU network is a voluntary organisation consisting of various institutions such as Business Support Centres (BSC), Chambers of Commerce, Technical Institutes, etc. These non-profit institutions provide consulting, training, counselling and other services to the SME sector. Members of the network receive financial support from the SME Agency for the provision of services through the submission of tenders for service projects. The KSU has been selected under the BEST exercise as one of the two Polish success stories, emphasising the fact that it has established and is implementing the certification and quality control mechanisms (audits). The KSU is more than just the network, it is a system – involving business support organisations, private sector consultants for specific instruments, the regional financing institutions selected for Phare 2000 and 2001, the various instruments financed by Phare and the Polish Government. The SME Agency plans to continue to build up the wider KSU from such “building blocks”. Several institutions for SME support were set up as a result of the government efforts to support SME development. The National Loan Guarantee Fund of the National Economy Bank was established in 1997 (on the base of the Guarantee Fund) to guarantee bank credits for Polish companies and municipalities. The guarantee covers investment credits and credits on raw materials for production, and the credit can be taken from a Polish or foreign banks in PLN or foreign currency. The Techniques and Technology Agency started its activity in the beginning of 1997, the main objective being the promotion and support of modern and innovative techniques and technologies, in order to increase the competitiveness of Polish products. One of the most significant programme achievements is the support for the development of SME in rural areas by introducing a preferential credit system and developing local credit guarantee funds. A large number of organisations and institutions also support SME development. Furthermore, there are more than 5,500 active SME development institutions and organisations registered in the SME Agency database on business support organisations. Steps have been taken in order to support the development of regional and local institutions in promotion or support of small and medium-sized enterprises in respect of training and information instruments. This has included the development of more than 30 centres affiliated to regional entrepreneurs’ organisations, Agencies and Regional Development Foundations. A Business Information Network (BIN) has also been created (20 regional information centres). Enterprise Incubators support small enterprises in the initial phase of their operations. In total, incubator companies (566) have created 3,120 jobs, and the firms that have already graduated out of incubators (approximately 151), have created 845 jobs. Crafts, merchant and tradesman organisations as well as chambers of commerce are represented on a national level - the Polish Craft Association, the Chief Council of the Associations of Private Trade and Services, and the Polish Chamber of Commerce. Trade chambers of commerce cover the entire country in their activities.

The implementation of the Phare Programme.

Within the period 1990-1999 the Phare assistance to SME sector totalled 37.3 M€. In 2000 the funding available was 37 M€ through the economic and social cohesion Programmes of Phare. Early Programmes focused attention on activities aimed at increasing the level of economic activity and generating employment, by setting immediate objectives in the areas of policy formulation, provision of services to SME, strengthening of business organisations and associations, and support to enterprise creation. Assistance provided under later Programmes aimed at: (i) the development of Polish exports by SME through upgrading their management, marketing, technology and product levels, and (ii) providing the SME sector with a package of co-ordinated national and regional actions targeted at promoting competitiveness. Phare assistance provided to the SME sector was generally well designed, efficiently implemented

the consultants specialising in advisory services for SME, *Database of the TIPS* (Trade and Technology Information and Promotion System of UNDP).

and created a number of positive results, which significantly contributed to the achievement of objectives as defined by respective Financing Memoranda. Although the assessment of the Programmes design, implementation, results and environment in which they were implemented was generally positive, some weaknesses were identified. Wider and immediate objectives of the assistance, compared with funds available, presented an extreme gap between resources and targets. Programmes assisting export promotion did not address the finance supporting exporters (such as export credit scheme, export guaranties, etc.). The assistance provided for export promotion and SME development was not based upon a list of priority sectors/ fields identified by the Polish government, in which Poland wants to develop exports and use them as Poland's specialities within the European single market.

The effect of Phare programme on SME development

The Phare programme in Poland has been in overall terms very effective in creating an awareness of the importance of the SME sector in the future development of the Polish economy. A regulatory framework, through Phare assistance to the SME Department, the Ministry of Industry and Trade, was defined, which has resulted in the creation of three significant institutions which form the corner-stones of SME development: the Department of Craft, Small and Medium Enterprises at the Ministry of Economy responsible for SME Policy and Strategy, the SME Agency, and the Polish Agency for Regional Development. These three organisations have been instrumental in encouraging the spirit of entrepreneurship, providing access to essential services for SME and developing local competency and capability in the area of regional development. All three have been significant players in the creation of the current vibrant SME sector in Poland. These organisations, supported initially by Phare, constitute significant resources of expertise, experience and competence in the preparation management and implementation of development programmes in Poland. The KSU network has played and continues to play a major role in the development of the SME sector. It has established itself as a source of professional, user-friendly high quality advice and consulting services to SME. It has continued to develop the range and content of its services and has in almost all cases achieved ISO 9000 standards of service provision in its operations. So successful has it been that its members win funding projects from all sources of government donor and regional institutions in addition to earning income from a focussed and tailored client fee structure. In this respect, a positive effect has been noted on the development of the entrepreneurship and competitiveness. The internationalisation of the SME has also resulted from the Phare assistance. The overall co-ordination of the instruments available to support SME has benefited from the Phare assistance that has supported an institutional framework conducive of the delivery of an effective support to SME. However, co-ordination with the activities funded under the MRD has not yet been ensured. No Phare assistance has been specifically addressed at the improvement of the financial environment for SME and no financial schemes have been set up by Phare. The success of the development of the National SME Support and Services Network is an example to other CEEC countries, which could undoubtedly gain from examining its development and operations⁶⁷.

The readiness in utilising SF for SME development

An integrated approach, with actions selected to contribute to a common objective, such as combating industrial decline, in particular with SF type measures, linked with interventions to promote the business environment has not been developed yet. A National Development Plan including a Section "industry" defining in an exhaustive way the government strategy toward SME development has not been developed yet. Geographical coverage has been defined in terms of NUTS II levels and Poland will be split into 16 Regions. However, the NUTS III

⁶⁷In this regard introductions are being made between the Romanian Ministry for SME and the Polish SME Agency.

regions have not been defined yet. A large number of Regional Operational Programmes has been produced but all are missing a clear distribution of roles and responsibilities, especially as far as SME development is concerned. As the situation stands at present, there is an apparent conflict of responsibility between the SME Agency and the Regional Development Agency (whose future is unclear), which has been designated the Implementing Agency for the Economic and Social Cohesion Programme. SME Agency should act as subcontractor for the SME related activities. Under this arrangement the SME Agency would be responsible for the provision of “soft” grants (grants for training consulting and advice etc.) to SME in selected regions through these regional “windows” while the Regional Development Agency will provide “hard” (investment grants) through these same windows also to SME clients. In many or most instances these clients will be the same for each grant. This arrangement is at best confusing and at worst will cause serious duplication of activities by both Agencies and confusion for the SME client who will have to deal with two applications for complementary assistance. In addition the opportunity to link appropriate business advice/consulting with investment grants will be missing. The impact of the provision of a combination of business planning advice and investment grants to an SME client could be seriously undermined by this anomalous arrangement. In the longer term the issue of the development of sectoral policies and strategies for the growth of the SME sector in Poland needs to be addressed. To date, the development of the SME sector has been across the broad spectrum of business. This has been essential to develop the entrepreneurial spirit, business acumen and employment through out the country. In future, consideration will need to be given to the issue of specific policies and strategies for the future development of individual business sectors, to build on key competencies and establish businesses which can compete on international markets and in their home market against imported products. Not having an approved National Development Plan and the related SOP further raises doubts about the present readiness for utilising the SF allocated to support SME development. Furthermore, there has not been any serious development toward the definition of mechanism to utilise the SF for the period 2004-2006. Undoubtedly, there is need to better define the Institutional framework to manage the SF.

The main challenges to be faced, in the near future, by the SME sector in Poland.

| Challenges to be faced by Poland at enterprises level. | Challenges to be faced by Poland at Government level. |
|---|---|
| <ul style="list-style-type: none"> • Being able to face the competitive pressures in the single market, particularly in relation to the present low productivity. • Coping with a fast changing legal environment, meeting the requirement of the <i>Acquis Communautaire</i>. • Upgrading management skills in order to increase efficiency and promote entrepreneurship. • Enhancement of the growth and competitiveness of the sector in a “knowledge-based” internationalised economy. • Integrating ‘Supply chain’ networks and improving export related marketing and product quality related skills. • Making their voice heard by authorities through the development of more effective business associations capable of representing the interests of the entrepreneurs through more effective lobbying. | <ul style="list-style-type: none"> • Better understand the actual needs of the SME sector, also with the support of statistical data (like the survival rate) to better reflect the present status of the sector. • Development and implementation of an “SME Strategy up to 2006” that will take note of the present needs, in terms of both financial and services needs. • Complete the structural reforms necessary to further restructure enterprises and to create a dynamic SME sector, carefully evaluating the actual impact of the new regulatory system on the SME activities. • To give business easier access to EU support services, programmes and to improve co-ordination of these facilities, ensuring effective co-ordination between the activities implemented by the MOE and the Ministry of Regional Development. • Ensuring the commitment of all the existing institutions supporting SME in joint efforts to ensure a better service to SME. |

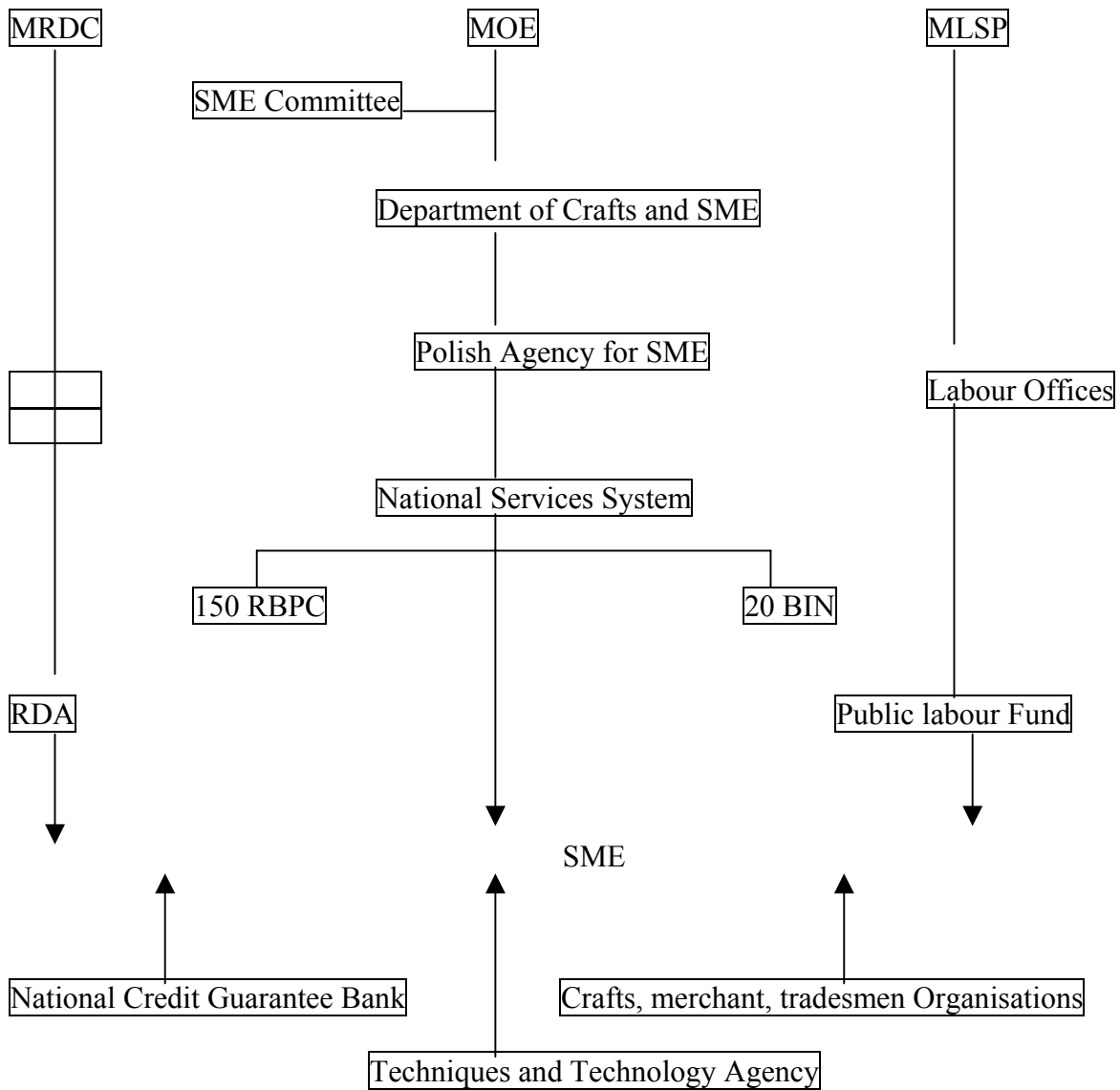
| | |
|--|--|
| | <ul style="list-style-type: none"> • Defining clear accountability roles for the implementation of SME development measures. • Improving horizontal factors of competitiveness, like entrepreneurship and management education, and development of a more friendly taxation system for the sector. Special attention should be placed on the definition of measures aimed at strengthening the export skills of the SME. • Clearing the gap between national and regional skills in planning development programmes, with specific attention placed on the readiness in utilising SF upon accession. • Ensuring adequate planning skills development at NUTS III level and defining financial support mechanisms to support this enhancement process. • Improvement of the financial environment for SME, granting adequate access to credit for start-up or innovation through the development of non-banking schemes. |
|--|--|

Recommendations

1. The Government should organised a specific programme aimed at increasing the productivity of the SME sector, to be achieved through the identification of measures aimed at considerably increasing the added value per employee.
2. The Government should launch a programme aimed at collecting valid statistic data focusing, in particular, on the survival rate. Overall the statistics data available are not exhaustive, and important data like the survival rate after 12, 18 and 36 months is not readily available.
3. The Government should ask the MOE to prepare a Strategy for SME development covering the period 2002-2006. Such a strategy should allow an assessment of the financial needs required for SME development. In this respect, the SME Agency should be involved in order to define the financial means required to support at least 20-25 % of existing SME. Such a strategy should be embedded in the National Development Plan to be prepared in the near future.
4. Before adopting any new legal standards affecting SME, the government should carry out a careful ex-ante analysis in order to identify its impact on the performances of the SME.
5. The policy of commercial banks cannot avoid an overcautious approach when SME are involved. Track record and collateral are indeed the only measures to reduce the risk of lending money to a very risky sector. The government should take note of that and plan a significant allocation of funds to permit start-up companies, and enterprises of recent creation to have access to non-banking financial schemes. These stages of development require not only fully developed business plans, but also support for obtaining appropriate loan or equity finance at these times. The provision of loan guarantees specifically aimed at growth companies can provide essential support to aid the growth of SME at a time when their collateral and track record are insufficient to secure loan finance.
6. The Commission Services should explore the possibility of allocating funds for non-banking financial schemes addressed at small and micro-enterprises in their preliminary stage of development.
7. There is an immediate need to differentiate the roles of the SME Agency and the Agency for Regional Development. The SME Agency should be the sole implementer of SME policy and programmes. By having both the SME Agency and the regional Development Agency operating 2 different grant schemes (investment grants and training grants) it is

