

**EMERGING ENTREPRENEURSHIP AND SME POLICY  
DEVELOPMENT IN THE BSEC AFTER THE  
ECONOMIC CRISES**

**FINAL WORKSHOP REPORT**

**on**

**“Strategies of the Development of Entrepreneurship and  
the SME Sector  
in the Black Sea Economic Cooperation Region”**

**organized by**

**ORGANIZATION OF THE BLACK SEA ECONOMIC  
COOPERATION (BSEC)**

**and**

**KONRAD-ADENAUER-STIFTUNG (KAS)**

21-22 July 2011  
Istanbul, Turkey



# EMERGING ENTREPRENEURSHIP AND SME POLICY DEVELOPMENT IN THE BSEC AFTER THE ECONOMIC CRISES

**Edited by**

**Dr. Antal Szabó**

**Ayşegül Çetin**

21-22 July 2011

Istanbul, Turkey

**Published by Konrad-Adenauer-Stiftung**

**Konrad-Adenauer-Stiftung e.V.**

All rights reserved.

No part of this publication may be reproduced in any form or by any means without the permission of

Konrad – Adenauer – Stiftung  
Ahmet Rasim Sokak No: 27  
06550 Çankaya-Ankara/TÜRKİYE  
Telephone : +90 312 440 40 80  
Faks : +90 312 440 32 48  
E-mail : info.tuerkei@kas.de  
www.kas.de/tuerkei

ISBN : 978-975-7968-99-3

Designed & Printed by : OFSET FOTOMAT  
+90 312 395 37 38 Ankara, 2012

7		<b>ABBREVIATIONS</b>	
9		<b>PREFACE</b>	<i>by Ambassador Leonidas Chrysanthopoulos</i>
15		<b>INTRODUCTION</b>	<i>by Dr. Antal Szabó</i>
19		<b>1. DEVELOPMENT OF ENTREPRENEURSHIP AND SME SECTOR IN THE BSEC COUNTRIES</b>	<i>by Dr. Antal Szabó</i>
29		<b>2. NATIONAL COUNTRY STUDIES ON THE SME SECTOR IN THE BSEC REGION</b>	
29		<b>2.1 Albania</b>	<i>by Tefta Demeti and Arber Demeti</i>
71		<b>2.2 Armenia</b>	<i>by Tigran Sukiasyan and Dr. Aleksander Poghossian</i>
113		<b>2.3 Azerbaijan</b>	<i>by Dr. Alakbar Mammadov</i>
133		<b>2.4 Bulgaria</b>	<i>by Dr. Zhelyu Vladimirov</i>
168		<b>2.5 Georgia</b>	<i>by Eteri Mamukelashvili</i>
198		<b>2.6 Hellenic Republic</b>	<i>by Dr. Irini Voudouris and Ioanna Deligianni</i>
217		<b>2.7 Moldova</b>	<i>by Dr. Elena Aculai and Valentina Veverita</i>
250		<b>2.8 Romania</b>	<i>by Dr. Zsuzsanna Katalin Szabó</i>
286		<b>2.9 Russian Federation</b>	<i>by Assoc. Prof. Irina Naoumova and Alexandr Vatolin</i>

302	<b>2.10 Serbia</b> <i>by Dr. Dejan Erić</i>
330	<b>2.11 Turkey</b> <i>by Umut Yilmaz Çetinkaya</i>
351	<b>2.12 Ukraine</b> <i>by Oksana Dugert and Dr. Oleh Levchuk</i>
372	<b>3. SWOT ANALYSES OF THE SME SECTORS IN THE BSEC REGION</b>
386	<b>Annex 1: Map of the Black Sea Countries</b>
387	<b>Annex 2: SME Statistics in the BSEC Countries</b>
400	<b>Annex 3: Index of SME Development in the BSEC Countries</b>
406	<b>INDEX OF AUTHORS</b>
409	<b>INTRODUCTION</b>
415	<b>KONRAD-ADENAUER-STIFTUNG - LIST OF AVAILABLE PUBLICATIONS</b>

## ABBREVIATIONS

ALL	Albanian lek
AMD	Armenian dram
AZN	Azerbaijani manat
BGN	Bulgarian lev
BSEC	Black Sea Economic Cooperation
BSEC WG on SMEBSEC	Working Group on SMEs
CIS	Commonwealth of Independent States
CEE	Central and Eastern Europe
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ERENET	Entrepreneurship Research and Education Network among the Universities of Central and Eastern Europe
EU	European Union
EUR	euro, the official currency of the eurozone
FDI	foreign direct investment
GDP	gross domestic product
GEL	Georgian lari
GVA	gross value added

IFC	International Financial Corporation
ILO	International Labor Organization
IMF	International Monetary Fund
KAS	Konrad-Adenauer-Stiftung
m	million
MDL	Moldovan leu
na	not available
NACE	Nomenclature statistique des activités économiques dans la Communauté européenne, commonly referred to as NACE, is a European industry standard classification system
NUTS	Nomenclature d' Unités Territoriales Statistiques (Nomenclature of Territorial Units for Statistics)
OECD	Organization for Economic Cooperation and Development
PERMIS BSEC	Permanent International Secretariat of the Organization of BSEC
RON	Romanian leu
RSD	Serbian dinar
RUB	Russian ruble
SEE	South-Eastern Europe
SMEs	small and medium-sized enterprises
TRY	Turkish lira
UNECE	United Nations Economic Commission for Europe
UAH	Ukrainian hryvnia
US	United States dollar
VAT	value added tax
WB	World Bank
WTO	World Trade Organization

## PREFACE

The economic and financial crisis the world economy has experienced and continues to experience nowadays is a result of human greed that creates a lack of confidence. Therefore the right response to it would be to restore the confidence by limiting human greed.

The financial crisis has made it more difficult and more costly for SMEs to receive credits and loans, hence marginalizing the access of small business to a vital source of financing. Therefore it becomes obvious that the governments shall secure a simple and straightforward access to finance for SMEs by providing enough liquidity and simplify the criteria for their access to financial resources. To take a broader look, the future financial system has to be re-designed to support the needs of consumers and enterprises, particularly SMEs, and not the "global speculators" which, in a way, are not associated with the production cycle. The Islamic Banking System could also be helpful in providing solutions for the liquidity issue.

The crisis itself and the changes it is bringing precipitate the need for SMEs to re-examine and modify their competitive performance and competitive strategies. One way of

doing that is for SMEs to participate in regional alternative economies that are emerging and have existed in many countries of the world. In 15 EU countries such economies have existed, the biggest one being in Germany with 60,000 members. Most of these economies have their own regional currencies that are used by their members. Many SMEs are also participating in regional alternative economies. In Greece for example, we have this system working in four geographical areas. Perhaps this might be the dawn of a post euro era in Europe.

As a common approach and a common vision, the SMEs must be given the right regulatory conditions to activate, the broader access to public procurement and governmental aid while the administrative burdens and red-tape shall be reduced or eliminated where possible. The governments at both national and local level must ensure that these recommendations are implemented as soon as possible in order to overcome the negative effects of the financial crisis.

Although the SMEs stand to be the most vulnerable to the potential global and regional ramifications of the ongoing economic and financial crisis, their flexibility enables them to match quick changes in the market demand and re-orient their activities and diversify their business using innovative approach to reduce losses and increase profitability.

The success of BSEC depends on the concreteness and effective implementation of common projects. There are two BSEC projects of major significance. These are the Black Sea Ring Highway project and the project on the development of the Motorways of the Sea in the BSEC region. They are related to the development of transport links in the region. They are expected to do much to foster intra-BSEC trade, as well as tourism, infrastructure and transport investments and economic prosperity among the countries of the Black Sea.

The Black Sea Ring Highway project envisages a four lane ring highway system, approximately 7,700 km long, to connect the BSEC Member States with each other. The project on the development of the Motorways of the Sea in the BSEC region, on the other hand, is about strengthening the maritime links among the ports of the BSEC Member States. Besides transport, one of the areas where the potential of Black Sea economic cooperation is most visible is in the area of trade. Currently,

intra-BSEC trade and investment are not at the desired level. Therefore, various initiatives have been launched within BSEC to contribute to the improvement of the trade situation. For example, BSEC has been cooperating with the United Nations Development Programme (UNDP) on this matter. Within this framework, the Black Sea Trade and Investment Promotion Programme (BSTIP) - the first joint project between the two organizations – has been launched. The project, which is co-financed by Greece, Turkey, the UNDP and BSEC, aims to develop trade and investment linkages among the BSEC Member States, with the direct participation of the business communities.

The Memorandum of Understanding on the Facilitation of Road Transport of Goods in the BSEC Region (signed in 2002 and put into force in 2006) is another concrete step taken by the BSEC countries to facilitate regional trade.

An important additional step has been taken in the sphere of road transport facilitation. Within this framework, a pilot project on the establishment of a BSEC Permit system for the road transit of goods was launched on in 2010, with the participation of seven BSEC Member States. This pilot Permit system is expected to facilitate the work of the road transporters and to contribute to trade relations among the participating countries.

The BSEC Agreements on Simplification of Visa Procedures for the Businesspeople and for the Professional Lorry Drivers Nationals of the BSEC Member States, signed in 2008 in Tirana, will also surely contribute to the trade cooperation among the Member States.

Currently, BSEC Members are discussing the modalities of establishing an information exchange mechanism for environmental protection. There is also an ongoing study on the possibilities of strengthening cooperation with other organizations, institutions and partners on issues related to the protection and rehabilitation of the Black Sea marine environment. Learning to live with climate change is an absolute priority for humanity. The BSEC Council of Ministers of Foreign Affairs, in its meeting in Thessaloniki in November 2010, adopted a Joint Declaration on Combating Climate Change in the wider Black Sea Area. This was the contribution of BSEC to the Cancun Conference in December 2010. Also, a project on

introducing climate change in the environmental strategy for the protection of the Black Sea will soon be launched, jointly with the UNDP.

Green energy is interrelated with planetary environmental protection. Supporting projects that promote sustainable energy development is a priority for BSEC. BSEC's capabilities to finance projects in renewable energy sources and energy efficiency through the BSEC Project Development Fund and the BSEC-Hellenic Development Fund - the two financial instruments of the Organization - have been enhanced.

In energy cooperation, another main priority for BSEC is to ensure the stability and security of energy supplies by developing a BSEC regional energy strategy and a 2020 strategy. BSEC is also committed to efforts towards ensuring the integration of the energy markets of BSEC and the EU by developing a joint BSEC-EU Plan of Action in energy and encouraging cooperation with the Energy Community.

In the area of SMEs, BSEC is currently focusing on high technology, innovation, technology parks and incubators with the objective to encourage innovative ideas, products, services and procedures. Our Organization is also focusing on bringing together and linking businesses, academics, business incubators and financial and state institutions from the BSEC Member States with the purpose of developing a culture of cooperation through networking. BSEC is also supporting the collaboration of SMEs and large companies, promoting measures to improve production efficiency. These objectives are pursued under the guidance of the Hellenic Republic as the Country Coordinator of the BSEC Working Group on SMEs.

I assume that during the two-day discussion the participants will exchange views and conclude recommendations on the future and potential activities of SMEs in the BSEC region. I wish you a fruitful session with concrete and promising results.

*Ambassador Leonidas Chrysanthopoulos*  
*Secretary General of the Organization of the Black Sea Economic*  
*Cooperation*  
*Permanent International Secretariat*

*Extract from his Statement at the Workshop on  
"Entrepreneurship and SME Policy development in the BSEC Region  
in the Time of Emerging from the Economic Crisis"  
(held on 21 July 2011 in Istanbul)*



# INTRODUCTION

by Dr. Antal Szabó

UNECE retired Regional Adviser on Entrepreneurship and  
SMEs

Scientific Director of ERENET

Since the launch of the initiative of the Black Sea Economic Cooperation (BSEC) in 1992, it has evolved into a full-fledged regional organization with the establishment of the Permanent International Secretariat (PERMIS) in Istanbul in 1994 and the adaptation of its Charter in 1999, supported by the Black Sea Trade and Development Bank based in Thessalonica. Now it has 12 members - Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Serbia, Ukraine and Turkey. Today the Organization represents a region of 336 million people with heterogeneous economic characteristics. See the map of the BSEC countries in Annex 1.

On 11 April 2007, the European Commission issued its communication to the Council and the European Parliament on "Black Sea Synergy – A New Regional Cooperation Initiative"<sup>1</sup>. Taking into consideration the pre-accession strategy with Turkey, the European Neighborhood Policy

and Strategic Partnership with Russia, this document would enhance synergies and provide a framework to ensure greater coherence and policy guidance.

In the course of 19 years of activity, BSEC has become a well-defined institutionally and treaty-based regional organization in the prosperous Black Sea area in the immediate vicinity of the European Union. As on 1 January 2007 two Black Sea littoral countries – Bulgaria and Romania – joined the EU, three out of its 12 member states are Members of the European community. On 25 June 2007, the Summit Meeting of the leaders of BSEC member states was held in Istanbul, on the occasion of the 15th anniversary of the Organization's establishment.

The adoption in Istanbul on 27 September 2001 of the document entitled "Declaration on Small and Medium-sized Enterprises at the Dawn of the 21st Century" by the Ministers in charge of SMEs, as well as the subsequent establishment of the Working Group on SMEs (WG on SMEs) on 16-17 May 2002, have been timely steps in the right direction. Today, SMEs rank high in the priority list of BSEC. The WG on SMEs is composed of representatives of the government officials from the BSEC Member States in charge of development of the national SME policies and supportive programs, the national SME support organizations and institutions, the Chambers of Commerce and Industry, and the business associations representing interests of SMEs.

By means of collaborative and cooperative efforts, particularly with the Representation of the Konrad Adenauer Stiftung (KAS), BSEC PERMIS has engaged in a campaign to raise public awareness in the BSEC region of the importance of SMEs. The United Nations Economic Commission for Europe (UNECE) and the National Institutions of some of the BSEC Member States responsible for SMEs have also contributed to those joint endeavors. Since 2006, the Entrepreneurship Research and Education Network among the Universities of Central and Eastern Europe (ERENET) headed by the former UNECE Regional Adviser on Entrepreneurship and SMEs has been supporting the activities organized by KAS and PERMIS BSEC. Through a series of 41 workshops that have been held, it has been possible to address various issues involved in the development of SMEs and to reach guiding conclusions.

During its first meeting, the BSEC WG on SMEs agreed on the mission of this group as follows:

- to help create an enabling business environment;
- to foster entrepreneurship; and
- to promote co-operation among SMEs in the BSEC region.

The BSEC WG on SMEs convened seven meetings until July 2010. The existing Action Plan is coordinated by the Hellenic Republic, Hellenic Ministry of Foreign Affairs, Hellenic Organization for Small and Medium Sized Enterprises and Handicrafts (EOMMEX) for the period November 2007 – 31 December 2011. The Plan of Action for 2007-2009 focused on High Technology, Innovation and SMEs, Technology Parks and Incubators Guided by the provisions of the Declaration on SMEs of the Joint Ministerial Statement of the BSEC (Istanbul 2001). The main subject of the BSEC WG on SMEs for January 2010 - December 2011 is "Green Entrepreneurship and Sustainable Development".

At the Meeting of the BSEC WG on SMEs held on 14 December 2010 in Istanbul, the participants adopted the Plan of Action for 2010-2011, suggested establishing a Forum to bring together all women's entrepreneur organizations. The WG also noted that the issue of BSEC Quality Award based on the Total Quality Management (TQM) principle has been considered within the BSEC Business Council and that appropriate steps are being taken by the Board of Directors of the BSEC Business Council and its International Secretariat in order to draft the terms of reference and to organize the quality performance competition for SMEs from BSEC region in cooperation with the interested institutions of the Member States.<sup>3</sup>

In spite of the importance of the subject, the achievement of the WG on SMEs has been on a modest scale due to frequently changing national representatives from individual BSEC countries.

In order to assist the analysis of the SME sector development in the BSEC region, especially in the transition economies as well as in the new or associated EU countries, the PERMIS BSEC and Konrad Adenauer Stiftung decided to organize a high-level policy meeting on the achievement and tasks of the entrepreneurship and SME development policies to be held at the end of 2007 at the BSEC Headquarters in Istanbul. The document, elaborated by the ERENET members for the Istanbul meeting and discussed at the Workshop with participation of high-level policy makers, is a unique guideline summarizing the main characteristics of the SME development in the BSEC countries. It presents the strengths and

weaknesses of the SME sector and sets the tasks for further improvement from country to country. The document was well received by BSEC Governments as a guiding document.

The world-wide financial and economic crisis started in the mid-2000s and affected all European economies. The impact is different in every country and even within the regions. The emerging global crisis left most transition economies unaffected until mid-2008, but hit hard afterwards as commodity prices collapsed, export contracted and capital inflow stopped. The economic output and the production declined sharply in the whole CEE from the Baltic States through the Danube basin up to the Black Sea, while unemployment rates soared dramatically. During 2009, the national currencies in Central and Eastern Europe eroded by 20-40% compared to EUR and USD. In April 2009, 11 countries requested financial help from the International Monetary Fund, including Romania, Serbia and Ukraine from the BSEC region. Since 2008, Russia has also been struggling in a deep economic crisis. In the European Union, Greece suffered a major blow and was left vulnerable to the existing EUR system. In spite of the fact that, the economic crisis seemed to be over by the end of 2010, the majority of the CIS countries in the BSEC will continue to feel the impact longer than other industrialized nations due to their rigid economy burdened with the overwhelming and overtly bureaucratic state role in the economy.

This Report was prepared based on the discussions among the Secretariat of the PERMIS BSEC, Turkish Representative of the Konrad Adenauer Foundation -KAS- and the former UNECE Regional Adviser on Entrepreneurship and SMEs, Scientific Director of the Entrepreneurship Research and Education Network among the Universities of Central and Eastern Europe - ERENET. All experts preparing the evaluation of the SME sector in geographically neighboring countries are Members of the ERENET Network, and express their views independently from the current Government authorities or any political parties.

The aims of the study are:

- (i) to review the current situation in the SME sector of the BSEC countries; and
- (ii) to provide assistance to strengthening the activities of the BSEC WG on SMEs as well as cooperation between the stakeholders and SME policymakers.

## **1. DEVELOPMENT OF ENTREPRENEURSHIP AND THE SME SECTOR IN THE BSEC COUNTRIES**

by Dr. Antal Szabó

UNECE retired Regional Adviser on Entrepreneurship and SMEs

Scientific Director of ERENET

The Black Sea region is a distinct geographical area with strategically located at the junction of Middle- and South-Eastern Europe, the Middle East, the Caucasian region, and the European part of the CIS except for Belarus spreading over several thousand kilometers of territory. It is difficult to state that there is a homogenous strategic interest of all its 12 Member States, except for promoting human rights, building democratic societies in all countries, steering their economies towards a market economy and promoting good governance.

In 2009, the total population was 331 million, 4 million less than in 2007. In 2007, more than 3 million SMEs in the BSEC region employed over 21 million workers in total, while the number of the unemployed amounted to more than 10 million. During the last three years, the awareness of the importance of entrepreneurship increased significantly. According to recent statistics provided by the authors of the national country studies, 12 million SMEs in the BSEC countries employ 46.5 million people, while the number of the unemployed also increased to 15.4 million. The average size of the SMEs is 3.88 persons per SME. The aggregated statistics in SMEs in the BSEC countries is presented in Table 1.

Since the foundation of the BSEC WG on SMEs, the transition countries have continued to make progress in economic reforms. The countries in South-Eastern Europe (SEE) made the most progress, spurred on by their aspiration to join the EU. Bulgaria and Romania have already succeeded. Croatia, The Former Yugoslav Republic of Macedonia and Bulgaria in SEE together with Georgia from the Caucasus were in the group of the first ten top reformers in 2006-2007 in accordance with the World Bank Doing Business 2008 Report.<sup>4</sup> Eastern Europe and Central Asia, as a region, surpassed East-Asia in 2007 in the ease of doing business. Several of the region's countries have even passed many economies of the old advanced EU countries on this score.

### 1.1. The World Bank Doing Business Ranking

The World Bank Doing Business Project provides objective measures of business regulations and their enforcement across 178 countries in 2008 and 183 economies in 2011. The Project aims at ranking the economies on their ease of doing business, with first place being the best. A high ranking on the ease of doing business index means the regulatory environment is conducive to the operation of business.

The world-wide financial and economic crisis affected all European economies as well as the BSEC countries. Ambassador Traian Chebeleu, Deputy Secretary General of BSEC PERMIS, highlighted in his opening speech at the BSEC Workshop on "SMEs in the time of global crisis" held in 2010 in Tirana, that "the economic potential of SMEs should not be undermined by the crisis that they neither created nor contributed to. While the adverse affects caused by the global financial crisis affected businesses of all sizes, the SMEs sector was the most vulnerable to these effects. Access to credits and loans was made more difficult for SMEs. Therefore, it became obvious that one of the first lines of action for the Governments is to secure a simple access of SMEs to financial measures. On the other hand, the crisis precipitated the need of SMEs to re-examine and adapt their competitive performance and innovation strategies." Traian Chebeliu also added, that "the financial crisis the world economy is still experiencing includes a crisis of confidence. Therefore the right response to it should include restoring the confidence, particularly when it comes to consumers and small enterprises."

**Table 1: Aggregated Statistics on SMEs in the BSEC Region in 2009**

Country *	Population [x1000]	No of SMEs	No of employees in SMEs	Unemployment
Albania (ALB)	3,194	98,238	193,733	143,340
Armenia (ARM)	3,244	132,879	465,761	76,155
Azerbaijan (AZE)	8,974	75,000 **	1,160,900	41,100
Bulgaria (BGR)	7,585	367,463	1,543,410	238,000
Georgia (GEO)	4,394	38,016	615,584	316,900
Greece (GRC)	11,283	849,389	2,200,000 **	628,700
Moldova (MDA)	3,566	43,658	316,200	81,000
Romania (ROU)	21,480	625,458	7,496,000	681,000
Russian Fed. (RUS)	141,909	2,992,699	12,223,800	6,162,400
Serbia (SRB)	7,321	314,827	872,540	502,982
Turkey (TUR)	72,039	3,222,133	17,021,600	3,471,000
Ukraine (UKR)	45,973	3,430,133	4,223,500	900,600
Total	330,962	12,189,893	48,342,028	13,243,177

Source: National country studies, 2011

Remarks:

\* Country codes are used in accordance with the UN system ISO AL-

PHA-3 effective as of 10 October 2010.

\*\* Estimation by ERENET Secretariat

The global financial crisis has renewed interest in good governmental rules and regulation. Having an effective business regulation, Governments and national authorities can support economic adjustment, especially in time of recession. Easy entry and exit of firms, and flexibility in redeploying resources, make it easier to stop doing things for which demand has weakened and to start doing new things. Clarification of property rights and strengthening of market infrastructure can contribute to confidence as investors and entrepreneurs look to rebuild.

The World Bank Doing Business project provides a quantitative measure of regulations for starting a business, dealing with construction permits, registering property, getting credit, employing workers, protecting investors, paying taxes, trading across borders, enforcing contracts and closing a business - all these indicators can be applied to domestic small and medium-size enterprises. However, the project does not deal with such important indicators as the business environment, competitiveness, labor skills of the population in a country, unemployment, corruption, hidden economy and poverty.

Nevertheless, as the World Bank states, "Doing Business functions as a kind of cholesterol test for the regulatory environment for domestic businesses. A cholesterol test does not tell us everything about the state of our health. But it does measure something important for our health."<sup>5</sup>

Doing business reforms made it easier to do business in the following countries:<sup>6</sup>

**Albania** made it easier and less costly for companies to pay taxes by amending several laws, reducing social security contributions and introducing electronic filing and payment.

**Armenia** made trading easier by introducing self-declaration desks at customs houses and warehouses, investing in new equipment to improve border operations and introducing a risk management system.

**Azerbaijan** improved access to credit by establishing an online platform allowing financial institutions to provide information to, and retrieve it

from, the public credit registry. In the field of paying taxes, a revision of Azerbaijan's tax code lowered several tax rates, including the profit tax rate, and simplified the process of paying.

**Bulgaria** eased business start-up by reducing the minimum capital requirement from BGN 5,000 (USD 3,250) to BGN 2 (USD 1.30). In the field of paying taxes, Bulgaria reduced employer contribution rates for social security.

**Georgia** improved access to credit by implementing a central collateral registry with an electronic database accessible online. To protect investors, Georgia strengthened investor protections by allowing greater access to corporate information during the trial. In the field of enforcing contracts, Georgia made the enforcement of contracts easier by streamlining the procedures for public auctions, introducing private enforcement officers and modernizing its dispute resolution system. While relating business closing, the country improved insolvency proceedings by streamlining the regulation of auction sales.

**Greece** made transferring property more costly by increasing the transfer tax from 1% of the property value to 10%.

**Moldova** reduced employer contribution rates for social security. Romania amended regulations related to construction permitting to reduce fees and expedite the process. In the field of tax paying, Romania introduced tax changes, including a new minimum tax on profit, which made paying taxes more costly for companies. Relating closing a business, substantial amendments to Romania's bankruptcy laws -introducing, among other things, a procedure for out-of-court workouts- made dealing with insolvency easier.

**Russia** eased construction permitting by implementing a single window for all procedures related to land use. In the field of closing a business, Russia introduced a series of legislative measures in 2009 to improve creditor rights and the insolvency system.

**Ukraine** eased business start-up by substantially reducing the minimum capital requirement. Ukraine also made dealing with construction permits easier by implementing national and local regulations that streamlined

procedures. In the field of paying taxes, the country eased tax compliance by introducing and continually enhancing an electronic filing system for value added taxes.

Table 2 summarizes the ranking of the BSEC economies on starting a business, dealing with licenses, getting credit, and eight other topics.

**Table 2: Doing Business 2008 & 2011 in the BSEC Countries by the World Bank**

Country	ALB	ARM	AZE	BGR	GEO	GRC	MDA	ROU	RUS	SRB	TUR	UKR
Ease of Doing Business Rank	136 82	39 48	96 54	46 51	18 12	100 109	92 90	48 56	106 123	86 89	57 65	139 145
Starting a Business	123 45	47 22	64 15	100 43	10 8	152 149	81 94	26 44	50 108	90 83	43 63	109 118
Dealing with Construction Licenses	168 170	73 78	159 160	103 119	11 7	42 51	153 159	90 84	177 182	149 176	128 137	174 179
Employing Workers	109 -	48 -	80 -	57 -	4 -	142 -	93 -	145 -	101 -	110 -	136 -	102 -
Registering Property	82 72	2 5	56 10	62 62	11 2	93 153	46 18	123 92	45 51	115 100	31 38	138 164
Getting Credit	48 15	36 46	26 46	13 8	48 15	84 89	97 89	13 15	84 89	13 15	68 71	68 32
Protecting Investors	165 15	83 93	107 20	33 44	33 20	158 154	98 109	33 44	83 93	64 74	64 59	141 109
Paying Taxes	118 149	143 159	141 103	88 85	102 61	86 74	111 106	134 151	130 105	121 138	54 75	177 181
Trading across Borders	70 75	118 82	173 177	89 108	64 35	65 84	122 141	38 47	155 162	58 74	56 76	120 139
Enforcing Contracts	74 89	64 63	30 27	90 87	42 41	87 88	17 20	37 54	19 18	101 94	34 26	46 43
Closing a Business	178 183	42 54	75 88	72 83	105 105	38 49	82 92	81 102	80 103	103 86	112 115	140 150

Remarks:

- (i) Code of country names are in accordance with the ISO 3166 standard.
- (ii) The World Bank Group: Doing Business Data 2008 and 2011. The upper figures relate to year 2008 and the lower ones to 2011, respectively.
- (iii) In the field of employing workers following the economic crisis, the picture became more complicated. The employing workers indicators are changing to reflect a balance between worker protection and flexibility in employment regulation that favors job creation. This is why ranking in the 2011 Report is missing. However, there is a comprehensive analysis on employing workers in the Doing Business 2011 Annex. <sup>7</sup>

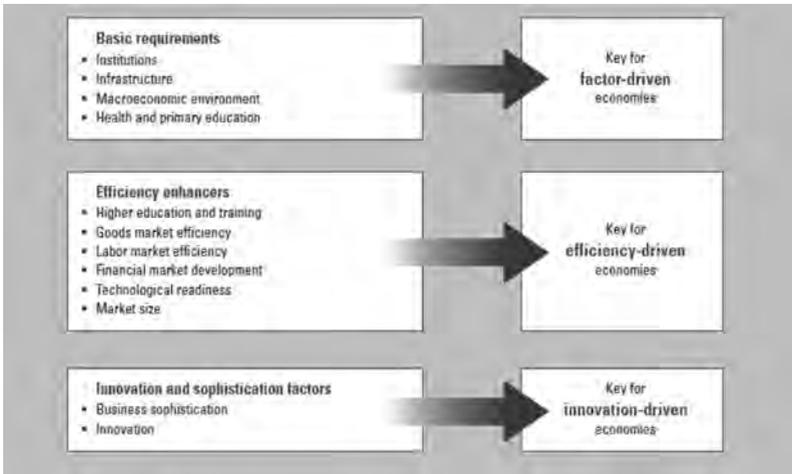
## **1.2. Competitiveness by the World Economic Forum<sup>8</sup>**

While the global economy remains unstable, and despite the fact that Governments are dampening the recession, growth in advanced economies still remains sluggish as they are mired in persistent unemployment and weak demand. Recent concerns about the sustainability of sovereign debt in Europe, and the stability and efficient functioning of financial markets more generally, have added to the list of concerns. The present situation emphasizes the importance of mapping out clear exit strategies to stand economies on a steady footing.

The World Economic Forum with its 30 years of experience provides detailed evaluation of the productive potential of the economies worldwide. The current Report ranks 139 economies including all BSEC countries with a very comprehensive set of parameters.

The World Economic Forum defines competitiveness “as the set of institutions, policies, and factors that determine the level of productivity of a country. The level of productivity, in turn, sets the sustainable level of prosperity that can be earned by an economy. In other words, more competitive economies tend to be able to produce higher levels of income for their citizens. The productivity level also determines the rates of return obtained by investments (physical, human, and technological) in an economy.”

Table 3 below summarizes the 12 most important pillars based for the assessment of a country competitiveness performance. These pillars represent certain stages of economic and social development starting from the factor driven economies (stage 1) via efficient-driven economies (stage 2) and finishing in innovation-driven economies (stage 3) as the more competitive ones.

**Table 3: The 12 pillars of competitiveness**

The World Economic Forum lists the BSEC countries at each stage of development as following:

- Stage 1 (factor-driven economies): Moldova
- Transition from stage 1 to stage 2: Armenia, Azerbaijan, Georgia and Ukraine
- Stage 2 (efficiency-driven economy): Albania, Bulgaria, Romania, Russian Federation, Serbia and Turkey
- Stage 3 (innovation-driven economy): Greece

**Table 4: Global Competitiveness Index 2010-2011 ranking**

Country/Economy	Rank	Score
Azerbaijan	57	4.29
Turkey	61	4.25
Russian Federation	63	4.24
Romania	67	4.16
Bulgaria	71	4.13
Greece	83	3.99
Albania	88	3.94
Ukraine	89	3.90
Georgia	93	3.86
Moldova	94	3.86
Serbia	96	3.84
Armenia	98	3.76

Source: The Global Competitiveness report 2010-2011, WEF, 2010.

### 1.3. Index of SME Development in the BSEC Countries

In order to evaluate the share of the SME sector in each BSEC country, we shall use the Index of SME Development introduced by the UNECE in 1999. It is a complex economic indicator, which incorporates the share of the whole SME sector in the overall performance of the national economy based on:

- (i) Share of private ownership;
- (ii) Share of SMEs in GDP, and
- (iii) Share of the labor force of SMEs in the total labor force of a country.

The Index of SME Development can be expressed in terms of percentage and/or EUR/USD per capita.<sup>9</sup>

It is difficult to state that a country with the highest Index has the most entrepreneurial culture or the SME sector is the most developed and advanced one. The major problem is the lack of harmonized SME statistics in the BSEC countries. National statistical offices of the CIS countries including Greece and Turkey do not calculate the contribution of the SME sector to GDP. This data is based on many cases on estimation by national SME authorities and/economic research institutions. Another problem is bound up with the hidden or shadow economy. According to the World Bank Research Paper published in July 2010, the country average hidden GDP estimation from 1999 to 2007 in the BSEC region varies from 27.5% for Greece to 65.8% for Georgia. Out of the 162 countries, the report has no evaluation for Serbia.<sup>10</sup> However, the Index of SME Development provides a good tool for comparative analysis and benchmarking of the development trends of the SME sectors in the BSEC region, and highlights the trend in changing the SME environment enabling or hindering and depressing or encouraging the entrepreneurs.

The share of half BSEC countries' GDP generated by the SME sector is less than 50%. For comparison, in the USA this estimate is 50-60% and in the European Union, about 70%. One of the secrets of the Chinese economic miracle is that the private SME sector in the country accounts for 55% of its GDP. It is remarkable that Elvira Nabiullina, Minister for Economic Development of the Russian Federation, recently made a bold projection that Russia's SME's share in GDP would reach 50% in the next 5-7 years. Russia's State Presidium proposed measures that would

encourage 60-70% of population to become “involved in entrepreneurial activity” by 2020. President Medvedev has stated specifically that he will support SMEs and would work to make the federal government support rather than obstruct their activities.<sup>11</sup>

**Table 5: Index of SME Development in the BSEC countries between 2008 and 2010**

Country	Share of private sector in GDP [%]	Share of SME sector in GDP [%]	Share of SME labor in total labor force [%]	GDP per capita [USD]	Index of SME Development [-]	Index of SME Development [USD/capita]
Albania	80	70	20	4,098	0.112	459
	82	73	21.8	3,616	0.130	544
Armenia**	84	41.7	42.1	3,689	0.1476	544
	84	42.5	42.2	2,686	0.259	404.7
Azerbaijan	70	13	21	5,508	0.0191	105.3
	75	15	25	6,008	0.028	169
Bulgaria**	85	33.9	45.3	6,548	0.130	855
	84	33.3	47.4	6,223	0.133	825.1
Georgia	89	12	37	2,921	0.0395	115.4
	91	15	37	2,629	0.051	133.3
Greece	60	27.4	86.5	27,610	0.142	3,927
	60	27	60	27,300	0.097	2,653
Moldova**	89	31.9	57	1,896	0.162	274
	89	28.9	59	1,524.2	0.152	231
Romania	80	71.7	66	9,239	0.379	3,497
	81	78.8	70.1	7,902	0.447	3,536
Russia*	65	45	40	6,856	0.117	802
	85	40	35.5	15,900	0.121	1,919
Serbia**	55	65.5	58	4,220	0.202	851
	60	35	43.2	6,647	0.091	603
Turkey*	80	27.3	78.7	5,408	0.168	906
	93	40	77.9	12,300	0.217	3,240
Ukraine**	65	16.3	59.9	7,500	0.0635	476
	60	15	60.4	6,933	0.054	376.9

Sources: ERENET Database, Figures in the first row refers to the year 2008 and the second one to year 2010; Strategies for the Development of Entrepreneurship and the SME Sector in the BSEC Region, KAS, Ankara, 2008.

Remarks:

\* The first row refers to year 2007;

\*\* The first row refers to year 2009;

\*\*\* The first row refers to year 2005 and the second one to 2008.

It is extremely remarkable that some countries like Albania, Armenia, Georgia and Moldova made a significant effort towards entrepreneurship development. However, the share of the SME sector in GDP is below the acceptable level in Azerbaijan, Georgia and Ukraine.

Albania and Armenia are in the process of following the selected way of their national economic development, and their economic and social fruits can be harvested slowly. Georgia has just started to reshape its economy and developed towards a more advanced one. From 12% in 2008, the country reached 15% of the share of the SME sector in 2010. Georgia brings the former chaos under its control.

The low share of the SME sector in GDP in Azerbaijan and Ukraine indicates that these countries totally neglect the significance of the SME sector in the economy. Azerbaijan has all the means to develop the private SME sector which can pave the way for its long-term economic growth following the drying up of the oil fields and oil wells. The country might follow the economic development patterns of certain Middle-East countries, like Kuwait for example. In case of Ukraine, the SME situation deteriorated after the crisis, especially after the introduction of the New Tax Code in 2011. The country's political power system is in permanent movement, which can be demonstrated in the case of the status and management of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship Development.

The trend in changing the SME Development Index in some countries, like Bulgaria, Greece and Serbia, indicates the impact of the economic crisis on the national economies. The worst scenario can be observed in Greece, the ancient cradle of the entrepreneurship, which at the time being is facing a restrictive financial request from the EU and other international financial intermediaries.

In spite of the fact that both Greece and Turkey have a remarkably large number of micro- and small enterprises, the share of the SME sector in each country is relatively low. In Greece there is a relatively high share of state-owned entities with low efficiency. Its GDP is the highest one in the BSEC region, but there is the big question as to whether this is a real or a virtual one. Turkey has a lower GDP but has the highest share of the private sector in GDP, generating a higher index of SME development like Greece - 3,240 in Turkey and 2,653 in Greece in 2010.

## **2. NATIONAL COUNTRY STUDIES ON THE SME SECTOR IN THE BSEC REGION**

### **2.1 ALBANIA**

by Tefta Demeti

MBA, Head of Business & SME Unit in Ministry of Economy, Trade & Energy, and

Arber Demeti, PhD candidate, Credit Risk Management, Raiffeisen Bank, Albania

#### **Introduction**

Albanian economy has registered a steady growth since 1992. In the period 2000-2008, the level of economic growth was on a scale of 6-7.7%, outstanding as one of the highest among BSEC countries. In 2009 and 2010, this rate declined to 3.3% and 3.9% respectively, due to the fact that the country faced a global economic crisis. The private sector plays the most important role in the Albanian economy and its contribution is estimated to be over 82% of GDP and employment level.

Small and medium enterprises are the engine of the economy. They are an essential source for the creation of new jobs; entrepreneur and innovation spirit, and have a crucial importance for increasing competitiveness. SMEs dominate the Albanian economy representing 99.9% of all registered businesses. The share of the SME sector in GDP is about 73% and the sector covers approximately 71% of all employees.

According to Doing Business 2011, in ease of doing business, Albania is ranked 82 out of 183 as compared to 136 out of 183 in 2007. Such improvement in ease of doing business is a result of several reforms undertaken in order to improve the business climate.

Maintaining high rates of economic growth in the upcoming years is a challenge for Albanian economy. Furthermore, taking into account the regional integration with the implementation of free trade agreements in the region and the free trade interim agreement with the EU, such a task will be much more difficult to achieve. During the regional and global integration process, Albanian economy will face with increasing competitiveness of other countries.

Finally, the Small Business Act, which is a new framework policy document, will be analyzed. It was endorsed by the European Council in December 2008 (EC, 2008) and Albania as well as the other BSEC countries is expected to move towards implementation of the policies identified in this Act.

### **2.1.1. National Economy and the SME Sector**

Between 1998 and 2010, economic growth in Albania averaged over 6.1% per annum. Over this period, the relative importance of agriculture declined from over 25% of GDP to 18.5% (still a very high value in comparison to other peers). The share of manufacturing rose from 6% to 9% of GDP but remains very low by regional comparisons. At the same time, construction became a more important sector of the economy, whose share of GDP rose from 8.3% to 13.9% between 2000 and 2008. Services remained stable as a share of GDP at just under 60%. Therefore, most of the recent growth for this period is attributable to a shift of labor from agriculture to services and manufacturing.

The strong growth was supported by strong remittances from the Albanians living abroad, with increasing levels of FDI, increased availability of credit, and high private savings, all of which contributed to high levels of investment. Total gross investment increased from 24.6% of GDP in 2000 to 29.5% in 2009, and private investment from 18 to 21.4% over the same period.

However, not all of these investments went into productive activities, with only about 10% of GDP going to investment for production purposes until 2006, as the bulk of investments were skewed towards the construction sector.

During 2009, although the Albanian industrial output faced a contraction of the growth rate as a consequence of the negative shocks coming from the global economic crisis, the overall economy still performed positively and demonstrated again that it is a vibrant economy. This growth has generally been supported by a satisfactory performance of the services sector and a return to its normal pace of agriculture. According to the Institute of Statistics (INSTAT), real GDP increased by 3.3% in 2009 and 3.9% in 2010. It is worth highlighting that this positive growth rate of

the economy for 2009 and 2010 was accompanied by the preservation of the macroeconomic stability within acceptable parameters, and is highly satisfactory if put at a comparative perspective with the countries in the region.

### **Public Sector and Fiscal Policy**

Public policy underpinned economic development in the past years. One of the greatest successes of public policy in Albania is the great reduction in poverty levels which accompanied economic growth. The absolute poverty headcount rate fell from 25.4% in 2002 to 12.4% in 2008. Even more pronounced was the decline in rural poverty, which fell by 47% from 2002 to 2008; in 2008 the poverty rate in rural areas was about 14%.

During the last few years, the business environment improved considerably. Examples of government programs which successfully improved the institutional framework for doing business include the introduction of a flat tax of 10% on businesses and individuals, and the creation of a one-stop shop for business registration. Also, between 2004 and 2009, Albania's governance indicators improved in all six areas measured by the Worldwide Governance Indicators, WGI, (WB, 2010), of government effectiveness and rule of law.

However, notwithstanding such significant progress, there is room and need for further improvement in various areas of implementation of critical laws and regulations in line with the requirements for EU accession, which also count for attracting foreign investment. To this end, establishing a fully functional system of Regulatory Impact Analysis (RIA) and of a permanent Regulatory Reform Task Force would lend added credibility to the process.

The relative improvement in Albania's economic outlook, as outlined above, owes much to sound fiscal and monetary policy frameworks that remain largely in place. Fiscal consolidation has supported the monetary policy framework which strives to keep inflation under control. In recent years, Albania's fiscal stance has been restrictive, while the monetary policy stance has remained broadly neutral.

Although strict application of prudent fiscal policy in the past supported

a downward trend in deficits and public debt declined from 62 to 53% of GDP between 2003 and 2007 in combination with strong GDP growth, this trend reversed starting with 2008 due to the increase of public investment. With the addition of growing concerns over the risks of sovereign debts, financing these deficits becomes increasingly difficult.

### **Banking Sector**

Since March 2009 when the government divested its remaining stake in United Bank of Albania, the banking sector has been fully privatized and according to EBRD data, at the end of 2008 foreign owned banks' share of assets amounted to over 93%. Italian, Austrian, Greek, German and French banking groups such as IntesaSanPaolo, Raiffeisen, National Bank of Greece, Commerzbank and Societe Generale, amongst others, are all present in Albania. The banking sector's capital adequacy ratio is a high 16-17% heading into 2011 and even though non-performing loans have increased from a pre-crisis 4% to approximately 8%, the banking sector is stable.

### **SME Development in Albania in Recent Years**

Small and medium enterprises are the engine of the Albanian economy. They are an essential source of the creation of new jobs, entrepreneur and innovation spirit and are crucial in growing competitiveness and employment.

Private sector contributed to more than 82% of GDP and more than 82% in employment. GDP per capita reached USD 3,677 in 2010 with a decrease by 10% compared to 2008; inflation declined from 3.4% in 2008 to 2.2% in 2009 and increased again during 2010 by 3.6%, staying within the Central Bank's target of 2% - 4%; unemployment increased from 12.7% in 2008 to 13.49% in 2010; remittances fell by 11.7% in 2010 compared to 2009 and by 27.5% compared to 2007 when remittances were at the highest level. SME sector contributed to more than 73% of GDP and more than 71% in employment<sup>12</sup>.

### **Definition of SME**

The definition of SMEs in Albania is based on the same criteria in terms

of employees as the EU definition; classification of thresholds differs in absolute terms for turnover and balance sheets because of economy size and performance. The number of employees is the main criteria employed in both definitions and there is consistency between them, seconded by turnover and balance sheet figures.

The Albanian definition of small and medium-sized enterprises consists of firms that employ fewer than 250 people, and have an annual turnover and/or a balance sheet total not exceeding ALL 250 million (approx. EUR 2 million).

Within the SME category, a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed ALL 50 million (approx. EUR 0.41 million).

Within the SME category, a micro enterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed ALL 10 million (approx. EUR 0.08 million).

Referring to the INSTAT data (INSTAT, 2011:3), the number of active enterprises<sup>13</sup> till the end of 2010 reached 100,687; which indicated a very slight increase by 1% compared to 2008. The new enterprises created during 2010 are 16,443 (NRC, 2011). The number of employees in non agriculture private sector during 2009 decreased by 0.9% compared to the previous year, while the number of employees during 2010 increased by 3.1%.

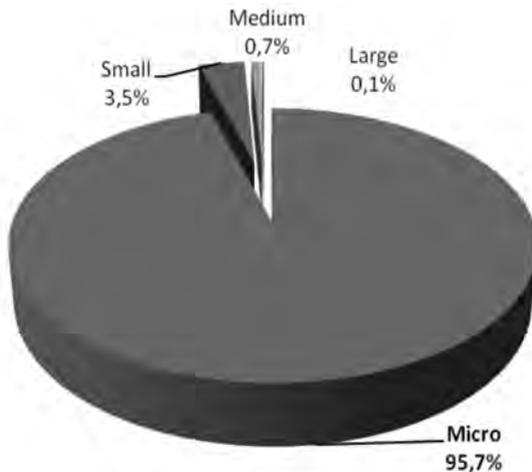
Birth rate of new enterprises for 2010 is 16% higher compared to 2009. In the following table are shown active enterprises by their year of creation. From 2005 to 2009, enterprises in Albania increased by approximately 55%.

**Table 6: Number of Active Enterprises (2005 – 2009)**

Year	2005	2006	2007	2008	2009	2010
No. of active enterprises	64,710	77,814	87,484	99,500	98,238	100,687

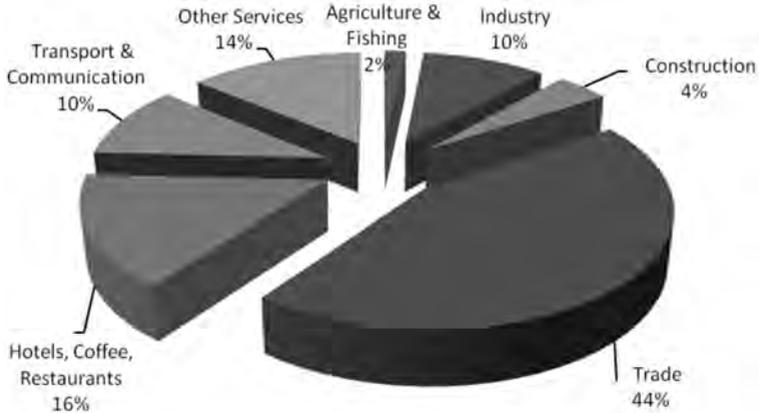
According to data from INSTAT, the share of SMEs is 99,9% of the total number of companies in 2009. SME contribution to exports in the year 2009 was approximately 69%. (33% from medium enterprises, 22% from small enterprises, and only 14% from micro enterprises). Referring to their structure, active enterprises for 2010 are as follows: micro enterprises with 1 to 9 employees make up 95.7% of the total active enterprises, small enterprises with 10 to 49 employees cover 3.5%, medium enterprises with 50 to 249 employees 0.7% and only 0.1% of the total number are large enterprises with more than 250 employees.

**Figure 1: The distribution of active enterprises by size in Albania**



About 50% of the active enterprises in Albania operate in Tirana and Durres. The spread of active enterprises by economic sectors are: trade 44%; industry 10%; hotels, restaurants 16%; transport and communication 10%; other services 14%; construction 4%; and agriculture and fishing 2%.

**Figure 2: The spread of active enterprises by economic sectors in Albania**



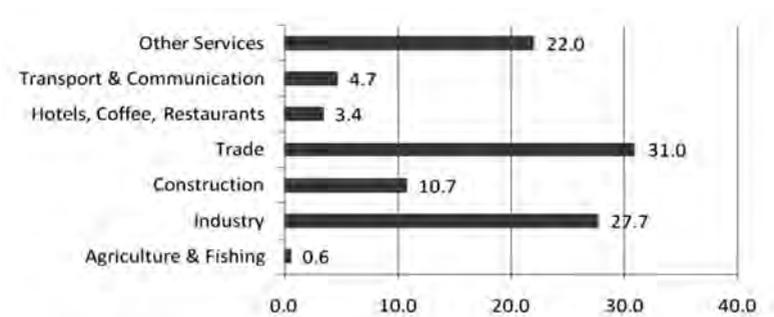
In the industry sector which covers 16% of the total number of enterprises in Albania, manufacturing dominates with 61.5%, construction with 30.6%, while agriculture and fishing comprise 7.9%.

In the service sector making up 84% of the total number, trade covers 55.6%, hotels and restaurants cover 17.4%, other services cover 15.7% and transport and communication cover 11.3%.

The number of enterprises exporting is 1,706. Their export for 2010 reached the value of EUR 1.1 billion with a significant increase of 56.4% compared to the previous year. Exports for the first quarter of 2011 increased by 46% compared to the first quarter of 2010.

Foreign and joint venture enterprises in Albania make up 2.2% of the total number of active enterprises in the country. Foreign investments for 2010 reached EUR 827 million with a growth of 17% compared to the previous year. FDI increased by three folds compared to 2006. Foreign direct investments were largely directed into the hydro-energetic and fuel sectors. Net FDI for 2010 reached 9.4% of nominal GDP in 2010, approximately 1.6% points higher than in 2009.

In the following graph it is evident that trade dominates with 31%, followed by manufacturing with approximately 28%.

**Figure 3: Distribution of FDI by sectors**

Source: Bank of Albania, 2010

Turnover for 2009 according to INSTAT (INSTAT, 2011:1) was 6.2% higher compared to 2008 and 23% higher compared to 2007. Turnover in services was 11% higher compared to 2009 and in industry 2% lower during the same period. The average turnover per employee in 2009 is increased by 10% compared 2007. 38% of the turnover comes from the industry sector and 62% from the service sector. The services sector comprises 55% of the total number of employees. Industry and construction sectors realized 49% of the total investments. The value added in 2009 (INSTAT, 2011:1) was 8% higher compared to 2008. Value added in services was 15% higher than 2008, whereas in industry it was 13% lower during the same period.

### **SME Development Policy**

The framework policy towards SMEs is included in the Business and Investment Development Strategy/BIDS for the period 2007-2013 (Albanian Government, 2007). Chapter II of this strategy is dedicated to SME promotion and development.

Another document is the Strategic Programme on SME Development for the period 2007 – 2009 (METE, 2007) which is an integral part of Sectoral Strategy of Business and Investment Development. The strategic programme for SMEs development refers to a three-year period and covers the narrative part and the action plan for implementing European Charter objectives for small enterprises.

The vision of this strategic program is:

- To improve the climate for accelerating business and investment development;
- To increase the competitiveness of SMEs in regional and global markets through development and information technology, and
- To reduce administrative barriers and create facilities for business.

The overall objective of this strategic program is sustainable economic development of the SME sector through increasing the number of new enterprises and ensuring continuous improvement on productivity, competitiveness and export indicators. The specific objectives that will help achieve the overall goal are as follows:

- Promoting an entrepreneurship culture; drafting entrepreneurship learning strategy; increasing labor force skills and promoting creative businesses.
- Developing growing businesses with internationalization potential.
- Improving the business climate for developing SMEs.
- Business registration only in one day through the establishment of one stop shop for business register and also the creation of the respective network with other prefectures; establishment and creation of the Regulatory Impact Assessment system to ensure evaluations and analysis of policies and the regulatory framework; standardization and unification of criteria and procedures on the issuance of licenses, permits, authorizations and certifications by local and central authorities.
- Increasing competitiveness through innovation and technology transfer.
- Enhancing SMEs funding: Creation of the Albanian Credit Guarantee Fund; application of other financial instruments such as factoring, improvement of leasing, etc. Increase microcredit funds, support of non-financial institutions with micro credit fund from foreign donors and the Albanian government; and strengthen the capacities of micro credit institutions.

### 2.1.2 Legislation and Ranking of Doing Business According to World Bank Methodology

According to Doing Business 2011, in ease of doing business, Albania is ranked 82 out of 183. Albania was ranked 86 in 2009 and 136 in 2007-2008.

**Table 7: Doing Business Indices for Albania**

	2011	2010	2009	2008	2007	2006
Ease of Doing Business	82/183	82	86	136	120	117
Starting a Business	45	46	67	130	121	108
Dealing with Construction Permits	170	173	170	160	161	131
Employing Workers	–	105	108	109	113	127
Registering Property	70	70	62	56	76	66
Getting Credit	15	15	12	61	48	41
Protecting Investors	15	15	14	168	162	136
Paying Taxes	149	138	143	125	125	132
Trading Across Borders	75	66	77	73	101	100
Enforcing Contracts	89	91	88	88	99	113
Closing a Business	183	183	181	181	89	73

Source: Reports of Doing Business (DB 2008, DB 2009, DB 2010, DB 2011)

Several reforms have been made towards the reduction of administrative barriers in business, which have improved the business climate in Albania.

#### Starting a Business

When entrepreneurs draw up a business plan and try to get under way, the first hurdles they face are the procedures required to incorporate and register the new firm before they can legally operate.

It is assumed that all information is readily available to the entrepreneur, that there has been no prior contact with officials and that all government and non-government entities involved in the process function without corruption.

It requires 5 procedures, takes 5 days, and costs 16.82% GNI per capita to start a business in Albania. Albania is ranked 45 overall for Starting a Business in BD 2011, showing significant improvement compared to BD 2007-2008 where it was ranked 130.

The process of the reformation of business registration through National Register Centre (NRC):

- Converting the registration process by a mixed process (judicial and administrative) in an entirely administrative process;
- Registration in a single day, with a single step, closer to the beneficiaries and electronic registration;
- Increasing transparency, impartiality and simplicity in registration;
- Immediate registration for trade, fiscal, social and health insurance and work effect with a single step;
- Simplification of requirements and documentation necessary for registration of businesses,
- Reduction of registration costs, eliminate contacts with administrative employees and thus reduce corruption;
- Provision of services at national level also being extended at the local government structures;
- Full compliance of standards of registration process with the European directives.

NRC has been functioning as a one-stop shop since September 2007. Business registration takes place within one day at NRC, with a minimal cost of ALL 100 (0.81 EUR). Prior to NRC, the time required for registering a business was 28 days in the Court. During 2010 16,433 new companies registered.

The reforms accomplished during 2007 and 2008 reduced the number of steps to start a business in Albania from 10 to 5. Companies are given an identification number by NRC at the time of registration, which is generated in the tax office, social insurance office and office of labor all

at once. By this way, four steps of registration were reduced into one. Also, the Law No. 9897, dated 10.04.2008 "On a change on Law No. 9640, dated 09.11.2006, amended the law on chamber of commerce and industry reducing the obligation of the companies to register nearby CCI. This registration is already voluntary. This brought the reduction of one step to for starting a business.

The procedures that are followed for business registration, in accordance with DB 2011 data are:

- Search for a unique company name (1 day)
- Notarize the incorporation documents (1 day)
- Request at NRC (1 day)
- Paying taxes (1 day)
- Make a company seal (1 day)

Companies need only 5 days to open a new business now, compared to 36 days in 2008, which is also connected with the cost reduction in opening the business.

According to data for the last four years, Albania has the following rankings:

**Table 8: DB Rankings of Albania 2008-2011**

Starting business	2008	2009	2010	2011
Ranking	130	68	46	45
Procedures (number)	10	6	5	5
Time (days)	36	8	5	5
Cost (% of income per capita)	21%	26%	17%	16.82%
Min. capital (% of income per capita)	34%	32%	0%	0%

Source: Respective reports of Doing Business (DB 2008, DB 2009, DB 2010, DB 2011)

According to Doing Business data, the average time to complete the overall start-up business process in OECD countries was cut between 2004 and 2008 by over 60%, from 32.8 to 13.2 days, while the average cost for the entrepreneur was reduced by nearly 50%, from 9.3% to 4.9% of average per capita income.

## **Dealing with Construction Permits**

To measure such regulation, Doing Business focuses on the construction sector. Construction companies are under constant pressure from government to comply with inspections, with licensing and safety regulations, from customers to be quick and cost-effective.

In Doing Business 2011 it requires 24 procedures, takes 331 days, and costs 381.3% GNI per capita to build a warehouse in Albania. Albania is ranked 170 overall for Dealing with Construction Permits being the last compared to the Western Balkan countries. It has taken some steps backward since in DB 2007 when it was ranked 161.

Reform in reduction of licenses did not include the construction permits. During 2007-2009, regulatory reforms in the field of licenses were focused in sectoral improvements, which brought a drastic elimination of the huge number of licenses and permissions. Of the 64 licenses, 21 were converted to self-declarations, 12 licenses were converted to auction and the others were decentralized.

National Licensing Centre, NLC has been functioning as a one-stop shop since June 9, 2009. It operates on the basis of the new law on licenses, authorization and permits Nr. 10081, dated 23.02.2009. It serves as a one-stop shop for licensing and permits that were previously obtained at various ministries. It operates according the principle "Silence is consent". Group I and II licenses are given by NLC itself within 2-4 days. Group III licenses, which are sent to ministries in line, take approximately 10-30 days to obtain.

NLC offers quick and transparent services to businesses interested in obtaining a license and/or permit. There are 8 service windows in Tirana and 9 service windows in other cities.

NLC did not include the construction permits which are delivered by municipalities.

## **Registering Property**

Ensuring formal property rights is fundamental. Effective administration

of land is part of that. If formal property transfer is too costly or complicated, formal titles might go informal again.

Albania is ranked 72 overall for Registering Property. According to DB 2011, it takes 6 procedures, 42 days, and 3.40% of property value to register property in Albania. In DB 2007 Albania was ranked 76, thus making some progress in 2011 by moving up 6 steps. In 2007 it took 7 procedures, 47 days and 3.6% of property value to register property.

### **Getting Credit**

According to Doing Business 2011, Albania is ranked 15 overall for Getting Credit while the survey of DB for 2007 does not present any information regarding getting credit in Albania. This improvement is due to the bank reforms that took place. Starting from 2005, all commercial banks in Albania have been privatized. Crediting of private sector (BA, 2011) for 2010 reached 39.5% in GDP, with a growth of 2 percent compared to the previous year, representing a significant growth compared to 2005 when it was 14.9% in GDP. The annual growth rate of credit portfolio is almost 10%, showing a slight improvement compared to 3.5% by the end of 2009, but still continues to be low. Credit granted by non-banking financial institutions continued to be low as well. As of December 2010, micro credit portfolio of these institutions comprised 3.7% of total financial system assets and 5% of total credit granted by financial system. According to sectors distribution of credit, banks have mostly financed the service sector due to the more optimistic developments in this sector, especially in trade by 34.5% of the total credit.

Strong investor protections are required to enable companies to raise the capital needed to grow, innovate, diversify and compete. In this regard, Albania is ranked 15th overall for protecting investors in DB 2011, being the first among the Western Balkan countries. In DB 2011, the Investor Protection index is 7.3 while in DB 2007 it was only 2.7 and ranked 168. This improvement owes to the reforms in the field of legislation of companies, namely the reforms in the field of trade legislation, drafted and approved by Law no. 9901, dated 14.04.2008 "On Company Law", which provides a contemporary, simple, clear and updated legal framework for companies. The legislation is fully compatible with the provisions of pri-

mary and secondary sources of the *acquis communautaire* and complies fully with all the principles ensuing from those provisions. Novelties of this law are as follows:

- Protecting third parties (creditors) that enter into relation with the company according to EU requirements.
- The removal of the obligation that 1/3 of employees be part of the supervisory board. In compliance with the EU Directives, the employee's council was created, having advisory and information competencies for the most important issues of the company.
- Protecting creditors: When the administrators of a company abuse the law, they respond with their property, except for the capital of the company, even if the company is limited liability.
- Provision of clear rules on the manager's duties, and fiduciary duties against the company, rules that prevent unfair competition of managing directors and share-holders.
- Preserving industrial secret.
- More clear determination of the role of companies inside a group, and also, in distinction with the existing law, the draft law foresees consequences for the parent company when they abuse with subsidiary companies. Prohibition in alternated appointments of directors in parent and subsidiary companies, hereupon a high level of "corporate governance" with the aim of creating a positive climate for the welfare of business.
- Provision of electronic communications.

Through the Law Nr. 10316, dated 16.09.2010 "On some additions to the Law Nr. 7764, dated 02.11.1993 "On Foreign Investments" the government has made some very important changes to the award of a special state protection certain categories of foreign investors, who in the process of investing encounter problems with property titles, from claims on property titles by third parties. The special state protection is provided for the foreign investments in public infrastructure, tourism, energy or agriculture on a real estate and when expected investment worth more than EUR 10 million.

### **Paying Taxes**

Taxes are essential to provide public amenities, infrastructure and services which are crucial for a properly functioning economy.

Albania has taken some steps backwards regarding paying taxes. It is ranked 149 overall for Paying Taxes according to Doing Business 2011 while in DB 2007 it was ranked 125.

**Table 9: Paying Taxes in Albania**

	2011	2010	2009	2008	2007	2006
Time (hours)	360	244	240	240	240	244
Payments number	44	44	44	44	44	44
Tot. tax rate (% profit)	40.6	44.9	57.3	57.3	46.8	50.5

Source: World Bank, Doing Business 2006, DB 2007, DB 2008, DB 2009, DB 2010, DB 2011

Fiscal Reforms have been made for the reduction of fiscal burden for businesses. Fiscal policy is increasingly influential in creating an encouraging and supportive environment for domestic and foreign enterprise. The main steps of the tax reform include the gradual reduction of the rate for the profit tax from 25% in 2000 to 10% in 2008; the change in the system of personal income taxation, from progressive to proportional with the same tax rate as those for corporate income (10%).

Tax policy reform has been based on the idea of lowering the tax rate and simultaneously extending the range of tax-payers. There has been a significant reduction of the tax burden on income from work. Currently the total measure of the tax-contribution on gross salary for social insurance and health is 27.9% of the gross monthly salary, down from 41.9% in 2000.

All these reforms shall bring a reduction in the fiscal burden of the businesses which will reflect in the next study of World Bank, Doing Business.

### **Trading Across Borders**

Making trade between countries easier is increasingly important for businesses in today's globalized world. Excessive document requirements, burdensome customs procedures, inefficient port operations and inadequate infrastructure all lead to extra costs and delays for exporters and importers.

Albania is ranked 75 overall for Trading Across Borders. It is not performing well among Balkan countries, leaving behind only Croatia. Nevertheless, compared to Doing Business 2007, Albania has significantly improved as in 2007 it was ranked 101 overall for Trading Across Borders. From DB 2007 to DB 2011, the time and cost for exporting and importing in Albania have been reduced.

### **Enforcing Contracts**

Where contract enforcement is efficient, businesses are more likely to find new borrowers or customers.

Albania is ranked 89 overall for Enforcing Contracts. There has been an improvement in this respect, compared to the DB 2007 where Albania was ranked 99. Except the cost (% of claim) which increased from 31.8 in DB 2007 to 35.7 in DB 2011,, the number of procedures and time (in days) has not changed for Albania.

### **Closing a Business**

A robust bankruptcy system functions as a filter, ensuring the survival of economically efficient companies and reallocating the resources of inefficient ones.

Albania is ranked 183 being the last one in closing a business. It has no practice on time and cost for closing a business, according to Doing Business 2011.

Through the operation of NRC, the procedures and time for closing a business have also been reduced. During 2010 the number of subjects de-registered was 26%, lower than the previous year.

**Table 10 shows the business closing by year.**

	Physical Person	Juridical Person	TOTAL
2011, first 3 months	1,343	75	1,418
2010	3,597	189	3,786
2009	4,716	440	5,156
2008	3,419	178	3,597

No cancellation appears to be made through the bankruptcy procedure. In the official website of the NRC, in the section "Orders & Judicial Decisions", 3 judicial decisions are published, showing "The opening of bankruptcy proceedings". These decisions under the legal form of society are respectively: 1- for limited liability companies and 2- for joint stock companies. We emphasize that these decisions are in the first phase of review by the courts.

All these reforms shall bring a reduction of the fiscal burden for the businesses which will reflect in the next study of World Bank, Doing Business.

### **2.1.3 SME Support Infrastructure**

A number of public agencies and non government institutions are supporting the SMEs by different services and training.

#### **Alinvest (New Agency AIDA) Services for SMEs**

Albanian Agency for Business and Investments (Alinvest) was the public agency and offered professional and high quality services for the Albanian SMEs during the period 2007-2010.

Alinvest contributed in the improvements of professional skills for SMEs. It has created the portal at [www.alinvest.gov.al/shqip](http://www.alinvest.gov.al/shqip) where businesses can find information on procedures of companies' registration; guidelines with best practices for techniques of managing (marketing, quality, finance, etc); business planning; export's guide; market information; market research; documents and procedures of exports; information and news regarding trade exhibitions and sales missions; connections with other national and international information sources; EU Programmes and donor projects and SMEs observatory.

Alinvest has also offered several seminars and workshops to various Albanian companies.

Business and Investment Development strategy also gives a special attention to the strengthening of Albanian businesses to increase the technological capacities of SMEs.

## **New Agency AIDA**

The Government of Albania through the Law no. 10303, dated 15.07.2010 "On creation and organization and functioning of the Albanian Investment Development Agency" that entered into force on 26 August 2010, creates AIDA as an investment promotion agency, and as a key player for attracting FDIs in the country. The Agency, in view of its activities, performs all acts and undertakes all the necessary initiatives to support private sector development and improve business climate, pursuing and helping private commercial entities in all phases of their economic activity as well as by intermediating and cooperating with investors and state authorities. The new Albanian Investment Development Agency (AIDA) is established replacing the late Albanian Agency of Investment and Business (Albinvest) and has three main mandates: facilitation and support to direct investments into Albania; increasing competitiveness of small and medium enterprises in Albania; and promotion of, and support to, export of goods and services.

It manages The Government Competitiveness Fund – EUR 200,000 per year, and Export Credit Guarantee Fund (ECGF) – EUR 1.6 million per 6 years.

Within AIDA, a specific Division, denominated Business Relay and Innovation Centre (BRIC), will have the express role of implementing the Business Innovation and Technology Strategy (BITS) and Business Innovation Technology Action Plan (BITS) for the years 2011-2016. The Albanian Government has recently adopted the (BITS) and its respective Action Plan (BITAP), through the Decision of the Council of Ministers (DCM) no. 104, dated 09.02.2011.

AIDA is a newly created agency continuing the work of previous Albinvest, which is no longer functioning. AIDA is in the phase of recruitment of staff and will hopefully start functioning properly at the beginning of June 2011.

## **Services from the Network of Chambers of Commerce and Industry**

In Albania there are 12 Chambers of Commerce and Industry. They offer

consultancy services for their members such as the issuing of goods origin certificate, support for members of the Chamber to resolve trade and civil disagreements through the intercession, and business missions. In 2010, 12 national and international fairs and exhibitions were organized alongside with 18 workshops and training courses. In addition, there are open service windows in CCI of Tirana and Durres for business registration, which are connected to the NRC and NLC.

### **Regional Development Agencies Network, NetRDA**

Regional Development Agencies Network also functions in support of SMEs, mainly in terms of consultancy and business plan preparation.

### **Online Service in Declaration and Tax Payments**

Since March 2009, electronic declaration has been extended to the entire country. In 2010, the expansion of this scheme showed a significant increase. With the Decision No. 55, dated 03.02.2010 "On the mandatory declaration of tax declarations and other tax documents, only through electronic form" published on Official Journal Nr. 10, dated 17.02.2010, all taxpayers, including small businesses, have the opportunity to declare their tax obligations electronically. This new, contemporary, comfortable and efficient way reduces time and costs of business. Mandatory taxes that are declared electronically include Value Added Tax with 152,015 completed statements, Annual Profit Tax, Social and Health Security with 161,082 completed statements, income tax from employment with 151,707 completed statements, monthly installments of the profit tax and Annual Tax on Personal Income (Small Business). More information is available at the website of the General Directorate of Taxation (GDT): [www.tatime.gov.al](http://www.tatime.gov.al)

### **Administration of Taxes**

On 1 March 2011, Taxpayer Service Centre of Tirana started functioning, which will serve about 40% of the Albanian taxpayers and will be followed by other service centers to be built in the regional departments. Through these centers, taxpayers will be offered quality service, quick information and simplified procedures, providing the opportunity to save time and reduce unnecessary contact with tax personnel through the use of modern technology and a new culture of service.

In order to improve the service to taxpayers, in the fight against corruption and informality, this Centre will offer service to about 50,000 taxpayers of the Regional Tax Directorate of Tirana, to the large or small businesses, individuals, physical or legal persons and also to the public to recognize the tax legislation and its amendments, to provide assistance and help in the voluntary implementation of the declaration and payment of tax obligations within the legal deadlines that are set out in legislation, etc.

All contacts made are managed through an electronic system, which is completely transparent to taxpayers as well as for tax administration, while maintaining data confidentiality and respecting deadlines defined in legislation. Services offered at this centre have shortened the timeframe for getting certificates by the taxpayers from the tax administration from 5 days to 2 days, proper management of time by offering quality service and meeting the requirements of the taxpayer within some minutes, thus eliminating the contact of taxpayers with tax inspectors

Another innovation in the work of Tax Administration is the establishment of Call Centre, which will be used for Tax Debt management and assistance to taxpayers to pay as soon as possible their obligations.

### **Online Procurements**

Since 1 January 2009 all public procurements are done only online through the Procurement Agency.

### **Online Services on Customs**

Since 2008, the computerization of all customs and the use of ASYCUDA program have significantly improved service to business, reducing the time of completing the documents and control of goods, almost 100% of customs declarations are made using the ACA ASYCUDA system (100% DTI - Direct Trader Input).

### **Electronic Government**

Through support from the Millennium Challenge Albania Threshold Agreement (MCATA) administered by USAID, progress made towards the

simplification of procedures for doing business concerns public administration performance in four main directions, namely Public Procurement, Business Registration, Tax Administration and Licensing. It is continuing the implementation of the project for other areas as well.

Based on the Decision of Council of Ministers No. 248, dated 27.04.2007 "On Establishment of the National Agency of Information Society", amended by Decision No. 837, dated 29.7.2009, amended by Decision No. 28, dated 20.01.2010, point 3 (ë), states that the National Agency of Information Society (NAIS) is responsible for the creation and administration of the government portal. Regarding the above, in November 2008 NAIS started the process of designing and implementing government portal, e-Albania.al.

This portal aims to serve as a single point of access that provides electronic services for businesses, citizens and government.

Currently, the services provided in this portal by the government to the businesses (G2B) is evaluated as follows:

**Table 11: Level of development / sophistication of business services**

Public services for the business	Maximal Level	Actual level of supply
Social contribution for the employees	(4)	4
Corporate Taxes	(4)	4
VAT	(4)	4
Registration of new companies	(4)	2
Presentation of the data in the statistics offices	(3)	1
Custom declarations	(4)	4
Environmental licenses	(4)	2
Public procurement	(4)	4

The condition for the provision of full service online is the identification and authentication of users. In this context, the NAIS through the project "Support for NAIS in order to build e-government infrastructure in accordance with European standards for the protection of personal data" funded by the EC in addition to other developments in the focus of this project, also aims at solving the identification and authentication of users who will receive full service online through the government portal. This implementation enables all systems that provide electronic services to enhance their service delivery in levels 3 and 4.

### **2.1.4 Industries, Branches, Regions, Clusters**

Developments in the industrial sector in Albania can be listed as follows, based on the classification of NACE Rev 1.1. This classification refers mainly to the specific weight of contribution of important sectors of the Albanian industry (NACE, C+D+E) to GDP over the past three years (2006-2008) and links these sectors with employment, investments, domestic market supply and export.

Manufacturing of garment and leather (NACE Rev 1.1: D17, D18, D19): The specific weight of this sector in GDP has continuously increased from 1.4% in 2006 to 1.6% in 2008. This is a sector which operates mainly with material supply from the contractor (subcontracting or à la façon) through cooperating with European enterprises (Italian, Greek, German, French, Belgian, Spanish, etc.). Being a sector with high global competitiveness, it was affected by the global crisis by end of 2008 and during 2009, especially the garment sub sector. Nevertheless, it remains a sector with comparative advantages (accumulated experience, geographic position, low-cost labor, completed investments, etc.), and with mid-term and long-term prospects for the Albanian economy. A characteristic feature of this sector is the high number of employed people, about 8.6% of total level of employment or about 28% of employees in this industry. Capital investments in this sector are relatively low compared to other sectors and in the year 2009, they amounted to EUR 12.6 million or 1.7% of total investments. This sector has realized 1.8% of the total turnover and 3.9% of total value added during 2009. During 2009, the number of firms fell by 2.1%, the number of employees fell by 13%, the turnover increased by 1.3% and value added increased by 5.3% as compared to previous years. (During, 2009 the turnover from the garment sub sector was reduced by 14.6% and the value added by 8.9% as result as the global crisis).

In the past five years, over 90% of the products of this sector were bound for export. In 2010, they amounted to approximately EUR 404 million, thus making up more than 34% of the total exports of goods of Albania. The exports increased by 33.8% compared to 2009, and the exports are in the same value as in the period before the crisis in 2008. This sector is the most important and ranks 1st among Albanian exports of goods.

Manufacturing of food products, tobacco and beverages (NACE Rev 1.1: D15, D16): This sector has provided a relatively constant contribution by taking up 1.3% of the GDP over the past three years. Production in this sector has increased from EUR 183.4 million in 2006 to EUR 235.5 million in 2008. The level of employees in this sector has slightly increased and reached 4% of total employment level in 2009 (or 12.5% of the total number of employees in the industry). Investments in this sector have been EUR 11.8 million in 2009 (or 1.7% of total investments), reduced by 51% compared to 2008. This sector has realized 2.6% of total turnover and 2.5% of total value added in 2009. In 2009, the number of firms fell by 9.2%, the number of employees increased by 4% and the turnover fell by 11% compared to previous years.

The contribution of this sector to exports in 2010 is EUR 67.5 million or 6% of the total exported goods of Albania, which increased by 24% compared to 2009. This sector ranks 4th among Albanian exports of goods.

Manufacturing of basic metals and metal items (NACE Rev 1.1, D27, D28, D29): Specific weight of this sector in GDP has kept increasing over the past three years, from 1.1% in 2006 to about 1.3% in 2008. Manufacturing of basic metals and their derivatives has experienced a considerable increase from EUR 154.5 million in 2006 to EUR 263.2 million in 2008, with an increase of approximately 70.4% compared to 2006. Employment in this sector has been stable with 2.5% of the total number of employees and the number of enterprises is 1.8% of total number of active enterprises. Capital investments in this sector have been EUR 22 million in 2009 (or 3 % of the total capital investments in the industry), increased by 2% compared to 2008. The turnover of this sector accounts for 2.4% of total turnover in 2009 and it is reduced by 26.5% compared to 2008. In addition, the value added realized by the sector accounts for 1.5% of total value added during 2009 and it is reduced by 56% compared to 2008. In 2009, the number of firms fell by 2.4% and the number of employees fell by 9.4% compared to previous years.

Export values of this sector have also experienced a considerable increase, from EUR 81 Million or 16% of the total export in 2006 to EUR 174.6 million or 19% of the total exports of industry in 2008. Contribution of this sector to export in 2010 is EUR 275.8 million or 23.6% of the total exported goods of Albania, which shows an increase by 1.5 times

compared to 2009. This sector ranks 3rd among Albanian exports of goods.

Other non-metal mineral products industry sector (NACE Rev 1.1, D26): Specific weight of this sector in GDP has kept increasing over the past three years, from 0.9 % in 2006 to 1.2 % in 2008. Production in this sector has increased from EUR 171.6 million in 2006 to EUR 180.1 million in 2008. Employment in this sector in 2009 reached 2% of the total number of employees and the number of enterprises was 1.2% of total active enterprises. Capital investments in this sector amounted to EUR 16.5 million in 2009 or 2.3% of total capital investments and they were reduced by 32.6% compared to 2008. This sector has realized 2.5% of total turnover in 2009, showing a decrease by 3.5% compared to 2008. In addition, the value added realized by the sector accounts for 2.8% of total value added in 2009 and it is reduced by 15.6% compared to 2008. In 2009, the number of firms increased by 42% and the number of employees increased by 7.2% compared to previous years.

Export values of this sector have increased considerably, from EUR 4.6 million or 0.6% of the total export in 2006 to EUR 9.5 million in 2010.

Sector of timber industry, its products, paper, paper and cardboard packing products and those for publishing and printing (NACE Rev 1.1, D20-D22, and D36): Specific weight of this sector in GDP has marked stability over the past three years. It has remained approximately at 1% of GDP, thus marking a slight increase in 2008 to approximately 1.1%. Production in this sector has increased from EUR 46.7 million in 2006 to EUR 63.8 million in 2008. Employment in this sector in 2009 reached 3.2 % of the total employees and the number of enterprises accounts for 2.1% of total active enterprises. Capital investments in this sector have experienced considerable increase, from EUR 6.4 million in 2006 to EUR 26.5 million in 2009, or 3.7 % of the total investments. The turnover of this sector accounts for 1.5% of total turnover in 2009, showing an increase by 23.5% compared to 2008. In addition, the value added realized by the sector accounted for 2.3% of total value added in 2009 and it increased by 34.5% compared to 2008. Export values of this sector reached EUR 34.8 million or 3% of the total exports in 2010, showing an increase by about 30% compared to 2009.

Extracting industry (mining & energy) (NACE Rev 1.1 C10-C14, E40): The specific weight of this sector in GDP has continuously increased from 0.7% in 2006 to 0.9 % in 2007 and increasing during 2008-2010 to more than 1% of GDP. The number of employees is about 8.3% of total employment which increased by 7.5% compared to 2008. Capital investments in this sector in the year 2009 were EUR 71.2 million or 10% of total investments and they increased 2.7 times compared to 2008. The turnover of this sector accounts for 2% of total turnover in 2009 and it shows a decrease by 18% compared to 2008. In addition, the value added realized by the sector accounts for 4.5% of total value added in 2009 and it fell by 27% compared to 2008.

The exports realized in 2010 amounted to approximately EUR 324 million, thus making up more than 28% of the total export of goods of Albania. The exports increased by 117% compared to 2009. This sector ranks 2nd among Albanian export of goods in 2010.

### **Industrial Policy**

The National Strategy for Development and Integration 2007–2013 (Albanian Government, 2008) is a key national strategic document. Industrial Policy is based on the objectives of this main document and the objectives of the Business and Investment Development Strategy (BIDS) 2007-2013. These two documents include objectives from the sectoral strategies such as Strategy of the SME, Mining Strategy and Strategy of Mineral Promotion; which are based on sector analysis and consequently on the elaboration of a series of regulatory and legal interventions which intend to maximize their growth. The development and implementation of this BIDS overall strategy has to serve and interact with sector strategies to achieve maximum efficiency and effectiveness.

