

STABILITY PACT

**SOUTH EAST EUROPE COMPACT FOR REFORM,
INVESTMENT, INTEGRITY AND GROWTH**



**SERBIA ENTERPRISE POLICY
PERFORMANCE ASSESSMENT
(SERBIA AND MONTENEGRO)**

Prepared by

**ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT
AND EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT**

MARCH 2003

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The Stability Pact for South Eastern Europe is a political declaration and framework agreement adopted in June 1999 to encourage and strengthen co-operation among the countries of South East Europe (SEE) and to facilitate, co-ordinate and streamline efforts to ensure stability and economic growth in the region. (see www.stabilitypact.org)

The South East Europe Compact for Reform, Investment, Integrity and Growth (“The Investment Compact”) is a key component of the Stability Pact under Working Table II on Economic Reconstruction, Development and Co-operation. Private investment is essential to facilitate the transition to market economy structures and to underpin social and economic development. The Investment Compact promotes and supports policy reforms that aim to improve the investment climate in South East Europe and thereby encourage investment and the development of a strong private sector. The main objectives of the Investment Compact are to:

- Improve the climate for business and investment.
- Attract and encourage private investment.
- Ensure private sector involvement in the reform process.
- Instigate and monitor the implementation of reform.

The participating SEE countries in the Investment Compact are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia, Moldova, Romania, Serbia and Montenegro¹. Building on the core principle of the Investment Compact that “ownership” of reform rests within the region itself, the Investment Compact seeks to share the long experience of OECD countries. It provides region-wide peer review and capacity building through dialogue on successful policy development and ensures identification of practical steps to implement reform and transition.

The work of the Investment Compact is actively supported and financed by seventeen OECD member countries: Austria, Belgium, Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Norway, Sweden, Switzerland, Turkey, United Kingdom and United States. (see www.investmentcompact.org)

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This report is an output of one of the Regional Flagship Initiatives of the Investment Compact for South East Europe, a key component of Working Table II of the Stability Pact. It has been jointly produced by the OECD and EBRD with the expert advice of local consultants. The main authors of the report are Ricardo Pinto (OECD), Francesca Pissarides (EBRD) and Peter Sanfey (EBRD). Background research and support was provided by Slavica Penev (Economics Institute, Serbia and Montenegro) and Milica Travica (Economics Institute, Serbia and Montenegro), who provided the first draft. The report was initiated and has benefited significantly from input and comments from Declan Murphy, Programme Director of the Investment Compact (OECD), Antonio Fanelli, Principal Administrator (OECD, Investment Compact). Jim Bourke (consultant, Ireland) has provided expert guidance on the report.

The assessments and views expressed in this report are those of the Investment Compact Team of the OECD secretariat and the EBRD Office of the Chief Economist and do not necessarily reflect the views of the institutions participating in this enterprise policy performance assessment or of OECD and EBRD Member countries.

NOTE

1. On 4 February 2003, the Yugoslavian Parliament adopted a new constitution for a state union called Serbia and Montenegro.

FOREWORD

Starting a business in today's environment brings opportunities and challenges. New lifestyles demand greater choice of products and services. New technologies and greater access to global markets have provided increased business opportunities. At the same time increased competition, insistence on quality and unremitting pressure for lower costs, just to mention some issues, represent major challenges for business. For Small and Medium-sized Enterprises (SMEs) the challenge is greater. They lack scale, resources and the capacity to handle complex business management. Typically, less than half survive more than five years and only a small proportion go on to become large companies. How to ensure the growth of the SME sector – a fundamental feature of all developed and growing economies – is a major policy challenge for all countries.

This Enterprise Policy Performance Assessment (EPPA) on Serbia (Serbia and Montenegro) seeks to help address that challenge. SMEs are a vital source of new jobs, exports and economic contribution to countries. The South East Europe (SEE) Compact for Reform, Investment, Integrity and Growth (Investment Compact), a key component of the Stability Pact, has consistently affirmed that the economic revitalisation of South East Europe is primarily dependent on private sector investment. Through the Investment Compact process, Stability Pact partners support and promote the structural policy reforms that will improve the climate for private enterprise and increase investment. Entrepreneurship and enterprise development are important elements in creating dynamic market economies. Notwithstanding measurable progress in various areas, the report shows that the environment for creating and sustaining businesses remains underdeveloped in Serbia. Reforming and improving the environment for entrepreneurship is a priority.

The EPPA draws on the practical experience and views of Serbian SME representatives, expert advisors and the complementary experience and skills of the Organisation for Economic Co-operation and Development (OECD) and the Office of the Chief Economist of the European Bank for Reconstruction and Development (EBRD), two Stability Pact partner organisations that have been closely involved in the reform process in transition countries.

The analysis and assessments made in this report provide valuable insights into the key issues confronting the government in Serbia, based primarily on research with SME owners and managers. The Stability Pact, through the Investment Compact for South East Europe, will continue to contribute to establishing this framework in Serbia and in the region as a whole through regular up-dates of the information contained in this report.



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CONCLUSIONS AND RECOMMENDATIONS

1.1. Summary Conclusions

The Serbian authorities have decisively embraced far-reaching economic reforms and these are in the process of being implemented. In recent years the Government and its agencies have provided greater support to the SME sector in recognition of the growing importance of SMEs for the national economy. This political support is manifested in recent developments such as:

- Creation of the Agency for SMEs and Entrepreneurship (ASMEE) and associated regional offices.
- Formulation and approval of a National SME Development Strategy.
- The formation of the SME Advisory Board (SMEAB).
- Provision for financial support to SMEs, including tax incentives.

This Enterprise Policy Performance Assessment (EPPA) highlights a number of issues, based on the private sector perspective, which the OECD and EBRD present to the Government's attention. It identifies a number of actions that could be taken to build further on the progress already made in improving the policy environment for SMEs.

In Serbia there is a relatively strong and continuous tradition of private sector activity. However, there currently is a worrying lack of dynamism in the small business sector. Sixty per cent of SMEs date from before 1992. There is continuing stagnation, or even decline, in the overall number of SMEs and there is low output and employment in the Serbian SME sector compared to OECD countries (OECD, 2003, p.15). This is reinforced by a fiscal and regulatory system that is not yet sufficiently attuned to stimulating SME development.

In overall terms, this study finds that the Government of Serbia and ASMEE, in consultation with the private sector, needs to renew and strengthen the efforts to ensure effective implementation of new policies to support the growth and development of SMEs. In line with the experience of other countries at this stage of transition, there are issues emerging relating to the availability of resources, the degree to which the needs of the SME sector are being taken into account and the practicalities and pace of implementation of policies to underpin SME development. It will take a determined effort to ensure that implementation is kept on track and momentum maintained.

Some of the practical problems include difficulties in:

- Communicating and consulting effectively with SMEs throughout the country.
- Co-ordinating the activities of the various bodies working to support SME development.
- Rapidly reducing complexity and ensuring coherence and consistency in policy, laws, regulations, procedures and support programmes, particularly between fiscal and development policies.
- Avoiding unnecessary changes in laws, regulations and programmes to facilitate planning of investments.

As stated in a recent OECD report (2003, p.16), the priority for the national authorities should be to reduce the administrative and fiscal burdens on the SME sector rather than trying to design special assistance

programmes to compensate for regulatory and fiscal difficulties. Only when a regulatory and fiscal environment favourable to SME is in place, can incentive programmes carefully tailored to the needs of SMEs play an important role in fostering development, as in other OECD countries.

1.2. Performance assessment Recommendations

The Institutional Framework for SME Policy

The approval of the National Strategy for the Development of SMEs and Entrepreneurship (2003-2008) in January 2003, together with the assignment of responsibility for SME policy implementation to a dedicated agency for the development of SMEs and entrepreneurship (ASMEE) confirms the Government's commitment to supporting the development of the SME sector.

The new institutional structure is evolving in a broadly satisfactory manner. There are still issues to be considered in relation to aspects such as:

- Implementation of the SME National Development Strategy.
- Inter-ministerial co-operation and co-ordination.
- Lack of information on ASMEE's activities in the SME sector.
- Financial sustainability of ASMEE and its regional network.
- Degree and type of consultation with SMEs.

Financial stability for ASMEE and the Regional Network

- Secure and stabilise the medium term future of these organisations through a mixture of national and international resources. Having invested in the policies, strategies and institutions at national and regional level, the Ministry of Economy should take the lead in ensuring financial stability for these institutions.
- Having approved the National Strategy for the Development of SMEs and Entrepreneurship (2003-2008), the Ministry of Economy should work to ensure the provision of adequate financial support for the effective implementation of the strategy.

Inter Ministerial Co-ordination

- Implement an Inter Ministerial Group on SME Policy, co-ordinated by the Ministry of Economy and including key Ministries such as Finance, to ensure that the needs of small businesses are fully considered in national policy-making. The disparate nature of SME policy-making and the limited degree of co-ordination that takes place make this an issue worth further consideration.

SME data and analysis

- Co-operate with the statistical office and relevant Ministries in order to systematically collect statistical information on the SME sector in order to analyse the underlying trends and determine appropriate policy responses. There is currently a notable data gap on SMEs in Serbia.
- Monitor the implementation of the National SME Strategy on a regular basis in order to ensure that it is proceeding as anticipated.

Communication with SME Stakeholders

- Communicate and consult with SMEs on Government policies and strategies by developing more representative, regular and permanent mechanisms for dialogue between Government and the sector.
- Strengthen the SME Advisory Board (SMEAB) to enable it to become a regular forum of communication and consultation with a wider range of SME stakeholders than is the case at present. Adequate

resources need to be devoted to this mechanism in order for it to be seen as an effective Government-SME stakeholder forum.

- Facilitate ASMEE's mandate to work closely with the organisations active in the SME field and to co-ordinate national efforts to develop SMEs by building effective co-operation between the key SME stakeholders and disseminated information through web sites and fora to ensure that SMEs are aware of the latest developments and can provide feedback.

Rule of Law and the Regulatory Environment

Administrative barriers pose a great obstacle to business development. The research suggests that is little awareness of efforts underway to reform the regulatory environment as it affects SMEs. The establishment of the Inter Ministerial Working Group on Reducing Administrative Barriers to Business is to be welcomed. However, the initiative seems to have been slow getting off the ground and SMEs will have to see beneficial effects on the ground, if they are to be convinced of the Governments seriousness in addressing these administrative barriers.

Registration, De-registration, Re-registration

- Implement an electronic firm registration system in Courts covering the whole country.
- Introduce a single code number for each enterprise, in order to save time and costs to entrepreneurs submitting the same basic information to different bodies.
- Evaluate, simplify and publish the regulatory regimes that affect the setting-up phase of businesses. The same applies to procedures for re-registering and terminating enterprises.
- Move towards the creation of a "One-Stop-Shop" system throughout the country, as in the case of other SEE countries such as Romania (see OECD-EBRD, 2002).

Regulations

- Develop and disseminate a check list of improvements that can be made to further eliminate, reduce or standardise the complexity of procedures for SMEs obtaining licenses, permits and certificates and setting predetermined short time scales for each procedure.
- Progress the proposed reforms pioneered by the Inter-Ministerial Working Group on Deregulation in close co-operation with ASMEE. SME stakeholders should be consulted before proposals are converted into law. The Working Group requires sufficient resource and capacity to recommend reforms and monitor implementation.
- Take steps to ensure a greater focus on a "proactive" and "enabling" approach by introducing the principle of "silent consent" as soon as practical ("silent consent" is where if the relevant public body fails to answer within a prescribed period, it will be deemed that consent has been given).

Tax Policy for Small Businesses

Tax policies and tax administration are considered by entrepreneurs to be key impediments to SME development in Serbia. The main issues relate to perceived high tax burdens, the frequent changes and lack of information dissemination, communication and consultation between Government, the tax administration system and entrepreneurs and the relative ease with which taxes can be avoided. The tax system is seen as impeding job creation and investment.

The main changes to the tax system that small enterprises would like to see introduced in Serbia include greater simplicity in the number of taxes, a crack-down on tax evasion, fair and consistent enforcement of tax legislation and administrative rules, etc.

Policy Principles

- The Ministry of Finance and the Ministry of Economy, in co-operation with the ASMEE and SMEAB, to work together to ensure that:
 - Simplicity, stability and clarity are achieved in tax policy.
 - The fiscal administration is made much more sensitive to the needs of the SME sector.
 - Tax laws and regulations are consistently and fairly enforced.
 - The process of amalgamation of taxes is continued.
 - Consultation with SMEs or their nominated representatives on tax issues is carried out regularly.
 - SMEs are able to obtain regular, simple and up-to-date information explaining the tax system.

VAT

- Introduce the VAT as soon as practicable (planned for the 1 January 2004).
- Design the VAT refund period to facilitate cash flow, using the international standard of one month.

Grey Economy

- Widen the tax base as an important means of fighting tax evasion. The introduction of VAT will be an important step in this process, since experience elsewhere in SEE indicates that it disincentivises informal entrepreneurial activity.
- Strengthen efforts to collect arrears, regardless of firm size.

Financial Instruments for Fostering New and Small Businesses

A healthy, profitable financial sector is the key pre-requisite for providing access to finance for SMEs on a sustainable basis. Profitable private financial intermediaries are the necessary link between domestic savings and investment by private sector enterprises, in particular SMEs, and the only way to ensure sustainable SME access to finance and other financial services. Reflecting the perception of the private sector, the aggregate data on the banking sector shows an extremely low degree of intermediation. Coupled with the extreme underdevelopment of the non-banking financial sector, this leaves micro-finance programmes and dedicated credit lines as the major formal source of external finance for the SME sector. New sources of finance for the SME sector such as leasing can prove to be an important stop-gap tool while bank sector restructuring progresses.

Bank-lending

- As a main priority, the National Bank (NBS) should reduce the 50% minimum reserve requirement for foreign currency denominated (forex) bank deposits.
- Take measures to improve access of banks to commercially-costed medium-term finance for on-lending, and improve ability of banks to assess medium-term risk. Measures that would help meet these objectives include allowing banks to lend in foreign currency and creating a credit information bureau, possibly under the auspices of the NBS initially. This can put pressure on the banks to sign-up for it and share information. Donor funding would be required for this purpose.