- inefficient and confusing for SME's needing help as to who to approach for which grants. Therefore the sole responsibility should be with the specialised SME Agency.
8. The SME Agency and the Agency for Regional Development are inter-linked in the area of SME development. This should be a strategic alliance of two development agencies, with Agency for Regional Development focussing on building structures and institutions at regional level, which will be the developers of regional plans, projects and facilities supporting the development of SME under the guidance of the MOE.
 9. Regional Financing Institutions (located mainly in RDA) should act as "one-stop shops" for regionally and nationally funded instruments (consulting and investment grants and such; regional level non-banking loans and guarantees where they already exist), development of regional instruments, regional inward investment, and regional business development infrastructure.
 10. In the area of SME development, the SME Agency should be responsible for provision of support for business development institutions (including business related infrastructure of national significance) and advice to government at all levels, instruments for SME, exports, pilot schemes and development of instruments, venture capital financing, and technology transfer and innovation. It should remain also as a managing institution (Implementing Agency) for the MOE part of development programmes (Phare, and in future, Structural Funds).
 11. In the longer term, the MOE should give consideration to the development of long term policies and strategies for individual business sectors. There is a need to undertake a major analysis of business sectors that can be capable of coping with international competition on the home and export markets. A SWOT analysis will identify some of the issues currently facing individual businesses in sectors and help identify future needs of these sectors to grow and compete internationally.
 12. The advent of globalisation places all business sectors in the competitive world economy. This places a responsibility on government to develop national and sectoral strategies for business development if they are to successfully compete in world markets. These strategies need to encompass all elements of business; foreign direct investment, sub-supply, brand development, technology and innovation, SME, business financing, linkages to universities and government business development policy.

Polish Business Support Network



ROMANIA

General Overview

According to the EU Commission (2000 Regular Report):

«Romania cannot be regarded as a functioning market economy. The vulnerability of the macroeconomic environment, the uncertain legal and institutional framework and the uneven commitment to sustained reforms have hindered the development of economic activity. Progress made on macroeconomic stabilization has been undermined by insufficient privatisation, the financial losses of the state-owned enterprises, the lack of widespread financial discipline and a growing black economy.»

Romania has a population of 22.46 M and an area of 238,391km², which makes it the second largest CC in terms of both population size and land area. A deep recession meant that Romania's economy contracted in size over the period 1995-99 by an average annual rate (in constant prices) of 0.6%. The GDP growth rate (in constant prices) in 2000 was 1.6%, which was significantly lower than in all other CCs (with an unweighted average of 4.6%) and the EU (3.3%). The situation has however improved in the period thereafter with the European Commission estimating GDP growth in 2001 at around 4.5%. GDP per capita (adjusted to PPS) was € 6,000 in 2000, which amounted to only 27% of the EU average (it was equal to 35% of the EU average in 1995). Industry makes up around a quarter of total Romanian GDP with significant contributions made by trade, agriculture and real estate services (see table below).

For two thirds of industrial sectors, the output for the first four months of 2001 was high in absolute volume, as compared to the same period in 2000. The highest output was registered by the sectors which significantly increased their export volume: chemicals and man-made fibres (+24.4%), and machinery and equipment (+7.2%). Other sectors have also significantly increased their output: furniture (+75.2%), publishing, printing and reproduction of recorded media (+39.6%), tobacco products (+28.8%), food products and beverages (+26.6%), pulp, paper and cardboard (+18.5%), construction products and other non-metallic mineral products (+14.5%), footwear and leather products (+14.5%) rubber and plastic products (+15.8%). Only four sectors edged down, the most important being: radio, television and communication equipment and apparatus (-24.0%) and road transport (-6.6%).

Export performances have been remarkable over the period 2000 – 2001 but the current account deficit widened in 2001. The sharp increase in export performances (+20%) came after three years of negative performances.

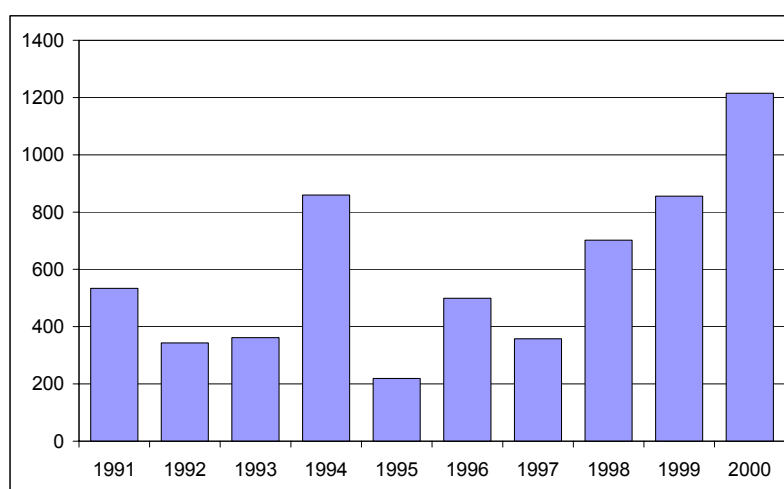
The unemployment rate in 2000 was 7.0%, which was comparatively low in relation to levels in several other CCs but increased to 7.7 % in the first quarter of 2001. Average monthly gross salaries stood at 2,876,645 lei (then around US\$111). Consumer price inflation stood at 45.7% in 2000 and fell to 37.2 % in 2001, a rate significantly higher than all other CCs (excluding Turkey) but an improvement on the 1997 level, which stood at 154.8%. There is no widespread political support for a currency board solution such as that employed in Bulgaria to address monetary policy weaknesses.

The private sector is still under-developed and state-owned enterprises account for a significant share of economic activity. Following a period of inactivity, the privatisation process has recently started to gain momentum, demonstrated by the sale of the state steel mill, SIDEX in 2001. The company, based in Galati in Eastern Romania, is the country's largest employer

(27,000 workers) and accounts for 6% of GDP. The State Ownership Fund has been abolished and replaced by the Authority for Privatisation and Management of State Assets (APAPS).

Levels of foreign direct investment (fdi) are low in comparison with other CCs and extremely low when viewed on a per capita basis. An unfriendly fiscal and regulatory environment, weak monetary policy, low labour productivity, poor product quality, and corruption are all cited as reasons for low levels of fdi. Levels of fdi fluctuated over the period 1991-2000, though showed an overall upward trend (see below). The countries with the highest levels of investment in Romania are Italy, the Netherlands and Germany.

Rates of FDI in Romania, 1991-2000 (US\$ M)



Source: Romanian Foreign Trade Centre (2002)

Status of SME Sector

It was estimated that there were 622,000 SME in Romania at the end of 1999, representing a 21% increase on the total at the end of 1996. A sizeable (but unknown) proportion of these may not however have been active at that time. There are approximately 28 SME per 1,000 inhabitants, which is a very low rate when compared with the value for the EU (48 per 1,000 inhabitants). In 1999 around 97.7% of the total number of enterprises in Romania were SME and the SME sector accounts for about 55 % of GDP employing 40% of Romania's work force in 2000.

In 1999 92.9% of Romanian SME were micro-sized, 5.8% were classed as small and 1.3% were medium-sized.⁶⁸ In 1999 69.3% of micro-enterprises were engaged in trade with a further 14.8% engaged in services and 9.4% in industry. In terms of small enterprises, a greater proportion (29.6%) were involved in industry but trade still accounted for the largest proportion (40.6%). 34.9% of medium-sized enterprises were engaged in industry, with 17.8% involved in trade. The remaining medium-sized enterprises were involved mainly in construction (16.1%), agriculture (11.8%) and services (11.2%).

⁶⁸ Law 133/1999 laid down formal criteria to define SME and is largely in line with EU regulations. Accordingly, micro-sized enterprises have less than 10 employees, small enterprises have between 10 and 49 employees and medium-sized enterprises between 50 and 250 employees.

Total employment in the SME sector in 1999 had increased by 6.7% over the 1997 level, despite a decrease over the same period in overall levels of employment. As a result, the share of employment in the SME sector in terms of the total number of employees increased from 38.2% of the workforce in 1997 to 40.2% in 1999. At a regional level there are quite significant variations in terms of the contribution made by SME to overall employment. For example, in 1999 SME accounted for 50.7% of total employment in the South-East and 50.2% in the North-West but only 29.3% in the capital region of Bucharest-Ilfov and 36.0% in the region of South-Muntenia. All regions with the exception of Centre (-0.2%) and Bucharest-Ilfov (-3.1%) recorded an increase in the share of SME employment over the period 1997-99.

Average value-added per employee within SME is much lower in Romania than in the EU. There is however significant variation between SME in Romania – both in terms of SME size and the sectors of the economy in which they operate. Value-added per employee for the SME sector as a whole stood at 53.0 M lei (€ 1,770 – at current exchange rates) in 2000. Micro enterprises had an average value-added per employee of 33.1 M lei (€ 1,105), small-enterprises 66.0 M lei (€2,204) and medium-sized enterprises 68.3 M lei (€2,281). These figures compare with figures for value-added per employee of €30,000, €50,000 and €95,000 for micro-, small-, and medium-sized enterprises respectively in the EU. In terms of value-added per employee in individual sectors of the Romanian economy, the service sector had the highest figure (63.4 M lei or €2,117) and the agriculture sector the lowest (36.3 M lei or €1,212). In Romania larger SME operating in the service sector have on average the highest rates of value-added per employee.

Broad Economic and Social Policies

Economic and social policies within Romania are not fully supportive of the SME sector. There is however a clear recognition on the part of policy makers of the need for better and more stable economic and social policies and efforts designed to improve the situation are underway. According to the National Plan for Accession of Romania to the EU (June 2001) “Sustaining the development of SME as major factor of economic growth and main employment sector, increasing the role of professional associations, private entrepreneurs, and SME in developing declining regions, in strengthening economically the local community” is a key Government priority.

The establishment of the Ministry for Small and Medium Sized Enterprises and Co-operatives (MIMMC) by Government Decree n° 15/2001 is proving the commitment of the Government towards the sector. MIMMC is responsible for elaborating policies supportive to the SME sector and for ensuring that SME interests are integrated into other policy areas. MIMMC co-operates with the Ministry of Development and Prognosis for the attenuation of the economic disparities between regions and for the strengthening of the competitiveness of each region through supporting SME sector development. The level of authority of MIMMC vis-à-vis other ministries is however unclear. In absence of a well defined endorsement, the MIMMC may not have the necessary authority to define and implement urgently needed reforms.

The legislative framework relevant to the SME sector is underpinned by three regulations:

- GD n° 297-2000 completing the Law n° 133-1999;
- GD n° 244-2001 approving methodological norms for implementation of Law n° 133/1999;
- GD n° 15/2001 for the organisation and functioning of MIMMC.

A wide number of decisions have been incorporated into the Law 133-1999 but actual implementation has been delayed.

The new Government Programme for 2001-2004 contains important measures to improve the business environment mainly by ensuring a proper legal, economic, and financial environment for enterprises. If implemented in full (and then enforced) they should help to ensure a more favourable operating environment for SME. The budget foreseen for the period exceeds 1.2 billion €.

In December 2001 MIMMC published an Action Plan to improve the business environment for SME. The main priorities are the simplification of the registration & licensing procedures for new SME, at streamlining the legal framework, reducing and simplifying the tax system, promoting access to finance, and providing an effective information system for SME. The Action Plan forms part of the Government Programme for 2001-2004 and contains over 70 different actions for 2002.

In addition, a Working Group has been established with the aim of improving the business environment and reducing the burden imposed on SME by administrative and regulatory requirements. This Working Group comprises representatives from ministries, Parliament, business associations and civil society and meets on a monthly basis. It was expected to finalise a detailed plan for further action by October 2001.

A National Strategy for SME Development has not been however been approved yet and there is an urgent need for such a strategy which Government Ministries, social partners, the business community and NGOs could embrace and which could provide coherence and strategic direction to all other sectoral policies impacting upon the SME sector.

Regulatory Policy

Regulatory policy is considered by SME-support bodies and ministries alike to be a major barrier to the future development of the SME sector. A large number of SME collapse each year as a direct result of the burden imposed by administrative and regulatory requirements. A key problem is legislative instability – new laws changing the operating environment for SME are frequently introduced, preventing medium- or long-term strategic planning by enterprises. Another general problem is the lack of enforcement of legislation. Enforcement capacities are weak at all levels of the public administration and this often has a detrimental effect on SME. A key problem in this regard is the behaviour of large enterprises. They frequently do not pay their full tax and social security liability, VAT and utility bills. This gives them an unfair competitive advantage over SME, which are unable to avoid such liabilities. In addition, large enterprises frequently avoid paying SME, which they have hired as sub-contractors. Many SME are only able to receive payment for their services to larger companies by bribing the relevant employees.

The situation as regards enforcement of contracts and the overall functioning of the judicial system is an unclear one. Several stakeholders maintain that the court system does work and SME can and do go to court to enforce contracts and other obligations. Other stakeholders maintain that in practice it is impossible to enforce contracts because of both the expense and time consuming nature of going to court as well as associated corruption. What is clear however is that there is a lack of specialised arbitration services to avoid SME as well as other entities needing to go to court to settle disputes.

Whilst establishing a company is in itself reasonably straightforward following the introduction of the *One-Stop Shops*, the various requirements both official and unofficial required thereafter are extremely time consuming and difficult to meet. In particular, meeting different municipal regulatory/inspection requirements (e.g. the Sanitary Inspection, Fire Brigade, Tax Authorities

etc.) can be very difficult as well as time-consuming and often results in having to pay a significant number of bribes.

One of the reasons why administrative requirements are so difficult for SME to meet is because the small business sector lacks the sort of lobbying capacity at a policy-making level enjoyed by larger (often state-owned) enterprises or other powerful entities. An example in this respect is the new Labour Code, which is burdensome for SME because of the complexity of its requirements. It was introduced following extensive lobbying by the Trade Unions, which mainly represent employees of large and state-owned companies. It is based largely on the French Labour Code, but a major difference is the fact that the French version only applies to companies with more than 50 employees.