The industrial policy is an important component of the Business and Investment Development Strategy. The main goal of the industrial policy is to guide and encourage investment in high technology, growth and competitiveness, modernization, diversification and specialization in open markets. Its strategic goal is

- To promote a steady growth,
- To promote dynamic and sustainable development of the industrial sector,

- To support and encourage the development and increment of domestic production,
- To improve productivity and competitiveness, product internationalization, foreign investment promotion and the better use of financial, human and natural resources,
- To improve legislation and undertake reforms of all regulatory barriers in order to reduce administrative and business costs,
- To improve the efficiency of services offered by public administration to industrial activities, i.e. R&D for new products with aim of value added in the country and businesses exports, development of a suitable environment for the culture of entrepreneurship, development of networks (Cluster) to business cooperation and technological innovation.
- Proactive industrial policy of the government consists of encouraging, supporting, creating and developing competitive industry in order to prepare them to participate in the global market based on scientific knowledge, innovations and development collaboration among industry players.

The sustainable development of the industrial policy in our strategies, programs and legislation is conceived as a state of balance on these three pillars:

- Investment development;
- Environment-friendly development, enforcing the mitigation measures, rehabilitation process and monitoring;
- Social aspects, with the involvement and understanding of community and increasing employment through creation of new job-places particularly for the zones with poor economic activity.

Industrial policy is a political priority for the Albanian government. With the implementation of these strategic documents, the government seeks to deal with major challenges, such as the need to enable the government, enterprises and experts to respond to the increasing competition in the globalization process; the shift towards a service-oriented economy; the migration of population to urban centers; the reduction of the specific share of agriculture in the national economy; the obstacles before the manufacturing sector; and unemployment. Efforts to build market institutions, which have no doubt been through great difficulties due to lack of

culture and heritage, leading to the growth of informal economy and corruption, are now useful lessons to be considered when taking a coherent approach to industrial development and business needs.

The implementation of this strategy fosters the liberalization process in the domestic market, which brings new energy for industrial development, product R&D, new export products, appropriate conditions for the development of entrepreneurship culture, business clusters, technological cooperation and innovation. The strategy itself facilitates the process of developing market institutions, combined with the coordinating role of the state to maintain the balance on the activities of the free market.

Applied policies are directed towards increasing the flow of foreign investment in the energy sector; infrastructure development; exploitation of mineral resources; extraction of natural resources like oil and gas; improving the business climate and infrastructure; reduction of informal economy; accelerating the privatization process of the country's strategic sectors such as TELECOM, ARMO and DSO; expansion and further development of the banking sector; securities market development; and development of port and airport services.

The following are among the policy targets: Improving legislation and undertaking a reform of all regulatory barriers in order to reduce administrative and business costs; improving the efficiency of services offered by public administration have served to industrial developments, research and development for new products with aim of value added in the country and businesses exports; development of a suitable environment for the culture of entrepreneurship; and development of networks (Cluster) to business cooperation and technological innovation.

Additionally, the strategy seeks to support industries and sectors to gradually transform their economic structure from a low value added production and export, to high value added products and sectors by promoting specific programmes for technology transfer and innovation.

There will be a careful prioritization of projects in order to match the available sources of finance.

Despite the efforts undertaken by the government in order to improve the business climate, the industry performance still remains weak for the

time being with regard to coping with the increasing global competitiveness.

To improve performance, the focus is set on better policy instruments which will enable the Albanian industry to keep up with the pace of Entrepreneurship Innovation & Technology developments in the EU, promoting better cooperation between FDI and SMEs and more investment in human resources and development.

In the period 2007-2009, the government has undertaken encouraging policies for the development of information technology, starting from students to entrepreneurs in order to increase the competitiveness of Albanian businesses in the regional and global market. It's in place with the legal framework Law No.9880, dated 25.02.2008 "On electronic signature" which is in fully accordance with EU Directive 1999/93/EC; Law No. 10128, dated 11.05.2009 "On electronic commerce" which is in fully accordance with Directive 2000/31/EC "On information society service", decreed by the President of Albanian Republic with Decree No. 6179, dated 25.05.2009 and has entered into force on 20.06.2009. From 2007 to 2009, the percentage of internet users among the population, especially among young people, increased in Albania, by 15.3% in 2007, 18% in 2008 and about 31.2% (source ITU) in 2009. This ratio was 2.4% in 2006.

Large investments are made in the banking sector, with an estimated total value of approximately EUR 200 million, along with investments in the telecommunication sector. By this way, the number of commercial banks that offer online services have increased.

Some foreign companies expressed their interests and are working for the establishment of technological parks, renewable energy projects, etc. to be completed in the period 2010-2013, which will increase the technological capacities in the coming years.

Privatization process went on further with the privatization of small and medium enterprises in the form of a public bidding. During 1993-1995, out of 2,434 state enterprises evidenced in the frame of the project with the German Government, 2,011 state enterprises were privatized. At the beginning of 1998, there were 423 registered enterprises and

undertakings with state capital. 340 commercial enterprises with state capital were privatized mainly through the public bidding procedure during 1998-2009.

Apart from the privatization of small and medium enterprises in Albania pursuant to Law No. 8306, date 14 March 1998 "On the privatization strategy for sectors of special importance", privatization of state commercial enterprises operating in the sectors of special importance (strategic) of economy has been ongoing since 1998.

To achieve the goals and the tasks defined in the Government Program and upon agreement with the IMF, WB and with other international organizations regarding the privatization of strategic sectors, work has been carried out in cooperation with the line ministries and directorates and upon the international assistance provided by a group of Italian companies in the legal, technological and financial area. In this frame, the privatization process started upon the implementation of the "Five Stars" project, which entailed five companies belonging to the strategic sectors including AMC, Albtelekom, Albkrom, Albbaker and Albpetrol.

The privatization of enterprises with state capital belonging to the mining sector, telecommunications sector, oil and gas extraction sector and air transport sector was accomplished over 1998-2009, while the privatization in the electrical power sector has started with the privatization of the "Distribution System Operator S.A."

25% of the inflow foreign investment came from the privatization process during the period 2003-2009.

Actually, there are 86 commercial enterprises with state capital participation operating in the Albanian economy.

Business Innovation and Technology Transfer Strategy (METE, 2011) is a new policy in compliance with EU policy and as such it will be implemented by METE in cooperation with other stakeholders and it aims to fill the existing gap in the field of innovation, regarding assistance to companies in the process of innovation, improvements of technological capacity; implementation of a proactive policy of innovation; creation of an innovation system to increase the interaction of institutions in support

for enterprises; filling a gap and creating a better connection between the policy of SME development with that of science and technology.

For the implementation of this strategic program, four important programs are proposed: 1. Innovation Fund; 2. Business Innovation Services; 3. Business incubator's program; 4. Development cluster's program.

Under implementation of this program, Business Relay Innovation Center, BRIC, will be established, which in its first phase will be a small structure with a staff consisting of 5 persons within the AIDA (former Albinvest). It started functioning in February 2011 and it is expected to have recruited the staff up to the end of the April 2011. BRIC has a clear mission: "To enable the Albanian business to renew and improve the products and/or its technology". BRIC will function as the main mediator and facilitator to promote innovation and technology development in business by providing the latter's links with the Albanian Research and Technology and Innovation Agency (ARTI), National Agency of Information Society/NAIS, universities, centers of excellence, etc. and also to be part of EEN.

#### **2.1.5. The Effect of the International Financial and Economic Crisis**

The Albanian financial sector has developed strongly in recent years and adequate regulation and timely monetary interventions helped to limit the impact of the global financial crisis. Savings have been adequate to finance relatively high levels of investment, and financial intermediation has increased enormously, although for many SMEs the access to credit remains limited. The strength of the financial system is a reflection of the strong and efficient supervision regime implemented during the last decade.

The last months of 2008 and the first months of 2009 were characterized by a decline in the financial system's activity, this being a difficult period for the entire world economy. However, the impact over the financial institutions that operate in Albania remained at low levels, as a consequence of non-exposure to the toxic assets which were considered to be the main cause of the worldwide crisis. Actually, it seems that the situation has started to come back to normal and the financial situation of the financial system as a whole and banking sector in particular, is more sustainable.

The Albanian financial system endured the direct and powerful strike of the global financial crisis, generated by the international financial markets' collapse. In 2009, the credit for the private sector was shrinking. In the first half of 2010, the activity credit level continued to be tight, while in the second half of the year 2010 and in the first months of 2011, banks have lightened the credit standards toward businesses and individuals as well. The inflation rate still stayed within the optimal borders of Bank of Albania's objective of 2 to 4%, at the average level of 3.8%.

Albanian economy in the past years (2005–2009) had a positive and stable growth where in 2008 the GDP growth rate reached one of its highest values, around 7.7%. During 2009, Albanian economy faced a decline of its growth pace, where the real growth of GDP for this year was 3.3%, due to the negative effects of the global economic crisis, especially during the second half of the year. The real growth of GDP for 2010 reached 3.9% (INSTAT 2011:2); whereby it should be noted that this performance is quite good compared to the economic performances of the region countries, showing that Albanian economy is a robust economy with an optimistic outlook.

As for the trade balance, during the year 2009 (INSTAT 2010:2), goods export reduced by 15%, compared to the year 2008, while imports also reduced approximately by 2%. The trade deficit for 2009 reduced by 3% compared with the year 2008. In 2009, remittances decreased by 6.2% (Bank of Albania 2010) compared to the previous year, whereas they still remain a fundamental financial source for the trade deficit cover.

## **Industry**

The production of the industry sector (which includes the extracting and processing industry) for 2009 shows a negative performance compared to 2008, with an estimated real annual growth of -1.2%. The increase in the energy prices and the inconstancy of the oil prices at international markets were some of the main reasons for this decline, but taking into account the prospect of future opportunities and the implementation of several measures and domestic policies, this sector is expected to have a stable contribution with a positive growth trend in the years to come.

## **Services<sup>14</sup>**

In 2009 the service sector shows a growth of 5.6% compared to 2008,

when it was registered as one of the highest positive growth of this service sector, with a growth of approximately 6.7%. The share of this sector was approximately 50.7%, in the nominal GDP during 2005-2009, which clearly shows the importance of this sector. The service sector has maintained its positive trend, with an average real growth rate of approximately at 6.3% (during the above time period).

### **Construction<sup>15</sup>**

The construction sector shows a negative real annual growth rate of -0.6 % in 2009, marking a considerable slowdown in its growth rhythm compared to 2008. Also, according to the forecasting data, this sector will continue to shrink at a level of -0.8% in 2010.

### **Agriculture<sup>16</sup>**

The agriculture sector shows a positive real annual growth, around 2.7% in 2009, despite the fact that this sector has been through a very difficult period during 2007-2008 because of the extremely unfavorable climate conditions.

## **2.1.6. Government Measures to Cope with the Impact of the Economic Crisis**

The positive developments during the global economic crisis in 2009 and 2010 are mainly attributed to the intertwining of the fiscal and monetary macro-economic policies pursued adequately, carefully and in a coordinated way by the government and the monetary authority. Another factor with an important contribution to the sustainability of the Albanian economy is the radical structural, fiscal, administrative and legal reforms undertaken by the government in the course of the recent years, as well as the budget policies with well-defined priorities. The pay-off of these reforms and policies coincided with this difficult period, smoothing to a considerable extent the negative effects of the global crisis.

In 2008 and 2009, in order to alleviate the contractionary impact of the global crisis, the fiscal policy was relatively more pro-active.

Along with the reduced availability of foreign funding and the increased cost of such funds, the uncertainty induced by unanticipated changes of

spending plans due to lower than expected revenues in 2010, increased risk aversion of foreign investors. Notwithstanding the fact that Albania had a highly successful first bond issue, future funding at appropriate terms and conditions depend upon the credibility of the debt reduction plan of the government. Such credibility of a macroeconomic framework aimed at achieving long term fiscal sustainability may be supported and enhanced by the introduction of a fiscal rule.

The radical structural, fiscal, administrative and legal reforms undertaken by the government during the last four years and also the fruitful budgetary policies of sharp priorities, helped avert most of the negative effects of the global economic crisis, giving a new impulse to the economy and to the main sectors in particular.

Fiscal reforms undertaken during 2007-2008 and the expansionist monetary policies applied during the first half of 2009 have made the tax system in Albania more simple and stimulant for the business development compared to the countries of the region. Tax policies have been applied according to the priorities of the government's National Strategy for Development and Integration. In line with this purpose, the distribution of the tax burden equally and with less deformation, has been an important element of these fiscal reforms.

In 2009, the right of compensation to later tax obligations and contributions of social health insurance with the amount of VAT to be refunded was ratified by law.

Extension or credit on time of the repayment of VAT on machinery, equipment and raw materials, 2008 was over 12 months in 2008 depending on the investment cycle and the start of production.

Further reduction of the fiscal burden for the employer is considered starting from 1 May 2009, along with the reduction of employer's social security contribution to the level of 15% from 30% in 2008. The payment for accidents and illness was reduced from 0.5% of the payments list to 0.3%. The payment for the branch of unemployment insurance was reduced from 2% to 0.9% of the payments list.

The Export Credit Guarantee Fund approved by the Decision of Council of

Ministers No. 489, dated 25.07.2007 was put into force during 2008. This fund is part of guarantees that the government issues. The maximum amount of the fund is ALL 200 million,(EUR 1.6 million) and it will be delivered for a period of 6 years.

ECGF will cover the banks' requirement toward the mortgage coverage for short term commercial loans. Each guarantee will be used to cover up to 85% of the credit's amount required and the maximum amount is ALL 10 million. Each guarantee will be valid for a period up to 1 year.

To manage this fund, a department was established in Albinvest which is handling all the necessary procedures and making financial and risks analyses of the beneficiary companies.

### **Finance and Credit Facilities**

The Albanian banking sector is sound. This is confirmed by its ability to overcome the global financial crisis easily and without serious consequences compared to other countries in the region. The financial environment has created the appropriate conditions for the expansion of credit. Crediting to the economy recorded a slight increase during 2009 and 2010 although this period is characterized by global financial crisis.

In order to improve the climate of SME financing, some measures have been taken in recent years regarding credit guarantee schemes.

Implementation of credit scheme for SMEs from the Italian program: In the framework of the Italian project to support SMEs during the period January 2008-December 2010, 40 companies are credited with a value of EUR 10 million. The financed sectors are agriculture, marble granite processing, shoe manufacturing, meat processing, underground constructions, aluminum products, etc. performing in different areas of Albania. In the frame of this project, the scheme for the credit guarantee fund for SMEs has been prepared, the implementation of which will begin in April 2011. Seeing the difficulties of business start-ups regarding access to finance from the banks, it was made available to provide loans from partner banks of the program to start ups in amounts from EUR 15,000 to EUR 50,000 with interest rates of 5.5% (lower than market rates).

The European Fund for Southeast Europe (EFSE): EFSE is one of the largest creditors of the Albanian micro and small enterprises finance sector. It has offered a total of approximately EUR 40 million of funding to local financial institutions since its start of operations in Albania in 2007. These partner lending institutions have on-lent the funds received from EFSE in the form of more than 8,500 business loans. EFSE's support to the Albanian financial sector does not only include financial investments, but also technical assistance, consulting and training offered to partner lending institutions with the aim of increasing the outreach to its target group.

EFSE has provided a loan of EUR 20 million to Banka Kombëtare Tregtare (BKT). The loan agreement signed on 26 November 2010 will contribute to expanding the micro and small enterprise lending operations of the Bank. It is the first loan agreement between EFSE and BKT, compensating for the lack of long-term credits available to SMEs in Albania.

### **Public Investment**

The high level of public investment was the main instrument of the fiscal policy used for mitigating the negative effects of the global crisis, economic activity having been supported by a considerable volume of public investments with 9.9% of the GDP, out of which 8.8% have been carried out by the central government. These policies and the acceleration of public investment served to soften the impact of the economic crisis, but resulted in increasing fiscal deficits of 5.6% in 2008 to 7% in 2009. Due to the fact that the economic consequences of the global financial crisis were not immediate for Albania, an ambitious growth and development plan went ahead as initially planned. The continuous improvement of the road infrastructure, the modernization of technology and the progress achieved in human capital development have enhanced the efficiency of the economy.

These developments have provided a positive impact on employment. The consequent increase in household income maintained a high level of consumption but the strong domestic aggregate demand had its impact on the sustainability of the current account of the balance of payments.

### **Industry**

This sector has a relatively stable role in the Albanian economy. With

better management from the stakeholders who denationalized two of the biggest state corporates in our country, namely ARMO (Albanian Oil Refining and Marketing) and OSSH (Electric Distribution System Operator), the efficiency of the sector is expected to improve.

Also, certain measures will be taken to improve the services and efficiency in energy of the electric state corporate of KESH (Albanian Power Corporate) and OST (Transmission System Operator), through additional investments for the construction of new production sources and for the reduction of the operational expenditures, by the Albanian government.

The volume weight of the Processing and Textile industry will be preserved, because of the advantage of low costs of their output in our country; coupled with the reduction of the capital tax (the tax on earnings has declined to 10% since January 2008); and the agro-industry earnings. The land market is expected to improve in parallel with the renovation of the technology in this sector.

### **Services**

It is forecasted that during 2010-2013 this sector will continue to maintain an enormous average real growth of 4.4%. The average level of contribution forecasted for the period of 2010-2013 shows the importance of this sector in the GDP growth, at a level of 3.3%.

The positive projections made for this sector are also correlated with an estimated increase in the indirect net tax ratio, in GDP, due to the continuous expansion on the tax base thanks to the fiscal reform and to the administrative improvement on one side; and the subsidy reduction (in GDP) on the other side, as a result of several state corporate privatizations and of the increase of the efficiency of those in property of the Albanian state.

### **Construction**

The projections for the construction sector's contribution to GDP growth for the period of 2010-2013 show a positive trend with a continuous increase, at the average value of 0.3%.

This increase and the positive dynamics expected in the construction sector for the forecasted period is attributed mainly to the stability of the house demand due to domestic migration and the intense business activity in our country; the high level of remittances in the real estate field; the reduction of the cost transportation; the improvement of the infrastructure in general and the increase of formalization of this sector in parallel with the expected construction permission for the coming years.

## **Agriculture**

The projections for the period 2010-2013 are in the same positive pace as 2009, with an average real growth value of around 3.8% and with an average contribution of 0.6%.

The positive growth expectation for the agriculture sector relies mainly on the improvement of the land market and also the implementation of sector policies by the Albanian government that aims the stable management of the land, such as the positive impact of the reimbursement of the VAT for agricultural products in order to encourage the use of national agriculture products; the increase of the efficiency of farms due to the introduction of the agriculture associate notion into the new agriculture law and also due to the reduction of informality; the public investment in water supplies and the government support for possible negative shocks that this sector might have from the imported prices; and the increase of the productivity due to the continuity of importing machinery in our country and due to the integration to the EU.

To conclude, Albania is ranked as a country that has for almost a decade shown a positive and high growth rate of over 6%. This is also confirmed by the past two years, which were like a real "stress test" for the economy. Despite all the energy problems, the drought in agriculture and lately the financial global crisis, which let off the main foreign economic markets, the economic growth of Albania continued to be high. The follow-up of the effective macroeconomic policies and the deepening of the structural and economic reforms, along with the introduction of advanced technology, the capital accumulation and the economy rebuilding toward a more efficient economic model, will assure the continuance of this economic pace in the medium term.

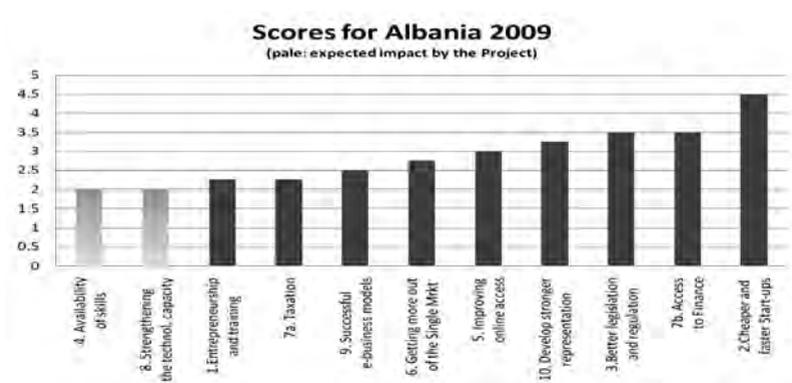
By considering and estimating the economic environment in 2010 objectively, it is crucial to make a serious commitment to achieve the objective for 2010 (the reduction of the total public debt by 2.1% points, from 59.2% of the GDP in 2009 to 57.1% in 2010), in order to minimize several macroeconomic risks and reach the final aim, keeping and consolidating macroeconomic stability.

### 2.1.7. SWOT Analysis of the SME Sector

Albania's SME policy performance over the period 2007-2009 was remarkable (see Annex 3). Albania's record of policy implementation has improved in all ten dimensions, in particular, in all the policy areas linked to the general operational environment such as company registration, regulatory reform, access to finance and export promotion.

National Register Centre, NRC, operates as a one stop shop and registering a business takes 1 day with a cost less than 1 Euro. National Licence Centre, NLC is a one stop shop, which can provide licenses in 2-4 days, maximum 10-30 days (not including the construction permits). Thanks to the fiscal reform, the flat tax is 10% for the income tax and for the corporate tax. In November 2008, NAIS started the process of designing and implementing a government portal, e-Albania.al. This portal aims to serve as a single point of access that enables providing electronic services for businesses, citizens and government.

**Figure 4: Albania's performance in 2009**



Source: OECD, SME policy index 2009.

The weak points in Albania's performance remain human capital development and technological capacity of SMEs (OECD, 2009). There is a shortcoming in the availability of skills since there is insufficient higher education and training. There is also a lack of entrepreneurship and training. The technological capacity also needs to be strengthened.

Development of Economic Zones in Albania is based on public and private partnership. During 2008 the Government announced 6 economic zones with the status of the industrial parks and during 2009 three economic zones were announced, two with the status of industrial parks and one with the status of a free zone, but none of them is in operation.

There have been previous attempts to set up business incubators in Albania, within donor-funded projects. Currently there are only 2 business incubators, one in Tirana and the other in Shkodra (METE 2007) but they are not performing the real tasks of the business incubators. The business incubator in Tirana opened 19 businesses and employed only 52 people in the last 18 years. The business incubator in Shkoder is operating mainly as a place for rental areas where one of the businesses in the garment field have employed more than 150 workers and has operated for more than 6 years.

Another problem is missing clusters (EC 2010). Clusters in Albania will be developed with the support of donor organizations. In the framework of Enterprise Development and Export Market Services Project (EDEM), financed by USAID, four new clusters have been established in tourism, meat processing, medical herbs and leather goods production industry (USAID 2005). However, as soon as the EDEM project ended, those clusters were also shut down.

### **2.1.1.8. Tasks for Improvement and Further Development of the National SME Sectors in Albania**

Albania needs continuous reforms in order to reach the level of other Union European Countries. The SME support policies and the implementation of these policies need to be improved. The following may be recommended in this regard:

- Creation of a national public education framework for the introduction of entrepreneurship in a lifelong learning strategy.

- Creating and/or enhancing a SME dedicated portal, with all information related to SMEs
- The systematic application of the Regulatory Impact Assessment (RIA).
- Plans for development of Training Needs Analyses, TNA models across all EU pre-accession countries.
- Promoting export with new instruments, establishing or strengthening export insurance and export credit to companies.
- Promotion of new financial instruments such as leasing, venture capital and private equity funds within the appropriate legal and regulatory regime is an important challenge with regard to the development on non-bank financial institutions.
- Creating business/technological incubators in the main prefectures of the country.
- Innovation competition. To stimulate an innovation competition which brings together academia and the private sector, aiming to promote the inventions and to protect and support the inventors. The competition also serves as a platform where innovators and business meet.
- Mechanisms to finance business services in support of innovation (e.g. voucher schemes) with an objective to improve domestic firms' access to business services supporting technological (i.e. R&D) or non-technological innovation.
- Improving domestic firms' access to finance to support technological innovation.
- Establishment of an Innovation Fund with the aim of improving domestic firms' access to finance to support technological innovation.
- Clusters and programmes that seek to consolidate the benefits of embryonic enterprise networks or clusters.
- Albania should be a part of the Enterprise Europe network, EEN
- Strengthening of the institutes to support private companies, especially micro and small.

### **References for further studies**

Albanian Government (2007), Business and Investment Development Strategy (BIDS) 2007-2013, adopted with Government Decree, No.795, date 11 July 2007. (Official Gazette of Republic of Albania No.170, page 5109).

Albanian Government (2008), National Strategy for Development and

Integration (NSDI), adopted with Government Decree, No. 342, date 12 March 2008.

Bank of Albania (April 2011), Statistical report

Bank of Albania (August 2010) - The Results of the Credit Activity

EC (2008), Small Business Act

EC (2010), Commission Opinion on Albania's application for membership of the European Union.

INSTAT (2010:1), Register of enterprises 2009

INSTAT (2010:2), Report for the foreign trade 2009

INSTAT (2010:3), Labours Questionnaire for 2008, published by INSTAT

INSTAT (2011:1), Structural survey of enterprises 2009

INSTAT (2011:2), GPD 2010, forth trimester 2010

NRC (2011), Annual Report 2010

METE (2007), Ministry of Economy, Trade & Energy in Albania, SME Development Strategic Programme 2007-2009

METE (2011), Ministry of Economy, Trade & Energy in Albania, Albanian Business Innovation and Technology Strategy 2011-2016, Government Decree, No.104, date 9 February 2011

OECD (2009), SME Policy Index 2009 Progress in the Implementation of the European Charter for Small Enterprises in the Western Balkans.

World Bank (2006), Doing Business 2007

World Bank (2007), Doing Business 2008

World Bank (2008), Doing Business 2009

World Bank (2009), Doing Business 2010

World Bank (2010), Doing Business 2011

World Bank (2010), Worldwide Governance Indicators (WGI)

## **2.2 ARMENIA**

by Tigran Sukiasyan

National Economic and Environmental Office, OSCE Yerevan Office, and Dr. Aleksander Poghossian, Principal Consultant and the Managing Director of Alpha Plus Consulting, Armenia

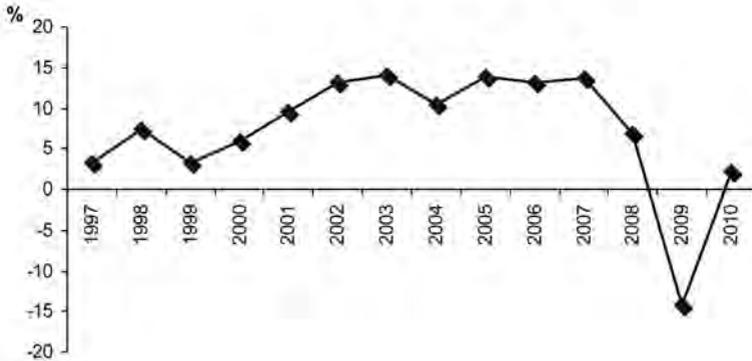
### **2.2.1. National Economy and the SME Sector**

#### Recent Development of the National Economy

Recently, discussions concerning the development of the Armenian national economy have intensified since Armenia faces new challenges due to its quite complicated geopolitical location, namely by the impacts of the world financial crisis.

Armenia is a small landlocked country situated at the intersection of Europe and Asia. It is bordered by Georgia to the north, Azerbaijan to the east, Iran to the south, and Turkey to the west. Armenia is a mountainous country covering an area of 29,800 square kilometers with a population of just over 3.2 million at the most recent estimate (official figure).

During the last 15 years the Armenian economy has been growing continuously. After the collapse of the Soviet Union and severe economic downturn in 1991-1993, the national economy expanded more than three times. Average annual growth rate during 1995-2008 was 9%. Significant economic growth was recorded during 2001-2007, on average about 13%. In the same period, the per capita GDP also increased from USD 670 in 2001 to USD 3,689 in 2008. During the last quarter of 2008 the world economic crisis made the real growth rate slow down significantly; as opposed to the previous years of 2-digit economic growth, in 2008 it was 6.8%. In spite of this fact, the output in 2008 exceeded the level of 2002 about 2 times, the level of 1995 about 3, and the level of 1990 about 1.7 times, due to the continuous economic growth in the previous years. The effect of the crisis continued during 2009, when the national economy experienced a downturn of about 14%. However, in 2010 the economy began to revitalize and 2.1% real GDP growth was recorded.

**Figure 5: Economic Growth in Armenia in 1997-2010**

The country's nominal gross domestic product in 2008 was USD 11.9 billion or USD 3,700 per capita, which was higher than USD 9.2 billion of the previous year (USD 2,853 per capita). In 2009 nominal GDP decreased to USD 8.7 billion (USD 2,686 per capita) contrary to the government's budget forecasts (over USD 13.6 billion was estimated). Finally, in 2010 when real growth revitalized, nominal GDP also increased reaching USD 9.7 billion which equals to USD 3,041 per capita.

As concerns the structure of GDP, in 2009 the share of industry made up 13.6% (it decreased during the last 5 years), the share of agriculture was 16.2% (decreased), the share of construction 18.8% (decreased), trade comprised 20.7% (increased over the last years), and the rest was comprised by other sectors.

As of 2008, average exchange rate for the Armenian national currency dram had been continuously rising for several years and was stabilized at AMD 306 for USD 1 for the year 2008. However, it fell suddenly by about 20-25% during the 2009 economic crisis, reaching even AMD 384 for USD 1 during the last quarter of 2009. Inflation, which remained fairly low in the early to mid 2000s, increased significantly as a result of higher priced imported goods coming into the country and jumped from 4.4% annual average in 2007 to 9% in 2008. Average exchange rate for the year 2009 stabilized at AMD 363 for USD 1, however in 2010 it reached the level of about AMD 380 per USD 1 again.

The annual unemployment rate in Armenia was 7% in 2009, up from 6.3% a year earlier. This was due to the world economic crisis. Previously (during the last decade), unemployment in Armenia was much higher

(well above 10%). The decrease in unemployment has been facilitated by rapid economic growth in the country in early 2000s, especially in labor-intensive sectors.

Average monthly salary increased in 2009 by 11.5% as compared to 2008, and annual average inflation went down from 9% in 2008 to 3.4% in 2009.

**Table 12: Main economic indicators of Armenia, 2007-2010**

	2007	2008	2009	2010
Population (mln)	3.23	3.23	2.24	3.26
Nominal GDP (bn USD)	9.2	11.66	8.71	9.73
GDP Per Capita (USD)	2,853	3,606	2,686	3,041
GDP real growth %	13.7	6.8	-14.2	2.1
AMD/USD exchange rate	342.1	306.0	363.3	373.6
Inflation, %	4.4	9.0	3.4	8.2
Unemployment rate, %	7.0	6.3	7.0	7.2

In general, the growth rate in Armenia was much higher than in developing and especially in developed countries. The economic growth rate in Armenia is higher also in comparison with the neighboring or similar countries, and only lags behind Turkmenistan and Azerbaijan, because of the sharp increase in oil and gas export revenues in those countries. Due to the above-mentioned growth and development trends, Armenia shifted from the group of Low Income countries (according to the World Bank classification) to the group of Low Middle Income countries.

The implemented "first generation" reforms played an essential role in terms of ensuring a decade-long double digit economic growth. Liberalization of economy and establishment of market infrastructures and institutions formed the basis for economic growth and development. Although its first-generation reforms have been largely successful, Armenia must focus on the second generation reforms to sustain growth, especially after the world economic crisis, by smoothing its negative effects. These reforms include sharpening competition through structural and institutional reforms, creating competitive conditions for economic activity and job creation, improving financial intermediation, fostering innovation, and integrating international services and factor markets.

The main source of economic growth in Armenia is the external savings, particularly remittances received from abroad and investments in development programs and infrastructures. The economy highly depends

on migrant remittances, and although the share of remittances in GDP decreased recently (from 24% in 2003 to 13% in 2008), the dependence still remains quite high. In 2007, Armenia was among the top 20 countries of the world in terms of the share of remittances in the GDP. Besides, to compare the top five remittance-receiving countries of the world<sup>17</sup> (according to 2007 data of the World Bank) with Armenia, per capita remittances to Armenia exceed the top value of per capita remittances by about 2.5-3 folds<sup>18</sup>. Moreover, remittances accounted for a considerable share of the income of households in Armenia (about 1/3 in 2006-2007). Therefore, it is clear that remittances are an important source of external financial flows for the Armenian economy.

Although starting from the end of 2008 remittances started to decline due to the world economic crisis, in nominal terms level of remittances is still high. Moreover, an increase was recorded in 2010 when the economy started to rebound. According to expert estimations, during the recent years the average amount of private remittances to the households of Armenia has constituted USD 1.5 billion annually.

During 2001-2008, economic growth was registered in almost all sectors of the economy and the construction and service sectors held the leading positions. Industry and agriculture had almost the same share in economic growth. The growth of the construction sector and its multiplicative effect in other sectors assured the substantial share in GDP growth. In the period 2001-2008, the average annual growth rate in the construction sector comprised around 19.6%. As a result, during the mentioned period, the share of construction sector in GDP increased from 10% to 27% and assured 1/3 of economic growth (more than industry and agriculture together). However, in 2009 when the country experienced economic downturn, the growing sectors were only services and retail trade, with modest growth rates of 1.3% and 1.0% respectively. The largest decline was recorded in construction and transportation.

The first signs of economic recovery shown at the beginning of 2010 became less prominent in July as the agriculture contracted by some 23% (January-July, year-on-year). As a result, the real GDP growth rate declined from the highest 8.8% (for January-May) to 4.0% (for January-July). The crisis, however, put some adjustment to the growth pattern of the Armenian economy, leading towards more equal contribution of different branches.

Key branches contributing to the economic growth are presented in Table 13 below.

**Table 13: Contribution of main economic branches to the GDP growth in 2007-2010 (%)**

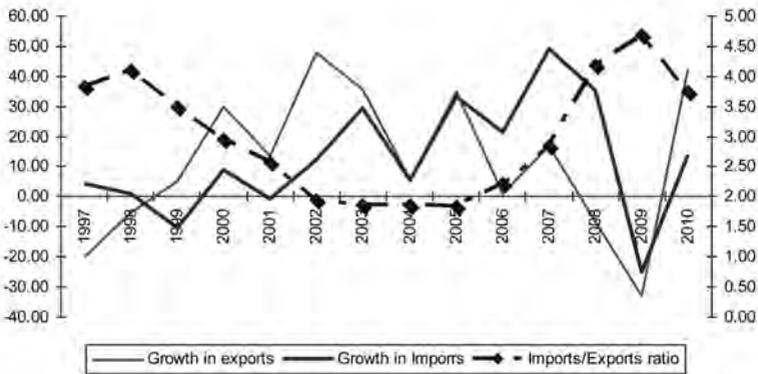
The major driver of growth was the mining industry. Mining was the most

	2007	2008	2009	2010
Industry	3.6	5.9	-11.7	49
Agriculture	13.8	2.9	-1.2	-85.6
Construction	31.9	26.5	-7.3	25
Trade and services	31.9	42.7	4.3	36
Other branches	18.8	2.2	181.6	75.6
GDP growth	13.7	6.8	-14.2	2.1

rapidly developing sector in the economy, recording a significantly higher growth rate compared to other sectors. With only 2.54% share in the total GDP, the mining industry sector contributed 32% of the total GDP growth in 2010.

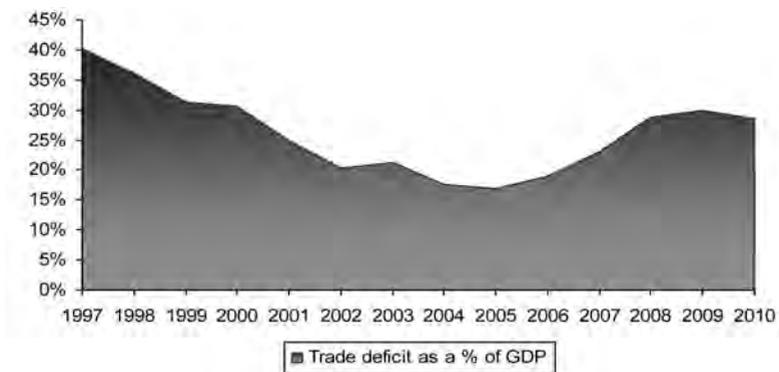
The deficit of the current account has been decreasing since 1998; however during recent years, especially in 2007 and 2008 it increased significantly, due to doubled deficit of trade balance. One should mention the fact that before 2001, imports exceeded exports by almost three times, whereas during 2002-2007 this ratio decreased almost twice (Figure 6).

**Figure 6: External sectors of the Armenian economy, 1997-2010**



In 2008 export volumes decreased significantly, and the share of exports of goods and services in GDP made up around 15% (while the share of imports in GDP was 40%). In 2010 merchandise exports grew at much higher rates than imports (43% vs. 23% as of January-July), reflecting positive developments in the external trade sector. As a result, due to large base for imports and exchange rate depreciation, the trade deficit increased from 32% to 37% of GDP. However, the net inflow of non-commercial private transfers (usual proxy for private remittances) increased by 7.5% in January-July 2010 (year-on-year) and may to some extent contribute to the improvement of the current account balance. Remittances from abroad and official transfers are an important source of financing for current account of balance of payments.

**Figure 7: Trade deficit as % of GDP, 1997-2010**



As can be noted in Figure 7, trade deficit shrank during the period of 2002-2006 due to the increase in exports, and decreased to 19% of GDP as compared to 40% in 1997. However, it started to increase again and reached 30% in 2009 due to the world economic crisis.

The relative volume of foreign direct investments in Armenia is rather small. In 2000-2008 FDI inflow constituted around USD 3 billion or 6% of the annual GDP on average. These investments were mainly directed towards the development of transport and communication sector, nonferrous-metal industry, mining industry, food industry, and construction and service sectors.

Credits to economy by the internal banking system have not been impressive either. As the main sector of the financial market of Armenia

during the last 10-15 years, the banking system has extended credits to economy that amounted on average about 9% of GDP. This indicator increased in 2009 and made up around 19% of GDP. In response to the economic growth as well as development trends in the mortgage market, banks have substantially increased the accessibility of consumer and mortgage credits for households. However, these indicators remain quite low in comparison to other countries.

Thus, since the deep downturn of 1991-1993 and up to 2008, the economy of Armenia entered the phase of continuous and rapid economic growth. The growth rate was especially high in 2001-2007. The private sector reacted to the liberalization of economy and other constructive reforms; whereas external savings were still the main source of financing the economic growth. The economic growth to a certain extent was accompanied by economic development; new types and branches of economic activities have come forward and developed. Nevertheless, the main drivers of economic growth were the construction and real estate sectors. The years of economic growth were attended by the stability of fiscal and external balances, as well as low and stable prices. The poverty incidence (especially of extreme poverty) has reduced substantially due to growth and employment, as well as public and private external transfers (remittances). The poverty incidence decreased to 22.7% in 2008 from 50% in 1999. 2009 world economic crisis, however, influenced the growth pattern of the Armenian economy. In 2010 fiscal performance was in a positive trend in January-August. The tax collection exceeded the planned indicator by 11% and grew by 20% compared to the previous year. However, price developments were not satisfactory. Due to 1.3% inflation in August (driven by 2.5% increase of food prices), the 12-months inflation reached 8.2%, which was 2.7% points higher than the upper bound of the inflation target. As concerns contribution to inflation, there is a drift from non-tradable to tradable. If during the first quarter the inflation was formed mainly by prices of non-tradable goods, in the second quarter of 2010 food products prices accounted for more than half of the inflation. Despite some negative signals coming from agriculture contraction associated with inflation in food prices, the general developments of Armenian economy in 2010 and more favorable global developments formed a more positive macroeconomic outlook for the national economy. All major branches of the economy registered some growth, bringing a 2.1% GDP growth in 2010.

## Recent Development of the SME Sector

Armenia's economic transformation since its independence has been profound. Currently the national economy is market-oriented, highly open to trade, capital inflow, and innovation, and is based on services, light industry and metals, construction, and agriculture. Small and medium-sized enterprises (SMEs) play an important role in economic growth, employment creation and reduction of poverty. Due to the consistently implemented government policy to support SMEs, indicators characterizing this sector improved during the recent years.

The SMEs in Armenia are classified according to the number of their employees in compliance with the Law of the RA "On Small and Medium Entrepreneurship State Support" adopted in 2000. Commercial companies or sole proprietors which employ respective average number of employees are classified as SME units (Table 14).

**Table 14: The Classification Criteria of SME units in Armenia**

Classification	SMEs		
	Micro (number of employees)	Small (number of employees)	Medium (number of employees)
Industry and other sectors of production	5	50	100
Construction and power engineering	5	25	50
Science and education	5	25	50
Transport, trade and services	5	15	30

Organizations engaged in crediting, insurance and investment activities, Lombard, security market professional actors, casinos, and organizations involved in gambling business, as well as subsidiary and dependent units are not considered as SMEs.

The share of the SME sector in the country's GDP, employment, taxes, duties and other obligatory payments, as well as in the number of economic entities, the SME development index, etc are the indicators, showing the importance of the SME sector in the economy, and are presented in this report. The comparative analysis of the data characterizing the SME sector in Armenia and other countries are also covered.

As indicated in the previous section, GDP, which is the main indicator of the economic development of the country, was equal to USD 11.6 billion in 2008 and USD 8.71 billion in 2009. Real growth of GDP was negative in 2009 due to the world economic crisis (-14.2%). However, in 2010 the economy rebounded, showing a modest growth rate of 2.1% as compared to double-digit growth of recent years.

**Table 15: Structure of GDP production by branches of economy, 2007-2009 (%)**

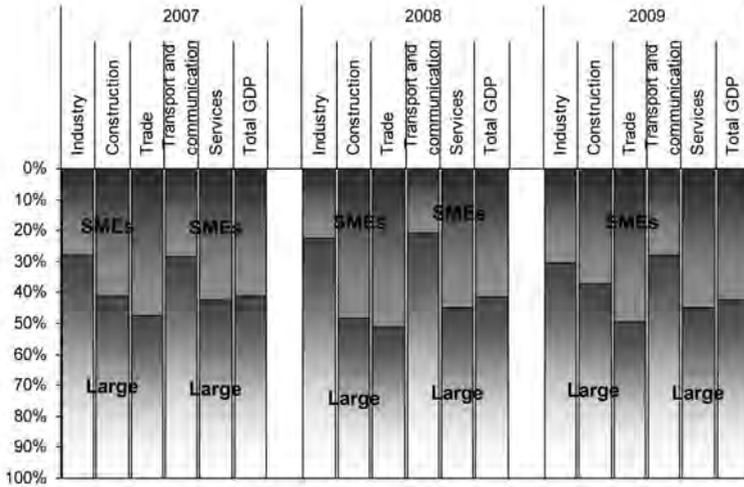
	2007	2008	2009
Total GDP	100.0	100.0	100.0
Industry (including Energy)	15.0	13.1	13.8
Construction	24.5	26.9	18.8
Agriculture	18.2	15.9	16.2
Transport and communication	18.2	18.2	20.7
Financial activity, real estate, renting and business activities	6.3	7.2	9.2
Other type of activities in service providing sector	9.1	9.4	13.0
Financial intermediation	-1.4	-1.7	-2.1
Taxes on product (subtracted subsidies)	10.0	11.1	10.5

As shown in Table 15, main branches that accounted for GDP production in 2009 were Transport and communication, Agriculture, Construction and Industry. The picture was almost the same in 2008, except that the share of the construction sector in GDP decreased from about 27% in 2008 to about 19% in 2009.

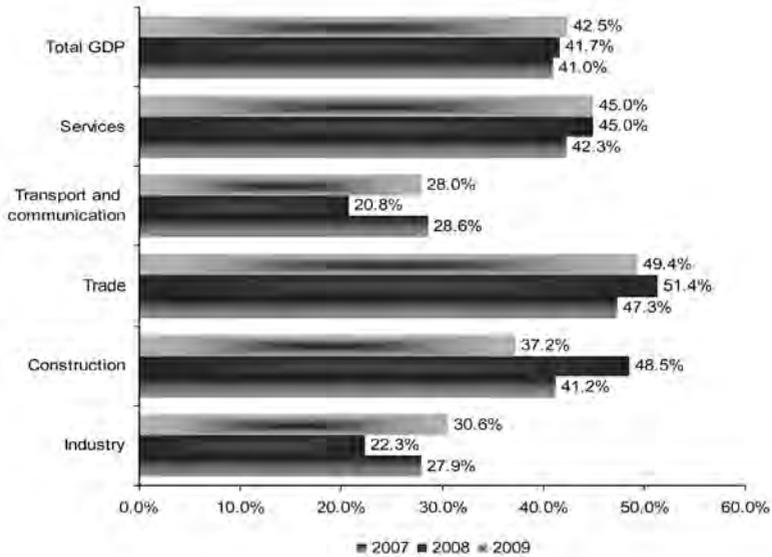
As concerns the contribution of SMEs and large enterprises in total GDP production as well as in main branches of economy, the picture is shown in Figure 8.

Statistics shown on Figure 8 were calculated through the statistical method of extrapolation. Despite the estimations in almost all sectors mentioned above, and in total GDP, it was impossible to evaluate the share of SMEs and large enterprises in agriculture and net taxes because of the absence of accurate data. Share of the SME sector in GDP in 2009 was 42.5% or AMD 968,722.5 million and 41.7% or AMD 1,110,304.2 million in 2008. This means that the share of SMEs in GDP increased by 0.8%. In 2008 this indicator was equal to 41.7%, which was 0.7% higher than the level in 2007 (41%), and exceeded the 1999 level of the indicator twice. Although the growth of this indicator was modest over the period of 2007-2009, the share of the SME sector in GDP remained above 40%, demonstrating the importance of the SME sector for the national economy.

**Figure 8: Structure of GDP by SMEs and large enterprises in branches of economy, 2007-2009**



**Figure 9: Share of SMEs in various sectors and in total GDP, 2007-2009.**



As our data already showed, GDP growth in 2009 was negative due to the world economic crisis. In 2009 modest growth was registered only in

services and retail trade sectors. In spite of the significant decline in GDP, the share of the SME sector in GDP increased, since the crisis hit mainly large companies, the SME sector is more flexible to economic fluctuations, and the anti-crisis activities undertaken by the government in order to mitigate the effect of the crisis on the SME sector were efficient.

As illustrated in Figures 6 and 7, the SME sector has significant contribution to GDP generation and particularly to various sectors of economy, e.g. trade is in the first place by contribution of SMEs, services hold the second place, and construction is the third. Construction is the only sector where the SME contribution to the sector significantly decreased in 2009 as compared to 2008 (37.2% vs. 48.5% of the previous year). In trade sector, this decrease made up only about 2% as opposed to 11.3% in construction. Data on other sectors show increasing tendency.

As of the beginning of the year 2010, the total number of registered commercial legal entities (LE) and sole proprietors (SP) was 136,008, of which 75,197 were sole proprietors and the rest were legal entities. According to expert estimations, about 97% of registered LEs and about 98% of SPs are SMEs.

**Table 16: Marz distribution of registered SMEs in 2009**

Marzes (Armenian Districts)	SME units	
	Number	Share in each Marz, (%)
Yerevan	61,857	46.5%
Aragatsotn	4,597	3.5%
Ararat	8,157	6.1%
Armavir	8,784	6.6%
Gegharkunik	6,703	5.0%
Lori	10,153	7.6%
Kotayk	10,745	8.1%
Shirak	6,946	5.2%
Syunik	6,744	5.1%
Vayots Dzor	2,636	2.0%
Tavush	5,603	4.2%
<b>Total in RA</b>	<b>132,923</b>	<b>100.0%</b>

Table 16 shows regional distribution of the SME units. Almost half of the SME units are based in the capital city Yerevan, the rest are almost equally distributed among the other 10 Marzes.

**Table 17: Distribution of SMEs in 2009**

	SP	LE	Total
Number of SME units in RA	73,693	59,230	132,923
Share in Total [%]	55	45	100

Table 17 shows the distribution of the SME units by legal status.

**Table 18: Distribution of SMEs in 2009 (by size)**

	Share of SME units [%]				Share of Large enterprises [%]
	Micro	Small	Medium	Total SMEs	
2008	74.0	18.3	5.4	97.7	2.3
2009	75.9	16.8	5.0	97.7	2.3

Table 18 shows the distribution of the SME units by size. Micro enterprises are dominant in the total number of SMEs.

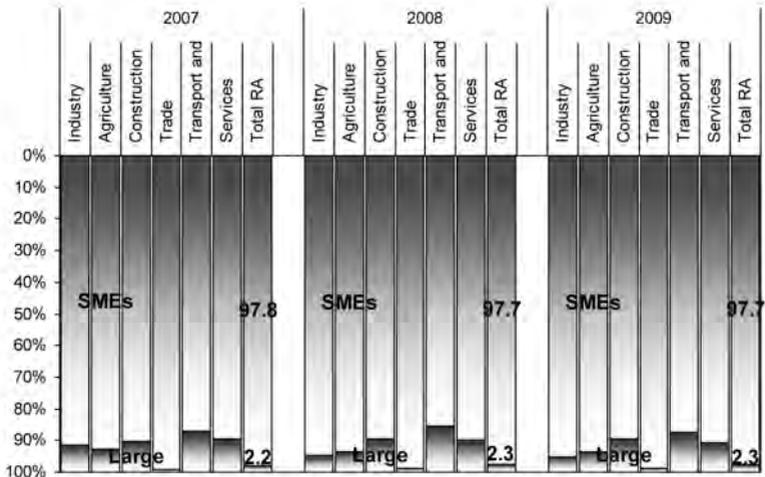
**Figure 10:1 Distribution of SMEs and large enterprises by sectors of economy, 2007-2009**

Figure 10 shows that in 2009, SMEs operated more actively in trade, agricultural food processing, industry and construction sectors. The share of the SME units was 98.9%, 95.0%, 90.4%, 90.5% and 89.6%, respectively.

The role of the SME sector was significant also in transport and communication sector (87.3%). And the last column for each year shows that SMEs made up vast majority of all registered enterprises in all three years.

Employment generated and maintained by the SME sector is another important indicator characterizing the importance of the SME sector for the national economy.

According to estimates, the average number of economically active population in RA in 2009 was 1,185.1 thousand people, 93.1% of whom or 1,103.7 thousand were employed, and 6.9 % or 81.4 thousand were unemployed and registered in the "RA Employment Service" under the Ministry of Employment and Social Issues. However, number of researches, statistics and expert estimation reveal that the unemployment rate is much higher in reality. Figure 11 shows the share of employment that SME sector ensures.

**Figure 11: Share of people employed in SME units in total number of employees, 2007-2009**

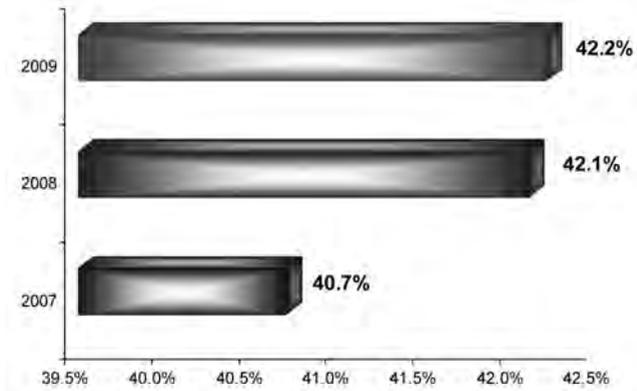


Figure 11 shows that during the period of 2007-2009, over 40% of employment in Armenian economy was provided by the SME sector.

The role of SMEs in new job creation is also noteworthy. For instance, in 2008 the number of newly established SMEs was more than 20 thousand, when around 27 thousand new jobs were created, 51.7% of which in RA Marzes, the rest in Yerevan.

As concerns foreign trade, over the period of 2007-2009, SMEs ac-

counted for up to 18% of exports and up to 38% of imports. Majority of foreign trade was, logically ensured by large companies.

**Figure 12: Foreign trade by SMEs and large enterprises, in 2007-2009**

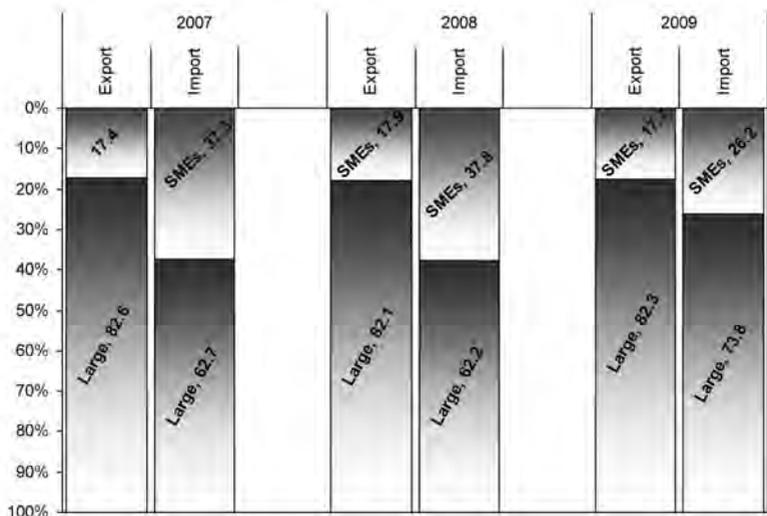


Figure 12 shows that export of SMEs did not exceed 18% of total exports for the period of 2007-2009 and the products imported by SMEs did not exceed 38% of total imports of the country. While share of SME exports remain almost at the same level during these three years, SME imports declined from 37.8% in 2008 to 26.2% in 2009.

By analyzing the comparatively small share of SMEs in foreign trade, especially in export, one can conclude that the SME sector mostly targets the internal market, since the requirements and competition is too high in external markets and SME units, as enterprises with limited funds and opportunities, often cannot overcome obstacles related to foreign trade.

Share of taxes, state duties and other obligatory payments paid by SMEs in total amount of the RA tax income to the state budget made around 25-30% in the last several years. In 2008 this indicator increased by 2.8% as compared to the previous year. However, in 2009 due to the world economic crisis, it decreased by 1.2%. As concerns the obligatory social security payments, SMEs paid around half of the country's total

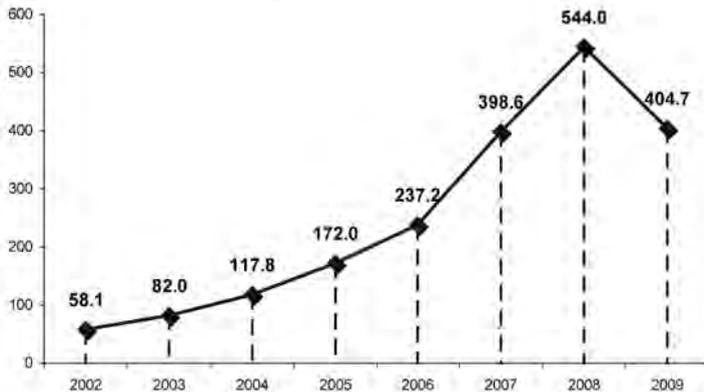
social security payments over the last 3 years. However, this indicator was about 10% higher previously.

In order to get the entire picture of the role and importance or significance of the SME sector for the national economy, an aggregated indicator called "SME Development Index" is calculated in the recent economic researches according to the methodology developed by the United Nations Economic Commission.

**Table 19: SME Development Index in Armenia, 2002-2009**

	Share of private ownership in economy [%]	Share of SMEs in GDP [%]	Share of the labor force of SMEs in the total labor force of the country [%]	GDP [USD per capita]	SME Development Index (expressed in terms of GDP per capita)
2002	81	34.4	28.2	739.9	58.1
2003	83	36.5	31.0	873.4	82.0
2004	84	38.6	32.9	1104.4	117.8
2005	84	39.8	34.0	1513.0	172.0
2006	84	40.3	35.1	1996.0	237.2
2007	84	41.0	40.7	2844.0	398.6
2008	84	41.7	42.1	3689.0	544.0
2009	84	42.5	42.2	2686.0	404.7

**Figure 23: SME Development Index in Armenia, 2002-2009**



As can be noted from Table 19 and Figure 13, the role and significance of the SME sector in the economy of Armenia has been increasing continuously and almost exponentially. In 2008, level of the index exceeded the

2002 level by almost 9 times. The only year that the index value dropped down by 25% was 2009, which was the result of the world economic crisis.

A comparative analysis will also be useful in order to find out the situation of the SME sector of Armenia as compared to other countries. In developed countries, SMEs constitute 97-99% of the economic units. In the USA, the share of SMEs in the total number of enterprises is 99.7%, the share in GDP is 52% and in the total number of employees is 53%. According to OECD data, in France and Spain the share of SMEs in the total number of enterprises is 99.8%, in Japan this figure is 99.7% and in Switzerland up to 99%.

The comparative analysis of the basic indicators of the SME sector between Armenia and countries located in South Caucasus region as well as number of countries in transition and/or developing countries demonstrates rather interesting results (Table 20).

Selection of the countries presented in Table 20 is preconditioned with geographical position, their relations with Armenia as well as comparable economic development tendency, area, population, and other circumstances in comparison with Armenia.

Due to the fact that the number of employees in Armenian SMEs is significantly lower than those in EU countries as well as the differences in GDP per capita, the SME Development Index in absolute terms is significantly lower than in advanced and emerging market economies. Azerbaijan and Georgia are in similar situation in comparison with other countries. However, there is continuous improvement in this term, which reflects the positive effect of the targeted and consistent Armenian national SME policy.

**Table 20: Comparisons of basic indicators of SME sector in Armenia with those of selected developing countries, 2008**

	Share of private ownership in economy	Share of SMEs in GDP	Share of the labor force of SMEs in the total labor force of the country	GDP [USD per capita]	SME Development Index (expressed in terms of GDP per capita)
	[%]	[%]	[%]		
Slovenia	70	56.5	62.6	26,779.0	6,630.0
Estonia	80	73.7	55.6	17,223.0	5,646.0
Lithuania	75	63.0	70.0	14,096.0	4,662.2
Latvia	70	58.2	69.3	14,909.0	4,209.2
Slovakia	80	45.3	66.0	17,565.0	4,201.3
Croatia	70	56.0	65.0	15,636.0	3,984.0
Hungary	80	36.9	56.8	15,409.0	2,583.7
Romania	70	55.0	21.0	9,300.0	751.9
Bulgaria	75	30.0	42.2	6,546.0	621.5
Azerbaijan	75	40.3	34.0	5,330.0	547.7
Armenia	84	41.7	42.2	3,689.0	544.0
Georgia	75	29.4	32.0	2,931.0	206.8

During the period of 2002-2009 around AMD 2.6 billion was provided by the state budget for the implementation of SME support state programs. Within the scope of these programs, around 20,000 SME units were provided with support and over the last 5 years, more than 20,000 applications of start-up and operating SMEs were satisfied. It can be stated that due to the consistently implemented government policy of providing support to SMEs, indicators characterizing this sector improved during the recent years.

Only in 2009, within the scope of the state support programs 9,370 SMEs were supported. Support (financial and other) was provided to 4,748 start-ups.

In 2009 the following state support programs were implemented:

- Establishment and strengthening of institutions of SME state support,
- Financial and investment support to SMEs,
- Support to start-up SMEs,
- Support to SMEs in applying innovations and advanced technologies,
- Business, information and consulting support to SMEs,
- Training of SMEs,
- Support to SME sales promotion,

- Organizing activities of “European enterprise network” communication center in Armenia (co-financing),
- Development and implementation of joint (co-funded) programs with international and foreign donor organizations in the spheres of state support.

### **Main Developmental Tendencies and Deficiencies Characterizing the Economy**

After the implementation of “first generation” reforms, the economy of Armenia reached quite a good standing of main economic indicators. Economy has been growing continuously during the past 15 years and reached a double-digit growth level.

Main branches of the economy were industry, construction, agriculture, transport and communication. International comparisons show that the agriculture and construction sectors have a substantial share in the structure of the Armenian economy.

Main branches contributing to GDP growth were industry, agriculture, construction, trade and services.

Before the world economic crisis, inflation showed a relatively low and stable trend, national currency had been continuously appreciating for several years and was stabilized by 2008. However, it depreciated sharply in 2009. The situation changed for almost all indicators in 2009 due to the world economic crisis, whereas starting from 2010 it started improving again.

As one of the steps of anti-crisis policy, the Central Bank announced a return to a floating exchange rate regime in 2009. Exchange rate balanced and stabilized around its market price, leaving behind the risks of financial crisis.

Before the crisis, almost all sectors of economy were growing. The growth of the construction sector and its multiplicative effect on other sectors accounted for substantial share in GDP. During the economic downturn in 2009, the growing sectors were only services and retail trade (with very modest growth rates). The first signs of economic recovery were shown in 2010. The major driver of growth was the mining industry, although it has a small share in GDP.

Trade deficit shrank during 2002-2006 due to the increase in exports. Afterwards, it started to increase again and reached 30% of GDP in 2009 due to the economic crisis. Unemployment decreased during the years of economic growth but increased by 0.6% in 2009. The level of poverty also decreased during the period of economic growth, but poverty rates went up during the crisis. Remittances were growing continuously before the crisis, but reduced in 2009. However, in 2010 remittances also started to increase.

The relative volume of foreign direct investments in Armenia has been rather small. Before the crisis almost all economic indicators were improving. The years of economic growth were accompanied by stability in fiscal and external balances, as well as stable prices.

In spite of all these trends moving in positive direction before the crisis, the economy had some deficiencies. Particularly, economic growth depended mainly on migrant remittances and investments in development programs. Poverty rate was still rather high. As mentioned above, the economy depended heavily on the construction sector. It is desirable to have a more stable and secure energy industry. Transport infrastructure also developed significantly since the mid-1990s, although here Armenia relies heavily on support from donor institutions, as governmental funds and private sector interest are still insufficient. Telecommunication is still weak in places. However, it is developing rapidly and several new companies have entered the Armenian market over the past two years. In addition, the government's focus on IT sector, with the goal of developing the Armenian e-economy, has led to internet coverage spreading to such an extent that the development of fiber optic communication lines is a serious consideration today. While social infrastructure has made progress over the last 15 years, it remains a comparative weakness for Armenia, with the healthcare sector in a particularly bad state.

Despite the progress recorded during the first eight months of 2010, key challenges for strong macroeconomic performance still remain. As in last year, the economic activity of main trading partners, especially Russia, remains essential for economic recovery.

As mentioned above, the implemented "first generation" reforms played an essential role in terms of ensuring a decade-long double digit economic growth. Liberalization of the economy and establishment of market in-

frastructures and institutions, eradication of controlled wages and prices and the privatization of most land and small companies, formed the basis for economic growth and development and Armenia's GDP and standard of living gradually increased. The country's infrastructure and financial system also made progress. Although the first-generation reforms have been largely successful, Armenia must focus on the second generation reforms to sustain growth, especially after the world economic crisis, by smoothing its negative effects. These reforms include sharpening competition through structural and institutional reforms, creating competitive conditions for economic activity and job creation, improving financial intermediation, fostering innovation, and integrating international services and factor markets.

### **2.2.2. Legislation and Ranking of Doing Business According to World Bank Methodology**

In order to perform entrepreneurial activity in Armenia, a company must be registered as a commercial legal entity (LE) or sole proprietor (SP). In Armenia the most common types of commercial companies are sole proprietors (SP), limited liability companies (LLC) and joint stock companies (JSC). Other legal forms of entrepreneurship according to Civil Code of RA might be also general partnership, limited partnership and commercial cooperative.

It is mandatory that an enterprise or entrepreneur perform activity based on a registration certificate from the State Registry.

An Individual Entrepreneur or Sole Proprietor is defined as a person who can perform activities independently on his/her behalf and at his own risk, without forming a legal entity, the main purpose of which is to gain profit (income) from using property, selling goods, performing works or delivering services.

Individual entrepreneurs can be the citizens of the Republic of Armenia and foreign citizens with capability, as well as those persons without citizenship, whose right of being engaged in entrepreneur activities is not limited by law.

A Limited Liability Company is a company established by one or more persons with a charter capital divided into shares determined by the company's charter. LLC is a commercial organization with the status of a

legal individual. It must have a separate property as its ownership and shall bear responsibility for its obligations with this property; it may acquire and utilize property and personal non-property rights, bear duties, be a claimant or respondent in court.

A Joint-Stock Company is a commercial organization, a business entity, the equity of which is divided into a certain number of shares certifying the right of shareholders. JSC is a legal entity, which has property that is separated from that of its shareholders. On its behalf, it can obtain and realize property and personal non-property rights, bear responsibilities, and act as a claimant or respondent at court.

The legal basis for commercial enterprises is established by the Civil Code of the RA (adopted on 28.07.1998, effective from 1 January 1999) and the following legal acts:

- The RA law "On sole proprietorship" (effective from 25.04.2001)
- The RA law "On limited liability companies" (effective from 21.11.2001)
- The RA law "On joint stock companies" (effective from 27.11.2001)
- The RA law "On firm names of companies" (effective from 15.12.1999)
- The RA law "On state registration of legal entities" (adopted on 03.04.2001 and effective since 2002)
- The RA law "On licensing" (adopted on 30.05.2001, effective from 27.06.2001).
- The RA Code of Administrative Violations
- The RA law "On Taxes".

The research implemented by the World Bank aims at ranking the economies (or 181 countries) on their ease of doing business. The first place is considered the best. A high ranking on the ease of doing business index means the regulatory environment is conducive to the operation of business. Armenia is ranked 44 out of 181 economies. The position of Georgia in the list is 15, while Azerbaijan holds the 33rd position. As concerns other countries, Romania is ranked 47, Turkey 59 and the Russian Federation 120 out of 181 countries. A ranking on the ease of doing business is not an absolute term and the indicators used in the evaluation of the ranking do not account for all factors important to doing business. However, improvement in an economy's ranking indicates that its government is creating a regulatory environment more conducive to operating a business.

**Table 21: Armenia’s ranking in doing business, 2008, 2009 and 2010**

Rank	2008	2009	2010
Ease of doing business	41	44	43
Starting a business	49	66	21
Dealing with construction permits	73	42	72
Employing workers	52	54	62
Registering property	2	5	5
Getting credit	25	28	43
Protecting investors	88	88	93
Paying taxes	147	150	153
Trading across borders	131	143	102
Enforcing contracts	63	61	62
Closing a business	47	47	49

### 2.2.3. SME Support Infrastructure

Small and Medium Entrepreneurship (SME) is considered as one of the priority directions for the development of the Armenian economy. The Government of Armenia consistently performs activities aimed at the development of the SME sector, through creating state support systems for SMEs.

SME development policy is aimed at expansion of the SME sector in the context of economic, social and political development of Armenia and enhancement of the role of the SME sector in the national economy. One of the main documents underlying this policy is the “Concept for SME Development Policy and Strategy in Armenia” adopted by the Government of RA in 2000. The document contains the economic, social and political objectives of SME development policy as well as the main directions for their realization. The adoption of this document served as a base for the adoption of the Law of RA “On State Support of Small and Medium Entrepreneurship”. The Law defines the criteria for SME units’ definition in the Republic of Armenia, as well as the key directions for state support of the SME sector.

Starting from 2001, the Government develops and implements annual programs of SME support, which are aimed at realization of the main directions for state support of SMEs defined by the Law on “State Support of Small and Medium Entrepreneurship”.

As concerns the institutions of SME support, the Ministry of Economy of the Republic of Armenia is authorized to elaborate SME development

policy and strategy, as well as being responsible for the elaboration of programs for development and state support of the SME sector in Armenia.

The Fund "Small and Medium Entrepreneurship Development National Center of Armenia" (SME DNC of Armenia) was established in 2002 as another responsible institution in this sphere. It is considered to be the main body responsible for the implementation of state policy of SME support in Armenia as well as programs of SME development.

Foreign and international organizations (projects) play a considerable role in the process for the elaboration and implementation of SME development and support programs (projects) in Armenia.

Financial support to SMEs is provided through the Loan Guarantees Provision program which allows the solvent entrepreneurs to get loans in terms of insufficient pledge amount and low liquidity, particularly specific for the SMEs operating in distant and close to the border regions of Armenia. The program provides up to 70% guarantee of the principal loan amount. The maximum amount guaranteed cannot exceed ADM 10 million. The annual interest rates for the loans provided by the SME DNC through this program and through partner banks are lower than current market interest rates.

Technical support to SMEs consists of Consulting support program, Business training and Sales promotion. Within the scope of the consulting support program, consulting is provided to SMEs in legal advice, analysis of enterprise's business activity, elaboration of investment and development plans, management and marketing, accounting and financing management, tax and customs, innovations, modern technologies and intellectual property rights protection, and other as requested. Preference is given to operating and start-up SMEs in distant and close to the border regions of Armenia.

Training support assumes business education and training to SMEs on clarifications on the Tax legislation of the RA, management, marketing, labor legislation of the RA, business law, sales techniques and skills, human resource management, time management, customer services, financial management, intellectual property protection, business ethics, tourism and other, as requested. Again, preferred beneficiaries are

operating and start-up SMEs in distant and close to the border regions of Armenia.

Support in sales promotion is provided to SMEs for adequate presentation of goods and services in the market. When choosing beneficiaries of the support program, preference is given to start-up SMEs, as well as those manufacturing new products, exporting or having export potential in distant and close to the border regions of Armenia.

#### **2.2.4. Industries, Branches, Regions, Clusters**

Along with many other countries, the world economic and financial crisis affected the Armenian economy, which was one of the fastest growing economies in the world in recent years. Although Armenia has recently joined the group of middle income countries, it still has a high poverty rate, and over 45% of the labor force is employed in the inefficient agricultural sector. The contraction of real output in 2009 was driven by decline in remittances from abroad and weakness in the critical construction and mining sectors. In the longer term, however, it is expected that Armenia will continue above-average economic growth once the major effects of the crisis have passed.

International comparisons show that the agricultural and construction sectors have a substantial share in the structure of the Armenian economy, as compared to other countries, while the shares of services and industry sectors are relatively small in comparison with other countries.

**Table 22: Structure of GDP by main branches, 2002-2009 (%)**

	2002	2003	2004	2005	2006	2007	2008	2009
<b>Industry</b>	22	22	22	22	18	16	13	14
<b>Agriculture</b>	23	22	22	19	18	18	16	16
<b>Construction</b>	14	16	15	22	25	26	27	19
<b>Transport</b>	7	6	6	6	-	6.9	6.7	-
<b>Trade</b>	10	10	11	11	18	18	18	21
<b>Other</b>								
<b>Branches</b>	24	24	24	20	10	10	10	13

During the years of high economic growth (starting from 2001), the structure of the economy underwent noticeable changes. The shares of construction increased significantly, while shares of agriculture and industry reduced about 1.5 times.

In 2008, construction and agriculture together accounted for the major share of employment and more than 40% of total GDP. Trade and industry followed these branches, ensuring 18% and 13% of GDP, respectively. In 2009, the structure of GDP changed towards more equal distribution; trade was in the first place with 21%, followed by construction (19%), agriculture (16%) and industry (14%). The sectors of transport and communication, energy and water supply and the real estate, renting and business activities have their special niche. All these seven sectors of economy assure more than 3/4 of GDP.

As concerns the growth of main branches in 2008, the highest growing branches were financial intermediation; fishing; hotels and restaurants; other services; real estate, renting and business activities; construction and trade. The majority of branches declined in 2009 due to the economic crisis; construction, agriculture and manufacturing sectors also declined.

In 2010 the major driver of growth was the mining industry. With only 2.54% share in the total GDP, the mining industry sector contributed 32% of the total GDP growth in 2010. Sectors of industry, agriculture and construction had negative contribution to GDP growth in 2009 (when GDP growth was negative). Industry, construction, trade and services had positive contribution to GDP growth in 2010, when the economy revitalized and recorded 2.1% growth.

Manufacturing as a part of the industry sector accounted for around 8.3% of GDP in 2009. The manufacturing sector in Armenia is based on 3 main branches, including food industry, metal industry and production of final metal items (1/4), and non-metal mining industry (9.5%). Other relatively large branches include chemical industry, tobacco industry, publishing and jewellery, which have almost the same volumes and each account for about 3% of manufacturing.

During 2007-2009, the mining industry expanded by 3.6%, however, in 2009 the mining industry experienced a decline of 11.4%. This is mostly conditioned by the impact of the world economic crisis and the decline of prices for raw materials, especially of copper and molybdenum in the world market. The main direction of the mining industry is the metallic ore mining, which makes up around 90% of the sector.

The branch of transport and communication has been expanding progressively during the recent years, and in 2009 accounted for 6-7% of GDP. Cumulative growth in this sector over 2001-2007 made up around 13.1%. Moreover, in 2007 this indicator was equal to 16.3%. In 2008 it slowed down to 9.4%. In the first quarter of 2009 the growth slowed even more, down to 3.4%.

In 2008, turnover of telecommunication and communication services increased by 15% as compared to 2007. 66% of this comes from the cellular communication, and 26% from the fixed telecommunication.

The fixed telecommunication services display a high tendency for decline, whereas the cellular telecommunication services are expanding progressively, though during the first quarter of 2009 the growth rate slowed down substantially to 2.5%. Significant decline in postal and courier services (by 50%) during the first quarter of 2009 may be explained by general decline in the economic activities, as well as by the increase of accessibility of internet services.

The sector of construction is one of the key branches in Armenia, which accounted for 27% of GDP in 2008, increasing by 7.2% in real terms as compared with the previous year. Starting from the third quarter of 2008, the growth rate in the construction sector tended to reduce, and during the fourth quarter of 2008 and first quarter of 2009, decline in this sector was recorded. In 2009, the share of construction in GDP decreased to 19%. However, it still remains one of the major sectors of the economy. More than half of the construction is realized in the sphere of apartment and housing construction.

The agricultural sector in Armenia accounted for 15.8% of GDP in 2008 and 16.2% in 2009, almost 1.5 times lower than in 2002. This sector grew by 1.3% during 2008 as compared to the previous year. The index of production volume in 2009 decreased by around 5.5% as compared with the same period of the previous year and was 95%. Around one third of the agricultural production in Armenia is comprised of cattle breeding and the rest is crop production.

Tourism is one of the key sectors in Armenia. Since 2001, tourism sector has been growing significantly. One of the key facts to indicate the devel-

opment potential of the tourism sector is the annual number of incoming tourists. During the last decade, the number of incoming tourists in Armenia was increasing by 20% on average. Over the period of 2000-2008, the number of visits to Armenia increased by 12 times. In the first half of 2009, 208 thousand tourists visited Armenia, which is slightly (0.1%) more than the number in the same period of 2008. About 60% of tourists were Diaspora Armenians. In the first half of 2009, internal tourism increased by about 13%. The purpose of 25% of the internal tourism was business, 13% medical treatment, and 51% recreation and entertainment.

Armenia is one of the leading information technology nations among the neighboring CIS and Middle East countries. As of 1998, 35-40 programming companies and internet connection providers were operating, which employed around 1000 specialists. Over the last decade, the number of both local start-up enterprises and branches of foreign companies increased significantly. In 2008 the number of IT companies operating in Armenia reached 175.

Since 2000, many foreign companies have established their branches in Armenia as the high professional level of the local specialists and comparatively low levels of expenditures were quite attractive. As a result, the number of technical and business specialists in the IT sector reached 5000 in 2008. In 2008 the turnover in the sector of programming and services was equal to USD 110 million, or only about 1% of the annual GDP.

Although only 11 companies specialized in the sphere of micro scheme design, the revenue of these companies amounted to 16% of the total turnover of the whole IT sector. Other profitable fields are internet services, network systems and communication as well as applied internet programs. The export volume of the sector was USD 70 million and was directed to more than 20 countries all over the world. The major part of exports (around 60%) goes to USA and Canada, 18% to Europe and 16% to Russia and CIS countries. Today, Armenian IT industry is one of the most dynamic and promising sectors of the economy.

### **2.2.5. The Effect of the International Financial and Economic Crisis**

The recent worldwide crisis originated from the USA markets and reached almost all the countries in the world. Economic growth all over the world has slowed down and a recession was recorded in 2009. In 2010 the world economy started to rebound. Among CIS countries, Ukraine and Georgia especially suffered from the crisis. Eastern Europe and especially Baltic countries recorded profound economic decline. The global financial and economic crisis has been affecting Armenia's economy since October – November, 2008. Risks related to the crisis were:

- Reduced or deferred direct private investments,
- Reduced remittances,
- Temporary fall in mining industry output levels,
- Delays or reductions in some investment projects in the sphere of construction.

The government of Armenia set the following targets in order to address the effects of this crisis:

- Maintenance of macroeconomic stability,
- Financial sector stability,
- Identification and use of extra incentives for economic growth.

Countries that are more and better integrated into international financial and commodity markets were affected by the crisis most profoundly.

Unlike developed economies, Armenia's banking and financial institutions averted panic, because of relatively low demand for liquidity. However, like many other countries, Armenia did not avoid negative effects of the crisis. Particularly, the following occurred:

- Reduced remittances from abroad,
- Lower raw material and mineral ore prices on the global markets,
- Lower demand for Armenian commodity and service exports due to decreased global demand and decreased exports,
- Decline in revenues from export as a result of reduction in global demand and price of copper
- Decline in tourism growth
- Shrinking inflow of investment into Armenia due to the lack of liquidity in the global economy and reduction of FDI,
- Pessimistic expectations,
- Changed trading conditions, regulation and economic relations.

The first wave of impact was directed towards the financial system and macroeconomic stability. Armenian authorities managed to avoid the impacts of the financial crisis and to protect the country's financial system. However, the impact on the real sector was inevitable. Falling real estate prices on the global markets led to diminished interest for domestic real estate immovable assets. Along with reduced investment, this brought the slowdown and relative inactiveness of the main driving force of Armenia's economy – the construction sector. In 2009 when the country experienced an economic downturn, the growing sectors were only services and retail trade, with modest growth rates of 1.3% and 1.0% respectively. The largest decline was recorded in construction and transportation.

Furthermore, the decrease in foreign demand for domestic goods and services resulted in less activity in the number of economic branches in Armenia. Trade deficit reached 30% in 2009 due to the world economic crisis (as opposed to previous years of shrinkage and decline to 19% of GDP). During the last quarter of 2008, the world economic crisis made the real growth rate slow down significantly. As opposed to the previous years of 2-digit economic growth, in 2008 it was 6.8% and in 2009 the national economy experienced a downturn of about 14%. However, in 2010 the economy began to revitalize and 2.1% real GDP growth was recorded.

The annual unemployment rate in Armenia was 7% in 2009, up from 6.3% a year earlier, as a result of the global crisis.

In spite of the significant decline in GDP (-14.2% in 2009), the share of the SME sector in GDP increased. The crisis hit mainly large companies since the SME sector is more flexible to economic fluctuations, and the anti-crisis activities undertaken by the government in order to mitigate the effect of the crisis on the SME sector were efficient.

In 2009 share of taxes, state duties and other obligatory payments paid by SMEs in total amount of the RA tax income to the state budget decreased by 1.2% as opposed to the 2.8% increase in 2008. The level of SME development index which shows the role and significance of the SME sector in the national economy dropped down by 25% in 2009 due to the global crisis. This was the only year when the index value declined; over

the last decade, it had been increasing continuously and almost exponentially.

Since Armenia had the lowest level of inflation among CIS countries, our country managed to maintain its overall economic stability. Low level of inflation was partly conditioned by the GoA's policy aimed at ensuring stable national currency. However, prices of strategic imports, particularly fuel and food, increased due to the crisis. There were also some negative signals coming from agriculture contraction, associated with inflation in food prices. Sharp depreciation of Armenian dram in 2009 (about 20-25%) caused fluctuation in commodity prices in early March, as well as increased utility fees in April 2009. Migration and remittances also started to decline at the end of 2008; however, an increase was recorded in 2010 when the economy started to rebound.