Non-bank lending

- Given the extremely low level of bank lending to the enterprise sector and the even lower level of bank lending to micro enterprises and start-ups, the central bank should allow non-depository credit organisations dedicated to lending to micro enterprises and start-ups to be set-up, at least as an interim measure. The central bank does not currently allow any lending to enterprises except through banks, thereby dramatically limiting the credit available at the bottom end of the market and to start-ups. The authorities should allow non-bank institutions to provide finance to the smallest entrepreneurs and to start-ups.

Legal reform

- Pass a number of urgently-required laws. These include the secured transactions law (due April/May 03), implementation of the registry for movable and intangible collateral, completion and approval of the leasing law (due April/May 03) and implementation of a registry for leases which must be closely linked to, or possibly part of, the collateral registry.
- Improve the regulatory conditions for and taxation of leasing. Leasing as a means of providing finance for productive equipment helps enterprises in the context of unavailability of bank finance and supports the recovery of investment and production. Providing that the ruling legislation allows recovery of the asset, it substantially reduces the risks to the lessor of operating in what would otherwise be considered a volatile and difficult environment in which to do business. The Government has the power to support the development of leasing activities, since the sector is very sensitive to its tax treatment and the protection of the rights of the lessor to recover assets when the lessee defaults on payments.

Advisory Services Supplied to New and Small Businesses

There is satisfaction with the range and quality of bookkeeping / accountancy and legal services currently provided by private consultancy firms. However, the range and quality of publicly funded business advisory services is regarded as poor and not focused on the needs of smaller enterprises. Private consulting firms that advise on the preparation of business plans tend to offer very standard packages that do not sufficiently take into account the needs of individual firms. Small enterprises have difficulties in accessing the Chambers of Commerce services and consider this compulsory service to be poor value for money, resulting in a common belief that SMEs should set-up other associations to represent their interests.

ASMEE and Network

- National policy to continue prioritising provision of support to SMEs, especially start-ups, through subsidised business support services in order to deal with market failure.
- Work towards achieving financial sustainability as soon as possible. ASMEE should formally review its regional network by the end of 2003 with a view to assessing sustainability and deciding how the range of services should be developed into the future to provide best value to SMEs.
- Strengthen capacity to support SMEs through provision of resources to train existing staff and hire qualified expertise. ASMEE and its regional network (as well as regional and local authorities) are the key organisations responsible for developing and implementing SME policy. However, they are relatively inexperienced in the area of enterprise policy and development, such as customer relations, research, policy formulation.
- Link national and donor financial support to business centres and regional development offices directly to the quantity and quality of the services provided to SMEs. A programme evaluation scheme should be established to provide the necessary feedback.

Quality and Accreditation

- Introduce a system of certification and accreditation of business advisory bodies to set standards and improve confidence in, and quality of, the services.
- Develop and publish a customer charter in each ASMEE regional office, setting out the range of services provided and the standards that will be adhere to.

Representative Bodies

- Evaluate the role of the Chamber of Commerce with regard to such issues as: nature of membership, organisational structure, linkage with Government institutions (e.g. information dissemination at branch level), etc.

Business Incubators

Very few of the SME participants in the research had heard of business incubators and none had had any experience with them. The Government is interested in encouraging their development and has initiated the drafting of a law enabling their establishment in Serbia. The National SME Strategy makes provision for the development of business incubators, but apart from suggesting ASMEE encourage their development, it does not spell out a strategy for their implementation. Only one business incubator initiative seems to be underway and development seems to be partly constrained by the fact that academics are prohibited from working in private companies.

- Promote the role of business incubators to Serbian entrepreneurs.
- Lift the prohibition on academic staff working in organisations such as business incubators.

Chapter 2.

INTRODUCTION

Private investment by Small and Medium-sized Enterprises (SMEs)¹ is a key generator of economic growth and social change in OECD member country economies. In most countries world-wide over 90% of all enterprises are SMEs. It is now widely accepted that the contribution of SMEs to new jobs, exports, innovation, competitiveness and regional development is vital to national development. How to benefit from and maximise this contribution is a continuous challenge for all countries. It is a particular challenge for countries undertaking the transition to full market economies

Economic development generally, and enterprise development specifically, depend first and foremost on the individual ideas, drive and initiative of entrepreneurs. However, the State has a fundamental role to play in providing a favourable framework and environment for private sector development in OECD member countries. In transition economies in South East Europe (SEE), where private investment levels lag behind those of developed countries, the necessity to create this enabling environment for SMEs and private investment is even more urgent. Reform of the business and investment environment for the SME sector leading to the creation of a dynamic entrepreneurial culture is crucial to drive the process of change in industrial structures and transition to market economy structures. Improving competition, innovation and strengthening the service sector, will generate employment growth, absorb unemployment due to restructuring and help build-up the tax base.

The OECD and the EBRD have undertaken a series of Enterprise Policy Performance Assessments (EPPAs) in all SEE countries in order to provide insights into the performance in developing the potential of the SME sector. This Enterprise Policy Performance Assessment seeks to assess progress in creating a supportive business environment for SMEs in Serbia and highlight issues that require attention and priority action. A major emphasis has been to elicit the views of SMEs and in particular obtain their practical experience and perceptions of the key barriers to business and new investment and assessment of progress in implementing policies to encourage the development of SMEs.

Previous OECD research has identified six broad dimensions of the framework and environment for supporting SME growth and development, which are particularly important for Governments to get right:

- Institutional framework for SME policy.
- Rule of law and the regulatory environment.
- Tax policy for small businesses.
- Financial instruments for fostering new and small businesses.
- Advisory services supplied to new and small businesses.
- Implementation of business incubators.

This EPPA for Serbia provides a qualitative “snap-shot” of the SME perceptions of the business and investment environment measured against the above six dimensions of good practice. It takes into account other OECD and EBRD studies, such as the Economic Survey of FR Yugoslavia (2003) and the Country Strategy (EBRD, 11 June 2002, <http://www.ebrd.com/country/index.htm>) and presents views on performance and progress made. It highlights issues and recommends actions to make further progress.

This report will be up-dated on a regular basis, thus allowing a fuller picture of progress to be developed over time. The methodology employed in the assessment is set out in box 2-1 below.

Box 2-1. EPPA Methodology

- I. The EPPA methodology has been designed to provide insights and assessments of the performance in the *implementation* of policies to improve the investment environment for business. The EPPAs have been conducted on a standard basis in all countries of the region and provide a benchmark for (a) highlighting key reform issues (b) measuring private sector insights and assessments of the business environment (c) assessing progress on a country by country basis and (d) comparative cross-country review for the SEE region. Given the very different policies, strategies, institutions, regulatory environment, etc. in Serbia and Montenegro, it was necessary, from a policy perspective, to separate out the analysis into discrete elements. Separate reports were prepared for Serbia and Montenegro, allowing the differences between the two systems to be examined.
- II. The main components of the EPPA undertaken in Serbia are as follows:
 - A question template was derived from extensive case study work on good practice in transition economies and OECD country experience (OECD-UNIDO, 1999) and used in the research.
 - Country-based experts/consultants were selected for their enterprise policy knowledge and experience.
 - Focus group research: focus group discussions were held with SME representatives.
 - Individual SME interviews: to validate the focus group research and to provide insights on key issues.
 - Expert interviews: to cross reference information from the focus groups and contribute to views.
 - Desk research: examination of existing reports, databases, documents, etc. for Serbia.
 - Expertise from OECD, EBRD and experts from OECD countries.
- III. Under the guidance of OECD, the focus group research with the private sector in Serbia was carried out by local consultants, *Economics Institute*, using a structured brief and template of questions developed by OECD and EBRD. The focus group research commenced in mid-2002 and other interviews and desk research extended into the second half of 2002. It focused on six dimensions of good practice in the following policy areas:
 - The Institutional Framework for SME policy.
 - Rule of Law and the Regulatory Environment.
 - Tax Policy for Small Businesses.
 - Financial Instruments for Fostering New and Small Businesses.
 - Advisory Services Supplied to New and Small Businesses.
 - The Implementation of Business Incubators.
- IV. Three focus group discussions took place in Belgrade, Central Serbia, Vojvodina and South Serbia. In all, 22 entrepreneurs took part in the detailed discussions, covering manufacturing and services, with some trade-oriented companies. The participants included representatives of micro, small and medium-sized companies, ranging from start-ups to well established firms. Standard templates were used for discussion and ratings.
- V. Individual interviews with 12 SME owners and managers and local SME experts were carried out, allowing for a wider perspective than the focus group discussions and to cross-reference the information that was obtained in the focus group discussions. The same template of questions/ratings was employed as for the focus group research. Representatives of 6 SMEs, as well as 6 institutions, including the Centre for Economic Development, Faculty of Economics and legal/tax experts took part in the research.

Box 2-1. EPPA Methodology (cont.)

- VI. The findings from the focus groups and interviews obtained through the procedure detailed above were complemented with additional information provided by the EBRD and OECD economic survey for FR Yugoslavia (see Appendix 1). The EBRD's Office of the Chief Economist has assessed progress in structural and institutional reform across the region since 1994. The EBRD jointly with the World Bank launched the Business Environment and Enterprise Performance Survey (BEEPS) in 1999. The BEEPS asks enterprises to evaluate economic governance and state institutions and assess the extent to which the business environment creates obstacles to the operation and growth of their businesses. In 2002, a second stage of the BEEPS was undertaken, surveying close to 6.000 firms across 26 countries of the region. An OECD survey of 404 SMEs was conducted in May 2002 as part of an economic survey of FR Yugoslavia. This survey, undertaken by the Economics Directorate of OECD, provided valuable additional insights and information.
- VII. The analysis in this EPPA is based on the methodologies described above (focus group research, expert interviews and secondary data collection) and is complemented by the EBRD assessment and the BEEPS 2002 results. All information has been analysed by the OECD and EBRD, resulting in the assessment presented in this EPPA.

NOTE

- I. The notation SMEs and small enterprises in this report also includes micro-enterprises, which according to the EU definition (http://europa.eu.int/comm/enterprise/enterprise_policy/sme_definition/index_en.htm) are independent enterprises with up to 9 employees and whose turnover or balance sheet asset value are \leq € 2 million. Small enterprises are likewise defined as having between 10 and 49 employees and turnover or balance sheet asset value of \leq € 10 million and medium sized companies as having between 50 and 250 employees and turnover of \leq € 50 million or balance sheet asset value of \leq € 43 million.

VIEWS FROM THE SME OWNERS AND MANAGERS

3.1. Introduction

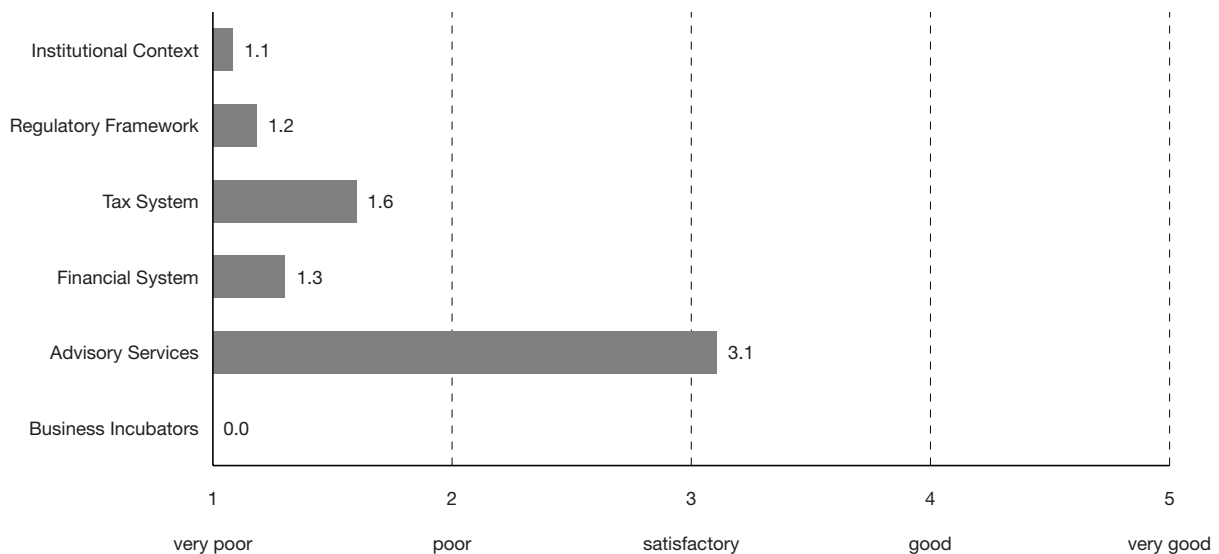
The analysis of the results of the research with the SME focus groups is presented below under six framework dimensions of good practice for the business environment:

- Institutional framework for SME policy.
- Rule of law and the regulatory environment.
- Tax policy for small businesses.
- Financial instruments for fostering small businesses.
- Advisory services supplied to new and small businesses.
- Implementation of business incubators.

The analysis highlights the main issues arising from the discussion with the private SMEs participating in the EPPA research. The key questions dealt with in the focus group research are summarised at the beginning of each section. The average ratings used to represent the views of the entrepreneurs range from 1 to 5 and can be read as follows: 1 = very poor, 2 = poor, 3 = satisfactory, 4 = good and 5 = very good.

The average ratings per dimension of good practice are highlighted in figure 3-1. In general, the ratings are very low, with the Institutional Context, Regulatory Framework and Tax System all rated close to “very poor”. Business Advisory Services obtained the highest average of rating i.e. “satisfactory”. No ratings were obtained for business incubators since none have been established in Serbia.

Figure 3-1. **Average Ratings of the Six Dimensions of Good Practice by SME Owners and Managers**



Some main points made by the participants during the focus groups are reported *verbatim* and the quotations most relevant to the analysis are highlighted in bold. Each section concludes with a summary of the issues emerging from the research. A separate OECD publication (2003) has recently examined the trends in private sector development, based on a survey of SMEs in Serbia and Montenegro (see box 3-1 for the main findings and appendix 1 for a detailed analysis) and this was referred to in preparing this report.