A Government Act, which entered into force on 17th June 2001, has established a *One-Stop-Shop* network through which new companies may be registered and get all the necessary operating permits. It reduces costs and the time required for setting up a company from 2-3 months to no more than 20 days. An important improvement from the previous system is the unification of the two fiscal and trade identification codes into a single code. The One-Stop-Shop operates within the national network of the Chamber of Commerce and Industry who also provide a telephone hotline to provide information for SME on registrations.

The Romanian fiscal system is extremely punitive for SME. It is extremely complex and does not differentiate to any significant extent between larger and smaller companies. A key problem is the fact that the fiscal system is always changing which does not allow SME to budget for their future liabilities and means they have to invest significant efforts in determining what their actual current liability is. This, combined with high marginal rates of income taxation and social security, means that the grey economy has grown in size, with many workers being paid informally for their services.⁶⁹ As is stated above, a major problem is also the low compliance of large companies with the fiscal regime. Another problem for SME is the time it takes for them to recover the cost of VAT, which they paid on intermediate inputs into their products. This is one of the problems being looked at by the working group on improving the business environment for SME.

Law 133/1999 established various fiscal incentives for SME. These included a full tax exemption on reinvested profits and a reduction of a firm's overall tax liability by 25% if they create an additional 10% of jobs. However, these two incentives are to be removed later this year at the behest of the IMF, which views them as being anti-competitive. Other mechanisms are being introduced, which, although not targeted specifically at SME, will undoubtedly benefit the small business sector. For example, revenues from exports are taxed at a lower rate of 5% (this is to be increased to 6%).

The measures identified in the Action Plan for the first half of 2001 have been implemented. These include the establishment of programme for stimulating R&D in the SME sector, training programmes for entrepreneurs and the establishment of a national consultancy network for SME. These initiatives may results in some improvements, but overall the business environment is still not supportive of an effective development of the SME sector. A comprehensive simplification of enterprise licensing remains overdue and no calendar has been drafted yet to streamline the existing legal framework. Heavy state controls are placing an

⁶⁹ The cost to an employer when tax and social security payments are included can be double the actual pay, which the worker receives.

excessive burden on SME. A large number of bodies are authorised to conduct inspections and audits of businesses leaving ground for corruption.

Access to Finance

Access to finance is a major problem facing the SME sector in Romania. The privatisation and restructuring process of the banking sector has not yet been completed and the sector is therefore not fully prepared to deal with the financing needs of SME. Banks are generally still very reluctant to offer credits to SME (especially to start-ups and micro-sized SME) because of the risk involved and the high costs per loan. Where credits are available, the level of collateral and the interest rate charged are often prohibitively high. Collateral is generally required for at least 140% of the value of the loan, but rates are often higher for smaller SME. Since the land market does not really function properly in Romania (except in the West and South-West of the country), SME are extremely limited in terms of what they can offer as collateral. Interest rates generally range from 42-60% per annum in real terms depending on the bank and type of loan.

Another major problem is the unwillingness on the part of lending institutions to give long term credits. There is no tradition of lending for more than three years and most loans tend to be much shorter. This is particularly problematic because long-term finance for investment is what most SME really need – indeed most can acquire finance for their short-term requirements relatively easily through informal sources. This leads to a problem whereby SME access short-term credits (intended for purposes such as overcoming cash flow problems) and then use them for long-term investment purposes. Accessing finance has tended to be even more difficult and time consuming outside of Bucharest because banks often refer decisions on credit applications to their national headquarters which are generally situated in the capital. Part of the reason for this is the fact that provincial banking staff still tend to lack the necessary experience and training to successfully evaluate SME loan applications. More advanced means of access to finance such as venture capital schemes or business angels have not yet been established.

High rates of inflation are also a major barrier to accessing loan finance. Nearly all credits are denominated in hard currency (generally US dollars) but most SME have a revenue stream denominated in Lei. The fact that in a high inflation environment the value of Lei has depreciated significantly against hard currencies means that it is difficult for debtors to effect re-payment. The only SME able to overcome this problem are those, which are able to hedge against a depreciating Lei by having a hard currency revenue stream. It tends however to only be the larger SME, which are active in export markets which are in a position to do this. High inflation also erodes the capability of SME to provide co-financing for support initiatives, such as longer term subsidised loans.

Despite all of these difficulties, there are some positive signs that the situation is improving, with a number of efforts underway within both the public and private sector to increase the availability of finance for SME. A National Guarantee Fund for SME was created as part of the SME Action Plan, with an initial contribution of the state to the share capital of about 1.85 M€.⁷⁰ The Fund provides guarantees for credits or other financing instruments obtained by SME from commercial banks or other sources. This is unlikely however to have any significant impact on access to credit issues without the amount of capital being dramatically increased.

Though much remains to be done, the Romanian commercial banking sector also appears to be striving to strengthen its lending and range of business services to SME. *Banca Comerciala*

⁷⁰ Exchange rate September 2001.

Romana (BCR), Romania's largest commercial bank in terms of both market capitalisation and size of its branch network, has SME as the cornerstone of its lending strategy for the period 2001-04. So far it has lent 15 trillion Lei (c. 500 M€) to SME. It generally requires 120% of the loan's value as collateral but crucially has taken a decision that two-thirds of the collateral requirement can now be covered by the estimated value of future assets. Other initiatives by BCR to facilitate SME lending include assisting SME with making loan applications and speeding up the decision-making process⁷¹ which has been achieved in part by moving responsibility for decisions on loan applications from BCR's Bucharest headquarters to local branches. Although BCR does not lend to start-ups, it does now commit to lend to businesses, which are only 4-5 months old (previously potential beneficiaries had to present balance sheets for at least 2 or 3 years).

Banca Romaneasca is also active in lending to SME and has developed initiatives to improve its level of customer care. Loan officers are being trained to offer assistance to clients for preparing the credit file needed for credit risk analysis. The bank is also accepting lower levels of collateral than its standard requirement by considering more the viability and the profitability of the business and of the project on a case-by-case basis. The *Romanian Savings Bank (Casa de Economii si Consemnatiuni, CEC)* also offers a range of credit schemes for SME. One such loan scheme targets agricultural enterprises wishing to invest in new equipment. Many loan applicants are also eligible for 25% of the cost of the loan to be met by the *Romanian Agriculture Development Special Fund*. There is however a feeling on the part of the National Council of Private SME (CNIPMMR – see below) that more funding needs to be made available for SME within the rural economy. Indeed, a large proportion of all SME financing in Romania appears to be offered in the comparatively prosperous major towns and cities of Transylvania as well as in Greater Bucharest. This is because lending institutions are more likely to be able to both disperse lending funds and ensure higher levels of repayment. As a result of this, SME in large parts of the country, particularly in the North, North-East, East (Danube Delta) and South have very little access to finance.

The EBRD has credit lines with three different banks: Banca Transylvania, BCR and Alpha Bank. The credit line run by Banca Transylvania has proven to be particularly successful and since the 5 M€ available was dispersed in just 1½ years, a further 5 M€ was made available. It was comparatively innovative insofar as it offered some consultancy and support to SME prior to lending them money and then contacted the SME afterwards to analyse exactly how the SME had used the funding. There have however still been problems getting the banks running these credit lines to lend to micro-SME, indeed when the EBRD contracts were initially offered to them, they initially refused to take the micro-credit facilities. Phare-funded consultants trained the loan officers in these banks in how to assess credit applications. Apart from the limited consultancy offered by Banca Transylvania, no training was offered however to SME in how to formulate business plans, make cash flow projections and deal with other skills necessary for loan applications. This is despite the fact that many different stakeholders (including the EBRD) see a lack of business skills as a major barrier to a more widespread take-up of SME credit schemes and the EBRD themselves are trying to move away from a focus on collateral in lending decisions to one which is more oriented towards evaluating the quality of business plans.

In terms of private sector SME financing activities, there are a number of different initiatives underway in which foreign commercial banks as well as foreign bilateral and multilateral donors are involved. The *Romanian-German Fund II*, which is run by the Kreditanstalt für

⁷¹ Decisions on short term loans are generally taken within 7 days.

Wiederaufbau (KfW) and Microenterprise Credit Romania S.A.⁷² (MCR) offers loans to enterprises with no more than 50 employees, 1 year of existence and involved in trade and services. There are three types of loans: Micro trade credit (max € 2 556); Micro Business credit (from € 2 556 to € 12 782) and Small business Credit: (from € 12 782 to € 51 129).

As well as there now being a wider range of institutions providing finance, several awareness-raising initiatives are underway. The National Council of Private SME (CNIPMMR) has agreed special partnerships for SME seeking to access credits with Banca Romaneasca, Banca Romana pentru Dezvoltare and BCR. The partnerships offer information, consultancy and assistance to SME in obtaining financing. In addition, in September 2001 MIMMC published a Credit Guide with information about all financial sources and conditions to access credit.

The Institutions Supporting SME and their Rationale

A large number of different Government ministries and agencies provide support to the SME sector in Romania. The Ministry for Small and Medium-sized Enterprises and Co-operatives (MIMMC) was set up by the new Government in January 2001. Its role is to elaborate and implement strategies aimed at stimulating SME development and to ensure coherence between these policies and Romania's broad economic and social policy. MIMMC has a total of 75 staff of whom 20 are working on SME policies. However, apart from strategy development, the Ministry does not have major influence in terms of ability to commit significant resources for SME development activities. It has been the implementing agency on only one Phare Programme – a credit scheme (RO-9711), with other Phare and multilateral donor projects being implemented by other ministries and agencies.

Several other ministries have responsibilities which impinge directly or indirectly on the SME sector. The Ministry of Foreign Affairs is responsible for external trade promotion and oversees the work of the Romanian Foreign Trade Centre which conducts export promotion, trade facilitation, attraction of foreign investment and market research. The Agency for Foreign Investment (ARIS) is a new institution subordinated to the Government, which is designed to centralise all the activities related to the promotion of foreign investments. The Ministry of Development and Prognosis (MDP) was set up in 2001 to promote regional, economic and social development policies and stimulate foreign investments in Romania. It is made up of the former National Agency for Regional Development (NARD) and the former General Directorate of Prognosis within the Ministry of Finance. The Ministry of Education and Research has innovation policy among its responsibilities. The Ministry of Industry and Resources has responsibility for the energy sector as well as standards and conformity assessment. The Ministry of Justice is responsible for company law.

MIMMC holds monthly meetings with other ministries, social partners and NGOs to discuss SME policy and its implementation. Stakeholders do not however consider overall policy coordination in the field of SME development to be good. Firstly, as is stated above, there is no National Strategy for SME Development, so there is no overall framework for SME policy, within which different ministries can synergistically work together.⁷³ Secondly, areas of

⁷² MCR lends exclusively to micro- and small-sized enterprises and is wholly owned by Internationale Micro Investitionen AG. It is planned that it will be converted into a fully-fledged bank early in 2002, with international shareholders.

⁷³ MIMMC is responsible for producing a National SME Development Strategy, but it is unclear when one will be produced.

jurisdiction between ministries are not always clearly defined and in certain policy areas different ministries are actually competing with each other for control. Thirdly, MIMMC is institutionally weak and lacks the resources required to fulfil its role. Moreover, relations between the Ministry of SME and Co-operatives and the Ministry of Development and Prognosis at a senior level are not good.

For a periodical, objective and systematic assessment of the initiatives for supporting SME, the creation of a comprehensive database is needed. This will make possible the analysis of the volume of used resources, of the implemented projects and their registered effects and of the national and local impact of policies, as well. This task should belong to MIMMC, which will collect the information in its own database, undertake a broad evaluation of the impact of the programmes, study the economic progress of the sector and elaborate the Annual Report upon SME sector, as well as new programmes according to the specific requirements for SME development.

The Regional Development Boards (RDBs) take strategic decisions on the direction of regional development policies and co-ordinate implementation activities at the regional level. They are made up of the Presidents of the County Councils within the region as well as county and municipality-level representatives. The RDBs' main responsibility is to oversee the activities of the eight Regional Development Agencies (see below), especially in terms of analysing their regional development strategy and annual/multi-annual regional development programmes, selecting projects and allocating resources from the Regional Development Fund. The RDAs were set up by the Law on Regional Development (151/1998) and are nominally NGOs. They draft regional development strategies and programmes and act mainly as implementing agencies for the strategies of the RDBs. The RDBs and RDAs are relevant to SME development because implementation of support mechanisms is increasingly being done at the regional level and this is likely to continue with implementation of the Structural Funds.

Municipal governments are nominally responsible for local SME development but few have the necessary human and financial resources and their role has largely been taken over by private sector support services (whose charges SME are often unable to pay) and the NGO sector (see below). There is a clear recognition of the need to both widen and standardise business support so it is offered in a consistent and coherent fashion in all parts of Romania instead of the current situation where delivery is much more fragmented and ad hoc. In 2001 the Government launched an initiative to create a network of business support. More than 200 NGOs, Chambers of Commerce and business organisations replied to a survey to evaluate the need for information and training. On the basis of the results provided, special courses are being created for the trainers in these different fields with the purpose of wider dissemination. A database with comprehensive information about all the business centres and their expertise is also under preparation.

Numerous NGOs are involved in the SME sector in Romania. A key institution in this regard is the National Council of Small and Medium Sized Enterprises in Romania (CNIPMMR), which is the only SME organisation operating throughout the country. Founded in 1992, it has over 60,000 member companies, 75 branches and 23 associated organisations at the local level. Broadly speaking, its remit is three-fold. Firstly, it undertakes lobbying activities on behalf of the SME sector (improving the administrative and fiscal environment etc.). Secondly, it is

involved in the tri-partite social dialogue (involving Government, employers' associations and trade unions) which has received greater emphasis since the new Government was elected in December 2000. Thirdly, it provides support services to members (consultancy on the legislative framework, export promotion and economic missions etc.). Although CNIPMMR is an employers' association it also sees supporting the employees of SME as part of its role, especially as the activities of trade unions tend to focus on larger enterprises.

The Chamber of Commerce and Industry of Romania and Bucharest (CoC) also play an important role within the SME sector in Romania. They offer a range of training⁷⁴ and support services to both SME and CoC staff in their 41 county-level offices. However, there is a fee for much of the training offered to enterprises by the CoC and many SME are either unable or unwilling to pay for such activities – even if it is directly relevant to their business. The CoC website offers a wide range of information on the services offered to the business community as well as access to databases of business opportunities, investment projects and presentations of companies, fairs and exhibitions. The CoC is also responsible for operating the *One-Stop Shop* strategy for business registration which includes a telephone information hotline (see above).