Due to the cautious public debt management, foreign debt/GDP ratio was kept at 13.4% as opposed to the average 33.4% across the CIS countries. The low level of public debt during the global crisis provided sufficient room for fiscal maneuvering, particularly, possibility to contract extra debt without putting at risk the public debt sustainability indicators.

## **2.2.6. Government Measures to Cope with the Impact of the Economic Crisis**

### **Relevance of Economic Policies to the Features of the Country**

The Armenian government recognizes that improved infrastructure lies at the heart of its economic growth, and has set up infrastructure development as one of its policy priorities. Improved infrastructure will help Armenia's economy to become modern and competitive. Competitiveness is one of the top priority goals set by the government and they realize that our current infrastructure in the mid-longer term cannot support this ambition. The government has the intention to use the power of the private sector in its infrastructure creation and has approved public-private partnership (PPP)-friendly legislation to facilitate this. PPP is considered to be one of the essentials, one of the key pillars of the government's infrastructure policy, and the new legislation will enable us to move ahead with the planned actions.

The following program sections are provided on the government's website:

- Government program,
- Medium term expenditure framework,
- Poverty reduction strategy,
- Anticorruption strategy,
- Millennium challenges,
- Anti-crisis action.

The current government program with main policies is posted under the Government Program section. Policies designed by the RA government are relevant to the needs and features of the country.

The key priorities set by the government are as follows.

Maintenance of macroeconomic stability and high rates of economic growth: The Government will have essential, but restricted role in the economy by creating a favorable environment for the development of the private sector. Macroeconomic policy will continue to ensure low inflation rates, low budget deficit and floating exchange rates. The final goal will be the significant economic growth, through provision of macroeconomic stability. The government has set an ambitious goal of turning Armenia into a "Centre of Excellence" for regional business development and investments. The geopolitical location of Armenia creates objective limitations for entrepreneurship, making it more costly compared to neighboring countries. Therefore, the government has decided that we need to:

- make our air and land transportations less costly;
- make our telecommunication systems all over Armenia more accessible and affordable;
- eliminate red tape in doing business, reduce the number of unjustified requests, high costs and long timelines for issuing licenses and permissions for starting a business;
- simplify the tax system, and provide for the online filing of tax returns;
- reduce the number of check ups by achieving improved quality;
- achieve qualitatively new standards in the customs system, thereby eliminating obstacles for competitiveness;
- reduce the tax burden.

Social integration and consolidation: Under this priority the issue of poverty should be addressed. Active involvement of the poor in the economic and civil activities is planned. Attention will be focused on the gap inherited from the past years which exists between the average pensions and average wages, which has resulted in a significant gap of living standards of the employed citizens and the retired pensioners (including the disabled). The government will gradually increase the pensions, and the plan is to make it 1,5 times above the poverty threshold. The work on introduction of multilevel retirement schemes will continue. The government intends to increase the efficiency of budget allocations seeking to mitigate the social tension. The family allowances system will be improved in terms of re-conceptualization and targeting the social groups truly in need. To ensure a public consolidation, it is required that the well-off people revise their living habits, not showing off their wealth and power.

Development of human capital: Without human capital development, all the programs may fail. Therefore, the government of Armenia plans to implement reforms in education, strengthening universities, aiming at having a knowledge-based society and such an educational system that will provide employees who will shape our future. Since education should be ongoing for the entire life, the government presents its Concept on ongoing education. It is planned to establish a link between the educational institutions and research centers, because in case of separating science and educational institutions, they will both become inefficient. Direct link between the educational institutions and business world is to be established. The education system will have innovative trends and the government will support it. The educational institutions have to be in a direct continuous contact with the public and provide for the accessibility of their achievements in the fields of research and development. The Government will create exclusive opportunities for the young to study in the prestigious schools of the world.

Under this priority, a new health care concept will be introduced. The quality and accessibility of the health care services offered by our health care institutions should match the best international standards. Armenia has to become a regional health centre. Also, the government will support provision of health care services to vulnerable families or those with limited means. The government will initiate the development of voluntary insurance systems of life and health. A new electronic system will be in-

roduced, which will include the patients' medical history along with other information. This will increase the efficiency of the system.

In addition, the basis of our national culture will be strengthened. The government intends to make the cultural resources accessible for the entire population of Armenia. This target includes the maintenance and rehabilitation of the historical cultural heritage, development of a library network within the country, being assessable to the best libraries of the world through the information-technological systems, also about the development of mass media, theatres and movies. Also, a special TV channel will be established which will adequately present the Armenian culture.

Environmental education, eco-friendly upbringing, and public awareness are other key issues and will be a good base for creation of a comprehensive and national unified ecology. Living in a clean environment is another important component of human capital development.

Establishment of effective public, local self-governing and private sector management systems and the introduction of the principles of corporative management: All the ambitious programs can remain unrealized if the working methods are not improved. Therefore the government plans to ensure application of new methods with the goal of hitting set targets through set actions. The best international standards in the field of management will be introduced. Transparency and efficiency in the public management system will be increased. Setting clear targets for the desired outcome and the performance assessment leading to that goal will become the main rule of reporting for the government. Procedural audit will be conducted by the Control Chamber of the RoA. The government plans to improve the quality of the services provided by the state and local self-governing bodies and the public will provide feedback on these services. An electronic management system will be introduced enabling the state and local self-governing entities to provide services via Internet/online, thus minimizing the need of the citizen to contact the state official. This aims at reducing corruption risks. Corporative management system in the real sector should be introduced. Moreover, the corporative management system will become a mandatory requirement for the companies with state ownership or with its participation. The concept of public private partnerships will be introduced. The wages in the public sector

should be competitive with those in the private sector, which also implies that the efficiency and quality of services should also be competitive.

Harmonized regional development: Currently the disruptive territorial development has become one of the serious obstacles for the economic and social development of Armenia. The overpopulated Yerevan hinders the regional development, as well as the natural development of Yerevan itself. The Government sets a challenge for itself of turning the town of Dilijan into a financial centre. Cultural, recreational, agricultural and industrial centers will be created outside of the capital Yerevan. This will bring more equal and harmonized regional development. Since one of our targets is to have a technological society, all distant areas in Armenia should have reliable Internet access. The modern information systems, knowledge and services will be made available and accessible to everyone. This will enable us to achieve an improved quality of life all over Armenia.

These are the top five priorities of the Government for the upcoming years. The government fights against poverty, corruption, migration, tries to apply practices of good governance, ensuring economic development, competitiveness, higher employment rate, higher incomes, less polarization in society, favorable business and investment climate, efficient budget system, tax and customs systems, secured copyrights and property rights.

Main sectors of the strategic development that the government focuses on are:

Industry (focus should be on management, productivity, knowledge-based industry, use of technologies and innovation issues, and development of mining industry),

- Agriculture,
- Environmental sector,
- Renewable energy sector,
- Transport and communication,
- R&D and IT, engineering,
- Healthcare,
- Education and science.

Selection of these sectors comply with the country's comparative advantages and "natural endowments". Natural endowments promoted by the country's promotion agency, Armenian Development Agency, are well educated, skilled, easily trainable, cost-efficient, young and growing labor force (with science-based skills), mining resources, tourism opportunities, being the first country to adopt Christianity, capacities in high tech. Main results that the government expects from the realization of these policies over 2007-2012 are:

- Annual real GDP growth of 8-10%;
- At least a 10% annual increase in investments;
- A significant reduction of regional economic disparities;
- A 10% increase in non-agricultural employment;
- An increase in state revenue collection by 0.3-0.4% of GDP per annum;
- A significant reduction of poverty: below 11.2% for poverty and below 1.6% for extreme poverty;
- Yearly increase in the level of pensions to ensure that average employment (insurance) pension is equal to the minimum welfare budget in 2012.
- Introduction of a multistage pensions system. Higher financing level for social security and insurance systems to reach 6.2% of GDP;
- Higher public expenditure on health care to reach 2.2% of GDP;
- Higher public expenditure on education to reach 3.5% of GDP.

### **Government Policies and Actions to Smooth the Impact of the Economic Crisis**

Anti-crisis policies adopted by different countries have some similarities. All of them eventually aim at stabilizing demand, promoting production and restoring trust in society. However, each case has its peculiarities, conditioned by the characteristics of policies. As opposed to many other countries, strengthening financial institutions and additional insurance of risks were no more priorities for the anti-crisis policy adopted by Armenia.

The first wave of the world economic crisis hit the financial system and macroeconomic stability, which could have led to an uncontrollable situation in Armenia. However, this was avoided due to temporary currency regulation policy, as well as excellent baseline indicators of the banking

system, high level of financial control and trust towards banks. Though this resulted in some loss of foreign reserves, it allowed managing the expectations in Armenia, at a time of financial panic in main partner countries, and giving time to economic and financial agents to make necessary revisions. In March 2009, the Central Bank announced a return to a flexible exchange rate regime. Exchange rate balanced and stabilized around its market price, leaving behind the risks of financial crisis. There were no significant losses by financial institutions in Armenia. Anti-crisis policies in Armenia are directed towards regulation of real and social sectors of the national economy.

In order to mitigate negative effects of the global economic crisis, the Armenian Government drafted an anti-crisis program which was submitted to the National Assembly on 12 November 2008.

The government's anti-crisis program is aimed not only at minimizing the adverse consequences of the global crisis, but creating ground for sustainable development and a new type of economic relationship in the country.

The overall goal of anti-crisis policies in Armenia is to prevent the economic crisis and reduction of employment, as well as to create basis for growth in post-crisis stage and long-term effective development. The main steps or components of the anti-crisis policy are the following:

- Implementation of balanced macroeconomic policies;
- Support to investment programs contributing to economic development;
- Improvement of business environment and support to entrepreneurship, including simplification of tax regulations and considerable reduction in administrative costs for small businesses;
- Implementation of large-scale projects aimed at infrastructure creation and development;
- Social risks management;
- Providing financial resources for small and medium-size enterprise lending;
- Implementation of sizeable infrastructure-oriented projects and creation of new jobs in these frameworks;
- Priority for welfare programs and State's social commitments.
- Carrying out reforms directed towards growth and development in post-crisis period.

Main principles set under the anti-crisis policy in order to cope with the crisis are:

- To comply with the best traditions of public finance management;
- To ensure a high level of accountability and transparency;
- To avoid or limit the application of possible non-traditional measures of government support to the private sector;
- To ensure development and implementation of public-private partnership (PPP), ensuring effective feedback with society and businesses;
- To apply developed Public Investment Assessment Systems (PIAS);
- To remain loyal to liberal economic policy principles and commitments acquired before WTO and other international organizations;
- To ensure sustainability of reforms;
- To ensure effective communication with the public and businesses;
- To maintain macroeconomic stability;
- To achieve macroeconomic stability through financial sustainability and stability;
- Efficient exchange rate policy pursuit;
- To implement expansive monetary and fiscal policies;
- To implement large-scale infrastructure-related programs;
- Business environment improvement and temporary support for entrepreneurship;
- Priority given to socially-targeted programs;
- Identification and use of extra incentives for economic growth.

In order to cope with the effects of the crisis, the government will perform the following actions:

- The RA government will implement pan-Armenian projects in line with the principle of private-public sector cooperation.
- RA Government will provide additional amenities for doing business in Armenia.
- RA Government shall develop a healthy business environment in Armenia.
- RA Government shall take steps to cope with the social and economic problems facing Armenia.
- RA Government will take steps to ensure public control over the projected actions, and their transparency.

As concerns the macroeconomic stabilization policy, the government and the Central Bank of Armenia are implementing anti-cyclic fiscal and monetary policies based on the assumption that increase in overall demand

is counter-cyclical and counteracts economic downturn, which in turn is supposed to revitalize the business environment. Proper coordination is emphasized as a priority in this process. Particularly, it has been decided to strengthen financial position of the Armenian banking system and inject extra liquidity into the economy, which can reduce interest rates. The CBA revised refinancing rate by decreasing it. Fiscal policy also has been aimed at expanding gross demand by increasing expenditures.

Another anti-crisis measure was tax and customs reform, under which taxes have been considerably simplified for all types of businesses, including small and medium-size enterprises.

In order to minimize “the contact area” between importers and customs officers and reduce corruption risks, customs broker’s offices and self-declaration desks are now available at customs houses and warehouses as connected to TWM online customs clearance processing software. Customs formalities have been simplified. This will save importers a lot of time and energy. Risk selection criteria have been revised in the TWM customs clearance software in order to enhance control efficiency. The number of documents required for import-export-related border-crossing purposes has been reduced to only 3. This will help save a lot of time during the clearance of imported and exported goods. In addition, the list of products subject to mandatory certification at the time of border-crossing was reduced from 65 to only 16.

The RA government focused attention on improving the business environment, undertaking an ambitious program of ensuring a sharp rise in our country’s global image in terms of entrepreneurship and reaching a top place in the list of the most business-friendly countries. Particularly, laws on immovable property tax, tax on means of conveyance and tax on return have been drafted, which envisage a single tax as a substitute for the currently applicable land and real estate taxes, a unified tax on return instead of today’s income and social security taxes. Thereby, only one form will be required to file and submit for each of these new taxes. In addition, the process of creating a legal person has been made considerably easier by calling off the requirement of possessing a corporate seal, reporting a minimum statutory capital, as well as by improving the regulatory framework conducive to less lending bank exposure (through the application of an automated system of ownership registration in the management of immovable property cadastre).

The government of the Republic of Armenia has initiated a series of infrastructure-related projects in the spheres of road building, communications, power engineering, industry, social security and so on. These projects of regional importance were chiefly designed prior to the global crisis, though by their anti-cyclic impact, they attracted more interest and can go a long way toward gaining control over unemployment, as well as fostering growth and development in the aftermath of the crisis. These measures are supposed to be carried out in cooperation with international organizations and the private sector based on the principle of public-private sector collaboration (PPSC). Once effectively materialized, these infrastructure-building projects can promote the efficiency of our anti-crisis efforts and help us find quick response to the economic downturn. The major projects are The North-South Transport Corridor Project; Rural Road Rehabilitation Projects; The Techno-park Project of Gyumri; Establishment of a free economic zone on a site next to Armenia's Zvartnots international airport; New NPP construction; Activities in the sphere of power engineering; and Construction.

The Operative Staff has been established to provide direct assistance to the real sector. The Staff observes business projects received from the private sector and determines the level of assistance required. This implies targeted support for individual enterprises aimed at generating new jobs, ensuring that imports are gradually supplanted by domestic products, enhancing the level of exports, promoting the use of local raw materials, stimulating the application of innovational technologies. For this purpose, the government will provide subsidies and state guarantees (including agriculture), direct lending and participation in corporate capital. As of 1 September 2009, small and medium-size enterprises had received state guarantees of AMD 233.5 million from the SME DSC under the credit guarantee program for 45 SME facilities covering a loan package of AMD 415 million. An economic stabilization lending program has funds of USD 500 million interstate loan available from the RF government, aimed at boosting the GDP through partial coverage of the needs of economic entities in borrowed funds. The program components will be addressing the banks and lending organizations by lending the mortgage market; exports; procuring and processing agricultural produce; implementing air transportations; fostering infrastructure-based tourism; providing loans to consumers; motor-car and housing buyers and, finally, lending small and medium-size enterprises. The second component consists of SME funding and the third component will provide lending to system-building enterprises.

Under the anti-crisis policies in agriculture, the government provided support to small farms with extra-normative water demand. Besides, the government has decided to subsidize loan interests due from the 60 most vulnerable farms of Shirak Marz. Moreover, AMD 35,000 per hectare has been allocated in State support for expansion of cereal crop areas in the alpine and border communities of Armenia to a total cost of AMD 1.5 billion in 2009. The FREDA venture fund has been established to support agricultural enterprises through lending and capital participation.

As concerns the state-private sector cooperation, the government has approved the construction of a center of agro-tourism and hotel accommodation next to Garni-Geghard highway. The government has similarly endorsed the 2009-2012 Jermuk Town Development Strategy and the conceptual objectives and priority tasks of Tatev Tourism Center's development program. The National Assembly of the RA has passed a law on the Pan-Armenian bank. The latter will serve as a strategic unit mobilizing efforts and resources from Armenians all over the world. The Pan-Armenian Bank started operating in 2010.

Welfare programs have also been developed; for instance, the "Affordable housing for young people" program, meant to extend housing support to vulnerable households; state-backed mortgage lending available to young families for the purchase of housing; and assistance in the following two directions: state support in the form of interest-free credits of 10 to 15 years' maturity covering the amount of 30% advance payment required under mortgage loans, households will get extra 10% coverage for each underage child in the family and partial state subsidy for mortgage loan interest, households will get additional 10% coverage for each underage child in the family until the age of maturity.

As of 1 January 2009, in order to achieve good compliance with the sustainable development and efficacious governance requirements, Armenia was included in the GSP+ system by the European Commission. Administered by the European Union, this system offers a preferential trade regime to member countries. The GSP+ system enables member countries to pay zero or very low duties on their exports to EU markets for about 6,400 types of products. The signing of the Republic of Armenia-European Union free trade agreement is a key objective behind the cooperation envisaged under the Eastern Partnership Initiative effective since 2008. The signing of this free trade agreement on the sidelines of

European integration processes will provide an exceptional opportunity to the Republic of Armenia to have access to the European common market and sell products of Armenian origin.

The government of Armenia undertook steps towards improving science and education. Government decrees were adopted related to the establishment of an international research center, to develop fundamental research and applied sciences in Armenia, and to improve the health care system, particularly in the fields of oncology and cardiovascular disease treatment. Armenia will turn into a regional center of oncology and will be able to export health care-related services and a regional center of applied physics enabling broader possibilities for education and experimental science. Armenian students and young researchers will be more actively involved in different exchange programs; a research-based chain of innovations will be shaped promoting the development of a broad range of scientific disciplines in the country which can facilitate important branches of economy such as applied natural sciences, agriculture, industry etc.

### **2.2.7. SWOT Analysis of the SME Sector**

See Chapter 3.

### **2.2.8. Tasks for Improvement and Further Development of the National SME Sectors in Armenia**

Based on the weaknesses of the SME sector described in the SWOT analysis table, the following recommendations have been made for the improvement and further development of the SME sector:

- Ensuring broader access for SMEs to sizeable lending available from the World Bank, the EBRD and the Asian Bank;
- Simplifying tax procedures, in particular by abolishing the rule on the mandatory accounting for enterprises with less than AMD 100 million-worth of turnover and introducing a system of flat taxing;
- Improving legal and regulatory framework for SMEs;
- Creating and developing appropriate infrastructures for the support of SMEs;
- Providing financial and investment support for SMEs;
- Developing and promoting new financial instruments for SMEs;

- Providing support for foreign economic activity (export promotion) of SMEs;
- Providing support for application of innovations and modern technologies in SMEs as well as for protection of their intellectual property rights;
- Providing support for application of international standards for quality control in SMEs;
- Providing support for utilization of business information, consultation and training services for SMEs;
- Creating business incubators;
- Improving quality and access to reliable statistical records for SMEs (surveys, databases available on respective websites);
- Enhancing the level of inter-regional cooperation among SMEs.

## 2.3 AZERBAIJAN

by Dr. Alakbar Mammadov

President of the National Productivity and Competitiveness Centre of the Azerbaijan Republic

### 2.3.1. National Economy and the SME Sector

Since 2005, a stable policy has been carried out to provide formation of national economy in the Azerbaijan Republic and its integration in the world economic system. Within that period it succeeded in achieving macroeconomic stability, diversification of economy, rapid development of non-oil branches and country regions, stability of a national currency, strengthening state support to entrepreneurship and stable improvement of the population's social welfare.

#### GDP Growth

Within 2004-2009, the GDP has increased by 2.8 times and accounted to USD 4,874.1 per capita in 2009 and USD 5,797.8 in 2010. The highest indicator in the GDP growth has been observed in 2006 by 34.5%. According to the totals of 2010, the GDP has grown by 5% (see Table 23 and Table 24).

**Table 23: GDP growth rates in Azerbaijan (%)**

2003	2004	2005	2006	2007	2008	2009	2010
11.2	10.2	26.4	34.5	25	10	9.3	5

In 2010, 52.6% of GDP was obtained from industry, 5.4% from agriculture, 7.5% from construction, 6% from transport, 11% from social and other service spheres.

Within 11 months of 2010, the legal and physical entities being registered in Azerbaijan have realized export-import operations with 143 world countries to the amount of USD 27.9 billion, where USD 6,599.4 million fell to the share of import, and USD 21,324.8 million to the share of export (USD 1,299.1 million fell to the share of export of non-oil products).

The total amount of investments for fixed capital in 2010 accounted to AZN 9,715.2 million (with a growth rate of 21.1%), where 75.2%, i.e. AZN 7,309.3 million (with a growth rate of 15.9%) fell to the share of domestic investments, and 24.8%, i.e. AZN 2,405.9 million (with a growth rate of 40.9%) to the share of foreign investments.

## **Financial System**

There are 46 banks operating in the country, out of which 21 bank have some foreign capital participation. In six banks, the foreign capital share ranges from 50 to 100% (in 13 – less than 50%), and two banks act as subsidiaries of a non-resident bank.

On 1 January 2007, the assets were AZN 3.8 billion (equivalent to USD 4.7 billion) and at the beginning of 2008, this indicator reached AZN 6.7 billion (equivalent to USD 8.3 billion), increasing by 78%. The cumulative capital of the banks on 1 January 2007 was AZN 603 million (USD 744 million), and as of 1 January 2008, it reached AZN 1 billion (USD 1.4 billion).

At the beginning of 1996, there were 200 banks with a total capital of USD 4.2 million in Azerbaijan. However, by January 2001, the number of banks had decreased to 59, with a total capital of USD 532 million. At the end of 2006, 44 banks were active: two state banks, 20 with foreign capital participation, and 22 commercial and/or joint stock banks. On 1 January 2007, the consolidated capital of these banks was USD 693 million.

As of the beginning of 2008, 142 lending agencies operated in Azerbaijan, including 46 mainly undercapitalized commercial banks dominated by the state-owned International Bank of Azerbaijan (45% of total banking assets) and 96 non-bank credit institutions, whose share in total assets and total capital are less than 3%. According to NBA requirements, the minimum amount of a bank's capital must exceed USD 12 million as of 1 July 2007. At the end of 2007, the total assets of the banking system was USD 7.7 billion. The consolidated credit portfolio amounted to USD 5.1 billion, 43% of which was held by state-owned banks.

The banking system remains quite small relative to the size of the economy. Even with high assets and the growth of loans and deposits in

Azerbaijani banks over the past few years, total banking assets were only about 26.7% of GDP, with loans accounting for about 19% and deposits only 13% at the end of 2007 – a much lower ratio than the 35-60% of GDP characteristic of the advanced transitional economies of Central and Southeastern Europe.

### **Poverty Alleviation**

Poverty alleviation and improvement of the population's welfare are among the main priorities identified by the Azerbaijan government, as poverty remains to be the major barrier to the stable development of population. The poverty level in Azerbaijan accounted to 46.7% in 2002. Due to executing the State Programme concerning poverty alleviation and regional development in the Azerbaijan Republic for 2003-2005, the poverty level 44.7% in 2003 went down to 13% in 2009. As a result of implementing the State Programme concerning poverty alleviation and stable development in the Azerbaijan Republic for 2008-2015, the poverty level was 9% in 2010.

### **Advanced Branches of the Economy**

The most advanced branches of the country's economy in the non-oil and non-gas sectors are agriculture, construction, engineering industry, tourism and other spheres. The most privileged sphere in the non-oil sector is the agrarian sector. 99.7% of products manufactured in the agrarian sector belong to the private sector, and accounts to 86% of GDP. 12% of the population is employed by the agrarian sector. Fuel, motor oils and mineral fertilizers necessary for manufacturing agricultural products are sold to farmers at a discount of 50%, and they became free of other taxes except land tax up to 2014.

Development of ICT sector also remains to be among priority spheres. Thus, with the purpose of developing this sphere the government adopted and successfully executed "State Programme (Electronic Azerbaijan) concerning ICT development in the Azerbaijan Republic for 2005-2009". 2011 was announced as a Year of Tourism in the Azerbaijan Republic.

## **Development of Regions**

With the purpose of using labor resources, natural and economic potential existing in the regions efficiently, intensifying development of non-oil sector of economy, reforming in the agrarian sector and increasing population's employment the government adopted "State Programme concerning socio-economic development of regions in the Azerbaijan Republic for 2004-2008" and "State Programme concerning socio-economic development of regions in the Azerbaijan Republic for 2009-2013", which included our regular measures provided in the Programme.

As a result of executing the "State Programme concerning socio-economic development of regions in the Azerbaijan Republic for 2004-2008", in the past five years the real amount of GDP has increased by 2.6 times, the nominal amount of GDP per capita by 5 times, and the amount of investments to the non-oil sector by 6.2 times. The growth in the country industry is observed as 2.5 times, with 25.2% in agriculture. The poverty level was reduced to 13.2% in 2008. In the period of State Programme executing, 766,000 new jobs have been created, including 547,600 permanent jobs, where 80% of newly created jobs fell to the share of regions. 27,500 new enterprises have been established, 40% of which are functioning in the regions.

### **Macro-economic Figures for the First Quarter of 2011**

The Azerbaijan economy has grown by 1.6% in the first quarter of 2011. The non-oil sector has grown by 5.6% and industrial production has increased by 0.3%. In the industrial growth, the share of the non-oil sector industry has increased by 9.8%. The level of currency reserves has reached USD 34.7 billion in the mentioned period.

**Table 24: Main Economic Figures for First Quarter of 2011 in Azerbaijan**

GDP Growth	1.6 %
Non-oil GDP Growth	5.6 %
Inflation Rate	9.6 %
Industrial Production Increase	0.3 %
Monthly Salary per capita	AZN 340 (USD 430)
Population under Poverty Line	9.1 %
Budget revenues	USD 3,503 billion
Budget Expenditure	USD 2,641 billion
Exports	USD 3.4 billion
Imports	USD 1.3 billion
Increase in the Revenues of citizens	16.0 %
Rise in the inflation in the first quarter of 2011	9.1 %
Growth in the Population incomes	16 %

### Foreign Trade Turnover

In January-February 2011, physical and legal individuals of the country have had commercial operations with 102 foreign countries with an amount of USD 4.7 billion. Exported products from Azerbaijan have covered USD 3.4 billion and imported products have covered USD 1.3 billion of foreign trade turnover.

In comparison with January-February of the previous year, physical volume of the foreign trade turnover has increased by 9.9%, as well as an increase in imports by 1.9 times and a 3.8% increase in exports. As a result of export prevailing import, USD 2.1 billion positive saldo has emerged. More than 85% of external commercial operations have been conducted with Italy, the United States of America, France, the Russian Federation, Malaysia, Ukraine, Turkey, Spain, Bulgaria, China, Germany, India, Israel and Kazakhstan.

### 2.3.2. SME Sector Development

#### Legal Basis of the SME Sector

Activities of the SMEs are mainly regulated by the Law of the Azerbaijan Republic "Concerning state support to the small-sized entrepreneurship" and Decree of the Cabinet of Ministers of the Azerbaijan Republic "Concerning approval of criteria for identifying small-sized entrepreneurial subjects by kinds of economic activities".

List of the laws related to entrepreneurship in Azerbaijan are as follows:

1. The Law of the Azerbaijan Republic "On Entrepreneurship" (15 December 1992);
2. The Law of the Azerbaijan Republic "On Enterprises" (1 July 1994);
3. The Law of the Azerbaijan Republic "On Protection of Foreign Investments" (15 January 1992);
4. The Law of the Azerbaijan Republic "On Farms" (8 April 1992);
5. The Law of the Azerbaijan Republic "On Bankruptcy and Insolvency" (23 June 1997);
6. The Law of the Azerbaijan Republic "On Leasing Service" (29 November 1994);
7. The Law of the Azerbaijan Republic "On State Registration of Legal Entities" (6 February 1996);
8. The Law of the Azerbaijan Republic "On Land Reform" (16 July 1996);
9. The Law of the Azerbaijan Republic "On Tender" (April 1997);
10. The Law of the Azerbaijan Republic "On Limited Liability Companies" (29 December 1998);
11. The Law of the Azerbaijan Republic "On Advertisement" (3 October 1997);
12. The Law of the Azerbaijan Republic "On Antimonopoly Activity" (4 March 1993);
13. The Law of the Azerbaijan Republic "On Collateral" (3 July 1998);
14. The Law of the Azerbaijan Republic "On Securities" (14 July 1998);
15. The Law of the Azerbaijan Republic "On Banks and Banking Activity" (14 June 1996);
16. The Law of the Azerbaijan Republic "On Joint-Stock Companies" (12 July 1994);
17. The Law of the Azerbaijan Republic "On Unfair Competition" (2 June 1995);
18. The Law of the Azerbaijan Republic "On Rent" (30 April 1992);
19. The Law of the Azerbaijan Republic "On Audit Service" (16 September 1995);
20. The Law of the Azerbaijan Republic "On State Support for Small Entrepreneurship" (4 June 1999).
21. The "State Program on Development of Entrepreneurship in the Azerbaijan Republic (1993-1995)" was adopted by Decree of the Milli Majlis (Parliament) dated 31 January 1993.
22. The "Program of State Support for Small and Medium Entrepreneurship in the Azerbaijan Republic (1997-2000)" approved by Decree No. 610 of the President of the Azerbaijan Republic Heydar Aliyev, dated 24 June 1997.

## Legal Definition of SMEs

Activities of SME subjects in the Azerbaijan Republic are divided into two groups; private entrepreneurs (i.e. subject engaged in the entrepreneurial activity not creating legal entity) and small and medium-sized enterprises functioning as a legal entity. From a legal point of view, private entrepreneurs unambiguously are considered to be small enterprises, but those registered as a legal entity are classified according to the two indicators (number of employees and annual turnover).

In accordance with the decree No. 57 of the Cabinet of Ministers of the Azerbaijan Republic from 20 April 2004 about classification of entrepreneurial subject by activity sphere, the small-sized business is identified according to the sectors as:

- construction and industry – with number of employees less than 40 and annual turnover less than AZN 200,000 (USD 247,000),
- agriculture – with number of employees less than 15 and annual turnover less than AZN 100,000 (USD 123,500),
- wholesale – with number of employees less than 10 and annual turnover less than AZN 300,000 (USD 370,500),
- other spheres – with number of employees less than 5 and annual turnover less than AZN 100,000 (USD 123,500).

The share of SMEs in GDP accounts approximately to 15%, and 25% in employment (the share of the private sector in employment is 69.3%, i.e. the economically active population in the private sector accounts to more than 2.8 million people).

In 2010, the number of private entrepreneurs exceeded 290,000, with 42.6% of them in trade, 20.2% in transport, 10.8% in service sector and 9.1% in agriculture. 36.1% of private entrepreneurs are functioning in Baku. 61.7% of enterprises are functioning in Baku.

**Table 25: Number of legal entities**

2004	2005	2006	2007	2008	2009	2010 (first half)
65,109	70,287	74,534	79,147	85,618	89,939	91,657

The number of legal entities registered within the first half-year of 2010 accounted to 91,675 including:

- 11,022 legal entities among 91,657 registered within the first half-year of 2010 belong to the state ownership,
- 1,758 ones to the municipality ownership,
- 72,705 ones to the special ownership.

In accordance with the 'One-stop Shop' system, more than 14,000 entrepreneurs were registered in the first quarter of 2011. In comparison with the relevant period of the previous year, it shows an increase by 46.1% in the number of people registered. In the first quarter of 2011, 61.2% of the entrepreneurs registered are from the regions.

**Table 26: Number of enterprises by kinds of ownership**

Kind of ownership	State	Municipality	Private	Foreign	Joint ventures
Number	11,022	1,758	72,705	4,508	1,664
Percentage	12.1	1.9	79.3	4.9	1.8

According to the number of joint ventures and enterprises with total foreign investments, the shares are as follows: Turkey 30.6%, Great Britain 11.3%, Russia 7.3 %, Iran 6%, USA 5.5% and Germany 2.7%.

#### Taxation

SMEs with taxable turnover less than AZN 22,500 i.e. USD 27,800 within the last three months may opt for a simplified tax regime. Under the simplified tax regime, taxpayers based in Baku pay 4%, and those outside Baku pay 2% of their gross proceeds as simplified tax. They are exempt from VAT, CPT, and corporate property tax; individual entrepreneurs availing themselves of the simplified tax are exempt from PIT and VAT. Both groups of simplified tax payers, however, do pay SST. Moreover, tax payers engaged in the construction of residential buildings are not exempt from VAT under the simplified tax regime.

The simplified tax regime is used by about 80% of individual entrepreneurs and SMEs. However, the difference between the tax burdens of simplified and standard tax regimes is very substantial. An SME moving to the standard tax regime has to pay 18% VAT instead of 2-4% turnover tax, 22% CPT on its corporate profit, property tax.

#### Activity Spheres of SME Subjects

In 2010 small-sized enterprises accounted to 75,636, i.e. 82.5% of the

total number of enterprises – legal entities functioning in the Azerbaijan Republic. 38.6% of them were in trade, 13% in agriculture, and 12% in construction.

### 2.3.3. Ranking of Doing Business According to World Bank Methodology

In the past five years, a number of efforts have been carried out towards the development of the business environment. Particularly the improvement of legal basis, application of “one-stop shop” system for registration of commercial enterprises (since 1 January 2008), simplification of estate register, etc. gave an opportunity to the Azerbaijan Republic to win status of a reformer country in the World Bank “Doing Business 2009” report. In the “Doing Business” reports reflecting estimations on opportunity of business environment prepared by the World Bank and International Finance Corporation, the Azerbaijan Republic took the 38th rank among 183 countries in 2008 and 2009, and the 54th rank in 2010.

Moreover, Azerbaijan is among the leading countries on “Starting a business” (15th rank), registration of property (10th rank), obtaining credits (46th rank) and protection of investors (20th rank).

However, the past three years’ Report proves that there is much more to do to improve indexes on construction licenses (160th rank), trading across borders (177th rank) and payment of taxes (103rd rank).

**Table 27: Ranking by Doing Business between 2009 and 2011**

<i>Ease of ...</i>	2009	2010	2011
Starting a business	38	38	54 (-16)
Dealing with construction permits	155	158	160 (-2)
Employing workers	62	33	-
Registering property	9	9	10 (-1)
Getting credit	12	15	46 (-31)
Protecting investors	19	20	20 (0)
Paying taxes	103	108	103 (+5)
Trading across borders	176	177	177 (0)
Enforcing contracts	25	26	27 (-1)
Closing a business	84	84	88 (0)

Other international institutions also highly appreciated reforms carried out in Azerbaijan towards entrepreneurship development and business environment improvement.

In the "Global Competitiveness Report" prepared for 2009-2010, Azerbaijan moved up 18 steps and took the 51st rank among 133 countries and the 1st rank among CIS countries.

In the report of the "Standard & Poors" Rating Agency, the outlook of the Azerbaijan economy was recognized as progressing from "Stable" to "Positive".

In their turn, state officials have announced completion of the transition period in the country economy. Thus,

- A typical legislative basis for market economy was created,
- Market institutions were formed,
- The foreign-economic activity became liberalized.

#### **2.3.4. SME Support Infrastructure (Business Support Providers, Special SME Finance Institutions)**

Different government and non-government organizations as well as private consulting companies are operating in the Azerbaijan Republic to render consulting services to entrepreneurs. They are State Service of Antimonopoly Policy and Protection of Consumers' Rights, National Fund to Support Entrepreneurship, Export Support Fund (AzPromo), Azerbaijan Investment Fund under the Ministry of Economic Development, including branch and regional business associations: Azerbaijan Entrepreneurs' Confederation (ASK), Azerbaijan Business Women Association, Azerbaijan Farmers' Union, National Productivity Centre, SMEs Support Centre, Economic and Social Researches Centre and Fund to Support Small Entrepreneurship.

The National Productivity and Competitiveness Centre is rendering information, consulting and training services to the SME sector. The Centre pursues its objective to raise productivity and competitiveness of small and medium-sized entrepreneurial subjects functioning in the Azerbaijan Republic. With the purpose of integrating into Europe, the Centre is organizing business tours to EU countries, holding business forums, providing participation of SME subjects in the international fairs and exhibitions. Trainings organized by the Centre cover marketing, finance, law, management, human resources and other topics.

Azerbaijan Business Women Association (Ganja city) is carrying out regular activity towards development of entrepreneurship among women.

ASK acts as a social partner of the government and Trade Unions' Confederation and protects interests of entrepreneurs before central executive authorities.

Economic and Social Researches Centre is conducting significant surveys on the improvement of the business environment in the country. Different international institutions functioning in the Azerbaijan Republic also render technical support to the SME sector. Turkish International Cooperation and Development Agency (TIKA), Germany International Cooperation Organization (GIZ), PUM Programme – Senior Experts from Netherlands, etc., render technical support to entrepreneurial subjects, and assist in acquiring international experience.

### **Financial Support to Entrepreneurship**

Financial support to entrepreneurship is rendered both by local and international financial institutions. The International Finance Corporation (IFC) and European Bank for Reconstruction and Development (EBRD) are carrying out different projects to render financial support to the entrepreneurial subjects.

The government is rendering financial support to the SME sector through the specialized fund, i.e. National Fund to Support Entrepreneurships (NFSE) and granting long-term and privileged credits (annual 6%) for entrepreneurial subjects. In the recent years, the amount of privileged credits allocated from state budget to NFSE has increased from AZN 50 million (approximately USD 60 million) to AZN 115 million (USD 150 million). The privileged credits are granted through agent banks (there are about 30 agent banks) to the advanced economic spheres – production and processing of agricultural products, tourism development and infrastructure projects in the amount of small, medium, large and huge credits (see Table 28).

About 142 credit organizations are functioning in the Azerbaijan Republic. Among them 47 ones are banks, but 96 are credit organizations not being banks with 3% share of capital and assets. Taking into consideration the volume of the economy, the bank system remains to be significantly small as assets generally make up just 26.7% of GDP. The major finance source of SMEs is their own funds. According to the IFC observations, the share of bank credits in the SMEs' own investments makes 4%.

## **Financing SME Operations**

In market economies, banks and other non-bank financial institutions, such as leasing companies and credit unions, are the main providers of financing.

Based on IFC's research, the penetration of bank credits as a share of SMEs financing for fixed assets was only 4%, with a similar percentage for the financing of working capital. More than 90% of entrepreneurs use their own assets for their operating capital and asset acquisition. Thus, despite the presence of 46 active commercial and state banks, approximately only 5% of entrepreneurs used banking services for their financing needs.

Credit terms are unfavorable for SMEs due to:

- High interest rates;
- Securitization of the credit;
- Period of borrowing. Currently, credits for SME financing are given by commercial banks in Azerbaijan mainly for 6 to 18 months maturity periods.
- Insufficient amount and payment period;
- Inaccessible requirement for the credit security;
- The procedures of applying for credit are too complicated.

**Table 28: Information on usage of resources of the National Fund to support entrepreneurship of the Azerbaijan Republic (2010)**

By economic spheres						AZN [x1000]
	Economic spheres	Number of projects	specific weight [%]	Credit sum	specific weight [%]	Number of jobs to be created [persons]
1	Production and processing of different industrial products	94	6.6	23,450.0	20.4	664
2	Processing of agricultural products	16	1.1	10,350.0	9.0	444
3	Production of agricultural products	1,303	91.1	55,651.9	48.4	3,970
4	Tourism development	3	0.2	2815.0	2.4	36
5	Development of service (infrastructure) spheres	14	1.0	22,733.1	19.8	495
<b>Total:</b>		<b>1,430</b>	<b>100</b>	<b>115,000</b>	<b>100</b>	<b>5,609</b>
By types of credits						
	Types of credits	Number of projects	specific weight [%]	Credit sum	specific weight [%]	Number of jobs to be created [persons]
1	Small credits	1,362	95.2	17,580.9	15.3	3,049
2	Medium credits	8	0.6	1,005.0	0.9	106
3	Big credits	26	1.8	14,966.0	13.0	688
4	Large-scale credits	34	2.4	81,448.1	70.8	1,766
<b>Total</b>		<b>1430</b>	<b>100</b>	<b>115,000</b>	<b>100</b>	<b>5,609</b>

The majority of banks cannot attract long-term low-cost resources for subsequent SME refinancing. Banks in Azerbaijan are operating in complex financial market conditions and need to offer high returns in order to attract deposits from individuals and legal entities.

Banks prefer to focus on lending for consumer goods, which in their view is less risky. The credit market for consumer goods is rapidly developing in Azerbaijan. Maturities and interest rates in the consumer market are significantly more attractive for the banks, compared to SME crediting. In cases of default, the banks always have the opportunity to repossess the goods that have been bought using the credit. Very often, these are goods such as cars, which are in demand and can easily be sold in the second-hand market.

There is poor mutual understanding between banks and SMEs. All in-depth interviews with the entrepreneurs demonstrated that they had a poor knowledge and understanding of the services and information that

banks offer. This corresponds to the lack of adequate and full information the banks have on their clients. Often businesspeople who have never applied for a credit complain about the terms and conditions offered by banks that they have learned by word of mouth, rather than direct experience with banks.

SME operations are not transparent, which force banks to incorporate the possible risks into the credit cost. Banks do not actively conduct information campaigns targeting SMEs and entrepreneurs are insufficiently informed about the services banks offer.

In many respects, the attractiveness of any bank service often stems from advertisements and promotional campaigns aimed at promoting the particular service. Banking services are from third parties and not as a result of the banks' communications with the business community.

Credit bureaus bridge such confidence gaps. A credit bureau is an institution that collects information on the borrower's credit history from creditors and from general sources. The bureau accumulates information on individual entrepreneurs and SMEs, such as payment history on previous credits (particularly defaulting payments) and information on court decisions and bankruptcies, and then makes a comprehensive credit report, which is sold to creditors. Currently, there is only one credit registry and it does not meet the typical credit bureau standards. A number of limitations prevent the credit registry from expanding into a proper credit bureau, such as:

- The registry information is closed for the non-banking financial institutions. Currently, 96 non-banking credit institutions operate in Azerbaijan. The target market for these non-banking credit institutions includes small farmers, trade and service SMEs, and individual enterprises, which mostly produce consumer goods, i.e., the target group for these micro crediting institutions includes mainly SMEs of various sorts. Not having accurate credit information on borrowers causes the micro crediting organizations to introduce tougher requirements (e.g., higher interest rates, shorter terms) in order to mitigate risks;
- Registry information does not offer a detailed analysis of the client. Unlike the registry, a credit bureau processes the information received: it generalizes, classifies, and sells clients credit reports (histories) to the banks. The registry services include only a small portion of the bureau's facilities.

### **2.3.5 The Effect of the International Financial and Economic Crisis**

The global financial crisis has influenced Azerbaijan also. The first negative influence of crisis has occurred in banking and construction sectors. The commercial banks were forced to pay credits from foreign financial institutions back in advance. This had a negative impact on obtaining of credits, especially for SMEs, caused increase of credit interests and burdening credit terms.

The construction sector entered a stage of stagnation; the construction boom in 2002-2007 stopped, and many people lost their jobs in this sector.

The labor market faced serious problems, when temporary shutdown of large enterprises caused loss of workplaces.

Slump in oil prices at the end of 2008 caused delay of big projects.

Generally, the share of domestic investments in the main capital accounted to 75% and foreign investments to 25%.

The GDP volume decreased from 25% in 2007 to 5% in 2010.

### **2.3.6 Government Measures to Cope with the Impact of the Economic Crisis**

Government has carried out special measures to cope with the impact of the financial crisis. The first step was taken by the Central Bank, where special preferences were given to commercial banks, and generalized credit interests were decreased.

During the world economic crisis in 2008-2009, monetary policy orientation of Central Bank of Azerbaijan (CBA) strictly expanded: refinancing rate was cut down from 15% to 2%, reserve requirement ratio from 12% to 0.5% . In exchange rate policy CBA maintained financial stability holding a pegged regime against the US dollar.

For the past 3 years financial support for agriculture product producers has been provided by the government.

During this period AZN 25.0 million has been allocated to the implementation of "The State Program on people's secure supply with agriculture products in the Azerbaijan Republic during 2008-2015". AZN 27.5 million discounted loans have been offered to the agro entrepreneurs. AZN 10.0 million of this has been the fund allocated for the development of agro entrepreneurship from the state budget.

In comparison with the previous year, the number of investment projects has risen by 1.7 times and the amount of lent discounted loans by 1.4 times.

On the basis of discounted loans 25 big and large-scale projects as well as investment projects for construction and reconstruction of five modern fridge storage-complexes with the capacity of 29,500 tons, 5 bakery products companies with the annual productive capacity of 78,100 tons, three poultry industries with the annual productivity of 13 million breeding eggs and 600 tons poultry, two meat factories with the annual productivity of 19,800 tons, five cattle complexes with 500 cattle giving milk and other products have been financed.

Moreover, the government has carried out different measures to finance social expenses, to the payment fund of labor, to support export. The local companies were empowered with some benefits from state orders. The ratio of national currency to USD and EUR was preserved.

In the first quarter, in accordance with the economic classification, 47.9% or ANZ 1.0 billion of income has been directed to financing social expenses. In comparison with the same period of 2010, this amount is 14.9% or ANZ 129.0 million more.

In comparison with the same period of the previous year, in the first quarter of the current year 17.2% or ANZ 57.0 million more was spent on the payment of social pensions and reliefs, 14.2% or ANZ 70.0 million more was directed to the payment fund of labor, and 3.8% or ANZ 1.6 million more was spent on food and medicine expenses.

In the first quarter of 2011, ANZ 546.0 million fund was spent on state investment expenses, with which financing of main investment projects were provided. Out of the same fund, ANZ 78.0 million was spent on construction and restoration of educational, medical, cultural, sport and other socio-cultural and domestic places. ANZ 94 million was spent on

construction and restoration of houses and other such kind of domestic places for disabled-soldiers, martyr families and ANZ 5.5 million fund was spent on construction and restoration of sport complexes and other sport places in the regions.

ANZ 363.0 million was spent on construction and restoration of the main energy, water supply, gas, transportation, communal, land-reclamation infrastructures, as well as ANZ 144.0 million on construction and restoration of transportation infrastructure, ANZ 24.0 million on construction and restoration works in Baku metro stations, ANZ 17.0 million on the increase of authorized capital of Baku electricity system stock company. ANZ 10.0 million was spent on reconstruction of drinking water and irrigation drainage, ANZ 20.0 million on the implementation of "The State Program on formation and development of cosmic industry in the Azerbaijan Republic" and ANZ 143.0 million has been spent on Azerbaijan Airlines close joint- stock company.

Alongside with expenses allocated from the state budget, ANZ 206.0 million fund was directed from abroad to construction and reconstruction of highways, water supply and land reclamation, agriculture, social and other infrastructures by the Azerbaijan government.

In the first quarter of 2011 relevant orders were signed by the president of the Azerbaijan Republic to allocate ANZ 31.0 million for the implementation of several social and infrastructure projects of key importance and for the continuation of renovation and construction works from the Reserve Fund of the President of the Azerbaijan Republic.

All of these implemented activities gave a good opportunity to decrease the impact of the global financial crisis.

### **2.3.7. SWOT Analysis of the SME Sector**

#### **Strengths**

The SME sector accounts to more than 15% of GDP produced in the Azerbaijan Republic, and 25% of employment. 90% of legal entities and 100% of private entrepreneurial subjects belong to the SME sector. 80% of newly created jobs belong to the SME sector. All these figures prove that SMEs are the major locomotive in the private sector.

- SMEs are the most productive and competitive manufacturers;

- SMEs play an important role in solving social problems, especially, poverty alleviation and increasing employment;
- SME development provides political and economic stability in the country;
- SMEs are the leading force in the development of non-oil sector. There is a strong legal, financial, technical and informational basis as well as human capital for the development of the SME sector in the Azerbaijan Republic. Thus, different legislative acts and State Programme are executed in the country to support the SME sector:
- SMEs promptly satisfy new requirements of market economy;
- SMEs play an important role in the development of regions;
- The necessary legal basis and state support are available in Azerbaijan for SME development.

### **Weaknesses**

Despite the activities implemented for the SME development in the Azerbaijan Republic, there are still weaknesses and problems in this sphere:

- Lack of free market economy knowledge and skills, experience in SME;
- Lack of new technology;
- Lack of specialists who can work with new technology;
- Lack of interest in the implementation of innovation projects;
- Lack of cooperation between universities and SMEs;
- Inadequate application of International standards in the protection of environment, OSH, etc.;
- Unfair competition and monopolism in trade sectors;
- Low level of SME sector share in export;
- Weak cooperation of MNC with SMEs;
- Problem with the implementation of economic laws, absence of an efficient mechanism;
- Azerbaijan is not a member of WTO. Economic integration process into EU is possible only through membership of WTO.

### **Opportunities**

Azerbaijan has concluded 21 production-sharing agreements with various oil companies. An export pipeline that transports Caspian oil to the Mediterranean from Baku through Tbilisi, Georgia to Ceyhan, Turkey (the Baku-Tbilisi-Ceyhan Pipeline) became operational in 2006. The pipeline is expected to generate as much as USD 160 billion in revenues for the

country over the next 30 years. It's a big opportunity to develop non-oil sector.

Opportunities for the development of the SME sector in the Azerbaijan Republic are great. Application of the "one-stop shop" system in the registration of enterprises, import-export operations, registration of real estate will increase the SME quantity.

Moreover, activities provided in the current State Programmes will provide a good opportunity to increase state support to the SME sector. In its turn, the execution of State Programme concerning youth employment strategy means stimulating young entrepreneurs' growth. The poverty alleviation Programme will help to increase employment and open new jobs, especially, to increase the number of new entrepreneurial subjects in the private sector.

State financial support to the SME sector is increasing year by year and will make its positive impact on strengthening the material and technical basis of SMEs.

The fact that Azerbaijan has joined the EU Eastern Partnership Agreement in March 2009 will support Azerbaijan in its economic integration into EU, and lead to the application of European development model of the SME sector in Azerbaijan.

### **Threats**

The quantity of people, especially young people, wanting to deal with the entrepreneurial activity in Azerbaijan is considerably less than the existing opportunities. Different surveys conducted among the young population prove that the majority of them (more than 60%) are willing to be employed by functioning enterprises, especially, transnational companies as an ordinary employee, rather than to start their own businesses. As a result, more than 70% of entrepreneurs engaged in the SME sector are adults above the age of 40. Only 7% of economically active women (women account to 51% of total population in the country) are entrepreneurs.

Oil and oil products still occupy the main share in the GDP, and comprise 90% of exports.

The SME sector's share in export is only 4%. SME competitiveness index

is too low. Large companies, especially, transnational companies are not interested in cooperation with the SMEs.

The 15% preference in the state procurement for SMEs provided in the Law of the Azerbaijan Republic "Concerning support to small-sized entrepreneurship" is not being practiced properly. Shadow economy" is still growing. Due attention is not paid to business education, business ethics as well as factors impacting the productivity growth of SMEs.

There are no mechanisms for the settlement of economic disputes.

### **2.3.8 Tasks for the Improvement and Further Development of the National SME Sector in Azerbaijan**

Special activities to improve and develop the National SME sector are carried out in the Azerbaijan Republic and, mainly, cover the following spheres:

- Development of business education, increasing attention to the vocational education;
- Improvement of legislative basis, improvement of special permission (license) system, simplification of registration procedures;
- Adaptation of socio-economic reforms to the European standards;
- Improvement of investment environment;
- Establishment of stable business infrastructure in the regions within the State Programme on Development of Regions;
- Increasing financial support to entrepreneurship, especially SME subjects and, thus, providing transparency;
- Holding awareness-raising activities among SME subjects to remove unfair competition, cases of corruption, etc.

The main goal of these activities is to increase the weight of non-oil sector in the economy as well as to increase the share of SMEs in GDP and employment.

It is aimed to increase the SME weight, especially in the following advanced spheres of economy:

- Energy
- Construction and construction materials
- Agro-industry: processing, packaging and storage of agricultural products
- Tourism
- Chemical industry and
- Metallurgy and electrical industry.

## 2.4 BULGARIA

Dr. Zhelyu Vladimirov

Associated professor, Vice-rector

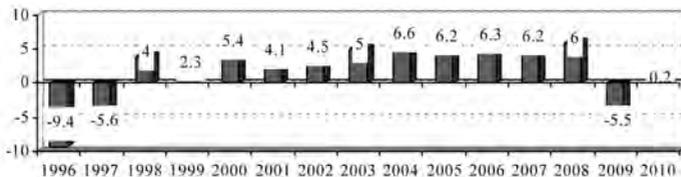
St. Kliment Ohridski Sofia University, Bulgaria

### 2.4.1. National Economy and the SME Sector

#### 2.4.1.1. Development of the Bulgarian Economy (1997-2010)

Bulgarian economic development after 1989 could be divided into three distinct periods: until 1997; from 1997 to 2008; and after 2008 with the beginning of the world crisis. The first period was characterized by a painful reconstruction of the economy on market rails and breaking off from the State dependency. During this stage, the privatization and enterprises' restructuring was insignificant, the emerging private sector was weak; there was a lack of clear regulations and incentives to entrepreneurship. The macroeconomic data for this period revealed an unfavorable environment to doing business – high level of inflation, currency depreciation, GDP drop, and decreasing employment. The economic crisis of 1996/1997 was one of the most dramatic events of the Bulgarian transition. It led to huge inflation, national currency crash, and economic collapse. At the beginning of 1997 the Currency Board was introduced, which assured a strict budget policy and currency stabilization. After 1996 the private sector created more than half of the country GDP, but at the beginning this growth was mechanic - at the expense of the shrinking share of the public sector. During the first 10 years after the changes, the investment rate dropped, and in the private sector it was even lower than in the public one (Table 29).

**Table 29: Investment rate to the GDP in Bulgaria (%)**



From 1997 to 2008 the country accounted a permanent growth, smaller inflation, and a FDI increase. In 2008 the GDP was almost four times

higher than in 1997, and the highest growth was registered in 2004 (6.6%) (Figure 14). However, the national GDP remained about 38% of the EU average. In 2009 the crisis brought to GDP a decrease of 5.5%, while in 2010 there was an insignificant growth of 0.2%.

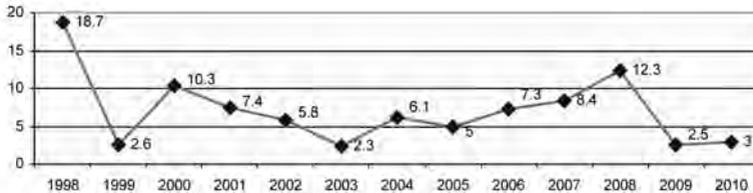
**Figure 14: GDP growth in Bulgaria (%)**

	1994	1995	1996	1997	1998
Total	16.0	14.3	15.3	13.9	12.6
In public sector	9.8	7.9	9.4	8.0	6.8
In private sector	6.2	6.4	5.9	5.9	5.8

Source: National Statistical Institute, Bulgarian National Bank

The driving forces for this growth until 2008 were the end consumption and investments in fixed capital. These investments increased their share in GDP from 11% in 1997 to 33.4% in 2008, but in 2009 decreased to 25% of GDP. The private sector grew from 63.4% in the GVA in 1997 to 81.2% in 2005, while the share of the public sector decreased respectively. Besides, in 2000 the inflation was a one digit number, but it increased dramatically in 2008, after which it decreased to 3% in 2010 (Figure 15).

**Figure 15: Inflation in Bulgaria (%)**



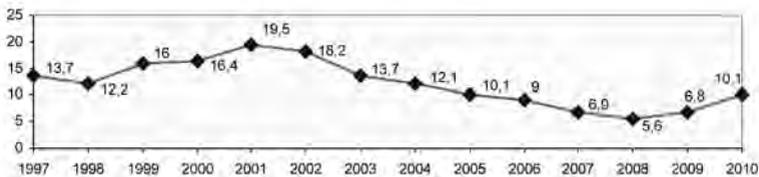
For the 1996-2009 period the share of industry in the GVA was around 29-30%, but the share of manufacturing decreased from 25% on average to 22%. This was due to the growth of services, particularly of real estate and business services. The construction increased its contribution to the GVA from 2.8% in 1997 to 8.6% in the last two years; the share of agriculture diminished from 26.2% to 6% for the same period; and the contribution of services increased from 45.9% to 63.6% respectively.

The GDP per capita grew from USD 1,251 in 1997 to USD 6,223 in 2009 (or EUR 4,700 according to the Eurostat). However, the country takes the last place on this indicator among other EU member countries. Bulgaria

is a country with the lowest minimum wage; in January 2011 it was EUR 123 per month, compared to EUR 157 in Romania, EUR 319 in Czech Republic, and EUR 1,758 in Luxembourg. The country GDP per capita on SPP reached 44% of the EU average (Eurostat, Minimum wages in the EU in January 2011).

The rate of unemployment increased from 13.7% in 1997 to 19.5% in 2001, after which it decreased to its lowest level of 5.6% in 2008. In 2010 it increased again to 10.1% (Figure 16).

**Figure 16: Unemployment in Bulgaria (%)**



Source: National Statistical Institute

For the 2002-2008 period, the labor productivity increased yearly on an average of 3.2%, but it remained about 1/3 of the EU-25 average. A little higher was its rate of increase in the industry, followed by services, while in agriculture it decreased. According the prognoses of the Eurostat, the labor productivity diminished by 2.2% in 2009 (Table 30).

**Table 30: Labor productivity in Bulgaria (changes in %)**

2002	2003	2004	2005	2006	2007	2008	2009 f
4.3	2.0	3.9	3.5	2.9	3.3	2.7	-2.2

Source: European economic statistics 2010: 148

While in 1997 the current account was positive, in 2008 it became negative and amounted to 25.4% of GDP. The main reason for that was the increased trade deficit. For the 1997-2008 period the Bulgarian exports augmented almost 3.5 times (from EUR 4,256.2 million to EUR 15,277 million), while imports increased by about 6 times (from EUR 4,306.7 million to EUR 24,036 million). The uneven increase of exports and imports led to the worsening of the trade balance from USD 798 million in 1997 to EUR -8,597.3 million in 2008 (24.3% of GDP). In 2009 this

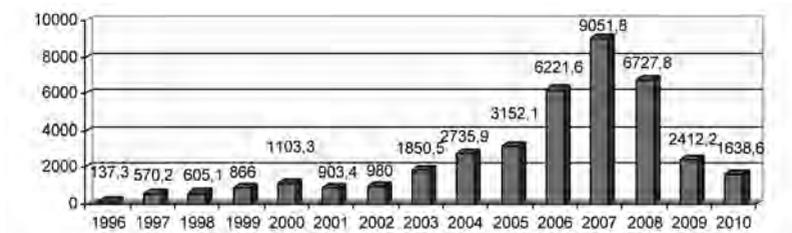
negative balance decreased to EUR -4,173 million or 11.9% of GDP. Due to the higher export and the lower import at the end of 2010 the current account balance decreased to 1% of GDP (BIA 2011).

The geographic structure of the Bulgarian export and import also changed toward an increasing share of the EU countries and a decreasing share of the CIS. The leading countries in the Bulgarian export in 2009 were Germany, Greece, Italy, Romania, Turkey, Belgium, and France, while the leading countries in the Bulgarian import were Russia (mainly petrol and gas), Germany, Italy, Greece, Romania, Turkey, Ukraine, Austria, France, and Netherlands.

According to the average values of the Balassa index, Bulgaria possessed the highest competitive advantages in non-ferrous metals, electrical power, fertilizers, raw or unprocessed tobacco, followed by ladies' and men's clothes, sanitary articles, fruit cans, etc. At the same time, the country gave way to other EU countries in respect to machines, equipment and transport means, animal and vegetable oils, foods and live animals, energy raw materials, petroleum products, etc. (MEET, Competitive advantages of Bulgaria).

Until 2009 Bulgaria attracted FDI in value of EUR 35,489.7 million, which reached 29.4% of GDP in 2007. With the beginning of the crisis, however, FDI dropped more than 5 times and in 2010 amounted barely to EUR 1,638.6 million or 4.5% of GDP (Figure 17). For the 1999-2009 period, leading countries in FDI were Austria (18.3%), Netherlands (18%), UK (7.9%), Greece (7.4%), and Germany (5.8%).

**Figure 17: FDI in Bulgaria (million EUR/per year)**



Source: Bulgarian National Bank

The State debt as a percent of the GDP decreased from 105% in 1997 to 16.1% in 2009, which was much less than the Maastricht criteria of 60%. In the last years Bulgaria covered all Maastricht criteria except for the inflation (Bulgarian National Bank).

#### 2.4.1.2 Industries and Branches during the Crisis

Since the end of 2008 the Bulgarian economy has entered a stage of severe recession. The recession in the developed countries, especially the EU member states, which are key trade partners of Bulgaria, led to decrease in the production and export. This resulted in a significant drop in the output of various sectors of the Bulgarian economy and in a decrease in the investments. However, the crisis has a differential impact on the different sectors of the national economy (Table 31).

**Table 31: Share of different sectors in the gross value added (%)**

Sector	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Agriculture, forestry, hunting and fishing	26.2	18.8	16.3	13.9	13.4	12.2	11.7	11.0	9.4	8.5	6.2	7.3	6.0
Mining and quarrying, manufacturing, electricity, gas and water production and supply	26.4	26.7	23.8	25.5	25.0	24.3	24.7	24.3	24.0	24.1	24.1	21.9	21.8
Construction	2.7	4.8	5.0	4.6	4.6	4.4	4.4	4.9	5.4	6.8	8.2	8.6	8.6
Wholesale and retail trade, repair of motor vehicles and motorcycles; Accommodation and food service activities; Transport and telecommunications	17.5	17.1	19.	20.9	22.2	23.1	22.9	23.4	24.3	23.8	24.4	23.5	22.8
Financial and insurance activities; Real estate activities; Business services	18.8	19.4	20.6	19.9	19.8	20.3	20.1	20.1	21.1	21.5	22.0	23.5	24.6
Public administration; Education; Human health services; Other services	8.4	13.2	14.8	15.2	14.9	15.7	16.1	16.3	15.8	15.3	15.1	15.1	16.2

Source: National Statistical Institute

In 2009 the Bulgarian economy shrank by 5.1% which is an indicator of a severe recession. This fact is not unexpected under the existing circumstances of a world economic and financial crisis and the high extent of openness of the Bulgarian economy and its dependence on external markets and capitals. The sector "Transport, storage, and communications" exhibited the most significant decrease in the gross value added. The sectors "Health care services", "Education", "Financial services", "Real estate services" and "Business services" registered increase in the gross value added. The tendency of a negative trend in the industry continued in the end of 2009 and the beginning of 2010. The sector registered a real drop of 7.5% in the last quarter of 2009 and had a contribution to

the decrease of GDP by 1.7%. According to the National Statistical Institute, in comparison with the first quarter of 2009 in the first quarter of 2010 the gross value added has decreased in real terms by 1.3%.

In the last quarter of 2009 the production of electricity decreased significantly, which resulted in a contribution to the decrease of the gross value added by 0.7%.

The gross value added in the mining and quarrying sector decreased by only 1.1.% in comparison with the last quarter of 2008. The main reasons for this small decrease are the changes on the international markets and the increase in the prices of raw materials, which influenced the development of this sector positively.

The situation of the construction sector continues to worsen in the last quarter of 2009 and first quarter of 2010. The main reasons for this negative trend in the sector are the drop in the demand and the difficulties to obtain financing. Foreign investments in this sector decreased by 52%. The prices as well as the volume of the construction activity decreased significantly in the third quarter of 2009 in comparison with the same period of 2008. The sector of agriculture and forestry registered a real drop of 3.3% in 2009. In the last quarter of 2009 the sector showed a decrease of 11.3%.

### **2.4.1.3. Bulgarian SME Sector Development**

#### **Definition of SMEs**

Bulgaria has accepted the EU definition of the SMEs (EC 2005). According to this definition, more than 99% of the Bulgarian enterprises are SMEs. This is not an exception as "SMEs are dominant firms in the world. Their relative number in the member countries of the EU, OECD, APEC and a number of Latin America countries varied between 80% and 99.8%. The SMEs sector is ...the main "employer", and it assures in most countries between 50% and 70% of the employment..." (Todorov 2008: 78).

#### **Demographic Profile**

The total number of SMEs in Bulgaria in 2009 was 315,850 or 99.8% of all non-financial enterprises. The microenterprises were 90.3%; small 8%; medium 1.5%, and big ones 0.2%. SMEs assured 76% of the em-

ployment, and the average number of employees per one enterprise was 4.9 persons (Table 32).

**Table 32: SME number and employment in Bulgaria, 2005-2009, 2009**

	Micro	Small	Medium	SMEs	Large	Total
<b>Enterprises</b>						
Number	285,881	25,201	4,768	315,850	715	316,565
%	90.3	8.0	1.5	99.8	0.2	100
<b>Employment</b>						
Number	594,210	497,951	461,003	1,553,164	488,754	2,041,918
%	29.1	24.4	22.6	76.1	23.9	100
<b>Occupied persons per enterprise</b>						
Number	2.1	19.8	96.7	4.9	683.6	6.5

Source: Bulgarian SMEs Promotion Agency (further as BSMEPA) 2011: 20

For the 2005-2009 period the number of non-financial SMEs in Bulgaria increased by 32%, while the number of large enterprises increased by 5%. In 2009 the number of SMEs augmented by 14.5%, and the micro-enterprises contributed mostly to this augmentation with 16.2% growth. The augmentation was due also to the changes in the methodology for accounting the SMEs and new classification for the economic activities (CEA-2008); implementation of the trade registers, etc. The layoff during the crisis period also led to the increase of the share of SMEs at the expense of the share of large enterprises.

Bulgarian non-financial enterprises are distributed unevenly over the sectors. Trade sector with the largest number of enterprises (143,190) is a typical small scaled sector in terms of average firm size (4 persons), while mining is represented mainly by medium-sized enterprises with an average number of occupied persons amounting to 71 (Table 33).

**Table 33: Enterprises in Bulgaria by sector and individual size, 2009**

	SMEs	Large	Total	Occupied persons per enterprise
<i>Sector by NACE.BG-2008</i>	<i>315,850</i>	<i>715</i>	<i>316,565</i>	<i>6.5</i>
Mining and quarrying	355	18	373	71.3
Manufacturing	31,860	317	32,177	17.9
Electricity, gas, steam	900	21	921	38.7
Water supply	586	41	627	51.2
Construction	23,521	85	23,606	10.1
Wholesale and retail trade	143,190	68	143,258	3.8
Accommodation and food service activities	25,938	24	25,962	5.4
Transporting and storage	19,258	48	19,306	8.3
Information and communication	7,894	21	7,915	8.4
Real estate activities	16,958	6	16,964	2.1
Professional, scientific and technical activities	34,348	5	34,353	2.6
Administrative and support service activities	7,654	61	7,715	12.1
Repair of computers	3,388	0	3,388	1.8

Source: BSMEPA 2011: 21

The SMEs were distributed unevenly by statistical regions too. In 2009 twice as many enterprises operated in Southern Bulgaria as in Northern Bulgaria, and more than half of these enterprises were situated in the South Western region, where the capital is. The smallest number of enterprises was reported in the North-West and North Central Region regions (Table 34).

**Table 34: Enterprises in Bulgaria by region and individual size, 2009**

Statistical regions	SMEs	Large	Total
<i>North Bulgaria</i>	115,225	234	115,459
North Western	29,145	56	29,201
North Central	33,290	87	33,383
North Eastern	50,660	91	50,751
<i>South Bulgaria</i>	252,238	532	252,770
South Eastern	52,542	87	52,629
South Central	65,877	118	65,995
South Western	133,819	327	134,146

Source: BSMEPA 2011: 22

During the period of 2006-2008, there were on average 48,442 newly created enterprises, while 35,836 enterprises closed in the same period. The Net enterprise birth was 12,605 enterprises or 4.9% (Table 35).

**Table 35: Enterprise birth and death in Bulgaria, 2006-2009**

	2006	2007	2008	Average 2006/2008	2009*
<b>Enterprise birth</b>					
Number	40,555	55,488	49,287	48,442	55,891
% of active enterprises	17.5	22.2	18.2	18.2	18.0
<b>Enterprise death</b>					
Number	35,602	36,191	35,716	35,836	43,470
% of active enterprises	15.4	14.5	13.2	13.2	14.0
<b>Net enterprise birth</b>					
Number	4,948	19,297	13,571	12,605	12,420
% of active enterprises	2.1	7.7	5.0	5.0	4.0

Source: BSMEPA 2011: 25; \* - estimation

It is expected that in 2009 the net enterprise birth would decrease to 4%. The newborn and the closed enterprises employed on average 2.6 and 2.7 persons, which indicated that these were mainly micro enterprises. For the period of 2006-2008 in sectors "Construction" and "Electricity, gas, steam and air conditioning supply" the net enterprise birth amounts

to 20% and 16% respectively, while in real estate activities the net enterprise birth was negative. In the latter sector, the survival rate was also the lowest (65.5% in comparison to 76.5% for all).

In 2009, the SME sector employed 1,553,164 persons, which was 76% of the country employment. For the 2005-2009 period, the number of jobs in SMEs increased by 18%, and the higher employment growth marked the small enterprises (25%), while in the large ones the employment decreased (-2%). The growth rate of the SME share in the employment augmented until 2008, but it dropped in 2009 in respect to 2008 (from 6.6% to 1.4%). In 2009 the employees in SMEs increased with 22,000, while the employees in large enterprises decreased with 45,000 persons. All size groups of enterprises, except for micro enterprises, were releasing employees. The lowest contraction was in small firms (with a decline of 0.2%), followed by the medium-sized enterprises (-8%). The highest proportion of job losses was in large companies (-9%). Only micro firms increased their number of employees with 11.5%, which led to their increasing share in total employment to 29% (Table 36).

**Table 36: Employment by enterprise size class, 2005-2009**

	2005	2006	2007	2008	2009
<b>Micro</b>					
Number of employed persons	516,007	489,198	509,178	532,745	594,210
% of the total number	28.4	26.1	26.0	25.8	29.1
<b>Small</b>					
Number of employed persons	399,763	428,955	457,275	498,989	497,951
% of the total number	22.0	22.9	23.3	24.2	24.4
<b>Medium</b>					
Number of employed persons	402,700	439,044	470,223	499,464	461,003
% of the total number	22.2	23.4	24.0	24.2	22.6
<b>SMEs</b>					
Number of employed persons	1,318,470	1,357,197	1,436,676	1,531,198	1,553,164
% of the total number	72.6	72.4	73.3	74.2	76.1
<b>Large</b>					
Number of employed persons	497,791	516,980	523,300	533,429	488,754
% of the total number	27.4	27.6	26.7	25.8	23.9
<b>Total</b>					
Number of employed persons	1,816,261	1,874,177	1,959,976	2,064,627	2,041,918
% of the total number	100	100	100	100	100

Source: BSMEPA 2011: 26

According to the WB survey about the impact of the crisis on companies in 6 countries (Bulgaria, Hungary, Turkey, Lithuania, Latvia, and Romania), large firms cut down more employees. This phenomenon was observed more sensitively in Hungary, where the share of large companies,

which decreased the number of the work force, was significantly higher than in small and medium sized ones. The latter marked an increase of the employment for the investigated period (Ramalho, Rodríguez-Meza, Yang, 2010).

In 2009 SMEs assured more than 90% of the employment in the sectors "Repair of computers", "Professional, scientific and technical activities", "Real estate activities", "Accommodation and food service activities", and "Retail trade". SMEs had the lowest share of employment in "Electricity, gas, and steam sector" (13%) (Table 37).

**Table 37: Employment in SMEs by economic activities, 2005-2009\***

	2005	2006	2007	2008	2009
<b>Number of occupied persons by NACE.BG-2003 and 2008*</b>					
Mining and quarrying	20.3	20.1	23.3	23.2	25.1
Manufacturing	85.4	85.2	86.7	87.9	88.8
Electricity, gas, water supply	9.8	10.8	11.3		
Electricity, gas, steam				13.1	13.0
Water supply				31.6	33.3
Construction	81.5	81.4	81.6	82.5	84.1
Wholesale and retail trade	88.4	86.9	85.9	90.9	91.3
Accommodation and food service activities	90.4	90.6	90.0	89.0	91.8
Transporting and storage	52.4	48.9	48.3	50.6	52.5
Real estate activities and business services	78.9	78.1	77.5		
Information and communication				65.7	68.0
Real estate activities				93.6	94.4
Professional, scientific and technical activities				95.4	97.5
Administrative and support service activities				54.7	58.2
Repair of computers				100	100

Source: BSMEPA 2011: 28

Remarks: \*Up to 2007 data refers to NACE.BG-2003. Data for 2008 and 2009 refers to NACE.BG-2008

The micro firms had a great share in the employment in five sectors: "Repair of computers" (84%), "Professional, scientific, and technical activities" (65%), "Real estate activities" (58%), "Trade" (51%), and "Accommodation and food services" (41%). The small firms were leading in the employment in "Construction" (32%), where their share was equal to the medium size firms. The medium companies contributed to the employment mostly in "Manufacturing" (31%), where their share was close to that of the large companies (31%). Two economic activities formed more than half of the SME employment – trade (32%) and manufacturing (26%) (BSMEPA 2011: 29).

## Financial Profile

In 2009 the turnover of the non-financial enterprises accounted for BGN 179,279 million (which was a decrease by 14% in comparison to 2008), or on average BGN 566.5 thousand per enterprise. The SME share in the turnover was 69%, although their turnover dropped by 10% yearly. This drop, however, was smaller than in large enterprises (19%). Different size classes of enterprises had relatively even participation in the turnover (about 23%) with the leading role of large companies (31%) (Table 38).

**Table 38: Turnover and value added by size class of enterprises, 2009**

	Micro	Small	Medium	SMEs	Large	Total
<b>Levels</b>						
Turnover in thousand BGN	39,919,386	42,031,829	41,746,653	123,697,868	55,607,586	179,305,454
Turnover of 1 enterprise	139.6	1,667.9	8755.6	391.6	77775.0	566.4
GVA in thousand BGN	5,498,575	6,925,196	7,917,086	20,340,857	12,131,139	32,471,996
Number of enterprises	285,881	25,201	4,768	315,850	715	316,565
No of persons occupied	594,210	497,951	46,1003	1,553,164	488,754	2,041,918
Labor cost per employee in thousand BGN	9.3	13.9	17.2	13.1	24.8	15.9
<b>Structure in %</b>						
Turnover	22.3	23.4	23.3	69.0	31.0	100
GVA	16.9	21.3	24.4	62.6	37.4	100
Number of enterprises	90.3	8.0	1.5	99.8	0.2	100
No of persons employed	29.1	24.4	22.6	76.1	23.9	100

Source: BSMEPA 2011: 32

For the 2006-2008 period the share of SMEs in GVA increased from 54% to 64%. In 2009, however, the GVA of enterprises decreased by 8%, and SMEs indicated twice as much decrease (10%) in comparison to large enterprises (4%). This caused the reduction of the SME share in GVA to 63%. In 2009 large enterprises had the biggest contribution to GVA (37%), followed by medium sized (24%), small (21%), and micro enterprises (17%) (Table 38). Although the labor productivity in SMEs increased for the 2006-2008 period more rapidly than in the large ones, in 2009 it decreased by 12%, while in the large enterprises it augmented by 4%. The labor productivity was lower in sectors where SMEs had a significant share in the employment (BSMEPA 2011: 33). In general, the labor productivity in SMEs continued to be almost two times smaller than in large ones (Table 38).

The dynamics of the profitability (measured as the gross operating surplus adjusted for the imputed wage of self-employed individuals, as a percentage of GVA) witnessed for a positive correlation with the labor productivity. The profitability was lower in micro firms (11%), while it increased with the increase in the size of the enterprise. In 2008 the profitability for the total non-financial economy amounted to 48%, while for the SMEs this amount was 40% (Table 39).

In 2009 the profitability dropped to 40%, which could be explained by the lower flexibility of labor expenditures. In this year, GVA increased by 2%, while the growth of the employees compensation was 7% in respect to 2008 (BSMEPA 2011: 37).

**Table 39: Profit margin by enterprise size class, 2008**

	Micro	Small	Medium sized	SMEs	Large	Total
<b>% GVA</b>						
Gross operating surplus	10.9	49.3	50.6	39.9	56.6	47.6
Labor expenditure	49.7	48.2	48.9	48.9	43.3	46.3
<b>Million euro</b>						
Labor productivity	3.7	6.1	6.9	5.5	13.2	7.5
Labor expenditure per occupied person	3.2	3.1	3.4	3.3	5.7	4.0

Source: BSMEPA 2011: 35

The share of SMEs in fixed assets (FA) in 2009 was 63%, with the greatest contribution of micro enterprises, while small and medium-sized had comparable shares (25% and 28% respectively). The real estate activities sector was leading in the FA investments (21%), which belonged entirely to the micro firms. The trade sector also had a significant share (16%) with a comparable participation of different sized class companies. The contribution of manufacturing was also 16%, which was due mainly to the medium-sized firms. The construction sector attracted 12% of the investments in FA, more than half of which were realized by micro enterprises. The FA structure by economic activities revealed the prevailing role of SMEs in the services, except for "Information and communication" sector. In the other sectors the FA were dominated by large enterprises (Table 40).

**Table 40: Gross fixed capital formation by enterprise size and economic activity (in thousand BGN, 2009)**

	SMEs	Large	Total	
	(%)	(%)	(%)	thousands BGN
<i>Sector by NACE.BG-2008</i>	<i>63.1</i>	<i>36.9</i>	<i>100</i>	<i>103,784,100</i>
Mining and quarrying	21.3	78.7	100	2,035,011
Manufacturing	45.8	54.2	100	21,943,540
Electricity, gas, steam	31.4	68.6	100	16,766,078
Water supply	40.4	59.6	100	1,017,423
Construction	89.0	11.0	100	8,665,551
Wholesale and retail trade	80.8	19.2	100	12,870,035
Transporting and storage	44.6	55.4	100	8,416,283
Accommodation and food service activities	81.6	18.4	100	5,252,095
Information and communication	24.3	75.7	100	3,497,713
Real estate activities	79.3	20.7	100	17,070,300
Professional, scientific and technical activities	99.4	0.6	100	2,390,130
Administrative and support service activities	87.9	12.1	100	1,402,300

Source: BSMEPA 2011: 38

#### **2.4.1.4. Bulgaria's Ranking on Competitiveness Indexes**

According to the Global Competitiveness Index 2010-2011, Bulgaria took the 71st place, moving 5 places up in comparison to 2008 and 2009 (Table 41), but remained 12 positions lower in comparison to 2004. The country had the worst positioning among other EU member countries. In comparison to 2004, Bulgaria was outpaced on the overall index by Turkey, Romania, and other countries. This was due mainly to the worsening of the position in respect to the quality of public institutions, where the country stepped back from the 59th place in 2004 to the 114th place in 2010. This position reflects indicators concerning the functioning of the law-court system (clumsy, ineffective); spread of corruption practices; ineffective fight against organized crime; insufficient intellectual property protection; sluggish regulation environment; lack of transparency in public procurements, etc. The other field in which the country ranked poorly was the infrastructure (80th), due to the overall infrastructure (120th) and the bad quality of roads (135th). Some improvements were marked in the macroeconomic environment, where Bulgaria moved from the 60th place in 2004 to the 35th place in 2006, but stepped back to 42 in 2010.