Box 3-1. OECD Survey of Small Enterprises in the FR Yugoslavia

This OECD survey was carried out in May 2002, the full details of which are provided in the OECD economic survey for FR Yugoslavia (2003, annex tables). Appendix 1 of this report is extracted from that report. The sample population for the survey was all small firms registered with the Commercial Court that had opened a giro account with the Clearing and Payment Service (ZOP) and filed the requisite returns. A random sample of active registered private enterprises was taken from the Uniform Register of Enterprises. The total sample of 404 firms was drawn equally from Belgrade, Vojvodina, Central Serbia and Montenegro. The sample was also stratified according economic activity: manufacturing, construction, commerce and services. The mean employment for the SME sample was 11 full-time and 1.5 part-time people. The survey technique was face-to-face interviews, using a detailed interview guide. The main findings of the survey were (2003, pp.94-97):

“The evidence presented offers a mixed assessment of small business development in Serbia. On the one hand, existing small businesses seem rather confident of their financial stability and plan to increase turnover in the future. On the other hand, entrepreneurs perceive a deterioration in a number of important elements in the economic and institutional environment for small businesses, including profitability, investment opportunities and tax conditions. Most disturbing is that the sector appears stagnant, with relatively little entry of new firms or exit of old ones. A dynamic small business sector exhibits sizeable rates of entry and failure in a competitive environment, hard budget constraints and rapidly changing market conditions. The legitimate small business sector in the FRY remains quite small by international standards, and the slow pace of private firm creation should be a major cause for concern.”

“The patterns observed in Serbia's SME sector reflect an on-going transition in the sector itself. It has had to shift away from dependence on the subsidised state and social sectors. It is natural that this transition will complicate SME development in the short term, however, it is vital that policy reforms facilitate the sector's transition. This means alleviating some of the administrative burdens of operating a legitimate small business, creating opportunities for the entry of new firms, and defending possibilities for fair competition.”

“The results of the OECD survey, as well as other sources of information, suggest that the low existing level of dynamism in the legitimate small business sector, and corresponding low rate of new firm creation in Serbia, should be a target for economic research and policy in the SME sphere. Future studies should focus on this question in particular, and clarify the existing problems. The simplification of registration procedures may be one critical measure in this area.”

In addition, this chapter presents selected analysis of the Serbian Environment and Enterprise Performance Survey (BEEPS) 2002 survey. The BEEPS is a survey of 250 Serbian enterprises and, like the focus groups, was carried out in 2002. Of these, 203 were considered to be SMEs (of which 42% micro, 33% small and 25% medium-sized) according to the EU definition for employment (i.e. they had less than 250 employees). The results presented in this document refer only to the responses provided by the SME sub-sample. The BEEPS research is based on a sample survey and provides additional insights. The BEEPS analysis is presented in separate text boxes (for example, see box 3-2) and a summary of main results is contained in appendix 2.

In cross-checking with the BEEPS analysis, the picture at the page 17 is broadly confirmed (see box 3-2.).

Box 3-2. Obstacles to Doing Business (BEEPS, 2002)

The entrepreneurs were asked to rate the severity of obstacles pertaining to several aspects of the business environment (the scores can be interpreted as follows: 1 = no obstacle; 2 = minor obstacle; 3 = moderate obstacle; 4 = major obstacle). Three areas of analysis overlap with the areas investigated through the focus groups methodology: regulation, taxation and provision of finance. On average they are rated respectively 1.8, 2.8 and 2.6 (i.e. between minor and moderate obstacles). A direct numerical comparison between the two types of analysis is not possible, due to the very different formulations of questions asked, however, the results are broadly consistent. It should be noted that the BEEPS included other areas of investigation in which obstacles of greater severity were identified, such as crime, land (title and access), labour regulations, etc.

3.2. Institutional Framework for SME Policy

The following issues were researched under this heading:

1. Clear assignment of organisational responsibility for the development of SME policy.
2. The effectiveness of organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs.
3. The quality and effectiveness of the SME development strategy.
4. The local and regional governments' mandate and resources (funding, people and skills) to promote SME development.
5. The information provided and awareness by business people of the Government's institutions, policy and programmes to support new entrepreneurs and develop existing SMEs.
6. The quality and regularity of consultation between Government and the private sector on SME policy and its performance and assessment.

Organisational Responsibility

1. Has clear organisational responsibility for the development of SME policy been assigned by Government?	Yes
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The SME owners and managers participating in the focus group research believe that the Government has demonstrated its readiness to support the SME sector, primarily through the establishment of the Agency for SME Development (ASMEE) and that fairly clear organisational responsibility has been assigned. However, they feel that after more than a year of operation, ASMEE still has not produced significant results and only a few of the entrepreneurs interviewed actually knew that regional offices have been created and are operational. The following opinion can be regarded as typical:

“The Government is making an effort to spur SME development, but we would also like to see some concrete results.”

Issues: SMEs acknowledge that some progress has been made in developing an institutional framework for SMEs in Serbia. There is awareness that the ASMEE has been established but there is little knowledge of the network of regional agencies. However, knowledge of ASMEE's activities and impact is almost non-existent.

Effectiveness of the Organisation/s

2. Rating given to the effectiveness of organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs.	1.0
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The effectiveness of ASMEE, the body created in 2001 especially to assist SMEs, was rated as “very poor” by the SME participants in the focus groups. The SMEs’ view was that government institutions have so far made little or no contribution to SME development:

“... after more than one year of operation, the Agency [ASMEE] has not yet produced any results.”

SMEs do acknowledge that the institutional system is relatively new and they anticipate some improvement in efficiency when the new arrangements settle down. However, based on past experience, they are concerned that there will be a lack of responsiveness and that a high level of bureaucracy will apply. Based on the discussions, SMEs have the impression that the government institutions have inadequate human resources and that people employed in ASMEE are not sufficiently motivated to help SMEs. They argue that if this were to continue, they would be discouraged from seeking help from the new bodies that have been formed.

Issues: There is little confidence as yet in the new Agency set up to support SMEs and entrepreneurs, but it recognised that the system is relatively new and improvements in efficiency are expected in the future. It is important that ASMEE obtains resources to train its staff and to ensure that it can respond quickly to SMEs’ needs.

SME Development Strategy

3. Rating given to the quality and effectiveness of the newly adopted SME development strategy.	1.1
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At the time of the research, only a draft SME strategy existed, which was subsequently approved in January 2003. Most SMEs were not aware that a National Strategy for SME development was in preparation at all. They believed that the Government has not really identified the key problems so that it would not be in a position to formulate appropriate policy responses. They believe that the Government should not consider the development of SMEs separately from the large enterprises, which deal with SMEs through sub-contracting and which are in need of restructuring. Moreover, they are sceptical that Governmental institutions are capable of “**really understanding**” the nature of the problems SMEs face and thus believe that they are unlikely to formulate appropriate policies for the sector.

During the focus group discussions, there was a consistent view that:

- The key problems are caused by the unstable political environment.
- Civil servants obstruct reforms.
- Government focuses on coercive measures, rather than on promotion and incentives to generate successful enterprises.

SME managers and owners appealed to the public authorities to:

“Try to catch-up with our problems, because even the enterprises with good prospects will soon begin to close their doors!”

Issues: Companies were unaware that an SME strategy was being developed. There was also a strong perception that Government policies and measures do not sufficiently take into consideration the needs of the small enterprise sector. There is considerable scepticism that governmental institutions are capable of formulating appropriate policies for the sector.

Local and Regional Governments

4. Rating given to the mandate and resources (funding, people and skills) local and regional government have to promote SME development.	N/A
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SMEs are aware that local authorities often establish secretariats and other institutions to assist SME development. However, they stress that these do not have significant influence on the economic situation. They perceive the combination of lack of human capital and limited financial resources as a problem. They do note that in certain municipalities, efforts have been made to simplify procedures, as is the case, for example, in Belgrade and other large cities in Serbia where some streamlining has occurred to assist businesses.

Issues: Local governments are currently perceived to have insufficient resources and skills for promoting SME development. Some municipalities are making efforts to streamline business registration and licensing procedures, but these are not being replicated throughout the country.

Information and Awareness

5. Rating given to the information provided to business people on government's institutions, policy and programmes to support new entrepreneurs and develop existing SMEs.	1.0
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The information available on government's institutions, policy and programmes to support new entrepreneurs and develop existing SMEs is rated as being "very poor" or practically non-existent. SMEs are unaware of any significant initiatives that ASMEE has taken to promote and publicise its operations:

*"The private sector does not receive much..., beyond general information."
"... the media are my main source of information."*

The common perception among those participating in the research is that ASMEE has not been able to do very much beyond:

"...some limited creation of awareness of its existence and its role and responsibility through the media."

In addition, according to many experts interviewed:

"There are no available data on the economic sectors that have good prospects or on markets where certain products could be competitive."

"There is no general public awareness of a governmental support policy emphasising the importance of SME development."

The participants believe that the Government needs a programme to brief business people about upcoming developments that might have an impact on their operations. For example they believe that many owners of SMEs remain unprepared for the introduction of International Organisation for Standardisation (ISO) standards and the necessary adjustments to their operations. One of the participants suggested that considerable benefits could be achieved from:

"... periodical reporting on current developments in the form of newsletters."

Issues: The representatives of enterprises are not sufficiently familiar with the governmental institutions, policies and programmes supporting new entrepreneurs and develop existing SMEs. There is a lack of dedicated sources of business information and communication.

Consultation between Government and the Private Sector

6. Rating given to the quality and regularity of consultation between Government and the private sector on SME policy.	1.2
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Continuing with the theme of communication, the private sector is convinced that currently no form of direct communication between Government and the private sector exists. There is a strong perception that there is a lack of direct communication between the Government and its agencies leading to:

“... a gap in communication between the Government and the SME sector.”

As a result, consultation with the private sector is very rare and has little or no influence. The only example of consultation that they were aware of, related to roundtable meetings within the Chambers of Commerce. The fact that they had not heard that an SME strategy was being developed and they know of no consultations on the subject, serves to reinforce a lack of trust in governmental structures.

Issues: The representatives of SMEs do not appear to have been informed about the SME development strategy or been involved in a process of consultation. There is a perception that the Government does not make sufficient efforts to acquaint SMEs with its plans and programmes. Consultations between the Government and SME or their representatives appear to be rare.

3.3. Rule of Law and Regulatory Environment

The following issues were researched under this heading:

7. The formalities for new company registration and comment on the process.
8. The procedures for obtaining licenses, permits and certificates necessary for business operations and
9. The existence of a Government approved programme for reducing the legal / administrative barriers for business and rating of the quality and effectiveness of this programme.
10. The efficiency of the programme for reducing the impact of corruption.
11. The quality and regularity of consultation between Government and the private sector / SME policy community on draft legislation and regulations that affect business.

Company Registration

7. Rating given to the new company registration procedure.	1.0
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Every single respondent awarded the lowest possible rating to the registration process, in other words it is considered as “very poor”. There was a common perception that the registration process, involving the commercial court, statistical office, national payment office and local authorities, is very problematic. It is estimated by the participants in the focus groups to take an average of 37 days and is:

“... far too complicated, costly and bureaucratic.”

The minimum requirement capital (\$5.000) for the establishment of certain types of firms is considered to be highly discouraging to the establishment of new firms.

The delays in registration are partly caused by the necessity of court involvement. The basic record keeping and limited IT systems in the commercial courts result in problems such as the same company name being used twice. SMEs believe that is almost impossible to complete the registration process without resorting to lawyers and consultants. Lawyers can play a useful role in finalising the procedures, but their services considerably increase the total costs involved, making them unaffordable to most start-ups.

Issues: The enterprise registration process is considered to be too complicated, involves too much bureaucracy, takes too long and is too expensive. It is considered to be too hard to complete the process without external assistance. The enterprise register is not yet computerised (except for Belgrade) and is perceived to be unreliable.

Licenses, Permits and Certificates

8. Rating of procedures for obtaining licenses, permits and certificates.	1.1
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SMEs and their representatives were in agreement that the procedures for obtaining licenses, permits and certificates for business operations are also “very difficult”. The process is not transparent enough because enterprises often simply do not know which documents should be submitted or which procedures should be followed. The process commonly involves corruption and a high degree of inconsistency in the application of the rules. Public servants have wide discretionary powers in making decisions on often minor issues that affect the issuance of permits, licences and certificates.

The SMEs participating in the research argue that the process takes too long, an average of 24 days for licenses and 31 days for certificates. Obtaining building permits is viewed as being particularly problematic:

“... if it takes one year to obtain a building permit, then there will be unlicensed construction, or enterprises will not invest in the construction of new business facilities.”

Part of the delay is agreed to be caused by the overlap between different institutions, particularly, overlap between the republican and federal authorities.

Further business regulation issues identified in the BEEPS survey are discussed in box 3-3.

Box 3-3. Business Regulations (BEEPS, 2002)

According to the BEEPS, the aspects of the business environment for SMEs pertaining to regulation (labour regulations, customs and trade regulations, title or leasing of land, access to land and business licensing and permits) are considered to be a less severe obstacle than the focus groups analysis suggests (average rating is 1.8, i.e. minor obstacle on an ascending scale of severity of constraints of 1 = no obstacle to 4 = major obstacle). However, variance in the rated severity of various aspects of the regulatory environment is rather high, with issues related to customs and trade regulations seen as the most difficult for entrepreneurs, followed by business licensing, labour regulations, issues related to titles or leasing of land and to access to land (respectively 2.2, 2.0, 2.0, 1.5 and 1.4).

Issues: The procedures for obtaining licences, permits and certificates required for business operation, take too long and are not sufficiently transparent, resulting in corruption. It is argued that the responsibilities of the various bodies need to be more clearly defined and co-ordinated to avoid overlap.

Programme for Reducing Administrative Barriers

9. Rating given to the effectiveness of the program for reducing administrative barriers for business.	1.3
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Many participants did not know of any such programme, but some of them were aware of it through the media. They believe that administrative barriers present the greatest obstacles to trade. The process of obtaining permits for new premises is an example. The SMEs in the focus groups feel that:

“...the administrative barriers are still the biggest great impediment to successful business – more effort should focus on simplifying the business environment.”