CRIMM (Centrul Român pentru Întreprinderi Mici și Mijlocii - the Romanian Centre for Small and Medium-sized Enterprises) is an NGO founded in 1992. It is a research body which conducts studies on the small business sector on behalf of the Romanian Government and other clients. In addition, it has been an implementing agency for Phare programmes and has close links with business support bodies and incubators throughout the country.

There are also numerous regionally or locally active NGOs within the SME sector. One such example is the Transylvania Business Centre (CAT) which was founded in 1992 in Cluj-Napoca. It has more than 1000 member companies and its main goal is to develop economic activity and stimulate trade and foreign investment in the Transylvania area. CAT offers business and consulting services, training programmes, support for developing direct economic contacts and for SME participation in international exhibitions and meetings.

Despite the activities of all of these different institutions, there are still major problems with the overall institutional structure of bodies providing services to the SME sector. A key weakness is the fact that there are too many different NGOs seeking to gain control of national level representation of the SME sector. There are currently 7 different legal entities seeking to provide nationwide representation and support services to SME. This has led to a situation where the provision and quality of service is uneven and the range of providers is confusing for potential SME beneficiaries. In addition, such a plethora of different bodies operating in an uncoordinated fashion means that the lobbying capacity of the SME sector as a whole is reduced. Furthermore, in general it is true to say that SME support at the national level is *donor-driven* as opposed to *need-driven* – that is to say many institutions exist more as a means of collecting donor assistance rather than to meet genuine needs within the small business community in a credible and coherent fashion.

⁷⁴ Training topics include accountancy, marketing and business plan development.

Although the institutional picture at the national level is crowded and confusing, the situation at the regional and local levels is very different, albeit still very problematic. At these levels much greater representation and support activities are needed. Current weaknesses, especially in terms of poor communication between the local/regional actors and the national level means that policy formulation and implementation at the national level is often divergent from local-level needs.

The Implementation of the Phare Programme⁷⁵

The Phare Programme has provided assistance to the Romanian SME sector since the start of the 1990s.⁷⁶ Assistance has been provided in several different guises, including loan and grant schemes as well as training and other capacity-building initiatives for various key ministries and agencies. In total, Phare has made available around 77 M€ to programmes directly targeting the SME sector in the period since 1992. However, only around 21 M€ of this was actually disbursed.

Programme RO-9711 (SME Small Fund Credit Scheme and Related TA) had as its aim the development of an SME lending culture within Romanian banks and to assist SME in overcoming existing funding constraints. It appears to have achieved positive results with 6 M€ disbursed to SME in 19 different counties and Bucharest. To date there has only one non-performing loan out of a total of 104. Three Romanian banks⁷⁷ were granted the role of disbursing the loan finance through RO-9711 in an attempt to develop the capacity and willingness of the Romanian commercial banking sector to work with the SME sector. These banks received technical assistance to help them discharge their role and used the available resources to train staff in SME Credit Application Risk Assessment. Programme RO-9807 (Regional Development Support) has provided a range of different support, including capacity building within the Ministry of Development and Prognosis (MDP) and newly established RDA/RDB network as well as grants for SME. The transfer of experience and know-how into the MDP is regarded as having been a success, but less so as far as the RDAs are concerned. Programme RO-9809.02 (The MARR Fund⁷⁸) is providing an SME revolving credit scheme for projects in the manufacturing and service sectors located in priority mining areas as well as grant aid to large and small scale infrastructure projects contributing to economic regeneration. Banca Comerciala Romana (BCR) is the financial intermediary and training seminars were delivered to its local credit officers. Over 30% of the credit line remains unspent because of a lack of interest on the part of potential beneficiaries.⁷⁹ Programme 9904 (RICOP⁸⁰) is designed to support the Romanian Government in the implementation of its industrial restructuring plans and the measures to address the associated social consequences in 17 different counties. There are a range of different activities including severance payments for redundant workers, public works projects and an SME finance scheme. However, the Programme has been significantly delayed (with few benefits to date) and has proven to be overly complex and difficult to implement.

⁷⁵ For a more detailed analysis of the Programmes mentioned within this section see the Interim Evaluation Report RO-ESC-02-105 produced by EMS Romania.

⁷⁶ RO 9207 – SME Development in Romania, which received funding of €10 M, was one of the first Phare programmes addressing the needs of the SME sector in Romania.

⁷⁷ Banca Romanesca, Casa de Economii si Consemnatiuni and Banca Comerciala Ion Tiriac.

⁷⁸ MARR: Mining Affected Regions Reconstruction.

⁷⁹ This is possibly because of the availability of grant aid being viewed as more attractive. If this is true it would lend some credence to the argument of the World Bank that Phare Grant assistance is *crowding out* loan financing in Romania (see the section on 'The Effect of the Phare Programme on SME Development').

⁸⁰ RICOP: Enterprise Restructuring and Employment Conversion Programme.

It has proven extremely difficult for SME to access the grant and loan finance which has been available through Phare. In particular, the match-funding requirements are often more than SME can afford (especially when they are denominated in hard currency – see above). In addition, the administrative requirements, especially in terms of formulating a detailed business plan, are over and above the capabilities of most SME and consequently most applicants have to hire consultants to draft the necessary plans. In terms of grant schemes, many SME agree *success fees* with consultants who get a sizeable proportion of the grant should the application be successful. It can also take an extremely long period of time (often nine-months or more) for the results of applications to be published, by which time many of the market opportunities upon which the applications were based may have passed by.

The Effect of the Phare Programme on SME Development

The Phare Programme has had a limited effect on the development of SME in Romania. However, it is important not to overstate the role of Phare in this regard, both in terms of grant/loan finance and administrative capacity-building. There are after all around 600,000 SME in Romania and only a tiny proportion have received financial assistance.⁸¹

In terms of administrative capacity development, significant efforts have been made in recent years (see above) but the effects of these have been limited somewhat by the high turnover of staff within key ministries as well as the lack of real political commitment to develop the RDA network. Under the measures addressing institutional building, no Phare assistance was conceived to support the simplification and improvement of the business environment through the strengthening of the existing structure(s) or by the setting-up of institutions specifically dealing with this important aspect of SME development. As a consequence, there has been no effect concerning the simplification of business environment. No assistance has been delivered to SME to provide support to the internationalisation of activities. The enhancement of SME competitiveness and internationalisation through better access to research, innovation, training and information services have not benefited from any PHARE assistance. No Phare assistance has specifically addressed the need to ensure adequate co-ordination of the facilities available to support SME development. It is still extremely difficult for individual SME and SME support organisations to get information about the areas supported by Phare and/or by other form of technical assistance, and the ways of obtaining this support.

The SME finance schemes developed by Phare over the last decade, have had a limited, although positive, effect by providing some financial support to SME in a climate of extreme difficulties in accessing credits. There is a feeling on the part of many stakeholders however that the grant and loan finance which has been provided has not always reached the intended beneficiaries. It has been suggested that those enterprises which are successful in receiving finance would often be able to access funding through normal funding mechanisms. There is also a spatial imbalance in terms of Phare support to the SME sector. The largest amounts of money go to the wealthiest regions (such as Transylvania) because dispersing funding is much easier there. Comparatively little goes to the regions with the lowest income levels or highest unemployment such as the North-East or the Danube Delta.

The difficulty in accessing such finance and the lack of transparency in loan application assessment procedures mean that many SME now have a cynical attitude towards Phare loan finance as a means of developing their business. Indeed SME have come to never rely on Phare funding but rather consider it a useful resource in the event that it materialises.

⁸¹ For example, Phare programmes 9711 and 9809 have between them only provided loan finance to 111 SME.

There is also a feeling on the part of some other donors such as the World Bank that Phare grant schemes having a *crowding out* effect on other bilateral and multilateral lending schemes because potential beneficiaries obviously prefer to access funding which they do not have to pay back. The European Commission Delegation disputes this however and points to the fact that SME are willing to pay for consultants to help develop business plans as evidence of the fact that grant schemes are not simply a means of free finance. Furthermore, there is a policy of differentiating between micro-sized SME or start-ups for which grants are targeted and loans established enterprises which are offered loans.

At a more strategic level, Phare programmes designed to support the SME sector have also been criticised as being too independent with many different discrete initiatives having very little interrelationship with other complementary Phare programmes or other sources of funding (ISPA, SAPARD and those funded by other donors). Adopting a more integrated, holistic approach it is suggested would allow greater co-ordination of interventions, avoiding duplication of activities and helping to encourage synergies between different sources of support.

The Readiness in Utilising SF for SME Development

Much remains to be done before Romania will be able to effectively utilise the Structural Funds. Romania's size (the second largest CC) and unitary (centralised) system of government are likely to make the decentralised and multi-agency implementation of the SF particularly difficult. A system of RDAs/RDBs has been created (each covering a NUTS II-style region) but it is still unclear whether it is an effective structure around which regional SF implementation activities can proceed. The RDAs lack the requisite political power, resources and know-how needed for SF implementation. In addition, the RDAs suffer from a very low profile which limits their ability to effectively engage SME at the regional and local levels. Worryingly, there appears to be a lack of political commitment at the national level to develop capacity the of the RDAs, as evidenced by the limited success of Phare interventions designed to strengthen the RDAs (such as that provided through RO-9807 – see above).

Aside from the practical implementation difficulties which threaten the effective disbursement of the SF, there are also attitudinal difficulties and problems of ignorance which need to be overcome. Firstly, there is a lack of awareness on the part of civil servants at the national level of the difficulties which will be faced in implementing the SF with many expecting a seamless, unproblematic transition from Phare-style interventions to SF-type ones. There is currently very little understanding of the highly decentralised system which underpins the SF and the practical difficulties which this poses in terms of project and programme design, partnership building, implementation, monitoring and evaluation. Secondly, there is a widespread lack of awareness at the regional and local levels of the opportunities which the SF present. This applies both to regional/local implementing stakeholders (RDAs, Counties, Municipalities etc.) but also to likely future beneficiaries including Chambers of Commerce, training providers, local economic development partnerships as well as SME themselves.

The Main Challenges to be Faced in the Near Future by the SME Sector in Romania

| Challenges to be faced by Romania at the enterprise level | Challenges to be faced by Romania at the Government level |
|---|--|
| <ul style="list-style-type: none"> • Operating within an administrative and fiscal environment which is complicated and rapidly changing and which often puts them at a competitive disadvantage vis-à-vis larger enterprises. • Operating in a high inflation environment where the value of the Lei rapidly depreciates and repayments on any hard currency denominated loan can become prohibitive. • Accessing sources of finance, which remains particularly difficult for small- and micro-sized enterprises as well as start-ups. • Accessing sources of long-term finance in the face of a domestic banking sector which is generally reluctant to loan for more than three years and imposes extremely rigid conditions on lending. • Gaining access to a broader range of high quality and tailored support services which in the case of the smallest enterprises should at first be free. • Developing the necessary management and business planning skills to be able to manage the enterprise effectively on a day-to-day basis as well as implementing plans for future growth and expansion based both on organic growth and loan finance. • Establishing the necessary level of representation and lobbying capacity at the national level so that future government policies are beneficial to the SME sector as far as is possible. • Improving the quality of Romanian products vis-à-vis foreign ones so as to increase the capacity to deal with the pressures of the Single Market. • Increasing productivity through developing a more highly skilled and motivated workforce with access to a more advanced capital stock. | <ul style="list-style-type: none"> • Ensuring a legislative and fiscal framework, which is both supportive to the SME sector and stable over time. • Ensuring that laws are properly enforced, especially vis-à-vis larger, state-owned companies, and that where necessary SME have proper recourse to the judicial system. • Stabilising monetary policy to overcome the harmful inflationary environment in which SME have had to operate over the last decade. • Producing a <i>National Strategy for SME Development</i>, which could provide coherence and a strategic focus to SME-support activities. • Implementation of a multi-annual budgeting system, to allow proper planning of the financing of SME support mechanisms over several years. • Implementing a more coherent system of support mechanisms for SME at the national level. In particular, institutions need to complement each other in their activities (instead of the current situation where they often work against each other or at least duplicate activities). • Strengthening SME-support bodies at regional/ local levels and ensuring that they meet local needs. • Ensuring better communication between SME-support bodies at the national level with those at the regional and local levels. • Much better and more widespread training for SME in different areas of business administration (accounting, marketing, IT, product quality etc.). • Increasing access to finance, especially for small- and micro-sized enterprises/start-ups and for long-term credits. • Speeding up the allocation of loan finance and shifting the current emphasis of evaluation criteria from collateral towards the quality of business plans (with accompanying training for SME in how to formulate business plans). • Developing a strong SME sector in the more deprived regions of Romania (North-East, Danube Delta & South) and in mono-industrial centres where there is little culture of entrepreneurialism. • Giving the RDAs the required level of technical and financial support so that they can discharge their current regional development responsibilities as well as their future ones (particularly in terms of SF implementation). |

Recommendations

1. The Government must focus on the creation of a stimulating environment for the establishment and development of SME by ensuring stability and coherence of legislation concerning SME; completion of methodological rules for the implementation of Law No. 133/1999; drafting of legislative guidelines for SME; and the drawing up of studies regarding the economical and social impact of the legal drafts upon SME.
2. The Government must endorse MIMMC with the necessary authority over other line ministries in order to develop (and enforce) a *National Strategy for SME Development* to give a strategic, co-ordinated focus to national SME policy for itself, other Government ministries, regional and local level actors, the NGO sector and SME themselves. If it is to genuinely have responsibility for policy implementation then it should be given the necessary resources to do this.
3. Actions should be taken to simplify (and reduce corruption within) the legislative and regulatory framework within which SME operate, building on (but going much further than) current initiatives such as the enterprise registration *one-stop strategy* policy. There should then be an undertaking to avoid additional legislation so as to create some sort of permanence to the legislative environment.
4. In addition to stabilising the regulatory framework, urgent measures need to be taken to ensure proper enforcement of the law, especially in terms of larger, often state-owned enterprises which frequently flout their administrative and contractual obligations.
5. MIMMC must develop adequate skills for monitoring and evaluating the effects of SME support policies and measures; monitoring and evaluation of the impact of the SME development programmes, financed by the state budget and external sources. MIMMC should also be assisted in the establishment and maintenance of a coherent statistical database to monitor the structure of the SME sector.
6. The Government should stabilise monetary policy, so as to reduce inflation and create an overall business environment, which is conducive to long-term planning and investment.
7. The Government should take actions to increase the access to finance (especially long-term lending and lending to start-ups/micro-sized enterprises). On the supply-side, this should entail incentives (fiscal or legislative) to encourage the commercial banking sector to be more risk-oriented and better equipped to undertake the necessary technical activities (e.g. analysis of business plans and cash-flow projections) associated with successful SME lending. On the demand-side, SME need to be equipped with the necessary skills to access finance, especially in terms of developing the ability to put together credible business plans. In this respect, the following initiatives must be developed by the Government, in collaboration with the PHARE Programme:
 - Establishment of the Credit Guarantee Fund for SME with an adequate level of capital (the current 1.85 M€ is definitely not adequate);
 - Carrying out a study to assess the modalities and conditions under which the guarantee mechanism shall work by carefully assessing the financial needs of the sector and reaching conclusions on the need to set up an ad hoc structure responsible for the management of the Guarantee scheme;