**Table 41: The Global Competitiveness Index 2010-2011**

Country	Overall Index	Institution	Infrastructure	Macro-economic environment	Health and primary education
Switzerland	1	7	6	5	7
Sweden	2	2	10	14	18
.....					
Estonia	33	31	32	19	29
Czech R	36	72	39	48	43
Turkey	61	88	56	83	72
Romania	67	81	92	78	63
Latvia	70	75	55	84	55
Bulgaria	71	114	80	42	58
FYR of Macedonia	79	80	91	47	69
Albania	88	63	89	101	56

Source: WEF, The Global Competitiveness Report 2010-2011: 17-22

The country ranked poorly also on the enterprise innovativeness and the business environment sophistication (respectively 92nd and 95th) (Table 42). This situation was due mainly to the weak cooperation between the business and universities (110th place) and companies' low expenditures for the R&D (96th place). The number of innovative Bulgarian enterprises was 4 times smaller than the EU average, and the degree of R&D commercialization was small. As for the clusters development, the country occupied 112th place. Goods market efficiency was hampered mainly by the weight of customs procedures (112th place), low efficiency of the antitrust legislation (114th place), high expenditures for agricultural policy (137th place), etc.

**Table 42: The Global Competitiveness Index 2010-2011 - continuation**

Country	Higher education and training	Goods market efficiency	Labor market efficiency	Financial market efficiency	Technological readiness	Market size	Business sophistication	Innovation
Switzerland	4	4	2	8	7	36	4	2
Sweden	2	5	18	13	1	34	2	5
.....								
Estonia	22	29	17	45	24	101	56	37
Czech R	24	35	33	48	32	42	34	27
Turkey	71	59	127	61	56	16	52	67
Romania	54	76	76	81	58	43	93	87
Latvia	35	72	52	86	51	95	80	77
Bulgaria	67	82	58	91	48	63	95	92
FYR of Macedonia	72	57	71	87	64	106	96	97
Albania	84	63	63	100	72	103	87	121

Source: WEF, The Global Competitiveness Report 2010-2011: 17-22

Bulgaria had competitive advantages on labor market, but now it occupied 58th position, mainly because of the “brain drain” (127th place), the weak reliance on the professional management (116th place), and insufficient cooperation between employers and employees organizations (113th place). The esteems of professional qualification and firms’ training (135th place), and the overall quality of education system (85th place) were also low, which placed the country in the 67th position on the indicator “Higher education and training”.

The most serious issues for entrepreneurs in 2010 were: corruption, noted by 15.1% of the interviewed; access to finance (13.8%); insufficiently effective State administration (9.7%); bad infrastructure (9.3%), etc. (The Global Competitiveness Report 2010-2011: 148).

#### **2.4.2. Legislation and Ranking of Doing Business According to World Bank Methodology**

The national legislation concerning the SME development includes the number of laws, related to SME development; State aid; crafts; cooperatives; Trade law; book-keeping; encouraging investments; VAT; local taxes and charges; income taxes; safety and healthy working conditions; Classification of economic activities. To this legislation belongs the EU regulatory framework, which includes European Charter for Small Enterprises and Small Business Act. Applicable to the EU level are also Lisbon strategy, “Programme for better regulation 2010-2013”, and the “Europe 2020” strategy, and to the national level: “Bulgarian economy – state and strategy for development – economic strategy of the Ministry of economy, energy, and tourism”, and “National strategy for encouraging SMEs 2007-2013”. The latter strategy was elaborated in line with the main EU directions (MEET 2010: 22-23).

The Law for Small and Medium-Sized Enterprises regulates the social relations associated with the implementation of the state policy promoting the establishment and development of small and medium-sized enterprises. The purpose of this act is to create conditions for the evolvement of a favorable and stable institutional and economic environment for establishment and development of competitive small and medium-sized enterprises. According to this act, the category of small and medium-sized enterprises (SMEs) comprises enterprises that have: (i) an average

number of the personnel fewer than 250 people on their payroll, and (ii) an annual turnover not exceeding BGN 97,500,000 and/or an annual balance sheet not exceeding BGN 84,000,000. From among the enterprises referred to as SMEs, small enterprises are the ones that have: (i) an average number of the personnel fewer than 50 people, and (ii) an annual turnover not exceeding BGN 19,500,000 and/or an annual balance sheet not exceeding BGN 19,500,000. From among the enterprises referred to as SMEs, micro enterprises are the ones that have: (i) an average number of personnel fewer than 10 people, and (ii) an annual turnover not exceeding BGN 3,900,000 and/or an annual balance sheet not exceeding BGN 3,900,000.

During the past several years, certain documents and laws were developed and adopted aiming at simplifying regulatory procedures. The Administrative Procedure Code (APC) aims at protection of the rights of citizens and companies in their contacts with the administration as well as achieving a simpler, quicker, approachable, and comprehensible administrative procedure. An important objective of the Administrative Procedure Code is to limit the conditions for corruption. For the first time, the parties are given the opportunity to reach an agreement during administrative proceedings. The implementation of this mechanism is expected to have effect in several directions: the opportunity to settle specific administrative disputes in a modern civilized, way; accelerated proceedings and lower number of court cases. The court phase also involves an opportunity to close administrative disputes on basis of an agreement. Time-limits for pronouncement on the issuance of individual administrative acts are specified with the objective to bring the administration under control and to protect the rights of citizens. Besides tacit denial, tacit consent is also employed in pronouncement on the issuance of individual administrative acts.

A Law on Restricting Administrative Regulation and Administrative Control over Economic Activity has also been adopted, but in effect this law is little known to the business community and is not being applied by the administration.

The optimization of the regulatory and legal framework for SMEs implies higher qualification and operational efficiency of the central and local administration. Some changes in legislation have a positive effect. The anti-

corruption mechanism provided for in the Civil Servant Law is effectively applied. The Law requires the civil servants to inform of any conflict of interest and find ways to avoid or settle such situations. The Code of Conduct for Civil Servants operates together with the Civil Servant Law and further develops the rules of conduct of civil servants. Its objective is to increase public confidence in the professionalism and ethics of civil servants and to enhance the prestige of public service. An important step towards a favourable business environment is the Conception for improvement of the administrative service in the context of the one-stop-shop principle and the Basic Model of one-stop-shop service. The Conception has been elaborated in fulfillment of the Strategy for Modernization of Administration.

In Bulgaria, e-management was initiated as a systemized and legally conditioned state policy by the Strategy for Modernization of the Public Administration – From Accession to Integration and the Strategy for Electronic Government. The first steps in the field of e-government were taken with the adoption of the E-Government Strategy, the establishment of a portal of official web-sites of Bulgarian institutions, the development and implementation of the one-stop-shop service concept, and the creation of electronic registers. The legal basis for the efficient functioning of e-government is the E-Government Law, which has been in force since 2008. Some good e-government practices and projects being implemented and resulting in a better SME environment include Register of Administrative Bodies and Acts of the Executive Authority Organs and Public Procurement Register.

The Law on Protection of Competition is fully harmonized with the European legislation in the sphere of competition with regard to the prohibited agreements, abuse of monopolistic and dominant positions in the market and concentration of economic activities.

The amendments and supplements to the Public Procurement Law introduced in the autumn of 2008 and the beginning of 2009 aim to increase transparency, simplify procedures, improve the conditions for the precise, exact and uniform application of the legislation, and increase ex-ante control, which would also improve the business climate.

The State Aids Law is fully harmonized with the European legislation. According to this Law, the Republic of Bulgaria shall be obliged to send

officially all state aid notifications to the European Commission through the Minister of Finance and the Minister of Agriculture and Forestry.

All these esteems witnessed for systemic weaknesses of the business environment, firms management, and inter-firms relations. It was not accidentally that the country stepped back in the "Doing business" classification too, occupying the 51st position in 2011 (44 in 2009 and 42 in 2008) (Table 43). This place was due mainly to the heavy procedures for dealing with construction permits, difficulties in trading across borders, paying taxes, closing a business, insufficient contract enforcement, etc.

**Table 43: Summary of Indicators for Doing Business – Bulgaria**

Doing Business 2011 Rank	Doing Business 2010 Rank	Change in Rank	
51	51	0	
Topic Rankings	DB 2011 Rank	DB 2010 Rank	Change in Rank
<i>Starting a Business</i>	43	50	+7
<i>Dealing with Construction Permits</i>	119	117	-2
<i>Registering Property</i>	62	56	-6
<i>Getting Credit</i>	6	6	No change
<i>Protecting Investors</i>	44	41	-3
<i>Paying Taxes</i>	85	95	10
<i>Trading Across Borders</i>	108	109	1
<i>Enforcing Contracts</i>	87	88	1
<i>Closing a Business</i>	83	79	-4

Source: WB 2011. Doing Business 2011 - Making a Difference for Entrepreneurs, <http://www.doingbusiness.org/~media/FPDKM/Doing%20Business/Documents/Profiles/Country/DB11/BGR.pdf>

Bulgaria exhibits similar ranking as Qatar, Botswana, Spain, Armenia, St. Lucia, and Azerbaijan and lags significantly behind the leaders in the ease of doing business - Singapore, Hong Kong SAR, New Zealand, and the United Kingdom. The rankings of the European Union member states reveal that in 21 EU countries it is easier to do business than in Bulgaria, while only 5 EU member states have worse rankings (Romania, Czech Republic, Poland, Italy, and Greece). Bulgaria implemented two reforms in the period June 2009 - May 2010 in order to make it easier to do business – the country eased business start-up by reducing the minimum capital requirements from BGN 5,000 (USD 3,250) to BGN 2 (USD 1.30). Bulgaria also reduced employer contribution rates for social security.

In 2011 Bulgaria registers the 43rd place in relation to the ease of

starting a business, which represents an improvement with by places in comparison with 2010. The total number of procedures required to register a firm in Bulgaria is 4, while the average number of procedures in the region of Central Europe and Central Asia and in the OECD countries is 6.3 and 5.6 respectively. The cost for starting a business in Bulgaria is significantly lower than the average cost in the region of Central Europe and Central Asia and in the OECD countries (only 1.6% of the income per capita). The paid-in minimum capital is 0.0% of the income per capita. The time required to register a firm is 18 days which is slightly more than the average time in the region of Central Europe and Central Asia (16.3 days) and in the OECD countries (13.8 days).

In relation to the ease of dealing with construction permits, Bulgaria dropped from the 117th place in 2010 to the 119th place in 2011. This is an area where the current legislation requires significant improvement. The total number of procedures for dealing with construction permits in Bulgaria is 24, which is significantly more than the average in the OECD countries (15.8 procedures). The time required to deal with construction permits in Bulgaria (139 days) is lower than in both the region of Central Europe and Central Asia (250.1 days) and OECD countries (166.3 days). The cost of dealing with construction permits in Bulgaria (measured as a % of the income per capita) is significantly higher than the average in the OECD countries but lower than the average in the region of Central Europe and Central Asia.

In 2011 it is relatively more difficult to register property in Bulgaria in comparison to other countries than in 2010. The Bulgarian ranking has dropped by 6 places to the 62nd place in 2011. The total number of procedures required for registering property is 8, which is more than the average in both the region of Central Europe and Central Asia and OECD countries. However, the average time for registering property in Bulgaria is less than half of the average time for registering property in the region of Central Europe and Central Asia and OECD countries. The cost for registering property in Bulgaria is comparable to the average in these regions.

The rank of the ease of protecting investors in Bulgaria in 2011 is 44, while in 2010 it was 41. The extent of disclosure index in Bulgaria is higher than the average in the region of Central Europe and Central Asia

and OECD countries, but the extent of director liability index is significantly lower than the average for these regions. The ease of shareholder suits index and the strength of investor protection index have very similar values to the average in the region of Central Europe and Central Asia and OECD countries.

In 2011 Bulgaria has increased the ease of paying taxes relative to other countries and has moved from the 95th place to the 85th place. The time for paying taxes and the number of tax payments per year in Bulgaria is higher than the average in OECD countries. The rate of profit tax, labor tax and contributions and total tax rate in Bulgaria is lower than in the OECD countries. The rate of other taxes is slightly higher than in the OECD countries.

In Bulgaria it is significantly more difficult to trade across borders than in most of the other countries participating in the ranking. In 2011 Bulgaria has improved its rank by 1 step and occupies the 108th place. In terms of all indicators used to measure the ease of trading across borders (number of documents to export and import, time to export and import, and cost to import and export) Bulgaria performs worse than the average in the OECD countries.

In 2011 Bulgaria has increased the ease of enforcing contracts relative to other countries and has moved from the 88th place to the 87th place in the ranking. The average number of procedures, the time and the cost to enforce a contract is higher in Bulgaria than the average in the OECD countries.

In 2011 Bulgaria occupies the 83rd place in terms of the ease of closing a business, while in 2010 its rank was 79. The recovery rate in Bulgaria is lower than the average in both the region of Central Europe and Central Asia and OECD countries, while the average time to close a business is higher than the average for these regions. The cost (% of estate) is similar to the average in the OECD countries and lower than the average for the region of Central Europe and Central Asia.

### 2.4.3. SME Support Infrastructure

The major institutions of the government operating in support of SMEs are as follows:

- Bulgarian Small and Medium Enterprises Promotion Agency (BSMEPA) is a government body, implementing the national strategies for SME development. BSMEPA provides information and consulting services, support and assistance. It has an active role at the regional level through its regional offices in each of Bulgaria's 28 administrative districts.
- Bulgarian Export Insurance Agency (BAEZ) supports Bulgarian exports and investments abroad. It provides export credit and domestic credit insurance and insurance of bank credit lines, investments abroad, letters of credit, and bank guarantees. BAEZ is a member of Credit Alliance and cooperates with most Bulgarian banks as well as with agencies for export insurance in other countries.
- InvestBulgaria Agency (IBA) is an executive agency assisting the Minister of Economy in the implementation of the policy in the field of investment promotion. IBA renders assistance for the encouragement, attraction, and support to investors and priority investment projects.
- National Employment Agency (NEA) is an executive agency for the implementation of the government policy on employment, which offers various services to employers.
- National Agricultural Advisory Service (NAAS) provides free-of-charge information, specialized assistance and expert advice to agricultural producers, cooperatives and associations. It includes Regional Agricultural Advisory Services (RAAS) based in Bulgaria's 28 administrative district centers.

A number of non-governmental organizations play a major role in supporting and promoting SME development in Bulgaria, namely:

- National Association of Small and Medium Business (NASMB)
- Bulgarian Chamber of Commerce and Industry (BCCI) (member of Eurochambres)
- Bulgarian Industrial Association (BIA) (member of BUSINESSEUROPE)
- Union for Private Economic Enterprise (UPEE)
- Bulgarian Association of Regional Development Agencies and Business Centres (BARDA)

- National Chamber of Crafts (NCC)
- Central Cooperative Union (CCU) (member of Cooperatives Europe and of the European Community of Consumer Cooperatives - Eurocoop)
- National Union of Worker Producers Cooperatives (NUWPC) (member of the European Confederation of Worker Cooperatives, Social Cooperatives and Social and Participative Enterprises - CECOP)
- Association of Social Enterprises in Bulgaria (member of Workability Europe)
- Selena Association of Women Entrepreneurs in Bulgaria.
- Association of the Family Business (member of the European Group of Family Enterprises - GEEF)

Research centers and institutes from the non-governmental sector working in support of SMEs include Centre for Economic Development (CED); Entrepreneurship Development Institute (EDC); Centre for the Study of Democracy (CSD); Institute for Market Economy (IME); and Economic Policy Institute (EPI).

Various financial intermediaries offer financial instruments, helping the SME sector. The banking sector, however, is the main source of external financing for Bulgarian SMEs, because it is more developed and controls more resources than non-banking financial institutions. Most Bulgarian banks compete to attract SMEs as an important set of business customers, offering financial instruments particularly for SMEs such as investment loans; mortgage business loans; specialized loans for SMEs; credit lines, overdraft, etc. As well as the provision of credit schemes, many banks in Bulgaria offer factoring services. In 2008 Bulgarian Development Bank was established to promote export and to support the implementation of the government economic policy in terms of SMEs. The Bank provides medium and long-term investment credits and export and pre-export financing directly to final beneficiaries (SMEs) as well as with the intermediation of other commercial banks.

Operating and financial leasing schemes are available to Bulgarian SMEs by a great number of leasing companies.

Several loan guarantee schemes for SMEs operate in Bulgaria. The National Guarantee Fund, which is a subsidiary of the Bulgarian Develop-

ment Bank, support all micro, small and medium-sized enterprises registered in Bulgaria. The Guarantee Fund for Micro-crediting established by the Ministry of Labor and Social Policy provides access to credits for SMEs, unemployed physical people, craftsmen, cooperatives and agricultural producers, and starting business.

External financial resources for SMEs from few venture capital providers and business angels are available in Bulgaria too. The funds providing venture capital to young companies are Global Finance, GED, Sigma Bleyzer, and Balkan Accession Fund. The Bulgarian Business Angels Network (BBAN) comprises private investors interested in doing business in Bulgaria and other South East European countries. The network was established as a legal entity in 2007 and became a member of the European Business Angel Network in 2008.

Business incubators are another way of providing financial assistance to SMEs and new businesses, but their capabilities are limited.

#### **2.4.4. The Effect of the International Financial and Economic Crisis**

The effects of the global crisis appeared in Bulgaria at the end of 2008, and a great part of enterprises turned out to be unprepared for it. This situation showed mainly in the form of delayed optimization of the number of personnel. That is why in the first half of 2009 there was not a significant drop in the employment. This process became more intensive in the second half of 2009 and particularly in 2010. In spite of the registered growth of 0.2% in 2010, the consumption and investments continued to decline, although with diminishing rates. In 2010 the inflation rate accelerated and reached 4.5% at the end of the year, while the yearly average inflation amounted to 2.4%. The higher inflation caused an additional decrease of the purchase power and hindered the recovery (BSMEPA 2011: 56, 57).

According to the SME survey at the beginning of 2011, the greatest share of the enterprises accounted a decrease of working capital (71%), personnel reduction (37%), and a decrease of compensations (22%). Difficulties to pay off credits showed 18%, while twice as many were those who were embarrassed to collect receipts (34%) (BSMEPA 2011: 65).

If the decrease in the working capital and employees' compensations was the largest among micro firms (respectively 79% and 24%), the personnel reduction was most spread among medium sized firms (67%). Small enterprises were presented more significantly among those, which lost markets (38%), had difficulties to pay off credits (32%), and which reduced activities (23% in comparison to 11% on average). The most affected sector was the construction, where 96% of SMEs reduced the personnel, 88% accounted a turnover decline, 60% lost markets, 58% had difficulties in paying current debts, and 53% had difficulties to collect their takings. The following more stricken sector was the manufacturing, while less affected were the SMEs from trade and services (Table 44).

**Table 44. Effects of the crisis by spheres of activity, %**

	Production	Trade	Services	Construction	Total
Personnel number was reduced	46	34	30	96	37
Personnel salaries were reduced	21	22	22	28	22
Company has difficulties in paying credits	22	22	13	23	18
Company has difficulties in collecting claims	44	34	29	53	34
Difficulties in paying current liabilities	21	20	23	58	23
Company froze its investment plans	26	25	18	28	22
Company lost markets	32	24	28	60	28
Company cancelled units and activities	8	16	6	20	11
Company turnover significantly decreased	78	75	69	88	71

Source: BSMEPA 2011: 66

At the beginning of the crisis a significant number of SMEs chose a strategy of waiting, while others oriented to the expenditures' shrinking, as a third group chose the active strategy towards a market share increase by new products and marketing approaches. On average 14% of the researched SMEs noted an enlargement of their product portfolio, 13% increased their market in the country, and 3% enlarged their foreign markets in 2010, mainly among medium sized firms (17%) (BSMEPA 2011: 68).

In the first months of 2011 the basic issues of the Bulgarian SMES were related to the general impact of the crisis; impossibility to reduce expenses, lack of markets, inter-firms indebtedness, great share of the "grey economy", and freezing of investments (Table 45).

**Table 45. Problems coming from the general market situation and economic crisis - by enterprise size class, 2011 (%)**

	Micro	Small	Medium sized	Total
General impact of the crisis over the sector	93	87	79	92
Impossibility to reduce company expenses	43	38	20	42
Lack of markets to realize company production	40	43	38	41
Inter-company indebtedness	26	44	54	28
Incidence of large grey part in the sector	28	16	25	27
Freeze of company investments	21	36	17	22
Relationship with suppliers	18	14	50	19
Reduced motivation of employees	14	13	17	14
Organizational effectiveness of the company	6	11	29	7

Source: BSMEPA 2011: 69

Because the micro enterprises dominated the SME sector, their values were close to average for all. The medium-sized companies were presented more significantly among those, which suffered the inter-firms indebtedness, relations with suppliers, and decline in the organizational effectiveness. Other common areas of difficulty for small companies were inter-firms indebtedness and freezing investments. SMEs from the construction sector suffered mainly from the lack of markets for their production. All these issues impacted SMEs in the production sector more severely (BSMEPA 2011: 69).

#### **2.4.5. Government Measures to Cope with the Impact of the Economic Crisis**

There were two main governmental approaches to cope with the crisis. The US one included an augmentation of public expenditures to revitalize the economy (which led to an increase of budget deficit), zero rate interest, decrease of taxes and social insurance payments of employees. Thus the US staked on the increase of revenues, engendered by the economic revival, and not on the drastic cutting of public expenditures. The hope was that the increased revenues would reduce the budget deficit. Germany stood for the opposite model, which contained severe restrictions and cutting off public expenditures through decreasing of minimal wages, social programme expenditures, etc. If the priority in the first model was increasing the revenues, the priority in the second model was reducing the expenditures.

Bulgaria followed the German model, and as a result at the beginning of 2010 the inter-firms indebtedness reached BGN 157 billions. The main

liabilities generator were public institutions and municipalities, which at the end of 2009 were indebted to firms by BGN 833 millions for accomplished public procurements, and another BGN 2.4 billions for non reimbursed taxes.

In 2010 in the National Council for Tripartite Cooperation, the Bulgarian government negotiated an anti-crisis package of 59 measures, which contained the following seven groups of measures.

(1) Measures for fiscal support: Providing additional internal and external financial resources for consolidating the financial reserve of the country; accelerating greenhouse gas emissions trading; privatization of minority shares in private enterprises; Silver Fund investment regime liberalization; temporary abolishment of the import tax preferences for budget organizations; establishment of public registers of rented public property and land; introducing changes in the regulatory regime regarding land renting; introducing a final tax on merchandize awards and cash prizes from games of chance; changing the method of taxing the insurance premiums; restoring to 1.1 (from 1.0) the coefficient used in calculating the tax pre-payment under the CIT Act for 2010; increasing the dividend from 50% to 80% from state-owned enterprises; treating as government/municipality income 50% of the revenues from renting in the state-owned/municipality-owned enterprises; introducing Luxury Tax; decreasing the time for paying social payment related to temporary incapacity to work in case of redundancy.

(2) Measures for limiting public spending: Establishing a work schedule for implementing an e-government; entrusting public services to private entities; granting concessions for underground resources and transport infrastructure. The government will propose officially to the Bulgarian parliament to approve a decrease in the subsidy for political parties with 15%; limiting with 10% the expenses of the organizations receiving financing from the budget; decreasing the budgets of the governmental and municipal institutions for representative clothes; providing additional subsidy from the government budget to the Ministry of Labor and Social Policy for social support activities.

(3) Measures for restoring financial discipline: Establishing a schedule for delayed payments owed to the business by the government for public

procurement projects; recovering VAT and excise duty to companies within the legal time-limit; accelerating delayed payments to beneficiaries of European funds; accelerating current schemes and starting new schemes under operational programs; increasing the advance payments to 40%; public registers for the funds due on public procurement, VAT, excise duty and European projects. After transferring the delayed payments to companies, the government to sign annexes to contracts for public procurement obliging companies to pay delayed salaries and social security payments as well as delayed payments to subcontractors and suppliers; immediate legislative revisions to guarantee that the period of refunding on behalf of the state to the companies will be declared a period without calculation of interest on due taxes and insurance contributions; simplified procedures and shorter time-limits of the procedure for declaration of bankruptcy; increasing the personnel of the Public Financial Inspection Agency by 10 employees; initiating financial inspection in several large state-owned companies. The Ministry of Finance will publish detailed information monthly about the execution of the revenue and expenditure sections of the budget, with an attached analysis, including the balance on VAT, the developments of the foreign debt with attached economic analysis, condition of the fiscal reserve, broken down into foreign currencies and current profitability. Every quarter, the Ministry of Finance would collect and publish information about financial results of all major state-owned companies.

(4) Measures for providing additional financial resources to enterprises: Increasing the capital of the Bulgarian Development Bank and utilizing at least 60% of the attracted financial resources for supporting SMEs. Analyzing the possibilities for the Bulgarian Development Bank to use the branch network of Bulgarian Posts PLC; supporting the carbon dioxide quotas trading by firms and establishing tax and accounting regulations for such transactions; introducing changes in the regulatory regime for foreign investments; facilitating visa issuing procedure for tourists of Russia and Ukraine; introducing changes in the tax regulations in order to strengthen the financial independence of municipalities and determining waste-collecting fees according to the amount of waste generated.

(5) Measures for supporting household income: Creating a mechanism for increasing the level of minimum salary including both social and economic parameters; removing the upper limit on the amount of unemploy-

ment compensation and fixing it at 60% of the income on which social security payments are made; introducing obligation for all unemployed people to register in the Labor Bureau within 7 days after becoming redundant; optimizing the food voucher system; stopping the increase in the state regulated prices of products and services of public interest temporarily; creating a mechanism for guaranteeing the pension funds' deposits in Bulgarian commercial banks; providing additional financing from the budget for the Ministry of Labor and Social Policy for the public dining-rooms.

(6) Measures for supporting labor market: Measures for maintaining employment in enterprises with difficulties, financed by the operational program "Human Resources" and the national budget; providing additional financial resources for supporting subsidized employment within the National Employment Plan; increasing the workforce mobility through establishing a system for monitoring and distribution of qualified employees at sectoral and territorial levels; facilitating the regulatory regime for assigning different work tasks to employees in the same or different enterprises; restricting the labor market access of workers from third countries except for highly qualified employees; supporting young people in finding a first job within the operational program "Human Resources"; introducing legislation guaranteeing free competition and restricting market distortions caused by monopolistic pressures on suppliers of products and services; inspecting the situation of companies threatened by close-down due to incompatibility with the EU ecological requirements and providing allowed state aid; collection by the National Revenue Agency of information about unpaid salaries and provision of summarized quarterly data by economic activity, at regional and national levels; using the right of the Minister of Labor and Social Policy to impose industry collective labor contracts if there is a consensus in the industry councils for tripartite cooperation.

(7) Measures for supporting social security systems: Temporary suspension until the end of 2011 of the reduction of social insurance contributions; waiver of increasing health insurance contribution; introduction of electronic patient health card by the end of 2010; measures for control and increasing the collectability of funds in the budget of the National Health Insurance Fund (NHIF); persons without health insurance on other grounds shall pay insurance contributions calculated on the income

from capital and property; reforming the pension system; confirming the principle that the minimum salary guarantees the right to receive the minimum pension if other requirements are accomplished; increasing the amount of the sum payable to employees in case of the insolvency of the employer; introducing tripartite management of the NHIF; establishing the concept, stages, and steps in the reform of the health system; postponing the pension increase for the widows and widowers and pensioners older than 75.

Most of the anti-crisis measures implemented by the government were oriented toward limiting budget expenses rather than generating revenues. Therefore, they did not have the expected effect. The realization of the measures for fiscal support proved to be very problematic. Measures which were expected to generate the greatest revenues for the budget were not realized. The trading with greenhouse gas emissions was blocked by the EU. The privatization of state minority shares in private enterprises was delayed. A final tax on merchandize awards and cash prizes from games of chance and a luxury tax were not introduced. The fiscal support was accomplished mainly through a 20% decrease in the expenses of ministries and other institutions.

The most important measure for restoring the financial discipline was exercised partially. Although a mechanism for the delayed payments owed to the business by the government for public procurement projects was established through the Bulgarian Development Bank, a large part of the due payments were not made until the end of 2010. No mechanism was found to guarantee that the companies that received the delayed payments would pay delayed salaries to their employees. The government has taken steps to create public registers for the funds due on public procurement and European projects and to recover VAT and excise duty to companies within the legal time-limit. Efforts were made to accelerate delayed payments to beneficiaries of European funds and the advance payments to beneficiaries were increased to 35%. The Ministry of Finance started publishing monthly detailed information on the expenditures, revenues, foreign debt, fiscal reserve, and financial results of all the major state-owned companies.

Although the measures for providing additional financial resources for enterprises were implemented, they were few and insufficient.

The government also tried to implement measures for supporting household income. The upper limit on the amount of unemployment compensation was removed. The food voucher system was improved. However, there is still no mechanism for increasing the level of minimum salary. The government was not able to stop the increase in the state regulated prices of services of public interest temporarily.

Most measures for supporting labor market were implemented, but their effect was limited. Several measures for maintaining employment in enterprises with difficulties were implemented. Additional financial resources for supporting subsidized employment within the National Employment Plan were provided from the national budget. The system for monitoring and distribution of qualified employees on sector and territorial levels is in a process of implementation. The regulatory regime for assigning different work tasks to employees in the same or different enterprise was improved. In some industries collective labor contracts were imposed. Two important measures for supporting labor market are still not realized. Legislation guaranteeing free competition and restricting market distortions caused by monopolistic pressures on the suppliers has still not been introduced. The efforts to help companies to comply with the ecological requirements in the EU were not sufficient.

Most measures for supporting social security systems were implemented. The reduction of social insurance contributions was temporarily suspended until the end of 2011. The health insurance contribution was maintained at the current level. The government and the social partners agreed to participate in the management of the National Health Insurance Fund. The greatest achievement in this area was the agreement between the government and social partners on parameters of the pension reform. However, there is still no decision persons without health insurance on other grounds to pay insurance contributions calculated on the income from capital and property.

#### **2.4.6. SWOT Analysis of the SME Sector**

##### **Weaknesses**

From the self-evaluation of the SMEs, entrepreneurs/managers stated that their greatest weaknesses were the following: creation of own trade marks (brands), patents, and other intellectual property; participation in

cooperative networks and clusters; thin export positions. Other characteristics which were evaluated as rather weak were access to finance; implementation of innovations, and marketing research. Practically all these activities which are leading to the creation of sustainable competitive advantages in the nowadays globalizing economy, turned out to be weak or the weakest sides of the Bulgarian SMEs.

### **Strengths**

The self-evaluation of the SMEs evidenced that the entrepreneurs esteemed as their strengths the qualified staff closely related with the firms' education and training; improved opportunities to access information due to the more intensive use of the ICT; better planning and marketing research. Although these good practices were of a key importance for the SME survival during the crisis, these practices seem not sufficient to create sustainable competitive advantages, which firms will need while going out of the crisis.

### **Threats**

According the researched entrepreneurs, they were facing two groups of acute problems at the beginning of 2011. The first group was related to the impossibility of decreasing the costs any further and the lack of markets for their products and services. The second group included the danger of the increasing inter-firms indebtedness (which hampered the relationships with suppliers); the presence of a great part of a "grey economy" in the respective sectors; and the freezing of the enterprises' investment plans. The indicated problem areas were in fact the main threats to the growth and competitiveness of the Bulgarian SMEs. These threats could be translated as issues of the business environment, financial security and firms' stability, and an insufficient access to the united European market. There was also a threat, related to the family business transfer among the oldest entrepreneurs<sup>19</sup>.

### **Opportunities**

The definite opportunity for the progress of Bulgarian SMEs was the relatively high educational level of their proprietors/managers. A little more than half of them were high school graduates, while the share of those with a university degree was smaller, 11%. The persons with a univer-

sity degree among entrepreneurs were twice as many as the country average. Two thirds of the interviewed entrepreneurs declared that they made use of one foreign language, and one fifth of two and more languages. It is worth noting that the number of female entrepreneurs who spoke a foreign language and had a high school degree was significantly higher than that of male entrepreneurs. It was also encouraging that the attitude towards a second business chance (in case of failure) increased with the age decreasing. The orientation of the greater part of SMEs towards local market definitely helped them to survive in the period of crisis (when the external demands were falling down). At the same time, however exports (where the medium size firms prevail) outlined as leading for the economic recovery. It means that in the medium term these enterprises have better perspectives.

#### **2.4.7. Tasks for Improvement and Further Development of the National SME Sector**

The evaluations of the impact and the research on effects of governmental policies for SMEs show that these policies had both positive and negative effects (Czarnitzki, 2006). Heterogeneity of these effects is confirmed also by the OECD research about SMEs in the EU (OECD, 2007). These effects can be explained by different enterprise stages of development that received governmental aid. The main task of the approaches for formulating policies in the support of SMEs is to clarify whether the inferior performance of SMEs is due to market or governmental policy shortcomings. The policies for stimulating SMEs need experimentation and impact assessment (pre and post) and this requires appropriate cognitive infrastructure (Veugelers, 2008).

In the Eurobank EFG economic research report on the new European markets, it was noted that Bulgaria needed to move to the new model of development with the accent on competitiveness and export. The times when the foreign investments were the engine for the country economic growth were over with the beginning of the economic crisis. That is why the country should look for new sources of growth, based this time not on crediting and consumption, but on improving the competitiveness and stimulating the export (Eurobank EFG, 2010). Bulgarian SMEs could improve their competitiveness and achieve a higher degree of integration to the EU and other developed markets if they strengthen the institutional

and corporate capacity in the following directions:

- Improving the access to finance as the ground of all processes related to the SMEs' competitiveness and their business success;
- Promotion of innovation and patenting activity;
- Promotion of internationalization;
- Training of entrepreneurs and increasing the qualification of SME employees;
- Promoting the implementation of good management practices, related to more intensive ICT using, more employee training, and developing marketing and business planning;
- Improving the institutional environment;
- Improving the process of formulating adequate and on-time policies for promoting SME development.

The short-term policies influencing the development of the SME sector, on the one hand, should be directed toward improving access to financing. On the other hand, these policies should focus on enterprises with good practices, which are the most stable in crisis. By this way, institutional support will be directed exactly toward the enterprises which can help the whole SME sector to return to the growth levels before the crisis. The policies with middle and long-term impacts on the SME sector should be directed toward innovational activities of enterprises, whose development has a significant role in achieving higher competitiveness.

Regardless of the time horizon of the conducted policies, the key factor for the development of the sector is the investments in human capital. That is why continuing the policies of development of human resources will contribute to a more rapid recovery from crisis as well as to the achievement of high economical growth in the sector.

## **Bibliography**

Czarnitzki, D. 2006, Research and Development in small and medium-sized enterprises, the role of financial constraints and public funding, *Scottish Journal of Political Economy*, 56, 3, pp. 335-357.

European Commission. 2005. New SMEs definition. User Guide and Model Declaration. Enterprise and Industry Publications,

[http://ec.europa.eu/enterprise/enterprise\\_policy/sme\\_definition/sme\\_user\\_guide.pdf](http://ec.europa.eu/enterprise/enterprise_policy/sme_definition/sme_user_guide.pdf)

European economic statistic 2010, [http://epp.eurostat.ec.europa.eu/cache/ITY\\_OFFPUB/KS-GK-10-001/EN/KS-GK-10-001-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-GK-10-001/EN/KS-GK-10-001-EN.PDF)

Eurostat. 2011. Minimum wages in the EU in January 2011, [http://epp.eurostat.ec.europa.eu/statistics\\_explained/index.php/Minimum\\_wage\\_statistics](http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Minimum_wage_statistics)

OECD. 2007. Framework for the Evaluation of SME and Entrepreneurship Policies and Programmes, Paris

Ramalho, R. J. Rodríguez-Meza, J. Yang. 2010. How Are Firms in Eastern and Central Europe Reacting to the Financial Crisis? Enterprise Surveys 2010, [http://www.enterprisesurveys.org/Financial\\_Crisis](http://www.enterprisesurveys.org/Financial_Crisis)

The WB. 2011. Doing Business 2011 - Making a Difference for Entrepreneurs, <http://www.doingbusiness.org/~media/FPDKM/Doing%20Business/Documents/Profiles/Country/DB11/BGR.pdf>

The World Bank. 2009. Doing Business 2010 report. Reforming through difficult times, Washington, DC: World Bank, <http://www.doingbusiness.org/reports/doing-business/doing-business-2010>

Veugelers, R. 2008. The Role of SMEs in Innovation in the EU: A Case for Policy Intervention?, Review of Business and Economics, Volume LIII, No 3, July-September 2008, pp.239-262, <http://www.econ.kuleuven.be/tem/jaargangen/2001-2010/2008/RBE%202008-3/2008-3%20-%20Veugelers.pdf> ABSTRACT

WEF, The Global Competitiveness Report 2010-2011, <http://www.weforum.org/issues/global-competitiveness>

Yordanova, D. 2010. Succession in Bulgarian family firms. An explanatory investigation. In Surdej, A. and Wach, K. (Eds.), Managing Ownership and Succession in Family Firms, pp. 110-120, Scholar Publishing House: Warsaw.

\*\*\*\*

Ангелов, И. (Ред.) 1999. Българската икономика до 2001 и отвъд до 2010 година. Фондация Фридрих Еберт, София [Angelov, I. (Ed.) Bulgarian economy until 2001 and further to 2010. Fridrich Ebert Foundation, Sofia]

БСК 2011. Задълженията на фирмите достигнаха 157 млрд.лв. към началото на 2010 [Bulgarian Industrial Chamber. The firms indebtedness reached 157 billions BGN at the beginning of 2010], [http://www.bia-bg.com/1/1/MIW-gRW7I5WnIIWHUZK3YJS-c9O3IdOfMhKvYZe7gRK-UdOLU9OHUIKL\\_gdaPIRmXctiP](http://www.bia-bg.com/1/1/MIW-gRW7I5WnIIWHUZK3YJS-c9O3IdOfMhKvYZe7gRK-UdOLU9OHUIKL_gdaPIRmXctiP)

Eurobank EFG: Фискалната дисциплина подобрява шансовете на България за ERM [Eurobank EFG: Fiscal discipline improves the chances of Bulgaria for ERM] II, [http://www.dnevnik.bg/pazari/2010/03/02/867029\\_eurobank\\_efg\\_fiskalnata\\_disciplina\\_podobriava/](http://www.dnevnik.bg/pazari/2010/03/02/867029_eurobank_efg_fiskalnata_disciplina_podobriava/)

Изпълнителна агенция за насърчаване на МСП. 2011, Анализ на състоянието и факторите за развитие на МСП. Българските МСП в условия на криза, София [Bulgarian SMEs Promotion Agency. 2011. Analysis of the situation and the factors for SMEs development in Bulgaria, Sofia]

МИЕТ. 2010. Годишен доклад за състоянието и развитието на МСП в България 2008. София [Ministry of economy, energy and tourism. Annual report on the situation and SMEs development in Bulgaria 2008, Sofia]

МИЕТ. Конкурентни предимства на България (MEET. 2010. Competitive advantages of Bulgaria), <http://www.mee.government.bg>

Тодоров, О. 2008, Ролята на малките и средните предприятия в световните икономики - някои аспекти, Икономическа мисъл, 4/2008, с. 69-79 [Todorov, O. The role of SMEs in the world economies – some aspects, Economic thought, 4/2008].

## **2.5. GEORGIA**

Eteri Mamukelashvili

Chief Specialist, Ministry of Economy and Sustainable Development,  
Tbilisi, Georgia

### **Introduction**

After gaining independence in 1991, Georgia implemented extensive reforms. Converting the country's economy from Soviet socialist system to the free market economy required a lot of hard work and energy. Plenty of economic ideas and theories have been discussed. However, the process of altering the economy required changes in the entire public governance system as well as in people's mentality. Most of the successful reforms came about as a result of the Rose Revolution in 2004. Since then, the government of Georgia has cut taxes and reduced business regulation in order to stipulate attractive business environment and enhance foreign direct investment inflow. This ultimately helped to create jobs, stimulate entrepreneurial activity in various fields of the economy, and increase welfare of the population. Promoting the development of private sector is one of the main goals of country's economic policy. Therefore, the need to develop private enterprise in Georgia was at the heart of the reforms implemented after the Rose Revolution.

In addition to developing private enterprise, creating a transparent public sector was one of the main challenges of the Georgian democracy. In summary, the liberalization of Georgia's economy helped to create jobs, attract foreign investments, develop tourism, and improve the country's macro-economic indicators. This paper illustrates how liberal economic reforms promoted economic stability in Georgia, helped and will further assist to develop Small and Medium Enterprises (SMEs).

#### **2.5.1. National Economy and the SME Sector**

Georgia's economy demonstrates a positive outlook and Gross Domestic Product growth is much higher than forecasted. Based on the economic reforms, Georgian economy has been diversified showing an upward tendency. From 2004 to 2010 the real GDP growth of Georgia was 41%. In 2010, nominal GDP of Georgia constituted USD 11,663.4 million, while

in 2004 it was only USD 5,124.7 million. At the same period, GDP per capita increased by 37% and reached USD 2,629 in 2010. [1]

According to the preliminary data of the National Statistics Office of Georgia, the largest share in sectoral structure of GDP in 2010 was held by industry (16.9%) followed by trade services (16.6%), public administration (13%), transport and communication services (11.6%) and agriculture, forestry and fishing (8.4%). Double-digit real growth was posted in the following sectors: manufacturing (20.3%), financial intermediation (14.7%), trade (14.1%), transportation (13.1%), hotels and restaurants (12.9%), other community, social and personal services (10.4%). Moderate real growth was recorded in real estate, renting and business activities (8.6%), construction (7.6%), communication (6.5%), mining and quarrying (4.7%), health and social work services (3.1%), education (2.3%), electricity, gas and water supply (2.1%).

Creation of favorable business and stable macroeconomic environment made Georgia attractive for foreign investors. Therefore, during the past years, FDI inflow to Georgia has been characterized by an upward tendency. Namely, in 2006 FDI to Georgia amounted USD 1,190.4 million, which is a 164.7% increase compared to the same indicator of 2005. The share of FDI in GDP was 15.3%.

In 2007, the FDI amounted to USD 2,014.8 million, which is a 69.3% increase compared to 2006. It is notable that in 2000-2007, FDI inflow to Georgia increased by 15%.

In 2010, the FDI in Georgia amounted to USD 553 million, which is an 11% increase from 2004, but due to the economic crisis and war it decreased by 16% compared to 2009, and by 35% compared to 2008. The total share of major foreign direct investor countries reached 86% in 2010. Netherlands was a leader country by FDI in Georgia, whose investment amounted to USD 143.2 million in 2010. The biggest countries by FDI in Georgia in 2010 are as follows: Netherlands – 25.9% of total FDI; USA – 19.6%; Russia – 9.3%; International Organizations – 9.1%; Azerbaijan – 8.4%; United Arab Emirates – 7.2%; Turkey – 6.8%; Other countries – 13.7%. Breakdown of FDI by major economic sectors in 2010 was as following: Transportation and communication (35.1% of total FDI), Industry (16.4%), Financial sector (16.2%), Real estate (15.3%),

Other (17%). According to the Survey on External Economic Activities of Enterprises, economic activities were primarily financed by FDI in 2010, constituting 70% of total investments, which is followed by financial services and privatization with 21% and 9%, respectively.

Starting in 2003, Georgian foreign trade turnover is characterized by an upward tendency that is supported by the liberal trade policy provided in the country. Competitive trade regimes in Georgia are Free Trade Regime – with CIS countries and Turkey (since 1 November 2008); Most Favored Nation Regime (MFN) – with World Trade Organization (WTO) member countries; Preferential Regime (GSP) – with USA, Canada, Japan, Switzerland, Norway; Preferential Regime (GSP+) – with EU (7,200 items) since 2005.

Due to the implemented liberal reforms of the Government of Georgia, enhanced relations with partner countries and new bilateral treaties, Georgian foreign trade diversified. Georgia has concluded double taxation treaties with 27 countries and has bilateral treaties on investment promotion and protection with 32 countries.

Georgia remains strongly committed to WTO as the primary basis for its trade policy. Georgia firmly believes that the best way to meet challenges facing an increasingly globalized world economy is trade liberalization. The basic objectives of the trade policy of Georgia are: integration into the world economy, which implies implementation of obligations undertaken by joining WTO and other international agreements; trade policy liberalization, including simplification of export and import procedures and tariff and non-tariff regulations; and diversification of trade relations by concluding free trade agreements with main trading or regional partners. Georgia has a very liberal trade regime with simplified trade procedures; there are no quantitative restrictions on export/import and no tariff quotas. There is also effectively no tariff escalation nor any tariff peaks.

In accordance with the Georgian legislation, no tariff duty is applied to export or re-export from Georgia. Export is exempted from VAT as well. Georgia does not use minimum export prices and export subsidies. There are no non-tariff restrictions (prohibitions, licensing) in international

trade included in the Georgian legislation except those cases where health, security, safety and environmental issues are concerned. The share of goods subject to non-tariff restrictions constitutes about 1% of the whole nomenclature.

Due to the reforms carried out by the Government of Georgia in 2003-2008, the barriers to foreign trade decreased tremendously, resulting in increased volumes of export and import flows. Whereas in 2000-2002 the average annual growth of trade turnover was 7.2%, this figure increased substantially in 2003-2008 and constituted 38.8%.

In 2010, Georgian foreign trade turnover amounted to USD 6,678.5 million, which is 21% more than in the previous year and 45% more than in 2006. This amount almost tripled compared to the 2004.

In 2010, Georgian export amounted to USD 1,583.4 million, which also almost tripled compared to 2004, increased by 69% compared to 2006 and by 40% compared to 2009. Traditionally, main export products of Georgia have been agricultural products (mineral waters, wine, nuts, and citrus). The structure of Georgia's export has changed in recent years and added to agricultural products were ferroalloys, copper ores, fertilizers, gold, medicaments, textile etc. Ferroalloys were the main commodity in Georgian export in 2010. Exported ferroalloys amounted to USD 263.9 million (16.7% of total export). Other important commodities in Georgian export are motor cars (14.4% of total export), ferrous waste and scrap (6.9%), gold (5.4%), mineral or chemical fertilizers, nitrogenous (4.6%), copper ores and concentrates (4.5%), nuts (4%), under nated ethyl alcohol, spirits, liqueurs and other spirituous beverages (3.4%), copper waste and scrap (2,6%), wine of fresh grapes (2.5%) etc.

In 2010, import reached USD 5,095.1 million (17% more than in 2009, 39% more than 2006 and 176% more than 2004). Main import products are petroleum, oil and gas, motor cars, medicines and different machinery. In 2010, main commodities in Georgian import were petroleum and petroleum oils (13.6% of total import), motor cars (6.1%), medicine (3.7%), wheat (3.4%), petroleum gases and other gaseous hydrocarbons (2.6%), electrical apparatus for line telephony or line telegraphy (2.2%), cigars (1.6%), sugar (1.5%) etc. In 2010, share of 10 biggest trade partners (Turkey, Azerbaijan, Ukraine, Germany, China, United States of

America, Russia, Armenia, Bulgaria, United Arab Emirates) in Georgian total foreign trade turnover amounted to 67%.

Well-being of population increased during the last decade: average monthly income of the total Georgian population increased by 66%, average monthly income per household grew by 68% and average monthly income per capita rose by 73% within the period of 2004-2008 due to growing salaries and job creation. According to the integrated studies of households and labor force, the level of income was characterized with an upward trend.

During the recent years, wages have been permanently increasing in both public and private sector. The same trend is fixed in average monthly nominal wage. Average monthly nominal salary increased by 4 times in the period 2004-2009.

The government developed tourism infrastructure for the facilitation of tourism sector, restored different tourist centers, and improved transportation. The number of non-resident visitors at national borders of Georgia increased by 6 times for the period 2004-2010. In 2010, number of arrivals of non-resident visitors at national borders of Georgia equaled to 2,032,586 (in 2004 it was only 368,312), which is a 36% increase compared to the previous year. Development of tourism positively influenced different sectors of the country's economy, such as transportation, production of primary agricultural products, service – including hotels and restaurants, trade etc., generating income for local enterprises, especially for SMEs and spreading economic benefits of tourism throughout the country. In 2010, a new airport was constructed in the mountainous region of Georgia (Svaneti, Mestia), which aspires to become one of the leading tourist attractions in Georgia.

Economic recovery and positive trends are reflected in the business sector in 2010. All indicators of business related figures are increasing. Deposits increased by 33% and loans increased by 2%. Compared to 2004, deposits and loans increased in 2010 by 5 and 7 times, respectively. In 2010, total turnover of business sector increased by 14% compared to 2009 and by 3 times compared to 2004. Furthermore, employment increased by 3% compared to 2009.

As mentioned above, during the last couple of years, Georgian government implemented broad and comprehensive reforms that touched every aspect of the country's life. These reforms included simplification of licensing procedures. The number of licenses and permits required in Georgia are at minimum, and rules for obtaining them are simple. [2] From 2003 to 2010, number of licenses and permits in Georgia decreased almost by 88%. There are only 103 licenses and permits (49 licenses and 54 permits) required in the country in 2010. Currently, licenses and permits are only used in the production of highly risky goods and services; usage of natural resources and specific activities. The procedures of issuing licenses and permits were significantly simplified, the "one-stop shop" and "silence is consent" principles were introduced which implies that if the person is not notified with rejection about issuance of license in limited framework, the license is considered as issued from the relevant body.

In the direction of promoting the development of private sector and enhancing sustainable economic growth, an important step by the Government of Georgia was Liberalization Tax Code – number of taxes and rates as well were significantly reduced. In 2004, there were 22 different taxes in Georgia. Numbers of taxes and tax rates have been gradually decreased. Since 2004, only 6 taxes have been in place out of the original 22: Value Added Tax (0% and 18%), Personal income tax (20% flat), Corporate Income Tax (15%), Import tax (0%, 5% and 12%) (only on agricultural products and construction materials), Excise (depends on the type of good) and Property tax (up to 1%).

Out of the six taxes in Georgia, five (Personal Income Tax, Corporate Income Tax, Value Added Tax, Excise Tax, and Import Tax) are state-wide, and one (Property Tax) is a local tax. There are no capital gains, inheritance, wealth, property transfer, social, branch remittance, or other taxes imposed in Georgia.

In 2008, corporate income tax reduced from 20% to 15%; Payroll taxes (personal income PIT and social tax) merged into one and weighted average tax rate was reduced from 27% to 25%. In 2009 reforms carried out towards reduction of tax burden were as follows: Income Tax rate was reduced from 25% to 20% and Tax rates for dividends and interest payments were reduced from 10% to 7.5%. The fact that the government

reduced taxes in Georgia resulted in the increase of tax revenues by 2.6 times from 2003 to 2006.

In 2007, unified Revenue Service of Georgia was established. Revenue Service merged into one tax, customs and financial police agencies. Since then, taxpayers have only one single governmental agency to deal with regarding tax issues.

Effectively functioning public institutions and rule of law led to dramatic reduction of informal activities. At the same time, better administration and simplified business regulations provoked the rapid growth of tax revenues. Customs and tax revenues increased by 11% from 2009 to 2010, and by 100% from 2005 to 2010.

A new "Tax Code" was elaborated in Georgia which is in force from January 2011. This new "Tax Code" provides more simplified procedures for doing business and special treatment (incentives) for micro and small businesses that will serve as an additional incentive for business development and overall economic growth. The new Tax Code aims to increase confidence towards the Georgian tax system and enhance trust in the Georgian tax authorities, by improving communication between taxpayers and tax authorities, by protecting taxpayers' rights, by making administration more efficient, and by harmonizing the Georgian laws with the best international tax practices. The new Tax Code offers low tax rates on existing taxes, or increased exemptions. Withholding taxes on interest and dividends will be eliminated by 2014. Individuals will also benefit by 2014 from the gradually reduced personal income tax rate of 15%. Micro and Small Business status shall reduce overall administrative and tax burden on individual taxpayers. The simplified rules for obtaining a residency status of Georgia is an opportunity for "high net worth" individuals, as they can become Georgian residents without their actual presence in Georgia.

Extended filing periods, automatic refunds, and simplified taxation on imports comprise the constantly expanding list of benefits offered to taxpayers. Income and gain received from listed securities and Government bonds have been exempted from taxation for both corporate and individual taxpayers. It is also noteworthy that Georgia already started convergence to European tax standards, in that it has recognized the

technical regulations of the OECD, and has introduced the generally accepted transfer pricing rules within the new Tax Code. This fact will consequently promote the development of the business environment and cross-border trading. Georgian tax legislation offers another unique opportunity to serve offshore companies in the most efficient and least costly way. International Financial Company, a financial institution established in accordance with Georgian tax legislation, carries out most of its services with parties outside of Georgia. [2]

A new Georgian Customs Code was established to simplify customs procedures. Customs Tariffs Reform significantly simplified and sharply reduced costs related to foreign trade. The number of import tariffs was abolished on approximately 90% of products and only 3 tariff rates (0%, 5%, 12%) exist instead of the previous 16. Georgia sets custom taxes on only certain kinds of agricultural goods and constructing materials. In addition, there are no quantitative restrictions (quotas) on imports and exports, as mentioned previously.

A Law on "Free Industrial Zones" (FIZs) was adopted. According to government's decision or on a basis of an initiative of physical person/legal entity, such a zone can be created on more than 10,000 square meters. Companies, acting within the zone, are exempt from profit, property and value added taxes. Besides, the import of goods, produced in the free industrial zone to the other regions of Georgia (outside the free industrial zone), as well as the export of foreign goods to the free industrial zone is exempt from customs tax.

Therefore, the Law of Georgia on Free Industrial Zones and the Tax Code of Georgia give manufacturers a unique opportunity to process, produce and export goods with a minimum tax burden. With Georgian Free Trade Agreements, one can export goods free of trade barriers to global markets consisting of over 300 million consumers. Thousands of goods can be exported from Georgia to the EU market, free of trade barriers under the GSP+ arrangements.

In 2010, among several new governmental initiatives was the creation of "Free Tourist Zones" aimed at the tourism development which has a high growth potential. Investors in construction of hotel facilities will enjoy tax

incentives (exemptions from Profit and Property Taxes for 15 years). Two FIZs have already been established in the western part of Georgia - Poti and Kutaisi.

Free Warehouse Company, from a taxation perspective, is designed as an integral logistical unit for international transit companies. The benefits include: exemption from corporate income tax applied to income received from re-exporting goods from free warehouses via the Free Warehouse Company and exemption from VAT on the supply of goods by a Free Warehouse Company to a VAT payer in a free warehouse. The Free Warehouse Company categorization can be effectively used by international cargo companies, large regional network distributors, and by any stakeholder desiring to transport goods from Central Asia to global economic markets, or vice versa, in the fastest and least costly way.

The removal of technical barriers for Georgian goods and services on the international market is an essential precondition for the further economic development of Georgia. In order to reach this goal, the reform of technical regulation system was implemented in Georgia, which ensured the removal of technical barriers in international trade, the improvement of investment environment, consumer rights protection, the increase of access of Georgian goods to the foreign markets, the implementation of obligations under the requirements of WTO, which basically includes the transformation of national mandatory standards into the voluntary standards, the eradication of corruption, and service transparency in the field of technical regulation.

As a result of the reform, national mandatory standards system was replaced by the voluntary standards and the state's regulating role in this system was minimized. This process is supposed to facilitate the expansion of entrepreneurial activity significantly. The introduction of voluntary standardization in Georgia gives entrepreneurs the opportunity to select the standard for their activities registered in the country, to use the standard of any country or any regional or international standard, to register standards in Georgian National Agency for Standards, Technical Regulations and Metrology and to use them for entrepreneurial activities, to elaborate their own standard for new goods, register it in the national agency and use it in entrepreneurial activity and obtain consultations for the selection and elaboration of standards.

Starting from 2004, provision of aggressive and transparent privatization policy was one of the important reforms of Georgian Government that was addressed to denationalization of the remaining state property in order to attract foreign investments, develop the private sector and effectively use the country's resources.

In 2010, Law on Information Technology Zones was passed. According to this law, incentives are provided to entrepreneurs in terms of exemptions from property tax and VAT in case of services export.

Georgia's geographical location creates an extra benefit for the country strategically. Georgia is situated at the crossroads of Europe and Asia. This creates the opportunity to transit goods from Asia to Europe, and vice versa. The country is spread between the Black and Caspian seas. Georgia is bordered by Turkey and Armenia in the south, by Azerbaijan in the east, and Russia in the north.

Georgia is pleased to emerge and serve as a physical and political bridge connecting European and Western markets to the vast Caspian/Central Asian potential, through an ongoing implementation of several major energy and transportation projects.

### **SME Sector Development**

Georgia is fully aware of the importance of the SME sector's contribution to the economy. It is considered to be a major tool in achieving various socio-economic objectives, such as employment generation, contribution to national output and exports, fostering new entrepreneurship and providing depth to the industrial base of the economy.

According to the Law on "The National Investments Agency of Georgia," Small and Medium Enterprises are classified as follows: An enterprise with an average number of annually employed not more than 20 persons and an annual turnover of not more than Georgian Lari - GEL 500,000 is defined as a small enterprise, and an enterprise with an average number of annually employed not more than 100 persons and an annual turnover of not more than GEL 1.5 million is defined as a medium enterprise.

As was previously mentioned, the new "Tax Code", which came in force as of January 2011, provides simplified procedures for Micro and Small

businesses. According to the New "Tax Code", Micro and Small businesses are covered by special tax regimes.

The status of Micro Business is given to a physical person who is not using hired persons and is conducting economic activity independently, with an annual total income that doesn't exceed GEL 30,000.

The Ministry of Finance of Georgia is responsible for giving and abolishing the status of Micro Business. The tax organ is responsible for giving a certificate for the Status. After the New "Tax Code" came into force, 4,575 new micro businesses were registered with the ministry of finance of Georgia from January 2011 to June 2011.

A physical person who has a Micro Business Status is free from income tax and current taxes.

The status of Small business is given to a physical person/an individual/sole entrepreneur whose annual total income from economic activity doesn't exceed GEL 100,000.

Small Business is taxed with one single tax. Tax rate for Small Business is 3% or 5% of income. Removing requirements of book keeping is in conformity with international standards. In the case of 5% tax rate, Small business is obliged to run only simple "purchases and sales journal" and cash registers. In the case of 3% tax rate, 60% of the income must fall on expenditures/consumptions, proved by documentations.

In 2010, 39,003 enterprises were operating in the country, among which the ratio of small enterprises was 81.5% (31,772) and that of medium size enterprises was 10% (3,733). In essence, most businesses in Georgia are small and medium enterprises. The number of enterprises in 2010 increased by 2% compared to the previous year and by 43% compared to 2004. The number of small and medium size enterprises increased by 15% in 2010 compared to 2009 in Georgia and by 35% compared to the same data for the year 2004.

In 2010, 42% of total employees in enterprises were working in small and medium enterprises, 20% in medium size enterprises and 22% in small size enterprises. The number of employees in small and medium

size enterprises decreased by 8% in 2010 compared to 2009 and by 1,5% compared to 2004, but the previous years were characterized by incensement of employment in SMEs. In 2009 number of employees increased by 18% compared to 2008.

Employment distribution in business sectors in 2010 by kind of economic activity is as follows: Industry – 24%, Trade – 17%, Health and social work – 16%, Transport and communications – 14%, Construction – 8%, Real Estate – 8%, other – 13%.

60% of employees in business sectors in 2010 were employed in the capital of the country, in Tbilisi, followed by Kvemo Kartli Municipality – 8%. Average monthly remuneration of employed persons in small enterprises increased by 5% in 2010 and in medium size enterprises by 25% compared to 2009 and the same data in small enterprises increased by 5 times and by 4 times respectively compared to 2004.

Turnover of small size enterprises in 2010 constituted USD 1,006 million which is 22.5% more than the same data for the year 2009, showing an increase by 100% compared to 2004. Turnover of medium size enterprises in 2010 constituted USD 1,023.4 million, which is 7% more than the same data for the year 2009, showing an increase by 33% compared to 2004. In 2010, the ratio of small enterprises in total turnover was 8% and the ratio of medium size enterprises was 9%.

Output of small size enterprises in 2010 constituted USD 594.7 million, which is 20% more than the same data for the year 2009, having tripled since 2004. Turnover of medium size enterprises in 2010 constituted USD 617.3 million which is 4% less than the same data for the year 2009 and showing an increase by 100% compared to 2004. In 2010, the ratio of Small enterprises in total output was 9% and the ratio of medium size enterprises was 9%.

### **2.5.2 Legislation and Ranking of Doing Business According to World Bank Methodology**

Georgia is the most active country worldwide in reforming business regulation, according to Doing Business 2011. Among the world's 174 (total 183) economies, Georgia improved its business environment the most in

the last five years, according to Doing Business 2011: Making a Difference for Entrepreneurs, the eighth in a series of annual reports published by International Finance Corporation (IFC) and the World Bank. By this measure, Georgia has been the most active worldwide in reforming business regulation and is number one in the list. Georgia has also been recognized as top 10 Doing Business reformers in previous years.

The Doing Business 5 year measure (from 2006 till 2011) of cumulative change illustrates that doing business became the easiest in Georgia. Georgia takes the first position in this ranking. This figure shows the distribution of cumulative change across the 9 indicators in the time between Doing Business 2006 and Doing Business 2011.

Georgia improved access to credit by implementing a central collateral registry with an electronic database accessible online. Georgia strengthened investor protections by allowing greater access to corporate information during the trial.

Incidentally, Georgia made the enforcement of contracts easier by streamlining the procedures for public auctions, introducing private enforcement officers and modernizing its dispute resolution system and improved insolvency proceedings by streamlining the regulation of auction sales.

In Doing Business 2011, Georgia takes the 12th position in Ease of Doing Business ranking. Georgia's ranking improved by 1 position compared to the previous year. In Ease of Doing Business Ranking, Georgia took the 15th place in 2009, the 18th place in 2008 and the 37th place in 2007. According to Doing Business 2011, compared to the previous year's same report, Georgia improved its condition in Ranking in the following measures of regulations: Getting Credits (by 15 positions), Paying Taxes (by 3 positions) and Protecting Investors (by 21 positions). Georgia's position was lower in the following measures of regulations: Starting a business (by 3 positions), Trading across borders (by 5 positions), Closing a business (by 10 positions). No change was indicated in the following: Dealing with construction permits, registering property and enforcing contracts. Georgia is listed among the countries where starting a business is the easiest. It requires only 3 days to start a business in Georgia and in this indicator Georgia takes the 3rd position among the countries in the

fastest group. Georgia is placed among the countries where dealing with construction permits and registering property are the easiest.

In *Doing Business 2011*, Georgia is ranked 8th overall for Starting a Business and 7th overall for Dealing with Construction Permits among the countries with good practice. Georgia is ranked 2nd overall for Registering Property among the countries with good practices.

In *Doing Business 2011*, Georgia is ranked 15th overall for Getting Credit, 20th overall for Protecting Investors, 61st overall for Paying Taxes, 35th overall for Trading Across Borders, 41st overall for Enforcing Contracts and 105th overall for Closing a Business.

One-stop shops are starting to expand beyond business registration formalities. In Tbilisi, Georgia, a public service center assists entrepreneurs not only with business licenses and permits but also with investment, privatization procedures, tourism-related issues and state-owned property management. According to a survey in 2008, senior managers in Georgia spend only 2% of their time dealing with regulatory requirements, and 92% of firms report spending less than 10% of their time on such requirements. By saving time, Georgian entrepreneurs save money, too. Another survey in 2009 found that the simplified procedures provided by the service center helped businesses save an average of 3.25% of profits that year. For all businesses served, this amounted to direct and indirect savings of USD 7.2 million.

After 6 years of steady improvements, Georgia has the most efficient permitting system. To comply with formalities in Tbilisi it takes 98 days, far fewer than the regional average of 250 days.

Georgia now allows property transfers to be completed through 500 authorized users, notably banks. This saves time for entrepreneurs. A third of people transferring property in 2009 chose authorized users, up from 7% in 2007. Georgia's new electronic registry managed 68,000 sales in 2007, twice as many as in 2003.

Improvements in customs clearance procedures, coupled with greater trade, contributed to a 92% increase in value added tax revenue (60–65% of which is collected at the border) between 2005 and 2009.

Enforcement of judgment was made more efficient in Georgia. Private enforcement officers were introduced alongside state enforcement agents, increasing enforcement capacity. Debtors can now pay creditors the outstanding debt before the closing of an auction to avoid the sale of their assets.

Georgia combined the state and private models, introducing private bailiffs in 2008 alongside the state bailiffs to increase enforcement capacity. Since 2009, the Georgian Ministry of Justice has issued 38 licenses to private enforcement agents.

According to the World Bank report *Investing Across Borders 2010 (IAB)* Georgia is one of the most open countries to foreign equity ownership among 87 countries as measured by the Investing Across Sectors indicators. Georgia is fully open to foreign investment for all of the 33 sectors covered by the indicators. There are neither sectors with monopolistic or oligopolistic market structures nor any perceived difficulties in obtaining any required operating licenses. With only 4 procedures and 4 days, Georgia is among the fastest countries in the world in terms of establishing a foreign-owned limited liability company (LLC). A foreign company requires no additional procedure other than the authentication of the parent company's documents abroad. According to the new order on the Approval of Instruction on State and/or Tax Registration Procedure of Taxpayers and Branches, a company must be registered on the same day of filing or the following day. The application is available online. Registering with the Entrepreneurial Register and obtaining an identification number and a certificate of state and tax registration are required in order to commence the company's activities. Companies in Georgia are free to open and maintain bank accounts in foreign currency. There is no minimum capital requirement for foreign or domestic companies. As of 2008, evidence of contribution to the company's capital is no longer required.

A foreign company can start a business in Georgia in less than a week. It's remarkable that companies can't start a business in a shorter period than in Georgia in any of the other countries investigated. In Tbilisi, Georgia's capital, registration of land-related rights has become a simpler and quicker process due to a law that was adopted in 2008. Both privately and publicly held land may be leased or bought. Lease contracts can be of unlimited duration. There are no restrictions on the amount of

land that may be leased. The time required to lease land from a private holder is about 1 week in Georgia.

In Forbes' "Best Countries for Business 2010" rating Georgia improved its position by 3 steps and now ranks 61st among 128 countries. In the same ranking for the year 2009, Georgia ranked 64th. According to Forbes, in 2010, Georgia improved its condition in the following indicators: Trade Freedom (rank 5) and Tax Burden (rank 44). Areas of recent improvement in Georgia include growth in the construction, banking services, and mining sectors. Georgia has overcome the chronic energy shortages and gas supply interruptions of the past by renovation hydro-power plants and by increasingly relying on natural gas imports from Azerbaijan instead of Russia. The construction on the Baku-Tbilisi-Ceyhan oil pipeline, the Baku-Tbilisi-Erzurum gas pipeline, and the Kars-Akhalkalaki Railroad are part of a strategy to capitalize on Georgia's strategic location between Europe and Asia and to develop its role as a transit point for gas, oil and goods. Georgia had historically suffered from a chronic failure to collect tax revenues; however, the government, since coming to power in 2004, has simplified the Tax Code, improved tax administration, increased tax enforcement, and cracked down on petty corruption.

Forbes' "Best Countries for Business 2010" rating involves the following indicators: GDP Growth, GDP per Capita, Trade balance as % of GDP, Population, Budget balance as % of GDP. Sources for the above-mentioned ranking are: Heritage Foundation (Economic Freedom Index); World Economic Forum (Global Competitiveness Report); Transparency International (Corruption Perceptions Index) etc.

In "The Global Competitiveness Index ranking 2010–2011" Georgia takes the 93rd position among 139 countries (with a score of 3.9). In 2009–2010, Georgia ranked 90th among 133 countries.

Moody's Investors Service assigned first-time Ba3/Not-Prime foreign and local currency issuer ratings to the government of Georgia in 2010. The outlook is stable. The decision to assign a rating of Ba3 reflects: The country's progress in building social, political and economic institutions and providing a healthy operating environment for business that is unique in the region; The government's proactive response to the global crisis and the 2008 conflict with Russia, which has addressed the curtail-

ment in foreign direct investment (FDI) and other capital inflows and maintained affordable debt service; Geopolitical risks due to the unresolved conflict with Russia.

Georgia's rating reflects marked progress in recent years in building institutional capacity that attracted substantial capital inflows and boosted growth while keeping government debt at affordable levels. Early in the decade, Georgia was stricken by widespread corruption and highly ineffective political leadership. However, this landscape was transformed following the Rose Revolution of 2003, which ushered in extensive economic and political reforms. In particular, the government introduced a liberal economic platform, with emphasis on improving the business operating environment. The authorities undertook a major effort to combat corruption, which led to a rapid improvement in government effectiveness. These reforms delivered strong growth, which was interrupted first by the conflict with Russia and then by the global downturn, but economic activity has recovered briskly so far this year. Over the medium to long term, the economic model is dependent on private capital inflows to deliver strong growth, but the FDI inflows have yet to reach their pre-crisis levels. However, generous aid solicited from the international community following the conflict with Russia and proceeds from the IMF stand-by program are more than covering any shortfall at present. Remittances, which correspond to roughly 10% of GDP, have largely recovered.

In Moody's opinion, the Georgian government has a credible programme to reduce the budget deficit from over 9% of GDP last year to 2%-3% within the next few years.

According to the Transparency International's "Global Corruption Barometer 2010", Georgia ranks the first among world countries in terms of decreasing corruption level. According to "Global Corruption Barometer 2010", 78% of surveyed people in Georgia claimed corruption level was decreased. Georgia is among the list of top world countries where corruption level is the least. 77% of surveyed people in Georgia considered the government's actions in the fight against corruption effective. About seven out of 10 respondents in Georgia consider their government's actions as being effective or extremely effective.

In the Paying Taxes 2011 – the Global Picture's "Ease of Paying Taxes Ranking", Georgia, compared to the previous year, improved its condition

by 3 positions and ranks 61st among 183 countries. In the Paying Taxes 2010 "Ease of Paying Taxes Ranking" Georgia took the 64th position. Compared to the Paying Taxes 2010, Georgia improved its position in the "Time to comply ranking" too in the Paying Taxes 2011 by 2 positions. Georgia is in the list of 10 countries where the Total Tax Rate is the lowest.

Standard & Poor's Ratings Services revised Georgia's outlook from stable to positive and at the same time affirmed country's "B+" long-term and "B" short-term sovereign credit ratings on the sovereign in March 2011. Standard & Poor's also affirmed Georgia's recovery rating "4". The "BB" transfer and convertibility (T&C) assessment on Georgia remained unchanged. Standard & Poor's Ratings Services outlook revision reflects their view of the likelihood of an upgrade if external performance continues to improve, allowing the country to build reserves and reduce its reliance on external funding, while also abating inflationary pressures. The company expects Georgia's external performance to improve, reducing external financing needs and inflationary pressures. The ratings on Georgia are constrained by diminishing but still considerable external, monetary, and political risks, and supported by good economic growth prospects and ongoing fiscal consolidation.

Following GDP growth of an estimated 6.4% in 2010, driven by a recovery in export growth and a rebound in credit growth to the private sector, Standard & Poor's Ratings Services expects that the Georgian economy will recover more rapidly than was anticipated. The company expects growth in the short term to benefit from an extension of public sector investment in infrastructure, energy, agriculture, and tourism. In the medium term, Georgia will be less reliant on donor grants and concessional funding.

According to the Global Economic Forum's "The Global Enabling Trade Report", Georgia takes the 37th place among 125 countries in "The Enabling Trade Index 2010". In The New York Times ranking "Best Places to Go in 2011" Georgia takes the 6th place. The magazine focuses on Georgia's high mountain resorts: "Georgia - A rustic ski wonderland on the verge of discovery. Tucked between the Black and Caspian seas and smattered with mountains, Georgia has the kind of terrain adventurous skiers yearn for: peaks reaching 16,000 feet, deep valleys and largely untouched

slopes. Known best for spectacular off-piste and heli-skiing, Bakuriani and Gudauri — each a short drive from Tbilisi — saw 30,000 visitors in 2009 and are expanding fast. And now, in efforts spearheaded by the Georgian president Mikheil Saakashvili, the ski-resort bug is spreading even further. In Mestia, the first groomed slopes of a new resort opened in December. Also earmarked as a winter hot spot is Goderdzi pass which can have snow coverage six months a year.”<sup>20</sup>

Fitch Ratings has revised the Outlook on Georgia’s Long-term foreign and local currency Issuer Default Ratings (IDR) to Positive from Stable and affirmed them at “B+” in 2011. The agency has also affirmed Georgia’s Short-term IDR at “B” and Country Ceiling at “BB-”. Fitch Ratings has assigned Georgia’s USD 500 million Eurobond, due 12 April 2021, a rating of “B+”. The Positive Outlook reflects Georgia’s strong economic recovery, a reduction in both the budget and current account deficits, an improvement in the financial sector’s health and some easing of political risk. The Georgian economy is recovering strongly, benefiting from the global economic recovery, large-scale international donor financing and an apparent improvement in trade performance. Fitch estimates a real GDP growth of 6.5% in 2010, after a contraction of 3.9% in 2009. The agency projects that the relatively strong GDP growth will continue; forecasting 5.0% and 6.0% for 2011 and 2012, respectively. Georgia’s ratings are underpinned by its level of human development, which is well above the “B” range median, a favorable business climate (underscored by Georgia’s 12th spot in the World Bank’s Ease of Doing Business rankings), low corruption and generally sound governance, strong GDP growth prospects, a track record of relatively low inflation and strong support from the international community.

### **2.5.3. SME Support Infrastructure**

The strategy to support and foster entrepreneurship development in Georgia includes creating an appropriate climate to improve access to finance for SMEs and to conduct policy and legislative reform; improving quality standards within the business community; increasing private sector participation in economic activities; professional and entrepreneurial education connection enhancement; assistance to start-ups; Entrepreneurial Education availability system development; maintaining program diversification; harmonizing the education system with the European and

international educational systems; training competitive staff for inter and international labor market satisfaction; supporting social partnership among the government, employer, professional unions, education providers and etc.

In order to identify Entrepreneurial Education Demand, surveys have been conducted by different organizations and institutes. Surveys include market tendencies general evaluation, labor market survey, market demand investigation, new market and product testing, entrepreneurial management evaluation and etc. Some demand areas identified in Entrepreneurial Education were Agriculture; Tourism; Handicraft; Construction; Information technologies and other fields. Training courses, programs and consultations involve Management; Marketing; Finance and Accounting; Licenses and Permits; Procedures for Incorporation; Business Planning; Starting Business; Human Resource Management; Service providing; Advertising, Communication; Design and Structure of Organization; ISO standards, GSP, GSP+ and others.

The scope of Governmental Employment Program for Small and Medium Business Development (2007) was to increase employment in Georgia, support regional economic development infrastructure and help the activities of small and medium enterprises through facilitating their access to credit. The aim of this program was also to provide vocational education for unemployed people in professional education centers. The beneficiaries of this program were small and medium enterprises operating in tourism business including start ups, which could provide jobs. Beneficiaries were selected by a bank through government credit. Government gave financial resource to a bank (which was selected by competition) to operate the program. Credit was given with a small interest rate for a 5-year period. Maximum volume of credit was GEL 50,000. GEL 5.5 million was allocated from the budgets for this program. Donor organizations were also involved in the program to conduct trainings, consultations, marketing and consultations. [16] As a result of this program more than 2,000 persons were trained. It appeared that volunteers were more than the program could cover.

The scope of the Governmental Program for professional skills training (2007-2008) was labor professional skills training and qualification development in labor market through government financing. The actors of this

program were persons willing to undergo professional skills training and professional training centers involved private companies demanding qualified labor. Person's age limitation was 25-65 years. During the 3-month period, Government financed labor salaries, while they improved their working skills in enterprises. As a result, about 114,000 persons were trained within this program, in the field of service, construction, manufacturing, industry and etc. [17] About 10% of the beneficiaries began working in the chosen training centers.

The aim of the Governmental program for professional education infrastructure development – Vocational Education for employment (2008) was to raise private sector's role in vocational education and to support satisfaction of labor demand with qualified trained human resources. To ensure this, government property was given to physical and private entities for the establishment of professional schools. The program's objective is to establish 50 professional training centers and to attract investments in this direction. Established professional training centers must maintain the profile of training centers for 7 years. [18]

The aim of the Governmental Program Cheap Credit (2008-2009) was to provide cheap credit for private enterprises, to establish new enterprises, to develop existing jobs and to create new jobs. The volume of credit was minimum GEL 20,000; Term of credit use was maximum 10 years. Interest rate was maximum 9%, grace period was maximum 3 years. Beneficiaries of this program were small and medium start ups in the field of agriculture, handicraft and other sectors. Government financing included following businesses: Reproduction of fruits and vegetables, Receipt and reproduction of tea, Tourism, Handicraft, Delivery of grapes and production of drink, Recipient points of milk and meat, Reproduction of nuts and cereals (wheat, sunflower seeds), Reproduction of timber, Production of briquette and wood-shaving tiles, Factories of poultry raising, Production of shoes and textile and others. Legal entity of public law "fund of municipal development of Georgia" implements documental monitoring and provides information to the Ministry of Economy and Sustainable Development of Georgia monthly and quarterly. The Ministry of Economy and Sustainable Development of Georgia, for its part, implements the evaluation of ongoing projects and plans work meetings in entrepreneurships. 130 projects were financed within the framework of "Cheap Credit" program with a total value of GEL 65 million (approximately USD 43 million). [19]

Presidential Program for Professional Education Centres Rehabilitation aimed at the rehabilitation of existing professional education centers. In the frame of this program, 10 professional education centers and 3 vocational education institutes were rehabilitated. Rehabilitation involved full renovation and providing the centers with modern equipment. [20]

Tbilisi city hall offers free computer and English courses, Computer and English Free Courses, Study to Be Employed. The basic knowledge of computers and English will assist the population to find jobs. Tbilisi city hall gives a chance to each citizen from the age of 23. People who wish to study English and computer skills should apply to the local administrative bodies. Tbilisi city hall will assist the successful ones to be hired at private companies and at governmental bodies.

In the frame of "Local Business Support Program" (since 2006), "Start the Business with the City Hall" projects are financed supporting tourism development; entrepreneurship development; supply of ecological products in different regions of Georgia; and the development of the territory of Tbilisi. More programs are financed in the trade field. Terms of Credit are as follows: Minimum amount – 5,000 GEL, Grace period – 2-3 month, Term of credit validity – maximum 60 months, Interest Rate – 4% per year. Beneficiaries are chosen by the commercial banks. Banks are chosen by the credit volunteers. [21]

International support for SMEs includes the following organizations: United States Agency for International Development (USAID), United Nations Development Programme (UNDP), United States Department of Agriculture (USDA), Millennium Challenge Georgia (MCG), International Labor Organization (ILO), Eurasia Partnership Foundation (EPF), International Organization for Migration (IOM), German Technical Cooperation (GTZ) and others.