Issues: Administrative barriers pose a great obstacle to business development. There is little awareness of efforts underway to reform the regulatory environment as it affects SMEs.

Government Anti-Corruption Programme

10. Rating given to the quality and effectiveness of the Government's programme for reducing the impact of corruption .	1.1
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The entrepreneurs in the focus groups argued that corruption is widespread and affects all aspects of the Serbian business environment, including customs and public administration, but also health and education. They are aware of the fact that some anti-corruption laws, such as the Public Procurement Law and the Law on Extra Profit have been adopted, but SMEs are not conscious of any significant achievements so far. They frequently wonder why laws previously announced, such as the Tobacco Law and the Law on the Income of Public Servants, have not yet been implemented since these are designed to impact on the levels of corruption in Serbia.

SMEs are particularly concerned that some firms are in a more favourable position because of their size and "connections" with certain political parties. They believe for example, that such companies benefit from postponement of tax payment, easier access to Government procurement and better treatment by inspectors.

There is an impression that the Government is not sufficiently concerned about the damage suffered by enterprises subject to inspection, or about ensuring that inspectors have the expertise and training to carry out their work. SMEs complained about frequent, aggressive inspections and the fact that they are threatened, in advance, with the negative results of the inspections.

The constantly changing regulatory environment also contributes to this situation by creating ambiguity and uncertainty, which in turn creates scope for rent-seeking activities (see box 3-4).

Box 3-4. Corruption (BEEPS, 2002)

Some evidence of corruption affecting the SME sector also emerged from the BEEPS analysis. It found that SMEs pay 1.5% of total annual sales in unofficial payments/gifts to public officials. Also, 16% of those interviewed admitted to having made frequent bribe payments. Corruption is the eleventh most severe obstacle to doing business (out of 21) and is rated 2.1 (i.e. minor obstacle), though studies attest to the significance of this issue (see section 4.2).

Issues: The level of corruption is of vital importance to SMEs. Although the Government is making an effort to combat it, entrepreneurs were not aware of the significant results achieved so far. Inspections are perceived to be abused by the various inspectorate services.

Consultation between Government and the Private Sector

11. Rating given to the quality and regularity of consultation between Government and the private sector on draft legislation and regulations that affect business.	1.4
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SME owners and managers maintained that consultation between Government and the private sector on draft legislation and regulations is very rare. There is an equally strong belief that even when consultation does occur, it is unlikely to have any significant impact on draft laws. Entrepreneurs are critical of the frequent changes in regulations and that the effects on business are not adequately considered when laws are changed. The following view is frequently expressed:

"No one from the Government has ever asked us for our opinion, and if we wanted to establish contact on our own initiative, we would confront a 'wall of bureaucracy'."

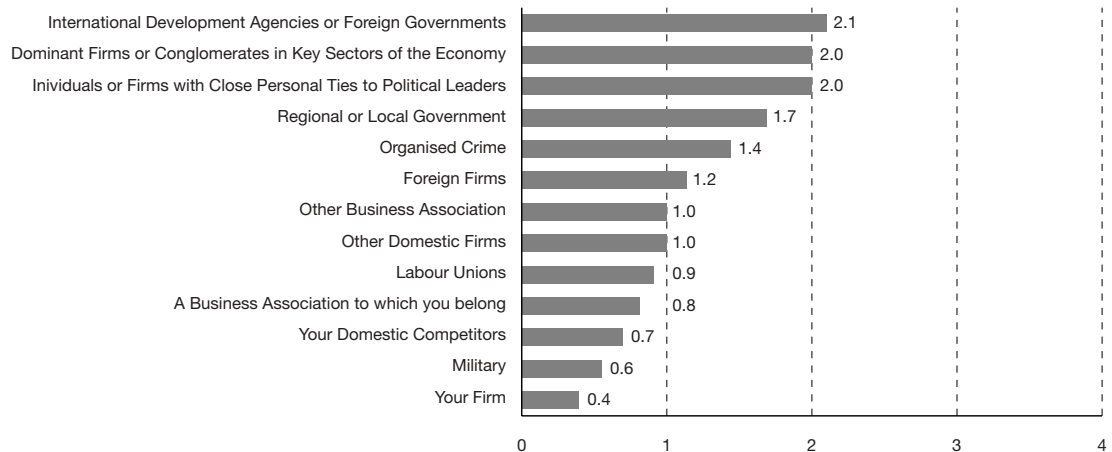
Entrepreneurs would welcome the opportunity to present proposals which have the capacity to make their business operations easier, but lament the lack of mechanisms to do so. They were critical of lack of harmonisation of laws with EU legislation and would welcome more consultation in this area.

The BEEPS survey examined another aspect of interest. Box 3-5 examines the private sector's perceptions of the lobbying power of various organisations on the making of laws and regulations.

Box 3-5. Private Sector Perception of Lobbying Power of Various Entities (BEEPS, 2002)

The entrepreneurs were also asked about the link (in terms of lobbying power) between the legislative powers and regulatory authorities with various organisations and economic agents. As can be seen from the chart below, international development agencies, large firms and conglomerates in key sectors of the economy, firms with ties to political leaders, regional or local government, organised crime and foreign firms are believed to be able to exercise, to a minor degree, some sort of lobbying power on the legislative and regulatory authorities. The entrepreneurs interviewed in the BEEPS believe that SMEs and their business associations have almost no impact on the making of laws and regulations.

How much influence do you think the following groups actually had on recently enacted national laws and regulations that have a substantial impact on your business?



Issues: Consultation with SMEs or their representatives is rare during consideration of new laws that have direct impact on the activities of SMEs. On the occasions when it does occur, there is no confidence that entrepreneurs' views will be taken on-board. They would welcome more consultation on changes affecting their operational environment.

3.4. Tax Policy for Small Businesses

The following issues were researched under this heading:

12. Whether the present tax policy encourages new enterprise and rating of the tax system in terms of the encouragement, support and ease of use that it provides to new and existing SMEs.
13. The stability and transparency of the tax system for small enterprises.
14. The consultation and communication between Government and the private sector on tax rates and incentives for enterprises.
15. Co-ordination of tax policy with other Government policies.

Encouragement of Enterprises

12. Rating given to how easy the tax system is to use and whether policy encourages and supports new and existing SMEs	1.1
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It is a truism that entrepreneurs generally consider the tax burden to be too high and this is no different in Serbia. The SME entrepreneurs participating in the research consider tax rates to be far too high, highlighting the sales tax (20%, reduced to 14% in 2003) and the taxes on salaries, where the top personal income tax rate is 20% and the combination of wage tax and social security contributions is considered to impose a heavy burden on employers.

The entrepreneurs participating in the research believe that most firms fail to report their true income in order to avoid tax payments and that corporate tax can be evaded relatively easily. This lack of compliance places a higher burden on any compliant companies and encourages activity in the grey economy. The entrepreneurs' view is that whatever tax relief may exist for SMEs, it is little more than "*symbolic*". The consensus was that tax policy does not stimulate SME development in Serbia. The tax system is also considered to be too complicated:

"There are too many forms of tax!"

There are significant costs incurred by businesses in managing a large number of individual but small taxes. The SME owners and managers participating in the research hold that it would be more effective:

"... to pay, for example, one tax of 10% than five taxes of 2% each."

There was a reduction in the number of tax forms in the first half of last year, compared to the recent past, when it was estimated that there were more than 200 different tax forms. As a result of this, the entrepreneurs were willing to concede that things were starting to move in the right direction.

Issues: Tax policy is considered to be a key factor blocking faster SME development in Serbia. The main issues related to perceived high tax burdens and the fact that some taxes remain easy to avoid. Although the number of tax forms has been significantly reduced, the tax system is still considered to be overly complicated.

Tax System Stability and Transparency

13. Rating given to the stability and transparency of the tax system for SMEs.	2.4
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Participants rated the transparency and stability of the tax system for small enterprises between "poor" and "satisfactory". Apart from the prevalent view that tax rates are simply too high, the greatest concerns are that the tax system is too unstable, with frequent changes in rates and types of tax. It was common to hear comments that:

"It would be better to prepare the taxpayer for changes and set a time-limit for adjustment prior to the introduction new standards, than to introduce ad hoc solutions and impose the obligation of immediate compliance."

Continuing with the theme above, it was strongly felt that businesses, especially smaller firms, should not be exposed to situations where they have to "*instantly comply*" with adjustments in Government tax policy:

"We often do not know what taxes we must pay!"

The main changes to the tax system that small enterprises would like to see introduced in Serbia were:

- Reduction in contributions/taxes on salaries.
- Reduction in sales and corporate tax.

- Lumping several small taxes into one larger tax.
- Incentives in areas such as job creation, investment and education and training, where the current tax relief is viewed as being “symbolic”.

Issues: Rapid changes and lack of transparency in taxation undermine the ability of enterprises to forecast and plan, by increasing uncertainty and thus lead to lower investment and job creation. Due to the high levels of non-compliance the tax burden is spread over too narrow a base. A number of changes are proposed by the SMEs participating in the research, meriting due consideration.

Consultation and Communication on Tax Policy

14. Rating given to the consultation and communication between Government and the private sector on tax rates and incentives for enterprises.	1.1
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The views expressed in this area are consistent with those on the consultation and communication on the Institutional Framework and the Rule of Law and the Regulatory Environment. The SMEs are convinced that consultation regarding tax rates and incentives is very rare. Moreover, even where they submit views, they simply do not believe that the Government takes their suggestions and proposals into account in planning development of the tax system. They believe that there was no consultation between the Government and entrepreneurs during the process of preparing recent new tax laws or changing the existing ones.

Issues: It is perceived that there is almost no consultation between enterprises and Government. The representatives of enterprises believe that consultation with the enterprise sector should be an integral part of tax policy-making.

Co-ordination of Tax Policy

15. Rating given to the tax policy co- ordination with the overall Government policy .	1.7
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SMEs participating in the focus group discussions suspect that tax policy is not co-ordinated with the rest of the Government’s economic policies. They have heard of the harmonisation of tax policy with other policies, but they do not have a clear picture about what has been done. They cite the example of the Government objective of stimulating export activities, yet there are no tax incentives for exporting firms or corporate development and:

“Job creation is certainly not stimulated by tax policy.”

Given that high levels of unemployment coexist with very high payroll taxes, they concluded that:

“The tax authorities are simply interested in increasing Government revenues without thought to incentives and consequences of tax policy.”

Box 3-6. examines the ratings obtained in the BEEPS survey for tax administration and tax rates. This confirms the type of feedback that emerged from focus groups and individual interviews

Box 3-6. Taxation Issues (BEEPS, 2002)

According to the 2002 BEEPS, the two aspects of the business environment for SMEs pertaining to taxation, tax rates and tax administration are at 2.9 and 2.7 respectively on the BEEPS scale, indicating that they are obstacles to doing business.

Issues: Co-ordination between tax policy and other aspects of economic policy relating to SME development is believed to be inadequate.

3.5. Financial Instruments for New and Small Businesses

The following issues were researched under this heading:

16. The stability, competitiveness and services of the banking system.
17. The commercial banks' interest/attitude in extending credits to the SME sector and lending attitude with respect to the SME sector.
18. The SME access to the following main sources of finance:
 - Own/family capital.
 - Micro finance.
 - Venture capital/Equity.
 - Others (e.g. credit unions).
 - Bank personnel skills.
 - Repatriation capital (from family / friends abroad).
 - Commercial banks.
 - Leasing.
 - Credit reference sources.
19. The availability of finance for SMEs at local and regional level.
20. The availability of funding for all sectors including technology companies.

Stability, Competitiveness and Services

16. Rating of the stability, competitiveness and services provided by the banking system.	2.1
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The entrepreneurs describe the banking system as “poor”, though the focus group discussions did reveal that some improvements are taking place. The quality of some services, for example, payment operations, is now regarded as satisfactory. However, SMEs view the financial sector as still unstable, its competitiveness as low and its services as underdeveloped. The availability of credit for SMEs is very limited and the interest rates charged are excessive:

“There is no real competition between banks. They all offer credit under virtually identical terms and conditions, which are unfavourable [to enterprises].”

Unreasonably high collateral requirements and interest rates, the very short maturity of credit offered and the cost of securing a loan, make borrowing from banks unattractive to small businesses. The entrepreneurs also feel that local banks do not have sufficient experience in the evaluation of business plans and complained about the lack of information on the soundness of the institutions and on changes within the sector:

“Set up independent rating agencies, which rank the banks on the basis of various business and market indicators.”

A more recent but positive trend is that certain credit lines provided by International Financial Institutions (IFIs) are now focusing exclusively on SMEs, however, the conviction remains that:

“... there is as yet nothing on the market to assist start-ups.”

Issues: In dealing with SMEs, the banking sector is not yet considered to be sufficiently stable, the degree of competition among banks is low and the range of services they provide is poor. Although some positive developments can be detected, credit is not sufficiently available, especially for start-ups, and in any case is too costly according to the participants of the focus groups.

Banks' Attitude to SMEs

17. Rating given to the commercial banks interest in extending credits to SMEs and their lending attitude to the SME sector	1.0
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The participants in the focus groups think that banks are not interested in lending to the small enterprise sector. There are no credit benefits aimed at stimulating the development of start-up companies. Collateral requirements are high (300% is typical) and SMEs often lack the required amount of assets to cover loans:

“There is a paradoxical situation in the banking sector. In most cases, the firms that need financial resources have no access to credits, while the successful ones, which do not need additional financing, are offered the funds without any conditions, even without presenting their business plans.”

Entrepreneurs believe that banks should show greater flexibility. For example, firms with an established track-record and customer base could be allowed to use their client contracts as a credit guarantee to bridge the time period until the proceeds of sale are received. The overwhelming perception of the sector is that commercial banks are only prepared to issue short-term loans and are yet to be convinced that lending to the SME sector can be profitable in the longer term.

Issues: Commercial banks are perceived to be overly cautious in their treatment of SMEs. There is a perception that banks should start lending for longer maturities and modifying their lending policies, as they negatively affect the SME sector.