- Coordinating an effective participation of Romania to the SME Community Programmes – the Fourth Multi-Annual Programme for SME (2001–2005) with DG Enterprise.
8. The Government should invest in a more widespread network of support-services for SME, which is broader in both its scope and geographical coverage. Attention should be given to the results of the 2001 Government Survey on SME support needs. It is already clear however that support services should be organised and offered locally and should meet local business needs. In addition, there should be a better balance between services, which are free and those for which a charge is levied. Although SME support services should make use of the available donor funds, they should be *need-driven* and not *donor-driven*. In this respect, the following measures could be taken in a framework of strengthening of international competitiveness of Romania SME:
- Support for the development of a business IT infrastructure network: centres of consultancy and management of information, business incubators, innovation centres and technology parks;
 - Establishment of a business information database for entrepreneurs;
 - Providing services for SME (financed from the state-budget and external sources) in order to improve their managerial capabilities, competitiveness and access to markets and information:
 - ❖ improvement of SME access to business opportunities (Strengthening of EICC, development of sub-contracting exchange network); and
 - ❖ support for the implementation of technical and quality standards ISO 9000 as well as the introduction of HACCP accreditation for the agro-industrial sector.
9. The RDAs should be strengthened in terms of both their capacity (in terms of both staff numbers and the level of staff expertise) and their legal standing to make them capable of discharging their role of promoting economic and social cohesion. Efforts should also begin without delay to make the RDAs (as well as other institutions within the Romanian administrative set-up) capable of implementing the Structural Funds.

SLOVAKIA

General Overview

The Slovak population in 2000 was 5.4 M. The new regime of economic measures began towards the end of 1998 with the aim of putting the economy back on track. The measures were essentially aimed at demand reduction, and the increase of regulated prices and taxes. The measures resulted in a slow-down of consumption, and economic growth from 1.9% in 1999 to 2.2% in 2000. In per capita terms the GDP in PPP was 10,800 €, 47.9% of the EU-15 average. Unemployment rose to 17.1% in 1999 and increased to 19.1% in 2000. The inflation rate is still considerably higher than neighbouring countries at 12.7% in 2000, but forecasts for 2001 anticipated an inflation rate of 7.5%. The business environment has begun to improve with larger FDI inflows of 504 M€ and 306 M€ registered in 1998/1999 respectively. The country has a healthy trade balance with a deficit of only 6% of its GDP, however foreign debt continues to be a burden and increase (42.10% of GDP in 1999).

Status of SME sector

The number of registered Natural Persons amounted to 295,750 in 1999 (292,788 in 1998), of which 266,903 (1.2% more than in 1998) were “Small trade licences”⁸², 11,231 (13.2% less than in 1998) (individuals doing business as freelancers), and 17,165 individual farmers (7.9% than in 1998). The number of registered “Legal entities” amounted to 58,333 (59,545 in 1998), of which 54,349 were Small enterprises and 3,294 were Medium-size enterprises⁸³. In 1999, there were 350,000 SME that, compared with the EU average, are bigger in terms of Micro enterprises and smaller in comparison to Small enterprises (respectively 96.4% compared with 93.0%, and 2.4% compared with 5.9%). Slovakia has 64.6 SME per 1,000 inhabitants (EU average is 48). SME account for 56% of total employment and the size class dominance⁸⁴ is the large one (44.0%). If taken together with the medium sized enterprises, large enterprises account for 59.3 % of total employment⁸⁵. The data are bigger than EU average (respectively, 34.1 % and 47.4%). The share of employees accounted for by the Small and Micro-enterprises (< 50 employees) is considerably lower than EU average (i.e.: 36.7 % compared with 52.5%). A year-by-year reduction of employment of 7.1% has been observed for the category of small enterprises, with the overall employment in SME, inclusive of the small trade licences, dropping by 4.0% in two years⁸⁶. Considering that “job creation” is perceived to be one of the main tasks of the SME sector, such a large decrease in employment among the SME is of concern. Poor performances have been registered by the SME sector in respect of foreign trade. The share of total exports related to the activities of the SME sector dropped, between 1998 and 1999, from 45.3% to 30.5%. A dramatic reduction of the export performances by Small enterprises (less than 50 employees) has been noted, and its share has been more than halved, moving from the 29.9% registered in 1998, to the 13.7% in 1999⁸⁷. Similarly, the share of total imports has dropped, from 53.9% in 1998, to 44.7% in 1999. In 1998, the sector contributed to 39.5% to the GNP, and, in 1999, the contribution amounted to 42.7%, showing an improvement compared with large enterprises⁸⁸. In 1998 the SME sector contributed to the total added value with 171,581 M SKK and, in 1999, the sector contributed with 191,702 M SKK. The added value per employees registered by the SME sector in Slovakia was 3,700 € in

⁸² i.e.: natural persons doing business in accordance to the “Trade Act” and registered with the “Small Trade Register”.

⁸³ Source: NADSME – State of SME in 1999.

⁸⁴ A country is said to be micro- small- medium- sized or large scaled if either micro, small, medium or large-scale enterprises have the largest share in total employment.

⁸⁵ Source: NADSME – State of SME in 1999.

⁸⁶ In 1997, SME provided jobs to 59.4% of the active population, this dropped to 57.1% in 1998, and 56% in 1999.

⁸⁷ Source: NADSME – State of SME in 1999. – Graphics 3.18.

⁸⁸ NADSME – State of SME in 1999. – Graphics 3.24

1998, and 4,300 €. The value added per employee generated by the sector is, however, not only considerably lower than the EU average (45,000 €), but is also lower the average registered in other CC (e.g. Slovenia (17,000 €) or Czech Republic (10,000 €). Overall the statistics data available are not exhaustive, and important data such as survival rate are not readily available. Furthermore, it is unclear how many registered enterprises are active.

Broad Economic & Social Policies

The broad economic and social policies are not yet fully supportive of effective SME development. The Ministry of Economy (MOE) has been given the responsibility for SME development, and relies on the advice of the Council for SME, created in August 1999. The Ministry of Construction and Regional Development (MCRD) also bears some responsibilities pertaining to SME development and will be responsible for the management of the funds allocated, under Phare 2000, to support SME. Policy implementation is mostly carried out by the National Agency for the Development of SME (NADSME). No clear lines of accountability have been established between the MOE and the MCRD, raising doubts about the effectiveness of the existing co-ordination mechanisms. Although a large number of documents have been approved by the government to define the most effective way to support, under different perspectives, SME Development, a comprehensive SME development strategy has not been produced and adopted by the Slovak Government. In March 2000, the government defined a new scheme to streamline all the support programmes funded (START Scheme). In June 2000, the Council for SME formulated a number of recommendations on how to simplify the business environment for SME, and two documents have been presented to the attention of the government.⁸⁹ Unfortunately, no concrete implementation plan has been produced. The regional development strategies have not yet been translated into an officially approved National Development Plan. SME development is not properly embedded into regional development strategies. The existing problems related to poor labour market flexibility are tackled by the National Employment Plan and also by the newly adopted Labour Code. The National Employment Plan builds on four pillars relevant to SME Development (improving employability, developing entrepreneurship, encouraging adaptability of businesses and employees and, equal opportunities). The Plan has been developed by the National Employment Office under the supervision of the Ministry of Labour, Social Affairs and Family, but implementation is still slow. The provision of State Support to the sector has been defined under the “NR SR Act No. 231/1999 Coll. II. on State Assistance”. In addition to harmonising the SME definition with that of the EU, the decree also establishes the position of State Assistance Office in the Prime Minister Office, which will supervise the fulfilment of the law. The Act is considered “... *relatively intricate and sometimes hardly intelligible, enabling a variety of interpretations ...*”⁹⁰.

Regulatory policy

Since 1998, special emphasis has been placed on the improvement of the business environment, recognising the need to reduce the legislative and regulatory burden, as well as to improve the conditions for SME access to finance. The regulatory policy is not yet adequate for development needs of the SME sector. The major problem for enterprises remains the unsatisfactory business environment and, consequently, the main tasks are (according to the MOE): (1) Eliminate significant administrative barriers, (2) Reduce the importance of tax-related burden upon entrepreneurs – natural persons, and (3) Reduce the complexity of the administrative procedures related to levies and charges. A number of changes to the existing

⁸⁹ The documents are: “Improvement of the Legal and regulatory framework for Support of business and investments” – “improvements of the tax and customs framework to support enterprises and investments”.

⁹⁰ Source: NADSME – State of SME in 1999.

regulatory framework have been implemented, but the newly adopted legal standards have not been supported by specific ex-ante analysis focusing on their likely impact on the SME sector. As a consequence, the fast-changing legal framework is creating additional problems for the sector. During 1999, 123 legal standards were adopted concerning SME (160 in 1998) and this has caused concern in the business community about the task of coping (the Taxation Act has changed at least 20 times during the past ten years). A number of changes to the existing regulatory framework have been implemented but, according to NADSME⁹¹ “... *changes made in 1999 cannot be claimed to have made a more pronounced contribution toward concrete improvement ... mainly because they only dealt with partial problems Obviously, there was a lack of systemic view of the dealing with prevailing barriers.*” Since January 2000, for example, a lump-sum taxation system has been introduced for selected small business and sole traders. In this system, the tax-rate is calculated from the volume of the income and is paid in advance. The practical application of the system needs substantial amendments to be able to fulfil its motivating purpose. Between January and April 2000, a considerably lower number than expected of business applied. An amendment extending the categories of eligible entrepreneurs was passed by the Parliament in September 2000, and should have been enforced in January 2001, but delays have occurred⁹². The SME are still adversely affected by the existing system of social and health security which imposes large burdens on enterprises. In this respect there is still need to develop a reform of the system toward both institutional and material aspects. Overall, the pace of change in the regulatory environment presents a key challenge for the sector as the government is developing a legal framework fully compatible with the acquis. The legal requirement to conform to the newly defined regulations is costly and difficult because of the new number of laws being passed and amended. The development of small businesses in accordance with economic policy objectives requires, above all, a predictable environment that is currently missing.

Access to finance

Access to finance still hampers the development of the sector. During 2000, there has been a gradual reduction and stabilisation of interest rates in the financial markets. The policy of commercial banks in respect of SME is linked to a cautious approach to the sector. This approach is associated to high interest rate (in the region of 20%) and very high collateral (up to 200%). The behaviour of the commercial banks is mainly attributed to the limited commercial interest offered by the relatively small amounts involved, and to the difficulties of foreclosing mortgages upon default. The problem is not linked with the lack of liquidity within the system. More specifically, micro and small enterprises have particular difficulty in accessing credit due to the lack of track record and difficulties in making the collateral available. In order to cope with this problem, the government has launched different initiatives, including Phare assistance. NADSME and the Slovak Guarantee and Development Bank (SZRB) are the two main actors active in proposing schemes to support entrepreneurs in the SME sector. The Loans Schemes run by NADSME build on a co-financing mechanism with five Commercial Banks (PolnoBanka, Slovenska Sporitelna, Istro Banka, Tatra Banka, and the Ludova Banka). With the financial support of the State Budget, Loans and Mutual Guarantee schemes are implemented through the SZRB. NADSME manages a loans based support programme (to support SME involved in manufacturing, crafts, services and tourism), micro-credit schemes (mainly addressing micro-enterprises) and, through the Seed Capital Company, equity schemes. The institutions have limited resources and the demand largely

⁹¹ Source: NADSME – State of SME in 1999.

⁹² Another example of this situation is offered by the decree N0. 118/1999 on import surcharge. This decree is amended from time to time and raises concerns about the uncertainty of the import regime. As a consequence, entrepreneurs are reluctant to embark upon import activities, not knowing exactly the charges demanded.

exceeds the funds available. Recently, the MCRD has launched a grant scheme to support SME development. The demand exceeds the offer and, out of more than 3,000 applications, only 30 have been accepted. There is a lack of adequate equity scheme mechanism. The Seed Capital Company was established by NADSME in 1994 to support SME development activities with equity and loan investments. The maximum investment is 5 M SKK (125,000 €). The Slovak-American Business Fund also provides financial support in the form of equity and the maximum amount ranges between 350,000 USD and 2.5 M USD.

The Institutions supporting SME and their rationale

The main institution supporting SME is NADSME. The Agency was established in 1993 by a joint initiative of the government and the Phare Programme. The government has entrusted NADSME with the implementation of the SME Development Policy. The SME support programme has been so far mainly focused on the activities carried out by NADSME and its country-wide network of Regional Advisory and Information Centres (RAIC) and Business Innovation Centres (BIC) that provides services to start-up and/or operational SME. The services provided by NADSME cover a very broad range of activities that, in some case, are also not specifically related to SME development, but encompass enterprise restructuring, export development, and FDI promotion. NADSME has developed a broad spectrum of skills to meet the shortfall of other national institutions capable of providing adequate services to the enterprise sector. NADSME is the co-ordinating body for the activities of the “Institutional Support Network” of 12 RAIC and four BIC. The Network covers the whole of Slovakia. RAIC and BIC provide potential and existing entrepreneurs with advisory and information services. Three main services are provided by NADSME. (1) The Network for the support of SME where the RAIC and BIC provided, during 2000, 1,549 start-up consultations and 1,912 professional consultations to existing SME. In comparison with the number of registered SME (353,393), the outreaching capability of the network is extremely low. (2) Financial Support Programmes, where since the beginning of its activity, the *Loans Schemes* have supported 1,033 applications, which is very small in comparison to the total number of registered SME. The total volume of loans amounted to 3.368 billion SKK, and the average loan was 3.2 MSKK. Under the *Micro-credit Scheme*, 209 loans have been offered, up to the maximum amount of 500,000 SKK, since the beginning of the scheme. During 2000, out of 177 applicants, 70 applications have been accepted. Since the beginning of the activity, the *Seed Capital Company* has supported 17 companies with 31 investments totalling 76.39 MSKK (1.8 M€). (3) Information related activities and international co-operation. NADSME has always paid particular attention to the information-related activities for which a specific role is played by the Euro Info Centre which, also through the BRE, supports SME in finding a EU partner to establish co-operation agreements. The Euro Info Centres of Presov and Bratislava have organised, with the financial support of DG Enterprise, a presentation of Slovakia to potential EU partners. In collaboration with the National Labour Office and with the French Government, NADSME has established the CEPAC Slovakia (Centre for Patronage and long term care for starting business). There are a number of business associations that which have not developed adequate skills to effectively assist their members. The “Subcontracting Exchange of Slovakia (SES)” was established in 1994 as a joint initiative of the MOE, UNIDO and the Phare Programme. At the end of 1999, the government established SARIO as a new institution responsible for providing assistance in the field of FDI promotion and export development. The export development component is extremely relevant to SME Development but, unfortunately, SARIO is presently facing major difficulties, and its support to SME development is extremely limited, if any. NADSME is practically the only institution active in providing support to SME, and therefore overall co-ordination of the activities carried out to support SME is guaranteed, but the question is whether SME support is adequate to satisfy the

needs of the sector. Currently, the number of services provided and the number of accorded loans are extremely low in relation to the number of registered SME.