Improving access to finance for SMEs is essential for the SME development in Georgia. However, the creation of an enabling environment and support to business development service providers are further conditions for the successful promotion of SMEs.

United States Agency for International Development (USAID), in line with this objective and to promote the growth and development of the SME sector in Georgia executed the Private Sector Support to Small and

Medium Sized Enterprises Project - "SME Support Project" from 2005 till 2009. The SME Support Project was designed to directly contribute to the achievement of USAID/Georgia's Strategic Objective for Economic Growth - "Accelerated Development and Growth of Private Enterprises to Create Jobs". SME Support Project was designed to address the needs of small and medium sized enterprises by providing assistance to: increase access to medium- and long-term financing through Development Credit Authority mechanisms; encourage increased participation of Georgian businesses in international markets through the adoption of internationally recognized self-certification standards; develop advocacy skills in selected Georgian business associations in order to more effectively engage government at all levels on a variety of business issues; and improve business skills, including training for youth and minorities. The SME Support Project contributed directly to the improved business environment for SMEs in Georgia including: assistance provided to increase SME finance by supporting SMEs and the agriculture sector; supporting microfinance institutions and micro enterprises; technical assistance and training for financial institutions; assistance to associations, educational organizations, and other institutions by supporting business associations to develop self-certification; providing support to business associations to develop advocacy skills; and supporting business associations, educational organizations, and other institutions to promote expanded skills and entrepreneurship. To complete project goals and objectives, the SME Support Project used a combination of direct assistance and a grants program with six rounds of disbursements grant awards. Notable achievements include the creation of business support organizations that provided consulting services and training and advocacy support to SMEs; advancing the development of the local credit bureau; setting up a Georgian Banking Training Center for financial institutions; support provided to institutions with USAID DCA guarantee loans which resulted in the increased access to finance for SMEs; developing business incubators throughout Georgia; providing assistance and training to internally displaced persons; developing the tourism industry and developing basic tourism infrastructure; and engaging the public private dialogue which resulted in the Government of Georgia actively meeting with business associations to get feedback on laws affecting the business community. Overall, the SME Support Project provided the Georgian business community with the needed foundation to develop and strengthen private enterprises and create new jobs.

The SME Support Project created 1,196 jobs; supported the creation of 162 enterprises; trained 4,562 people to develop entrepreneurship skills and improve their businesses; fostered direct assistance to 4,544 MSMEs; trained 1,237 potential borrowers in accessing finance; and trained 602 loan officers on providing commercial financing to MSMEs etc. USAID Projects supporting SME sector in Georgia also included: Pilot Business Development and Employment Program; Regional Student Consulting Program in Adjara; Agribusiness Lending Training Program; Regional Student Consulting Program in Samtskhe-Javakheti; Innovative Economic Development Education Program in Shida Kartli etc.

IFC (International Finance Corporation), a member of the World Bank Group, is also supporting Small and Medium Enterprises in Georgia. Given the particular importance of SMEs for the Georgian economy, IFC's priority is to reach a broad number of these enterprises through continued support to banking sector to ensure access to finance for them. Following the August 2008 conflict, IFC responded quickly to support its banking clients enabling them to continue lending to retail clients and SMEs, two key client bases that drive economic growth in Georgia, at the same time promoting stability in the sector and signaling IFC's continuous engagement in the country. IFC also helped bankers in Georgia via conducting training to develop their ability to provide financial services to small and medium-sized enterprises, thus helping create new jobs and sustain economic recovery. IFC also provided advisory services aimed at improving the investment climate by reducing administrative barriers to starting and operating businesses. In 2010, IFC launched the Georgia Tax Simplification Project to lower tax compliance costs for micro, small, and medium enterprises and expand their tax base. IFC Georgia Tax Simplification Project supported Georgian Government in adopting the new legislation (New Tax Code, as well as the secondary legislation) enforced from January 2011 to reform taxation system for micro and small companies. IFC's cumulative investments in Georgia since 1995 (Georgia became a member of IFC in 1995) amounts to nearly USD 500 million in 36 projects across a variety of sectors. IFC is also helping raise food safety standards in the country.

The United Nations Development Programme (UNDP) implemented a project named Increasing Access to Finance for Micro Businesses in Conflict Affected Regions (microfinance), which was funded by the European Union. Within the programme Inclusive Financial Systems in

Georgia (IFSG), UNDP conducted business development services and provided micro loans for businesses. The Inclusive Financial Systems in Georgia (IFSG) project's three Business Development Service Providers (BDS Providers) administered a total of 94 Information Sessions (1,727 beneficiaries), 223 Business Skills Trainings (2,132 beneficiaries) and 899 Consultations (775 beneficiaries). The BDS Providers also assisted the target beneficiaries in preparing 491 business plans, which were used to access 146 loans and grants from the IFSG's seven partner financial institutions, ProCredit Bank, Liberty Bank, Action Against Hunger, People in Need and International Organization for Migration. A total of 2,555 target beneficiaries directly benefited from the BDS Providers' business skills trainings and one-on-one consultations. The IFSG's seven financial institutions disbursed a total of 3,144 loans valued at GEL 4,581,593 (USD 2,573,929) to the project's target beneficiaries operating in 356 towns and villages, including; 1,776 loans to women entrepreneurs, 214 loans to internally displaced persons (IDPs), 220 loans to start-up enterprises and 2,218 loans to support primary agricultural production. A total of 184 target beneficiaries received two or three loans with IFSG funds as of September 2010. The UNDP disbursed the GEL equivalent of USD 1,781,000 to seven partner financial institutions for on-lending to the IFSG target beneficiaries during the life of the project. A total of 2,960 target beneficiaries accessed loans from the IFSG's partner financial institutions as of September 2010.

UNDP's Entrepreneurial Education Centre conducts business trainings, consultations, helps start ups, self employment, enhances business and professionals cooperation. UNDP also supports Modernization of Vocational Education and Training System in Georgia. UNDP Vocational Education Project is to contribute to improving the quality of vocational education and training, increasing incomes and employment opportunities among the rural poor.

There is a functioning Business Incubator in the region of Georgia, in Adjara. The main aim of this incubator is to stimulate business development in Adjara by supporting start-ups. The incubator aims to support start-ups for future sustainable development and profit, so that they could develop new technologies, create new jobs and reinforce local and national economy. UNDP contracted with Georgian Business Development Service Providers (BDS Providers). The BDS Providers offer business skills trainings and one-on-one consultations on topics such as; business planning,

business plan development, marketing, financial accounting, agricultural production, access to credit, etc. There are also several organizations which are supporting SMEs in Georgia, including banks providing preferential financial resources and different institutes offering entrepreneurial education etc.

#### **2.5.4. Industries, Branches, Regions, Clusters**

Infrastructure is the main sector where financial resources were mobilized thanks to the positive effects of the world economic crisis. Infrastructure sector involved: road, communal, water delivery, irrigation etc. infrastructure in the regions of Georgia. Also agricultural equipment renovation, public schools construction-reconstruction and University infrastructure development were conducted. Living conditions were provided for the refugees from the war in 2008. Also, Governmental Program "Cheap Credit" was mobilized for SME development.

World economic crisis affected the construction sector of Georgia negatively. Construction sector by GDP decreased by 3.1% compared to the previous year. World Economic Crisis and the war in 2008 also affected the FDI inflow in Georgia negatively.

#### **2.5.5. The Effect of the International Financial and Economic Crisis**

While reforming the country's economy, Georgia was faced by two significant challenges: the Russian invasion in 2008 and, subsequently, the world economic crisis. Although the war with Russia and the financial crisis hit Georgian economy at around the same time in 2008, the country demonstrated exceptional resilience and was able to contain both crises, largely due to the substantial aid provided by Georgia's international partners in the amount of USD 4.5 billion.

In October 2008, at the Donor Conference, which was held in Brussels, donors promised assistance for Georgia in the amount of USD 4.5 billion. 40% of this financial resource was grant and 60% long term credit with high level preference. As of March 2011, consent of donors has reached to 90% of the promised resource. There are registered agreements between the Government and private sector for this amount. It's expected that the entire promised amount will be contracted for in 2011.

Donor's assistance to the Government was used to maintain living conditions for refugees from the war in 2008 and also for the financing of the following sectors: Road Infrastructure, Energy, Municipality, Agriculture and others.

While most nations of the world, including the industrialized countries of Western Europe, suffered from economic downturn in 2008, Georgia's economy was able to grow by 2.3% in 2008. However, the country's economy declined by 3.8% in 2009. The primary cause of this decline was the contraction of the construction industry in Georgia and the decline in foreign investment inflow (-57.9%). It is also noteworthy that the banking industry of Georgia was resilient in the midst of the global financial crisis.

Although real estate and construction industries were negatively affected by the financial crisis, they show some signs of recovery - in January-November real estate transactions increased by more than 20%, and the growth of construction sector (in GDP) during 2010 amounted to 7.6%. Due to the growth of economic activity and creation of new jobs, the rate of unemployment decreased to 13.3% in 2007 (13.6% in 2006). However, in 2008, employment decreased as a result of the global economic crisis and August events with Russia and the rate of unemployment reached 16.5%.

### **2.5.6 Government Measures to Cope with the Impact of the Economic Crisis**

In order to cope with the global financial crisis and the aftermaths of the conflict with Russia, the government of Georgia launched a stimulus package which included investments in infrastructure in the amount of GEL 2.2 million and social aid package in the amount of GEL 1.6 billion. The social aid package was designed to help the most vulnerable part of Georgia's population. On the other hand, investment in infrastructure was aimed at attracting foreign investment.

The main goals of the government's strategy were to stimulate the economy, by maintaining jobs, attracting donor's financial resources in a short period and investing in infrastructure; social assistance by assisting people who were under the poverty level and insurance expansion;

attracting international investments; facilitating foreign trade by avoiding double taxation and signing free trade agreements; tax liberalization; and developing the energy sector.

The government of Georgia decreased taxation rate which allowed economic stimulation. From 2009, thanks to the decrease, an extra GEL 250 million has stayed in the economy.

In addition to the economic stimulus package discussed above, the government of Georgia drafted a new stimulus package in 2009 with the primary purpose of strengthening the construction and banking sectors of the economy. More specifically, the stimulus package entailed granting loans to construction companies.

The Georgian Government had already elaborated an anti-recession plan in September 2008. Georgian economic recovery was supported by the IMF (USD 750 million), and Brussels' Donor Conference (USD 4.5 billion). International financial crisis also affected the government's decisions: already planned activities were accelerated and were further elaborated. One of the primary reasons Georgia was able to overcome the financial crisis and the aftermath of its conflict with Russia was its international financial support, as mentioned previously.

Georgia's sound fiscal and economic policy is evidenced by the real GDP growth of 6.4% in 2010, beating analysts' expectations. Furthermore, growth is demonstrated by other economic indicators evaluated by the international financial institutions such as the World Bank and the International Monetary Fund.

External shocks didn't hinder the government's commitment for further reforms, either. As was mentioned, during the last 2 years Georgia's position in international ratings improved.

One must also mention that the National Bank of Georgia (NBG) guaranteed financial stability by providing a prudent monetary policy for insurance price stability. More specifically, inflationary pressures that were created by the increasing prices in international markets were eliminated by NBG by conducting effective monetary and fiscal policies and promoting economic growth based on private sector financing.

### **2.5.7 SWOT Analysis of the SME Sector**

See Chapter 3.

### **2.5.8 Tasks for Improvement and Further Development of the National SME Sector**

Georgia has a growing SME sector, which is essential in ensuring employment and promoting sustainable economic development in Georgia. As the share of SMEs in the total number of enterprises is so high and their contribution to the overall economy significant, it is vital to further develop micro, small and medium businesses in the country. Towards this goal, it is imperative to provide SMEs with financial and technical assistance. Thanks to the Georgian government's efforts in the direction of tax liberalization and special incentives for Micro and Small businesses, there is a solid foundation for SME sector growth. The most important change in this direction was the "New Tax Code" which came into force from January, 2011. Incentives, stimulus and opportunities which are created for SMEs with the "New Tax Code" will certainly give raise to their activities and help SMEs' further development in the country in the near future.

In terms of providing international business opportunities for SMEs, Georgia will need assistance from its international partners. Incidentally, educating Georgians about entrepreneurial opportunities offered by SMEs is essential to ensure the growth of this sector. For further SME development in Georgia, it is also necessary to raise business skills in the country among small and medium business operators. This will increase the competitiveness of Georgian products in the global market, which will ultimately result in increased exports and international trade. Furthermore, it is crucial to develop quality infrastructure that meets European standards. Therefore, Georgian national quality institutes need to adopt international best practices of quality control in order to support SMEs. This paper is based on the premise that liberalization of Georgia's economy yields economic growth and attracted foreign investments. It is very important to raise employment in Small and Medium Enterprises. Therefore, providing opportunities for SMEs in terms of access to finance and education is one of the main goals of Georgia. Among the various issues discussed in this paper were GDP growth, liberalization of Georgian Tax Code, the role of the SME sector in the Georgian economy, interna-

tional organizations' evaluation of Georgia's economic performance, and Georgia's strategies to deal with the aftermath of its conflict with Russia and the global financial crisis.

In conclusion, we believe that the role of SMEs will increase in Georgia's economic development as the country continues to liberalize its economy.

## **Bibliography**

- [1] National Statistic Office of Georgia
- [2] "Georgia – Pocket Tax Book", the Ministry of Finance of Georgia
- [3] Law on "The National Investments Agency of Georgia"
- [4] Tax Code of Georgia
- [5] "Doing Business 2011 – Making a difference for Entrepreneurs"
- [6] World Bank report "Investing Across Borders 2010"
- [7] Forbes – "Best Countries for Business 2010"
- [8] "The Global Competitiveness Index ranking 2010–2011"
- [9] Moody's Rating
- [10] The Transparency International's "Global Corruption Barometer 2010"
- [11] "Paying Taxes 2011 – the Global Pictures"
- [12] Standard & Poor's Rating
- [13] Global Economic Forum's "The Global Enabling Trade Report"
- [14] The New York Times – "Best Places to Go in 2011"
- [15] Fitch Ratings
- [16] "Governmental Employment Program for Small and Medium Business Development"
- [17] "Governmental Program for Professional Skills Training" (2007-2008)
- [18] "Governmental Program for Professional Education Infrastructure Development – Vocational Education for Employment" (2008)
- [19] "Governmental Program Cheap Credit" (2008-2009)
- [20] "Presidential Program for Professional Education Centres Rehabilitation"
- [21] "Local Business Support Program" – "Start the Business with the City Hall" (2006)

## 2.6 HELLENIC REPUBLIC

Dr. Irini Voudouris and  
Ioanna Deligianni  
Athens University of Economics and Business

### 2.6.1. National Economy and the SME Sector

#### National economy<sup>21</sup>

During the period between 2002 (introduction of the euro - EUR - as the national currency) and 2008 (start of the recent global economic crisis), the Greek economy presented substantial growth in terms of GDP (an average growth rate of approximately 3.5%) whereas the average growth rate for the Eurozone at the same period was slightly above 1%. In 2008, GDP reached EUR 184 billion, formed by consumption (EUR 168 billion), investments (EUR 41 billion), exports (EUR 45 billion) and imports (EUR -70 billion). In this period, the introduction of the new currency and the organization of the Olympic Games had formed a positive economic climate<sup>22</sup> (an average of 99 units compared to an average of 100 units for the eurozone). The unemployment rate for the same period was about 9.3% whereas the inflation rate was around 3-3.5%. Despite the relatively positive economic condition, the unbalanced structure of the GDP (over-consumption, highly negative Current Account) combined with the delays in the implementation of structural changes and the situation of public economics (rapid accumulation of gross external debt which exceeded 110% of GDP in 2008, second highest in the EU) had a negative impact on competitiveness. Specifically, the country's competitive position worsened from 33 in 2002 to 52 in 2008 in the global rating.

With its economy in such a vulnerable position, Greece could not deal with the challenges of the global financial crisis, which exploded at the end of 2008. The effect of the economic crisis was perceived in its full intensity in the second half of 2009. Public budget deficit increased substantially over the limit of the Stability and Growth Pact. To avoid default, the country asked for the support of the mechanism of the IMF, the EC and the European Central Bank (troika).

The course of the Greek economy in the last two years (2010-2011) is shaped mainly by the domestic financial crisis, the effect of which has been mitigated -to a small extent- by the recession of the global eco-

conomic crisis. The depression of the Greek economy has experienced an escalation during the last quarter of 2010, reaching the level of 6.6% (when the corresponding value for the same quarter of 2009 did not exceed the level of 0.7%). For the whole year 2010, the decline of GDP reached the level of 4.5% (from 2% in 2009) mainly due to:

- The decrease of total final consumption –public and private- by 4.9% in terms of GDP.
- The decrease of investments (especially the private ones) by 12.3% (following a decrease of 21.5% in 2009). This decrease is driven by a 31.7% decrease in fixed assets in transport equipment, an 18.6% decrease in housing and a 17.7% decrease in metal products and machinery.

On the contrary, the increase of exports (by 4.8% in products and 3.2% in services versus 2009) combined with the decrease of imports (by 4.8% versus 2009 mainly coming from products) had a relatively positive effect on GDP.

Regarding the unemployment, the relative index presented a substantial increase, reaching the level of 14% in the last quarter of 2010 for the first time since 1998. It should be noticed that only in 2010 it gained 3% points (from 9.5% in 2009 to 12.5% in 2010).

As far as the inflation rate is concerned, its value presented a slight decrease in the last quarter of 2010, from 5.5% to 5.1%.

However, the budget deficit has decreased by 1.9% points of the GDP, reaching the level of 10.1%. Despite the important exacerbation of the depression observed in the last quarter of the previous year, the first economic data on the course of the economic activity in Greece for the first months of 2011 show that there is either an attenuation of the rate of decline or even an upward trend in some economic indices. More specifically:

- the industrial production still declines but at a lower pace (-5.2% in January 2011)
- the order placements increased by 9.1% in Jan 2011 vs. 6.5% in December 2010
- exports increased by 30.7% in January 2011 compared to the corresponding month in 2010.

## SME Sector<sup>23</sup>

According to the European Commission 2003 recommendation, SMEs in Greece are defined as follows:

Small and medium- sized enterprises are the enterprises:

- employing less than 250 employees,
- with annual turnover not exceeding EUR 50 million or with annual total balance sheet not exceeding EUR 43 million,
- fulfilling the autonomy criterion, i.e. not belonging by 25% or more of the capital or voting rights to one or more enterprise which do not fall under the SME or micro-enterprise definition (depending on the case).

Very small, small and medium-sized enterprises are categorized as follows (Table 46):

- Very small enterprises: employ fewer than 10 persons
- Small enterprises: employ fewer than 50 persons having either an annual turnover not exceeding EUR 10 million, or an annual total balance sheet not exceeding EUR 10 million.
- Medium-sized enterprises: employ fewer than 250 persons, either having an annual turnover not exceeding EUR 50 million, or an annual total balance sheet not higher than EUR 43 million.

**Table 46: Categorization of enterprises in Greece**

Enterprise Category	Staff headcount	Turnover	Total balance sheet
Medium-sized	<250	<50 million €	<43 million €
Small	<50	<10 million €	<10 million €
Micro	<10	<2 million €	<2million €

Greek enterprises total 849,820. The overwhelming majority of them are SMEs (99.9%). The SME sector is structured as follows:

- Micro firms: 820,021 (96.5%)
- Small firms: 25,789 (3%)
- Medium-sized: 3,579 (0.4%)

From 2002 to 2008, the number of SMEs has grown by 8%, which is less than the average EU-growth (13%). The net growth in the number of companies occurred particularly in the group of small and medium-sized enterprises. In the period 2002-2008, employment in Greek SMEs

increased by 15%, which is above the EU-average of 12%. In general, employment grew in small and medium-sized enterprises and decreased in large enterprises. Value added by SMEs was fluctuating with an overall increase of 37%, which is above the EU average growth of 28%.

The contribution of all SMEs to employment (87%) is in Greece higher than in the EU (67%). This difference is mainly due to the small-scale structure of the Greek-SME sector. The percentage of micro enterprises is higher than the European average. Greek micro firms employ more people (58%) than the European average micro enterprise (30%), (all figures refer to the year 2008). It is important however to note that a very important percentage of micro-firms represent purely commercial enterprises focusing on consumption of imported goods. It is only natural that those SMEs were the first ones to suffer from the present crisis. During the period 2009-2011 the financial crisis had a significant negative impact on Greek SMEs. However the average number of firms that bankrupted was among the lowest in West Europe (Table 47).

An explanation to this could be found in the culture of Greek SMEs, which are to a great extent family owned. Greek mentality, which, although favoring entrepreneurial intention and start-up, is characterized by high levels of uncertainty avoidance<sup>24</sup> and thus leads to low rates of innovation and opportunity entrepreneurship. Greek entrepreneurs are struggling for their companies to survive. They avoid acting as serial entrepreneurs, closing or selling one company and creating another. In addition, the Greek institutional and legislative framework does not help in that direction (strict bankruptcy legislation, heavy bureaucracy, personal guaranties for bank loans, few opportunities for a second chance).

**Table 47: Number of bankruptcies during the crisis**

Countries	Number of bankruptcies/ 10.000 firms <sup>25</sup>	
	2010	2009
Luxemburg	321	242
Denmark	207	183
Austria	163	236
Belgium	160	165
France	102	188
Norway	93	109
Germany	89	96
Netherlands	87	165
Ireland	75	87
Sweden	72	131
United Kingdom	69	90
Portugal	47	40
Italy	24	23
Spain	14	16
Greece	7	4

In Greece, support to the development of the SME sector is mainly held by the National Reform Plan, the “umbrella document” for the national development policies in the priority areas of government intervention.

The priorities of the NRP<sup>26</sup> for 2008-2010 were to:

- Continue fiscal consolidation and achieve the long-term sustainability of public finances;
- Increase productivity mainly through reforms in the Public Administration, the operation of markets, investment in human capital and promoting a Knowledge-Based Society;
- Improve the business environment, enhance competition, further open product markets, increase the outward orientation of the Greek economy and boost its competitiveness;
- Increase employment, reduce unemployment and improve the effectiveness of the educational, training, re-training and life-long learning systems.

The National Strategic Reference Framework (NSRF 2007-2013) supported by the Structural Funds aims at transforming Greece into an extrovert economy, highly competitive and with strong international presence.

The most relevant operational programmes<sup>27</sup> for the achievement of this objective are:

- Competitiveness and Entrepreneurship. The Programme promotes

research, innovation and their linkages, reinforces entrepreneurship and networking, the quality of products, the control mechanisms of the market and the energy supply system, including the production of power by renewable energy sources.

- Digital Convergence. The Programme aims to raise productivity and competitiveness. It supports the dissemination of ICTs in the business sector and the civil service, the development of digital services to the citizen, etc.
- Education and Lifelong Learning. The Programme aims at improving the quality of basic skills, introducing reforms in order to increase the accessibility to lifelong training for all, increasing the attractiveness of vocational training and education.
- Human Potential. The Programme aims at creating the conditions for full employment, the reinforcement of the adaptability of firms and the employability of the work force in the changing economic environment and within the global competition arena, the enhancement of the employment of women, as well as employment of youth and some vulnerable minorities and of social cohesion.

Overall, between 2007 and 2013, several programmes support explicitly the creation and growth of SMEs, including activities related to access to finance, research and innovation, technology transfer, access to information and communication technologies or environmentally friendly production. Specific attention to improving SMEs' access to finance is paid through JEREMIE ("Joint European Resources for Micro to Medium Enterprises initiative") and JASMINE ("Joint Action to Support Micro-finance Institutions in Europe"). Moreover, SMEs are the main beneficiaries of the "Competitiveness and Innovation Framework Programme" (CIP). In addition, SMEs can benefit from more advantageous participation rules in the NSRF 2007-2013 - a 75% funding rate compared to 50% for large industry partners and 100% cost-coverage for project management. Funding is open to all SMEs whether they are performing research themselves or are going to outsource a research need.

### **2.6.2. Legislation and Ranking of Doing Business According to World Bank Methodology<sup>28</sup>**

In Greece, actions are taken to improve the regulatory and legislative environment. However the position of the country in both regulation and legislation is low in comparison to other countries.

According to the World Bank report Doing Business (DB) in 2011, the Greek economy occupies the 109th place in the total ranking of Ease of DB among 183 economies. However, doing business has become slightly easier by an absolute value of 0.03 during the last five years (based on the distribution of cumulative change across the 9 indicators of DB).

The score of Greece in each of the 9 indicators comprising the Ease of DB (for the year 2011) is as follows:

**Starting a Business:** The position of Greece in this index is 149, lower than in 2010 which was 146. This change was mainly due to the slight increase of both the cost required to complete the procedures of starting a business and the paid-in minimum capital prior to the beginning of registration. The values of the remaining two components of this indicator (procedures, time) remained unchanged. In the particular indicator, the performance of the Greek economy is inferior to those of the comparator economies (Austria, Belgium, France, Germany, Italy).

**Dealing with Construction Permits:** The position of Greece in this index is 51, remaining unchanged since 2010. More specifically, the two out of three components of this indicator (procedures and time) remained unchanged whereas the third component (cost) presented a slight increase, without, however, affecting the overall country rank. In this indicator, the performance of Greece is comparable to those of Belgium and Austria, better than the one of Italy but worse than the ones of Germany and France.

**Registering Property:** Greece is ranked 153 overall for Registering Property; substantially lower than its 107th position in 2010. The reason driving this decrease is mainly the increase in the transferring property taxation. Greece made transferring property more costly by increasing the transfer tax from 1% of the property value to 10%. The other two components of this indicator (procedures and time) remained unchanged. The performance of Greece in this indicator is worse than those of Austria, Germany, Italy and France whereas better than the one of Belgium.

**Getting Credit:** Greece is ranked 98 overall for Getting Credit; slightly lower than its 97th position in 2010. Although all four components comprising this indicator (namely strength of legal rights index, depth

of credit information index, private bureau coverage, and public registry coverage) remained unchanged or even presented a slight improvement, the slight decrease of the overall rank of the Greek economy was due to the faster improvement of the other economies. The performance of Greece is comparable to that of Italy whereas it is inferior to the ones of Austria, Germany, Belgium and France.

**Protecting Investors:** Greece is ranked 154th overall for Protecting Investors. Its position in this index remained unchanged since 2010. The performance is lower than the ones of the comparator economies.

**Paying Taxes:** Greece is ranked 74th overall for Paying Taxes, remaining unchanged since 2010. In all components (total tax rate, payments and time) comprising this indicator, no significant changes have been remarked. The performance of the Greek economy is better than the ones of Germany, Austria and Italy whereas it is worse than the ones of France and Belgium.

**Trading Across Borders:** Greece occupies the 84th position in this indicator, scoring lower than 2010 (by three places). In perspective to the comparator economies, the procedures to import and export goods are more time consuming in Greece whereas the documents required and the costs associated with imports and exports are comparable (overall, the performance of Greece in this indicator is inferior to all comparator economies).

**Enforcing Contracts:** Greece is ranked 88th overall for Enforcing Contracts, one place better than in 2010. All components comprising this indicator remained unchanged (procedures, time and cost). The performance of the Greek economy is inferior to the ones of Germany, France, Austria and Belgium whereas it is better than the one of Italy.

**Closing a Business:** Greece is ranked 49th overall for Closing Business, scoring 6 places lower than in 2010. This decrease is partially due to a slight decrease in the recovery rate component of the indicator. All other components (time and cost) remained unchanged. The performance of the Greek economy is lower than the ones of the comparator economies.

### 2.6.3. SME Support Infrastructure<sup>29</sup>

The most important public organizations promoting SME competitiveness and entrepreneurship, by developing legal instruments and multi-annual programming documents for policy elaboration are the Ministry of Finance (MoF), the Ministry of Development and Competitiveness (MDC) and the Ministry of Education (MoE) through the General Secretariats for Investment and Development (GSID) and for Fiscal Policy, the General Secretariats for Research and Technology (GSRT) and for Industry (GSI) and other General and Special Secretariats<sup>30</sup>:

GSID provides the incentives for investment schemes. The GSID is also in charge of the regional development policy, which is implemented via the operational programmes. Tax incentives for R&D to firms are relatively recent. Moreover, the MoF is supporting SMEs also through its subsidiary bodies such as the Hellenic Foreign Trade Board (OPE), supporting the promotion of Greek products abroad, the Invest in Greece Agency which aims to attract foreign investors and analyze investment trends, the Centre of Planning and Economic Research (KEPE) which monitors and studies the economic environment in Greece and the New Economy Fund (TANEO) which is the first fund of funds in Greece.

GSRT is still supporting most of the public research centers, R&D activities in universities and firms as well as S&T based innovation. The law 3653/2008 redefined the competencies of the GSRT and created some new bodies to handle the future of research governance and funding, with emphasis on basic research. This included an Inter-ministerial Committee in order to assure coordination of funding sources, a National Research and Technology Council to draw priorities and a flexible implementing National Agency for Research and Technology. The Agency is managed by a board of academics or high level researchers and has two basic directions: fundamental and applied research. Moreover, a new unit has been established inside the GSRT, staffed internally to manage measures of the operational programme Competitiveness and Entrepreneurship. The GSI aims at supporting the establishment of new firms, improving the SME environment as well as general standards. This Secretariat is supervising the standardization and accreditation organizations and the Agency supporting the SMEs. It is also handling most of the measures and schemes of the operational programmes addressing

entrepreneurship, private industrial investment and technical infrastructures for manufacturing. An increased interest for innovation in SMEs is demonstrated by the GSI.

Under the MoE, the universities are the main actors defining research orientations and the rules of supplying fresh knowledge to the market. The MoE has already promoted various legislative acts to modernize the education system. The operational programme Education and Lifelong Learning 2007-13 also belongs to the MoE and has a strong impact on the design and implementation of measures related among others to research and entrepreneurship.

The National Competitiveness Council established in 2000 as an advisory body by the former Ministry of Development, in coordination with the former Ministry of Economy, contributed to the sophistication of measures favoring competitiveness. In 2008, more attention was given to the National Competition Commission, an independent authority which controls the development of cartels in the national market. The Economic and Social Committee (OKE), a tripartite body composed of representatives of trade unions and the government is involved in assessment of the policies.

The main organizations supporting the implementation of policies elaborated are:

- The ministerial General Secretariats mentioned in the previous section which are also the implementing agencies of the policies they prepare internally and/or with the assistance of external experts.
- The research centers that have taken additional missions in the past decade to popularize knowledge, exploit research results, supply knowledge-intensive services to industry, promote European and international networking and long term links with the economy. Some of the centers were assigned specific missions in promoting innovation: four of them by creating science and technology parks and incubators and more recently one in supporting the development of a cluster in microelectronics. With the exception probably of this latter initiative, the others have shown limited impact, but are still in operation.
- The sectoral companies, created in the late 1980s to support industrial research and technology transfer in industries of high economic interest which are currently being grouped into larger entities.

- Organizations dealing with standards introduction and enforcement: Standards Organization (ELOT), National Accreditation System (ESYD) and National Metrology Institute (EIM), as well as the Industrial Property Organization (OBI) and the ministerial section on trademarks.
- Organizations supporting industrial policy such as the organization for SMEs and Handicrafts (EOMMEX) which is managing at present schemes in favor of entrepreneurship and European cooperation among SMEs, the Observatory of SMEs and the Foundation for Economic and Industrial Research (IOBE).
- A few private VCs emerged either as affiliates of large banks or as initiatives of other financing institutions, focusing nevertheless on more traditional investments. Most interesting among them for entrepreneurship and innovation seem to be those linked to the S&T parks and incubators.
- In the area of education and lifelong learning the General Secretariat for Youth plays an important role in promoting entrepreneurship among youth while the General Secretariat for Adult Education, the Institute of Adult Continuous Training (IDEKE) and the Vocational Training Centers and Institutes (KEK-IEK) support lifelong learning.

Overall, in Greece there is an amount of organizations making and implementing policies and programs related to entrepreneurship, innovation, SME competitiveness. There is also emphasis on policies targeting lifelong learning and the collaboration between research centers and SMEs. However, the main weakness of the existing policies and programs is that they are fragmented. There are more than 40 organizations, involved in the promotion of entrepreneurship and SMEs, with programs covering entrepreneurship, education and learning, R&D, regional operational programmes, whereas there is a lack of an integrated national policy scheme, focusing on the promotion of a well defined strategy of SME competitiveness rather than on general support.

#### **2.6.4. Industries, Branches, Regions, Clusters Economic Activities - Industries<sup>31</sup>**

The first attempt to introduce Code Numbers of Activities (KAD) in Greece took place in 1986 and was based on a Statistical Classification of Economic Activity known as NACE (used in the European Economic Community since 1970). The NACE classification (5-digit code system) was enriched using data from the "tables of net profits coefficients" of

the Greek Ministry of Finance, creating a 7-digit national activity code number. In 1998, under the guidance of the Centre of Planning and Economic Research (KEPE), a new codification was established according to the demands of the Regulation (EC) 3037/90 and EUROSTAT. In order to develop the specific codification, appropriate information from EUROSTAT and the UN Statistical Agency had been used. From 2008, according to the Regulation (EC) 1893/2006, there is a new codification based on the statistical codification NACE-revision 2. However, the Greek authorities decided to further develop the specific codification at lower levels drawing upon the Classification of Products by Activities (CPA) of the year 2008 (Regulation (EC) 451/2008). More specifically, each NACE-rev.2 code was decomposed in either the production of more specific products or the provision of more specific services. CPA 2008 unfolds in both a 5-digit code level (1,337 categories) and a 6-digit level (3,138 sub-categories). Furthermore, in order to better satisfy the national demands in terms of taxation and auditing, 4,800 new codes were added under the 6-digit system of CPA creating the final 8-digit national system. This system includes 9,400 code numbers (compared to the 615 code numbers of NACE-revision 2).

### **Geographical Territories – Regions<sup>32</sup>**

Greece follows the NUTS (Nomenclature d' Unités Territoriales Statistiques) classification which is a hierarchical system for dividing up the economic territory of the EU for the purpose of:

- The collection, development and harmonization of EU regional statistics.
- Socio-economic analyses of the regions.
- Framing of EU regional policies.

This classification consists of three levels:

- NUTS 1: major socio-economic regions
- NUTS 2: basic regions for the application of regional policies
- NUTS 3: small regions for specific diagnoses

In Greece:

- NUTS 1 involves 4 main geographical departments: Northern Greece, Central Greece, Attica, Aegean Islands and Crete
- NUTS 2 involves 13 regions (peripheries)
- NUTS 3 involves 51 prefectures (nomoi)

It should be noted that recent reforms in the structure of local authorities will result in new classifications

## **2.6.5. The Effect of the International Financial and Economic Crisis**

The effect of the financial crisis on the main sectors of the Greek economy can be summarized in the following sectors.<sup>33</sup>

### **Industrial Sector**

The local financial crisis had a significant negative impact on the Greek industrial sector, leading to a decrease of production by 10% in 2009 and by 5.8% in 2010. This downward trend is contradictory to the course of the industrial sector in the remaining Eurozone, which experienced a much lower decrease (by 1.8% in 2009) or even an increase (by 1.9% in 2010) in the corresponding years. More specifically, in Greece, the electricity sector had experienced the larger decrease of production (by 8.8% in 2010, following a decrease by 9.6% in 2009). The mining and quarrying sector had also experienced shrinkage of production by 7.8% in 2010, following a reduction of 9.6% in 2009 while, in the manufacturing sector, the production had been reduced by 4% in 2010 (following a corresponding reduction of 6.5% in 2009). Here it is important to note that 16 out of the 24 industries of the manufacturing sector had presented a downward trend whereas the remaining industries comprising this sector had experienced a slight increase. Among these industries that contributed positively to the Greek economy are the food and beverages industry (presenting an increase of 0.8% in 2010 following a 5.4% increase in 2009), the pharmaceutical industry (presenting an increase of 2.4% in 2010 versus an increase of 12.6% in 2009), the metal industry (presenting an increase of 16.3% in 2010 following a 13.4% decrease in 2009), the petroleum and carbon derivatives industry (presenting an increase of 5.1% in 2010 versus an increase of 16.6% in 2009) and the motor-driven and trailer vehicle industry (presenting an increase of 41.5% following a 5.5% decrease in 2009).

### **Construction Sector**

The Greek construction sector had experienced significant loss due to the local financial crisis. The average year construction index has presented a decrease of 36.5% in 2010, following a decrease of 17.5% in 2009. The corresponding index in the Eurozone had a downfall of 8.2%, fol-

lowing a downfall of 7.6% in 2009. The highest reduction in the Greek construction had been mainly observed in the West Macedonia region (in the Northern Greece geographical department), the Southern Aegean region (in the Aegean Islands and Crete geographical department) and in the Eastern Macedonia and Thrace (in the Northern Greece geographical department).

### **Retail Sector**

The impact of the financial crisis on the Greek retail sector is reflected in the retail sector index which presented a decrease of 6.2% in 2010, following a decrease of 11.3% in 2009. The industries that suffered the most significant loss in 2010 are the wear and footwear industry (-11.2% versus +1.4%) and the food-beverages and tobacco industry (-4.5% versus -1.5%). The industries that experienced a less intense decrease in 2010 are the fuel and lubricants industry (-9.2% versus -27.8% in 2009), the books and stationery industry (-3.4% versus -24.0% in 2009), the supermarkets (-5.4% versus -6.5%) and the furniture and home equipment (-13.3% versus -15.4%). The only industry of the retail sector with a positive trend in 2010 (although in slower rate than in 2009) is the drugs and cosmetics one (+1.1% versus 2.1% in 2009).

### **Wholesale Sector**

The financial crisis exerted a negative effect on the wholesale sector, leading to a decrease of the corresponding index by 4.9% in 2010 (versus a 9.3% decrease in 2009).

### **Services Sector**

The negative impact of the financial crisis on the Greek services sector in 2010 is reflected in 12 out of 14 industries of the specific sector (versus 11 out of 14 in 2009). Substantial decrease is observed in the information industry (-33.0% versus -12.8% in 2009), the advertising-public opinion research industry (-24.1% versus -18.4% in 2009), the law, accounting and consulting services (-6.5% versus -12.3% in 2009), the telecommunication services (-11.4% versus -8.4% in 2009), the accommodation-restaurant services (-8.7% versus -8.8% in 2009). On the contrary, the only sector with a positive trend is the security services with an increase of 1.4% (versus an increase of 13.4% in 2009).

### **2.6.6. Government Measures to Cope with the Impact of the Economic Crisis<sup>34</sup>**

Under the guidance of the troika (International Monetary Fund, European Commission and European Central Bank) the Greek government has already introduced and continues introducing a series of measures in order to cope with the impact of the financial crisis. These involve:

Fiscal consolidation: A number of measures have been adopted to ensure the fiscal deficit ceiling such as:

- cuts in the public sector wage bill,
- cuts in the state's operation expenditure,
- cuts in extra-budgetary funds expenses (through the assessment of the mandate, viability and expenses of all entities subsidized by the public sector and their mergers and closure for e.g. educational institutions),
- cuts in state-owned enterprises (through the implementation of restructuring plans and privatization),
- cuts in operational defense-related expenditure,
- cuts in healthcare and pharmaceutical expenditure,
- cuts in social benefits,
- cuts in expenditure by the public investment budget,
- increases in taxes (through e.g. an increase in VAT rate, increases in the consumption tax in fuels, cigarettes and drinks, introduction of luxury tax, tax increase in the real estate property of offshore companies),
- increases in social contributions receipts, and
- increases in local government revenue (e.g. from tolls, fees, etc.)

#### **Privatization**

A number of steps have been taken in order to put in place a privatization programme for a number of assets of the Greek government such as listed and non-listed companies concessions and real estate (including commercially viable land).

#### **Structural reforms**

Several growth-enhancing structural reforms have been legislated and are being implemented in pensions, healthcare, labor market, product and service market regulation and other reforms to improve business

environment. Other than the reforms that are part of the fiscal consolidation efforts (e.g. tax increases, pension, healthcare), which might have a negative impact on the entrepreneurial activity of the economy, these reforms aim mainly at removing rigidities, reducing production costs and increasing domestic competition and international competitiveness (e.g. new regulation for employment and layoffs (lower severance for legislation concerning employment and layoffs, increased employment flexibility, lower payment for overtimes, liberalization of several professions). In addition, reform aiming at removing bureaucracy and facilitating the creation of SMEs (one stop SME) has been legislated, however results from its implementation are not apparent yet.

### **2.6.7 SWOT Analysis of the SME Sector**

See Chapter 3.

### **2.6.8. Tasks for Improvement and Further Development of the National SME Sector<sup>35</sup>**

In Greece, providing funding to SMEs will be more difficult in the future as a result of the economic crisis. However, after the implementation of the structural reforms, the regulatory and legislative environment will be less rigid, the products/ services market and the labor market are expected to improve business environment and to be more favorable for SMEs.

In the current and the post-crisis environment, competences and strategies of SMEs could be more important than the national environment for the development of the SME sector.

#### **The tasks of SMEs**

The current entrepreneurial environment is substantially different. The typical consumer is more demanding, seeking to satisfy the same needs with less money and with an intense competition in supply. There are tremendous pressures coming from emerging multinationals from low-cost countries offering products with average combination of price and cost (the target market of the Greek products). Internationalization is intensifying with the invasion of foreign products in the domestic market.

At the same time, the demand for corporate social responsibility is increasing. This, in turn, may provide opportunities to several firms to differentiate their offerings incorporating innovative and socially/environmentally sustainable solutions.

In this light, many Greek SMEs will be pushed to their limits. Some of them will survive and even prosper by adapting to the new environment and exploiting new opportunities. The balance between those that will survive the crisis and those that will fail is going to determine the competitiveness of the country. Opportunities may be identified in sectors such as the food and beverages, tourism, alternative energy.

SME strategies are of critical importance. The recipe of success should be based on differentiation, both in terms of quality and innovation, however at lower costs. Local differentiation and creativity may constitute the main sources of difference.

Moreover, SMEs will have to cope with international competition, promote advanced internationalization modes and exploit international resources and opportunities. The link with the domestic market and the state will be weakened. Ideas and experiences coming from the international market may result in lower cost innovations.

Therefore, SMEs will have to intensify their efforts towards the continuous introduction of innovation drawing upon ideas from customers, suppliers and partners in the international market. That means that a model of "open innovation" could be followed with less investment in innovation based on Research and Development, where Greek SMEs present a systemic lag behind their European counterparts<sup>36</sup>. Incremental innovation, especially during implementation, is more appropriate to Greek entrepreneurial practice.

The sustainable growth approach, mainly in terms of its ecological aspect, may provide Greek firms with opportunities to innovate combining Greek tradition and creativity.

### **Public Policies**

The impact of the national environment depends on its attractiveness for creating companies. Some actions have already been taken to improve regulation and legislation. However, much more needs to be done. A

rapid increase in “ease of doing business” will provide opportunities to new ventures creation and increase foreign investments in Greece. Public policies and programs exist but they are fragmented. For example, policies and programmes for entrepreneurship, innovation and competitiveness have for a great part been developed separately. It would be crucial to re-examine public policies focusing on the promotion of a well-defined strategy of international competitiveness based on innovative differentiation. This strategy could build upon the strengthening of mechanisms of idea generation and adoption, international networking and extroversion, technology adoption and adaptation that would facilitate the introduction of innovative offering to the international markets rather than on general support.

### **Society**

At societal level, the biggest benefit for the national SME sector will come from an intervention to the societal system of values and the enhancement of a culture of creativity, innovation, risk-taking and entrepreneurship, based on new ideas, multiculturalism and internationalization. Efforts towards this direction have already started inside universities. However, an integrated effort should be supported by all educational institutions at all levels.

### **Bibliography**

Commission Staff Working Document on the Implementation of Commission Recommendation of 6 May 2003 concerning the Definition of Micro, Small, and Medium-Sized Enterprises 2009. European Commission.

Currency Policy Report 2008. Bank of Greece.

Doing Business 2011. Full Report. Making a Difference for Entrepreneurs.

World Bank and International Finance Corporation.

Doing Business 2011. Greece. Making a Difference for Entrepreneurs

World Bank and International Finance Corporation.

European Innovation Scoreboard, 2009

"The status and prospects of SMEs in Greece", 2008, EOMMEX, European Profiles.

Hofstede G (1991) Cultures and Organizations: Software of the Mind. London: McGraw.

Inno-Policy TrendChart- Innovation Policy Progress Report, Greece 2009, European Commission, Enterprise Directorate-General

Lioukas, S. 2011, "The Greek companies in the post-crisis era: Strategies for international competitiveness", Eds. Union of Greek Banks, forthcoming.

National Onomatology of Financial Activities 2008. Ministry of Economics.

Note of the joint Commission/ECB/IMF mission to Greece (3 May-2 June) 2011

Small Business Act Fact Sheet Greece 2009. European Commission Enterprise and Industry.

Summary Annual Report 2008: Current Situation and Perspectives of Greek SMEs. National Observatory for SMEs.

The Greek Economy. Terminally Report March 2011. Foundation for Economic and Industrial Research.

## **2.7 MOLDOVA**

Dr. Elena Aculai

Scientific researcher-coordinator of the National Institute of Economy, Finance and Statistics of Moldova and

Valentina Veverita Superior lector of the State University of Moldova

### **Introduction**

The sector of small and medium-sized enterprises (SME) of the Republic of Moldova makes a contribution to social-economic problem solving, first of all, market satiation with consumer goods and services, creation of work places and securing/ increasing the citizens' living standards.

However, numerous problems impede SME development; both internal within an enterprise (like managers' lack of knowledge and of working experience; inappropriate speciality and qualification of workers and specialists; lack of other resources for business development) and external problems (complexity and laboriousness of legislative requirements; restricted access to different types of resources – finances, consultations, trainings; corruption; political instability, etc.). During the last years, the financial and economic crisis has negatively influenced the business development.

### **2.7.1. National Economy and the SME Sector**

#### **2.7.1.1. The Analysis of the National Economic Development**

The economy of the Republic of Moldova suffered a deep economic crisis after the USSR's dissolution. The GDP indicator is still lower compared to 1990: in 2009 the GDP made 53.2% of the level in 1990.

Carrying out the analysis of the national economic development during the past 10 years, it's possible to distinguish the following stages:

- 2000-2006: this period is characterized by stable positive tendency of all the main macroeconomic indicators: growth of GDP, export and import, volume of industrial production, agriculture (except for 2003) and construction, foreign direct investments (except for 2002-2003); decreasing unemployment rate (according to ILO).
- 2006-2008: the positive tendency continued, although the growth rate of certain indicators was lower, for instance GDP (in 2006 and 2007), construction volume (in 2008). Other indicators were charac-

terized by lower absolute values in some years, for instance, export indicators (96.4% in 2006); industrial and agricultural production (in 2006-2007).

- In 2009, practically all macroeconomic indicators of the Republic of Moldova displayed a considerable decrease as a result of the worldwide financial-economic crisis. As compared to the previous year 2008, in 2009 the following indicators declined significantly: GDP (94.0%), export (80.9%), import (66.9%), agricultural production (90.4%), industrial production (78.9%), construction (65.0%), and foreign direct investment (12.2%).

The tendencies of macroeconomic indicators of the Moldovan national economy between 2005 and 2010 are shown in Table 48.

**Table 48: Tendencies of Macroeconomic Indicators of National Economic Development in 2005-2010**

	Units	2005	2009	2010- preliminary
Gross domestic product (GDP), nominal	MDL m	37,652	60,430	71,849
	USD m	2,988.3	5,437.6	5,810.1
GDP, real: -to previous year	%	107.5	94.0	106.9
-to 1990	%	48.9	53.2	
Rate of inflation, at the end of the year	%	10.0	0.4	8.1
Exchange rate of national currency, annual average	MDL/USD	12.6	11.1	12.4
External commerce    Export (F.O.B.)	USD m	1,091.3	1,287.5	1,582.1
-to previous year	%	110.8	80.9	122.9
Import (C.I.F.)	USD m	2,292.3	3,278.3	3,855.3
-to previous year	%	129.6	66.9	117.6
Industry production (in current prices),	MDL m	20,770.0	22,643.9	27,056.5
in real terms: -to previous year	%	107.0	78.9	107.0
Agriculture production (in current prices),	MDL m	12,688.0	13,300.0	19,715.0
in real terms: -to previous year	%	100.8	90.4	107.9
Fixed capital investments for agricultural development, financed from all the sources (in current prices)	MDL m	7,796.5	10,878.9	12,927.4
in real terms: -to previous year	%	121.4	65.0	116.7
Foreign direct investment in national economy (net)	USD m	190.7	86.4	198.9
Number of population (at the end of year)	1,000 persons	3,589.9	3,563.7	3,580.4
Employment (at the end of year)	1,000 persons	1,319.0	1,184.4	1,143.4
Number of employees (at the end of year)	1,000 persons	660.0	608.2	
Number of unemployed conforming ILO (at the end of year)	1,000 persons	103.7	81.0	92.0
Unemployment rate conforming ILO	%	7.3	6.4	7.4
Average nominal monthly salary per employee in economy	MDL	1,697.1	2,972.2	3,246.7
	USD	129.2	240.3	261.8
-to previous year nominal	%	128.7	108.2	111.0
real	%	114.2	101.0	103.0

Source: Materials of the Ministry of Economy, Direction of Macroeconomic Analysis and Forecasting

Two groups of social sphere indicators were of steady dynamics during 2000-2009:

- Such indicators as the population employed in economy and the number of employees declined almost yearly – the fact explained by demography processes and able-bodied population's emigration.
- At the same time, such showings as nominal and real monthly salary per employee in the economy grew on the contrary (though the real wage level was of minimal growth of 101%).

In 2010, according to preliminary data, almost all the indicators improved: GDP, export and import, industrial and agricultural production volume, construction, foreign direct investment. The exception was the indicator of unemployment rate, which kept the negative tendency in 2010. We suppose that the entrepreneurs in the period of going out of the crisis don't rush to create/restore working places, but try to achieve production growth firstly by means of other factors.

As positive results of the state policy of the previous period of time the following can be noted:

- The Government managed to bar the banking system from the crisis and bankruptcies.
- Rate of exchange of the national currency relative to USD and EUR did not suffer drastic fluctuations.
- In spite of strict budget restriction, the social programmes realization has been continued, particularly the increase of salaries has been provided. It was a significant state measure for a poor country in conditions of worsening economic situation (closing enterprises, reduction of funds sending by labor migrants).
- The European vector in the politics of the country has been sharply formulated and partially realized.

The adverse tendencies and results, which could not be surmounted by the Government, are the following:

- Business conditions have worsened. The Government could not support, all the more stimulate the supply and demand in the country. In unfavorable conditions of reduction of money transfers by labor mi-

grants and unacceptable crediting conditions of business, the significant part of enterprises was forced to cut down sales volume, other enterprises have gone bankrupt.

- The deterioration of the main external markets of Moldova (CIS and the EU) as well as Romania's entry into the EU in 2007 and the following complication of border crossing between Romania and Moldova (both for goods and people) complicated the situation for Moldovan enterprises.
- Price increase on importing energy supply made Moldovan goods even less competitive both in internal and external markets.
- The deterioration of the economic situation contributed to aggravation of political problems, which grew into the political crisis. The political crisis is being overcome at present, but still has not been resolved (as the President has not been elected, threat of reelection exists).
- The territorial conflict has not been solved and what is more, the process of conflict settlement has not progressed at all.

### **2.7.1.2. The Analysis of the SME Sector's development Business/ SMEs Regulating Legislation**

Main legislative documents, which have created the basis for entrepreneurship's formation and development, include Law On Property, which created the possibility of private business development in the country, and Law On Enterprises and Entrepreneurship, which set general conditions for functioning of enterprises of all legal forms, types of activities and sizes.

SME activity is being regulated by a special normative documents package. The main one is the Law On Support of Small And Medium-sized Enterprises Sector. Along with this, separate groups of SMEs are being regulated by Law On Peasant (Farmers') Entrepreneurs, Law On Limited Liability Companies, etc., which provide for possibilities of development of different forms of SMEs, which are different by procedures of establishment, taxation, accounting and reporting. It is possible to create a small business without founding the enterprise in Moldova on the basis of the entrepreneur patent (Law On Entrepreneur Patent).

The Law On Support of Small And Medium-sized Enterprises Sector (No. 206-XVI from 07.07.2006, Official Monitor No.126-130/605 from

11.08.2006) was adopted in 2006 and replaced the Law On Small Business Support and Protection, adopted in 1994. The new law changed the criteria of enterprises belonging to small business sector and introduced definition of medium-sized enterprises. These changes made the normative base of Moldova advanced to EU standards. The following classification of enterprises on micro-, small and medium-sized is given in the law (Article 2):

Micro-enterprise is a managing subject, which corresponds to the following criteria: annual average listed number of employees should be no more than 9 persons, annual sales revenue sum – no more than MDL 3 million, total yearly assets cost – no more than MDL 3 million.

Small enterprise is a managing subject, which corresponds to the following criteria: annual average listed number of employees should be no more than 49 persons, annual sales revenue sum – no more than MDL 25 million, total yearly assets cost – no more than MDL 25 million, excluding enterprises, which come upon criteria of micro-enterprises.

Medium-sized enterprise is a managing subject, which corresponds to the following criteria: annual average listed number of employees should be no more than 249 persons, annual sales revenue sum – no more than MDL 50 million, total yearly assets cost – no more than MDL 50 million, excluding enterprises, which come upon criteria of micro- and small enterprises.

The subjects of the SME sector also include managing subjects - natural persons, carrying out entrepreneurial activity with the condition of their correspondence to the criteria above.

The following groups do not belong to SME subjects:

- managing subjects, which hold the dominating position in the market;
- managing subjects, the statutory capital of which contains the share of the non-SME legal person founder (or shareholder, or stockholder) at the rate of more than 35%, with the exception of nonprofit organizations;
- trust and insurance companies;
- investment funds;
- managing subjects, imported excisable goods;

- banks, microfinance organizations, savings and loan associations and other financial establishments;
- exchange shops and pawn-shop;
- enterprises engaged in gambling industry.

At present, the specialists of the Ministry of Economy in collaboration with the EU experts develop the draft of the new Law On Small and Medium-sized Enterprises.

### **Tendencies of SME Sector Development in 2005-2010**

According to statistical data, the SME sector has been demonstrating the steady growth tendency during the whole period of economic reforms since the beginning of 1990s. This tendency existed in later years.

Statistical data do not allow the analysis of the SME sector dynamics for the last 10 years, as in 2006, the new Law on Support of Small and medium-sized Enterprise Sector was adopted and the criteria for the definitions of SME changed. The National Bureau of Statistics - NBS - has re-counted the statistical data on SMEs for 2005 with regard to the new criteria. However, the statistical data before 2005 are incommensurable with the later data. That is why in this paper we use the statistical data beginning in 2005.

### **Number of SMEs**

According to NBS, since 2005, the number of SMEs has increased slightly but permanently; from 32,400 to 43,700 units (see Table 49).

**Table 49: The Dynamics of SME Number in 2005-2009, units**

Indicators	Number of enterprises					
	2005	2006	2007	2008	2009	2010
Total enterprises, including:	33,141	26,158	39,987	42,121	44,633	46,670
SME sector, including:	32,444	35,542	39,320	41,109	43,658	45,600
Medium-sized	1,657	1,724	1,774	1,685	1,589	1,600
Small-sized	6,440	6,544	7,194	8,329	8,264	9,100
Micro enterprises	24,347	27,274	30,352	31,095	33,805	34,900

Source: Bank of statistical data of NBS of Moldova:

<http://statbank.statistica.md/pxweb/Database/RO/databasetree.asp>. Access 10 April 2011.

The yearly growth rate of the number of SMEs amounts to 109.6% in 2006 and 110.6% in 2007. After 2008, growth rates reduced, making up 104.6% in 2008 and 106.2% in 2009. Thus, even in 2009, when most macroeconomic indicators declined significantly, the number of enterprises continued to grow. Growth rates of the number of SMEs are close to the corresponding indicator on total enterprises. Yearly differences make up less than 1%.

Within the SME sector, the dynamics of the number of medium-sized, small and micro-enterprises vary. In 2006-2007, there was a slow-down in the increase of the number of medium-sized enterprises, from 104.0% to 102.9%; in 2008-2009 the absolute number of enterprises decreased (95.0% and 94.3% correspondingly). In 2010, the number of medium-sized enterprises maintained the level of the previous year. The growth rates of small enterprises increased not only in 2006-2007 (from 101.6% to 102.9%), but also in 2008 (115.8%), in contrast with the other two groups of enterprises. In 2009, their number practically did not change (the index was equal to 99.2%), but in 2010, it grew significantly (110.1%). The number of micro-enterprises increased during the whole analyzed. Though the growth rate of this indicator diminished in 2008 (from 111.3% in 2007 to 102.5% in 2008), in 2009, the rate of growth has again to 108.7%. Thus, the general tendency of the number of micro-enterprises corresponds to the tendency of the SME sector, but with relatively high fluctuations.

On the whole, the growth of number in the SME sector enterprises increased first of all due to micro-enterprises and also due to small enterprises. These groups of enterprises are distinguished by high share and growth rates.

**Table 50: Growth/ Reduction Rates of the Number of Enterprises in 2006-2010, compared with the previous year**

Indicators	Growth rates [%]				
	2006	2007	2008	2009	2010
Total enterprises, including:	109.1	110.6	105.3	106.0	104.6
SME sector, including:	109.6	110.6	104.6	106.2	104.4
Medium-sized	104.0	102.9	95.0	94.3	100.7
Small-sized	101.6	109.9	115.8	88.2	110.1
Micro enterprises	112.0	111.3	102.5	108.7	103.2

Source: Bank of statistical data of NBS of Moldova:

<http://statbank.statistica.md/pxweb/Database/RO/databasetree.asp>. Access 10 April 2011.

The share of SMEs in the total number of enterprises was changing a little over the analyzed period. Maximum fluctuations of this indicator varied from 98.33 per cent in 2007 to 97.6 per cent in 2008.

During the period of 2005-2010, the shares of micro-, small and medium-sized enterprises within the total SME sector had different tendencies. The share of medium-sized enterprises steadily declined from 5.11% in 2005 to 3.4% in 2010; the share of micro-enterprises grew annually (with the exception of 2008) from 75.04% in 2005 to 77.43% cent in 2009; and the share of small enterprises had no pronounced tendency.

The total number of employees decreased annually at all the enterprises according to NBS within the period of 2005-2010, like in the other areas of the economy (see Table 51.)

**Table 51: The Dynamics of the Average Number of Employees in 2005-2010, persons**

Indicators	Number of employees					
	2005	2006	2007	2008	2009	2010
Total enterprises, including:	578,011	574,933	574,131	572,129	539,195	526,190
SME sector, including:	317,163	332,720	343,525	328,065	316,244	309,400
Medium-sized	145,323	143,342	140,821	125,482	115,055	108,800
Small-sized	105,223	107,182	111,662	120,249	117,104	121,000
Micro enterprises	66,617	82,196	9,042	82,334	84,085	79,700

Source: Bank of statistical data of NBS of Moldova:

<http://statbank.statistica.md/pxweb/Database/RO/databasetree.asp>. Access 10 April 2011.

The employment tendency can be stated as follows: In 2006-2007, there was a growth of employment (annual growth rate was equal to 104.9% and 103.3% correspondingly); whereas in 2008-2009, an opposite tendency is observed in employment (annual decrease rate was equal to 95.5% and 96.4% correspondingly).

In different SME groups, the dynamics of employment showed different tendencies. At medium-sized enterprises, an absolute reduction in employment took place within the whole analyzed period. In 2008-2009, the employment reduction rate intensified; reaching a peak in 2008 (89.1% compared to the previous year). In small enterprises group, the employment rate increased in 2006-2008; there was a relatively small reduction in 2009 (reduction rate – 97.4%). At micro-enterprises, there was a

significant growth in employment in 2006-2007; whereas in 2008 there was an absolute reduction in the number of employees (the reduction rate was equal to 90.4% compared to the previous year); followed by a small growth in 2009 (102.1%).

Based on this data, it can be assumed that micro-enterprises are more susceptible to downturns in the economic environment than small enterprises; nevertheless, they recover faster.

The share of SMEs in GDP increased in 2005-2006 from 22.4% to 35.0%. After 2005, in 2009, this indicator decreased from 35.0% to 28.9%

### Sales Income Indicator

In 2006-2008, a considerable growth of sales income took place at Moldovan enterprises. But in 2009, there was a significant decrease in this indicator (see Table 52). In the SME sector, the reduction of sales income began earlier, in 2008 (97.3%) and continued in 2009 (88.5%). The mentioned tendency was typical for medium-sized enterprises (the most considerable reduction was equal to 87.2% in 2009) and for micro-enterprises (the drastic decline was in 2008 – 69.2%). Sales income increased in small enterprises in 2008 (111.1%), but decreased in 2009 (86.6% compared to the previous year).

**Table 52: The Dynamics of Sales Income in 2005-2009**

	Sales income				
	2005	2006	2007	2008	2009
Total on enterprises, In current prices, MDL m	97,668.3	117,372.4	148,512	175,058.4	146,447
In comparable prices, MDL m	na	111,146.5	130,374.9	147,193.2	149,989.9
Index with regard to the previous year (in comparable prices, %) including:	na	113.8	117.3	112.9	101.9
SME sector, MDL m (in current prices) including:	42,115.4	54,280.7	66,786.6	64,984.1	57,480
Medium-sized	16,221.2	19,305.1	24,881.2	23,306.2	20,316.3
Small	20,620.6	25,891.5	30,230.0	33,598.7	29,104.2
Micro	5,273.6	9,084.1	11,675.4	8,079.2	8,057.6

Source: Bank of statistical data of NBS of Moldova:

<http://statbank.statistica.md/pxweb/Database/RO/databasetree.asp>. Accessed 10 April 2011.

### Financial Results (profit) of Profited Enterprises Indicator

The dynamics of the profits and losses before taxation is shown in Table 53. The sum of profits (+) and losses (-) before taxation of enterprises (including the SME sector) grew in 2006-2008. Besides, at the SME sector, including two groups of enterprises from this sector (excepting small enterprises), the sales volume decreased in 2008, but the profit continued growing. In 2009, the profit reduced in all groups of enterprises, but grew again in 2010.

**Table 53: The Dynamics of profit (+)/Loss (-) before taxation**

Indicators	Profit (+)/Loss (-) before taxation, MDL m					
	2005	2006	2007	2008	2009	2010
Total enterprises, including:	3,799.5	4,965.6	10,836.3	15,549.4	3,666.8	na
SME sector, including:	1,100.3	1,748.1	3,777.5	5,483.2	2,243.2	5,456.9
Medium-sized	488.9	587.1	1,486.0	1,847.0	725.6	1,031.5
Small	581.0	911.2	1,855.1	3,124.4	1,357.5	2,842.4
Micro	30.4	249.8	436.8	511.8	160.1	683.0

Source: Calculated by the authors based on statistical data from <http://statbank.statistica.md/pxweb/Database/RO/databasetree.asp>. Access 10 April 2011.

By calculations, the Index of SME Development increased 3 times in 2005-2008; decreased by 84% in 2009 compared to the previous year.

#### 2.7.1.3. The Characteristics of the SME Sector in 2010

In the Republic of Moldova, there is no single register or institution which takes account of all SME sector enterprises and micro-businesses, working without registering as an enterprise. The following official bodies take account of different groups of SMEs:

- Statistics bodies,
- Land cadastre bodies,
- Taxation bodies,
- Registration Chamber attached to the Ministry of Justice.

The main source of the data for SME analysis is the National Bureau of Statistics of the Republic of Moldova (NBS). The NBS admits and processes financial reports of the enterprises, which: (i) are active, i.e. car-

ried out some activity during the reporting period; (ii) use the complete accountancy system of dual recording (which all small and medium-sized enterprises are obliged to do, and a part of micro-enterprises, preferring to use the complete accountancy system instead of the easy system). The NBS of Moldova recorded 45,600 enterprises at the end of 2010. The majority of enterprises (98%) belong to the SME sector, 59% of the total number of employees is engaged; 37% of the total sales income is received; and 48% of the profit of profited enterprises by the results of the current year is made in SMEs. About 35% of GDP fell on SMEs. Micro-enterprises prevail in the total number of SMEs (75%). Small enterprises make 20%, medium-sized enterprises – almost 3% of SMEs. Main indicators of the SME sector of 2010 are shown in Table 54.

**Table 54: Main Indicators of SME Sector in 2010**

Indicators	Total SME	Medium-sized	Small	Micro
Number of enterprises, units	45.6	1.6	9.1	34.9
% of Total enterprises	97.7	3.4	19.6	74.8
Average number of employees, persons	309.4	108.8	121.0	79.7
% of Total enterprises	58.8	20.7	23.0	15.1
Sales income, MDL m	65,263.2	22,799.2	33,992.7	8,471.3
% of Total enterprises	36.8	12.8	19.2	4.8
Profit (+)/Loss (-) before taxation, MDL m	5,456.9	1,931.5	2,842.4	683.0
% of Total enterprises	41.4	14.7	21.6	5.2

Source: Calculated by the authors on basis of the statistics data.

The Land Cadastre registers and considers peasants' (farmers') enterprises (farms), created on the basis of land plots, which were allotted to villagers in the process of the land privatization or were subsequently purchased or rented. According to the Land Cadastre's data, there were 399,842 peasants' (farmers') enterprises of different land area from 1 to 100 hectares, registered as of the end of 2009. Among them (the data calculated by Dr.V.Moroz and A.Ignat, the Institute of Economy, Finance and Statistics, Chisinau, Moldova), 145,466 (36.4%) were farms with land plots of the area of less than 1 hectare. We suppose the owners of

such small plots of land are not occupied with entrepreneurship. 7,276 (1.8%) were farms with land plots of the area of more than 100 hectares. They probably should be placed among large businesses. The rest of the farms we suppose are SMEs. They comprise 247,100 of farms, i.e. 61.8% of all peasants' (farmers') enterprises, registered in the Land Cadastre.

The Taxation Authority is the place where entrepreneurs engaged in micro-business without registering as an enterprise are registered and reported. They include the holders of the entrepreneurship patent. Their activity is being regulated by the Law on the entrepreneurship patent. Though the taxation authority does not publish the returns about the entrepreneurship patent holders' activity, according to its information, 15,537 patent holders were registered in the country as of 31 December 2010. They transferred about MDL 26 million to local budgets in 2010.

The data from the Registration Chamber of the Ministry of Justice may give information about the tendencies of entrepreneurship development in Moldova. This information is accumulated in the State Register's database, where all the registered and officially liquidated enterprises are recorded.

As of 1 December 2009, the State Register contained information about 153,819 juridical persons and individual enterprises. According to approximate evaluation, about 94% of them, i.e. 144,600 units refer to SMEs.

Summarizing data from all the available sources – Registration Chamber, Land Cadastre, Taxation Authorities, we estimate the number of SMEs at the end of 2009 to be equal to 407,200 units.

#### **2.7.1.4. Data about the Number of Registered and Liquidated Enterprises**

Data from the State Register does not allow for analyzing the SME sector. However, a rough estimation can be drawn, as SMEs constitute the absolute majority of enterprises of the Republic of Moldova. An additional advantage of the State Register's database is the timeliness of its information, characterizing the situation as of 2010 and partially 2011.

According to the State Register, the number of registered enterprises declined annually during the period of 2007-2010: from 11,480 enterprises in 2007 to 6,488 in 2010. The lowest level of this indicator took place in 2009: the rate of change of the number of registered enterprises was equal to 72.9% in 2009 compared to 2008. In 2010, the number of registered enterprises continued to decrease, though at a lower degree: the reduction rate was equal to 89.9% compared to the previous year. On the basis of data received from the State Register, the indicator characterizing the net growth of the number of enterprises was calculated (as difference of registered and liquidated enterprises). This indicator has shown that net reduction of the number of new enterprises took place during the years 2007-2010. In 2008-2009, this tendency strengthened. In 2010, the number of newly-created enterprises continued to reduce, but not as dramatically.

According to the latest data of the State Register (as of 1 March 2011), 158,109 juridical persons and individual entrepreneurs were registered. The structure of the registered enterprises by legal forms is shown in Table 55.

**Table 55: The Structure of the Registered Enterprises by Legal Forms as of 1 March 2011**

Legal forms	Number of enterprises [units]	Share [%]
Individual enterprises	87,225	42.5
Limited liability companies	73,876	46.7
Joint-stock company	4,837	3.1
Cooperatives (production cooperatives, consumer cooperatives and entrepreneurship cooperatives)	4,054	2.6
State and municipal enterprises	1,455	0.9
Non-commercial organizations	3,105	2.0
Others*	3,557	2.2
Total	158,109	100

\* filial branches, collective societies, special partnerships, leased enterprises, inter-managing enterprises, collective farms, farms associations and other enterprises.

Source: Data of the State Register, <http://www.cis.gov.md/ru/content/241>

If we assume the predominant share of enterprises registered in such legal forms as limited liability companies, cooperatives and non-com-

mercial organizations to be SMEs, then the share of SMEs makes up about 94% of all the enterprises registered in the State Register, that is 148,000 SMEs minimum.

### 2.7.2. Ranking of Doing Business According to World Bank Methodology

In Doing Business-2011 ranking, the ease of doing business is evaluated by 9 indicators. Moldova's position in 2011 and the change as compared to the previous year are presented in Table 56.

**Table 56: Moldova's Ranking Change in Doing Business-2011**

Ranking indicators	Ranking 2011	Ranking 2010	Change in 2011
Starting a Business	94	78	-16
Dealing with Construction Permits	159	163	4
Registering Property	18	17	-1
Getting Credit	89	87	-2
Protecting Investors	109	108	-1
Paying Taxes	106	102	-4
Trading Across Borders	141	141	No change
Enforcing Contracts	20	20	No change
Closing a Business	92	91	-1
Rank of Moldova in Doing Business	90	87	-3

Source: <http://logos.press.md/Weekly/Figures/872-08.pdf>

As compared to the previous year, Moldova's rank has declined on three points in Doing Business-2011, so Moldova is ranked 90th among 183 countries.

The best ranking of Moldova applies to Registering Property (ranking 18). It requires 5 procedures and takes 5 days.

The lowest one among 9 ranking indicators is Dealing with Construction Permits (ranking 159). It takes 30 procedures and 292 days to deal with construction permits.

Dealing with Construction Permits became the only indicator on which Moldova has bettered its position. Moldova went up 4 ranks, but the overall situation in Dealing with Construction Permits remains very complicated for entrepreneurs.

On two indicators – Trading Across Borders and Enforcing Contracts – Moldova retained the previous year's ranking: 141 and 20 correspondingly.

For the rest of the indicators, scored by Doing Business ranking, Moldova's place has worsened. The most significant one is the indicator of Starting a Business (16 scores down).

The Government activity is not entirely reflected in the ranking of 2011. Very important reforms with positive influences in the future have been initiated by the Government after the ranking's compiling. Among essential positive measures taken by the Government in 2010, the following should be noted:<sup>37</sup>

- The adoption of Laws: On construction permits' issue, On officers of the court; introduction of the "one window" principle in the issuing of construction documents.
- The receipt of the first license on opening of a Credit Histories Bureau in Moldova. The lack of credit bureaus was estimated in last year's report as one of the principal shortcomings of the business climate.
- The introduction of online services (i.e. possibility of making electronic tax payments) and electronic documents circulation that fit in with up-to-date tendencies of business development.
- The reduction of social insurance due rates for entrepreneurs.

### **2.7.3. SME Support Infrastructure**

Support for entrepreneurship is implemented both by the state institutions and business service providers.

The following state institutions participate in SME support:

The Ministry of Economy of the Republic of Moldova for a long time was the single institute which developed and realized the state policy in respect of the entrepreneurship and SMEs. In particular, the Ministry of Economy provides and develops strategic directions for the Government and the Parliament referring to the SME support policy at national and regional levels; prepares suggestions for the correction of the policy taking into account the practical situation; submits the policy to international organizations' approval, first of all to the European institutions; and coordinates the work of sectoral ministries and local authorities. In the framework of the Ministry of Economy, SME sector development is the direct matter of regulation of the Direction of policies of SMEs and the development of liberal professions, where 6 persons are engaged.

The Organization of SME Development (ODIMM) is the state agency with a staff of about 20 persons engaged, created in 2007 and subordinated to the Ministry of Economy. Main objectives of its activity include the realization of the state policy, connection between the centre and regions, coordination of all types of financial support to SMEs, and closer work with the entrepreneurs. At the same time, the Ministry of Economy retains functions of developing the state policy in the SME domain, its monitoring and the estimation of introduced measures.

At the local level, each municipality and District Council employ a specialist who controls the SME activity in the corresponding territory.

Besides, public institutions in different periods of time participate in support of certain groups of enterprises. In particular, in order to support the innovative businesses, the state created 3 scientific-technologic parks and an innovation incubator in the framework of the Academy of Sciences of Moldova. The state participates in rendering of certain services to businesses by means of public institutions. In particular, the state:

- renders services to the enterprises, engaged in exporting of goods and interested in attracting investments by means of the public organization Moldovan Investment and Export Promotion Organisation (MIEPO);
- guarantees credits by means of the Fund, operating in the framework of the Organization of SME Development (ODIMM);
- organizes exhibitions and trade fairs by means of the International Exhibition Centre "Moldexpo".

In order to substantiate the state policy, the scientific centre – the Institute of Economy, Finance and Statistics (IEFS) analyzes the current situation in the SME sector. On the basis of the official statistical data, surveys and interviews with the entrepreneurs, main problems faced by SMEs, and measures for their solutions are revealed.

Providers of business services offer various types of services to SMEs, including information, consultations and business training.

According to the data of the Ministry of Economy, there were 111 institutions providing business services at the beginning of 2005, among them: 70 consulting centers, 28 informational centers, 13 SME incubators and industrial parks.

At present, there are 181 institutions registered in the database of business services providers on the web-site <http://odimm.md/infra.htm>; about half of which are registered in the capital but offer services throughout the whole country.

The list of services includes consultations directed to business development such as accounting, taxation, goods advancement, and personnel management. Also, the following services are offered: book-keeping and auditing services, business plan development, market research, external economic activity; trainings for accountants, managers and other specialists are available too. Specialized services are offered only for such groups of enterprises in agricultural business and enterprises from the rural area.

The financial support to SMEs is offered by many commercial banks, but crediting conditions (rate percentage on credit and security, estimated on the base of undervalued price) put barriers for many entrepreneurs. The SME Supporting Fund functions in the framework of the State Organization of SME Development. At present, it renders services of credits guarantee to SMEs. The Fund offers two products of guarantee; to active enterprises and to start-ups, including those which have limited access to other sources of finance.

There are also associations of mutual crediting and credits guarantee in the rural areas, rendering financial support to their members. The associations of mutual crediting and credits guarantee offer small loans, which are easy to access and are unsecured for the most part for SMEs, rural area population and socially vulnerable groups, as the presence of commercial banks is limited. As of 30 September 2009, the number of associations' members rose by 6% compared to the same period of the previous year and was equal to about 127,000 persons. Nevertheless, the network of associations of mutual crediting and credits guarantee is characterized by the growing financial dependence on external sources. Thus, 70% of the loans given to the members were offered by means of bank credits and drawn external sources. They declined by 35% at the end of 2009 compared to the same period of the previous year, conditioned by the effects of the world financial crisis.

Despite being represented by a considerable number of institutions, the business services market is characterized by the following negative aspects:

- Insufficient diversity of rendered services and the discrepancy between offered services and needs of certain groups of entrepreneurs;
- Disproportions in territorial distribution of market infrastructure institutions, their concentration mainly in the capital and other cities;
- Irregularity of infrastructure development in different market segments (for instance, institutions serving the labor market and small business are less developed, while the banking sector was formed at financial market a long time ago and is functioning well now).

Underdeveloped market infrastructure hinders effective entrepreneurship development, worsens the conditions and restricts opportunities for the SMEs.

#### **2.7.4. Classification of Enterprises**

The state policy of entrepreneurship support is directed towards the creation of favorable conditions for the development of entrepreneurship as a whole. At the same time, the specific characteristics of separate groups of business and their significance for the national economy at present and in perspective are taken into consideration. This enables the implementation of well-founded methods addressing separate groups.

The Moldovan statistical bodies classify enterprises mainly by the following criteria:

- Size (micro-, small, medium-sized and large);
- Types of activities/ sectors;
- Forms of ownership;
- Economic regions or districts.

In separate (sampling) surveys, additional classification criteria are used for the statistics:

- for enterprises: location of the business (urban or rural area);
- for entrepreneurs: gender, age, educational background.

For instance, the research carried out by the National Bureau of Statistics in 2009 confirmed the need to take into account the gender aspect in the development of an enterprise.<sup>38</sup>

As for the specifics of enterprises from the rural area, distribution of entrepreneurs by area of business showed that the share of entrepreneurs in urban areas is significantly higher and constitutes 83.2%; only 16.8% of all entrepreneurs operate in rural areas. In this respect, the share of rural entrepreneur population in the total population represents 58.7%.

While comparing difficulties that enterprises encountered in 2008, it was found that rural entrepreneurs encountered difficulties more often (81.3%). Lack of funds, lack of advanced technologies, limited access to credits, and lack of raw materials – all afore-mentioned problems were more often underlined by entrepreneurs in rural areas. In urban areas, the share of respondents that mentioned problems is relatively lower – 72.3%.

The proportion of enterprises involved in export in urban areas is a little higher and comprises 12.9% (in rural areas the percentage is 11.6%).

Besides, while carrying out surveys and interviews, we classified the entrepreneurs by the following criteria:

- Enterprises were classified by age (start-ups, young and mature). Differences among these groups were registered in different projects depending on the objectives of the research. For instance, the project carried out by the Institute of Economy, Finance and Statistics, which included the questioning of more than 500 entrepreneurs about their access to resources, evidenced that the main problem of starting enterprises (working under 2 years) was access to finance; of young (working under 6 years) and older enterprises – problems related with personnel and equipment; of mature enterprises – problems related with limited access to information (Source: Elaboration of programme for economic growth, 2007)
- Running business persons were classified in two groups: (i) those who have entrepreneurial abilities, and (ii) those who were pushed into business owing to different reasons and were forced to be engaged in entrepreneurship activity having no proper abilities, skills, experience and other necessary resources.

The above groups may be called entrepreneurs and proprietors.<sup>39</sup> The proprietors, as a rule, are the owners of individual enterprises or family firms, or work without the creation of a legal entity (including house-

holds, partially engaged in entrepreneurship, and self-occupied persons). This group of entrepreneurs do not have precise limits marked in quantitative and qualitative parameters (size of the enterprise, legal form or sector of the economy). They, as a rule, are characterized by low income level, are not aimed at long-time development and are inclined to change the position of the owner to the employee on conditions that an alternative working place with comparable wage exists.

### **2.7.5. The Effect of the International Financial and Economic Crisis**

The specifics of the selected groups of enterprises determine how they were influenced by the crisis.