Access to Finance

18. Rating given to the access to the main sources of finance to small businesses	N/A
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There is currently only a limited range of different types of finance to choose from in Serbia. Other than credit from commercial banks, the most common form of finance is own or family capital. SMEs argue that the only credit lines available to them come from the IFIs or bilateral donors. The terms and conditions of available credit (mainly the level of interest rates and collateral requirements) were criticised by the participants in the focus groups. Given the perception of a dearth of finance for SME development, the SME owners and managers were unable to discuss or rate access to the various types of finance, such as leasing, venture capital, credit unions etc.

Boxes 3-7 and 3-8 examine respectively the sources of finance for SMEs' needs and their perception of the ease of obtaining bank loans.

Box 3-7. Sources of Finance for SMEs' Needs (BEEPS, 2002)

According to the BEEPS, the two aspects of the business environment for SMEs pertaining to finance (cost of and access to capital) are rated between modest and moderate obstacles to doing business (respectively at 2.8 and 2.4). They are ranked third and sixth in the set of 21 potential obstacles to doing business. Overall, the survey results highlight that the relative severity of the cost of capital as an obstacle to doing business appears to be secondary only to economic policy uncertainty and high tax rates. Supporting this finding, an analysis of the sources of finance used by the Serbian entrepreneurs in the past to finance both their working capital needs and new investments shows a very heavy reliance on internal funds and loans from family and friends (87.4% for working capital and 80.4% for new investment). This is not unlike any other country in the world, however, the dimension of the reliance on internal funds is far larger than in western economies. Private local banks account for a very small share of financing needs (2.9% for working capital requirements and 2.6% for new investment requirements). Supplier credit (5.1%) appears to be of moderate relevance to satisfy the financing needs for working capital while leasing has *de facto* no role in financing SMEs. At present, foreign-owned banks are virtually irrelevant in the provision of finance to the SME sector (0.4% for both types of loans). It has to be noted that almost all enterprises interviewed (97% of them) managed to find the necessary finance, be it internal or external, for their working capital and investments needs). The following table presents the relevance of sources of finance used by interviewed entrepreneurs for working capital needs and to finance new investments in percentage of total.

Box 3-7. Sources of Finance for SMEs' Needs (BEEPS, 2002) (cont.)

Working Capital		New Investment	
Internal funds	82.3	Internal funds	86.7
Supplier credit	5.1	Family/Friends	3.0
Family/Friends	4.2	Private local banks	2.6
Private local banks	2.9	Supplier credit	2.1
State-owned banks	2.0	Equity	1.9
Equity	1.7	State-owned banks	0.8
Money lenders	0.6	Government	0.7
Government	0.5	Foreign banks	0.4
Foreign banks	0.4	Customer credit	0.3
Customer credit	0.2	Money lenders	0.2
Other	0.1	Other	0.0
Credit cards	0.0	Credit cards	0.0
Leasing	0.0	Leasing	0.0

Box 3-8. SMEs' Perception of Ease of Obtaining a Bank Loan for Working Capital/Investment Needs (BEEPS)

A further question was asked regarding the entrepreneurs' perception of the ease with which they would be able to obtain a loan from a commercial bank for both working capital needs and for financing a new investment. The answers appear to be rather positive – especially as far as working capital loans are concerned – considering that the same entrepreneurs when asked about previously used sources of finance stated that only a very minor share of their investment needs (0.4%) was satisfied by commercial banks. It is worth noting that SMEs believe that accessing bank loans for the financing of new investments is relatively more difficult than accessing working capital loans from banks. A very high percentage of entrepreneurs were unable to answer this question. This unusually high rate of Not Applicable responses could be explained by the fact that a very small fraction of enterprises has so far had access to banks. The entrepreneurs' responses to this question are presented below in percentage of total.

	Working Capital	New Investment
Impossible	2.0%	8.4%
Very Difficult	7.9%	15.3%
Fairly Difficult	18.2%	20.7%
Fairly Easy	29.1%	15.3%
Very Easy	20.2%	9.9%
na	22.7%	30.5%

Issues: Bank loans are not an important funding source for Serbian enterprises. SMEs rely heavily on own/family capital to business purposes. Other forms of finance are not considered to be accessible by the participants in the research, calling for the diversification of financing options.

Access at Local and Regional Levels

19. Rating given to the access to financial sources at **local and regional levels**

1.3

Participants in the focus groups believe that finance for SME development is not yet available at local and regional level - appropriate forms of finance for SMEs are simply unavailable in Serbia. There seems to be little difference in access to finance at local, regional or national levels. But given the general positive

development trend in banking sector reform, an increase in the regional availability of bank credit is expected in the future.

Issues: Credit availability for SMEs is very limited throughout the country.

Funding Availability to All Sectors

20. Rating given to the access to financial sources for all sectors including technology companies	1.1
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The funding that is available to SMEs is not targeted to specific sectors of economic activity. Unlike other countries in the region, in Serbia no financial programmes exist to foster the development technology companies *per se*:

“There is currently interest from private funds and individuals in investing in the IT sector, although venture capital is not a customary source of finance for enterprises in Serbia.”

Issues: There is no sectoral targeting of finance by Government agencies or commercial banks.

3.6. Advisory Services for New and Small Businesses

The following issues were researched under this heading:

21. Satisfaction with the range and quality of advisory services available to new entrepreneurs and SMEs and rating of the present services and comment on the changes needed.
22. Efficiency of advisory services operations.
23. Responsiveness of advisory services provided to demand and the needs of enterprises.
24. The skills, experience and quality of the staff providing business advisory services.
25. The continuity of business advisory services available.

Range of Advisory Services

21. Rating given to the satisfaction with the range and quality of private advisory services available to new entrepreneurs and SMEs.	3.2
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In marked contrast to the persistently “poor” or “very poor” ratings obtained for the other dimensions of the business environment, the SME participants felt “satisfied” with the range and quality of services for new and existing SMEs currently provided by private consultancy firms. The reverse side of the coin is that they believe that the range and quality of advisory services provided by the state agencies currently involve little more than *“political marketing.”* For example:

“Personal connections are necessary to be able to participate at a seminar for SME governance organised by the Agency.”

Note that the rating above relates only to private consultancy firms, and does not cover other institutions such as the donor-funded initiatives and/or the network of the Agency for SMEs, which were perceived to be “very poor”. Based on their experience, the advice and information that is delivered though the latter does not satisfy their needs:

“They avoid providing the requested information and services that are provided, are of little or no use.”

In addition, a large proportion of the entrepreneurs feels that they are discriminated against, when it comes to accessing the services of the Chambers of Commerce and trade associations. In their opinion, the Chambers of Commerce have a “special” relationship with some, usually large, firms to the exclusion of others:

“The costs of membership of the Chambers and trade associations do not guarantee the availability of necessary services, except in the case of certain interest groups, who use their privileged position to develop their own businesses.”

The SME owners and managers believe the existence of four different Chambers of Commerce is unnecessary for a country the size of Serbia. There was a strong feeling during the focus group discussions that SMEs should set up their own representative bodies:

“We [SMEs] should found our own associations which would represent our specific interests.”

Issues: There is satisfaction with the range and quality of services currently provided by private consultancy firms, however, the range and quality of publicly funded business advisory services is regarded as poor and not focused on the needs of smaller enterprises. The compulsory membership of the Chambers of Commerce is rated very poorly, mainly because of a strong perception of the poor value for money the Chambers provide. There is a common belief that SMEs should form their own associations, to represent their interests, rather than continuing to relying on the Chambers of Commerce for support.

Efficiency of Advisory Services

22. Rating given to the efficiency of advisory services available to SMEs	2.3
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The private sector believes that the delivery of the business advisory services by the official state agencies is not very efficient or helpful. They usually have to wait too long for the information requested from the agency and its branches. These services are provided free of charge, but do not meet the needs of enterprises.

This contrasts, from the entrepreneurs' point of view, with the performance of service providers operating on a commercial basis, such as law, accountancy and consulting firms. These charge for their services but are perceived to be more efficient in delivering their services. At the same time, however, the fees charged are generally not considered affordable by SMEs.

Issues: The efficiency of publicly funded business advisory services is believed to be “poor”. The fees for private sector services are often too steep for SMEs, but the services offered are perceived to be “satisfactory”. There are significant issues that need to be tackled in the provision of business advisory services in Serbia.

Responsiveness to Demand

23. Rating given to the responsiveness of advisory services to demand and needs	2.6
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SMEs maintain that the responsiveness of existing business advisory services is close to “satisfactory”. Regarding public sector provision, the entrepreneurs feel that they have to wait too long for delivery of information or advice requested. They found it problematic to obtain meetings and due to the extended and uncertain nature of the process and sometimes renounce trying to obtain support. The following illustrates the frustrations that can be experienced:

“During the first contact with ASMEE, potential entrepreneurs are offered a brochure ... contain[ing] some general economic indicators and political information. After studying this brochure, they can contact the Agency again for additional information or a meeting. In the follow-up contact, the clerk will write down their phone number and promise that they will be contacted within a specified period by a member of the Agency's specialised staff to arrange a meeting. As a rule, the return call is not made, so that one must call again and again, each time with an uncertain outcome. After all the efforts, the impression gained is that it is impossible to arrange a meeting with the ... Agency. Due to the frustration of this procedure most people give up trying [to obtain the services they need].”

Issues: The above type of experience may discourage SMEs from seeking to obtain information and support from ASMEE and its network of business advisory centres. The introduction of appropriate procedures for dealing with information requests, combined with staff training in customer service appears to be called for.

Human Capital

24. Rating given to the skills, experience and quality of the staff providing advisory services	3.2
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Entrepreneurs rank the expertise of the advisory services provided by private sector lawyers and bookkeepers as being satisfactory, although not perfect:

“... some of the services provided by consulting firms are not sufficiently transparent and realistic. The mass preparation of business plans, for example, without a professional and customised approach, leads to fiascos, i.e. working to stereotypes and inferior quality of services provided.”

The entrepreneurs believe that the staff of the public sector advisory agencies are not sufficiently motivated and that overall, there is a general lack of professional knowledge, skills and experience. According to participants:

“... this prevents them from supporting SMEs in an adequate manner.”

Issues: Entrepreneurs feel that the services provided by government bodies are in need of considerable development: the professional knowledge and skills of staff needs to be improved and the real needs of SMEs need to be the focus of their activities. Private consulting firms sometimes offer overly standardised packages that do not sufficiently take into account the needs of individual firms, for example, in the preparation of business plans.

Continuity of Provision

25. Rating given to the continuity of advisory services available	3.4
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The participants in the research simply reaffirmed the point that the publicly-funded advisory services are considered to be in need of up grading in terms of quality, range of services and responsiveness. They believe there are many specialist providers offering adequate consulting services, though these were not always affordable by SMEs:

“The continuity of advisory services is not adequate. Moreover, you need to contact them several times for information. If you succeed in getting in touch with them, it does not necessarily mean that they will provide you with the information requested.”

Issues: There is a perception that the continuity of advisory services is inadequate. This calls for an evaluation of the effectiveness and sustainability of the business advisory services on offer.

3.7. Business Incubators

The following issues were researched under this heading:

26. The use of and the experience with business incubators; and the rating assigned to them by new entrepreneurs and existing SMEs.
27. The efficiency of the Government policy and programme encouraging business incubators.
28. The state of the business incubators' governance structures.
29. The locations, the infrastructure and facilities of business incubators.

30. The extent to which the business incubators' activities are focussed on the needs of the local entrepreneurs.
31. The extent to which the operating conditions, services and charges are transparent and clear.

Experience with Business Incubators

With the exception of a minority of participants, very few of the entrepreneurs had heard of business incubators. None were either aware of Government policy and programmes to support business incubators or had any direct experience with them. No ratings were obtained for this analysis and the discussion should be treated with due caution.

An example given of difficulties in establishing business incubators concerned academics, since they are prohibited from working in private companies, even within the universities. By default, this means that they are also unable to set-up incubators within universities, which significantly limits the scope for developing such initiatives in Serbia.

Nevertheless, entrepreneurs believed an IT sector business incubator is being developed in Belgrade, but that no firms have joined as yet. Because of the lack of information and experience, it was not possible to obtain feedback on such issues as corporate governance structure, focus on entrepreneurs' priorities or operating terms and conditions, etc.

Issues: Only one business incubator initiative is underway. Very few participants had any information, knowledge or experience of business incubators. Entrepreneurs are convinced that there are no policies or programmes to support the implementation of business incubators. Even if such initiatives existed, it was expected that they would be constrained by the fact that academics are prohibited from working in private companies within universities.

Chapter 4.

ASSESSMENT

This Chapter presents the OECD-EBRD assessment, again using the framework of the six dimensions of good practice for improving the business environment. It reviews the current situation in each of the areas and assesses progress being made in creating a supportive business environment for the SMEs, taking into account the SME views set out in Chapter 3 and other OECD and EBRD studies. The assessment leads to the set of recommendations by OECD and EBRD that are set out in Chapter 1 of this report.

4.1. Implementation of the Institutional Framework for SME Policy

The Situation on the Institutional Framework

The *Ministry of Economy and Privatisation* is the organisation responsible for defining and implementing the National Strategy for the Development of SMEs and Entrepreneurship. Two of its departments deal with enterprise issues. The *Department for Development of SMEs* determines national policy and strategy for SMEs and the *Department for Private Entrepreneurship* deals mainly with sole-traders. The SME Department has been focusing on issues such as finalising the SME strategy, improving access to finance through a state credit guarantee fund and developing a network of regional agencies to deliver enterprise support to firms. Improvement of the SMEs statistics and better communication strategies are acknowledged to be priorities. It has a staff complement of five people dealing specifically with SME related issues, as well as international experts providing technical assistance.

The *Republican Agency for the Development of SMEs and Entrepreneurship* (ASMEE) was established in 2001. Its primary objective is to support the development of SMEs and, in particular, to use the framework of the new SME strategy, as the basis for its implementation activity. It will eventually have a central staff complement of 12-15. The Agency is focusing on the following activities:

- Implementing the Ministry's policies.
- Establishing and co-ordinating the regional network (see below).
- Encouraging access to finance for SMEs.
- Implementing the National Strategy for the Development of SMEs and Entrepreneurship (2003-2008).
- Initiating legislative changes.
- Developing entrepreneurship.
- Transferring know-how and information to SMEs.
- Running training programmes.