The implementation of the Phare Programme.

Up to 1998, three Programmes were funded by Phare (16.4 M€) to support Slovak SME Development. Since 1993, the development of small and medium enterprises was constrained by restricted access to credit. In 1993, the Slovak Government and Phare supported the establishment of NADSME. The first phase of Phare support saw the creation of BIC, RAIC, European Information Centres, a loan guarantee scheme and a small loan scheme. Since 1993, the number and importance of Small and Medium-size Enterprises has increased substantially. The overall aim of the Programmes was to develop a competitive Slovak private sector, ready to face the pressures of the EU internal market, and to contribute to economic development. The immediate objectives were to strengthen NADSME, to develop the infrastructure network, to improve access to credit and information, to create new enterprises, and to introduce spin-off activities. The medium-term priorities of the Accession Partnership (AP) aim at taking measures to stimulate domestic and foreign investment in small and medium-sized enterprises. There is also a focus on promoting competitiveness of SME. Phare Programmes in the SME sector have contributed to all of these priorities. The implementation of financial schemes for the development of SME was carried out in close collaboration with financial institutions, RAIC and Business Information Centres. The activities were managed in a transparent way and the participating banks regularly informed NADSME on how the funds were disbursed. Between 1993 and 1999, Phare assistance to the SME sector was addressed in an effective way, fulfilling a wide range of important needs of Slovak entrepreneurs. The sector was supported by an effective countrywide network of Information Centres; access to credit substantially improved, and the NADSME developed skills in planning and co-ordinating State support to the sector.

The effect of the Phare programme on SME development

Under the Measures addressing Institutional Building issues, no Phare assistance has been specifically designed to support the simplification and improvement of the business environment, through the strengthening of the existing structure(s) or by the setting-up of institutions specifically dealing with this important aspect of SME development. As a consequence, there has been no effect on the simplification of business environment. The financial schemes developed by Phare since 1993 to support SME financially have had a positive effect of providing support at a time when access to credit was a key factor adversely affecting SME development. Both the Micro Credit and the Phare Loan Schemes have improved the access to credit. A few commercial banks participated in the schemes, but the resources available were only adequate for a small number of SME. Phare involvement in promoting the launch of the highly important Guarantee and Equity Schemes has been very limited. Phare assistance to the improvement of the financial environment for SME has been limited, and access to credit is still very difficult. The assistance delivered by Phare, through NADSME, has had a positive effect in the development of an effective network of information and counselling. The issue of the SME competitiveness has not received adequate assistance from Phare. The support to the five business incubators established by the BIC Network has been very limited, and the internationalisation of the SME has not benefited from the Phare assistance. Positive outcomes come from the assistance provided to the Euro Info Centre established within NADSME. The Phare assistance to NADSME has been expedient in enhancing the co-ordination of the existing facilities to give businesses easier access to existing support services and programmes.

The readiness in utilising SF for SME development

Presently, the utilisation of SF for SME development is unlikely. An integrated approach, with actions selected to contribute to a common objective, such as combating industrial decline, in particular with SF type measures, linked with interventions to promote the business environment has not been developed. Geographical coverage has only been established at NUTS II level (three regions are expected). Nothing has been defined yet in relation to the NUTS III regions. A Managing Authority for Structural Funds has not been selected, and the MCRD has not established a National Regional Development Agency. So far, an integrated network of regional development agencies does not exist, and the strengthening and/or the development of adequate administrative capacity of the institutions responsible for the implementation of, at least, the pre-structural funds, has not taken place. There is no approved NDP to underpin both multi-annual programming for SF projects financed from Phare 2002-06 and the preparations for Structural Funds. A confused division of competence and responsibilities still adversely affects the effectiveness of the MCRD. The situation regarding the eventual utilisation of the SF to the benefit of SME development is even more complex due to the important role played by the MOE through NADSME. Any future SF strategy cannot avoid involving NADSME.

The main challenges to be faced, in the near future, by the SME sector in Slovakia

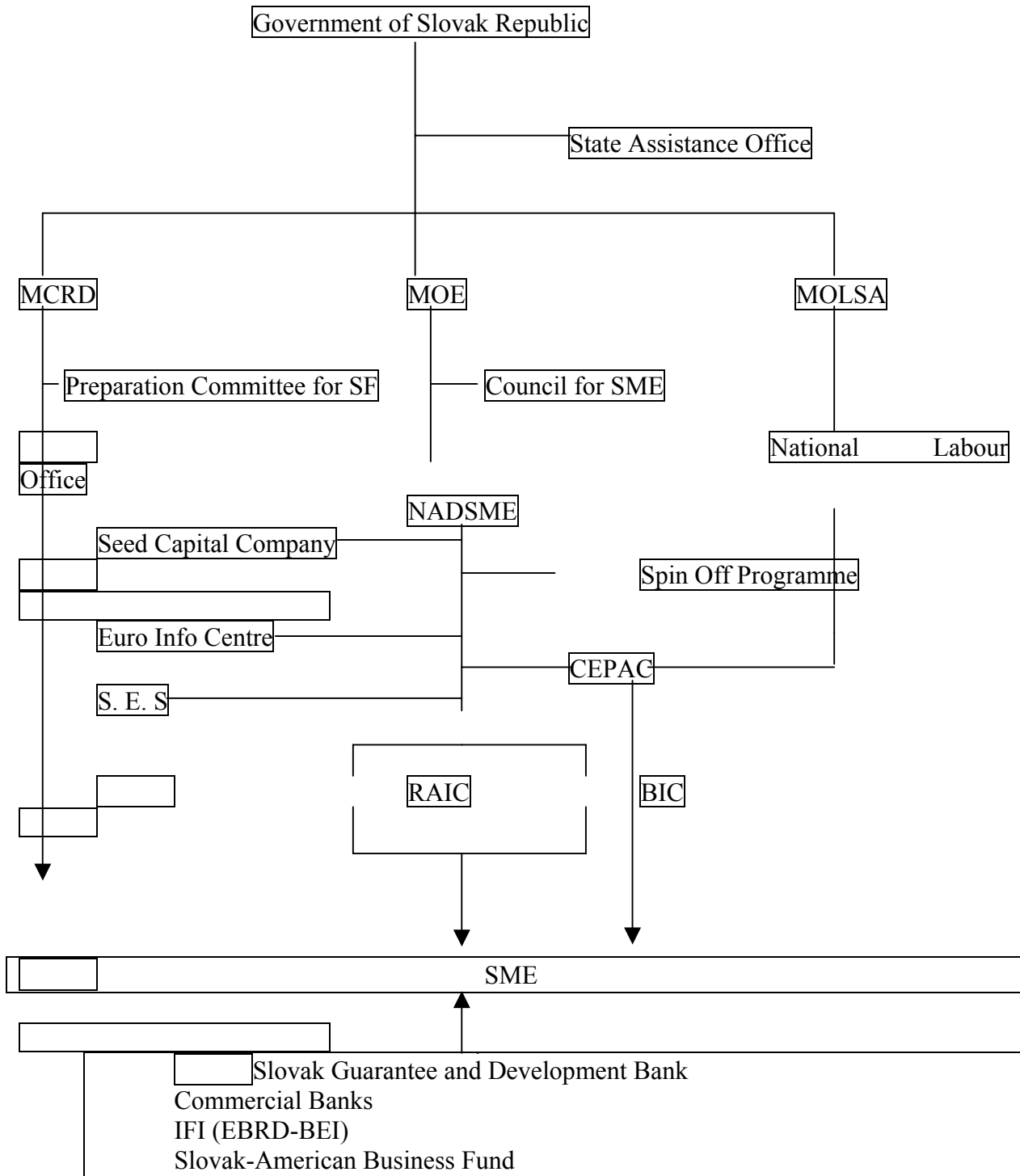
| Challenges to be faced by Slovakia at enterprises level. | Challenges to be faced by Slovakia at Government level. |
|--|---|
| <ul style="list-style-type: none"> • Being able to face the competitive pressures in the single market, particularly in relation to the very low labour productivity and added value per employee in comparison with the average EU, and CC such as Slovenia and the Czech Republic. • Coping with a fast changing legal environment, meeting the requirement of the <i>Acquis Communautaire</i>. • Gaining access to information and high quality support services at a bigger rate than present. • Upgrading management skills in order to increase efficiency and promote entrepreneurship, particularly at micro and small enterprise level. • Enhancement of the growth and competitiveness of the sector in a “knowledge-based” internationalised economy. • Integrating ‘Supply chain’ networks with the existing FDI and improving export-related marketing and product quality related skills. • Coping with a still unfriendly financial environment. • Making their voice heard by authorities through the development of more effective business associations capable of representing the interests of the entrepreneurs through a more effective lobbying activity. | <ul style="list-style-type: none"> • Better understand the actual needs of the SME sector, with the support of more reliable statistical data. • Development and implementation of specific programme addressing the simplification and improvement of the administrative and regulatory framework. • Complete structural reforms necessary to further restructuring enterprises and to create a dynamic SME sector. Specific attention has to be placed on micro- and small enterprises. • Give business easier access to Community support services, programmes. • Defining clear accountability role vis-a-vis the implementation of SME development measures. • Improving horizontal factors of competitiveness, like entrepreneurship and management education, or the development of a more friendly taxation and social security system. • Clearing the gap between national and regional skills in planning development programmes, with a specific attention placed on the readiness in utilising SF upon accession. • Ensuring adequate planning skills development at NUTS III level and defining financial support mechanism to support this enhancement process. • To enhance the capacity of the MOE and to create appropriate structures for efficient planning, development, management, control and monitoring of the material and financial sources which use funding from the SF. • Improvement of the financial environment for SME, granting better access to credit for SME development and/or start-up or innovation through |

| | |
|--|---|
| | <p>the development of non-banking schemes.</p> <ul style="list-style-type: none"> • Further support the SME sector in order to reach a level of employment similar to EU average (i.e. 65.9 %) |
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Recommendations

1. The MOE should analyse the reasons for the reduction of employment in Small enterprises. Small enterprises are intended to be one of the engines of the economy and the government should tackle this problem as a matter of urgency.
2. The government should prepare a plan to increase the productivity of the SME sector through the identification of measures aimed at considerably increasing the added value per employee. An in-depth operational and management review analysis should be carried out, taking advantage of the existing network of RAIC.
3. The statistics data should be improved. Data are not exhaustive, and important data such as the survival rate after 12, 18 and 36 months are not readily available. The data should also indicate what percentage of registered enterprises is active.
4. The MOE should prepare a Strategy for SME development covering the period 2002-2006. The Strategy should evaluate the financial needs of SME development, and specify measures to attain them. The Strategy should be embedded in the NDP.
5. The regulatory environment is still unfriendly and different steps have to be taken. The government should prepare an action plan to reduce administrative burden on SME focusing on:
 - Eliminating significant administrative barriers;
 - Reducing the importance of tax-related burden upon entrepreneurs – natural persons;
 - Reducing the complexity of the administrative procedures related to levies and charges.
6. Before adopting any new legal standards affecting SME, the government should carry out a careful ex-ante analysis in order to identify their impact on the performance of SME.
7. Although track record and collateral are the only measures to reduce the risk of lending money to a very risky sector, the government should take note of the cautious of commercial banks and plan a significant allocation of funds for start-up and development from non-banking financial schemes. The government and the European Commission should explore the possibility of allocating funds for the implementation of non-banking financial schemes addressed at small and micro-enterprises in their preliminary stage of development. In absence of that, a further decline of the micro- and small sector may be unavoidable.
8. In order not lose time, the government should explore the possibility to reallocating the funds for the implementation of the SARIO business plan to NADSME. The European Commission should do the same for the budget allocated under Phare 99.
9. At present only NADSME fulfils the extremely important role of facilitating all the measures foreseen to support SME. The government should identify other organisations to support SME.

Slovak Business Support Network



SLOVENIA

Overview

Slovenia has a population of 2 M, however amongst the CC's it has the fastest growing population. This is due to the strong inward migration occurring, most likely from other states of the former Yugoslavia. The country has a strong economy statistically. The GDP in Slovenia is the highest among the CC's. In terms of PPP the per capita income was 18,800 € (71.40% of the EU-15 average). The yearly real GDP growth rate was on average 4.3% in the period 1994-2001 and it is expected to remain above 4% in 2002. Inflation seems to be the main problem over the last few years with the rate in 2000 at 8.9% but forecasts expect the rates to fall by 2001 to 5.2%. The unemployment rate is one of the lowest amongst the CC's at 6.90%. The economy has a slight trade deficit of 6% of GDP. For such a strong performing economy statistically it is surprising that inward FDI per capita is one of the lowest amongst the CC's at 85 €. The amount of foreign debt as % of GDP is in line with other strong CC economies.