Analyzing the changes in the number of SMEs by main types of activity during the crisis (2008-2009), it should be noted that the crisis had a relatively less influence on the trade sector, where the indicator continued growing in 2008 (104.8%) and 2009 (106.5%). The indicator's growth in the transport sector retained too, but at a lower degree (102.5% in 2008 and 101.3% in 2009).

SMEs from agriculture and manufacturing industry were influenced by the crisis in the most negative way. The construction sector was affected by the crisis a bit later, compared to other sectors – in 2009.

The change in the number of SMEs by types of activity in 2007-2009 is presented in Table 57.

**Table 57: The Rates of Growth/ Reduction of SME Number by Types of Activity in 2007-2009 (%)**

Main types of activity	2007	2008	2009
Agriculture, hunting and forestry	106.0	100.8	105.1
Manufacturing industry	110.5	99.8	101.8
Construction	114.7	104.9	101.8
Wholesale and retail trade, including the repair of motor vehicles, motorcycles, household and personal goods	109.6	104.8	106.5
Transport, warehouse and communications	111.3	102.5	103.1

The crisis influenced employment indicators, sales income and number of profited enterprises more significantly.

In 2008, employment reduction took place in all basic sectors. In 2009, the reduction of this indicator continued; it especially declined in construction (92.0% in 2008 and 88.7% in 2009).

It should be noted that in Agriculture, hunting and forestry sector the employment reduction took place even before 2008.

**Table 58: The Rates of Growth/ Reduction of SME Employment by Types of Activity in 2007-2009 (%)**

Main types of activity	2007	2008	2009
Agriculture, hunting and forestry	89.7	90.2	94.2
Manufacturing industry	102.9	92.3	94.1
Construction	112.9	92.0	88.7
Wholesale and retail trade, including the repair of motor vehicles, motorcycles, household and personal goods	105.6	96.5	98.2
Transport, warehouse and communications	105.5	93.3	98.5

The crisis influenced employment indicators, sales income and number of profited enterprises more significantly.

In 2008, employment reduction took place in all basic sectors. In 2009, the reduction of this indicator continued; it especially declined in construction (92.0% in 2008 and 88.7% in 2009).

It should be noted that in Agriculture, hunting and forestry sector the employment reduction took place even before 2008.

The most dramatic decline of sales volume indicator was registered in construction both in 2008 and 2009. In 2009, sales volume fell in all sectors, especially in construction (70.6%); agriculture, hunting and forestry (85.9%); manufacturing industry (86.4%); transport, warehouse and communications (88.1%); and trade (90.1%).

**Table 59: The Rates of Growth/ Reduction of SME Sales Volume by Types of Activity in 2007-2009 (%)**

Main types of activity	2007	2008	2009
Agriculture, hunting and forestry	105.6	128.2	85.9
Manufacturing industry	124.0	100.3	86.4
Construction	137.8	86.3	70.6
Wholesale and retail trade, including the repair of motor vehicles, motorcycles, household and personal goods	120.4	93.1	90.1
Transport, warehouse and communications	125.1	104.4	88.1

In 2008, the number of profited enterprises grew in basic sectors, but declined in 2009. The maximum reduction took place in agriculture, hunting and forestry (78.9%) and construction (81.6%).

**Table 60: The Rates of Growth/ Reduction of SME Sales Volume by Types of Activity in 2007-2009 (%)**

Main types of activity	2007	2008	2009
Agriculture, hunting and forestry	126.9	109.1	78.9
Manufacturing industry	114.5	105.9	86.6
Construction	114.4	108.4	81.6
Wholesale and retail trade, including the repair of motor vehicles, motorcycles, household and personal goods.	113.3	113.8	93.3
Transport, warehouse and communications	108.9	112.0	109.1

Analyzing the changes of the number of SMEs by economic regions, it should be noted that in 2008-2009, relatively low growth rates were registered in the North Region. Faster growth in the number of enterprises was registered in Central and South regions. The highest growth rates took place in U.T.A. Gagauzia in 2009.<sup>40</sup>

The classification of doing business persons as “entrepreneurs” and “proprietors” (see above) is not used by statistics bodies. Thus, their motivation, business development objectives and output indicators can be discovered only by surveys and interviews. Interviews have shown that the crisis influenced the entrepreneurial activity of “proprietors” in an extremely negative way. The reduction in sales and income of this group of entrepreneurs caused a part of these enterprises to go bankrupt or move to the shadow economy. This had a considerable negative influence not only on entrepreneurial activity, but on the living standards of their families, which were not high initially.

#### **2.7.6. Government Measures to Cope with the Impact of the Economic Crisis**

The policy on SMEs is presented in the State Programme for Supporting Small and Medium Enterprises Development during 2009-2011, which represents the main mid-term political and socio-economic framework for the development of SMEs. The Programme is guided by the firm participation of SMEs in strengthening the economy of the Republic of Moldova. The Programme represents the outcome of numerous consultations with the civil society, ensuring its compliance with the priority needs of the sector.

In the framework of this document, 5 strategic activity directions have been planned:

- 1) Assurance of a favorable legislative and normative framework for the establishment and development of small and medium-sized enterprises;
- 2) Improvement of the financial environment for small and medium-sized enterprises;
- 3) Promotion of entrepreneurial culture and managerial performances of small and medium-sized enterprises;
- 4) Development of competitiveness and internationalization of small and medium-sized enterprises;
- 5) Intensification of the dialogue between the Government and the private sector.

Among the most significant measures realized in the framework of strategic directions, the following should be noted.

**Priority direction 1: Assurance of a favorable legislative and normative framework for the establishment and development of small and medium-sized enterprises**

The over-regulation of the business by the state affects SMEs in a negative way. It is necessary to encourage central and local authorities to identify and implement efficient initiatives to improve the activity environment for small and medium enterprises.

With the purpose of simplifying the fulfillment of regulating procedures and reducing corruption opportunities, alterations were made in legislation and one-stop windows have been introduced:

- From 03 September 2010, the one-stop was introduced, according to which the state register body in collaboration with public authorities receives all the necessary information for state registration of juridical persons and individual enterprises and delivers state registration information to public authorities by electronic network without involving the registration's claimant in this process.
- Application of the one-stop window's principle to improve customs procedures at border customs offices since 2009 ensures electronic data exchange between the Customs Service and institutions, involved in customs procedures of goods. During 2010, the informational automatized system "Frontiera" (i.e. "Frontier") has been improved. It is adjusted to the needs of control authorities, who

participate in a one-stop window, ensuring the online information exchange among the authorities empowered to control goods and carriers at the border.

- In 2010, the new version of the web-portal of electronic fiscal services [www.servicii.fisc.md](http://www.servicii.fisc.md) was launched, complete with new functions and modules. This web-portal constitutes the one-stop window, which includes the totality of softwares and web-applications to ease the interaction between tax-payers and the State Fiscal Service. At the same time, in 2010, various actions of optimization and development of methods of fiscal reporting by means of informational automatized systems "Electronic Declaration" and "Rapid Declaration" were realized.

### **Priority direction 2: Improvement of the financial environment for small and medium enterprises.**

The complexity of SME financing, especially at the initial stage of their activity, is frequently a major obstacle for them.

Investors and banks avoid funding establishment costs of SMEs due to the involved risks, and entrepreneurs do not fully acknowledge the reasons of investor and bank concerns, and this fact further complicates the granting of necessary financial assistance.

The State grants small and medium enterprises guarantees through different financial tools, thereby facilitating the possibility of obtaining credits from banks.

For the purpose of financially supporting the process of fostering the export of local products, and the actions for the prioritized development of economic sectors, the Government has undertaken efforts to attract international credit lines.

Another challenge in this field is remittance investment and its efficient use by businesses. Taking into consideration the importance of remittance for the economy of the Republic of Moldova during the last few years, political initiatives focus on improving large-scale investment opportunities for setting up new businesses, thus responding to the interest by migrants and their families to make investments.

An example of the improvement of SMEs' access to financial resources: the State-owned Fund for Credits' Guaranteeing offers two guarantee products: one for active enterprises, another for start-ups:

- For active enterprises: the sum of guarantee consists up to 50% of the credit, but not higher than MDL 700,000. The guarantee period is up to 5 years;
- For start-ups: the sum of guarantee consists up to 70% of the credit, but not higher than MDL 300,000. The guarantee period is up to 3 years.

At the end of 2010, the Fund's portfolio consisted of 30 active guarantees with a total sum of MDL 6.7 million, which guaranteed credits in volume of MDL 18 million. The guaranteed credits promoted the improvement of the production capacity in agriculture, food industry and wood manufacture. As a result, the beneficiaries of guarantee registered the 45.0% growth in sales income and 25% increase in the number of employees; 34% of producers directed the production to export.

Also, the grant given by the Government of Japan aimed to increase the SME competitiveness by leasing equipment with zero rate, where the grant makes 40% of the cost of equipment. Since the launch of the programme, more than 120 leasing contracts have been signed and the equipment of a total sum of more than USD 12.5 million has been delivered.

### **Priority direction 3: Promotion of entrepreneurial culture and managerial performances of small and medium enterprises**

For the purpose of achieving sustainable economic growth, it is important not only to create a favorable environment for the able-bodied population in terms of labor force development and employment, but also to set up a favorable climate for cultivating entrepreneurial spirit.

The education in this field should cultivate abilities that generate entrepreneurial behavior, as well as creativity, an initiative spirit, risk acceptance, self-trust, teamwork skills, etc.

The entrepreneurial culture shall be developed through the general training system, vocational and educational systems, and by extending

the re-qualification system for unemployed people, in cooperation with universities, institutions, and organizations involved in the field of small and medium enterprise counseling.

Development of consultancy services granted to small and medium enterprises for drafting business and marketing plans, including obtaining finance from structural funds, and implementing market and feasibility studies, shall become a component of the process for promoting an entrepreneurial culture.

Examples of betterment of providing the entrepreneurs with information and consulting services:

- By Government initiative to facilitate SME access to information, new informational web-sites ([www.mec.gov.md](http://www.mec.gov.md), [www.odimm.md](http://www.odimm.md), [www.businessportal.md](http://www.businessportal.md)) have been created and were visited by more than 108 thousand of visitors in 2010.
- The united database of Business Service Providers (PSA) has been created, in which the descriptive information about active Business Service Providers' activity is presented. Their services are orientated to consulting and rendering necessary support to the entrepreneurs of the Republic of Moldova.
- Examples of trainings of entrepreneurs:
- By Government initiative, the Programme of continued training "Efficient Carrying-out of a Business" has been launched, which aims to improve qualification of both active and potential entrepreneurs in entrepreneurship and management. Thus, by means of this Programme, 51 training courses in 18 locations were organized, 1,480 persons were trained, among whom 475 were entrepreneurs and 1,005 were employees of SMEs. An important point is that 928 of trained persons (i.e. 63%) were women.
- In the framework of the Programme "Start-ups Support", training seminars were organized in different districts of the Republic with the purpose of improving knowledge and entrepreneurship abilities in the fields of financial management; labor legislation; registration as a VAT-payer and the application of the related legislation; and efficient sales techniques.
- With the help of USAID/BIZTAR Project from the USA, seminars and round-tables were organized, where questions of social insurance, rapid declaration, inventory of permits issued by central public authorities, "Guillotine 2+ Plus" were discussed.

- Support for national business environment was also offered by the Project of Moldovan-German Partnership in business sphere. With the support of the project, a training session was carried out; round-tables and seminars were organized referring to enterprise intellectual property protection, force major in an enterprise's activity, trade marketing and communication, efficient communication techniques in business area and environment protection. This provided an efficient dialogue between local public authorities and non-governmental associations representing entrepreneurs' interests.

#### **Priority direction 4: Development of competitiveness and internationalization of small and medium enterprises**

The Government's efforts to foster an increase in the competitiveness of small and medium enterprises sector are special, as at present this sector has the largest capacity to create new work places and to ensure income sources.

The Government of the Republic of Moldova fully recognizes the importance of the innovation process within small and medium enterprises, which is necessary for their survival and prosperity at the international level, due to the fact that markets evolve rapidly and the competitive scramble from other economies becomes harsher and harsher. Implementation of research-development and innovation activities, as well as of new technologies, is the methods that may be used by Moldovan small and medium enterprises for achieving performance goals in their area of activity.

Examples of the SME activity's impulsion in innovation and technology transfer sphere:

- The Academy of Sciences of Moldova in collaboration with the Ministry of Economy organized the International Conference "Innovation Networks – The New Formula for Regional Development" in the framework of the investment week "Moldovan Business Week 2010" with the participation of scientific and business community.
- In 2010, as a result of the cooperation between SMEs and institutions of research and innovation at the national level, more than 50 enterprises implemented innovation results and 16 new agreements with national research institutions were concluded with the mediation of Projects of Innovation and Technology Transfer. At the same time,

in order to continue the development of innovation infrastructure in the city of Balti, the branch of Innovation Incubator "Inovatorul" was opened there, while the branch of the Park "InAgro" was opened in Cahul.

- In 2010, in the Business Incubator in Soroca 25 new workplaces were created, so the number of existing workplaces grew from 55 at the beginning of the year to 80 at the end of the year. At the end of the first year of activity, companies-residents of the Business Incubator in Soroca reached the total turnover sum of MDL 24.9 million. One of the companies-residents was assisted in the promotion of their own production to external markets with the financial support of the Programme BAS BERD Moldova.

With the purpose of optimization and efficiency growth of the potential of enterprises and institutions in elaboration, utilization and management of intellectual property objects, the State Agency for Intellectual Property (AGEPI) introduced a new type of services – Property Preliminary Diagnosis, which is rendered to SMEs from 2009 following the best European practices in entrepreneurship domain. In 2009-2010, about 1,039 enterprises from the SME sector received titles of protection for intellectual property objects.

Examples of the cross-border cooperation's stimulation:

- In 2010, the District Council Cahul jointly with the General Council of Romania organized the Economic Forum "Cross-Border Cooperation Romania-the Republic of Moldova", where economic units from the south region of Moldova participated.
- Workers of the District Council Cantemir and chiefs of SMEs also participated in the Economic Forum "Cross-Border Cooperation Romania-the Republic of Moldova". The key problems of collaboration and international cooperation were discussed there: partnerships Romania-Republic of Moldova for the access to European funds; efficient utilization of commercial transactions, proposed by the EU; investment climate in the Republic of Moldova.

### **Priority direction 5: Intensification of the dialogue between Government and the private sector**

The intensification of the dialogue between the Government and the pri-

vate sector is implemented through its participation in the improvement of the legislative and normative framework, and the consolidation of institutional and functional capacities of the structures representing small and medium enterprises.

In this context, the Government should support the national associations of entrepreneurs by attracting donor support for their institutional and human capacity building, and shall facilitate their participation in European networks for business assistance and research and development programs funded by the European Commission.

Examples of Forum organizations which promote dialogue:

- Annually in May, under patronage of the Government of the Republic of Moldova, the International Forum of Small and Medium-sized Enterprises is organized. Three types of measures are carried out in the framework of the Forum: (i) SME exhibition with additional programmes (i.e. round-tables and informative seminars for SMEs); (ii) The International Conference of SMEs; (iii) National Contests for SMEs.
- 212 micro-, small and medium-sized enterprises, handicrafts-men and farmers, presenting products and services of agriculture, food industry, construction, textile, tourism, etc. have participated in the exhibition in 2010. The exhibition was visited by about 4,200 persons from all the republic and 150 persons from abroad. Also, in the framework of the Forum, 6 round-tables, 2 informative seminars, 1 training and several presentations of companies and products were held, which considerably contributed to the awareness of economic units about the interpretation of Fiscal and Customs Code articles and consolidation of the consulting services market.
- In 2010, the International Conference of Small and Medium-sized Enterprises on the subject "Innovations. Modernisation. Competitive Management" served as a platform for discussions about the creation and development of a competitive business environment, elimination of obstacles in the way of access to financial resources, improvement of the business support infrastructure, education of the competitive management culture and innovative entrepreneurial abilities. The conference included 3 workshops, where about 250 persons participated: representatives of the business environment, public authorities sector, academic environment, non-governmental organizations,

business associations, national and international institutions.

- In June 2010, in the framework of organization of the Investment Week "Moldova Business Week 2010", the Moldovan Investment and Export Promotion Organization (MIEPO) elaborated the Standard Profile of Investment Opportunities, which was distributed for completion to central and local public authorities and private sector units of the Republic of Moldova. As a result, 272 investment profiles were placed on CDs "Moldova: Focus on Relocation" and "Moldova: Investment Opportunities", which were distributed within the Investment Week and Diplomatic Missions of the Republic of Moldova abroad.

With the purpose of support to certain groups of enterprises or entrepreneurs, the following programmes, financed from the state budget and gaining quite a lot of popularity, were developed and partially realized by the Government.

The National Programme of Economic Support of the Youth, elaborated in 2008, is directed to young people's integration in social-economic life of the country, in particular, to stimulation of entrepreneurship skills of young people, for many of whom it is the opportunity of starting their own business. The Programme will last until 2013 and consists of 3 parts:

Part I: Training and consultations in business.

Part II: Financing of rural investment projects by means of granting the repayable commercial credits and also the financing of leasing contracts. The maximum sum of issued credits is MDL 300,000 that is equal to USD 27,000 USD, 40% of which are constituted by grants from the state. Credits are given for the period from 2 to 5 years.

Part III: Post-financing monitoring.

In the framework of the National Programme of the Youth's Economic Ability (PNAET), in 2010 alone, credits with the total sum of MDL 132.74 million have been extended, including grants on MDL 52.86 million, destined to 474 projects. Also, 15 training seminars were organized in 12 locations, by means of which 405 young persons (among whom 61 were entrepreneurs and 188 were women) were trained on the topic of modes

of business organizing and development. With the support of the International Organization for Migration (IOM), the entrepreneurship training course was organized for 21 socially vulnerable young people from the Cahul district. After the course, they try to found their own business. By means of the project "Migration Component Implementation's Support, Development of the Partnership for Moldova-EU Mobility", implemented by IOM, the most viable businesses will be financed by grants of up to EUR 2,000.

The Pilot Programme for attraction of return payments in the economy "PARE 1+1" was elaborated in 2010 and is designed for the period of 2010-2012. The necessity of this programme is explained by the fact that more than one million citizens of Moldova work abroad and the total annual money transfers, sent by migrants through commercial banks exceed USD 1 billion.

The Programme "PARE 1+1" is designed for attraction and investment of migrants' money transfers to the development of rural areas. The grant of the state is equal to migrants' contribution, but not higher than MDL 200,000 (i.e. EUR 12,000). Also, additional consultations in entrepreneurship sphere are granted. This Programme is to be an effective instrument to stimulate investments in the economic development of the country and to overcome mass migration and brain drain from Moldova. Since the project's starting date, 36 dossiers for participation have been put and the first training courses session (with the participation of 21 persons) have been organized.

### **2.7.7. SWOT Analysis of the SME Sector**

See Chapter 3.

In spite of the measures taken by the state during the past years, the majority of SMEs do not feel adequate positive changes in their activity. As earlier, they have to face significant barriers at all stages of the work. Only the long-term purposeful and consecutive state policy concerning SMEs – the policy based on the study of business reality and taking into account entrepreneurs' opinion, co-ordinated with policies of other countries from the region – will allow improving business environment and raising the SME competitiveness.

### **2.7.8. Tasks for Improvement and Further Development of the National SME Sector**

For further development of the national SME sector, the governmental support in the following directions is needed:

1. The continuation of the regulatory reform and the implementation of the system of Evaluation of the Regulation's Impact. The importance of this task is conditioned by grave bureaucracy-related problems, which entrepreneurs face in the process of business regulation and control.
2. Strengthening of the dialogue between business sector and public authorities, which will create prerequisites for public-private, social and other forms of partnership. The first step to strengthen the dialogue should be the governmental support of the process of SME business-associations development.
3. The support of participation of SMEs in various forms of business associations such as clusters, holdings, consortiums, etc. This would contribute to the strengthening of the resource source of enterprises and to the integration of the national economy in European and world-wide economy. The opportunity for Moldovan SMEs to participate in the EU operational programmes, directed to support clusters, would be desirable.
4. The development of cooperation among SMEs, public authorities and providers of training, informational and consulting services for the business. This would allow making business services, rendered by providers, to satisfy the needs of entrepreneurs to a higher degree and to take proper account of general tendencies of the country's economic development.
5. The stirring up of the public authority's activity at the regional level. The policy of SME support today is being carried out in a considerable degree at the national level. As a result, conditions for SME development vary much in the capital and in other regions, in spite of the fact that Moldova is a small country.
6. Focus of the public authorities' attention on the smallest-sized enterprises, which need particular support: individual enterprises, family firms, self-employees, households. These entities are not regarded by the public authorities as an important part of the entrepreneurship, although they perform vital social functions in the society.
7. The special accentuation of the policy should be done on such groups of entrepreneurs as the youth and women. It is stipulated by low share of young people in business (the average age of entrepreneurs

- is 45 years in Moldova) and by the female entrepreneurs' characteristics.
8. The stimulation of SME innovation activities by introducing economic incentives for businesses and creation of market infrastructure institutions, directed to the elaboration and introduction of innovations.
  9. Widening and detailing of the database of SMEs working in Moldova, including all groups of SMEs registered in diverse institutions (the Ministry of Justice, taxation authorities, National Bureau of Statistics, etc.). To make this information more accessible to politicians, business community and researchers.
  10. Participation of the Republic of Moldova in the discussion, ratification and monitoring of international documents drafts, which are adopted and realized at the territory of the EU and are directed to SME development. In particular, taking into account the European vector of Moldova's development, the joining of Moldova to Small Business Act for Europe is the matter of current importance.
  11. Proclaiming by the Government of priority and stability of the SME support policy: formulation of the principal objective of the SME support policy for medium and long-term period; administration of guarantees of preservation of conditions for running business at least 5 years under any legislation's change; annual approval of a certain funds rate for SME support in state (local) budget.

### **References for further studies**

- Law On Support of Small And Medium-sized Enterprises Sector (2006). N206 - XVI from 07.07.2006 //Official Monitor of RM.-2006.- N126-130.
- Aculai Elena (2009). Conditions for Enterprise Creation and Development: Gender Analysis (independent project). Statistics of Moldova, UNDP, UNIFEM. "Nova Imprim" SRL, Chisinau. – [http://undp.md/presscentre/2009/Statistics\\_24Dec/block\\_Bussines\\_ENG\\_29-03-2010\\_NEW.pdf](http://undp.md/presscentre/2009/Statistics_24Dec/block_Bussines_ENG_29-03-2010_NEW.pdf)
- Calac Dmitrii (2010). DOING BUSINESS-2011: Moldova is Late With Reforms. Logos Press, No. 40 (872) / 5 November 2010 / <http://logos.press.md/Weekly/Main.asp?IssueNum=872&IssueDate=05.11.2010&YearNum=40&Theme=4&Topic=28294> (in Russian)
- Elaboration of programme for economic growth / Project for applied researches. Scientific report. Institute of Economy, Finance and Statistics ASM (IEFS), Chisinau, 2007.
- National Bureau of Statistics of the Republic of Moldova (2011). Statistics databank of Moldova: <http://statbank.statistica.md/pxweb/Database/RO/databasetree.asp>. Access 10 April 2011.

## **2.8 ROMANIA**

Dr. Zsuzsanna Katalin Szabó

Dean of the Faculty of Economics, Law and Administrative Sciences, Petru Maior University, Targu Mures, Romania

### **2.8.1. The Development of the National Economy**

A short review of the development of the national economy is necessary in order to understand the SME sector in Romania. The history of the Romanian economy can be divided into three periods.

After World War I, a radical agricultural reform and the new constitution, one of the most democratic on the Continent, created a generally democratic framework and generated a fast economic growth. However, the economy showed an opposite tendency in the period 1944 – 1989 and during the Ceausescu administration, the heavy industry used many resources and produced low-value products.

#### **Transition Economy**

The transition in Romania started in 1990 and was more difficult than in other central and eastern European countries. At the end of the 80's, the Romanian economy was near a collapse after 40 years of centralized planning, which was concentrated only on heavy industry and on big, non-profitable infrastructural projects.

The transition to a market economy meant synthetically the development of two processes - the transfer of ownership from state-owned enterprises into private hands and the emergence of new private companies as a result of the private and independent initiatives. These two processes developed more or less simultaneously, but with different paces. Both processes have a great impact on the labor market.

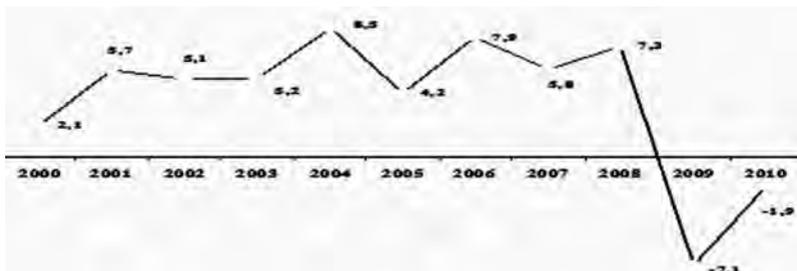
Privatization of industry was pursued with the transfer in 1992 of 30% of the shares of some 6,000 state-owned enterprises to five private ownership funds, in which each adult citizen received certificates of ownership. The remaining 70% ownership of the enterprises was transferred to a

state ownership fund, with a mandate to sell off its shares at the rate of at least 10% per year. The privatization law also called for direct sale of some 30 specially selected enterprises and the sale of “assets” (i.e., commercially viable component units) of larger enterprises. The government tried to reduce the social costs of the transition and for this reason hesitated to introduce tightening of financial system and starting the privatization of a big non-profitable enterprise. The result was a negative economic growth; with the poverty level decreasing from 20% in 1996 to 41% in 1999.

From 2000, the Government started to implement macroeconomic policies to help and to encourage the economic growth. A tightly controlled financial policy was followed by a monetary policy which created financial discipline in the enterprise sector and a solid base of public finance and fiscal system. In the winter of 2004, the political leadership of the current government introduced a flat tax of 16% that became effective on 1 January 2005. This was done in the hope of higher GDP growth and greater tax collection rates. The reform, which some called a “revolution” in taxation, was met with mild discussions and some protests by affected working classes (Figure 18).

In 2009, after years of economic growth, the trend of Romanian GDP showed an incredible downturn. Nobody expected such a break-up. Most of the companies tried to survive, if they had, with the reserves accumulated during prior years while others started to move into insolvency.

**Figure 18: GDP growth variation 2000-2010**



At the macroeconomic level, the Romanian economy in 2009 was characterized by the following:

- After many years of alert and positive economic growth, an in-

flection point is reached by the significant and sudden fall of GDP (-7.1%, after an increase by +7.3% in 2008);

- The inflation rate in relation to CPI was brought under control reaching a 5.6% level in 2008 and 4.7% in December, 2009. In the last decade, the National Bank of Romania (NBR) recorded a notable performance in controlling inflation. From 2004 to 2009, a one-digit inflation rate has been maintained;
- The annual average rate of unemployment growth after a relatively long period rose significantly in 2009, to 7.8%;
- A significant shrinkage of the budget deficit was recorded (8.3% of the GDP, compared to 5.4% of the GDP the previous year);
- A depreciation of the national currency has emerged since the first quarter of the year, reaching quotas of 4.2-4.3 RON/EUR, which generated a growth of the exchange rate of approximately 15.2%;
- The substantial diminution of the current account deficit (4.5% compared to 11.6% of the GDP in 2008);
- An inflation control was obtained based on some measures related to cigarette taxation before the deadline set, the depreciation of national currency, the early adjustment in the non-governmental sector, but insufficient in the public one, the rigidities on the goods and services market, as well as on the labor market. Although anachronistic in relation to the market economy, these reacted as a brake in the escalation process of consumer prices;
- The governmental plan of crisis management, introduced by the Romanian authorities starting in April 2009, was based on a loan agreement with the EU, the IMF and other international financial institutions, with a total value of EUR 20 billion.
- NBR created, in collaboration with the Ministry of Public Finance, a strategic plan for the banking sector which represented as well one condition of the stand-by agreement signed with the IMF. According to this plan, the starting point of the management in the financial-banking crisis applies private market solutions based on the situation of the banking group and the accountability of the shareholders to offer support with additional funds.
- Unlike other states in crisis, in Romania it was not necessary to offer support by injecting public funds for credit institutions, this being the task of the retail banks shareholders, as a result of the negotiations;
- The Romanian GDP/capita fell reaching a level of EUR 5,400 per capita, which represents a four times lower level than the EU-27 average.

- Imports have been growing more rapidly than exports as a result of the consumer demand, as well as of the appreciation of the national currency in relation to the most important currencies (EUR and USD);
- Despite the decrease of the investment flux towards Romania, there was an increase in the country's currency reserves, as a result of the stand-by loan agreement with the IMF;
- Despite the unfavorable economic framework and the unpredictability which characterized the year 2009, the private sector's contribution to the creation of GDP is kept at the 70.5% level due to the prompt adjustments made by the private sector in the new context.

Despite positive signals, recession persisted in Romania in 2010. In 2010, the National Institute of Statistics (NIS) announced the seventh consecutive quarter decline in GDP; along with the ongoing social unrest.

Economic recovery largely depends on improvements of the SME situation, which has been seriously affected by the credit crunch determined by the crisis.

Recession has persisted in Romania and analysts expect growth rates to remain low in the next period. The GDP will not have an increasing tendency in 2012, neither; and it will achieve the same level as in 2008. (Table 61) In spite of the optimistic forecasts from the part of the authorities and from the part of the business on economic development in 2011, the same downward trend is continuing<sup>41</sup>. Analysts state that the recession will continue to affect Romania in 2011.

**Table 61 GDP in Romania 2007-2012**

Year	2007	2008	2009	2010	2011	2012
GDP [EUR m]	124,728.5	139,765.4	117,457.4	121,941.2	128,171	138,457

Source: European Economic Forecast, Spring 2011

### **The SME Sector**

Starting from 1990, the number of SMEs has grown significantly over the years. This phenomenon means not only an increasing process in their number but also the diversification of their activities. The weight of the private sector in GDP was 16,4% but in 1996 the weight of the private

sector achieved 55%. In the period 1991-1996, the level of FDI was very low; it was around EUR 1 billion for the whole period.

In Romania more than 99% of all enterprises are micro, small and medium size enterprise.

The weight of turnover achieved by active SMEs has an increasing tendency. In 2006 it was 58.8% and over 60% in 2007. The weight of turnover achieved by the private sector was 83.9% in 2004, and 89% in 2008 and it was estimated 92% for 2010. Thus the role of SMEs, the role of the private sector in Romanian economy is significant.

In 2007 the weight of turnover achieved by active SMEs by size had the following structure: Medium size enterprises had a contribution of 36%, small enterprises 34% and micro enterprises 29%.<sup>42</sup> The distribution on economic sectors of the rate of turnover by active SMEs in 2007 was: trade 67.4% – with a decrease from 69.2% in 2006; industry 20.1%; the rate of energy maintained the same level as in 2006; (we have to remark that the food manufacturing has the biggest contribution in the industry with 18,5%); construction increased from 8.7% in 2006 to 10.4% in 2007; and agriculture, forestry, and pisciculture had a contribution of 2.1% which increased from 1.9% in 2006.

Starting from 2008, SMEs confronted big difficulties in Romania. The world crisis began to show its effects in Romania in October 2008. The effects of the crisis become perceptible at first by companies. It was the private sector, the SMEs, which showed austerity measures first, not the public sector. A survey run by the CNIPMMR for the period of October 2008 to March 2010 shows that 49.71% of SMEs reduced their activity, only 7.3% enlarged their activities and 27.91% went bankrupt.

### **The Role and Importance of SMEs in the National Economy and Employment**

The notion of small and medium-sized enterprises which in reality is presented as a multiform phenomenon in an environment that is still economically, socially and politically unequal, was defined for the first time in the European legislation in Recommendation 96/280/EC. The current definition of micro, small and medium-sized enterprises – SMEs – is to be

found in the recommendation of the European Commission 2003/361/EC, regarding the definition of the micro enterprises and small and medium-sized enterprises, a definition that makes a clearer distinction between companies.

The definition was also taken over in the Romanian legislation through Law no. 364 on 14 July 2004. On stimulation, set up and development of small and medium-sized companies was changed through Law 175/2006. The enterprise is considered the type of organization of an economic activity, patrimonial autonomous and authenticated related to the laws in force to do business for making profit, under competence conditions, some of them being: companies, natural persons that carry out economic activities independently and family partnerships according to the legal provisions in force.<sup>43</sup> Thus, the SME categories in Romania are: micro-enterprises (0-9 employees with an annual gross turnover or total assets of EUR 2 million equivalent in RON); small enterprises (10-49 employees with an annual gross turnover or total assets of EUR 10 million); medium enterprises (50-249 employees with an annual gross turnover of EUR 50 million or total assets of EUR 43 million).

### **The Evolution of SMEs in Romania and its Impact on GDP and Economic Growth**

Table 62 presents the number of SMEs by size.

**Table 62: SMEs by size**

Size	2000	2001	2002	2003	2004	2005	2006	2007
Micro	375,804	374,255	377,499	417,366	358,78	386,561	410,763	431,029
Small	29,121	30,340	302,312	33,856	36,392	39,128	43,419	47,022
Medium	7,504	7,737	7,761	8,147	9,121	9,158	9,322	9,577
TOTAL	412,429	412,332	415,491	459,369	40,300	434,847	463,504	487,628

Size	2008	2009
Micro	602,711	573,299
Small	49,560	43,724
Medium	9,753	8,435
TOTAL	662,024	625,458

Source: INS, MEBE, ONRC

In 2009, based on the financial and economic crisis, a fall in absolute figures of the number of SMEs registered in Romania was recorded, for the first time after four years of continual demographic growth. Thus, on

31 December 2009, the number of SMEs registered at the Trade Register was 625,458 enterprises compared to 662,024 at the same time of the year 2008, with the demographic dynamics of total SMEs recording a decrease by 6.5% compared to the previous year. However, the level of demographic development in 2009 is superior to the one reached in 2007, this fact emphasized by a growth index of 128.7%.

On the other hand, only 379,627 of the total registered SMEs were active at the end of 2009, which accounts for 60.6% also reached in 2008. Moreover, we have to underline the fact that despite the very different macroeconomic characteristics of the two consecutive years, 2008 considered to be the year with the highest economic growth in the last four years and 2009 characterized by economic recession, the relationship between the number of registered SMEs and the number of the active ones remained at the same level. The evolution of SMEs between 2007 and 2009, presented in Table 63, highlights a series of peculiar aspects.

**Table 63: Changes in the number of active SMEs**

Period	2007	2008	2009 1 <sup>st</sup> half	2009 2 <sup>nd</sup> half	Total Year	2010
<b>Registered</b>	142,073	140,642	60,979	55,043	116,022	119,048
<b>Cancellation</b>	20,401	17,676	12,037	31,578	43,615	171,146
<b>Suspension</b>	12,012	12,019	71,250	62,112	133,362	66,428

Source: National Trade Register Office, ONRC<sup>44</sup>

The data presented in the table bring us to the conclusion that, in 2009, the crisis year, the newly set up SMEs continued in a more reduced dynamics, while withdrawals from the economic environment increased substantially and suddenly, through strike-off and especially through suspended activity.

The cancellations in 2010 were the after-effect of GO 44/2008.

Regarding the impact of the financial crisis on the SMEs:

- 133,000 SMEs suspended their activity, which represents a growth of over eleven times compared to 2007;
- 43,600 firms were struck off from Trade Register, which represents a growth of over 2.3 times compared to the number recorded in 2007;
- The process of setting up new SMEs slowed down, despite the fact that 116,000 new firms were set up;

- The main form of withdrawal from the market was the suspension of the firm's activity, the number of the suspended companies being three times higher compared to the number of those struck off;
- The most affected sectors of activity were the real estate intermediation services; construction; the management and support industry and services; and wholesale and retail;
- The newest legal entities were set up in the sphere of professional, scientific and technical activities.

Thus, the decreasing tendency became more accentuated in 2009; the activities of over 10 times more enterprises than in 2008 were suspended in this same period. In 2009, the total number of cancellations and suspensions were higher than the number of the registered ones. The "White Charter of SMEs 2010" stresses that in the first half of 2009, over half of SMEs faced serious problems due to economic crisis and reduced their activities, 14,8% went bankrupt and only 4.23% boosted business.<sup>45</sup>

In 2010, more than 171,146 SMEs suspended their operations. The main cause of this suspension of activity was considered the introduction of the minimum flat tax. The entrepreneurial index calculated for the first half of 2010 was -8.5 points which means that the business environment and the SME sector deteriorated compared to the same period of 2009.

The outlook of the SME sector in 2011 is not encouraging. The survey by the National Union of Romanian Employers (October 2009) reveals pessimistic results regarding the growth perspective of the Romanian economy in 2011. In addition, it is estimated that the economic situation of SMEs will continue to deteriorate in 2011, restructuring plans and a further market contraction leading to the bankruptcy of many enterprises. The main reasons of this situation are considered to be: political instability (42%), the international context (29%), and poor lending policy of banks (23%). Entrepreneurs are concerned by increased fiscal control actions. The relation with the credit institutions presents another problem for Romanian SMEs.

The structure of active enterprises (micro, small, medium and large enterprises) by size class does not present a meaningful change. Changes appear inside each sector (Table 64); for example, the number of micro enterprises from trade and other services decrease but increase in

industry and construction in the same period. Therefore, a restructuring procedure can be observed.

**Table 64: Number of SMEs by Sector**

Sector	2000	2002	2003	2004	2005	2006	2007	2008	2009
Agriculture, forestry and pisciculture	9,925	10,523	13,704	11,746	11,958	12,859	14,036	19,586	17,939
Industry and energy	45,719	52,923	59,555	54,993	55,718	56,873	59,492	70,593	65,483
Construction	11,808	18,842	24,542	25,197	29,265	34,757	45,896	73,389	69,619
Services	344,977	333,203	361,568	312,364	337,906	359,015	368,204	498,456	472,417
TOTAL	412,429	415,491	459,369	404,300	434,847	463,504	487,628	662,024 401,138*	625,458 379,627**40

Source: INS, MEBE, ONRC

In 2010, the number of active SMEs is under 380,000. The density of SMEs on a national level (31.86 SMEs per 1,000 inhabitants in 2009) is still lower than the EU average, which is more than 50 SMEs per 1000 inhabitants. In rural areas this number was 6.4 SMEs per 1,000 inhabitants in 2005. The weight of the private sector in GDP in 2009 was 70.5%. Table 65 shows the shares of the sectors in the private sector's contribution to the GDP.

**Table 65: Private sector's contribution to the GDP**

	2003	2004	2005	2006	2007	2008
Services	42.6	45.2	50.4	49.7	51.8	48.8
Construction	9.5	9.9	9.1	10.5	12.1	14.5
Industry	31.2	27.7	28.8	29.3	28.7	28.1
Agriculture, hunting, forestry	16.7	17.2	11.7	10.5	7.4	8.6

Source: Romania in cifre 2009, NIS

The survey done by CNIPMMR shows that in 2009, 71.35 % of the Romanian entrepreneurs had university or post university studies, 26.3% were high school graduates, and only 2.4% were with elementary school studies (White Charter of SMEs, Romania, 2010). Data from the European Commission show that the average EU funds absorption is 8.6% which is

below the EU average (17%). Romania is ranked after Bulgaria (10.2%) and Poland (20.4%). The contraction rate increased from 16% in 2009 to 42% in 2010.

The data presented by the NIS in "Romania in figures" published in 2010 emphasize the negative repercussions of the crisis on SMEs in different sectors of activity. The following changes can be observed:

- 60% plunge in the first half of 2009 compared to 2008, in the number of SMEs in the field of real estate intermediation services;
- 40% recoil compared to 2008 in the number of construction companies;
- 20% fall in the number of SMEs in the manufacturing industry, as well as in administrative and support services;
- 10% decrease in the number of active SMEs in the sector of wholesale and retail in 2009 compared to 2008.

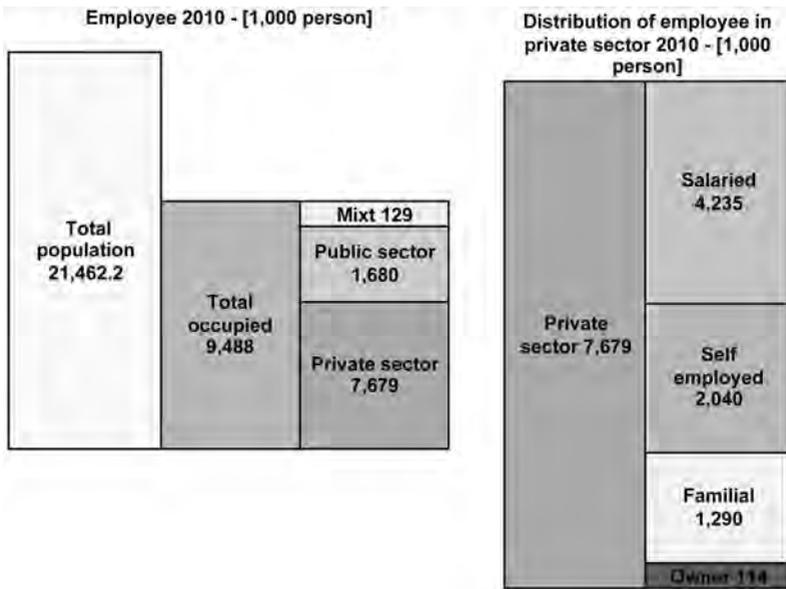
At the same time, there are sectors where the complicated conjuncture of the first half of 2009 brought significant increases in the number of active SMEs, 4.2 times to be exact. Followed by professional, scientific and technical activities, in the sectors of water distribution, sanitation, waste management and remediation activities, the number of SMEs increased in 2009 by approximately 50%, compared to the number of those existing at the end of December 2008. Moreover, an increase of 12.6% was highlighted in the transport and storage sector.

### **The Share of the SME Sector in Employment**

In 2007, Romania had a population of 21,584,365 and ranked 43rd in the world and 13th in Europe and 7th in the EU in this respect. In 2010, the population decreased to 21,462,200. (NIS, 2010). The population density as of 2007 was 90.3/sq km, about the same density as that registered in Austria or Slovenia, ranking 74th in the world and 26th in Europe.

The distribution of Romania's workforce by sector is very similar to the relative output of each sector. The share of the number of employees in all SMEs compared to the total number of employees in the economy as a whole has an increasing tendency. (Figure 19 and Figure 20).

Concerning human resources in SMEs, the following can be observed: in 2008 the number of employees in SMEs increased at an average of 1.27 persons per enterprise compared to 2007; more than 80% of enterprises employed less than 5 employees and only 3.84% of SMEs employed more than 20 people. The most frequent criteria in evaluating the employees within SMEs are: experience (in 57.51% of enterprises); spirit of responsibility (56, 87%); personal knowledge and abilities (53.69%); degree of involvement in organization (52.50%); competence in the field of activity (48.59%); seriousness (42.13%).<sup>48</sup>



**Figure 19: Data – Occupied persons - 2010**

Source: NIS, 2010



### Figure 20: Distribution of Workforce

For the enterprises to keep their activity, to create benefit and new jobs, it is necessary to be competitive on the local, regional, national, and European level. These mean that SMEs must invest in innovation. Expert analysis underlines that research departments in Romanian SMEs are missing. BISNet Transylvania, a network, was created in the center region, financed by the European commission (PC7 framework) which offers consultancy and information for SMEs. (<http://www.fonduri-structurale.ro/> )

### 2.8.2. Legislation and Ranking of Doing Business According to World Bank Methodology

Doing business 2011 ranked Romania on the 56th place, which means that the business environment is worsening. Table 66 shows the evolution and the changes in rank. No significant differences between 2010 and 2011 can be observed.

**Table 66: Ranking of Doing Business (2009-2011)**

	2009	2010	2011	Change in rank 2010/2009	Change in rank 2011/2010
Ease of Doing Business	45	55	56	-10	-1
Starting a Business	30	42	44	-12	-2
Dealing with Construction Permits	87	91	84	-4	7
Employing Workers	110	113	-	-3	-
Registering Property	112	92	92	10	0
Getting Credit	12	15	15	-3	0
Protecting Investors	38	41	44	-3	-3
Paying Taxes	148	149	151	-1	-2
Trading Across Borders	43	46	47	-3	-1
Enforcing Contracts	30	55	54	-25	1
Closing a Business	88	91	102	-3	-11

The cost of starting a business decreased from 2.9% of income per capita in 2010 to 2.6% in 2011. Based on law, the authorization to start a business can be obtained easily but to start the activity documents and other authorizations must be obtained, which takes from 3 to 7 months. The time depends on the county council's own regulations.

The time required for Dealing with Construction Permits decreased from 243 to 228 days and the cost from 87.9 to 73.9.

The time (hours) for Paying Taxes increased from 202 to 222.

The recovery rate for Closing a Business decreased from 28.5 to 25.7.

Romania established special pre insolvency procedures in 2010 for distressed companies trying to avoid bankruptcy.

### **The SME Promotion Policy and Practice**

The Romanian law was adapted to the requirements of the European Community law. The state encouraged the skills creating profit, employment, innovation and research, through the available means (regulation, credits, fiscal facilities), for which it created the necessary legal framework for protecting and developing entrepreneurial initiative, as well as the necessary bodies for achieving this goal. It has assimilated as overriding objectives the ten courses of action set by the European Charter for Small Enterprises, the coordination and implementation strategy being entrusted to the National Agency for Small and Medium-Sized Enterprises and Cooperatives.

- In Law no. 346/2004 we can find provisions regarding the administrative procedures (SME protection is assured in their relation with the state; the simplifying of administrative procedures)
- development programme (facilitating access to financing, non-reimbursable grants, the set up of guarantee funds, promotion of foreign investments)
- access to public services and assets belonging to autonomous administration, national companies and state-owned companies (unifying the stages of notices and preliminary agreements issue, priority access to the hiring, leasing or purchasing of available assets)
- priority access to public acquisitions of goods, works and services (they benefit from 50% discount for criteria related to turnover, warranty; they can benefit from technical consultancy, access to information electronic services)
- information services, assistance and consultancy, stimulation of the research and development and innovation authority, professional training (training programmes supported by the National Agency for Employment, state-owned and private educational institutions)
- SMEs transfer (it refers to continuity, job security, the stimulation of economic activities)

## **Better laws and regulations**

Law no. 300 dated 28 June 2004 - regarding the authorization of natural persons and family associations to perform independently economic activities,

Law no. 52/2003 concerning decision-making transparency in public administration,

Law no. 85 on 5 April 2006 regarding insolvency, fiscal facilities (article 107 in the Fiscal Code sets the taxation quota on the micro-enterprises income to 3% in 2009);

Government Decision no. 166 on 13 February 2003 regarding fiscal facilities for students who wish to set up their own business;

Government Decision no. 442 on 10 April 2003 concerning the approval of some measures for attracting, training and settling young people in research.

In order to support and develop the activity of SMEs, also by law, bodies, public and private institutions, non-governmental organizations and business and consulting centres have been created:

- National Agency for Small and Medium-Sized Enterprises and Cooperatives subordinated to the Government
- Chamber of Commerce and Industry of Romania, a non-governmental organization with subsidiaries in all counties
- National Confederations and Patronage Associations that gather entrepreneurs from different professional categories aiming to protect their members' interests

## **The Government**

Act through the Ministry of SMEs, Commerce, Tourism and Liberal Profession – from December 2009 through the Ministry of Economy, Commerce and Business Environment - continues to improve:

- - the access of SMEs to financing,
- - financial support of investments in equipment,
- - new technologies and products,
- - ensuring access to the results of research and development activities,

- - facilitating cross-border cooperation,
- - promoting Romanian products to export,
- - developing an appropriate business infrastructure

### **Legal and Administrative Environment for Supporting the Development of SMEs**

Decree of Law no. 54/1990 on the organization and development of the individual entrepreneurs and family associations, published in the Official Journal of Romania no. 20 on 6 February 1990;

Law no. 300/2004 on certifying natural persons and family associations that carry out independent activities, published in the Official Journal of Romania on. 576 on 29 June 2004;

Law no. 31/1990 on companies changed and republished in the Official Journal of Romania no. 1066 on 17 November 2004;

Law no. 36/1991 on agricultural companies and other forms of partnership in agriculture, published in the Official Journal of Romania no. 97 on 6 May 1991, modified and republished on the bases of the modifying documents published in the Official Journal of Romania the first part, until 23 May 2007;

Law no. 1/2005 on the organization functioning of the cooperatives, published in the Official Journal of Romania no. 172/28 February 2005;

Law no. 26/1990 on the Trade Register Office, published in the Official Journal of Romania no. 49 on 4 February 1998, republished including the modifications published in the Official Journal of Romania, the first part, until 30 April 2008;

Published in the Official Journal of Romania no. 681/29 July 2004, Law no. 346/2004 abrogated Law no. 133 issued in 1999 on the stimulation of private entrepreneurs for the set up and development of the small and medium-sized enterprises – cooperatives.

The Romanian legislation has been oriented towards education and entrepreneurial training, in this respect.

- the National Agency for Partnership between Universities and Economic and Social Environments has been set up
- fast and cheap set up of new enterprises through OGU no. 27/2003 regarding the tacit approval procedure, the measure according to which in case of administrative silence, the permit is considered as approved was set up,
- better laws and regulations -Law no. 300 dated 28th June 2004 regarding the authorization of natural persons and family associations to perform economic activities, independently
- Law no. 52/2003 concerning decision-making transparency in public administration,
- Law no. 85 on 5 April 2006 regarding insolvency
- fiscal facilities (article 107 in the Fiscal Code sets the taxation quota on the micro-enterprises income to 3% in 2009);
- GD no. 166 on 13 February 2003 regarding fiscal facilities for students who wish to set up their own business; the students are not required to pay for the initial costs of getting the authorizations.
- GD no. 442 on 10 April 2003 concerning the approval of some measures for attracting, training and settling young people in research.
- Law no. 359/2004 on the simplification of formalities when registering at the Trade Register Office of natural persons, family associations and legal persons, their fiscal registration as well as when authorizing the functioning of legal persons, modified by GEO no. 75 on 30 September 2004.

### **2.8.3. SME Support Infrastructure**

The institutional framework for the support of SMEs in Romania include government structures having responsibilities in the field of SMEs, namely the Ministry of Economy, Trade and the Business Environment; and the Agency for Implementation of Projects and Programmes for SMEs.

In July 2010, The Ministry of Economy, Commerce and Business Environment (Ministerul Economiei, Comerțului și Mediului de Afaceri – formed in December 2009) published the strategy necessary for SMEs to survive the crisis. The total budget is RON 10,255.63 thousand, 62% of which from national funds and 38% from European funds.

(<http://incubat.ro/uploads/Strategia-guvernamentala-privind-dezvoltarea-imm-urilor.pdf>)

There are also non-governmental structures and business consulting centers in order to support and develop the activity of small and medium-sized enterprises in Romania, also by law, bodies, public and private institutions. Among these, the following can be mentioned:

- 8 Regional Development Agencies
- The Post-Privatization Foundation
- The Romanian Centre for SMEs
- The Centre for Implementation of Performance Management
- The Group of Applied Economics
- The Romanian Centre for Economic Policies
- The Network of SMEs Development Centres

### **The system of Chamber of Commerce**

- The Chamber of Commerce and Industry of Romania,
- The Counties' Chambers of Commerce
- Bilateral Chambers of Commerce.

Organizations and patronage confederations and representative professional associations (other representative institutions of the business environment)\*

- The National Council of SMEs in Romania
- The National Union of Romanian Employers
- The General Union of Romanian Industrialists
- The Employers' Confederation of the Romanian Industry
- The Romanian National Employers
- The National Confederation of the Romanian Employers
- The Employers' Confederation of Industry, Services and Commerce of Romania
- The Alliance of the Romanian Employers' Confederations
- Regional Employers' Confederations
- The Foreign Investors Council of Romania
- Sectoral Professional Associations
- The Union of Free Professions in Romania (18 member organizations)

\*The list is by no means exhaustive.

The National Agency for Small and Medium-Sized Enterprises and Cooperatives is subordinated to the Government, its major task being the issue and implementation of programmes for the development of

this category of enterprises (consultancy, informing, providing financial support); the Chamber of Commerce and Industry of Romania, a non-governmental organization with subsidiaries in all country's counties, aims to promote economic activities for entrepreneurs, to represent and protect their interests, etc.; National Confederations and Patronage Associations gather entrepreneurs from different professional categories, aiming to protect their members' interests (the National Council of Small and Medium-Sized Enterprises in Romania, the Romanian Association of Businessmen, the Romanian Patronage, the Alliance of Romanian Patronage Confederation, Business and consultancy centers; Institutions for financial support).

The National Institute for SMEs (Institutul National pentru IMM) was founded in 1998 and promotes SMEs interests at the national level, supports technology transfer activities for SMEs, supplies low price consultancy services to SMEs, and present studies regarding the SME sector. ([www.inimm.ro](http://www.inimm.ro) )

The Chamber of Commerce and Industry of Romania (Camera de comert si industrie), founded in 1990, is the coordinator and national representative of the business in Romania, is a member of Euro-chambers ([www.ccir.ro](http://www.ccir.ro) ), and it is the most powerful association representing the Romanian business environment that holds together bilateral chambers of commerce, business associations and the entire network of 42 territorial chambers of commerce and industry. It is a non-governmental self-sustaining organization which supports the business community's interests and mostly of its members in the dialogue with the national authorities and international organizations. It acts to create a steady coherent business environment favorable to the development of the private sector in Romania, as well as to create a real market economy open to foreign markets and companies. It supports the business community by providing business services, organizing economic missions, training programs, detecting business opportunities. Collaborating with the Chamber of Commerce and Industry of Romania can be a benefit for any Romanian or foreign company who wants to develop a business either on domestic or foreign markets, as well as to improve the skills of the staff or to get economic information from various sectors.

National Council of SMEs in Romania (Consiliul National al Intreprinderilor Private Mici si Mijlocii din Romania) was set up in 1992. (<http://www.>

[cniipmmr.ro/eng/about.htm](http://cniipmmr.ro/eng/about.htm)) The mission is promoting and protecting the economic, production, commercial, financial, juridical and any other interests of small and medium private enterprises. It is a member of the most important international organizations and co-operates with similar associations abroad. It has 73 branches all over the country (in all 41 counties), which represent over 55,000 SMEs. CNIPMMR each year publishes the White Charter of SMEs in Romania.

Craft Foundation Romania (Fundatia pentru Mestesuguri) was established in 1997 and represents particularly craft enterprises, promotes public recognition of Romanian crafts on national and international level. The foundation cooperates with other public and private organizations related to this field. (<http://www.crafts.ro/English%20Version/>)

Business organizations for social enterprises in Romania are:

- National Union of Consumption Cooperatives (Uniunea Nationala a cooperatiei de consum) incorporates business organizations, enterprises, entrepreneurs. ([www.centrocoop.com](http://www.centrocoop.com) )
- The National Union of Handicraft and Production Cooperatives of Romania (Uniunea Nationala a cooperatiei mestesugaresti) ([www.ucecom.ro](http://www.ucecom.ro)) is the representative of the whole system of handicraft cooperatives organizations in relation to Romanian authorities, other than internal or international bodies. It functions in the fields of production and export (textile products, ready made clothes and knitwear, handmade carpets, knotted and woven, leather footwear and other leather goods, furniture and other wooden products, metal products, handicraft articles. Services provided to population and companies are body care; motor vehicle repairs; training, advertising and organizing of trade fairs and exhibitions, tourism and medical treatment. Commercial activities include sales, import - export, through the specialized companies.
- National Association of Romanian Credit Unions (Uniunea Nationala a Caselor de Ajutor Reciproc ale salariatilor din Romania).
- The employers' organization - Alianta Confederatiilor Patronale din Romania (ACPR) - was founded in 2004 and represents the collective interests of the business community. ([www.confederatii.ro](http://www.confederatii.ro) )
- Organizations which represent enterprises run by women entrepreneurs – Association for Women Entrepreneurship Development - ADAF was founded in 2001 ([www.cdep.ro](http://www.cdep.ro)); Coalition of Women

- Business Associations - CAFA - was founded in 2004. ([www.cafa.ro](http://www.cafa.ro) )
- Organizations which represent enterprises run by young entrepreneurs - The International Junior Chamber of Romania – was founded in 2002 in Romania in Timisoara, Constanta, Brasov, Cluj-Napoca, Iasi and in future in Tirgu Mures (<http://bne.jci.ro>); Young Entrepreneurs Associations of Romania (Patronatul tinerilor Intreprinzatori din Romania). (<http://ptir.ro>)
  - The Young Entrepreneurs Association from Romania (YEAR) is the only employer organization in Romania that represents at national level the interests of Romanian young entrepreneurs aged between 18 and 40. At national level, YEAR is member of (CNIPMMR) and at European level - of JEUNE – European Organization of Young Entrepreneurs. It has 6 regional structures: The Young Entrepreneurs Association from South West, Oltenia region, from West region, from South-East, from South-Muntenia, from Centre Region and from North–West region. The main activities are: to represent the young entrepreneurs’ interests in relation with national authorities, to provide consultancy and assistance to young entrepreneurs from Romania, to elaborate and implement specific programs, to develop working reports and set-up networks among young Romanian entrepreneurs, and to organize entrepreneurial training programs.

Information on the business incubators (10 at present), their location, functioning, and financing can be obtained through <http://www.incubat.ro/en/index.php>.

#### **2.8.4. Industries, Branches, Regions, Clusters**

It is generally known that many groups or segments, affected in different ways by the world economy crisis or which react to it distinctly, can be found within a national economy. There are segments in which the human or even the financial resources are mobilized thanks to the positive effects of the crisis, whereas there are other segments in which the crisis – as the final step – meant growing deficits in the certain region, branch or holding.

Several types of partitioning are usually available at the same time within a national economy. Some of these may be felicitous, because they open the door to international comparison (for example the classification of

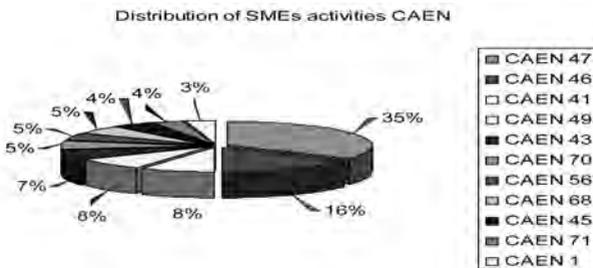
economic activities by the European nomenclature NACE, while some others may be easily defined only in the context of that certain economy. In this case, both points are important: i) the correct argumentation and ii) the explanation why the author thinks that certain group is homogeneous or specific.

In Romania the object of activity is set in conformity with the Classification of National Economic Activities – CAEN Code. Therefore, the Government Decision no. 656/1997 regarding the approval of the Classification of National Economic Activities<sup>49</sup> as well as the Order of the National Institute of Statistics no. 337 on 20 April 2007 regarding the updating of the Classification of the national Economic Activities - CAEN<sup>50</sup> were issued and published.

From the legal texts mentioned, it can be understood that an entrepreneur can develop, in the same legal form acknowledged by law, specific activities in various economic domains.<sup>51</sup>

In 2008, 69% of the total SMEs were concentrated on 11 activities of a total of 82. In each activity there are more than 10 000 enterprises. (Figure 21)

**Figure 21: Distribution of SME activities**



In 2007 62 activities were defined. In 2008 the modified CAEN was adopted, thus NACE Code corresponds with the Romanian CAEN code from 2008. Compared to the situation in 2005, informatics and agricultural activities entered among the first ten activities.

## **Business Networks and Cluster Development**

We can obtain more information about cluster development from this country report: Romania has been elaborated as a part of the Europe INNOVA Cluster Mapping Project (2007) and on [www.clusterobservatory.eu](http://www.clusterobservatory.eu), [www.oxfordresearch.eu](http://www.oxfordresearch.eu), [www.ensr-net.com](http://www.ensr-net.com).

In Romania there is no enforced legislation for clusters. Clusters are part of all the national, regional and sectoral strategies, policies and plans. Two terms are used for clusters: "entities from the innovation and technological transfer infrastructure", defined in GO 406/2003, and; "clusters", in GO 918 from 19 July 2006.

Organizations and departments responsible for the implementation of cluster policy on national level are:

- Ministry of Economy and Trade/April 2007 Ministry of Economy and Finance/ December 2009 Ministry of Economy, Commerce and Business Environment
- National Agency for SMEs and Cooperation
- National Authority for Scientific Research
- Ministry of Education, Research and Youth
- Ministry of Communications and Information Technology.

There are no regional programmes for cluster development in Romania. Successful cluster programmes are concentrated in the west region: the automotive industry, agribusiness (USAID), CLOE-City Hall of Timisoara cluster activity (<http://www.clusterforum.org/>). The interest of companies in developing clusters will increase.

The main competitive advantages considered by the entrepreneurs among the competitors are: the quality of products/services offered (64.70%); price-quality relation (41.31%); low price of the products/services offered (34.03%); company's reputation (10.28%); the quality of employees (8.28%); the distribution channels used (6.64%); post-sales services rendered to clients (6.01%); the innovation capacity (4.55%); the quality of the management (3%); the relationships with political/economic environment (2.82%). (See "White Charter of Romanian SMEs, "2009)

To increase economic competitiveness, the development of the innovation infrastructure and the dissemination methods of research results for industrial and commercial applications will be encouraged. The national R&D and Innovation Plan for 2007-2013 shall encourage companies to take part in corporations to initiate innovation projects. The compatibility of research projects with industrial policies shall be verified. To increase the competitiveness of human resources employed in SMEs, financial measures shall be instituted to support researchers' participation in investments in the business environment.

Special attention shall be paid to the increase of competitiveness of production and services from the agricultural and forestry sector.

The poor infrastructure is considered to be the biggest barrier in building a cluster policy.

Concerning innovation, the "White Charter of Romanian SMEs" (2009) remarks the followings: Investments in innovation of above 50% are more frequent in the newly established SMEs and the highest percentage of investments in innovation is in the North-West region. In the case of micro enterprises, only 7.89% invest more than 50% in innovation, 44% of the small enterprises invest around 5-20% and 15.97% of medium sized enterprises invest more than 50%.

Internet/Intranet is most frequently used in order to: communicate with suppliers/clients (75.43%); obtain information about business environment (62.88%); facilitate communication within the company (44.04%); and make transactions, contracts and payments (38.49%). The internet for communication is used by 88.14% of the SMEs in the central region. 9.3% of SMEs have no computers, are not utilizing internet facilities, e-mail and e-commerce.

Concept of economy/company based on knowledge among SMEs: the enterprises of 10-15 years old (53.17%); the medium size enterprises (58.47%); service units (55.09%). The enterprises are managed by entrepreneurs having university degrees.

In Romania, company strategies are concentrated on the reduced costs of the factors of production and not on the improvement of the productivity.

The average of output per man-shift (OMS) calculated with the turnover/employee in SMEs is EUR 41,183 and shows an increasing tendency. The highest level of productivity was registered by medium size enterprises.<sup>52</sup>

### **2.8.5. The Effect of the International Financial and Economic Crisis**

The global economic and financial crisis has emerged in Romania through many channels and developed in the following fields.

The institutional consumption channel/public procurement – as a result of the lack of efficiency in attracting the European resources made available to Romania, as well as by limiting the access to financing from bank sources; and as a result of reducing the external private credit lines from parent banks, having an impact on the overall evolution of non-governmental credit. The first and the second plan of manifestation are interconnected, taking into account the reimbursement principle, which governs access to European funds based on projects, and the necessity to activate bridge financing from attracted resources;

The direct foreign investments channel – ending or restricting the major investment projects, as a result of interrupting finances from bank sources, as well as the manifestation of a prudence or even aversion of foreign investors towards the risks of continuing the development of projects in Romania;

The external trade channel – the fall in exports as a result of diminishing the demand on the traditional export markets, but also the reduction of the imports as a result of the fall in the domestic demand for consumption;

The population's purchasing power channel – the gradual, but significant decrease of population and companies' consumption initially, as a result of the adjustment processes in private companies, and then, of introducing government austerity programmes in the budgetary sector.

Furthermore, the fall in the population's purchasing power was caused also by the dramatic diminution of the banks' supply of consumer credits.

The national wealth channel – by the substantial reduction of the value of many categories of assets, especially the real estate ones, which are predominant in the category of assets that are used as collateral, as well as by increasing the share of bad loans in the assets of credit institutions.

The main effects of financial and economic crisis manifested certain macroeconomic concerns:

- General economic downturn, which affected both domestic and external demand, causing companies to reduce investments and downsize their business, which resulted in an increasing unemployment;
- Enhanced fiscal deficit from RON 24.6 billion in a period of 9 months in 2008 to RON 30 billion in the same period of 2009;
- Increased difficulties in accessing finance, credit becoming more expensive for both the state and companies. In addition, the high fiscal deficit forced the government to compete with private sector for cash and liquidity in general, in detriment of the private sector;
- Reduced foreign investment from RON 14 billion in the first nine months of 2008 to RON 6.8 billion in the same period of 2009, in conjunction with the inclusion of Romania by the credit rating agencies in a risk category well below investment grade;
- Increased liquidity risk, both for the banking and the business sector;
- Emergence of solvency risk for both the banking sector and the real sector;
- Manifestation of contagion risk: foreign ownership in the Romanian banking system has an overwhelming share (Greece 30%, Austria 24%, Netherlands 12%, Italy, Hungary, and France 6%). Redraws of funding from parent companies or closure of branches in Romania had a chain effect throughout the economy.<sup>53</sup>

The SME sector has been severely affected by the crisis in 2009. 195,742 companies ceased their activity (133,362 suspended, 18,766 dissolute, 43,615 voluntary liquidated). At the same time only 75,246 companies were set up in 2009, compared to 118,115 in 2008.

Most SMEs face big problems with Romania's business environment. 83% of companies consider business environment to be negative or neutral and only 17% consider it favorable.

The difficulties faced by companies in 2009 are: decrease of internal demand, excessive taxation, overwhelming bureaucracy, delays in bill pay-

ment by private companies, high credit costs, inflation, relative instability of the national currency, difficult access to credit, corruption, increase of salary expenses level, competition with imported products, personnel employment, training and retention, excessive controls, unpaid bills by state institutions, poor infrastructure quality, decrease of export demand, obtaining consultancy and lack of training for the company.

Business opportunities in 2010 are: increase of sales on the internal market, penetration of new markets, assimilation of new products, creation of a business partnership, use of new technology, obtaining a grant, export increase.<sup>54</sup>

According to the CNIPMMR survey, the number of companies registered in the first six months of 2010 declined 3% compared to the second half of 2009 and the number of companies closed grew by 460%.

The number of firms with profit declined by 2%, and the profit itself dropped by 5.1%. The turnover of SMEs diminished by 7.8% on average, and investments declined by 6.45% compared to the second half of 2009.<sup>55</sup>

The estimation of the National Prognosis Commission (CNP) for 2010-2014 is:

- unemployment rate is estimated at 8.5% for 2010 and expected to decrease to 8% in 2011 and to 6.5 % in 2014
- the GDP is expected to have an increasing tendency by 1.5% in 2010, 3.9% in 2012 and 4.5% in 2013.

According to the estimates, over 90% of the SMEs feel the recession. The outlook of the developmental regions is as follows: 19.02% of the SMEs in the N-W region went bankrupt, 72.63% of the SMEs reduced their activities in the Central region, in the N-E region 27.84% of the SMEs are working in the same conditions as before and in Bucharest 8.07% of the SMEs have an ascendant evolution.

The SMEs feel the economic crisis through the diminution of the demand, leading to the imbalance between demand and supply. The first effects of the crisis constrained the SMEs to make a new evaluation of their projects on investments. The estimates show that the majority of them will stop the investments in development projects to avoid the non-favorable credit conditions and the financial instability. (<http://www.9am.ro>).

Concerning the benefit (profit), only 18% of SMEs kept the forecasting established in 2008, 76% of SMEs started to reduce their activities and 16% looked for investors for new capitalization. Another obstacle for SMEs represents the qualification and the experience of the young managers. They have got competencies in situations where the weight of turnover increases, yet, they don't have experience in the case of financial insufficiency.

Different SME sectors are affected in different manners. The extent to which they are affected depends on the activity area. SMEs with activities in the domain of food, consultancy for EU funds, executor, and pharmacy weren't affected because these activities are indispensable. The stabile sectors with linear evolution are less affected by the crisis, such as public services, medical, veterinary, food, agriculture (see <http://www.wall-street.ro>. IMM-urile-in-criza..).

Some companies and some sectors in Romania weren't affected by the crisis because they are underdeveloped (for example agriculture).

More affected sectors: estate and all the sectors which have connection with estate (construction, brokerage firm), textiles, construction and auto.

In 2008, high profit rates were obtained in various associative activities such as: financial intermediates; real-estate transactions; services to enterprises; research-development, etc. and very low profit rates in manufacturing of tobacco products and air transports. (See the "White Charter of Romanian SMEs", July 2009)

In the near future agriculture and tourism can be developed. (<http://www.wall-street.ro>. IMM-urile-in-criza)

In terms of activities, sectors registered the following: 72.31% of SMEs in tourism reduced their activities, 17.71% of SMEs went bankrupt from the industry; in transportation 28.82% of SMEs are working in the same conditions and had an ascendant evolution of 7.01% of SMEs in services. ("White Charter of Romanian SMEs, "2009)

The most important measures to save SMEs considered by the representatives of the National Associations of Romanian Employers are: resum-

ing credits; VAT payment by companies on collecting; deduction of excise duty on gas, electricity and fuel; facilitation of government guaranteed loans; regulation of the price of raw materials by the Competition Council; reorientation of the business to more profitable activities; deduction of social contributions; financing from banks and access to funds from CEC Bank and Eximbank.<sup>56</sup> The anti-crisis plan proposed for SMEs is as follows: tax exemption for reinvested profit; capitalization of CEC Bank and Eximbank; making the Counter-Guarantee Fund for SMEs operational; earmarking large funds from the state budget to promoting exports; and increasing the state's contribution to financing this activity.

Romania is not in Euro zone; therefore, in the last month of 2008 and in 2009 had to confront with the depreciations of the national currency. In the case of Romania, according to the EC, the budget deficit in 2008 reached 5.2%.

An interdepartmental group established by the Government consisting of representatives of the Ministry of Finance and of other Ministries and institutions, identified 558 taxes and fares, established by a number of 185 normative acts in Romania. Out of these 558 taxes, fares and charges, 74 are of fiscal nature and 484 are taxes and tax revenues (at the Ministry of Environment there are 102 taxes and charges, at the Ministry of Administration and Interior 50, at the Ministry of Economy 41, at the Ministry of Transport and Infrastructure 40, at the Ministry of Agriculture 37, at the Ministry of Health 35, Justice 30, Sanitary Veterinary Agency 29, Labor 24, and others). Considering the number of taxes, Romania is situated in the first place in Europe and the fourth place in the world see (<http://www.business-point.ro>)

Concerning financing, the "White Charter of Romanian SMEs" (2009), remark the following: more than 60% of SMEs finance their economic activities from their own sources; 51.05% of enterprises apply for bank credits for financing their activities; and 9.57% of SMEs use leasing. Higher levels of self-financing are recorded in the enterprises which are under 5 years old (65.82%) and in the industry enterprises (70.61%). Higher degree of applying for bank credits financing is to be found in SMEs of 10-15 years old, in enterprises involved in tourism sector (64%) and in units of superior overall performances (55.77%).

World Bank prognosis is that from January 2010 the GDP will increase by 1.3%. If the same GDP growth rhythm is maintained in the next years, Romania will need four years to recover from losses caused in 2009, which means by the end of 2013.

The Romanian economy will show a positive trend from the second half of 2011. At the national level, most optimistic expectations for business development in 2011 are recorded in the macro region 3, but it is unlikely for these expectations to materialize in the absence of upward trends in terms of investment, domestic and external demand for products and services and consistent government measures to aid the SME sector.

### **2.8.6. Government Measures to Cope with the Impact of the Economic Crisis**

The package of governmental measures applied between 2008 and 2009 having an impact on the evolution of the SME sector, in the context of the economic crisis, aims at four fields:

- The development of the institutional framework,
- The simplification of the administrative procedures,
- Facilitating access to financing,
- Changes in the fiscal policy.

#### **The Simplification of the Administrative Procedures**

1. Emergency Government Ordinance no 44 as of 16 April 2008 on business activities conducted by authorized individuals, individual enterprises, and family-owned businesses

2. Emergency Government Ordinance no. 38/2009 for the amendment of paragraphs (2) and (3) of the Emergency Government Ordinance no. 44/2008 on business activities conducted by authorized individuals, individual enterprises, and family-owned businesses

3. Emergency Government Ordinance no. 49/2009 on the freedom of establishment of service providers and freedom to provide services in Romania, published in the Official Journal of Romania, no. 366 of 1 June 2009.

4. The Memorandum on the reduction of the number of non-fiscal taxes and tariffs, adopted by the Romanian Government on 11 March 2009. The Memorandum establishes the avoidance, reduction or amalgamation, according to case, of the 558 taxes existing at that moment, as well as of the 185 normative acts through which these had been enforced.

For the application of the provisions, an inter-ministerial work group was formed by representatives of the Ministry of Finance and of the other ministries and institutions involved in the administration of these taxes, who started the process of reduction/elimination/amalgamation, based on the cost/benefit analysis for each tax or tariff. By 15 July 2010, 215 taxes and tariffs had been eliminated, the process being under development until 2010.

### **Facilitating Access to Financing**

1. Law no. 175 as of 13 May 2009 for the amendment of paragraph (1) and art. 26 of Law no. 346/2004 on the stimulation of establishment and development of SMEs.

2. Law no. 154/ as of 11 July 2008 for the approval of Emergency Government Ordinance no. 5/2008 on the general financial framework for the JEREMIE participation fund Romania, published in the Official Journal 544/2008.

3. Government Decision no. 101 as of 18 February 2009 for the amendment of G.D. no. 1211/2001 on the establishment of the National Guarantee Fund for SME Loans, published in the Official Journal 127/2009.

4. Emergency Government Ordinance no. 23 of 11 March 2009 on the set up of the Romanian Counter-Guarantee Fund, published in the Official Journal no. 190/2009.

5. Law no. 312/12 October 2009 for the approval of Emergency Government Ordinance no. 23-2009 on the set up of the Romanian Counter-Guarantee Fund, published in the Official Journal 692/2009.

6. Interventions in order to increase the level of absorption of structural funds in the first half of 2009:

- Facilitating access to financing from structural funds by increasing the maximum pre-financing quota given to beneficiaries, from 15%

to 30% of the eligible value of the financing contract, as well as the introduction of pre-financing for beneficiaries who receive grants, of up to 35% of the non-refundable financial allowance;

- The reduction in the number of documents requested when handing in the folder of a request for finance and their replacement by statutory declarations, offering the possibility to access funds by enterprises with a certain level of debt to local or state budget.

These measures have been included in the Applicant's Guide for every financing scheme/project request approved by management authorities for operational programmes.

### **Changes in the Fiscal Policy**

1. Law no. 329 of 5 November 2009 on the measures taken in order to reduce the effects of the economic crisis and to fulfill the obligations imposed by the agreements signed with the European Commission and the International Monetary Fund, for the support of the business environment in order to overcome the financial difficulties and to re-launch the trade circuit, published in the Official Journal 761/2009.

2. Emergency Ordinance no. 92/30 June 2009 on the postponement of payment of fiscal obligations which have remained unpaid as a result of the effects of the economic-financial crisis, published in the Official Journal no. 800/2009.

3. Law no. 363.2009 on the approval of Emergency Government Ordinance no. 92/2009 allowing deferred payments of tax liabilities because of the effects of the financial-economic crisis.

4. Emergency Ordinance no. 28 as of 18 March 2009 on the regulation of some social protection measures, published in the Official Journal 186/2009, which came into effect on 25 March 2009.

5. Emergency Ordinance no. 34/2009 on the rectification of the budget for 2009 and regulating certain financial-fiscal measures, published in the Official Journal no. 249/2009

6. Government Decision no. 488/2009 for supplementing the Methodological Norms Emergency Ordinance no. 34/2009 on the rectification

of the budget for 2009 and regulating certain financial-fiscal measures, published in the Official Journal no. 249/2009

7. Government Decision no. 488/2009 for supplementing the Methodological Norms of applying Law no. 571/2003 on the Fiscal Code, published in the Official Journal no. 286/2009.

Since October 2008 the Government has developed an action plan to tackle the economic crisis, that had to be applied from 1 January 2009 and which provided:

- Allocation of a minimum of EUR 10 billion over the next four years for investment in the economy;
- Reducing social insurance contributions by 10 points;
- Allocation of RON 220 million for social housing;
- An award of 5% tax reduction of the tax to pay on time by companies and individuals;
- Tax exemption on dividends reinvested and invested in a new companies;
- Providing incentives to businesses for each new job created, in amount of EUR 1,000 if they employ people who are unemployed for more than three months;
- Allocation of EUR 500 million in addition to "The farmer scheme";
- Increasing the share capital of CEC Bank by EUR 250 million in order to finance SMEs and investment in agriculture.

After this, in early 2009, a new anti-crisis plan "common anti-crisis platform measures" which contain 74 measures was discussed by the Government.

To improve and stimulate the economy in crisis, the ruling coalition adopted 32 anti-crisis measures in August 2009, which will be implemented thorough 2010.

28 measures were implemented before 1 July 2009, plus 4 measures carried over from the first half (non taxation of reinvested profit, capitalization of CEC bank, public-private partnership, supplementing the budget for research).

In the area of supporting SMEs, the Government has increased state aid scheme for SMEs five times and has decided to postpone for six months

the payment of debts for firms that are affected by the economic downturn with 2 conditions: the first condition is that the current monthly debt to the State is paid, the second condition being that they must prove by system of safeguards that they can and have the means to pay their outstanding debt in the future.

The procedures relating to accessing European funds were simplified and an increase of pre-financing rate for European projects, from 15% to 20% and 20% to 30% was made available.

The implementation of these measures has not generated the expected results. As a result, the taxation was increased and the flat tax produced effects in the number of SMEs (183,000) going bankrupt. By closing these companies, 56,000 people were directly affected by job loss, while the state lost about RON 100 million revenue for the budget.

The key austerity measures applied from 1 July 2009 in order to reach the budget deficit target of 6.8% of GDP agreed with the IMF and the EC:

- Cutting the salaries in public sector by 25%;
- Increasing the VAT from 19% to 24%;
- Cutting by 15% in most of social transfers (excepting pensions);
- 16% tax on interest on deposits and on luncheons tickets (instead of 0% previously);
- 16% tax on capital gains from securities hold by more than 1 year (instead of 1% previously);
- Transformation of special pensions in normal state pensions (excepting the pensions of magistrates);
- Cutting expenses with goods and services in ministries, governmental agencies, local administrations and state companies;
- Lower transfers from state budget towards local budgets;
- Decrease in subsidies for population (the measure is not yet effective and it refers to subsidies for thermal heating);
- Lay-offs in the public sector. The current plans are to lay-off up to 60,000 peoples in the coming period.
- A "solidarity tax" for people owning more than one dwelling. The tax on housing property is 65% higher for the second dwelling, 150% higher for the third dwelling, and 300% higher starting with the third dwelling;
- Higher taxes for owners of passenger cars;

- Lower deductibility for expenses in case of incomes from intellectual property rights;
- Measures to limit tax evasion.