It has set itself three particular goals (OECD, 2003 p.95), to:

- Invigorate economic development in the regions.
- Directly spur entrepreneurship.
- Propose legal and regulatory changes to improve the operating environment for SMEs.

ASMEE has developed a network of *ten regional sub-agencies* with an average of five staff in each office. These are located in Belgrade, Kragujevac, Krusevac, Nis, Novi Sad, Novi Pazar, Subotica, Uzice, Zajecar and Zrenjanin. International donors, such as the EU, are funding the network. It is anticipated that it will

ultimately be expanded into a wider network covering the whole of Serbia, through German and Swedish-funded initiatives, which have a broad regional development remit. It is anticipated that each of the regional sub-agencies will eventually set up more *local sub-offices* with up to three staff in each. The funds are expected to come principally from donor organisations in the short-term and from the municipalities in the longer term. The financial sustainability of both ASMEE and the regional network is far from assured. ASMEE has received €150.000 start-up funding, but does not yet have a regular state budget. The funds from the majority of regional agencies are available only to assist the start-up of SMEs and not for supporting their ongoing operations. The whole network relies almost entirely on donations, leading to the possibility of problems with their continuity into the future. The regional agencies are mandated to achieve financial sustainability in a short period of time (a couple of years), compared to similar bodies elsewhere in SEE.

Following a long period of gestation, the *National Strategy for the Development of SMEs and Entrepreneurship* (2003-2008), which acknowledges the prime importance of the SME sector for successful economic transition in Serbia, was adopted by Government in January 2003. Its priorities are to:

- Support SMEs in priority economic sectors.
- Provide institutional support and advocacy for enterprise and entrepreneurship.
- Remove the legal and regulatory barriers.
- Provide finance for SME development.
- Work to improve SME competitiveness.
- Provide new knowledge and skills for the SME sector, by undertaking education and training
- Promote exports by SMEs.
- Improve SME performance on the domestic market.
- Prepare SMEs for the Digital Age.
- Reduce the “grey economy”.
- Undertake analysis of SME performance.
- Promote, implement and review the progress of the National SME Strategy.
- Co-ordinate international aid and technical assistance.

Apart from the Ministry for Economy and Privatisation *other ministries* involved with SMEs in Serbia include Finance and Economy, Labour and Employment, International Economic Relations, Trade, Tourism and Services and Science Technology and Development. SME feedback suggest that there is presently little co-operation between these various ministries on SME matters. In addition to working with the Ministry for Economy and Privatisation, ASMEE is seeking a mandate to co-ordinate the SME activities of all the other ministries involved with this sector. It is essential for SME development that ASMEE is given support for this initiative.

Other bodies in Serbia also play a significant role in SME development. These include: the Serbian and Yugoslav Chambers of Commerce and Industry, Regional Chambers of Commerce, National Bank of Yugoslavia and Development Fund of the Republic of Serbia, Serbian Investment and Export Promotion Agency and the Serbian Export Credit Agency, established in October 2002.

There are presently very few mechanisms enabling consultation between SME stakeholders and Government. The main such initiative is the *SME Advisory Board* (SMEAB), which includes selected business people to advise Government on priorities for reform. This has been operating since 2001 and is a potentially useful tool. It reports to the Ministry of Economy and Privatisation, rather than the Agency for SMEs and does not yet include the wider SME policy community. The Chambers of Commerce, the Associations of Entrepreneurs and other players also have a role in supporting the SME sector.

The *Regional State Administration and Local Authorities* have a vital role to play to encourage economic development and enterprise development. The resources and personnel available to them are very limited. The Ministry of Local Administration and Local Self Government would like to improve the services delivered to SMEs through bodies as such the various inspectorates, the courts, customs and taxation authorities.

Assessment

The Government of the Republic of Serbia is aware of the importance of SMEs to economic development and the process of building the basic institutional infrastructure for SME development has been carried out within a relatively short period of time, compared with other countries in the SEE region. As outlined above, responsibility for SME policy development and implementation has been assigned to a Department within the Ministry of Economy and Privatisation, a National Strategy for SMEs has been approved (in January 2003), the Agency for the Development of SMEs and Entrepreneurship (ASMEE) has been established, and so has a regional network to support the implementation of small enterprise policy. All this confirms the Government's commitment to this area of policy at a time of strong competition for resources.

Much of this progress has been made with limited and unstable resources. ASMEE is operating on a tight budget and it is unclear if and when state resources will be forthcoming in order to secure its future and that of the network of regional offices that is in the process of being created. It is the responsibility of the Ministry of Economy to ensure that this issue is tackled as a matter of urgency, using all possible means, international and national, in order to secure the institutional gains that have been made in the last couple of years.

Linked to the above, ASMEE itself will need to demonstrate to the SME stakeholders that it is obtaining value for the resources the state and the international community is providing to assist SME development and that it is continuously enhancing the services and programmes targeted at the SME sector. It will have to invest in statistical data gathering and monitoring of the SME sector to obtain information on an ongoing basis to support its activities.

Based on the research, it appears as if entrepreneurs know, in general terms, that an extensive institutional structure is in the process of being developed by the Government to support SME development in Serbia. There is awareness that the Agency for SMEs (ASMEE) has been established but little is known of the network of regional agencies. Knowledge of ASMEE's specific activities and impact on the ground is almost non-existent and entrepreneurs believe that they are largely left to their own devices by the State.

As far as SME owners and managers are concerned, the existing institutions have not yet achieved satisfactory results. There is little confidence in the ability of these institutions to meet the "real" needs and priorities of SMEs and a belief that the institutional system could be much more effective, achieve better co-ordination and create a better institutional environment to support SME development. On the one hand, it is accepted that these institutions have been operating for only one or two years and that they do not have sufficient financial resources and adequately trained and experienced personnel to make a significant impact on SME development. As discussed earlier, ASMEE's medium-term future must be secured and it must secure a resourced programme of activities in order to operate effectively. The capacity of its staff, national and regional, must be enhanced to ensure that they can respond to the needs of the SME sector.

Consultation between the Government and SMEs and their representatives on policy-related issues are almost non-existent. For example, the representatives of SMEs do not appear to have been informed about the National Strategy for the Development of SMEs and Entrepreneurship or to have been involved in a process of consultation. Entrepreneurs' principal source of information is the media (i.e. newspapers and television). In addition, due to a lack of expertise and understanding of their real needs, SMEs do not yet have confidence that the governmental institutions are capable of formulating appropriate policies. Government will need to be more proactive in communicating with the SMEs and their representatives, for example, the strategy needs to be communicated in a manner that instils confidence in SMEs. Adequate funding must be provided to ensure it is implemented in an integrated and coherent manner.

The main mechanism for dialogue with businesses, the SME Advisory Board (SMEAB), operates within the Ministry of Economy and Privatisation. Although such a body offers considerable scope for effective dialogue and consultation, it does not include wide representation. The development of this

body to allow for regular communication and consultations with a wide range of SME stakeholders could be of benefit to the Ministry of Economy and Privatisation, ASMEE and the wider SME policy community. Other communication channels between the government institutions and entrepreneurs do not exist. The establishment of such channels and their regular use would be of widespread benefit. Moreover, it would be beneficial for the Ministry of Economy to seek to convene an Inter Ministerial Group on SME Policy, including key Ministries such as Finance, in order to better co-ordinate policy affecting this sector of activity.

Local and regional authorities are interested in encouraging SME development within their territories. The efforts some municipalities are making to streamline business registration and licensing procedures are acknowledged by SMEs. However, their impact to date appears to have been insignificant, due to the lack of adequate financial resources and skilled personnel. These problems are accentuated by the lack of communication and dialogue with enterprises.

4.2. Implementation of the Rule of Law and the Regulatory Environment

The Situation on the Rule of Law and the Regulatory Environment

In order to *register a new business*, the following steps have to be undertaken (G17, 2002, p.13):

- Register with the commercial courts.
- Register at the Republican Bureau of Statistics.
- Open a business account with the Bureau of Payments and Clearance (ZOP).
- Open a business account with a commercial bank.
- Obtain a certificate confirming that facilities meet minimum requirements.

The feedback from Serbian small businesses is that there is a perception that the process is too bureaucratic, takes too long, and costs too much, estimated to be between €230 (G17, 2002) and €290 (Economics Institute, 2002, p.24). The average time required to obtain operating licenses is 22 days and involves up to 10 visits by the entrepreneurs (G17, 2002, p.42 and EI, 2002). There is a recurring cost to firms, as many of the licenses have to be regularly renewed.

Recent amendments to the *Federal Law on Enterprises* and the *Law on Private Entrepreneurs* have simplified some of the registration processes. Companies are now allowed to start their operations and then to obtain all relevant *licences, permits and certificates*. However, there are still significant costs for businesses, arising from registration fees, legal fees, official charges, travel, opportunity costs and bribery.

Over and above the costs of registering and for obtaining permits and licenses, there are about 15 authorities, including the Revenue and Audit Police, that have the right to *inspect enterprises* and which may arrive at premises several times per year. This remains one of the biggest concerns of small businesses.

A number of studies on removing administrative barriers to business development are underway, such as removing obstacles to foreign investors (FIAS, 2002) and organisations such as GTZ and the World Bank are developing programmes focusing on deregulation.

A donor / IFI-funded project is underway through an *Inter Ministerial Working Group on Deregulation* set-up to simplify the business environment in Serbia. This initiative consists of four different elements, under the chairmanship of the following ministries:

- Business registration (Ministry of Privatisation and Economy).
- Inspections (Ministry of Trade).
- Ombudsman (Ministry of Foreign Relations).
- Other obstacles (Ministry of International Economic Relations).

Its mandate is to comment on all proposed laws and regulations, prepare a simplified registration procedure and propose further measures to simplify the business environment. However, the Inter Ministerial Working Group on Deregulation is not perceived to have been very active since being formed in 2001, though it is anticipated that its activities will be re-invigorated in future.

A new *bankruptcy law* is under preparation for Serbia. This law is expected to enable creditors to recover outstanding debts from bankrupt firms much more rapidly than is the case at present.

The *commercial courts* are overburdened and there are frequent complaints from the business sector that they act very slowly (see also FIAS, 2002). It is common for firms to have to wait for years, before judicial decisions are made.

A new Law on Public Procurement has been passed, which will result in the implementation of a *Public Procurement Agency*. Procurement rules in Serbia are equal for all forms of business, regardless of size. Large enterprises are normally better placed to understand and comply with the requirements of public procurement systems and meet the costs involved in tendering for contracts.

The *informal / grey economy* constitutes about 35-40% of Gross Domestic Production (GDP), according to independent research by the Centre for International Private Enterprise, Economics Institute (May 2001/2002). Many legally registered enterprises undertake a part of their activities through the grey economy, for example by paying the sales tax on a reduced statement of the value of the products sold.

Bribery and corruption are known to be rife in Serbia (CLSD and CIPE, 2001; FIAS, 2002), and the tools to counteract this have traditionally been weak. The new Government has invested political capital in attempting to counteract this activity through initiatives such as the Law on Extra Profit, Anti-Money Laundering Law, Public Procurement Law and the Law on Courts and Judges. (see FIAS, 2002, pp.8-10).

Assessment

The procedures for registering enterprises, issuing of permits, licences, certificates, etc. are bureaucratic, time-consuming, expensive and are often associated with corruption. Many different types of documents and licenses are required in order to submit a company for registration. In addition, it is almost impossible to complete the registration process without buying-in external assistance from lawyers or agencies specialising in enterprise registration. There is a need to simplify the complex procedures to reduce the cost and time burdens, especially on smaller enterprises, and to encourage more entrepreneurs to initiate businesses and/or register existing commercial activities.

The Enterprise Register at the commercial court is not yet computerised (except for Belgrade) and is unreliable. Businesses wishing to register cannot be certain that another firm bearing the same name has not already been registered, resulting in potential extra costs and legal difficulties. The court should implement an electronic firm registration system as a matter of urgency. Not unreasonably, entrepreneurs expect the registration period to be simplified and shortened and the submission of documents in electronic form should be possible in future.

The procedures for obtaining licences, permits and certificates required for business operation are similarly bureaucratic and characterised by frequent changes and instability. They take a long time to be processed and are not sufficiently transparent. Enterprises often do not know which documents they should submit or indeed to whom to appeal in case of difficulties. Permits and licenses are granted for too limited a period, leading to higher costs for the business. Apart from the time cost to enterprises, the opportunities for rent-seeking behaviour are significant, with entrepreneurs also complaining about the arbitrary nature of the process and fines applied.

Administrative barriers still pose a great obstacle to business development. There is little awareness by those participating in the research of efforts underway to reform the regulatory environment as it affects

SMEs. The establishment of the Inter Ministerial Working Group on Deregulation is to be welcomed. The initiative seems to have been slow getting off the ground and SMEs do not yet obtain any significant benefits. There is little confidence that any improvements proposed will be translated into real action and it is believed that will be a long time before the benefits are felt “on-the-ground” by entrepreneurs. SMEs will have to see beneficial effects soon if they are to be convinced of the Government's seriousness in addressing the regulatory reform issue. In this context, the introduction of the principle of “silent consent” needs to be expedited. Under this arrangement, if a response is not made within a predetermined period by the public body concerned permission is deemed to be granted.

Good results have been achieved in combating the “grey economy” in the oil and tobacco products sectors. However, the “grey economy” still constitutes a very high proportion of economic activity. It results in reduced tax revenues and, therefore, a higher tax burden and unfair competition on more compliant businesses. The process instituted to reduce incentives to operate in the “grey economy” should be expedited and implemented in a systematic and determined manner in all sectors of the economy.

The level of corruption, a widespread phenomenon in Serbian society and a corrosive issue that badly affects the business environment, is of vital concern to SMEs. The efforts to tackle corruption are welcome. SMEs acknowledge the Government focus on this issue, but are sceptical about its likely impact, since the results achieved so far are modest. However, it is accepted that it is too soon to fairly assess the impact of the new action programme, which started in 2002. Again SMEs will have to see beneficial effects on the ground if they are to be convinced of the Government's seriousness in addressing corruption.