Status of SME

SME were developing well before secession and the large majority of enterprises are SME. From 1990 to 1998, the number of SME increased from 15,905 to 117,390. In 1998 they accounted for 99.7 % of all companies, 57.6 % of employment and 57.1 % of sales⁹³. In 1999, the number of SME reduced to 99,700. The sector accounted for 99.7% of the total number of enterprises, 63.8% of employment and for the 61.6% of sales^{94 95}.

| Size Classes | Micro (0-10) | Small (11-50) | Medium (51-250) | Total SME | Large (> 251) | TOTAL |
|---------------------------------------|-----------------------|---------------------|----------------------|-----------------------|----------------------|-----------------------|
| Number of Enterprises (in 1,000s) (*) | SLO 95.5 EU 18,486 | SLO 3.1 EU 1,175 | SLO 1.1 EU 170 | SLO 99.7 EU 19,810 | SLO 0.3 EU 40 | SLO 99.9 EU 19,850 |
| % of total enterprises | SLO 95.5 EU 93.0 | SLO 3.1 EU 5.9 | SLO 1.1 EU 0.9 | SLO 99.7 EU 99.8 | SLO 0.3 EU 0.2 | SLO 100 EU 100 |
| Employment (in 1,000s) | SLO 180 EU 39,330 | SLO 63 EU 22,140 | SLO 125 EU 15,640 | SLO 368 EU 77,100 | SLO 209 EU 39,860 | SLO 577 EU 116,970 |
| Employment share | SLO 31.2 EU 33.6 | SLO 10.9 EU 18.9 | SLO 21.7 EU 13.3 | SLO 63.8 EU 65.9 | SLO 36.2 EU 34.1 | SLO 100 EU 100 |
| Employment person per enterprise | SLO 2 EU 2 | SLO 20 EU 20 | SLO 111 EU 90 | SLO 4 EU 4 | SLO 673 EU 1,000 | SLO 6 EU 6 |
| Turnover per enterprise (M€) | SLO 0.1 EU 0.2 | SLO 2 EU 3 | SLO 7 EU 23 | SLO 0.2 EU 0.5 | SLO 51 EU 215 | SLO 0.4 EU 1.0 |
| Value Added per employee (x1,000 €) | SLO 15 EU 30 | SLO 21 EU 50 | SLO 17 EU 90 | SLO 17 EU 45 | SLO 22 EU 90 | SLO 18 EU 60 |

(*) The data do not specify if the number refers to registered or active SME.

The structure of SME in number and size corresponds closely to the EU average. However, Turnover and the Added Value per employee is considerably below the EU average (200,000 € compared with 500,000 € for turnover; 17,000 € compared with 45,000 € for Added Value per employee). According to the draft Slovenia BEST Report, only 36.8 % of the Micro and Small

⁹³ CC BEST – Draft report Slovenia - 2000

⁹⁴ Institute for Entrepreneurship and Small Business Management – “Slovene Entrepreneurship Observatory 2000” – Maribor, December 2000.

⁹⁵ Institute for Entrepreneurship and Small Business Management – “Slovene Entrepreneurship Observatory 2000” – Maribor, December 2000.

enterprises operate profitably, and 44.2% show a negative result. These enterprises account for less than 20 % of total exports. The size class dominance⁹⁶ in Slovenia is the Large one (36.2 %). If considered together with the medium-sized enterprises, the large enterprises account for 57.9 % of total employment. The data are bigger than EU average (respectively, 34.1 % and 47.4%). This difference is bigger if compared with EU Countries of Micro size class dominance (e.g.: Italy, France, Spain and Greece. The share of employees accounted for by the Small and Micro enterprises (< 50 employees) is lower than EU average (42.1 % compared with 52.5%).

Broad economic and social policies

Recently, three ministries (the Ministry of Economic Affairs, the Ministry of Small Business and Tourism and the Ministry of Economy and Regional Development) have had competence on enterprise policy and SME development, without ensuring the necessary co-ordination. However, in 2000, a newly established Ministry of Economy (MoE) assumed responsibility for economic aspects of SME and a specific Department has responsibility for “Entrepreneurship and Competitiveness”. The Ministry of Labour, Family and Social Affairs has partial responsibility SME development. No National Strategy on SME has yet been adopted by the government. A Working Paper “Small and medium sized enterprises and entrepreneurship development strategy in Slovenia for the period 2001-2005 period” defining the sectors needs on the basis of a benchmark analysis was produced in September 2000, by the former Ministry of Small Business and Tourism. The document defines a global strategy of SME in Slovenia but, following the ministerial re-organisation, the document must be updated. The lack of international competitiveness attained by the local SME is well understood by the Government in terms of added value per employee and profitability (34% compared with 48% for the total SME, and 39% compared with 60% for the micro and small enterprises)⁹⁷. Since January 2001, the MoE has been preparing a “Programme for SME development and competitiveness” aimed at increasing production, technological development, promotion abroad and new investment. The regional development strategies have not been translated yet into an officially approved National Development Plan. SME development is not well-embedded within regional development strategies, and there is growing concern about the management of the SF addressing SME development needs.

Regulatory Policy

Recent field research conducted over 2,500 Micro and SME, show that only 5% of the enterprises consider that the existing situation has no constraints in respect of business performance⁹⁸. In comparison, among the EU-15 the answer is 23%. The finding of this research support the statement that the business environment is not yet fully supportive of the sector. The slow pace of the public administration reform keeps the SME development below its potential. In order to set up their own companies, would-be entrepreneurs are forced to invest 12 weeks of their time, while the costs of funding such a company total € 1,500. More than 60% of entrepreneurs are reported to spend more than six hours a week on administrative tasks. They encounter barriers in the form of acquisition of all sorts of different permits, transfer of activities to new owners, declaration of taxes and contributions, etc. The Government of Slovenia is aware of this shortcoming and, since November 1999, has designed the Anti-Bureaucratic Programme in the framework of the “National Plan for Employment”,

⁹⁶ A country is said to be micro- small- medium- sized or large scaled if either micro, small, medium or large scale enterprises have the largest share in total employment.

⁹⁷ Intended as the difference between value added and labour costs as a share of value added.

⁹⁸ Institute for Entrepreneurship and Small Business Management – “Slovene Entrepreneurship Observatory 2000” – Maribor, December 2000.

with objective of eliminating administrative barriers to the faster development of SME⁹⁹. Since the beginning of 2001, the government has named a responsible person for the Plan and formed an inter-ministerial working group to implement it. On May 31 2001, the government adopted a number of resolutions including the adoption of an *Action Plan* for its implementation. The Action Plan only focuses on the definition of deadlines for finding solutions to a number of barriers, without specifying the dates for completion. The Action Plan has identified 29 problematic aspects grouped under eight headings¹⁰⁰. The aspects are relevant but no firm information is currently available about the expected time for completion. The tax environment is critical to SME development, and has become “less friendly” with the elimination of some tax relief measures, the introduction of a complex VAT system, and the differences in tax burdens of companies and sole traders. The attitude to grey economy is developing very slowly, though a untrusting attitude to entrepreneurs continues to exist, probably based on tax evasion issues.

Access to Finance

In Slovenia, the entrepreneurs consider access to finance as the main problem hampering business performance¹⁰¹. The poorly developed financial and capital markets are a crucial problem, and the main sources of early-stage financing are the savings of entrepreneurs. This is associated with related problems such as expensive funds, the non-existence of some forms of financing for companies (e.g.: venture capital, franchising, leasing, etc.), and a shortage of other forms of financing (equity and venture capital funds, sources for financing spin-off activities, etc.). The State provides limited financial support but it is not well co-ordinated and generally works on pilot-project basis. It is unclear who is actually responsible for the overall co-ordination and monitoring of the financial support provided by the State budget. Commercial banks (for which the privatisation process is still lagging behind) do not suffer from a shortage of liquidity, but are only willing to provide SME with loans at unfavourable conditions. High interest rate, high collateral demanded by banks (with problems with mortgaging non-business related real estate), extensive documentation required, almost no grace period granted, mostly short-term loans, lack of willingness to support start-up activities, etc. contributes to make access to credit difficult for SME. Other forms of finance are available to SME but, as the Risk Capital schemes, are underdeveloped in Slovenia, and only a few funds are active, limit the capital available for equity investment to a few hundreds M €¹⁰². The State supports SME through a number of organisations, such as the “*Small Business Development Fund*”, active, since 1992, supporting the promotion and development of small business units with an initial capital of 20 M USD. The Municipalities are involved in the provision of subsidies (mainly under the form of subsidised interest rates) for start-up and expansion performed by micro and small enterprises operating at municipal level. Ten Regional Guarantees Schemes have been launched to support enterprises willing to take bank loans. Five regional development agencies manage (in collaboration with local banks) *Micro*

⁹⁹ The Programme has four main goals: (a) The reduction of administrative and other fees prescribed for the registration and commencement of operations of new enterprises. (b) Shortening of the time required for opening a new enterprise (up to 14 days). (c) The elimination of all administrative, organisational and technical barriers hampers a faster SME development. (d) Establishing an employment and labour law system in the area of SME to provide sufficient flexibility to SME, while ensuring adequate degree of social security for workers.

¹⁰⁰ (a) Registration and start of company’s operation. (b) Land Use; (c) Small Business; (d) Labour legislation; (e) Administrative procedures; (f) Consumer borrowing; (g) Access to official gazette on internet; (h) Access to Court register.

¹⁰¹ Institute for Entrepreneurship and Small Business Management – “Slovene Entrepreneurship Observatory 2000” – Maribor, December 2000.

¹⁰² The IFI are involved in this sector mainly through the World Bank and the EBRD which, in association with Phare, owns 65% of the “SFM” Fund (40 MDEM of capital). The EBRD has also launched, in association with Phare, the Phare-EBRD SME Facility, which will launch Equity schemes in Slovenia. The SFM has been operational since 1995 and some companies have benefited from the Fund. So far, the EBRD SME Facility has not provided any financial support to local SME. Two agreements have been however established with the State-owned, Nova Kreditna Banka Maribor and the Bank of Koper.

credits schemes on pilot project bases and, so far, they have met a very positive response. It is unclear if the scheme will be replenished in future and, consequently, sustainability is at risk¹⁰³. Resistance to co-ownership is, however, a key negative aspect of Slovene entrepreneurship that is not supportive of risk capital and equity scheme development. According to a recent survey¹⁰⁴ more than 50% of entrepreneurs are not prepared to renounce to any ownership. Thirteen percent would accept up to 20% of external equity, twenty percent would accept up to 30% and only twelve percent would accept more than 30% of external equity.

The Institutions supporting SME and their rationale

The main actors for the implementation of SME policy in Slovenia are the Small Business Development Centre and the National Agency for the Regional Development. A large number of support organisations exist but their services are not co-ordinated. The business-related information is dispersed and an information system giving access to information and counselling for entrepreneurs has not been developed. During the early 1990s, the Ministry of Small Business and Tourism started to develop the concept of a Small Business Support Network. This concept has evolved and, currently, the situation is supportive of the sector. The Small Business Development Centre (SBDC) is a public institution established by the government in 1992 to co-ordinate the activities of the Small Business Support network. It is responsible for the implementation of the SME Strategy as well as for the implementation of the second pillar (“entrepreneurship promotion”) of the Government Action Programme for Employment (2001-2001) developed by the Ministry of Labour, Family and Social Affairs. There are two Euro Info Centres, of which one is in Ljubljana and acts under the aegis of the Chamber of Commerce, and another one acts under the aegis of the SBDC. The new role planned for the SBDC implies an important internal reorganisation, inclusive the recruitment of new staff, although at which level the SBDC has been endorsed by the MoE with the necessary authority to implement its co-ordinating role within the Small business Support network is unclear. The SBDC is also expected to follow-up the implementation of the Anti Bureaucratic Programme. In collaboration with the magazine “Podjetnik”, the SBDC has set up the first “Business Angels” club in Slovenia. So far, its activities have been limited to the organisation of some meetings between the “Angels” and the entrepreneurs. On average, the SBDC assists, through the network, entrepreneurs with 10,000 services a year (covering nearly 10% of total SME). From a legislative point of view, the role of the National Agency for Regional Development (NARD) is clear. Article 16 of the General provision of the Balanced Regional Development Act (16/6/1999) relates to co-ordination of regional development activities, preparation of plans and monitoring of activities. Unfortunately, the issue of the role of Managing Authority of the SF, immediately or after Accession, is not mentioned, and this causes uncertainty in the interpretation of the NARD’s role by the Slovene administration, and even within the MoE¹⁰⁵. The draft National Development plan (11 November 1999) assigned to NARD a many-fold role covering, inter alia, the task of establishing a methodology for preparing regional development strategies. However, co-ordination and co-operation between NARD and other department of the MoE is weak and has caused serious delay to the implementation of Phare programmes covering SME Development at regional level¹⁰⁶. No Operational Plan covering the activities to be carried out by the Regional Development

¹⁰³The financial support provided by the Municipalities can also take the form of non-banking scheme. An example of good practice is provided by the scheme managed, without bank intermediation, by the SME Development Centre Goriska. The Centre has been active since 1992 and has always proved to be efficient and flexible in supporting the needs of SME. The available annual fund is however limited to 2.5 M€

¹⁰⁴ Institute for Entrepreneurship and Small Business Management: “Slovene Entrepreneurship Observatory 2000”, Maribor, December 2000.

¹⁰⁵ OMAS: Interim Evaluation Report, R/SL/REG/01035, 10 August 2001.

¹⁰⁶ OMAS: Interim Evaluation Report, R/SL/REG/01035, 10 August 2001.

Agencies, with specific reference to activities aimed at SME development, has been approved. The Chamber of Commerce and Industry and the Chamber of Craft provide support to the SME through its network of 13 regional Chambers of Commerce and Industry as well as with the network of 62 Regional Chambers of Crafts. The Chamber of Commerce and Industry is responsible for providing assistance to the Medium sized enterprises with more than 50 employees, as well as enterprises dealing with High Tech, Manufacturing, Trade and Services. The activities of the Chamber of Crafts are limited to the Craft activities. The Network of Business Support Services mainly provides two kinds of measures for SME, on the basis of the “Voucher” system¹⁰⁷: “Hard measures” (financial support and premises for incubators, technology parks and enterprises zones) and “Soft measures” (information, advisory and consulting services, training, etc.). The Government has co-founded Regional Entrepreneurship Centres¹⁰⁸ which, apparently, are not embedded into the Small Business Development network. The Centres have the basic purpose of decentralising promotional and development activities and developing programmes, as well as ensuring more effective co-ordination of local centres. Since March 2001, the MoE has launched the “Entrepreneurship Forum”. The Forum establishes a partnership between the MoE and Slovene companies in defining economic policies that would stimulate the competitiveness of the companies. Since March 2001, three Forums were organised, the first one focusing on technological innovation. Three Technology Parks have been established over the past few years to support access to R&D and innovation and are organised in a different manner. The Ljubljana Technological Park is a mixed private-public company, the Styrian Technology Park is public agency owned company with its own premises (built with Phare support under the CBC Austria/Slovenia), and the Primorsky Technology Park is a newly grown mixed public-private owned company with a network tendency. The development of incubators lags behind and the innovation-related activities have practically ceased. To further support innovation, the government promoted the establishment of the “Small business innovation network”. This is a new initiative to link together all the regional development agencies, regional and Local Development Centres. It is not clear what role is left for the SBDC. Slovenia is carrying out a “Cluster Development Programme” which promotes enterprise networking and co-operation in product development, technology improvements, joint marketing and specialisation in the supply chain. Three sector of activities have been chosen: Automotive, Transport and Tool-making.