(Source: Economic Overview as of June 2009, 19 July 2010, Raiffeisen Bank S.A  
<http://rbd.doingbusiness.ro/ro/1/articole-recente/all/442/economic-overview-december-2010>)

## **2.8.7 SWOT Analysis of the SME Sector**

See Chapter 3.

## **2.8.8 Tasks for Improvement and Further Development of the National SME Sector**

The Government continues to act, through the Ministry of Economy, Commerce and Business Environment, for improving the access of SMEs to financing, financial support of investments in equipment, new technologies and products, ensuring the access to the results of research and development activities, facilitating cross-border co-operation, promoting Romanian products to export, and developing an appropriate business infrastructure.

### **Individual Strategies, Distinct Initiatives/Measures**

**Agriculture:** Romania has a larger share of the population in agriculture than any other European country. Large re-allocation of resources (labor, capital, land) from agriculture will be necessary or this sector will continue to exert a powerful drag on per capita income growth. Despite the significant potential, productivity remains low and a large number of small and medium-sized farms struggle to survive competition. It is highly probable that addressing these challenges in agriculture will require well-coordinated agricultural and non-agricultural strategies and vision.

**Labor market:** Romania already suffers from shortages of labor in segments of the market. Yet, at the same time, labor participation, especially among some groups (young, women, and older workers) is too low and acts as a drag on income convergence and growth potential, in

particular when taking into account the declining and ageing population. Labor participation needs to increase, as well as internal mobility. Flexibility of the labor market therefore needs to be enhanced.

**Education:** Investment in human capital is needed to sustain productivity enhancements. The evidence of skills mismatches in a general environment of labor shortages points to challenges regarding the relevance and flexibility of the education system for the labor market, including the quality of education and the access to education, especially in rural areas.

**Infrastructure:** Substantial infrastructure investments are required both to meet the demands of the *acquis communautaire*, and to secure economic competitiveness and productivity growth. Investment in infrastructure also has important fiscal implications, and enhancing the capacity to absorb Structural and Cohesion Funds should be a clear priority.

**Energy:** Investments in energy, both new capacity and refurbishment, necessary to sustain economic growth, meet at the same time with the environmental and climate change imperatives, and ensure the security of supply, which will be large and involve complex decisions.

This is the time to think more thoroughly about energy efficiency and alternative sources of energy, and understand better the contribution they can make, within a regional framework, to meet the energy challenges.<sup>57</sup>

The most important tasks for the improvement of the SME sector in Romanian can be formulated as follows:

1. The state should pay its debts toward the private sector. Moreover, it ought to be involved in the reduction of delays in payments.
2. The regulations should be re-evaluated and abrogate those that were adopted and had a negative impact on business environment (for instance: GO 44/2008 – the minimum tax).
3. The state should supervise the abusive/excessive fiscal control.
4. The state ought to focus on export actions and it should promote its national products.
5. The state should introduce and encourage trainings for managers in order to teach them how to take decision at a time of crisis.

6. The state should analyze the low level of EU funds absorption and it should take actions and make regulations in order to increase it.
7. The state should protect its national products against cheap and low quality imports.
8. The state should promote adequate policies which help to reduce large differences among the developmental regions.
9. The state should take decisions to stop the outflow of qualified work-force abroad.
10. The state should invest and help the development of SMEs in the agricultural sector.

## **2.9. RUSSIAN FEDERATION**

Assoc. Prof. Īrina Naoumova, University of Hartford (USA) and  
Alexandr Vatolin, Institute of Management and Business, Nizhniy  
Novgorod (Russia)

### **2.9.1. Economic Trends and SME Legislative Framework**

Russia is still in transition to free market economy although the insiders and the Government are usually saying the transition is already over. During the past ten years, the Russian State was heavily involved in re-designing the economy structure, putting significant emphasis on oil and gas and raw material industries.

After chaos and kleptocracy, established by Gorbachov's and Yeltsin's regimes, Russia desperately needed the "Rule of Law", which was proclaimed as a goal for the President Putin's election campaign. By that time the largest and most efficient companies had been privatized. Poverty and criminal schemes forced Russian people to sell their shares (vouchers) off directly and indirectly to the future oligarchs, politicians and criminals.

In the white waters of transition, large companies received more attention from the state and potential foreign and domestic investors, leaving small and medium sized companies alone with their issues and problems. Extremely harsh environment, tax burden and lack of support for SMEs were the signs of reality for almost entire of Putin's in-power period.

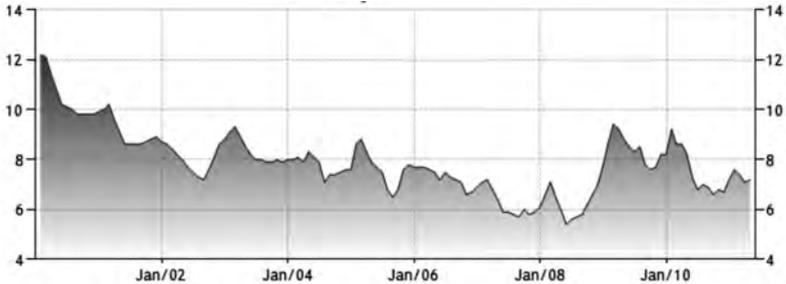
There were some other macroeconomic goals successfully achieved but in terms of SME support, the country did not improve much. By 2007 it became evident that Russia was gradually recovering from Yeltsin's anarchy and transforming itself in a market economy.

While in 2002 GDP was USD 0.25 trillion, it grew to USD 1.67 trillion in 2008; in 2009 when global crisis occurred it dropped by 7.8%, and later grew back to USD 1.49 trillion in 2010.

GDP per capita was steadily growing, also reaching USD 15,900 in 2010 (for comparison, in 2000 it was USD 1,761). In ten years, Russia's population dropped by 2.2 million (around 1.6%), from 145,166,700

(2002) to 142,905,200 people (2010) but large number of immigrants from former Soviet Union countries (interestingly enough not necessarily ethnic Russian) partially compensated for this drop. High unemployment rate (see Figure 22) and significant poverty (around 13% of the population was below the poverty line) forced the government to seek decisions in supporting the SME sector.

**Figure 22: Russian Unemployment Rate (%)**



The 2009 economic crisis following global financial crisis pushed Russian economy back, proving its inefficiency in facilitating steady economic growth as it was initially expected. In 2008 Mr. Medvedev was elected as the President of the Russian Federation, moving its Ex-President to the Prime Minister's position. Mr. Medvedev had to reconsider his predecessor's approach to economic growth and announced the course for "innovation economy". Thus, hope has been returned to technology driven SMEs. Mr. Medvedev officially proclaimed that innovations and wide range of services would be expected from SMEs. State support to SMEs was also promised.

Interestingly, at the same time in 2009 the Russian society in general overcame its negative attitude to entrepreneurs, and started to see entrepreneurs and small businesses as contributors to the Russian economy. Thus, 70% of population now pays high respect to entrepreneurs for their passion in achieving company goals (2009 Global Entrepreneurship monitor report). In spite of governmental priorities (oil and gas, and raw material industries) in 2000-2008, the Federal Law No. 209-FZ On SME Development has been adopted in July 2007.

It describes the state policy in SME development in Russian Federation as follows:

- Create competitive environment and favorable administrative climate for SMEs (Urgent measures to abolish administrative limitations on private business activity, Decree of the President of the Russian Federation No. 797 of 15 May 2008);
- Help in marketing SMEs products and services abroad;
- Support SME growth and job creation;
- Facilitate the increase of SME share in GDP along with the increase of the share of taxes from SME sector to Federal budget, the budgets of the subjects of the Russian Federation and local budgets.

The law states that in order to achieve these goals, the power and responsibilities of federal governmental bodies, governmental bodies of subjects of the Russian Federation and local self-government bodies had to be compiled. For the first time, regional, local and municipal powers become responsible for SME support.

Participation of SME sector representatives and experts from NGOs became mandatory for drafting normative acts related to SME activities at federal and lower levels. Equal access to resources and non-discrimination are considered to be among the main principles in SME support. Importantly, "Simplified Regime" in regard to taxation, bookkeeping, registering a firm, supplying statistical data, contractual procedures and municipal property transfer/privatization has been developed and implemented. Programs of financial support, institutional and procedural infrastructure for SME support have been required to be developed by the Law on Federal and all lower levels.

Notably, the Law regulates all the procedures related to SME and SME associations, coordination and consulting bodies, non-governmental organizations and associations of companies officially registered as any type of SME.

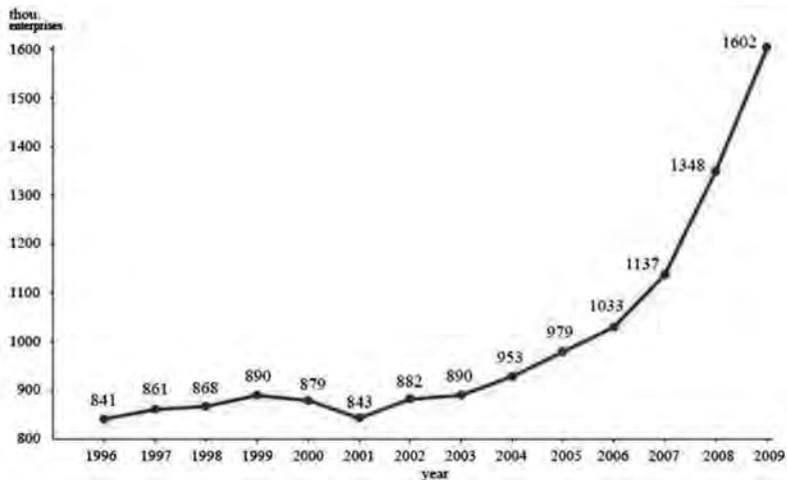
The definition of SME companies has been also established by this Law: micro businesses – 1-15 employees, not more than RUB 60 million in turnover; small firms – 15-100 employees, not more than RUB 100 million in turnover; and medium sized – 101-250 employees, not more than RUB 250 billion in turnover. Although there are some differences in the EU and Russia's approaches, the definitions of the SME sector as a whole is pretty much consistent.

**Table 67: EU-Russia SME definition**

EU SME definition (01.01.2005)	Medium-sized		Small		Micro	
	EU	Russia	EU	Russia	EU	Russia
Employee headcount, and either: Annual turnover, max	250	101-250	50	15-100	10	1 - 15
or: Annual balance sheet, max	EUR 50 million	RUB 1 billion	EUR 10 million	RUB 400 million	EUR 2 million	RUB 60 million
		EUR 27.34 million		EUR 10.94 million		EUR 1.64 million

Source: <http://www.doingbusiness.ru/definition-of-smes-eu-vs-russia.html>

According to latest statistics, there are 18,500 SME companies registered now in Russia (micro businesses are not included). Number of employees in the SME sector is around 17 million people; with 21% contribution of SMEs in GDP; and 22.5% of working-age population is employed in the Russian SME sector.

**Figure 23: Small Businesses in Russia (100 or less employees)**

Source: <http://en.opora.ru/>

Figure 23 shows a steady growth of the SME sector in Russia, especially after 2008, when the strategic change occurred. More attention was paid to developing support infrastructure for SME development.

Since 2008 (Presidential Decree #797, May 2008), consulting agencies have been involved in SME support. One of the most influential NGOs "OPORA Russia", representing interests of more than 370,000 Russian SME companies, immediately created the Bureau to support the rights of SME companies and their employees. They also have their branches in 20 Russian regions.

As a result of the change of governmental and societal attitudes to entrepreneurship and SME businesses, the growth in numbers for 2008 compared to 2005 was rather substantial. The global crisis hit Russia in 2009 and caused the drop in SME operational numbers. In spite of a drawback of the economy, Russia was very consistent compared to the typical Western countries' trend, and even showed a growth in employment in the SME sector while large companies were dropping in numbers of employees. The effect of the crisis can be seen in the statistical chapter.

In addition, both tables prove that micro- companies were more sustainable in crisis than medium sized firms since for micro- businesses the turnover/employee ratio was higher. This could be explained by limited options for operational loans for medium-sized companies while micro-firms were more flexible, having smaller need for cash in hands. Practitioners also prove the trend of steady growth primarily in micro-sector.<sup>58</sup>

Although the above tables provide support to the growing SME numbers, the researchers from National Institute of Business Research insist that the number of bankrupt SMEs has been much higher than before. Interestingly enough, according to the official Federal Statistic Services data, SME assets/capital funds ratio is ~1.7 times better than for non-SME companies in Russia.

**Table 68: Share of assets and capital funds of SME companies in Russia, 2009 (end of the year) (%)**

	Share of medium sized companies		Share of small companies		Share of companies NOT registered as SME	
	Assets	Capital funds	Assets	Capital funds	Assets	Capital funds
Total	2.6	1.5	5.7	12.0	91.7	86.5

### 2.9.2 Ranking of Doing Business According to World Bank Methodology

According to Doing Business annual survey<sup>59</sup> based on each previous year's data, Russian Federation has dramatically limited its freedoms for doing business – the index dropped seven points down (see Table 69). While financial components like getting credit or paying taxes did not change much and were still in the compatible dynamics with other Eastern European and Central Asian countries, although they also dropped two points down each, the major drawback was related to increased bureaucracy of starting business (-4), closing it (-10) and registering business property (-6).

Thus, both for starting business and registering business property, they were not as costly as for Eastern European and Central Asian states and OECD region. Nevertheless, regarding the time for registering and number of procedures, Russia was far behind its peers. For closing business being also very time inefficient, it became very costly because of the low recovery rate that dropped down significantly during the last year. With no interest of insurance companies to share risks with small businesses, their financial burden and bankruptcy fall down on the owners' shoulders, only lowering the indicator.

**Table 69: Doing Business Index (Russian Federation)**

Indicators	2011	2010	Change of factor
<i>Russian Federation</i>	123	116	-7
Starting a Business	108	104	-4
Dealing with Construction Permits	182	182	0
Registering Property	51	45	-6
Getting Credit	89	87	-2
Protecting Investors	93	92	-1
Paying Taxes	105	103	-2
Trading Across Borders	162	162	0
Enforcing Contracts	18	18	0
Closing a Business	103	93	-10

Source: <http://www.doingbusiness.org/economyrankings/>

### 2.9.3 Industry Shifts in the Russian SME Sector

As stated above, Russia's economy has gone through several crises including transformational (from socialist to capitalist economy) and finan-

cial crisis triggered by international causes in 1998 and 2009. Russia's industries lost their ever existing advantages and had to deal with the market shrinkage. They lost their clients abroad and within the former Soviet Union. Thus, a significant shift occurred in the industry structure of the SME sector and Russian economy as a whole. The distribution among industry, services and agriculture changed in favor of services. In 2000, the share of SME revenues in services was close to 60%, while the share of industry and construction was around 38%, and 16% reflected revenue share of industry. By 2005, the industry and construction share in SME revenues dropped to 14.7%, where construction became predominant, industry share counted for 6.84% in SME revenues; and the services grew up reaching 85%.

The number of farmers registered in 2000 as SME firms was rather small (261,700); they produced 3% of the agricultural products in the Russian economy. It dropped insignificantly to 257,400 while their efficiency (in terms of production of agricultural products) increased almost two folds. The trend continued even further. By 2010, the number of farmers declined to 105,258 but their share in all agricultural products jumped to 7.5%.

Mirroring Russia's steady economic growth in oil/gas, energy, rare material and machine building industries, the share of industry and construction generated revenues reached 19.75% by 2010, while agricultural SMEs were responsible for 4.04% of SME generated revenues, leaving services on a little bit lower level than in 2005 but still very high, close to 80%.

The fastest services growth has been reported in wholesale, real estate operations, transportation and telecommunication.

The above data provided support to slow improvements in agricultural sector that was proclaimed as a goal for several governmental programs starting from 2003. Restructuring of financial sector, including bank loans to the SME sector, establishing of mortgage services, and interest rate reduction resulted in developments in construction, although economic crisis in 2009 hit construction companies' operations dramatically.

Governmental political support of large corporations against small industry companies affected the situation negatively, but at the same

time large businesses became a sort of market for SME B2B (business to business) companies. Thus, the number of SMEs in machine building, mining and energy related industries were growing faster than in other industries. Recent initiatives of President Medvedev focusing on innovations also might have resulted in this growth.

#### 2.9.4. Regional Disproportions in the Russian SME Sector

Regional map of SME development is following the industry trend. Thus, according to National Institute of Business Research, a decline in the number of local SMEs occurred in 2010 in several Russian regions. Official statistics of Russian Federation Statistic Services also demonstrate uneven regional growth in SME numbers, where a slight increase was reported in Central region and Russian South.

Interestingly, Urals region, North-Western and Russia's Far East where oil/gas and machine building large corporations and their infrastructure (like pipelines connecting Russian companies with their European partners and clients) were located showed substantial growth.

This proves the statement that SME development during the last five years was territorially concentrating around successful large businesses serving their needs, and in a proximity to capital cities (Moscow and St. Petersburg).

**Table 70: Number of SME in Russian Districts**

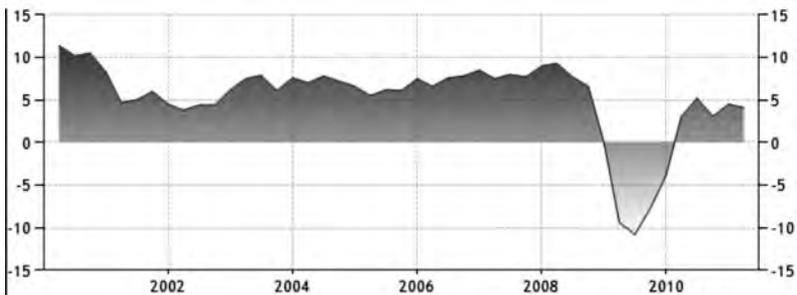
Russia's Regions/ Districts	Number of companies – Beginning of 2009			Number of companies – Beginning of 2010			% growth in SME number by region
	Medium sized	Small and micro-firms together	Micro-firms	Medium sized	Small and micro-firms together	Micro-firms	
Central Okrug	3,756	413,218	331,122	4,351	474,370	401,230	12.9
North-Western Okrug	1,625	204,024	172,581	1,557	261,185	230,078	21.7
Southern Okrug	1,841	145,261	105,323	1,984	170,860	143,368	14.9
Volga Okrug	3,245	251,485	192,727	3,588	287,639	240,567	12.5
Urals Okrug	1,227	92,588	81,414	1,322	136,102	122,352	31.7
Siberian Okrug	1,878	185,658	140,297	2,171	207,039	181,415	10.4
Far East Okrug	598	55,432	41,552	574	85,296	55,651	14.9
Total Russian Federation	14,170	1,347,667	1,065,016	15,547	1,602,491	1,374,661	15.8

### 2.9.5. The Effect of the International Financial and Economic Crisis

As mentioned previously, Russian President Medvedev declared the need to switch from the oil and gas related growth of the economy to innovation-related. Dependability of Russian economy on raw materials and natural resources leaves almost no room for economic maneuvers. The thorough analysis provided by the National Institute of Business Research showed that research institutes and universities (the Soviet era structure of innovation producing organizations) has been destroyed almost to a ground point during transition crisis. Their creative personnel have left for business. Majority of them started their own companies using their research background and technology patents. This reality forced Russian government to reconsider the role of the SME sector in the economy.

Significantly positive (but still slow) changes occurred in the attitude of the Russian government towards small businesses during the last five-six years. Financial crisis and following economic downfall played controversial role in this change. Limited "petro-growth" of the economy has pushed government to look for alternate ways of growth, and facilitated a positive shift in the government's attitude towards the SME sector. On the other hand, with the fall of financial markets, Russia lost almost a quarter of its FDI that significantly affected large companies. As for small businesses, they had almost no support from the government in previous years anyway, and could survive without loans from any international lenders who were not contributing to the SME sector in Russia at all.

**Figure 24: Russia's GDP Growth Rate Adjusted by Inflation**



The crisis hit small technology driven firms indirectly through their client and partner companies – large Russian and international corporations who limited their innovation spending and R&D projects dramatically. In 2007 and 2008, the number of small businesses in industry in Russia was gradually declining (almost 12% in two years) although in the traditional oil producing areas and industrial regions of Russia it has slowly grown (less than 3-4%).

The diagram on Russia's GDP growth rate adjusted by inflation shows that international crisis hit the Russian economy in 2002 slowing the growth rate down, and forcing a dramatic decline in 2009. In both cases, the numbers reflected the world trends proving the dependency of Russia's economy on international market forces. On the other hand, with the growth of unemployment, the labor cost dropped significantly, opening the window for SMEs to hire better personnel for cheaper cost. Real estate market stagnation pushed the owners to switch to the leasing strategy, which increased the demand and dropped rental prices. Small businesses could now operate more efficiently. In addition, St. Petersburg School of Business research proved that the majority of established small businesses (79%) agreed that the global crisis made growth more difficult, and limited its opportunities.

### **2.9.6. Government Measures to Cope with the Impact of the Economic Crisis**

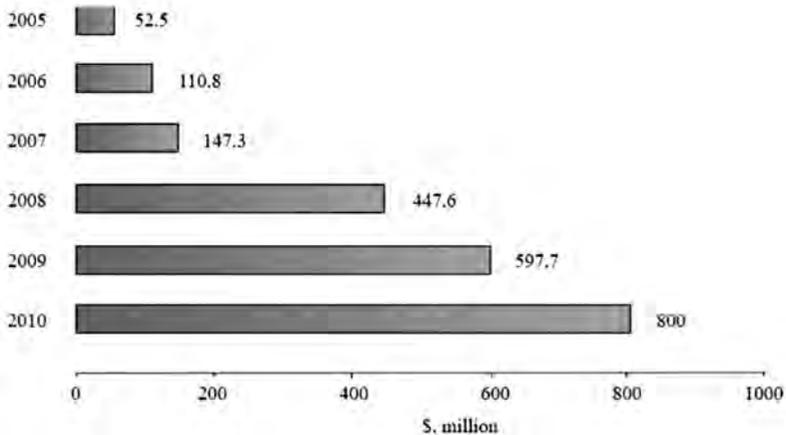
Transformation of the Russian economy and the following economic crisis created a so-called "addicted" to petro-export economy. The Russian government finally recognized a need to support the SME sector but still considers it to be a secondary goal.

Some measures helping small businesses to survive and grow have been taken since 2008. They include involvement of NGOs representing interests of the sector in governmental policy development, simplification of tax regime, availability of unemployment benefits for potential entrepreneurs who plan on registering a company, grants and various options of financial support, lower payments compared with other companies for the use of infrastructure, some regional support programs, and simplification of procedural framework leading to the reduction of administrative pressures.

The severe downturn in the Russian economy occurred in 2009. However, the statistical tables do not reflect significant fluctuation in numbers although some decrease in turnover is seen for all categories of SME companies. We would like to emphasize that it could be seen as a positive effect of governmental support to the SME sector prior to the crisis. In just one year, the number of SME firms grew by 20%. As the National Institute of Business Research reports, in 2009 alone (while Russia's GDP went down by 7.8%), 127,600 people launched their businesses having registered unemployment with benefits of RUB 58,800 per person.

Russian government in a pre-crisis period created state programs that were granting money for entrepreneurs. Federal Labor Service reported that as a result of state support, only 5% of the companies registered in 2009 went bankrupt. In 2010, the Ministry of Social Development had a grant pool of RUB 14 million distributed among almost 250,000 people; RUB 11 million will be granted in 2011. Although it helped many companies to survive during the crisis, some analysts are critical to the long-term subsidies that could misbalance market forces and support less efficient businesses.<sup>60</sup>

**Figure 25: Federal Financial Program for SME Support**



Source: <http://en.opora.ru/>

Figure 25 provides data on funds allocated for SME sector support through Federal Program. They are growing significantly year by year.

One of the most efficient instruments, tenders, designed for limiting corruption and helping SMEs in developing close partner relationships with large businesses was established in Russia by the Federal law also. In 2009 alone, 11.9% of all tenders in Russia involved SME companies. Although there are still some procedural misunderstandings, especially on local and regional levels, SMEs get more publicity and opportunities for fair competition.

Unfortunately, recent events and the inconsistency of the SME development strategy raise doubts as to the Russian government's intentions to enhance the SME sector. Starting from 1 January 2011, small businesses are obliged to pay 2.4 times higher taxes than in 2009. The firms that enjoyed a simplified taxation regime and paid 15% taxes (with the total annual revenue not exceeding RUB 60 million) will now pay 34%. For the companies that were on traditional tax system, the tax burden would increase from 26% to 34% also. The expected consequence of the 2011 tax reform is the return to the "grey" practice; paying salaries in cash, showing lower numbers in the books. Many small companies went bankrupt with the raise of social taxes. Thus, in general the share of social payments increased countrywide, but at the same time the share of income from real estate operations and entrepreneurship went down.

### **2.9.7. SWOT Analysis of the SME Sector**

Strengths are primarily concentrated in high level of education, gender structure, and industry distribution. High potential of further developments is based on large number of technology driven companies and close traditional relationship with large companies, geographically located in the same area which is lowering transaction costs for the small businesses.

The Global Entrepreneurship Monitor (GEM) study performed in Russia has also provided evidence for high level of female involvement in entrepreneurship activities: "In Russia 4.6% of all men and 3.2% of all women are early-stage entrepreneurs... Established business showed a higher level of female participation over the years..." GEM methodology

is focusing on personal drivers for entrepreneurship. Thus, the proportion of necessity-driven and opportunity-driven entrepreneurs is rather stable in Russia even during the crisis, with opportunity-driven making up 70% of activity against 30% driven by necessity (that is not typical for transitioning countries and corresponds more with the trends in well developed economies). The motive for maintaining income was also proved to be relatively high and measured at the level of 29.8%.

Among weaknesses, with strategic focus on innovative economy and governmental grants available for technology driven companies in Russia, the SME sector still has inefficient structure with less than 1% of SME companies in science and research. It does not use the potential of high educational level up to its limits yet. Although a steady growth in numbers proves SMEs to be more attractive for Russian citizens, it is still minuscule for a large country like Russia.

Threats for SME sector development in Russia are consistent with other countries and include the global crisis, budget shortages, and limited support from international investors due to their low interest in the areas other than high-technology and telecommunication, and inefficient structure of the economy as a whole. Political factors are also critical, as well as the high level of corruption in Russia. Governmental support and simplification of administration regimes including taxation and book-keeping are also crucial for SME sector development. With the lack of financial resources for future sustainability of the pension system, Russian government is in the process of cutting these SME benefits off.

The other significant threat is a traditional resistance of Russian banking industry in general and other financial institutions and even their unwillingness to work with small companies. Even when the loans are available for the SME sector, the procedural difficulties in many cases prevent them from seeking financial resources from banks.

In many agricultural regions in Russia, low level of infrastructure development is limiting the SME economy growth. Non-systematic and/or sporadic governmental actions of support in one industry without coordination with other related industries can be destructive for SMEs and Russian economy as a whole. Having high expectations for the future at the beginning, such companies lose hope soon and never return to business again.

Nevertheless, opportunities for SME sector development are more promising now than 5 years ago. They include easier access to foreign suppliers, products and markets; easier customs regime with several countries; more respect to Russian companies from foreign counterparts and reliable business partners; and higher S&P investment rating for Russia. Innovative economy, proclaimed by President Medvedev as a further step of Russia's economic development suggests that the SME sector would be deeply involved in direct and indirect ways in developing, manufacturing, maintenance, promotion, selling and other services related to innovations.

As stated previously, a proximity to large companies successfully operating on domestic and international markets could be considered as a positive factor for SME companies who work as suppliers and partners for these large ones.

Social factors are also favorable for SME development now; as GEM research showed, over 70% of Russian citizens treat entrepreneurship and small businesses with high respect. The increasing flow of immigrants from former Soviet Union countries could help SMEs improve their efficiency due to the lower salaries typically paid to short-term low-qualified workers.

### **2.9.8. Tasks for Improvement and Further Development of the National SME Sector**

Summarizing the above analysis based on official statistics data, it should be stated that a significant positive shift in a societal attitude toward the SME sector occurred in Russia recently. In addition, Russian Government finally realized the importance of SME support and took some steps forward in creating legislative framework and financial infrastructure needed to improve the SME sector to reach the standards common for the European countries.

The strategic focus on creation of an innovative economy proclaimed by President Medvedev two years ago require support for technology driven small and medium sized businesses. Not many improvements have been made in that direction yet, except probably a "so-called" Seliger's Campaign (Medvedev's initiative, the Annual Lake Seliger's Innovation Forum involving high school and college level students).

The lack of entrepreneurial educational programs at Russian universities and insufficient number of qualified professors could be considered as one of Russia's most critical disadvantages against other countries like Hungary or Turkey. This is limiting the SME sector's flexibility now and will be severely damaging to the economy in future. Russia's slow involvement in international SME cooperation with suppliers from neighboring countries (Black Sea, Central Asian, Caspian and Baltic Sea regions, etc.) entrepreneurship research communities (like ERENET, for example), lack of participation at international conferences, workshops and seminars, minuscule support to entrepreneurship incubators, lack of investment structures (absence of angel investors and venture capitalist firms, or any other forms of financial support for the SME sector) are the urgent areas of strategic focus in this regard.

Another area that still awaits significant changes and governmental attention is retiree's involvement in the SME sector. Russia is a rapidly aging country that will be forced soon to spend enormous funds to support its pension programs. Tax breaks and simplification of book keeping and registering a firm for retiree owners of small businesses could at least partially help in solving this problem.

Russia already has quite a lot of experience in launching "National Projects"; it might be the time to start one with more focus on SME development all over the country.

## **Bibliography**

1. Russian Federation Statistics Services ([www.gosstat.ru](http://www.gosstat.ru) )
2. Сборник «Малое Предпринимательство» за 2005, 2006, 2007, 2008, 2009, 2010
3. Federal Law № 209-FZ «On SME Development» , 2007
4. Urgent measures to abolish administrative limitations on private business activity, Decree of the President of the Russian Federation No. 797 of May 15, 2008
5. GEM (Global Entrepreneurship Monitor) reports: 2006, 2007, 2008, 2009 , St. Petersburg School of Business
6. OPORA Russia official site (<http://en.opora.ru/>)
7. National Institute of Business Research, news: <http://rt.com/news/prime-time/small-businesses-dying-breed/>
8. Comparative study site: <http://www.tradingeconomies.com>
9. Informational site "doing business.ru": <http://www.doingbusiness.ru/definition-of-smes-eu-vs-russia.html>
10. Doing Business - Measuring Business Regulations. Comparative statistics. <http://www.doingbusiness.org/economyrankings/>

## 2.10 SERBIA

Dr. Dejan Erić

Institute of Economic Sciences and Belgrade Banking Academy, Belgrade, Serbia

### 2.10.1. National Economy and the SME Sector

In the first decade of the 21st century, the Republic of Serbia had quite positive rates of economic growth in the scope of 2.4-8.3 % average per year. This growth came to a halt due to the global economic crisis in the second half of 2008, facing a real drop in the GDP of almost 3% in 2009. The negative effects of the crisis were felt during 2010 as well. Towards the end of 2010, there was a small recovery, i.e. the forecast says that it would be possible to achieve a realistic growth of GDP of a maximum of 3%.<sup>61</sup> Table 71 shows the most important macro-economic parameters related to the economy in Serbia in the past few years.

**Table 71: Selected Macroeconomic Parameters of Serbia (2005 – 2010)**

	2005	2006	2007	2008	2009	2010
GDP growth %	5.6	5.2	6.9	5.4	-2.9	1.5
GDP, EUR m	20,358	23,520	29,542.7	34,259	31,511	33,016
GDP per capita, EUR	2,736	3,173.5	4,002.2	4,661	4,304	4,528
Inflation – growth of consumer prices	17.7	6.6	11	8.6	6.6	10.3
Growth of export, %	27.2	43.4	37.3	24.3	-26	10.5
Growth of import, %	-2.7	25.9	40.9	23.3	-34.7	-0.7
Industrial production, %	0.8	4.7	3.7	1.1	-17.6	3.2
FDI, EUR m	1,244.6	3,492.2	1,820.8	1,824.4	1,372.5	932
Unemployment, %	20.8	20.9	18.1	14.0	16.6	20.0
Budget deficit-surplus, % GDP <sup>(1)</sup>	0.3	-1.9	-1.7	-1.8	-3.3	-3.5
Public debt of Republic of Serbia, % GDP <sup>(1)</sup>	48	39.6	30.6	26	32	40.7
External debt, % GDP <sup>(1)</sup>		63.3	60.2	64.8	70.4	81.0
Value of dinar in relation to EUR <sup>(1)</sup>	85.5	79	79.24	88.60	93.01	105.49
Value of dinar in relation to USD <sup>(1)</sup>	72.21	59.97	53.72	62.9	63.59	79.28

Source: World Economic Outlook Database, International Monetary Fund, Institute for Statistics of Republic of Serbia, National Bank of Serbia, Institute of Economic Sciences

As the most important tendencies and characteristics of the economic growth of Serbia, we can emphasize the following:

- Increase of GDP per capita from EUR 2,736 in 2005 to EUR 4,528 in five years.

- Highly emphasized inflation pressure. Serbia is the leader in the region by the inflation rate. This factor leads to a decrease in the purchasing power and endangers the level of living standard of the entire population.
- Very high import dependency, which creates big problems in the payment balance of the country. A positive outcome of the crisis is that the export fell less than the import scope.
- Insufficient level of foreign investments as a significant engine of development – in the given period, the highest inflow of FDI was in 2006 in the amount of EUR 3.5 billion, which would be insufficient for faster economic growth. This factor is specifically emphasized because a lot of SMEs are tightly connected to the arrival of bigger foreign companies seeking suppliers and partners.
- Very high unemployment rate – as one of the latent, not only economic, but also social problems in Serbia – on the average between 14% and 23%.
- Increase of the level of debt, especially of the country, to almost all parameters.
- Constant drop of value of the national currency (Serbian Dinar - RSD) in relation to Euro and US dollar, which additionally created instability in businesses of all economic subjects in Serbia, especially the SME sector.

Other than the information given in the tables, it can be stated that the economy in Serbia faces the following problems as well: unbalanced regional development (priority is given to Belgrade and the northern part of Vojvodina), poor export structure (mostly raw material or products with lower degree of processing), existence of informal economy (which is significantly reduced in the past few years), high administrative barriers and economy load (which have significantly become apparent in crisis conditions), corruption, undeveloped road and railroad infrastructure etc.

In such a macro-economic environment, over 300,000 economic subjects do business, out of which the biggest number are small and medium companies (SMEs). Micro enterprises dominated in the structure of the SMEE<sup>62</sup> sector in 2009 (96.1% or 302,484 in total), while small enterprises accounted for 3.1% (9,873) and medium for 0,8% (2,470) of the total number of enterprises. Out of 302,484 micro enterprises, there were 226,241 entrepreneurs.

The number of SMEEs increased in 2009 compared to 2008 by 12,125, which was mostly due to the rise in the number of entrepreneurs and micro enterprises which, because of their weak economic strength, did not contribute to the development level of the overall sector. As a result of the crisis, the number of employees decreased by 7.2%. Although relevant statistical data on the SMEE sector for the year 2010 are not available yet, further worsening in key indicators can be expected.

Pursuant to the current legal regulations in Serbia, the sizes of enterprises are defined in line with 3 main criteria - number of employees, annual income and value of assets. Small enterprises are the ones which meet the following criteria:

- Average number of employees up to 50 (in case the enterprise employs up to 9 employees, it is a micro enterprise).
- Annual income less than EUR 2,500,000.
- Value of assets less than EUR 1 million.

This group also comprises a subcategory of micro enterprises with fewer than 10 employees. Medium-sized enterprises are the ones which meet the following legal criteria:

- Average number of employees between 50 and 250.
- Annual income between EUR 2,500,000 and EUR 10,000,000.
- Value of assets EUR 1,000,000 – EUR 5,000,000.

According to the Report on Small and Medium-sized enterprises and Entrepreneurship 2009, the SMEE sector had a dominant share in the number of business entities (99.8% or 314,827) and accounted for 33% of GDP and 42.3% of total employment of Serbia. The SMEE sector generated 66.7% of employment (872,540 employees), 67.8% of turnover (RSD 4,380 billion) and 57.4% of GVA (RSD 819.2 billion) of the non-financial sector of Serbia.

An attempt to sum up the most important information about the SMEE sector in Serbia is given in Tables 72 and 73.

**Table 72: SME Sector Development Indicators in Serbia (2008-2010)**

	SMEs			Share of SMEs		
	2008	2009	2010	2008	2009	2010
Number of enterprises	303,449	314,827	na	99.8	99.8	na
Number of employees	940,159	872,540	na	67.2	66.7	na
Turnover (mill. RSD)	4,662,624	4,380,545	na	66.6	67.8	na
GDP (mill. RSD)	837,990	819,206	na	59.1	57.4	na
Export (mill. RSD)	274,506	275,378	na	45.9	50.5	na
Import (mill. RSD)	751,817	627,147	na	60.5	60.9	na
Commodity balance (mill. RSD)	-477,311	-351,769	na	74.2	72.8	na

Source: Report on small and medium sized enterprises and entrepreneurship for the year 2009 & 2010

**Table 73: Number and structure of commercial entities in SMEs sector in 2009**

Type of organisation	Micro	Small	Medium	Total	
	Number	Number	Number	Number	Structure [%]
Enterprises	76,243	9,873	2,470	88,586	28.1
JSC	844	558	651	2,053	0.7
LLC	69,576	8,806	1,533	79,915	25.4
Others*	5,823	509	286	6,618	2.1
Entrepreneurs	226,241	0	0	226,241	71.9
Total	30,484	9,873	2,470	314,827	100.0
Structure [%]	96.1	3.1	0.8	100.0	

\* Includes: partnership, limited partnership, state-run enterprise, public enterprise, cooperative

Source: Report on small and medium enterprises and entrepreneurship for the year 2009, page 15

### 2.10.2. Legislation and Ranking of Doing Business According to World Bank Methodology

In comparison with the previous Doing Business Reports, Serbia has generally improved slightly. The most important ranking in this report is "Rankings on the ease of doing business". In 2010 Serbia's rank was 90, but in 2011 it is 89 (out of 183 economies). Aggregate ranking on the ease of doing business is based on the set of indicators that measure and benchmark regulations affecting areas in the life cycle of a business:

starting a business, dealing with construction permits, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and closing a business, employing workers and getting electricity. Five-year measure of cumulative change in Doing Business indicators between DB2006 and DB2011 DB is 0.1, and illustrates the relative level of change in the regulatory environment for local entrepreneurs. The ranking of other significant indicators is as follows:

- Starting a Business – 83rd Rank in DB 2010 – 75 (-8 places)
- Dealing with Construction Permits – 176th Rank in DB 2010 – 174 (-2)
- Registering Property – 100th Rank in DB 2010 – 105 (+5)
- Getting Credit – 15th Rank in DB 2010 – 14 (-1)
- Protecting Investors – 74th Rank in DB 2010 – 73 (-1)
- Paying Taxes – 138th Rank in DB 2010 – 134 (-4)
- Trading Across Borders – 74th Rank in DB 2010 – 71 (-3)
- Enforcing Contracts – 94th Rank in DB 2010 – 94 (No change)
- Closing a Business – 86th Rank in DB 2010 – 101 (+15)

Analyzing the position of Serbia, we can see that there is improvement in two areas - registering property (improvement of a total of 5 positions) and closing a business (15 positions). In one – enforcing contracts there is no change, and in six, the position of Serbia is worse compared to last year.

Serbia is among the countries that streamlined the procedures for starting a business. One of them refers to the registry which can now publish information about the company registration, so companies no longer have to arrange with a newspaper to advertise it. It requires 7 procedures (Eastern Europe and Central Asia average is 6.3, OECD – 5.6), takes 13 days (EE&CA – 16.3, OECD – 13.8), and costs 7.95 % GNI per capita to start a business in Serbia (EE&CA – 8.5%, OECD – 5.3%). The changes in trends in certain elements connected to business start-up can be seen in Table 74.

**Table 74: Trends in starting a business in Serbia**

	2008	2009	2010	2011
Rank	-	-	75	83
Procedures (number)	11	11	7	7
Time (days)	23	23	13	13
Cost [% of income per capita]	8.9	7.6	7.1	7.9
Paid-in min. Capital [% of income per capita]	8.0	6.9	6.1	6.0

Source: Doing Business, 2011

One of the biggest problems in Serbia is to obtain a construction permit. It is a problem which prevents faster investments and growth for a number of years. To get such kind of permit in Serbia, it requires 20 procedures (EE&CA – 22.2, OECD – 15.8), takes 279 days (EE&CA – 250, OECD – 166), and costs 1,821.39 % GNI per capita (EE&CA – 645.5, OECD – 62.1).

With regard to Registering Property, Serbia made an improvement of 5 positions compared to Doing Business 2010. It takes 6 procedures in Serbia (average in EE&CA is 5.6 and OECD – 4.8), 91 days (EE&CA – 38.3, OECD – 32.7), while the cost as % of property is 2.7% (EE&CA – 2.4%, OECD – 4.4%). It cannot be denied that certain steps have been taken, but the registration procedure is still relatively slow – it takes 91 days on average.

Getting Credit is one of the elements we can be very proud of in Serbia, since it holds the 15th position (drop in one position compared to DB2010). With regard to this element, the indicators - strength of legal rights index for Serbia is 8 (on scale 0-10, while the average for EE&CA region is, 6 and for OECD countries it is 6.9), depth of credit information 5 (on scale 0-6, while for EE&CA 4.0 and OECD 4.7), public registry coverage (% of adults) is 0.0 (EE&CA - 13.1, OECD – 8.0) and private bureau coverage (% of adults) is 100% (EE&CA – 21.3, OECD – 61.0). Here, we should point out that we discuss procedures only, not the conditions for getting credit. The latter is not affordable, at least for many owners of SMEs.

Protection of investors is an area where Serbia is good, in the 74th position, which is lower than last year. This element consists of four indicators and Serbia's ranking with regard to the countries from Eastern Europe and Central Asia and OECD can be seen in Table 75.

**Table 75: Protecting Investors**

Indicator	Serbia	Eastern Europe & Central Asia	OECD
Extent of disclosure index (0-10)	7	6.3	6.0
Extent of director liability index (0-10)	6	4.0	5.2
Ease of shareholder suits index (0-10)	3	6.2	6.8
Strength of investor protection index (0-10)	5.3	5.5	6.0

Source: <http://www.doingbusiness.org/data/exploreeconomies/serbia#protecting-investors>

Serbia's ranking in trading across borders is 74th, 3 positions lower than in DB2010.

Paying taxes, unfortunately, is not an area where Serbia can be proud. Serbia's ranking is the 138th position, which is four positions lower than 2012. Here it is necessary to emphasize the 66 payments per year which is significantly higher than EE&CA countries (41.7) and several times higher than OECD countries. OECD (14.2).

The only ranking with no change is Enforcing Contracts where Serbia takes the 94th position. Analyzing 3 indicators influencing this position, it can be seen that in Serbia it takes 36 procedures (opposed to 37.1 in EE&CA countries, or 31.2 in OECD countries), 635 days (opposed to 402.2 in EE&CA countries, or 517.5 in OECD countries) and 28.9% cost (as % of the claim, opposed to 26.6% in EE&CA countries, or 19.2% in OECD countries).

The area with the highest level of progress for Serbia is Closing a Business, since it increased its position by 15 places, from 101 to 86. The comparison with the average in E&CA and OECD countries can be seen in Table 76.

**Table 76: Closing a Business in Serbia**

Indicator	Serbia	Eastern Europe & Central Asia	OECD
Recovery rate [cents on the dollar]	29.5	32.6	69.1
Time [years]	2.7	2.9	1.7
Cost [% of estate]	23	13.4	9.1

Most of the Eastern European economies still have elements of etatist legal systems whose roots can be found in the multi-decade socialist dominance. In the ex-socialistic counties there was almost no bank-

ruptcy. This is no longer the case region wide. Improvements have been made in a number of areas, ranging from regulation of insolvency administration and out-of-court settlements to prevention of fraud and abuse in insolvency proceedings. Serbia passed a new Bankruptcy law aimed at, among other aspects, reducing the length of insolvency procedures and introduced out-of-court agreements and a unified reorganization procedure. Concerning the support to access to credits, Serbia is one of the leaders in the region. Serbia also has legal time limits for registration procedures, but the problem lies in the discrepancy in the procedures. After the law reforms, out-of-court enforcement is allowed in Serbia. Serbia has achieved the greatest progress with regard to closing a business.

### **2.10.3. SME Support Infrastructure**

At the very beginning, it can be stated that there is a good and well-developed institutional support for the SME sector. It consists of a bigger number of institutions and organizations, out of which we can emphasize the following:

1. Ministry of Economy and Regional Development – within which there is a specific organizational part headed by one of the Minister’s assistants in charge of the area of small and medium companies.
2. National Agency of Regional Development (NARD) within which there is the previous Agency of Development of SMEs and entrepreneurship.
3. Fund for the Development of the Republic of Serbia – which attempts to provide affordable loans to entrepreneurs and owners of small and medium businesses.
4. Fund for the Development of the Autonomous Province (AP) Vojvodina – similar role as the previous institution, only regionally oriented towards Vojvodina.
5. Guarantee Fund of the Republic of Serbia – provides services in the SME sector with the aim to easily access banks and bank loans as external source of financing.
6. Guarantee Fund of AP Vojvodina – has a similar role, only connected to Vojvodina territory.
7. Agency for Insurance and Financing Export (AOFI) – provides a set of services for SMEs which are export-oriented, mostly through services of insurance, finance, consulting etc.
8. Agency for Foreign Investments and Export Promotion (SIEPA) – it

also provides a set of services in connecting them with foreign investors, promotion of foreign export and import etc.

9. National Employment Agency – close cooperation in the area of legal regulations, by-laws about employment, collective negotiations, human resources employment, education and knowledge innovation.
10. Chamber of Commerce – within which there is the Entrepreneurs Society which was founded in 2003, with the main aim to protect the interests of its members – entrepreneurs.

The Ministry of Economy and Regional Development (MERD), through the Sector for SMEE Development, is competent for formulating the policy of SMEE development. The National Agency for Regional Development (NARD) is directly accountable for the implementation of strategic documents and in this field liaises with other agencies (Serbian Investment and Export Promotion Agency, Export Credit and Insurance Agency, and National Employment Service) as well as with the network of regional agencies and local centres. The Council for Small and Medium-sized Enterprises being a body that coordinates activities aimed at defining SME policy and analyzes the state of the SMEE sector was involved in designing the Strategy for Development of Competitive and Innovative SME 2008-2013, which was adopted in October 2008. From the end of the year, the Council worked on the draft Action plan for the elimination of administrative barriers, which was adopted at the beginning of 2009, but in practice brought improvement for the owners of SMEs in Serbia.

One of the most important institutions was the Republic Agency for Development of Small and Medium Enterprises and Entrepreneurship (RASMEE). It was founded in 2001. Through the network of its regional units it offered services to small and medium-sized business owners and entrepreneurs in Serbia. Some of these activities entail<sup>63</sup>: participating in the preparation of the strategy of development of SMEs, performing the professional assistance necessary for the realization of local and foreign investments and innovations in SMEs, creating a unique data base system of statistical data and information relevant to the development of SMEs and entrepreneurs, preparing and delivering programs of education of instructors and consultants for the development needs of SMEs, etc...

At the end of 2009, RASMEE was annulled as specific legal entity. It became an integral part of the National Agency for Regional Develop-

ment (NARD), so it lost a part of its identity. Despite numerous critics from professional circles, the Ministry of Economy and Regional Development did not pay much attention to arguments, but included the Agency in the newly formed Agency. We find it to be a big mistake and a very bad signal to the entire community of small and medium enterprises and entrepreneurs was sent. However, NARD took over many significant functions from RASMEES, above all has been active in providing both financial and non financial support to SMEs. A number of incentive programs have been designed and implemented in attempt to foster further development of SME sector.

Financial support for the SMEE sector was not defined under any document in the previous period. A part of that policy was contained in the European Charter for Small and Medium-sized Enterprises under principle 7. The provision of financial support was awarded to numerous institutions that function on the cooperation basis, but still not sufficient. The implementation of the Strategy for the Development of Competitive and Innovative Small and Medium-sized Enterprises for the period 2008-2013 set the orientation of financial support and development of the financial market that should significantly facilitate the operation of SMEs.

A few institutions in the Republic of Serbia provide financial support to the SMEE sector from public sources, either in the form of grant or by offering favorable loans. The following institutions participate in providing financial support to SMEs from government sources: Developing Fund of the Republic of Serbia, Guarantee Fund of the Republic of Serbia, National Agency for Regional Development, National Employment Service, Export Credit and Insurance Agency of the Republic of Serbia and Serbia Investment and Export Promotion Agency. An additional support from the budget is provided on a national level by the Ministry of Economy and Regional Development, Ministry of Agriculture, Trade, Forestry and Water Management, and Ministry for National Investment Plan, as well as on the provincial level by the Development Fund, Guarantee Fund and Capital Investment Fund of Vojvodina.

Development Fund - approves loans for financing investment projects and short-term loans for liquidity encouragement. The Fund is an intermediary in the implementation of three governmental programs for financing SMEs: loans for under-developed regions, start-up loans and loans for self – employment.

The Guarantee Fund - plays an important role in supporting SMEs by guaranteeing for the loans that are approved by banks and other financial institutions, and furthermore by helping them access financial markets in order to secure necessary funds for their development. An important instrument of SMEE support in access to credit funds is the reduction of the number of conditions that need to be fulfilled for approval of credit guarantees. The Guarantee Fund of the Republic of Serbia, the Guarantee Fund of Vojvodina and a few municipal funds issue guarantees to SMEs operating in different areas, newly-founded enterprises and agricultural producers. EBRD recommendation is that all credit guarantees should be in private ownership in order to ensure more efficient allocation of resources through adequate support mechanisms.

Significant progress has been made in financing business start-ups. In 2007, the Ministry of Economy and Regional Development began approving start-up loans. The National Agency for Regional Development, together with a network of regional agencies and centers, participates in project realization, thus enabling decentralization of the loan applications collection. Regional disposition of loans approved in 2007, 2008 and 2009 was unbalanced, while the largest number of beneficiaries belonged to the City of Belgrade and Sumadija County. In 2009, the total of EUR 44 million was approved mainly in the sectors of food processing, beverages and tobacco production, services, wood processing and transport and communications.

Over the past several years there has been significant progress with regard to the development of support measures for potential entrepreneurs and start-ups through the network of regional agencies and offices of the National Agency for Regional Development. The Serbian Chamber of Commerce and the Republic Agency for SMEE Development organize various trainings for SME owners and potential entrepreneurs. The EBRD program TAM/BAS provides consulting support and advises Serbian enterprises on how to boost exports, profitability and growth. The main goal is to provide adequate advice and guidelines on procedures for registration of enterprises, legal issues, as well as to provide support in the field of business planning and receiving micro-financial funds.

The National Agency for Regional Development realizes the support for the development of human resources and business education through following activities:

- Trainings for business beginners - In 2009, NARD, in cooperation with regional agencies and centers, organized 230 trainings for 3,217 persons, potential starters. The aim of the seminar was to improve the entrepreneurial culture, knowledge and skills of potential entrepreneurs, to increase the number of SMEs and the number of enterprises which survive on the market as well as to reduce the number of the unemployed. The specific goals of the seminar were the following: testing entrepreneurial culture, upgrading the knowledge and skills of potential entrepreneurs, providing the necessary package of information on the possibilities of the realization of a business idea; providing information about legal regulation and the tax system, professional assistance in the assessment of a business idea through building of a business plan.
- Mentoring - In 2009, the cooperation with the National Employment Agency (NEA) on the realization of activities for the purpose of development of entrepreneurship was continued. 98 mentoring programs for enterprises which were funded with the support of NAE funds were provided.
- Consulting - The entrepreneurial service continued to provide legal and financial consulting to potential and existing SMEEs in this period. The National Agency for Regional Development continued to provide consulting services to SMEEs by providing support and assistance to NARD offices and regional agencies/centers.
- Development of Youth Entrepreneurship Program, etc.

Financing of SMEs is based on the following laws and bylaws: the Budget Law, Public Agency Law, Law on the Agency for SMEE Development, Law on the Development Fund of the Republic of Serbia, Law on the Guarantee Fund of the Republic of Serbia, Decision on the Foundation of the Development Fund of AP Vojvodina and Foundation of the Guarantee Fund of AP Vojvodina.

The scheme of financial assistance is very significant, but the amounts are definitely not sufficient. One of the biggest problems for the SME sector in Serbia is a very limited access to sources of financing. Other than own means of the owners, the most significant source are bank loans, which are exceptionally expensive. Another problem is that there are no micro-credit financial institutions in Serbia. Also, there is no law about this type of institutions, which limits the potential sources of financing for the entrepreneurs in Serbia.

#### **2.10.4. Industries, Branches, Regions, Clusters**

The structure of the SME sector has not changed to a large degree in the past few years in Serbia. It has remained quite stable. The SMEEs predominantly influence the operational indicators of all the sectors in the Serbian economy except for the following ones: Sector of mining and geology, Electricity, gas and water supply sector and Transportation, warehouse and logistics sector in which large enterprises are dominant. In 2009, 73.3% of all SMEEs were operating in the following sectors: Wholesale and retail trade, Manufacturing, Real estate and renting and Construction. Furthermore, 77.4% of employees in SMEEs were employed in the above mentioned sectors. Nearly 84.4% of the total turnover and 79.7% of GDP of the SMEE sector in 2009 were generated in the above mentioned 4 sectors. The SMEE export-import activity was mostly influenced by the following two sectors: Manufacturing and Wholesale and retail trade (10,544 exporters realized RSD 246.7 billion of export which accounts for 45.2% of the total export of the non-financial sector and 89.6% of the total export of the SMEE sector; while 15,657 importers realized RSD 562.5 billion of import which accounts for 54.7% of the total import of the non-financial sector and 89.6% of the total export of the SMEE sector)<sup>64</sup>.

The SMEEs account for more than 99% of all enterprises in all the districts in Serbia, they employ more than 60% of the workforce in the districts (except for the City of Belgrade, District of Bor and Pcinj, and Podunavsko district where they employ 56.2%, 58.8%, and 57.3% respectively). The SMEE sector predominately influences the generation of turnover and GDP in almost every district in the country (except for the Podunavsko district with regard to turnover and South-Backa, Branicevo, Bor and Pirot districts with regard to GDP). The SMEEs in the City of Belgrade and South-Backa district account for 39.5% of the total number of SMEEs (92.836 or 29.5% and 31.614 or 10.0% respectively), employ 42.5% of the total number of employees (278,657 or 31.9% and 92,827 or 10.6% respectively), generate 55.1% of the total turnover (RSD 1,886.9 billion or 45.3% and RSD 524.8 billion or 12.0% respectively) and 56.1% of the total GDP (RSD 37.1 billion or 45.3% and RSD 88.3 billion or 10.8%) of the SMEE sector.

According to the productivity level, an increase in regional disproportions occurred. The GDP per employee indicator within the SMEE sector is 3 times greater in the City of Belgrade than in the Zajecar district. The

most developed districts (the City of Belgrade and the South-Backa district) have the best GDP per employee ratio, while all enterprises operating in the City of Belgrade and all middle-sized enterprises in South-Backa and Srem districts have the above average GDP per employee ratio.

In line with the Strategy for the development of competitive and innovative small and medium-sized enterprises in the period 2008-2013, the Government of the Republic of Serbia has adopted and started implementing the Program for supporting the development of clusters with an aim to promote the SMEE and regional development. Today, there are 13 operating clusters and 12 cluster initiatives. The operating clusters differ according to the obtained level of development. There are 4 clusters in the 3rd phase, 5 in the 2nd phase and 4 in the 1st phase of development. The most developed clusters are the following: The Automotive Cluster of Serbia, The Serbian Software Cluster, the BIPOM Cluster and the Sumadija Flower Cluster. The cluster initiatives are considered to be in the so-called zero phase of development and are yet to be developed. The existing clusters are facing numerous problems which mostly relate to the: lack of necessary financial resources, low level of awareness about the concept of clusters, ignorance of the cluster members, lack of appropriate knowledge and skills of the cluster managers, and insufficient institutional support. The concept of clusters is still relatively unfamiliar to the wider public in Serbia, particularly among entrepreneurs in less developed regions. Unless the positive effects that are derived from gathering on the basis of clusters become more understandable, further strengthening of the existing clusters and more intensive forming of new ones cannot be expected.

National Investment Plan (NIP) funds, local government funds, and donors' funds were used for financing business incubators i.e. adaptation, reconstruction and additional building. NIP funds were allocated to most incubators (some incubators failed to realize the funds although they have been approved). Almost all incubators are financed from contributions of the state and local authorities, and partially from the funds obtained from renting. Incubators in Vojvodina (Zrenjanin, Subotica and Senta) were mainly financed from the budget of AP Vojvodina (VIP). No incubator has managed to achieve self-sustainability so far.

The role of the Serbian government in promoting cluster development and creating cluster policies has been increasing in the last decade. Since clusters are related to prosperity and SMEs benefit from them, the Cluster Development Support program was implemented by the Minis-

try of Economy and Regional Development and the National Agency for Regional Development. Table 77 presents the most important parameters in regard to the clusters in Serbia.

**Table 77: The Most Important Parameters on the Clusters in Serbia**

Second phase clusters	Number of companies	Number of scientific research and supporting institutions	Number of employees	Total turnover in EUR
Automotive Cluster of Serbia	40	5	12,000	280,000,000
Serbian Software Cluster 7	13	5	2,020	na
BIPOM Cluster	30	9	1,722	32,000,000
Galenit cluster for collecting and recycling batteries and accumulators	13	3	1,200	350,000,000
Dundjer Niš Construction industry Cluster	53	6	1,226	1,500,000
Kraljevski odmor-Kraljevo touristic cluster	20	6	2,000	31,052,631.5
Medical tourism cluster	19	4	na	na
Netwood-furniture industry cluster	9	3	180	na
Agency for Timber -timber processing industry	130	11	5,500	90,000,000
Serbian film association	44	3	Na	5,200,000
ICT net	19	2	2,000	85,500,000
Sumadijski cvet (Sumadija Flower)	134	10	780	3,700,000
<b>First phase clusters</b>				
Istar 21- Cluster for the development of tourism in Danube region	28	11	37	7,200,000
Memos cluster-metal industry	14	5	308	9,000,000
Feniks - Air industry	13	5	730	15,000,000
Asstex-textile industry	14	3	728	9,500,000
Agroindustrija (Agricultural industry)	18	3	209	3,300,000
Facts-fashion industry	9	3	1	20,000,000
Poluks- food industry	20	7	1,099	33,300,000
Fond-tourism in Palić	25	5	600	2,000,000
Vojvodina Information technology cluster	33	3	1	31,600,000

Source: Ministry of Economy and Regional Development, <http://klasteri.merr.gov.rs>

We can conclude from this information that the number of clusters in Serbia has significantly increased, as well as the score of turn-over in them. The biggest clusters are connected to the automobile industry, which is a direct consequence of the arrival of Italian FIAT in Serbia. The automobile industry is generally known as a field which requires the existence of a large number of suppliers, most of which are from the sector of SMEs. Almost two years after the arrival of the Italian manufacturer of automobiles, there was a revival of the supporting and assisting businesses. The growth of clusters in the areas of IT and new technologies is also very welcome.

The key problems of incubators are the following:

- financing operational costs;
- unsettled property-legal relations;
- inadequate management.

We believe that the development of the clusters in Serbia was exceptionally dynamic and that, despite the specified problems, they present the right way towards uniting and collecting entrepreneurs in the creation of a new environment where the entrepreneur activities can be revived.

#### **2.10.5. The Effect of the International Financial and Economic Crisis**

The economic and financial crisis has particularly impacted the transition economies in South-East Europe, including Serbia as well. After the period of encouraging economic growth of approximately 5.5% annually, the Serbian economy entered a recession which turned out to be more severe than what the policy-makers were willing to acknowledge at first. The world financial crisis has exposed the deep-rooted problems of the Serbian economy. Along with the country-specific transitional crisis, the global one has further worsened the already difficult economic situation, bringing forward another harsh period of unemployment, impoverishment, and economic uncertainty.

The first negative consequences of the influence of the global crisis were felt at the beginning of October 2008, where there was a sudden

withdrawal of down-payment of the population from the bank accounts. However, a more serious influence on the situation in the real sector, which was manifested in the fall of the scope of the economic dependency, scope of production, inflow of foreign direct investments (FDI) and growth of budget deficit and unemployment were felt during 2009 when the GDP fell by over 3%, and some branches (such as construction) reduced the scope of activities by more than 30%. Some of the direct consequences are as following:

- Reduced demand, primarily on the local market (most SMEs have been predominantly focused on) – almost every second small and medium sized enterprise has faced this issue,
- Illiquidity, i.e. inability to collect debts, which additionally deteriorated financial performances,
- Hindered servicing of approved credits – directly caused by illiquidity and delayed collection of debts, which decreased credit rating of many SMEs, and influenced on even less favorable access to bank credits, which, as will be described further, are a dominant resource of financing for this economic sector,
- Foreign exchange rate negative fluctuation – which, one has to admit, has not had any significant influence, and which, despite various pressures, has remained relatively stable. Extremely good work of the central bank – National Bank of Serbia - is of particular importance under such circumstances,
- Downsized inflow of foreign direct investments (FDI),
- Decreased demand for products/services on the international market.

The key SME indicators for the year 2009 are significantly worse than those for the previous years. The crisis deepened the SMEs' already existing structural problems, especially the following ones: dominant share of micro and small enterprises, low level of competitiveness, heavy dependence on external sources of finance, poor export capacity and insufficiently developed relations with large enterprises. Moreover, being the most profitable part of the Serbian economy, the SME sector became the least profitable one with the profitability rate of 39.6%<sup>66</sup> (41.3% in large enterprises).

According to the official information, it can be seen that the crisis influenced the reduction of the scope of entrepreneurs' activities. Namely, there was a drop in the number of start-ups, as well as new entrepre-

neurs. Due to the fall in external and internal demand, investment drop, an increase in the risks and costs of doing business, and the fear of failure increase, the entrepreneurial climate was much less convenient. Followed by the slowdown in opening, growth and development and speed-up in closing down business entities, the healthy entrepreneurial dynamics recorded in the previous years was interrupted in 2009. The possibilities for new jobs to be opened and for the productivity to grow were rather limited.

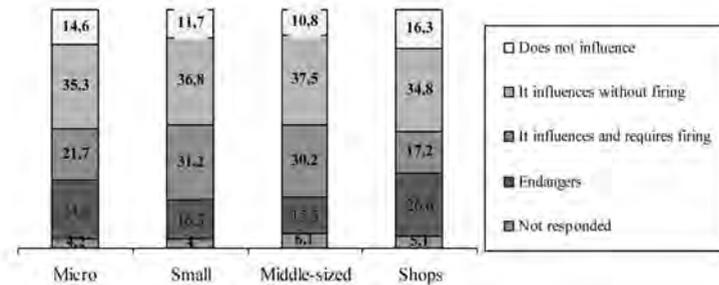
The outbreak of the world financial and economic crisis along with its effects being spread throughout the Serbian economy and society, a decline in employment, turnover, GDP and profit of the SME sector occurred. Compared to 2008, the total number of people employed in the SME sector decreased by 7.2%<sup>67</sup> in 2009 (67,619 persons), thus withholding the positive impact of the sector on reducing social tension in the country. Since the beginning of the transition process in Serbia, the SME sector was the only segment of the economy in which the employment was continually increasing. Furthermore, a 14.7% drop in turnover, 11.2% in GDP and 15.5% in profits were noted in 2009, as well. The negative tendency of the concentration of the number of SMEs in only two sectors (Wholesale and retail trade 34.4%, and Manufacturing sector 17.2%) and mostly in two regions (the City of Belgrade with the share of 29.5% and South-Backa District with the share of 10.0%) continued in 2009.<sup>68</sup>

The crisis has brought about serious issues in the SME sector in Serbia. According to a research conducted in mid-2009 by the Republic Agency for Small and Medium Enterprises and Entrepreneurship development – RASMEE, "Current state, needs and problems of small and medium sized enterprises and entrepreneurship - Report on the Research"<sup>69</sup>, 21% of respondents claimed that the crisis jeopardized the company's survival, 24% that the crisis required redundancies, 36% that the crisis influenced but with no redundancies needed. Only 14% respondents admitted the crisis had no influence on their business. On the basis of these results on a representative sample comprising almost all economic activities and regions in Serbia, it is obvious that over 80% of SMEs have been more or less influenced by the crisis.

This research discloses particularly interesting differences in the impact of the crisis depending on the size of enterprises. Entrepreneurs, owners

of independent shops feel much more threatened (almost 27% respondents) than small and medium sized enterprises (16%). On the other hand, a small number of shops (only 17%) have envisaged redundancies in comparison with SMEs (the figure even up to 30%). Please see Figure 26 which presents the impact of the economic crisis on survival and redundancies.

**Figure 26: Influence of the economic crisis on survival of companies and redundancies**



Source: RASMEE, 'Current state, needs and problems of SMEs in Serbia, Belgrade, 2009, page 28

The recession led to a loss of investment opportunities, as well as to a decrease in the share of equipment and construction work in the technical structure of investments. According to the share of investment in GDP, the SMEE sector accounted for 27%, which is 5% below the average of the economy. The micro enterprises were hit most by the crisis with their investment spending dropping from 29% in 2007 to only 9% in 2009. An increase in the cost based competitiveness indicators accomplished in the period 2004-2008 was disturbed in 2009, while small and micro enterprises, which contribute significantly to employment but are less productive, were affected the most.

Due to the crisis, a reduction in the number of exporters and importers was recorded in 2009. Because of the lack of domestic consumption, the drop in import was much faster than the drop in export, so the rate of import export coverage increased (52.8% in 2009) especially in the SMEE sector.

In 2010, 9,816 business entities were established in the Serbian economy, which points to a slight decrease (9,869 in 2009). At the same time, there were 10% less new entrepreneurial firms. According to the National Agency for Regional Development, there were about 345,000 SMEEs operating in Serbia in 2010, which indicates a 12% raise in the number of SMEEs in comparison to 2009. Despite that, the mortality rate increased mostly as a result of two things – the outbreak of the world financial and economic crisis and an increase in the number of governmental duties on SMEEs. Notwithstanding the fact that the government intended to reduce the administrative burdens on SMEEs by at least 25% by 2011, some 17 additional duties were added to the 65 already existing taxes for entrepreneurs mainly on the local level. Approximately 20 entrepreneurial firms are closed down every single day in Serbia. In 2010, for the first time since the records were kept by the Serbian Business Registers Agency, the number of closed entrepreneurial firms was greater than the number of newly opened ones. Only in October 2010, a total of 543 business entities were opened and 875 were closed down, while a total of 2,569 entrepreneurial firms were opened and 2,626 were closed down.

Due to the world financial crisis and an increasing number of different burdens and taxes introduced by the Serbian government, SMEEs have been facing serious problems in their day-to-day operating. The majority of them are dealing with liquidity problems. According to a survey conducted by the Union of Employers of Serbia, out of 17,000 Serbian enterprises ranging from large ones to entrepreneurs, more than 80% are not liquid and are indebted. In 2010, every third enterprise in Serbia had liquidity problems, while in 2009 it was every fourth. Because the economy is not liquid, the banks are under increasing pressure. The banks are compensating the risk they are exposed to by raising the prices of their credits, which additionally worsens the already difficult position of SMEEs in providing financial resources.

The Serbian economy has been experiencing difficult times for more than two decades now. Even today, after more than 20 years, it is still below its pre-crisis level. It was widely believed that along with the process of transition, the SMEE sector would become strong and able to absorb unemployment and generate economic growth. Notable steps forward had been taken after the political changes in October 2001, particularly

regarding the SMEE sector. The institutional infrastructure and the business environment for the establishment, operation and development of SMEEs were significantly improved, but are still not satisfactory enough. The outbreak of the world financial and economic crisis interrupted the positive tendency in the development of SMEEs, thus emphasizing and deepening the already existing problems and bringing new ones forth.

### **2.10.6. Government Measures to Cope with the Impact of the Economic Crisis**

Two months after the first impact of the global economic crisis on the economy in Serbia, in mid-November 2008, the government of the Republic of Serbia adopted the first package of measures which were aimed at banks and the financial systems. The goal was to stabilize the banking system and prevent a bigger outflow of deposit, especially in foreign currency, which presented a specifically emphasized problem (additional estimates show that almost 1 billion euro deposit was withdrawn in that period). As the crisis was becoming stronger and had more significant effects which were seen in the drop of economic activity (in 2009 there was a drop in GDP of almost 3%), the Government aimed the focus of its measures to the realistic sector. The measures meant:

- State warranty for deposit insurance on savings accounts – where the border was increased from EUR 3,000 to EUR 50,000. This measure proved to be really effective, since it brought the reduction of panic among citizens who were saving and stopped further withdrawal of deposits. It is important to stress that by changes of “Law on Deposit Insurance” in December 2008, depositor is considered not only as individual entity but also Small and Medium-Sized Enterprise defined by law which regulates accounting and auditing<sup>70</sup>.
- The tax on capital profit was annulled – with the aim to prevent a trend of price drop on the Belgrade stock-exchange.
- The tax of 0.3% on transfer for absolute rights in share trade was annulled – which did not represent a more significant measure in the battle against the global crisis, but more a correction of the deviation which existed in the financial business in the 90’s.
- Measures for support of liquidity of the economy which meant: extension of the deadline to pay previously taken loans, relief of possibilities for taking loans from abroad through the annulment of obligatory reserves on newly taken loans, measures towards annulment of

negative exchange rates etc. These measures were temporary, since the illiquidity became deeper with time. For Serbia, it was one of the biggest problems and negative effects of the global crisis.

Another set of measures which the Government of the Republic of Serbia undertook were aimed at the real sector, i.e. preventing the growth of unemployment and drop of economic activity. Out of this group, the following should be emphasized:

- Savings measures of the country, which were recommendations from the International Monetary Fund (IMF) and which entailed the reduction of salaries in public companies, agencies and government institutions – which was done at the beginning of 2009, but not in sufficient measure.
- Limitation in the employment in state organs, reduction of the number of employees through lay-offs and rationalization – which was more declarative than essential.
- Affordable loans – for liquidity, investments, financing of permanent working capital, developmental, investments, etc. The unaffordability of loans will be discussed further, and it should be stated that very limited real sources appeared to be the biggest problem.
- Subsidizing interest rates for loans for liquidity and financing permanent working capital in 2009, which had a very good impact, but the scope of the loan was not sufficient to satisfy extremely high needs of the economy, especially of the SME sector.
- Other than those mentioned, the government brought a set of additional measures and regulations, such as: Regulation about the conditions of using co-financed loans for investments with guarantee from the Guarantee Fund in 2009, Regulation about the conditions and criteria for subsidizing interest rates for consumer loans for supply of certain permanent consumer goods in 2009 – in affordable conditions, to influence the prevention of demand drop and further strengthening the crisis in the real sector, measures to encourage employment – affordable tax exemptions for employers who employed trainees, etc.

As particularly significant measures, different credit support programs can be emphasized, with the aim to stabilize interest rates and reduction of expenses of financing for SMEs. It is the government's estimation that by this way of subsidizing, economic subjects received about EUR 1.1 billion and total public expenses for these purposes amounted to EUR

55 million in 2009<sup>71</sup>. The main purpose of these measures was to keep businesses alive and increase employability, improve liquidity and realize positive rates of economic growth.

The whole idea of the program was to activate the credit potential of the banks with minimum budget costs. Commercial banks should approve credits according to their ordinary credit policy and risk evaluation. Government intention is to subsidize interest rates with budget funds and therefore make credits more attractive to the users. Credit users who apply for the subsidized credits have commitment to maintain all employees during the credit period. Three types of credits are subsidized:

Liquidity credits - Market interest rates are subsidized by 4% points per year. Maximal credit amounts are:

- Micro enterprise credit up to EUR 20,000.
- Small enterprise credit up to EUR 50,000.
- Medium enterprise credit up to EUR 500,000.
- Large enterprise credit up to EUR 2,000,000.

Investment credits - Government will subsidize interest rates of these credits by 3,5% points per year and the installment period is 3-5 years with a grace period of 6-12 months.

- Micro enterprise credit up to EUR 30,000.
- Small enterprise credit up to EUR 200,000.
- Medium enterprise credit up to EUR 1,500,000.
- Large enterprise credit up to EUR 4,000,000.

For export oriented companies, total credit amounts could be doubled. Total amount of approved loans during 2010 can be seen in Table 78.

**Table 78: Total amount of credit approved by banks in 2010 in EUR**

Credit type	Small enterprises	Medium enterprises	Large enterprises
Liquidity	263,451,741	341,731,343	581,637,629
Investments	74,368,504	75,132,114	96,189,060

Housing and personal consumption loans.

These measures brought certain results, so there was a slight recovery of the economy and growth of the real GDP of around 1.7 % in 2010.

The positive effects which were brought by the program of subsidized loans encouraged the government to renew this program in March. For these purposes EUR 70 million will be provided. Some industrial sectors will be especially stimulated such as bus, lorry and tractor production, construction machines production, wagon production etc. Credit conditions will stay the same, although amounts to be approved will consequently be higher. For example, credit limit for liquidity improvement of small enterprises is EUR 100,000.

Other than those mentioned, there was a certain group of measures from the Government of the Republic of Serbia at the time of the crisis, which was aimed at balanced regional development. In 2010, the Ministry for Economy and Regional Development presented a program for balanced regional development. By this program, all undeveloped municipalities in Serbia are divided into 3 groups<sup>72</sup>:

- Devastated municipalities - These municipalities are developed below 50% of the average regional development level. For these municipalities, the Government will provide about EUR 70 million for medium and large enterprises to invest in fixed assets or perpetual working assets. Credit period is up to 8 years with a grace period of 2-3 years and a fixed interest rate of 2% per year.
- Not developed municipalities - These municipalities are developed between 50% and 60% of the average regional development level. For these municipalities the government will provide about EUR 10 million. Credits are approved for 2 to 5 years and the interest rates vary from 2 to 2.5% depending on the municipality development in which the subject operates.
- Underdeveloped municipalities - These municipalities are developed between 60% and 80% of the average regional development level. Interest rate for fixed assets procurement, reconstruction, modernization and perpetual working assets vary between 2% and 3.5% per year. Total amount provided for this purpose is about EUR 20 million.

According to the information from the Ministry for Economy and Regional Development, the total financial and non-financial assistance in the SME sector during the first year of the crisis was around EUR 318.1 million.

In addition to the above-mentioned measures, in order to neutralize the effects of the financial crisis, the government presented a new Bankruptcy Law in January 2010. The main goal of the new law is to make the bankruptcy procedure quicker, cheaper and simpler. Also, the new law should implement automatic bankruptcy as a new legal instrument. This instrument will try to remove "virtual companies" which do not pay its employees and contributions to the budget but usually do illegal business and enhance illiquidity chains<sup>73</sup>.

The opinion about the measures that the government undertook, as well as their efficiency are very different, even opposing. On the basis of public statements from government representatives, it can be concluded that a lot has been done. However, when the entrepreneurs and owners of small and medium businesses are heard, there are many objections, especially to the sharpening of bureaucratic procedures, increase of duties and taxes, etc. Some answers could be given at the end of 2011, or even during 2012, where the real effects of some of the measures from the government can be seen. There are many efforts, there are certain results which are visible, but time will show the outcome. Even now, it can be said that more and better could have been done.

### **2.10.7. SWOT Analyses of the SME Sector**

See Chapter 3.

### **2.10.8. Tasks for Improvement and Further Development of the National SME Sector**

The ability to recognize problems: Around 100 years ago, the pioneer of Scientific Management, Frederick Winslow Taylor, explaining the biggest contribution of his theory, emphasized that it additionally brings mental revolution. He actually inferred a different way of thinking. Something similar is very present today, in a totally different field. Namely, one of the biggest problems in business and life is lack of ability to recognize the problem. According to the authors, the first task for improvement and further development of the SME sector is fast and early recognition of the most important problems of this sector. They differ in countries and there is no universality. Some are common for all, but still have different forms. Others are specific for certain countries and connected to different national settings. In the case of Serbia, a typical example would

be the approach to limited financial sources, complicated procedures for getting construction permits and slow bureaucracy.

Regional cooperation must be strengthened: Many countries of the BSEC region which are closed in their national borders are too small, with modest potential of the home market, thus having a very limited potential of growth. Certain countries in the region of south-east Europe have signed the CEFTA agreement, and its potential is not in the least used. Queues at borders, trucks waiting at customs terminals create a sad picture of the region. Other than that, there is unfinished infrastructure, bureaucracy etc. which make business more difficult. Without a bigger market, there can be no faster growth and development in any of the countries. Opening the market, destruction of barriers, reduction of bureaucracy, construction of infrastructure are just a few lines in the area of regional cooperation.

Reduction of bureaucracy and bureaucracy procedures: Certain countries in the BSEC region have already become EU members. Other countries have or expect a candidate status, and yet, there is a third group of countries which will most probably never become EU members. According to numerous opinions, a great weakness of EU is represented in the slow and complicated decision-making process. The countries which are not in the EU should not accept such decision-making. In order for the BSEC region to become a region for development of international cooperation and economic relations, it must remove other complicated procedures and speed up the turnover of goods, capital and people which is one of the civilization achievements in EU and most certainly one of its advantages.

Education: Increasing the level of knowledge, introducing knowledge management, organizations' participation and innovation – these elements need to be priorities for the biggest number of SMEs in the BSEC region. Today we live in a society of knowledge and it becomes an economic factor number one without which all the rest, such as work, capital and land (by the opinion of classical economists) or information (according to more recent views) become more and more significant. Learning, knowledge, ability to apply it and results stemming from it are absolute priorities for each country and the entire BSEC region.

Development of new technologies: It is a pre-condition for increasing competitiveness of the SME sector for almost all countries, raising the

quality, reduction of expenses and creation of foundation for further growth and development.

There need be pressure to the governments to reduce procedure, guarantee stability, remove bureaucracy and build infrastructure which must connect the entire region. Region is more of a geographical, not political or economic term. There are different systems, cultures, religions and it is a huge wealth of the region. However, the relations between countries are still rather based on bilateral, not multi-lateral relations. Achieving an agreement on the highest political level about connecting the region through construction of common infrastructure objects can be the smallest common denominator, beneficial for each country, and the entire region.