The current mechanisms for consultation on draft legislation and reforms to the regulatory environment are in need of development. Consultation with SMEs or their representatives on new laws that have direct impact on the activities of SMEs is rare. On the occasions when it does occur, there is little confidence that entrepreneurs' views will be taken on-board seriously. SMEs would welcome more consultation, in particular, on harmonisation of laws with EU legislation.

4.3. Implementation of Tax Policy for Small Businesses

The Situation on Tax Policy for Smaller Businesses

The main focus of Serb *tax policy* in recent years has been to work towards neutrality and transparency in the tax system, and major tax reforms were undertaken in the first half of 2001. Lower nominal rates, for example on payroll taxes and a broadening of the tax base have yielded increase revenues (OECD, 2003, p.14). This marked a break with the past which was characterised as: “a confusing mass of taxes, tax rates, and exemptions” (OECD, 2003, p.77). However, much SME activity still evades tax altogether, resulting in a higher burden on compliant companies.

The sources of revenue at the *federal level* include, sales tax and excise and customs duties. Other taxes, including personal income taxes and corporate taxes, social security contributions, surcharge taxes (for social programmes) and property tax operate at the *level of the republic*. Tax collection, regulation and compliance are also the responsibility of the republic.

Employment income is subject to a flat rate of 14% withholding tax. In addition to the personal income tax on salary, employers calculate and deduct the three types of social security contributions, namely pension and disability insurance, health insurance and unemployment insurance (altogether about 16%). *Personal income tax* rates are progressive in nature and range from 10%-20%. It is anticipated that they will be reduced to 10% in future. There has been reduction in overall payroll tax deduction, however, the burden of labour taxes still encourages businesses to operate in the “grey economy” (OECD, 2003).

All enterprises were subject to the *company profits tax regime*, which was 20%, has been reduced to 14% in 2003, making it one of the lowest in SEE. There is a *tax credit* of 30% against profit tax liability (up to a ceiling

of 70%), for SME investment in fixed assets (except for items such as cars, furniture, carpets and paintings). The unused part of the tax credit may be carried forward over a period of five years. Companies that employ new workers are entitled to a tax credit of 40% on gross salaries paid for the first two years. Companies also benefit from:

- Accelerated depreciation for certain categories of fixed assets (such as IT and training equipment).
- Carry forward of losses generated from business activities.
- Tax exemptions for employment of disabled people.
- Tax credits for branches located in underdeveloped regions.

The Ministry of Finance is preparing a tax incentive programme, but its details are not yet known.

A *sales tax* is levied at a rate of 20% on goods and services (except for basic food products) and is not deductible. *Value Added Tax (VAT)* is expected to be implemented in January 2004.

Serbia charges a 0.29% tax on most financial transactions carried out, such as clearing payments and payments from accounts with the exception of pension and salaries. A one-off *extra-profits tax* has been introduced in order to recover some of the profits made through the previous regime's activities favouring particular firms.

There has been a trend of fiscal amendments through bylaws, interpretations and opinions (SEED, 2002, p.15). This considerably complicates the operating environment for enterprises. There is currently little scope for enterprises and their representative organisations to discuss, respond to and prepare for proposed changes to the fiscal regime.

Assessment

The tax system has been significantly improved. The number of tax forms has been reduced. Tax rates, such as corporate tax, have also been reduced, while the tax base has been broadened somewhat, leading to higher revenues. Despite recent reductions in the tax burden and a recognition that the tax system is improving, SMEs were very critical of the tax administration system, not least the poor collection rates (arrears are 6% of GDP) and the failure to track down and identify undeclared income. There is widespread "grey economy" activity, which results in unfair competition and puts a higher burden on compliant taxpayers. The total number of taxes is still excessive and places a significant burden on small enterprises, particular those that cannot afford tax experts to ensure they remain on the right side of the law.

The transition process to a market based economy and the resulting changes in quite a number of tax laws have increased uncertainty and made it very difficult for enterprises to plan for their tax liabilities. This adds to the compliance cost on firms and leads to lower investment and less job creation. To avoid further discouraging entrepreneurship and SME business development and stimulate a reduction in the "grey economy", the Government needs to continue to widen the tax base by relentlessly tracking down undeclared income. The VAT should be introduced as soon as practicable (planned for the 1 January 2004) since experience elsewhere in SEE indicates that this also works to disincentivise informal entrepreneurial activity. The VAT refund period should be designed to facilitate cash flow, such as the international standard of one month.

There is almost no consultation between enterprises and the Government on tax policy and its administration. The absence of mechanisms for consultation means that unexpected or aggravated cash flow problems can jeopardise start-ups or investment plans. A recent example is that enterprises have not been sufficiently informed, let alone consulted, about the forthcoming introduction of VAT or the way in which the tax system will function in the new circumstances. Experience elsewhere suggests that both Government and the business sector would benefit from a mechanism allowing for more effective, regular and timely consultation on proposed changes.

There is insufficient co-ordination between tax policy and other aspects of economic policy relating to SME development. Tax policy and its administration remains one of the key factors blocking faster SME development in Serbia.

4.4. Implementation of Financial Instruments for Fostering Small Businesses

The Situation on Financial Instruments

Banking sector reform has advanced dramatically since the collapse of the Milosevic regime in October 2000. Prior to this date, the banking sector in Yugoslavia had suffered from years of isolation, the effects of directed lending to state or regime-linked companies and inadequate banking supervision. The banking system became almost completely insolvent with the larger state-owned banks bankrupt and unable to perform basic services. By the year 2000, only some smaller privately owned banks were providing any genuine banking services. As a result, indicators of banking activity, such as domestic credit as per cent of GDP, were very low.

Following the change of management in November 2000, the National Bank of Serbia (NBS - at that time still called the National Bank of Yugoslavia) started an ambitious bank reform programme in order to improve the regulatory framework and strengthen bank supervision. These improvements are captured by the EBRD transition indicators, with banking sector reform jumping from 1 (the lowest score) in 2001 to 2+ in 2002 (and non-banking financial sector reform moving from 1 to 2-). One key early measure was the introduction of a deposit insurance scheme in mid-2001, as a result of which during the period of July – September 2001, the banking sector received an additional 35m in individuals' foreign currency deposits, more than the cumulative increase over the previous five-year period. The introduction of the Euro in 2002 and the conversion of its predecessor currencies further increased the level of Euro-denominated deposits in the banking system by the end of 2001.

Table 4-1. **EBRD Score for Financial Sector Reform**

		1997	1998	1999	2000	2001	2002
Financial Institutions	Banking reform & interest rate liberalisation	1.0	1.0	1.0	1.0	1.0	2.3
	Securities markets & non-bank financial institutions	1.0	1.0	1.0	1.0	1.0	1.7

Source: EBRD.

Due to the reduced lending to state sector, domestic credit dropped to 30.6% of GDP at end 2002, from 33.3 per cent at end 2001. Despite the rapid increase in bank credit to enterprises since mid-2002, domestic credit to the private sector is still low at 7.2% of GDP.

Table 4-2. **Domestic Credit to the Private Sector (in % of GDP)**

1996	1997	1998	1999	2000	2001	2002
9.2	10.8	11.2	9.8	8.2	6.0	7.2

Source: EBRD and National Bank of Serbia

The NBS's restructuring programme included a review of prudential regulations, strengthening of the off-site reporting and analysis, introducing of on-site risk-based supervision, enhancing supervisory enforcement measures and strengthening of loan classification and provisioning. As a result, during 2001

the licences of 23 banks were suspended, several banks merged and the overall number of banks decreased from 85 at end-2001 to 48 at end-2002. Furthermore, in January 2002 the NBS put into liquidation the four largest banks - Beogradska banka, Beobanka, Investbanka and Jugobanka - which accounted for approximately 80% of the total banking sector and employed 8.500 people. Moreover, in August 2002 the ownership of 16 loss making banks was transferred to the state for subsequent privatisation/liquidation as part of the Paris Club agreement. The supervision of the banking system is being further strengthened by amendments in the Banking Act adopted in 2002, which introduced stricter requirements for banks' licensing procedure and increased minimum capital requirements. The Law on Prevention of Money Laundering, which is expected to improve the transparency and further underscore improving public confidence in the banking system, was introduced in July 2002.

The ongoing restructuring of the Serb banking sector has brought deep changes to the old and inefficient banking system. The closure of the biggest banking players, the existing low level of banking activities relative to GDP and the economic potential of the country has created opportunities for growth-oriented local and foreign banks entering the market. Several foreign banks have already entered the market, including – Alpha Bank, Commercial Bank of Greece, Société Générale Yugoslav Bank, the Micro-Finance Bank, Raiffeisenbank, HypoVereinsbank, Hypo Alpe-Adria-Bank and National Bank of Greece (branch) and Nova Ljubljanska Banka (branch).

The remaining *commercial banks* consist of:

- State or socially owned banks, some of which are suffering from frozen assets and foreign currency liabilities. Most of these will need to be restructured and privatised, or closed down.
- Newer commercial banks which face increasingly tight prudential regulations.
- Several foreign banks, playing an increasingly important role, with an estimated 16% of Serbian bank capital and 13% of assets (OECD, 2003, p.78).

There is some way to go yet before the level of competitiveness between banks increases appreciably, however, confidence in the banking system is being restored, with the foreign banks and the top two Serbian banks enjoying the lion's share of new deposits.

Table 4-3. **Cost of Credit Available from Official Sources**

	Foreign Currency ¹ Denominated Loans	
	Micro Finance Bank Interest Rate	Banks not dedicated to micro and SMEs
Micro loans	21%-24%	22%-40%
Small loans	15%-21%	12%-27%

Source: Group for Small Business, EBRD

As far as SME *financing* goes, the Micro Finance Bank (MFB) and the USAID-funded Opportunities International Savings Bank are the only institutions currently fully dedicated to micro- and SMEs. Other local banks are increasing their lending to the SME sector albeit from a very low base. The NBS continues to forbid lending by any entity that is not registered as a bank, with the exception of the Development Fund of the Republic of Serbia (DFRS), which grants loans at lower than market rates to SMEs. This fund continues to report directly to the Prime Minister's office and its lending and monitoring criteria remain unclear. Kreditanstalt für Wiederaufbau (KfW) and the European Investment Bank (EIB) have also provided loans directly or indirectly to some Serbian banks for on-lending. MFB continues to report a high level of demand for loans but in the absence of functioning pledge and mortgage laws/registries and high collateral requirements from banks, SME lending remains restricted.

Assessment

A healthy, profitable financial sector is the key pre-requisite for providing access to finance for SMEs on a sustainable basis. Profitable private financial intermediaries are the necessary link between domestic savings and investment by private sector enterprises, in particular SMEs, and the only way to ensure sustainable SME access to finance and other financial services. Reflecting the perception of the private sector, the aggregate data on the banking sector shows an extremely low degree of bank intermediation. Coupled with the extreme underdevelopment of the non-banking financial sector, this leaves micro-finance programmes and dedicated credit lines as the major formal source of external finance for the SME sector.

4.5. Implementation of Advisory Services to New and Small Businesses

The Situation on Advisory Services

The central role played by SMEs in the process of transition calls requires good quality, responsive business advisory and information services. However, other than the Chambers of Commerce and *bookkeeping/accountancy and legal services* and some limited business planning services, there has been very little development of private sector advisory services in Serbia. The delayed process of transition in Serbia, together with the associated market dysfunction has meant that private sector business services, such as business consultancies, training and tax consultancies, have not emerged in great numbers (SEED, 2002, p.18). A WB/IFC SEED programme focuses partly on raising capacity with respect to the provision of business consulting services for SMEs.

The embargoes and sanctions of the last 10 years have also meant that international donors and organisations such as the European Commission, Department for International Development (DFID), USAID, UN Development Programme and World Bank have not set-up business information and advisory agencies, to the same extent as elsewhere in SEE. In terms of the public sector, ASMEE *opened ten regional offices* in 2002 that cover 60% of Serbian territory. The National SME Strategy anticipates more regional offices and local sub-branches to be developed. However, since the great majority of resources for the implementation of these offices come from international donors such as AER, GTZ and SIDA, it is unclear how and whether this ambitious programme can be implemented and sustained in the long term. Achieving sustainability, delivering effective services, partly on a commercial basis, and effective co-ordination of the network will be major challenges confronting ASMEE.

Finally, there are four sets of compulsory *Chambers of Commerce and Industry* at federal, republican, provincial and regional level. Within the Chamber system, there are also general associations of entrepreneurs (sole proprietors) at municipality level.

Assessment

There is satisfaction with the range and quality of the bookkeeping/accountancy and legal services currently provided by private firms, although the fees are often considered to be too high for small businesses. Those private consulting firms that advise on the preparation of business plans fail to take into account the needs of individual firms, so that the range of services could be diversified and the standards raised over time.

Following a slow start, major progress has been made in developing a national network of business support services, co-ordinated by ASMEE. Although these are embryonic organisations requiring time and technical assistance in order to become established and add value, the early experience suggests that there is a need for rapid improvement. By contrast to the private sector provision, the public sector is perceived to provide a poor range and quality of business advisory services, not sufficiently focused on the needs of smaller enterprises. Due to poor past experiences with the responsiveness of government advisory bodies, there is a danger that SMEs might not even try and seek to obtain information and

advice from ASMEE or the regional network of centres it has set up. ASMEE and its network of business support centres will need to respond quickly in order to ensure that these perceptions do not become entrenched.

SMEs are dissatisfied with the expensive and compulsory services provided by the Chambers of Commerce mainly because of difficulty accessing their services and thus the poor value for money they are regarded as providing. Many argue that they should not be forced to be members of organisations that do not support them adequately and call for either reform or establishment of their own associations. The role of the Chamber of Commerce is in need of evaluation with regard to such issues as nature of membership, organisational structure, linkage with government institutions (e.g. information dissemination at branch level), etc.

The skills in basic advisory services provided by private sector lawyers and bookkeepers are regarded as satisfactory. Whilst acknowledging that these are relatively new organisations, the services delivered by public bodies, in particular ASMEE and its regional network, still need to be developed. The motivation, professional knowledge and skills of their staff need to be enhanced and focused on the needs of SMEs. There is a need to improve the quality and effectiveness of their services and to deliver an appropriate range of advisory, information and training directly to SMEs, through qualified business consultants. Without this, the donor-funded agencies may have difficulty in achieving financial sustainability in the relatively short timeframe envisaged.