The implementation of the Phare Programme.

Phare assistance to the sector totals 3.65 M€, of which 1.6 M€ was allocated under earlier general technical assistance programmes. A wide range of actions aimed at SME development have also been funded under Phare Cross-Border Co-operation (CBC) Programmes with Italy and Austria¹⁰⁹. The Wider Objectives of the latest programmes support the integration of Slovenia into the EU, and a transformation into an internationally competitive market economy, to be achieved through the restructuring of the industrial base, and the development of the private sector. The Immediate Objectives focus on the establishment of an effective and efficient advisory support service to SME, as well as financial assistance. However, the design took no account of the existing Slovene SME network. Although the design of the Programmes was approved by the Slovene Government and the European Commission, the institution building activities were to a large extent carried out in isolation from the existing

¹⁰⁷ The Voucher Model is a tool by which the government subsidises information and advisory services. In 2000, the system was implemented at two pilot centres. The system supported 91 persons, out of which 23% were entrepreneurs operating within existing companies and 77% potential entrepreneurs.

¹⁰⁸ CC BEST: Questionnaire for Slovenia, 2000

¹⁰⁹ See OMAS Consortium Reports: R/SL/CBC/99095 dated 11 August 1999, R/SL/CBC/99096 dated 13 October 1999, and R/SL/CBC/00083 dated 7 February 2001.

national network. The Regional Micro and Small Enterprises Financial Scheme was designed with over-ambitious objectives in relation to the resources allocated, and with an unattractive interest rate. A large proportion of the Wider Objectives were not achieved, and were unlikely to be achieved in the medium term, in particular, the support for the integration of Slovenia into the EU, and the transformation into an internationally competitive market economy by restructuring of the industrial base. Activities addressing the Immediate Objectives of establishing an effective and efficient advisory support service to SME had limited results, but even these were not sustainable in the medium term because they were carried out in isolation from the SME network. The NPAA identifies a number of short and medium term sectoral priorities. The short-term priorities concern progress in the adoption of the sector legislation, as well as the definition of an SME in accordance with the EU. The medium term priorities address a wider range of actions aimed at strengthening SME competitive advantages. Phare has contributed to the overall AP priority measure of promoting the development of SME. The Phare approach neglected the important aspect of the approximation of legislation, which was considered a short-term priority in the NPAA, and for which no specific assistance was requested by the government. The Phare Micro-Credit Scheme was unlikely to be sustainable due to the lack of plans to replenish it in the medium term. With regards to institutional capacity to support the SME development, there was a need to bring together into a coherent network, a number of existing institutions, ensure co-operation among them, and transparency of work. Phare assistance to the sector has proved to be not effective.

The effect of Phare Programme on SME development

No Phare assistance was specifically conceived to support the simplification and improvement of the business environment through the strengthening of the existing structure(s) or via the setting up of institutions specifically dealing with this important aspect of SME development. As a consequence, Phare assistance has had no significant effect on the business environment. No assistance was designed to support SME policy development and, consequently, no effect has been observed. No assistance was conceived to address the weaknesses of the SME financial environment in Slovenia under SME policy development, and there are no improvements of the financial environment for SME. Limited Phare funds (1 M€) were utilised by the Direct Financial support to SME, for the design of a Micro and Small Enterprises Financial Scheme to support productive investments in small and micro sized enterprises. However, the interest rate offered by the Scheme was not competitive with alternative sources of finance. The Phare support has been delivered in isolation from both the SBDC and the Small Business Development Fund, raising serious doubts about the relevance and sustainability of the support. The effect has been negligible. Under the measure Institutional Building, the limited assistance provided by Phare has been carried out in isolation from the existing network developed to support the SME with information and counselling (SBDC). No activity was specifically designed to promote research and development as a tool to be developed by an existing organisation, but a minor effect has been registered after assistance to the TIPO organisation. Under the Phare CBC Programme with Austria, a Technological Park was established but the support was limited to building the facility. Overall, no significant effect has been observed for the enhancement of competitiveness and internationalisation as a consequence of Phare support. No assistance has been designed to support the existing SME network (the Small Business Development Centre). Phare assistance was given to help the Chamber of Economy identify its role in the pre-accession strategy, and to develop a four-year action plan. However, the output was considered by the Chamber to be too general, and was only used as a basis for an internal study. Not having supported the existing SME network the Phare assistance has had an adverse effect in respect of the

enhancement of co-ordination of bodies and organisation supporting the SME development, and too little has been done by Phare to promote entrepreneurship at regional or local level.

The readiness in utilising SF for SME development

An integrated approach, with actions selected to contribute to a common objective, such as combating industrial decline, in particular with SF type measures, linked with interventions to promote the business environment has not been developed. Geographical coverage at the level deemed most appropriate by the CC but with the NUTS II level as the minimum, with the possibility of focusing on areas with specific and severe problems, has not been established yet. A Managing Authority, firstly in view of EDIS, and eventually to comply with SF requirements has not been selected and NARD is not fulfilling its overall co-ordinating role effectively. Slovenia has not yet approved a National Development Plan to underpin both multi-annual programming for ESC projects financed from Phare 2002-06 and the preparations for Structural Funds.

The main challenges to be faced, in the near future, by the SME sector in Slovenia.

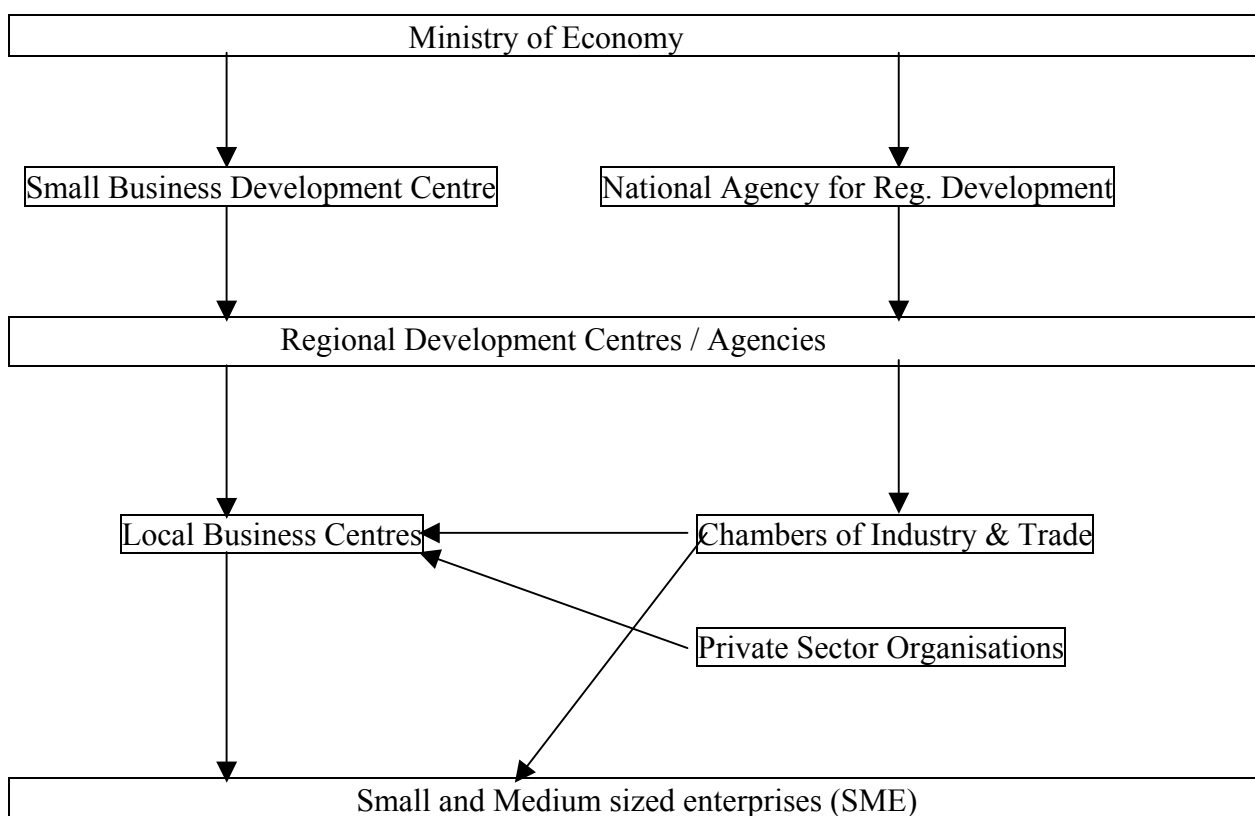
| Challenges to be faced by Slovenia at enterprises level. | Challenges to be faced by the Slovenian Government. |
|---|--|
| <ul style="list-style-type: none"> • Being able to face the competitive pressures in the single market, particularly in relation to the presently very low added value per employee in comparison with the average EU data. • Coping with a fast changing legal environment, meeting the requirement of the <i>Acquis Communautaire</i>. • Gaining better access to information and high quality support services. • Upgrading management skills in order to increase efficiency and promote entrepreneurship. • Enhancement of the growth and competitiveness of the sector in a “knowledge-based” internationalised economy. • Integrating supply chain networks and improving export-related marketing skills. • Making their voice heard by authorities through the development of more effective business associations capable of representing the interests of the entrepreneurs through effective lobbying. | <ul style="list-style-type: none"> • Simplification and improvement of the administrative and regulatory framework through the Implementation of the “Anti bureaucratic programme”. • Complete structural reforms necessary to further restructure enterprises and to create a dynamic SME sector. • To give businesses easier access to Community support services, programmes and to improve co-ordination of these facilities. • Ensuring the commitment of all the existing institutions supporting SME in joint efforts to ensure a more effective co-ordination in order to provide better services to SME. • Improving horizontal factors of competitiveness, such as entrepreneurship and management education, or development of a more friendly taxation system for the sector. • Closing the gap between national and regional skills in planning development programmes, with specific attention to the readiness in utilising SF upon Accession. • Improvement of the financial environment for SME, granting better access to credit for SME development and/or start-up or innovation. |

Recommendations

1. The MoE should establish a more effective system to ensure adequate co-ordination between its various departments addressing SME development.
2. The MoE should verify the soundness of the measures planned, within the forthcoming NDP, to further develop the SME sector.
3. The Anti-Bureaucratic Programme is a highly innovative and necessary tool to overcome some of the main hurdles hampering development of SME. Implementation is proceeding at a too slow pace and the MoE should explore, with the European Commission and the Government Office for European Affairs (GoEA), whether technical support could be provided under the Phare Programme, and/or the Multi Annual Programme designed by the DG Enterprise to support SME development in order to support its implementation.

4. The MoE should carry out a survey of the current taxation system in order to define measures to simplify and make the existing taxation system for SME more friendly (taking account of the Internal Market Chapter of the acquis).
5. Access to finance available should be reviewed in order to explore (taking advantage of the conclusions of the IV Round Table with Bankers) a better way to support the SME sector. Specific attention should be paid to defining instruments that, with the eventual support of the SF, could better support start-up, seed capital and other non-banking activities supportive of SME. Specific emphasis should be placed in developing a more efficient system of Guarantee Schemes.
6. The EBRD/ Phare SME Facility has failed to materially support SME and has only proved to be of financial and technical support for the two State-owned participating banks. Very little is known about the way the facility is implemented and the MoE and the European Commission should advertise the relevance of the Facility.
7. Under the Anti bureaucratic Programme, the MoE should consider the political and technical measures needed to address a "one-stop-shop", not limited to information but providing also administrative support, to provide information on the services made available to SME. In this respect, the SBDC should explore, together with the MoE and GoEA any specific needs to be addressed by the European Commission.
8. The readiness for utilising the SF is questionable. The MoE should, as a matter of urgency, appoint, and endorse with the necessary authority over the other administrations, an effective Management Authority. The MOE should request NARD to prepare a plan to ensure the effective utilisation of the SF as a tool to support the further development of the SME sector.

Slovene "Small Business Support Network"



Annex 10. Nine Key Objectives for the *acquis communautaire* for SME Development

1. Financial support for the development of the small business sector.
2. Strengthening the dissemination of information, consultancy and training in small business units, establishment of an information system for SMEs, supporting innovations, technological development, promotion of quality, training in the field of internal relations in small businesses.
3. Supporting internationalisation of small business activities, integration of small business into international markets, and co-operation among small businesses, and between small and larger enterprises in CEEC and abroad.
4. Creating an environment, which stimulates the development of entrepreneurship among special target groups, on farms and in underdeveloped regions.
5. Encouragement of rapidly growing export-oriented and technologically advanced enterprises.
6. Analyses of the adaptability of small business in various sectors for integration into the EU, supplementing strategic directions of small business development, and supplementing the institutional support of small business at the national, regional and local levels for activities within the EU.
7. Introduction of financial instruments supporting small business and influencing regional development.
8. Introduction of infrastructure projects, systematically planned development of areas intended for business activities, and for regional development.
9. Transfer of EU instruments for SME support at the national level; establishment of mechanisms for the transfer of *acquis communautaire* into enterprises.

Annex 11. Status of Implementation of the Phare-EBRD SME Facility

Loans Window

So far agreements have been established for the management of the Loans Window with financial intermediaries in Bulgaria (*Unionbank Commercial Bank Ltd*) – Czech Republic (*Ceska Sporitelna a.s.*) – Estonia (*AS Sampo Bank - formerly AS Optiva Bank*) – Latvia (*Unibanka*) – Lithuania (*Siauliu Bankas AS*) - Poland (*Bank Slaski SA; Bank Zachodni; Pekao SA; PPA Bank; WBK*) – Romania (*Banca Comerciala Romana; Banca Transilvania*) – Slovenia (*Banka Koper dd, Nova Kreditna Banka*) – Slovakia (*Vseobecna Uverova Banka*).

Equity Window

SME funds have been established in the Czech Republic (*GIMV n.v.*) and Hungary (*ABN Amro – Capital Hungary Kft*).

Annex 12. List of Interviews

| Persons Interviewed | Date | Phone/Fax |
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