The research indicates that the main types of advisory services demanded by SMEs include: information on the tax system, partly due the difficulties caused by recent reforms in this area, accounting services and advice on access to credit. Entrepreneurs do not appear very willing to pay for business advisory services and consultancy advice.

4.6. The Implementation of Business Incubators

Business Incubators are generally defined as special facilities for new and young developing businesses that provide such businesses with premises, infrastructure, a comprehensive range of services and support that can improve their ability to initiate and run their operations during the early developmental period. The combined features of physical facilities, focus on start-ups and SMEs and “soft” advisory and support services provided are what distinguish Business Incubators from other industrial centres or industrial estates (OECD-UNIDO, 1999, p.51-53).

The Situation on Business Incubators

There are currently neither laws nor regulations on establishing business incubators in Serbia. However, the Government has recognised the potential importance of business incubators and has initiated the drafting of a law enabling their establishment in Serbia, including financial and tax incentives for the registration of incubators, import of equipment and employment of new personnel. The recently approved *National SME Strategy* also deals with the issue, tasking ASMEE with responsibility for establishing them within the broad context of encouraging innovation, as well as for facilitating the development of privately owned business incubators. Although the international community has been active in assisting the development of business incubators elsewhere in SEE, there appear to be no plans to do so in Serbia at present.

The first embryonic business incubator in Serbia began with the high-tech (IT) sector in *Belgrade*. It is in the process of negotiating contracts with potential SMEs. In addition, a number of informal expert groups organised within software firms and university faculties such as in *Novi Sad*, can be considered as precursors to business incubators.

University academics are interested in working with business incubators to help implement their research. However, they are currently not permitted to work in business ventures such as incubators.

Assessment

Very few of the SME participants in the research had heard of business incubators and none had had any experience with them. The Government is interested in encouraging their development and has initiated the drafting of a law enabling their establishment in Serbia. The National SME Strategy does allude to the development of business incubators but apart from suggesting ASMEE encourage their development, it does not spell out a detailed strategy for their implementation.

Only one business incubator initiative seems to be underway. The development of business incubator is partly constrained by the fact that academics are prohibited from working in private companies, meaning that they are also unable to form incubators within universities.

NOTE

1. Despite the fact that banks are not allowed to lend in foreign currency, the interest rates charged are indexed to hard currency exchange rates, thus interest rates presented here are presented as interest rates on loans in foreign currency.

Chapter 5.

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Chapter 6.

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Ministry of International Economic Relations - <http://www.mier.sr.gov.yu>

SIEPA - Serbian Investment and Export Promotion Agency - <http://www.siepa.sr.gov.yu>

Serbian Agency for the Development of SMEs and Entrepreneurship - <http://www.sme.sr.gov.yu>

Government of Serbia - <http://www.srbija.sr.gov.yu>

Yugoslav Chamber of Commerce - <http://www.pkj.co.yu>

Serbian Chamber of Commerce - <http://www.pks.co.yu>

Belgrade Chamber of Commerce - <http://www.kombeg.org.yu>

Euro Info Correspondence - <http://www.eicc.co.yu>

Appendix 1.

OECD Survey of Small Enterprises in the FR Yugoslavia

This OECD survey was carried out in May 2002, the full details of which are provided in the OECD economic survey for FR Yugoslavia (OECD, 2003, annex tables). The data in this appendix are extracted from that report. The sample population for the survey was all small firms registered with the Commercial Court that had opened a giro account with the Clearing and Payment Service (ZOP) and filed the requisite returns. A random sample of active registered private enterprises was taken from the Uniform Register of Enterprises. The total sample of 404 firms was drawn equally from Belgrade, Vojvodina, Central Serbia and Montenegro. The sample of 404 small enterprises was also stratified according economic activity: manufacturing, construction, commerce and services. The mean employment for the SME sample was 11 full-time and 1.5 part-time people. The survey technique was face-to-face interviews, using a detailed interview guide. The main findings of the survey are highlighted below.

Change in the Business Environment for SMEs in the Past Two Years

Thirty nine per cent of respondents believed that the SME business environment had deteriorated, compared to 23% believing it to have improved. Thirty eight per cent either did not know or felt it was unchanged. Tables A.1 and A.2 provide some of the details. The main messages are that market demand, profit margins and investment opportunities have deteriorated for many SME businesses over the previous two years. The results are fairly consistent between Serbia and Montenegro. The decline in profit margins was linked to the lower investment opportunities (OECD, 2003, p.93).

Over 50 % of respondents have seen no change in their relationship with their employees, the tax authorities, local authorities, state regulators, protection from criminals and the efficiency of the judicial system. Seventeen per cent stated that tax legislation has improved, but 30% (39% in Belgrade) said it had actually deteriorated. Eighteen per cent have seen an improvement in the ease of obtaining licenses, but 49% said it was unchanged with 9% (20% in Belgrade) saying it had deteriorated.

Table A.1 Views on the Change in the Business Environment in the Last Two Years (%)

	Improved	Unchanged	Deteriorated	Don't know
Market Demand	27	23	43	7
Profit Margins	17	22	54	7
Investment Opportunities	23	25	40	12
Availability of External Finance	28	33	24	15
Freedom to Compete for Business	25	45	19	12
Relationship with Employees	23	72	3	2
Relationship with Tax Authorities	14	62	19	6
Relationship with Local Authority	14	62	13	10
Relationship with State Regulators	13	62	11	13
Relationship with SME agencies	11	44	9	36
Ease of Obtaining Licenses	18	49	9	36
Tax Legislation	17	41	30	11
Protection from Criminals	16	50	16	18
Efficiency of Judicial System	9	53	17	21

Most respondents, both in Serbia and Montenegro, believe the burden of taxes, social contributions and license and other fees had increased in the previous two years. These findings are consistent with the focus group discussions and analysis in the preceding chapters of this report.

Table A.2 Perception of the Change in the Burden on Small Businesses in the Last Two Years (%)

	Increased	Unchanged	Decreased	Don't know
Taxes	65	22	8	5
Social Contributions	55	25	17	4
License and other Fees	51	32	8	8
Number of Licenses / permits / certifs.	32	45	12	11
Employment Regulations	24	48	7	21
Health and Safety Regulations	30	50	2	23
Environmental Regulations	24	50	2	23

Firms indicated that the most significant difficulties they had in starting-up were as set out in Table A.3. The results are also consistent with the feedback from SMEs given in Chapter 3.

Table A.3 Ranking of Difficulties in Starting Up

	Overall	Belgrade	Vojvodina	Central Serbia	Montenegro
Funding	1	1	1	2	1
Registration Procedures	2	2	2	1	2
Registration Costs	3	4	4	3	3
Obtaining Licenses	4	3	3	4	4

Table A.4 analyses how a range of indicators of activity in SMEs changed in the last two years. The deterioration in profitability in many firms is again confirmed, however, a significant minority have seen an improvement. This, together with an improvement in competitiveness and some improvement in employment, augurs well for the future. So far the changes introduced by the Government are impacting to a surprisingly limited extent on employment, though it is not clear whether this is official employment or not.

Table A.4 Change in Indicators of Activity in the Last Two Years (%)

	Improved	Unchanged	Deteriorated	No Response
Sales	29	32	38	1
Production Level	31	34	21	13
Profitability	20	35	45	
Competitiveness	41	39	20	
Average Wages	31	49	21	
Number of Employees	25	64	11	

Respondents indicated that in addition to insufficient customer purchasing power, the three most significant difficulties in the ongoing operation of their firms were: increasing input costs, insufficient capital and insufficient credit. Over 55% found it difficult to obtain bank credit. Sixty per cent of SMEs found it difficult to obtain financial support from other sources and over 70% found it difficult to purchase new equipment. Most firms had no difficulty with hiring or dismissing staff.

The following summarises the situation for SMEs, with the economic environment generally being worse than the average in Serbia compared to Montenegro:

- 10% of firms found it quite easy to purchase timely business advice, with 34% finding it difficult.
- 8% found it quite easy to obtain licenses / certificates, with 40% finding it difficult.
- 3% found it quite easy to lobby the authorities, with 69% finding it difficult.
- 18% found it quite easy to protect the business from extortion, with 30% finding it difficult.
- Only 3% found it quite easy to expand their business, with 66% finding it difficult.

When asked, 30% (39% in Belgrade) said that the tax situation was particularly obstructive to their firms operations, again an issue which is reflected in the focus group discussion in Chapter 3.

Legal and Regulatory Situation

When asked what action they would take if they believed that the regulatory authorities were exceeding their legal authority, 54% said they would negotiate a compromise, 17% said they would comply anyway and 12% said they would go to court.

Most respondents rated having a strong, friendly relationship or a good working relationship as being more important in business than having a formal contract. Seventy five per cent said they would usually use face-to-face negotiation to resolve conflicts with customers and suppliers, with only 14% saying they would resort to commercial court. A significant minority (36%) said there was no effective ways to collect debts.

Table A.5 indicates the extent to which participants believed they could rely on formal contracts. While most respondents (68%) felt they could “usually / always” or at least “sometimes” rely on contracts, a sizeable minority (32%) believe they cannot rely on contracts, with the situation being somewhat better in Belgrade.

Table A.5 **Extent to which Formal Contracts can be relied on to Obtain Payments (%)**

	Overall	Belgrade	Vojvodina	Central Serbia	Montenegro
Hardly Ever / Not at All	32	27	26	31	43
Sometimes	31	22	36	25	39
Usually / Always	37	50	38	44	19

Dealings with Institutions

Table A.6 analyses the difficulty SMEs have in their working relationship with various institutions. The State, Tax, Public Prosecutor, Local, Licensing and other Regulatory Authorities were all found by 40% or more of SMEs to be difficult to deal with, only 10% or less found it quite easy to deal with them. This compares with 28% who found the banks quite easy to deal with.

Table A.6 **Difficulty in Establishing a Working Relationship with Various Institutions (%)**

	Difficult	Not So Difficult	Quite Easy
State Authorities	54	40	10
Tax Authorities	50	40	10
Public Prosecutors Office	50	38	4
Local Authorities	43	48	9
Licensing / Certification Authorities	42	44	5
Other Regulatory Authorities	40	48	5
Banks	25	46	28

Business Services

Table A.7 analyses the situation in relation to whether there are sufficient services available to small businesses. The main areas of shortage of services are: Business Consultancy, Financial, Advice on Certificates, Leasing, Intellectual Property and IT.

Table A.7 **Sufficient Suppliers of Particular Services to Small Businesses (%)**

	Enough	Not Enough	Practically None	Don't Know
Financial / Credit (banks)	41	38	9	12
Business Consulting	21	34	25	20
Advice on Producing Certificates	30	33	15	22
Leasing Contracts	10	31	33	26
IT Software and Databases	49	28	8	15
Advice on Intellectual Property	22	26	29	24
Legal Advice on Firm Registration	55	24	9	12
Other Legal Advice	56	25	8	11
Internet Service Providers	63	20	6	11
Auditing	77	11	4	7
Book-keeping	89	6	1	4

Business Outlook

The prospects for the future and the commitment of the SME sector to growth are confirmed by the plans of SMEs in both Serbia and Montenegro to increase sales and output and keep the firms intact, as set out in the analysis of firms' plans for 2002 in Table A.8. However, it also confirms a lack of dynamism in Serbian SMEs. In addition, in answer to a related but separate question, 69% of firms said they expected their business to survive longer than the next three years.

Table A.8 **Plans for 2002**

	Yes	No	Undecided	Don't Know
Increase Turnover Significantly	69	15	16	
Increase Output Significantly	53	20	17	10
Radically Change the Product Line	16	58	16	10
Acquire Other firms	8	79	13	
Establish Subsidiaries or Branches	19	67	14	
Break-up the Firm	2	92	6	
Merge with another Enterprise	3	89	8	
Liquidate the Firm	2	94	4	
Sell the Firm	2	92	5	

Appendix 2.

Obstacles to Doing Business (BEEPS, 2002)

The main results of the 2002 Serbian Business Environment and Enterprise Performance Survey (BEEPS) are summarised in the following table. It contains the average score assigned by respondents to each aspect of the business environment, where the scores can be interpreted as follows: 1 = no obstacle; 2 = minor obstacle; 3 = moderate obstacle; 4 = major obstacle.

Rating of Severity of Obstacles to Doing Business (BEEPS, 2002)

Economic policy uncertainty	3.1
Tax rates	2.9
Cost of financing	2.8
Macroeconomic instability	2.7
Tax administration	2.7
Access to financing	2.4
Anti-competitive practices of other producers	2.3
Contract violations by customers and suppliers	2.2
Customs and trade regulations	2.2
Functioning of the judiciary	2.1
Corruption	2.1
Business licensing and permits	2.0
Labour regulations	2.0
Organised crime	1.9
Skills and education of workers	1.8
Street crime	1.8
Telecommunications	1.8
Electricity	1.7
Transportation	1.5
Title or leasing of land	1.5
Access to land	1.4

Source: EBRD.

The Organisation for Economic Co-operation and Development (OECD) groups 30 member countries sharing a commitment to democratic government and the market economy. With active relationships with other countries, Non-Governmental Organisations and civil society, it has a global reach. Best known for its publications and statistics, its work covers economic and social issues from macroeconomics, to trade, education, development and science and innovation. Over time the OECD's focus has broadened to include extensive contacts with non-member economies and it now maintains co-operative relations with some 70 of them. These contacts aim to further economic integration by making the OECD's experience available to other countries and enabling the OECD to profit from the insights and perspectives of non-members. (see www.oecd.org)

The European Bank of Reconstruction and Development (EBRD) was set up in 1991 to support the development of market economies in central and eastern Europe and the Commonwealth of Independent States following the collapse of communism. The EBRD supports the economies of its 27 countries of operations by promoting competition, privatisation and entrepreneurship. Taking into account the particular needs of countries at different stages of transition, the Bank focuses on strengthening the financial sector, developing infrastructure and supporting industry and commerce. The EBRD is the largest investor in South Eastern Europe and is also an active contributor to the Stability Pact. (see www.ebrd.com)

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