Considering Serbia, it is certain that the most important challenges are:

- The completion of transition processes, first of all in the real sector, especially in the activities of public enterprises.
- The changes in the economic structure - in the past two years are the arrival of Italian Fiat which became one of the majority owners of the only Serbian car manufacturer. Unfortunately, due to problems in Italy, FIAT has not started production on a larger scale yet, and employed a bigger number of domestic suppliers. We firmly believe that it represents a big and realistic opportunity for many SMEs in Serbia. Nafna industrija Srbije (Oil Industry Serbia), a leading oil company, was sold. However, there were not as many new businesses for SMEs there, as could have been expected.
- Further development of the domestic market, which is still developing, despite the backlog caused by the global economic crisis.
- Using the full potential of CEFTA, regional agreement among neighboring countries.
- At the end of 2011, Serbia is expected to become a candidate country for EU – it will create new opportunities.
- Serbia also has signed contracts on free trade with Turkey and Russia, and there is a great opportunity for domestic SMEs in that segment.
- The support of the Government of the Republic of Serbia to the development of entrepreneurship and small and medium business cannot be denied. Although the financial means are very limited, there is greater awareness in Serbia about the importance of entrepreneur-

ship and concrete efforts which show resolution to help the sector are taken. A lot has been done to improve the infrastructure for the operation of SMEs, but there are questions, as well.

The most important problems and threats are connected to the still sensitive political situation about the independence of Kosovo. Out of the other questions, it should be pointed out that there is no complete legal regulation and firm legal frame in certain areas, there are problems with tax regulations and procedures, limited sources of financing, high illiquidity and exceptionally difficult charge of receivables, higher competition on domestic market, etc.

## **2.11 TURKEY**

Umut Yilmaz Çetinkaya

Ph.D. Candidate, Anchora Consulting, Science and Technology Policies Research Centre, Middle East Technical University, Ankara, Turkey

### **2.11.1. National Economy and the SME Sector**

KOSGEB Strategic Plan (2011-2015)<sup>74</sup> puts that SMEs constitute 99.8% (approximately 3.5 million SMEs) of all business and 49.9% of all investments; contribute the 77.9% to the total employment, 55.2% to value added and 59.8% of export. According to Turkish Statistical Institute (TUIK, 2008), SMEs, engaging with wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods consist of 39.8% of; engaging with transport, storage and communication consist of 17.3% of; engaging with manufacturing consist of 12.8% of; and SMEs engaging with 'other' activities consist of 30.1% of all SMEs in Turkey. Micro enterprises (1-9 workers) account for 95.7% of all business units in Turkey. Small enterprises with 10 to 49 employees represent only 4%, while medium-sized enterprises represent 0.3% of the total. In accordance with the 2003 census results, general partnerships are the most common legal form (more than 80%), followed by the limited partnerships with 13%; whereas joint stock companies (little more than 2% ) is a less preferred business form in Turkey.

All legislations are mainly shaped within the framework of EU regulations to increase competitiveness and innovativeness of SMEs. Notable among the legislations are the following:

Until recently, several classifications incompatible with each other, as such, preventing the determination of the appropriate policies related with SMEs were used by several public/private organizations to define SMEs. Following the regulation enacted on 18 November 2005<sup>75</sup>, the definition of SMEs in use was harmonized with the EU definition<sup>76</sup>; though there are differences between two definitions in terms of annual net sales and annual balance, which result from the economic conditions between two parties (summarized and illustrated in Table 79).

**Table 79: Definition of SMEs**

Parts	Enterprise Category	Headcount	Turnover	Balance Sheet Total
EU	medium-sized	< 250	≤ € 50 million	≤ € 43 million
	small	< 50	≤ € 10 million	≤ € 10 million
	micro	< 10	≤ € 2 million	≤ € 2 million
Turkey	medium-sized	< 250	TLY 25 million (~12,5 €)	TYL 25 million (~12,5 €)
	small	< 50	TLY 5 million (~2,5 €)	TYL 5 million (~2,5 €)
	micro	< 10	TLY 1 million (~0,5 €)	TYL 1 million (~0,5 €)

The Law on the Establishment, Coordination, and Duties of Development Agencies (Law No. 5449 Date of Approval: 25.1.2006): Development Agencies (DA) is established to provide technical support to the planning works of local authorities; support projects ensuring the implementation of regional plans and programmes as well as to monitor and evaluate them; contribute to the improvement of the regional capacity in relation to rural and local development; improve cooperation among public sector, private sector and NGOs; ensure effective and efficient resource utilization; promote business and investment facilities of the region; follow and coordinate centrally the permission and license transactions and other administrative transactions of the investors; support SMEs and new entrepreneurs in cooperation with other related institutions; promote activities related to bilateral or multilateral international programmes.

Technology and Innovation Support Programmes Regulations of TUBITAK<sup>77</sup> (dated 16/01/2007 and No: 26405): It is targeted at the improvement of research-technology development capability, innovation culture, and competitiveness of Turkish firms.

TTGV<sup>78</sup> Law (dated 16/01/2007 and No: 26405): It was aimed to support R&D and technological innovation projects of the private sector in Turkey since 1991.

With Degree Concerning State Encouragement published in the Official Gazette dated 16/07/2009 and No: 27290, following incentives are provided to investors including SMEs<sup>79</sup>:

- The general investment incentive regime
- Incentives for large-scale investments
- Region and sector-based incentives
- R&D support
- Industrial Thesis (SANTEZ) program

- Loans for technology development projects
- Training support
- State aid for exports

KOSGEB Law (No. 3624): With the amendment of Law published in the Official Gazette (No: 27612 dated 15/06/2010), number of sectors, which KOSGEB serves, was increased by adding new support mechanisms on existing ones to improve the competitiveness of SMEs.

### **2.11.2. Legislation and Ranking of Doing Business According to World Bank Methodology**

Turkey is ranked the 65th in terms of doing business among 183 countries by Doing Business 2011: Making a Difference for Entrepreneurs. There are nine categories used for making comparison among the involved countries. These categories and changes have been realized in Turkey since 4 November 2010 while a document was current as of 1 June 2010. Since then, a number of changes have already taken place in Turkey, with a potential to effect Turkey's position in the rank; as summarized below:

#### **Starting a Business**

A pilot project, called Central Legal Entity Information System, started to be implemented in Mersin Trade Registry Office by 19 April 2010. The System, creating a central database for trade registries, will depend on a unique identification number for all legal entities and will enable the on-line application for trade registry services. With this project, transactions such as registry, amendments, etc. can be done via online services. It is believed that when the project is implemented nationwide, Turkey's rank in terms of "Starting a Business" might increase.

#### **Dealing with Construction Permits**

The long time frame required for the acquiring of the permits results mainly from the insufficient communication among the authorities. "Support to Further Implementation of Local Administration Reform in Turkey (LAR PHASE 2)" project financed by the European Commission and implemented with the technical support of UNDP aims to "develop and strengthen the administrative capacity and cooperation of Turkish Min-

istry of Interior, Unions of Local Authorities and Local Authorities themselves in the task of ensuring the effective implementation of new policy and legislation on local administration". One of the expected outcomes of the project is the sharing of data and information obtained from the local surveys with the Ministry of Interior. In this way, problems related with the construction permits shall be analyzed by the authorities from the Ministry of Interior, which has the potential to increase Turkey's rank vis-à-vis "Dealing with Construction Permits".

### **Registering Property**

Following the issue of Regulation Regarding the Immovable Assets and Incorporeal Rights Acquisition by the Foreign Capital Enterprises, issued in the Official Gazette No: 27721, dated 06/10/2010, the process for the foreigners to obtain possession was simplified, which may have a positive influence on Turkey's position in the rank.

### **Getting Credit**

Public institutions, specifically KOSGEB and Development Agencies, increased their relations with banks via making different protocols in further of credit obtaining process of SMEs to eliminate constrains for accessing the credits faced by SMEs, which may have a positive impact on Turkey's ranking. For instance, a SME could obtain bank credit which has lower bank interest relatively to the market conditions, due to KOSGEB support, which pays some part of bank interest on behalf of SMEs.

### **Paying Taxes**

Shelter for entities against corporate taxes, VAT, payroll withholding taxes and other income withholding taxes was provided with Tax Amnesty Law (dated 25/02/2011 and No: 6111), which has potential to increase Turkey's position in the rank.

### **Trading Across Borders**

With the Regulation No: 27942 on the Transformation of Warehouses into Logistics Centres, dated 23/05/2011, up to 64% tax reduction was supplied to the exporters. With this regulation, having potential to increase export activities of some sectors, Turkish position in the rank may rise.

### **2.11.3. SME Support Infrastructure**

MoIT<sup>80</sup> (Public): It is the main Ministry of State that is responsible for the implementation and coordination of SME policies; for the establishment, organization and cooperation of organized industrial zones, technology development zones, industrial zones and small industrial sites.

SPO<sup>81</sup> (Public): It is the main public organization responsible for preparing and coordinating annual, long-term and development plans on national, regional, and sectoral basis.

KOSGEB (Public): KOSGEB is a governmental institution affiliated to MoIT, which makes important contributions to the development of SMEs via using different support mechanisms in financing R&D activities, marketing, training, exports, credits, loans, etc. Those services are provided throughout the country with the help of Service Centres, Business Development Centers (IGEM) and Technology Development Centers (TEKMER).

TEKMERS<sup>82</sup> (Public): Technology Development Centres, as a department of KOSGEB and managed by Service Centres, are established in coordination with the local university and Chamber of Commerce and Industry. They provide start up premises, material and equipment, support training in finance, marketing, etc. to develop the cooperation between the private sector, including SMEs and entrepreneurs, and academic accumulation.

The Under-secretariat of Treasury (Public): It is responsible for the Investment Encouragement System used by enterprises including SMEs and entrepreneurs.

DTM<sup>83</sup> (Public): It is mainly responsible for increasing export efforts of the enterprises, including SMEs, as well as for the foreign investments and technology transfer in Turkey; and setting up and organizing Free Zones.

TOBB<sup>84</sup> (Semi-Public): As the highest level representative of the Turkish private sector, it is mainly responsible for ensuring unity and solidarity between chambers and commodity exchanges; for improving cooperation among the members; for leading and guiding the members to increase their competitiveness.

TESK<sup>85</sup> (Semi-Public): It is mainly responsible for preserving the interests of its members, representing tradesmen and craftsmen domestically and abroad, and supporting the establishment of small sized industry sites for small-enterprises.

TUBITAK (Public): It is responsible for the promotion, development, organization, conduct and coordination of research and development in line with national targets and research institutions.

USAMP<sup>86</sup> (Public): Established by TUBITAK, universities and industry, US-AMPs target to create a suitable environment to foster joint R&D activities of industrial companies and universities.

IGEME<sup>87</sup> (Public): It is mainly responsible for research, training, trade information and promotion services to provide new markets and business opportunities for enterprises including SMEs; and for coordination of public institutions concerned with export activities.

KA<sup>88</sup> (Semi-Public): There are 26 agencies established for improving regional development, innovativeness and competitiveness and for increasing the collaboration among regional actors and central administration. They use alternative mechanisms to achieve their goals. Among others, grants given to public and private organizations, including SMEs, are among the most popular incentives.

TTGV (Semi-Public): A non-profit organization established by public and private bodies to improve the international competitive position of the industrial companies via providing long-term credit to their R&D and technological innovation projects of the private sector.

KGF<sup>89</sup> (Semi-Public): Fund, established in 1990s and started to be used actively in 2007, provides guarantees to SMEs for increasing their ability to benefit from bank credit.

Venture Capital and Business Angels: The number of organizations providing start-up supports has increased recently. TUBITAK and KOSGEB (public), TTGV and KOBİ A.S<sup>90</sup> (semi-public) and several private firms including banks have developed mechanisms to finance start ups. In general, it can be stated that while development of high technology prod-

ucts/process and profitability of the investment are the main criteria for TUBITAK and TTGV; profitability of the investment is the main criteria for KOBİ A.S and several private companies. KOSGEB gives support to business ideas with different concerns mentioned organizations above, i.e. although profitability of investment is taken into consideration, the main purpose of the KOSGEB support is to contribute to national economy through helping entrepreneurship to develop further in Turkey. In terms of business angels, the situation is ambivalent in Turkey. Implementation of the business angels as a notion has been observed for many years in Turkey; however, this implementation has very recently been started to be called as "business angels" per se. In this framework, it can be said that formal networking activities of business angels has just started in Turkey.

#### **2.11. 4. Industries, Branches, Regions, Clusters**

Although the discussion on the existence and importance of clusters and regional innovation system (RIS) does not smooth down and produce an answer agreed upon by all parties, there is an important discussion on the importance of clusters in Turkey. Studies in Turkey on agglomerations, clusters, regions, etc. are based on Porter's Diamond Model and that is why Porter's approach is taken into consideration in this study, despite its certain shortcomings<sup>91</sup>. According to Porter and colleagues, cluster is a "critical mass of companies in a particular field and in a particular location, whether it is a country, a state or region, or even a city". For those, basically many clusters consist of firms, tangible (e.g. physical factors) and intangible factors (e.g. knowledge resources). In accordance with Diamond Model, the Development of a National Clustering Policy Project launched in March 2007 and ended in 2009 with financial support from the European Commission was implemented in Turkey for making Turkey one of the few countries with a national clustering policy. In the mentioned project, 20 clusters were prioritized<sup>92</sup> and roadmaps for 10 clusters (summarized below based on the results of the project) were prepared. On the other hand, roadmaps for the remaining 10 clusters (foreign trade in Samsun, machinery in Samsun, furniture in Yozgat and Kayseri, natural stones in Sivas, apricot in Malatya, textile in Kahramanmaraş, machine-woven carpet in Gaziantep, woodworking in Trabzon, winter tourism in Erzurum and Kars, tourism in Mardin) were not prepared in order not to lead to an unfair competition in these cities, which are in the target of Regional Competitiveness Operational Programme.

Mersin Processed Food (MPF) Cluster: Existence of natural resources; fruitful conditions for agriculture and stockbreeding; availability of inland and nearby countries market; logistic and chemical industries; special areas (Free Zone and the Organized Industrial Zone) offering important advantages to SMEs; life quality in the city; previous studies (e.g. RIS Mersin Project) increased the awareness of innovation and collaboration; the large labor pool and the existence of two universities are the important advantages of MPF cluster. On the other hand, shortage of qualified workforce, advanced materials and machines; insufficient cooperation between firms and knowledge resources such as universities, research institutions; difficulties to achieve financial resources especially grants; insufficient social capital, local demand for triggering the improvement of production/service techniques, innovative solutions, and fully implementing international standards are the main disadvantages of the MPF cluster. Therefore, processed food (agro-food) sector is selected as a special group (cluster) due to "geographical concentration of interconnected companies, institutions and industries operating in the agricultural sector as well as food and beverage industry"<sup>93</sup> in Mersin. On the other hand, although the critical mass has accumulated in the region, insufficient maturation of the networking activities among the actors is acknowledged as the most important factor that prevents improvement of the competitiveness of MPF cluster.

Ankara Software (AS) Cluster<sup>94</sup>: Especially with the establishments of several technoparks, sufficient number of software companies (agglomeration) has been achieved in Ankara, which is important for obtaining critical mass. However, Ankara software cluster is a latent cluster, which means that existence of critical mass, institutions, support mechanisms etc has not increased awareness among the actors that they are part of a cluster; though highly qualified people have been employed. Furthermore, insufficient number of firms participated in the global value chain or lack of formal organization e.g. software exporters union (lack of this kind of structure prevents the exporters to obtain state supports, which brings disadvantage conditions for software exporters when compared to the other sectors receiving export support) is an important obstacle for improving the current conditions in AS cluster. In this sense, with the implementation of the public intervention mechanisms<sup>95</sup>, which is in line with the current market mechanism, actors' awareness for improving their capabilities and know-how to integrate themselves into the global

value chain shall not only be increased but this mechanism shall also accelerate the clustering process of AS.

Ankara Construction and Engineering Machines (ACEM) Cluster<sup>96</sup>: Ankara machinery industry has grown significantly over the last two decades and probably the main reason for the development of metal and machinery industries cluster (e.g. OSTIM) in Ankara is state-owned enterprises (specifically state-owned defense and aviation companies). Starting from the 1960s, private firms started to fix parts of worn-out machinery or to manufacture basic parts of machines for those enterprises; and the accumulated knowledge in those firms led them to develop their own skills and turn-key machines. Furthermore, many of the manufactures have already realized that their competitive advantage should not be solely based on price strategy due to the existence of China and India; but also on the specialization to produce higher-value added products both for responding to their customer demands and for increasing their competitive advantage (e.g. TURQUM<sup>97</sup>). Furthermore, besides their location in the capital city of Turkey, which brings an important advantage, e.g. easy access to any part of Turkey or the world, firms have the opportunity to reach well-educated human resources (graduates, academicians and researchers) and some specialized services (e.g. product design) due to the existence of several public and private universities, laboratories, test centers, institutions and firms. On the other hand, the number and capabilities of these are limited when compared to their counterparts in advanced countries, which slows down the development of RTD (Research, Technology and Development) activities and innovative products and process. Finally, contrary to the development of machinery sector trends in the world, except for Italy and some countries of Asia, there are many spin-off firms in the sector. Rather than the creation of positive externalities expected to trigger the firms on specialization to produce higher-value added products; this process causes the existence of many producers without sufficient financial and technical knowledge to compete with their rivals.

Denizli Home Textile (DHT) Cluster: Several home textile products, especially towels, bathrobes, bed sheets and bed linens, are produced in Denizli, where exists an important competitive advantage. These are know-how (tacit knowledge) accumulation, regional solidarity, critical mass and cooperation culture. On the other hand, cooperation among the firms in

the cluster is mainly limited in the manufacturing process rather than in cooperation in R&D, development of innovative products and production process, which means that even if the cluster is developed in terms of basic conditions; required mechanisms and institutional structures for competing with rivals in the world market have not improved to a satisfactory level. For instance, required mechanisms for bringing the latest technology, market information, etc. into the region or the capacity of family-owned firms, which are very prevalent, to compete with producers in the world has not developed as much as desired. Therefore, the existence of qualified work force, value chain, knowledge accumulation, spirit of entrepreneurship, solidarity, developed infrastructure, availability of raw materials, and flexible production can be accepted among the most important factors held by the region to compete with rivals in the world. However, external dependence in terms of textile technology, insufficient R&D activities, production of value-added products and innovative activities can be regarded as the most important regional deficiencies. Thus, the development of the region's brand image, as well as the implications of the prerequisites set by this image, having traditional values and consisting with global expectations, developed by those who are in value chain are required for increasing the competitiveness of the region.

Konya Automotive Parts and Components (KAPC) Cluster: The geographical location in particular of Konya automotive parts and components cluster, which enables the firms to access many markets and resources, the university, which provides well educated human resources, large labor pool and awareness in the importance of industrialization bring important advantages to the KAPC cluster. On the other hand, the negative image resulted from imitating (counterfeiting) auto-parts and implementation of traditional supplier practices should be eliminated for further development of the cluster. Moreover, although the importance of R&D activities, collaboration and innovation are realized by some members of the cluster, the current competition strategy, based on price instead of quality, is not sustainable and that undermines the cluster's future and causes to spread a negative image. In this sense, appropriate policies should be implemented in KAPC cluster to improve its competitiveness. For instance, importance of ISO 16949 -the most popular certificate for supply chain in the automotive industry and many OEMs require the active implementation this certificate- can be disseminated to not only increase the competitiveness of the cluster but also to improve the cooperation among the cluster members.

Bodrum Yacht Building (BYB) Cluster: Starting from the 1970s, parallel with the development of tourism and so-called Blue Voyage, Yacht Building Cluster in Bodrum (a district of Mugla province) has started to develop and the "gulet" has become the flagship of the cluster. Currently, more than 80% of the yacht building capacity is located in Bodrum. Today, the cluster has important advantages in terms of human resources (tacit knowledge) and climatic conditions where humidity is stable. Advantage in terms of human resources stems from the craftsmanship of the local foremen, who usually have no formal education. In this sense, cooperation with the local university is limited and needs to be improved. On the other hand, infrastructural problems such as the number and functionality of slipways, places in which yachts are manufactured, displayed and sold, and changing tourist profile<sup>98</sup> (from high to low-income), who are the most important yacht customers, undermine the competitiveness of the cluster. In addition to these, insufficient capacity of the three marinas in Bodrum is another important obstacle for the development of Bodrum Yacht Building Cluster. Even if the demand for the activities of the cluster increases, the competition strategy of the cluster is currently based on price, which undermines the sustainability of the cluster, and there are not sufficient mediators for members of the cluster, which bring the newest opportunities in market, technology and financial resources. Furthermore, due to official regulations resulting from the unique characteristics e.g. archaeology of Bodrum, it is not easy to make an investment in yacht building. Therefore, under the current conditions, tailored policies shall be developed with the participation of public and private sector to improve BYB cluster.

Manisa Electrical and Electronic Appliances (MEEA) Cluster: Starting from the mid-90s, Manisa EEA Cluster has developed very rapidly. The geographical proximity to İzmir and its port, developed infrastructure including transportation, existence of critical mass in terms of number of firms and foreign investment play a critical role in the development of MEEA cluster. However, despite the relatively good conditions, there is still deficiency in terms of qualified human resources. From the firm strategy and rivalry perspective, although there are global firms including OEMs, it is not easy to say that a strategy based on R&D and innovation is common for many of the firms in the cluster. Moreover, in terms of related and supporting industries, the cluster is in a good position, but the special services in technology transfer, design, innovation, accessing

financial resources need to be developed to increase the competitiveness of the cluster. In terms of demand conditions, this cluster has a distinctive advantage due to the popularity of electronics and related technology in society. Thus, the quantity and quality of R&D and innovative activities in firms, suppliers and supporting industries shall be improved not only for increasing cooperation among the actors of the cluster but also for attracting new ones, who are potential to bring new technology and information.

Marmara Automotive (MA) Cluster: Having approximately 30 years of experience, the MA cluster consists of three provinces (Bursa, Kocaeli and Sakarya), where at least 11 OEMs are located networked with hundreds of firms e.g. suppliers in different parts of the Marmara region and the country. In terms of factor conditions, the cluster is located in the Marmara region which is geographically proximate to Europe and Istanbul, Turkey's largest market. However, several important factors hamper the factor advantages of the cluster: EU's gaining population; the automotive production capacity of new EU members; and increasing production activities in Asia. Although the Marmara region is the most developed region in Turkey and has many special areas such as technoparks, organized industrial zones and free zones, there are important problems in terms of tangible infrastructure such as roads, railroads, ports, etc. In terms of intangible infrastructure i.e. knowledge and information producers, distributors, etc. there are many actors; however, their capacities and capabilities are not fulfilled with the actors of the clusters to the desired level.

Eskisehir, Bilecik, Kutahya Ceramic (EBKC) Cluster: Although the ceramic sector, having important portion in all export activities of Turkey, is accepted as a traditional sector, firms in this sector have to implement R&D activities and find innovative products and production processes in order not to stay out of the market. An important part of the sector is located in EBKC Cluster, as a latent cluster, consisting of three districts (Eskisehir, Bilecik ve Kutahya). Existence of important knowledge resources, developed human resources, raw materials, transportation infrastructure and facilities provided by OSB can be accepted as important factor conditions in the region. However, new material requirement for the production of ceramics increases the external dependence of the region. In terms of firm strategy and rivalry, the most important advantage of the region is the existence of the critical mass, though networking activities have

not developed as much as desired mainly due to lack of trust among the actors. In terms of demand conditions, it can be argued that there is an important unsaturated national market; however, tendency of consumers to the low profile products does not trigger the sector to develop high-value added products. On the other hand, the increasing demand for ceramic in different sectors such as medical, energy, automotive, etc., has the potential to trigger the cluster to learn new knowledge and obtain new capabilities. Finally, insufficient number of machine producers, which are mainly located outside the region, and of special services, e.g. design firms, are important obstacles before the improvement of the competitiveness of the cluster.

### **2.11.5. The Effect of the International Financial and Economic Crisis**

Electricity consumption decreased by 10% in January 2009 compared the same month of the previous year. Industry production dropped by 23.7% in February 2009 compared the same month of the previous year; and the biggest constriction was realized in capital goods (44.8%), the second one realized in durable consumer goods (25.7%), the third one realized in intermediate goods (24.2%) and the last one non-durable goods (14.8%). Sales of the industry sector decreased by 15.5% in February 2009 compared to the same month of the previous year. Starting from late 2007, while the share of SMEs in total credit dropped from nearly 52% to approximately 44%, non-performing credit started to increase from below 4% to nearly 8% in mid-2008. Put differently, between December 2006 and November 2009, cumulative growth in SME credit amounted to some 35%, it was only about half the rate of growth in non-SME corporate credit.

In accordance with the situation of fabricated metal products, the most noteworthy reduction in industrial turnover was observed in the sub-sectors of manufacturing (non-metallic mineral products, fabricated metal products and basic metals). On the other hand, interestingly enough, 15% of the firms stated that their sales increased during the crisis in the same period, which may be pointing to the fact that the composition of the market shares across the firms in Turkey started to change due to economic crisis.

In terms of response of the firms to crisis, according to the Survey<sup>99</sup>, 33.7% of firms delayed their payments to the suppliers and tax authori-

ties, approximately 46% of firms restructured their debts, 0.2% of firms were filed for bankruptcy or insolvency, and 25.4% of firms obtained some form of state-aid during this term.

Furthermore, in terms of ex-post effect of the crisis, it is understood that nearly one-third of the performance of the firms is mainly related with external conditions rather than internal conditions in Turkey. In other words, according to the Survey, accessing finance (25.9%), tax rates (18.2%), political instability (17.5%), informal sector (14.7%), and insufficient qualified human resource (9.1%), are the most important external factors that determine the performance of Turkish firms.

#### **2.11.6. Government Measures to Cope with the Impact of the Economic Crisis**

The measures taken by the government to cope with impact of the economic crisis and to increase innovativeness and competitiveness of Turkey are mainly related with major legal regulations stated in question one of the Survey. Put differently, especially after the crisis, the Turkish government has focused on three types of mechanisms: DAs, KOSGEB, and state encouragements for investments. A short description of policies and supports provided by these mechanisms are given below:

**Development Agencies:** With the Council of Ministers decree in 2009 (Official Gazette of 25 July 2009), the decision for the establishment of 16 new development agencies came into effect. Therefore, in addition to the 10 previously established agencies, a total of 26 KAs were founded in Turkey. These agencies, among others, provide 3 types of financial support (stated below) and these supports played a critical role in stimulating market mechanisms.

- Direct Financial Support
  - Call for Proposals
  - Direct Activity Support
  - Guided Project Support
- Credit Interest Support
- Interest Free Credit Support

**KOSGEB:** In addition to the manufacturing sectors, service and trade sectors were included to the KOSGEB target audience with the amendments in Law 5981 (Official Gazette No: 27219 and dated 5 May 2009).

Moreover, with the decree of the council of ministers (Official Gazette No: 27353 and dated 18 September 2009), sectoral priorities were determined. Finally, with the amendment of KOSGEB Law published in the Official Gazette (No: 27612 dated 15 June 2010), which KOSGEB serves, new support mechanisms were added to the existing ones to improve the competitiveness of SMEs. Below are the new support mechanisms for SMEs which were put into practice not only to increase the competitiveness of SMEs but also to recover the economy from adverse conditions;

- SME Project Support Programme
- Thematic Project Support Programme
- Cooperation- alliance Support Programme
- R&D, Innovation and Industrial Practice Support Programme
- Entrepreneurship Support Programme
- General Support Programme

State Encouragements<sup>100</sup>: With Degree Concerning State Encouragement published in the Official Gazette No: 27290 dated as 16 July 2009, the following incentives are provided to investors including SMEs. These investment incentives scheme is changed in accord with the current economic and social conditions. In this sense, information related with investment incentives scheme is not solely explained below to picture the government's respond to the economic crisis but also to explain the general approach of the Turkish State's economic and social development. This incentive can be categorized under 7 headings:

1) General investment incentive regime: Although general investment incentive regime is based on tax benefits, in some cases, credit can be provided to the investors. In this sense, investment regime changes in accordance with the subject, location and the scale of the investment. Major instruments used for incentives are:

- Exemption from customs duties: Imported machinery and equipment for projects with an incentive certificate is free from customs tax.
- VAT exemption: Locally purchased or imported machinery and equipment for projects with an incentive certificate is free from VAT.

2) Incentives for large-scale investments: Incentives for corporate tax rate and social security premium are changed in accord with the sectors.

- Investments, started before 31 December 2011, is subjected to corporate tax rates between 2-10%, and social security premium contribution for employers for up to 7 years.
- State land can be allocated.

### 3) Region and sector-based incentives:

- Investments started before 31 December 2011 are subjected to corporate tax rates between 2-10%, and social security premium contribution for employers for up to 7 years.
- State land can be allocated.
- Interest support (Zones 3 and 4).

Zone 1	Zone 2	Zone 3 and Zone 4
Investments that generally require the use of advanced technology, such as the automotive and supply industry, electronics, pharmaceuticals, machinery, medical and optical devices will be covered by incentives.	Technology-intensive sectors will be generally supported. In this framework, machinery, smart multi-functional textiles, non-metal mineral products, paper, and food & beverage investments will be incentivized.	Investments in agriculture, agriculture-based manufacturing industry, ready-to-wear clothing, plastics, rubber, metal goods, tourism, health and education will be covered by incentives.

Some additional sectors will be incentivized regardless of location:

- The investment types which are covered by Specialized Organized Industrial Zones established by the Ministry of Industry and Commerce may benefit from regional incentives (except for the zones in Istanbul) even if they are not among the selected sectors operating in the region.
- Investments related to the transportation of cargo and/or passengers by sea may benefit from the incentives applied in Zone 2, whereas investments related to cargo and/or passenger transportation by air can benefit from the incentives available in Zone 1. Meanwhile, no incentive is provided to air taxi operations.
- Railway investments by the private sector for inter-city cargo and/or passenger transportation, as well as railway investments for local cargo transportation are subject to incentives in all regions. In cases where transportation activities are available in more than one region, the expenditure related to the procurement of carriers is covered within the scope of the incentives granted to the region with the lowest development level.
- Housing heating/cooling investments, achieved through geothermal energy and/or power plant waste energy, may benefit from regional incentives.

### 4) Research and Development - R&D - support:

R&D Law: When a minimum of 50 people are employed in a R&D centre, R&D investment projects receive special incentives with this implementation until 2024:

- 100% deduction of R&D expenditure from the tax base if the number of researchers exceeds 500, then in addition to the 100% deduction,

half of the R&D expenditure increase incurred in the operational year compared to the previous year will also be deducted.

- Income withholding tax exemption for employees (this item will be effective until December 31, 2023.)
- 50% of social security premium exemption for employers for a period of 5 years.
- Stamp duty exemption for applicable documents
- Techno-initiative capital for new scientists up to TRY 100,000.
- Deduction from the tax base of certain funds granted by public bodies and international organizations.

Support for Technology Development Zones<sup>101</sup>:

- Offices ready to rent, and infrastructure facilities provided.
- Profits derived from software development and R&D activities are exempt from income and corporate taxes until 31/12/2023.
- Deliveries of application software produced exclusively in TDZs are exempt from VAT until 31/12/2023.
- Wages of researchers along with software and R&D personnel employed in the zone are exempt from personal income tax until 31/12/2023.
- 50% of the employer's share of the social security premium will be paid by the government for 5 years until 31/12/2024.

TUBITAK<sup>102</sup> and TTGV<sup>103</sup> both compensate or grant R&D related expenses and capital loans for R&D projects. In general, following projects are eligible for incentives: Concept development, technological research & technical feasibility research, laboratory studies in the translation of a concept into a design, design and sketching studies, prototype production, construction of pilot facilities, test production, patent and license studies, activities concerning the removal of post-sale problems arising from product design, renewable energy production, energy efficiency improvement, environmental impact-reduction projects.

5) Industrial Thesis (SANTEZ<sup>104</sup>) Program: It was aimed to develop university and industry collaboration. 25% of the total budget is being covered by the company, which will commercialize the outputs of the program and the rest of the budget is being covered by Ministry of the Trade.

6) Training Support: In some cases ISKUR, the National Recruitment Agency, gives support to vocational training projects for a maximum pe-

riod of 6 months. Moreover, upon satisfactory request, vocational schools may be opened by Ministry of Education (in this case, cost of a trainee team could be supported by the Ministry).

- Direct salary support for interns, and unemployed candidates that are registered at ISKUR<sup>105</sup>, (partial wage=TRY 15/day) during the pre-employment training session.
- Social security premium expenses (occupational accidents and occupational diseases) are covered by ISKUR.
- Program expenses such as the trainer's fee, energy and water bills are partially paid to the employer by ISKUR. The total amount is calculated by the cost per trainee and the employer must bill ISKUR for the services given.
- ISKUR considers the employer (company) the legal party in this training program.
- A certain number (percentage) of trainees must be employed after the program.

7) State aid for export<sup>106</sup>: This support is mainly given to support export activities and to increase the competitiveness of the firms in the global market. It consists of several incentives such as participation in exhibitions and international fairs, expenditures for IPRs (Intellectual Property Rights) applications (e.g. patents), market research, etc.

### **2.11.7. SWOT Analysis of the SME Sector**

See Chapter 3.

### **2.11.8. Tasks for Improvement and Further Development of the National SME Sector in the BSEC Region and Turkey**

1. Similar to the situation in developed countries, access to financial resources is one of the main problems encountered by SMEs in Turkey. From the perspective of credit resources, many SMEs are not 'bankable' due to quality of data, information and knowledge provided to financial resources by SMEs. In this sense, special measurements to increase SMEs' financial capabilities may be provided to make SMEs 'bankable'; also the numbers and efficiency of different financial resources such as long-term credits, venture funds, and business angels, should be developed. Moreover, an important part of SMEs cannot access the loans provided by national and international institutions/organizations. The

main reason is that SMEs cannot prepare and execute their projects in accordance with the requirements of institutions/organizations. In this framework, quality and support for consultancy firms, which can be a bridge between private and public sector, should be improved via giving support to consultancy firms for international accreditation.

2. Except for the minority of firms, many SMEs do not apply for the R&D supports provided by several resources. There are two main reasons for this situation: The first one is lack of appropriate human resources and know-how accumulation. The second one is related with perception of SMEs on RTD activities. Product and process improvement activities are not accepted as suitable R&D activities by SMEs. In other words, generally, scientific or applied research activities for product development are usually acknowledged as RTD activities by SMEs and that is why SMEs rarely benefit from R&D supports. To overcome this situation, the efficiency and effectiveness of policies for improving awareness on RTD and innovation should be improved. For instance, dissemination of success stories can be used as a tool for increasing awareness on RTD and innovation.

3. Differences in sectors, regions and scales of firms require different mechanisms. In other words, some regions (or sectors) in Turkey are still in stage one (factor driven), some in stage two (efficiency driven economy) and some in stage three (innovation driven), and the rest are in-between these stages. In this sense, policies and support to be provided by authorities shall be tailored to elaborate the implementations for increasing labor, total productivity as well as competitiveness and innovativeness of Turkey.

4. Another important policy area is related with the cost of employment which also pushes into unrecorded activities. In this sense, institutions, may take much more initiatives to reduce this burden on firms, specifically micro and small sized.

5. One of the main causes for insufficient working capital is the difficulty in collecting revenues in Turkey. In this sense, a new mechanism related with business ethics and awareness in good governance implications shall be developed.

6. Although the importance of high quality products is articulated by all public and private actors, there is no clear incentive and mechanism to

be benefited by SMEs to compare their products/services with the bests in the global market. In this sense, appropriate support should be provided for SMEs.

7. Absorptive capacity is one of the key factors to increase the competitiveness of SMEs. In this sense, mechanisms should be elaborated to increase absorptive capacities of SMEs in accordance with the best practices in the world.

8. Especially regarding the prevalence of the family-owned businesses, special support focusing on increasing their managerial and capital skills shall be given to these firms to increase their productivity.

9. In addition to school education, on-the-job training is crucial to increase human capacity of SMEs. In this sense, long-term job training specified to the requirements of SMEs shall be supported, which shall not only improve labor productivity but also help to improve value-adding activities done by employees.

10. Regarding the importance and role of SMEs in economic activities, policies aiming the widespread use of internet shall be encouraged to integrate those into national and international networks. Furthermore, the number of e-implications aimed to reduce bureaucratic procedures shall be increased.

11. According to analysis of the survey mentioned, there is negative association between the firm-level productivity and the number of the features of regulatory environment. To meet the requirements of the regulations, firms may prefer to follow unofficial ways due to time constrains to obtain required permission, contracts, etc. Moreover, the results of the survey also show that firms rivaling with the informal structures show low level of productivity. Therefore, the decrease in the number of the features of regulatory environment shall not only increase the position of Turkey in "doing in business" rank, which is an indicator for attracting FDI, and the performance of firms, but also help to decrease the informal economic activities.

12. According to World Bank Report, in contrast to SMEs in comparator countries<sup>107</sup>, micro and large firms grow faster than SMEs in Turkey. In this sense, firms which have high growth rates (gazelle) should be sup-

ported and appropriate policies should be tailored for them. Development of such policies will also help to increase the number of firms, which are parts of global value chains.

13. With the increasing efficiency, effectiveness and transparency of RAs, these agencies can be better used for not only the synchronization of vertical and horizontal policies but also to help the elimination of climate constraints at the local level. In other words, they can act as 'one-window' shops which means that they can serve as a bridge for easing the relations between firms and state bodies; like a pipeline between the region and the rest of the world for bringing the latest opportunities in the market, technology and financial resources.

14. A governance mechanism should be developed and the efficiency of this mechanism and its constituents should be increased in order to obtain further benefit from the policies and implementations. For instance YOIKK<sup>108</sup> can be seen as one of the crucial interfaces between public and private sectors. Some decisions taken at the council cannot be implemented properly due to overlapping responsibilities among the state institutions, which negatively affect the business activities.

15. Although cooperation in projects for product and process development, marketing, logistic, etc. among the SMEs is supported by several incentives to increase competitiveness and efficiency of SME activities, SMEs show reluctance for these cooperation activities due to insufficient human resources, lack of pre-competition cooperation culture and issues of trust. In this sense, to facilitate the cooperation among firms, appropriate support including financial issues shall be developed to provide the participation of service provider firms (e.g. consultancy firms) into these projects, which shall be responsible for the project management and coordination among the firms.

## **2.12 UKRAINE**

Oksana Dugert

Business Consultant, Konsulttitoimisto Seppo Hoffrén Oy Consultancy,  
Kyiv, Ukraine and

Dr. Oleh Levchuk

Senior Fellow, Presidium of the Academy of Sciences in Ukraine

### **2.12.1. National Economy and the SME Sector**

Private property and private entrepreneurship was 100% destroyed in rural and urban Ukraine by the communist regime with the help of ideology and terror. After rehabilitation of private entrepreneurship and independence of the country in the beginning of 1990s, SMEs started to progress at a great speed. In quantities dimension development of SME in Ukraine practically approached those in EU countries.

Implementing a simplified tax system in 1998 made the biggest contribution to the growth of the number of small companies and individual entrepreneurs. Since this system was introduced, the number of businesses registered as payers of a fixed task has increased twelve times; they have created a market of local products and became the back-bone of the new born middle class in Ukraine; these entrepreneurs started paying twenty-nine times more taxes to the state budget than before, according to ex-head of the State Committee on the Entrepreneurship Development Olexandra Kuzhel, whose "child" the simplified system was. Unfortunately, this legal provision was practically destroyed by the new tax code of 1 April 2011.

Global financial crisis became a huge challenge for the Ukrainian SME sector. Because of acute political battles and competition among different power branches, the country's leadership was unable to take efficient steps for mitigation of the consequences of the crisis. Thus, the global financial crisis was accompanied in Ukraine by local political crisis and an unprecedented collapse of the country's banking system.

The last National Report on the State and Perspectives of Entrepreneurship in Ukraine published in early 2010 admitted that the governmental

system of regulation was too burdensome for business and requires deregulation measures. Ukrainian business responded to overregulation with low social responsibility, tax evasion, shadow operations and withdrawal of capital abroad. This is a “lose-lose” situation, which is unfavorable for economic development, solving social problems, overcoming poverty, and ensuring higher standards of life.

Independent local and foreign experts conclude that SMEs have developed in Ukraine despite the actions of changing governments. Their qualitative characteristics reflect difficult operating conditions. As a result, their contribution to economic and social change is less than it could be, mainly due to an unstable environment and an institutional context that has yet to establish the framework conditions for sustainable private sector development.

### **Legal Definition of SMEs in Ukraine and Major Legislation on the SME Sector**

On 7 February 1991, the Parliament of Ukraine adopted the Law “About entrepreneurship”; State Committee on Promotion of SMEs and Entrepreneurship Development was created in May 1991. This was the legislative basis for the start of SME development in Ukraine. In the beginning of 1998, key legislative changes were made, which introduced new methods of simplified taxation and reporting for small businesses.

During the past years Ukraine has been taking some steps to closer affiliation with the European Union, which in the near future is supposed to bring Ukraine to association with the EU and creation of free trade zone, and eventually to EU membership. The last changes to legislation with respect to legal definition of SMEs were made in Ukraine in response to EU recommendations. These changes have been recorded in 2008 by the Law of Ukraine «About introducing changes to some legislation acts of Ukraine on the issues of entrepreneurial activity’s regulations» of 18.09.2008 No. 523-VI. Thus, as of 2009, companies with average number of employees up to 50 persons and volume of gross revenue under UAH 70 million (1 EUE is UAH 11.5) are referred to as small business. Big companies are those with more than 250 employees and the volume of revenue after sales of products exceeding UAH 100 million. All other firms are referred to as medium. Furthermore, individuals registered as entrepreneurs are also considered to be SMEs. As a result of the new

classification, the number of SMEs has increased considerably starting from 2009. However, national statistics were not fully harmonized with the EU definitions and provides the data for “small entrepreneurship” embracing small companies and individual entrepreneurs, practically excluding a cluster of medium-sized companies. In Europe, according to EC definition, enterprises are not considered as SMEs if other companies that do not belong to that category, possess more than 25% of the capital. This is not the case in Ukraine where ownership does not matter in terms of classification.

Radical reforms in public control and supervision in Ukraine were declared by the “Law on Principles of State Supervision (Control) of economic activity” (adopted in 2007, last amendments made in January 2009), which was supposed to organize the process of controlling businesses by various bodies, to reduce the number of processes and thereby reduce the pressure on businesses. However, execution of the law has been very slow; it seems that local governments have completely ignored this legislative initiative.

New Ukrainian Tax Code came into power from 1 January 2011 despite mass protests of SME organizations all over Ukraine and happened to be the most notorious piece of legislation dealing with the SME sector. Due to negative reaction of the whole business community, the clause of the Tax Code dealing with the simplified tax system for SMEs was postponed until April 2011. This Tax Code practically eliminated 90% of the simplified tax system.

Nataliya Korolevskaya, Chairperson of the Parliamentary Committee on industrial and regulatory policy and entrepreneurship development, commented that those who adopt such a law have an intention to reduce the economically-independent population in Ukraine. Dmytro Liapin, Chairman of the Property and Freedom Institute, Ukraine, agrees with her, saying that Ukrainian tax system is a serious obstacle to business development as it is characterized by frequent changes, numerous internal contradictions and complexity of tax administration.

### **Importance and Role of the SME Sector in Overall Economy**

The number of SMEs in Ukraine reduced by 40% during 2009. This information was released in March 2010 by the head of the Party of Small and

Medium Business, Yaroslav Misiats. According to his judgment, most of these “lost” SMEs entered “shadow” economy; whereas the rest ceased operations because of the crisis. “In the structure of GDP the share of SMEs is only 15% but this was the only mechanism that would allow to build and develop the state’s economy”, he said. The Report of the Antimonopoly Committee stated threefold reduction number of business entities in 2009 due to growing of the oligarchic sector.

According to official statistics, the proportion of SMEs in total economy stayed at the same level in 2009 as in the previous year and amounted to 99.5% (in 2007 it was 99.6%). According to the State Committee of Statistics of Ukraine, as of the beginning of 2010, the share of small companies was 93.7%, medium – 5.8%, big – 0.5%. Besides, one could see positive dynamics in the number of individual entrepreneurs: in 2008 their number increased by 9% compared to the previous year; in 2009 the same trend continued, their number grew by 8% compared to 2008. These figures prove that small entrepreneurship, under favorable conditions, could be the engine of the business sector in Ukraine.

More than half of the SMEs in Ukraine are concentrated in seven regions: in Kyiv (20.2%), Donetsk (7.3%), Dnipropetrovsk (7.0%), Kharkiv (6.8%), Odesa (5.9%), Lviv (5.8%) and in Crimea (4.8%). The number of SMEs in calculation for 10,000 of population increased in Ukraine from 72 in 2008 to 75 in 2009 and practically reached the level of 2007 (76).

At the beginning of 2010, small and medium companies were employing the majority of Ukrainian labor force, according to official statistics some 60.4%, which is practically the same as in the previous year (59.9% at the beginning of 2009). Some changes were inside the SME sector: the share of small enterprises grew from 24.9 to 26% while the proportion of medium firms fell from 35% to 34.4%.

The share of SMEs in total sales volume (products and services) differs from region to region. This figure is much higher in such regions as Crimea (25.4%), Kirovohrad (33.1%), Kherson (35.3%), Chernivtsi (28.5%), and city of Sevastopol (29.3%). At the same time, the share of SMEs is significantly lower in Donetsk region (10.0%), Volyn (10.6%), Dnipropetrovsk (13.2%), and in city of Kyiv (14.9%). As to the share of individual entrepreneurs, their share in total sales was growing and grew almost twice from 2006 to the end of 2009.

The areas of economy where small businesses are the most intensive in Ukraine are practically the same as in the European Union; namely wholesale and retail trade, manufacturing, repair services, construction, real estate, renting and legal advice. The share of small entrepreneurship in the volumes of sales by economic activity is as follows: retail – 65.6% in 2009 to 62.7% in 2008 (including car retail and services); wholesale – 42.9% in 2009 compared to 44.4% in 2008; real estate (including rent and engineering services) – 11.4% in 2009 to 10.3% in 2008; industry – 9.4% in 2009 to 9.1% in 2008; construction – 6% in 2009 compared to 7.0% in 2008; transport and communication – 4.3% in 2009, the same as in previous year; agriculture – 3.3% in 2009 to 2.6% in 2008.

On the other hand, the contribution of small and medium businesses in Ukraine is only as much as 15% of national GDP, while in developed countries this rate reaches 70%. Reasons for such poor SME efficiency are numerous: corruption, unfavorable tax system, and lack of financial resources. "Our entrepreneurs must pay 99 kinds of taxes and spend for this about 58% of their income, while in developed countries this figure is 40%", stated Valerij Rudich from the International Institute of Management during the round table dedicated to the problems of SME development in Lviv in February 2011. For instance, the time needed for getting all the necessary permits for construction is 420 days when in most of European countries it takes only a few weeks; while the share of SMEs in the construction sector of Ukraine is one of the biggest among different sectors of the economy.

The new Tax Code caused a reduction in the number of individual entrepreneurs who are in the simplified tax system. 57% more individual entrepreneurs withdrew from official registration during the 1st quarter of 2011 in comparison with the same period of 2010, and 30% less than early 2010 dared registering business in the first quarter of this year. Decline in the number of individual business people who used to work according to the simplified tax system will continue until the end of the year, unless the government compromises with businesses and brings the promised amendments to the Tax Code relating to a simplified system. Experts expect that by the end of the year, the number of closed companies headed by individual entrepreneurs will rise to 300,000. This negative process immediately affected the unemployment rate. According to the data of the State Employment Centre, with the adoption of the new

Tax Code, informal employment in Ukraine has increased twice already after the first month of its operation.

According to the methodology of the ILO in the 1st quarter of 2010, unemployment among the working age population in Ukraine was 9.8% among the economically active population aged 15-70 years - 9%. This is official data released by the State Committee of Statistics on the 27 April 2011.

### **2.12.2. Legislation and Ranking of Doing Business According to World Bank Methodology**

Despite certain improvements in tax burden (mostly for big business), registration and licensing, the overall business environment in Ukraine is perceived as rather unfavorable, as the country is still very far from being an easy and friendly country for making business. Nevertheless, if we were to apply a glass half-full approach, there is some room for optimism because the country moved up two positions from 147 in the World Bank report: "Doing Business 2010" to 145 in the same report for 2011. So it belongs to those 85% of the 174 world economies where doing business became a little easier for local firms during the last year.

The most positive transformation with a ranking change of 18 positions occurred in the category "starting business", but not due to the introduction of a one-stop shop dealing with registration of new companies as it was supposed to be according to the governmental decisions approved earlier in Ukraine. It is still necessary to deal with 10 various procedures and spend 27 days on average to be registered as a company or an entrepreneur.

At the same time, Ukraine eased business start-up by substantially reducing the minimum capital requirement (paid-in minimal capital) which decreased 70 times compared to the previous year and 100 times compared to 2008. Besides, similar to Portugal and Serbia, the registry can now publish information about the company's registration, so companies no longer have to arrange with a newspaper to advertise it.

Ukraine also made dealing with construction permits a little easier as in this category Ukraine got the 179th place in 2011 and used to be 181st a year ago.

Ukraine eased tax compliance by introducing and continually enhancing an electronic filing system for value added tax. However, paying tax (rank 181) remains the same headache for accountants as it used to be, since it takes 657 hours per year.

According to the World Bank surveys of businesses, managers in 108 economies consider the availability and reliability of electricity to be the second most important constraint to their business activity, after access to finance. In more developed countries, a business with moderate electricity demand can get a connection in 40 days or less. But in Ukraine it takes 309 days.

The criteria where Ukraine is in the first 100 ranking are not numerous: the country received the 32nd rank for Getting Credit (30 in 2010) and is ranked 43 for Enforcing Contracts, which means that its juridical system allows more or less efficient resolution to sales disputes.

Table 80 shows Ukraine's DB rankings in 2010-2011.

**Table 80: Doing Business Rankings of Ukraine 2010-2011**

Ranking	Doing business 2011 Ukraine	Doing business 2010 Ukraine	Change
<i>Ease of Doing Business</i>	145	147	+2
Starting a Business	118	136	+18
Dealing with Construction Permits	179	181	+2
Registering Property	164	160	-4
Getting Credit	32	30	-2
Protecting Investors	109	109	0
Paying Taxes	181	181	0
Trading Across Borders	139	139	0
Enforcing Contracts	43	43	0
Closing a Business	150	145	-5

Ukrainian entrepreneurs say that closing a business is much more costly and complicated than starting it, and the Report proves this by the ranks Ukraine got (150 in 2011 with regress of 5 ranks), with so many SMEs not formally closed but just "hanging in the air" after entrepreneurs stopped their business and even left the country.

### **2.12.3. SME Support Infrastructure**

State Committee of Ukraine for Regulatory Policy and Entrepreneurship Development, the strategic aim of which is to create a comfortable busi-

ness climate, was formed with the aim to play a key role in improving the situation of SMEs in Ukraine and coordinate other governmental and non-governmental players in this sector of the economy. In the National Report on the status of entrepreneurship in Ukraine 2010, it was stated that the basic priority of the Committee was radical deregulation of all spheres of economic activities. Unfortunately, it does not have the necessary levers and finances to implement its good intentions.

Important steps of Ukrainian authorities attempting to create the necessary SME support infrastructure in the country are as follows:

In July 2008, the Order of the President was signed with a title "The issues of implementation in Ukraine the principles of the European Charter for Small Enterprises" (No. 603/2008); the Decree of the Cabinet of Ministers was issued on the same issues (No. 587). Both these documents declare such direction of the SME support as:

- providing privileged conditions for quick start-up of entrepreneurial activity,
- providing access to information and modern technologies,
- creating adequate legal and taxation basis according to the norms and standards.

The Action Plan envisaged the development of eleven legal drafts; launching educational programmes for SME development by the state employment bodies; cooperation of Ukraine with the countries participants of the European Business Register; representation of local SMEs' interests in international trade negotiations; development and support of information portals for the exchange of information among Ukrainian SMEs and foreign companies.

On 16 February 2009, the Prime Minister of Ukraine and EC Vice President signed the Declaration about cooperation on the politics in the area of SME development. This was the beginning of a practical implementation of the European Charter on small and medium businesses, which Ukraine joined in the summer of 2008. State Committee on the issues of entrepreneurship is an official partner in implementation of the agreement. Ukrainian officials believe that it will provide Ukraine an opportunity to coordinate the efforts in further development of the SME sector in the country with the rest of the European countries. Introduction of the

European SME Charter in Ukraine is supposed to promote the development of small and medium business, improvement of relations between state power and entrepreneurs, bettering the business environment and increasing the competitiveness of Ukrainian SMEs.

There are quite a few NGOs in Ukraine which declare support to SME development and promotion. The Union of Small Enterprises of Ukraine was created in June 1990 and united individual business people and small companies of various forms of ownership. Later it was transformed into the Union of Small and Medium Enterprises, and in 1996 into the Union of Entrepreneurs of Small, Medium and Private Enterprises of Ukraine.

In July 1990, The Union of Leasers and Entrepreneurs of Ukraine was formed. In February 1992, Ukrainian Union of Manufactures and Entrepreneurs (УСПП) was founded. The Association of Promotion of Private Entrepreneurship "Unity" also has been developing effective mechanisms of support to small businesses as well as implementation of the ideas of social partnerships.

The danger of imposing unfavorable rules of game for SMEs by the new Tax Code united most of the numerous business organizations in the Assembly of NGOs for Small and Medium businesses of Ukraine. In October-November last year, the most active representatives of small businesses started mass protests demanding resignation of the incompetent government in most regions of the country.

The entrepreneurial movement took a small break during cold winter months and continued its struggle in spring 2011. The Assembly of NGOs for small and medium businesses of Ukraine organized a number of auto rallies all over Ukraine with the slogan "Take Ukraine from oligarchs, return it to its citizens". Final protests occurred at the end of April 2011 in Kyiv. Protesters demanded the government to save the simplified tax system, to revise the new tax code and to postpone its introduction until next year. Assembly of NGOs for small and medium businesses of Ukraine brought together some 100 organizations of entrepreneurs. The rally was supported by the Confederation of Free Trade Unions, some youth movements, Association of lawyers of Ukraine, Ukrainian Union of Veterans, Union of Officers of Ukraine, and Association of Ukrainian Banks. What the rebelled SME representatives gained so far were prom-

ises of the government to revise the adopted Tax code and present the new version of it to the Parliament this year.

Financial services to SMEs are another major issue for the Ukrainian SME sector. The biggest banks represented by 25 institutions concentrate the largest portion of assets in their portfolios, including loans, investments, and they attract the largest share of clients from the SME sector. The banks that lend to small and medium enterprises in Ukraine often work in the framework of the international financial institutions (EBRD, German-Ukrainian Fund) and are mostly situated in the capital or big regional centers. They use so-called scoring systems to evaluate optimal set of socio-demographic characteristics of the borrower under which the probability of loan defaults are low. The situation in Ukrainian provinces is even more desperate for entrepreneurs; numerous small banks do not have any capacity to serve small and medium businesses.

In the structure of the credit system of Ukraine, there are no specialized institutions that serve small and medium businesses. On top of this, the cost of loans for Ukrainian SMEs is very expensive; in the first quarter of 2010 it exceeded 20%.

Practically all banks give credits for businesses only with real property as collateral. Upon switching of majority of companies to grey reporting, it is practically impossible to evaluate the real situation at the enterprise, and banks offer businesses liquid collateral loans as a compensation for the lack of information about companies.

All experts agree that it's necessary to create favorable conditions for citizens and businesses in obtaining loans, to simplify the procedure of their provision, to reduce interest rates, and to increase terms of credits. The mechanism of state support to small and medium businesses in obtaining loans should be improved and national micro credit programmes should be developed.

#### **2.12.4. Industries, Branches, Regions, Clusters**

The economic crisis had a strongly negative impact on the efficiency of the Ukrainian economy. In the Global Competitiveness Index for 2009-2010, Ukraine dropped by ten positions. In 2010, the share of unprofit-

able companies in Ukraine exceeded the profitable ones while the official profitability of the economy fell 4 times. In January-March 2010, only 49% of enterprises were bringing profit in Ukraine, whereas for the same period of 2009 this rate was 51.6%.

Before the crisis, speculative markets were the most profitable sectors in Ukraine; for instance, construction projects and real estate deals were giving up to 200% of profit. The real estate and car markets began falling down like houses of cards after the crisis, and the collapse of the financial market destroyed other areas, which still have not recovered completely, especially those highly dependent on energy resources such as construction, metallurgy, heavy machine building, chemical sector etc.

However, there were also those entrepreneurs who only gained due to the crisis. Dramatic devaluation of the national currency, which occurred in October 2008, and increased prices for imported goods, turned out to be a good ally for Ukrainian manufactures and helped them expand their presence on the shelves of local shops. All big retailers started promoting local products. The share of Ukrainian goods sold in the biggest chains of construction materials supermarkets ("Epicenter", "Nova Linia", and "Praktiker Ukraine") increased by 30% during the crisis. Ukrainian producers dominate now in such categories as paints, dry mixes, wood products, household goods, PVC products, water-heating equipment, roofing, wallpaper and tile; while import prevails in flooring, plumbing materials, electrical instruments and some other segments where Ukrainian producers do not actively work yet. Imports continue shrinking, according to International Center of Perspective Research, and by the end of 2011 the proportion between Ukrainian and imported goods in construction supermarkets is expected to be 85% to 15% respectively (now it is about 70% to 30%). In most European supermarkets, the share of local producers is 80-90%. In Ukraine this share used to be much lower. The global financial crisis changed the situation in favor of local manufactures, most of which are SMEs in this sector.

Another positive effect of the crisis is the fact that Ukrainian business has lost its naive faith in speculative markets and began investing in the real sectors of the economy. High competition forces entrepreneurs to invest in original projects; and the high tech component in their production will grow in the future. After the crisis, clever entrepreneurs have moved

their investments to sectors with rapid circulation of money: agribusiness, repair, services, cloth and footwear manufacturing, although investments were less than before the crisis. To sum up, it can be stated that investors who avoided speculative markets and were investing into the markets with rapid turnover of money and mass consumers eventually were the winners.

This tendency will continue in the near future because under all circumstances people will eat and dress, get sick and receive treatment, use transport to get to their jobs, raise children and provide them with the best possible education. According to all forecasts, agriculture, food production and pharmaceutical companies, mining, transport, communication and education will demonstrate good performance. Even though the companies will not have fantastic profits, they will survive, especially by reducing their production costs.

Collector agencies are expected to be the most profitable, as most financing companies need their services after they suffered losses due to the inability and unwillingness of counterparties to repay debt. Companies which rely on state order and firms that are financed from public sources are also safe. Road construction, housing and other necessary social businesses stay afloat in any case. This is especially true in Ukraine before the European 2012 football championship.

Businesses in the production, sale and installation of safes and security systems also are very likely to prosper. The accumulated savings of the population, the majority of whom lost faith in banks, should be stored somewhere. And since this "somewhere" has been recently limited to the territory of own apartment or house, it is not surprising that Ukrainian customers showed an increased interest in investing into safety of their homes. Another crisis aftermath phenomena is the fact that jewellery business has been experiencing an unprecedented rise and jewellery companies have been multiplying their profits. People literally swept jewellery products from the shelves, seeing in them an alternative to bank deposits in a matter of urgency.

Finally, the SMEs which are "lucky" in post-crisis Ukraine are the following: personnel agencies; consulting companies, specializing in mergers and acquisitions, reducing costs etc; as well as companies with fixed

rates, such as telephone companies; energy producing companies and others. Tourism and recreation businesses possess good perspectives during and after the crisis as well – this field is developing very quickly. One of the widespread explanations of this trend is that most of the Ukrainians who lost their faith in the banking system start living “here and today”, and instead of saving money they started to spend on leisure and traveling.

### **2.12.5. The Effect of the International Financial and Economic Crisis**

At the end of 2008, the Ukrainian SME sector found itself in extremely difficult economic conditions caused by the world financial crisis. In the report revealed by the IMF on 10 September 2009, Ukraine was cited as a country hit very hard by the global slowdown due to sharp decline in the price of steel and a significant increase in the price of natural gas from Russia. Ukraine also suffered from a reversal of capital flows, threatening liquidity in the banking system. Since the beginning of 2009, big enterprises, first of all, in coal mining, metallurgical, machine building and chemical industries, started mass dismissals of their employees. Orientation of citizens, especially those dismissed, towards active economic strategy and their desire to open their own business has been closely associated with solving major social problems, first of all overcoming poverty and supporting vulnerable groups of the population. However, many potential entrepreneurs shortly came to understand that it was not so easy to start a business in Ukraine. National Report on the Situation of Entrepreneurship clearly states that further development of SMEs in Ukraine is restrained not by collective consciousness or personal factors but by various institutional reasons, such as pressure on small and medium companies from several state institutions.

Metallurgical and construction companies suffered the most from the effects of the financial crisis. There is a big share of small and medium enterprises in the construction field (95.5% in 2009). Banks stopped providing credits, and immediately the cost of a square meter of housing space dropped, and as a result most of the construction projects were frozen for an uncertain period of time. Tax for land and rent fees have been also burdensome for SMEs and created obstacles on the way of entrepreneurship development. At a time of crisis, this causes consumer

prices to increase and reduces the purchasing power of citizens.

The main problems encountered by small and medium entrepreneurs during the crisis were the following:

- Most of Ukrainian banks did not provide loans to small and medium entrepreneurs; and those which offered loans put forward quite unfavorable conditions, for instance, taking loans in dollars or euro. Nobody could predict what the exchange rate would be when it is time to pay back the loan;
- Highly disordered regulatory environment in all spheres of economic activity;
- Idle legislation on entrepreneurship, despite the reform of its separate areas - because of the failure of laws and regulations of Ukraine Cabinet of Ministers by a majority of representatives of all levels of government and local authorities;
- Misbalanced, mainly because of political disputes, and ineffective state administration including judiciary;
- Unprecedented corruption in all branches of power.

From early 2009, the business climate continued deteriorating. Among the factors adversely affecting business development indicators were decline in consumption, problems in Ukraine's banking sector, tighter credit conditions in the real economy, limited state investments and financial support to businesses, and decline in foreign investment into the private sector of Ukraine. These changes had a negative impact on employment and social protection. At the state level, certain measures of state support for business were approved. However, they were mostly declarative as were not backed up by sufficient financial resources and political power, and, as a result, did not lead to significant improvement. Future perspectives of the Ukrainian SME sector largely depend on how the collision with the New Tax Code will be resolved by the government.

#### **2.12.6. Government Measures to Cope with the Impact of the Economic Crisis**

Unlike most countries that met the crisis with minimal inflation rate, Ukraine in recent years was characterized by a very strong inflationary trend. The Ukrainian Government was forced to combine the anti-crisis policy with opposing inflationary and other negative economic tendencies. Thus, the measures to prevent destructive destabilization of the

main macroeconomic indicators such as inflation, exchange rate, indicators of banking sector stability, level of budget deficit, etc., unfortunately, affected the business climate in Ukraine negatively.

The Government tried to compensate the adverse effects of the macro-economic stabilization actions by direct support to some key sectors of the Ukrainian economy such as mining and metallurgy. Those measures were aimed at reducing the cost of domestic steel products, for instance: reducing prices for electricity and railway transportation, cancellation of 12% extra charges for gas for metal manufactures, 5-day VAT refunds for exporters and deferred payments for income tax; providing companies of metallurgical sector with loans at minimal rates, state regulation of retail prices.

Introduction of an additional 13% import duty was another instrument to support local manufactures. However, this tool was shortly abolished for most goods, because rapid devaluation of hryvnia practically removed the need for additional protection from excessive imports.

As one can see, all governmental anti-crisis activities were concentrated mainly on creating favorable conditions for enterprises of strategic branches of the national economy and mostly large and medium-sized companies. Meanwhile, small businesses were left virtually alone with the problems of the deteriorating financial situation, cost increases and narrowing consumer markets.

Furthermore, the Law of Ukraine "On establishing subsistence minimum and minimal wage in 2010", became a basis for increasing salaries and social payment practically in all sectors. The effect of this legislation was especially seen on small businesses, possessing a small number of employees and low level of pay.

During 2009 and January-February 2010, the Government adopted more than 130 anti-crisis decisions, which were supposed to help small and medium entrepreneurs. These decisions dealt with such problems as:

- Removing pressure on businesses from controlling bodies.
- Reforming of the permit system and improvement of licensing procedures.
- Eliminating burden of forced (paid) administrative services.

- Improvement of the registration process, fighting corruption.
- Simplifying and streamlining licensing procedures.
- Improvement of policies on taxation.
- Strengthening social protection of entrepreneurs.
- Development of information policy, education and training of entrepreneurs.

Unfortunately, the crisis of political power and the poor coordination of government institutions made it practically impossible for the government to implement its own decisions and put into action necessary tools. The State Committee of Ukraine for Regulatory Policy and Entrepreneurship, given the need for immediate changes with respect to financial and economic crisis, had to push other actors for improving state support for businesses in Ukraine. The Committee was aware of this mission and recognized the urgent need of radical deregulation of economic activities in core areas of the economy. However, many of the approved anti-crisis policy measures remained as good policy intentions. Their implementation could happen either after adopting by the Parliament or endorsement from the President. And even if everything mentioned actually happened, their functioning would be possible only after the funds are available, which most often is not the case. The situation resembles a vicious circle.

In mature market economies, the state is a major factor influencing the nature and pace of SME development. In Ukraine, similar to other post-Soviet countries such as Belarus and Moldova, many enterprises are set up, survive and sometimes even grow despite the government; they work and develop only due to the creativity of individuals in mobilizing resources and their flexibility in adapting to hostile external environments. The problem is that in these situations the number of firms remains small and their contribution to economic development rather limited. In such a context, there must be political will to create the framework conditions for private sector development to become embedded and sustaining.

### **2.12.7. SWOT Analyses of the SME Sector**

See Chapter 3.

### **2.12.8. Tasks for Improvement and Further Development of the National SME Sector**

Chairperson of the Parliamentary Committee on Industrial and Regulatory Policy and Entrepreneurship Development, Nataliya Korolevskaya, stressed that the main task of Ukrainian representatives of small and medium businesses is not turning into economic slaves (SME protests final event at the end of April 2011 in Kyiv). Entrepreneurs are in trouble now because as soon as they start working, they have to break laws; they immediately become guilty and should “negotiate” with the authorities, thus losing their human dignity and independence.

The list of actions which could improve the situation of the SME sector in Ukraine can be further elaborated. However, to put it briefly, it is imperative to perform one major thing – implement all the good intentions, which were declared in laws and various governmental decisions during, before and after the financial crisis.

In the “Programme of Economic Reforms in Ukraine for 2010–2014” it is outlined that for the creation of infrastructure necessary for the promotion of entrepreneurship development, it is essential to develop and support the networks of business centers, business incubators, innovation centers, and techno parks; promote compact business clusters with developed infrastructure and ready packages with permissions for starting activities.

Ukrainian SME community (as demonstrated by the events of the 6 months since the new Tax Code was voted) has been demanding to change the tax system as one of the major obstacles in the survival and further development of small and medium entrepreneurship in Ukraine. The level of shadow economy in Ukraine continues growing. Although the authorities publicly recognize the problem, in reality they do nothing to restore budget revenues. In developed countries, the shadow economy makes up around 5-10% of GDP. In contrast, most domestic and foreign experts estimate the shadow economy of Ukraine to take up around 40-60% of GDP, the figure that stifles national development. Official sources state significantly lower rates – State Statistics Committee at 15-18% of GDP, Ministry of Economy - 28-35% of GDP. In the study “Shadow economies all around the world” by the World Bank, it is estimated that in the

annual turnover, the shadow sector of the Ukrainian economy amounts to UAH 400 billion (USD 50 billion).

As the shadow economy is synonymous with corruption, Ukrainian authorities urgently need to tackle both when facing up this phenomenon. The largest barriers standing in the way of business generally and SMEs in particular is extraordinarily high tax burden coupled with the excessive regulations and the system of permits, which slow business efforts to a snail pace, as stated by the analytical digest "Democracy Watch" published by the Foundation "People First". "The principle reason why people avoid paying taxes anywhere in the world is not greed or a desire to cheat the government, it's because either the taxes are unreasonable or the public can see little or no social benefit. In Ukraine we have both."

An opinion poll conducted by the World Economic Forum last year showed that the Ukrainian business community has perceived instability of political situation as the main obstacle to economic activity. The Government could substantially enhance business efficiency by enhancing the stability of the political environment in which businesses operate. Fighting corruption and improving governance, also could probably provide high return to small and medium businesses because bad governance, particularly in the form of high levels of corruption and weak administrative capacity, is determined as one of the most significant constraints to economic activity and growth in Ukraine. The reform of the distorted legal and financial infrastructures that exist in Ukraine is the highest priority for the survival and development of the Ukrainian SME sector, bettering the economic situation and improvement of the social climate in the country.

The concrete measures to be accomplished in Ukraine for the improvement and development of the SME sector are the following:

1. Change the existing tax system as one of the main obstacles for the survival and further development of SMEs in Ukraine, as well as a reason of growing shadow economy and corruption in the country. The largest barriers standing in the way of the SME sector is extraordinarily high tax burden coupled with the excessive regulations and the system of permits.
2. Simplify the procedures for obtaining necessary permissions, licenses, certificates and other technical regulations to start business operations.

3. Decrease the number of various controlling visits to small and medium companies.
4. Create an infrastructure for promotion of entrepreneurship development, in particular, networks of business centers, business incubators, innovation centers and techno parks; compact business clusters with developed infrastructure and ready packages with permissions for starting activities.

Implementation of these tasks will create a more favorable environment for growing efficiency of the SME sector in Ukraine.

### **Bibliography**

Small Business shallows. "Commersant Ukraina" Newspaper. 20 April 2011

1,3 million of economic entities are registered in Ukraine. Statistics of the Agrarian sector of Ukraine, 1 March 2011 <http://agroua.net/statistics/statnews>.

Commercial Code of Ukraine. Last edition of 24 May 2011.

About situation and perspectives of entrepreneurship development in Ukraine: National report/Group of authors. Kyiv, 2010.

Activity of enterprises. Statistical publication. State statistics committee of Ukraine./Edited by I. Zhuk. Kyiv, 2010.

Activity of small enterprises. Statistical publication. State statistics committee of Ukraine /Edited by I. Zhuk. Kyiv, 2010.

Establishment of state institute for assistance of small entrepreneurship development. / S. Dryga (Director General of the Ukrainian Foundation for the Entrepreneurship Development). Electronic scientific publication of the National Academy of Sciences "State administration: improvement and development", 20 January 2010

Credit Crisis in Ukraine: facts, reasons and ways to restore. / Dr. Ricardo Guicci, Robert Kirchner, Vitalij Kravchuk. Publication of the Institute of

Economic Research and Political Consultations. German Consultative Group. Berlin/Kyiv, June 2010.

Development of small entrepreneurship in the region: Theoretical basis, problems and perspectives. /O. Rybak. Economic Bulletin of Donbas" No. 2 (20), 2010

The Role of Government in SME Development in Transition Economies. / David Smallbone. Friederike Welter

Ukrainian Business: Return to Zero. / Serhij Chyhyr. Economichna Pravda, 31 August 2010.

Shadow economy covers Ukraine once again. "Democracy Watch". Digest of "People First" Foundation, 10 September 2010.

Small business experiences effects of crisis. "Moskovski Komsomolets". 10 February 2009

Lawyers: Businesses deep in debt, not yet out of crisis/Oksana Faryna. Kyiv Post. 18 September 2009.

Olexandra Kuzhel: Small and medium businesses can save a domestic market during the crisis/ Maxim Kuzmenko. <http://www.rbc.ua>

The state should support robust enterprises. Kyiv Post, 11 June 2009.

Future generations in debt / Nataliya Bugayova, Kyiv Post, 24 September 2009.

Economic crisis in Ukraine, Belarus and Russia: washing out a stability of the states? Research @ Branding Group.

<http://www.rb.com.ua/eng/company/publications/2009/730.html>

Ukraine's Deputy Minister of Economy: Because of the ongoing economic crisis, Ukraine will be challenged by withdrawal of capital and growing oil prices.

[http://ru.debaty.org/article/enterprises\\_main/media\\_enterpr/104.html](http://ru.debaty.org/article/enterprises_main/media_enterpr/104.html)

Who and how should the state support during the crisis? / Vitaly Kovalenko <http://blog.liga.net>

Entrepreneurs' riot / Vasyl Khudytsky, 14 July 2009, <http://www.prostobiz.ua>

Small business – favorable environment to prevent crisis. *Ukrainian Business Review*, #9, 2009

Interview with Oksana Prodan, head of the Council of entrepreneurs at the Cabinet of Ministers. *Ukrainian Business Review* #12

I believe that small business has the future. Interviews with the President of the Union of small, medium and private enterprises Viatcheslav Bykovets. *Ukrainian Business Review* #27-28 and #46-47.

World financial crisis – test for Ukraine /Bohdan Danylyshyn (the Minister of economic affairs of Ukraine). Newspaper "Dzerkalo Tyzhnya", # 38 (717), 2008.

Explanatory note to the Draft Law of Ukraine "About introducing changes to some legal acts on minimization of negative consequences of financial crisis for agents of business activities"/ N. Korolevska, M. Kravchenko, M. Chechetov, Members of Parliament of Ukraine. [http://voas.gov.ua/?action=news&id\\_news=102](http://voas.gov.ua/?action=news&id_news=102)

Influence of economic crisis on the enterprises of Ukraine. /N. Bohats'ka, I. Val'chuk. Vinnytsia trade-economic university, Kyiv national trade-economic university.

Small enterprises: determination criteria. Formation of market relations /H. Andriushchenko. #10, 2008.

Small and medium businesses are on the verge of a nervous breakdown/ Vitaliy Khyzhansky, <http://www.day.kiev.ua>

Under crisis, every ineffective decision in regulatory politics will have painful reaction in the society/ K. Kuznietsov. Newspaper *Economichna Pravda*. #11, 2008.

### 3. SWOT ANALYSES OF THE SME SECTORS IN THE BSEC REGION

#### ALBANIA

<p><b>STRENGTHS</b></p> <p>(i) Implementation of strategic document for SME development successfully, especially in the reduction of the administrative barriers;</p> <p>(ii) National Register Centre, NRC, as one stop shop, register of business in 1 day with less than 1 Euro;</p> <p>(iii) National Licence Centre, NLC as one stop shop, which can provide licenses in 2-4 days and maximum 10-30 days (not included the construction permits);</p> <p>(iv) Fiscal reform. The flat tax by 10% for the incoming tax and for the corporate tax.</p>	<p><b>WEAKNESSES</b></p> <p>(v) Missing financial schemes to support start ups;</p> <p>(vi) Poor access of micro enterprises to financial sources;</p> <p>(vii) Poor access of SMEs to financial resources;</p> <p>(viii) Lack of alternative financial sources for SMEs as venture capital or business angels;</p> <p>(ix) Deficiency of providing business services;</p> <p>(x) Poor performance in innovation;</p> <p>(xi) Lack of availability of skill;</p> <p>(xii) Deficient technological capacity of firms;</p> <p>Albania has not yet joined the EEN.</p>
<p><b>OPPORTUNITIES</b></p> <p>(xiii) The implementation of a new strategy for increasing the competitiveness of SMEs through technology transfer and innovation;</p> <p>(xiv) Strong government engagement for improving the business environment;</p> <p>(xv) Existing SME donors Forum to create synergy to implement new projects through international cooperation (EU countries and international/ foreign organizations);</p> <p>(xvi) EC Decision that Albanian be candidate country during the year 2011.</p>	<p><b>THREATS</b></p> <p>(xvii) Political interference in the public agency staff;</p> <p>(xviii) Corruption is seen as one of the major threats hindering the development of SMEs;</p> <p>(xix) The low budgeting schemes for supporting SME development;</p> <p>(xx) Frequent changing of the fiscal legislation.</p>

Source: Ministry of Economy, Trade & Energy, Albania, 2011

## ARMENIA

<p><b>STRENGTHS</b></p> <p>(i) Elaboration and implementation of SME development state policy and annual support programmes;</p> <p>(ii) Existence of Small and Medium Entrepreneurship Development National Centre of Armenia (SME DNC of Armenia) which provides support for SMEs and development of corresponding infrastructures for SMEs;</p> <p>(iii) Stable macroeconomic growth and positive trends in the SME sector;</p> <p>(iv) Improvement of the situation in labor market and solution of a number of serious social problems;</p> <p>(v) Significant contribution of the SME sector in GDP (42.5% in 2009);</p> <p>(vi) Flexibility of the SME sector; in spite of the significant decline in GDP, the share of the SME sector in GDP increased during the crisis;</p> <p>(vii) Over 40% of employment in Armenian economy was provided by the SME sector;</p> <p>(viii) About 1/3 of taxes, state duties and other obligatory payments paid by SMEs in total amount of the RA tax income to the state budget is paid by SMEs;</p> <p>(ix) Increasing role of the SME sector in the economy reflected by the SME Development Index in Armenia (exponential increase during the last decade);</p> <p>(x) Under the anti-crisis policies, tax and customs reforms were initiated, taxes have been considerably simplified for all types of businesses, including small and medium-size enterprises.</p>	<p><b>WEAKNESSES</b></p> <p>(xi) The SME sector mostly targets the internal market, since the requirements and competition is too high for external markets and SME units, as enterprises with limited funds and opportunities often cannot overcome obstacles related to foreign trade;</p> <p>(xii) Elaboration and implementation of SME state policy started relatively late compared to other transition economies;</p> <p>(xiii) Low demand in local market;</p> <p>(xiv) Lack of reliable official statistics on SMEs;</p> <p>(xv) Poor access of SMEs to financial resources;</p> <p>(xvi) Lack of business incubators;</p> <p>(xvii) Low competitiveness of SMEs;</p> <p>(xviii) Lack of quality consciousness of SMEs;</p> <p>(xix) Lack of managerial skills of SME leaders especially in Marzes;</p> <p>(xx) Low level of inter-regional cooperation between SMEs.</p>
<p><b>OPPORTUNITIES</b></p> <p>(xxi) Operation of SMEDNC of Armenia throughout the country;</p> <p>(xxii) Good opportunities for tourism;</p> <p>(xxiii) Membership of Armenia to World Trade Organization (WTO) enhances the opportunities of SMEs to enter the foreign markets;</p> <p>(xxiv) Armenian Diaspora might play a significant role in the internationalization of domestic SMEs;</p> <p>(xxv) The continuous and targeted SME development policy will strengthen SME support system and enlarge geographical and financial opportunities;</p> <p>(xxvi) Increasing international cooperation will provide new opportunities for SMEs to implement new projects and enter new markets;</p>	<p><b>THREATS</b></p> <p>(xxvii) Bureaucracy and corruption are seen as major threats hindering the development of SMEs;</p> <p>(xxviii) High polarization for income distribution of population;</p> <p>(xxix) Unfair competition;</p> <p>(xxx) Unsettled regional conflicts around Armenia.</p>

Source: Alpha Plus Consulting, Yerevan, 2011

## AZERBAIJAN

OPPORTUNITIES	THREATS
<p>(i) Application of "one-shop stop" system in the registration of enterprises, import-export operations, registration of real estate will cause increase in the SME quantity;</p> <p>(ii) Activities provided in the current State Programmes will give a good opportunity for increasing state support to the SME sector;</p> <p>(iii) The execution of State Programme concerning youth employment strategy means stimulating young entrepreneurs' growth;</p> <p>(iv) The poverty alleviation programme will enable to increase employment and to open new jobs, especially, to increase the number of new entrepreneurial subjects in the private sector;</p> <p>(v) State financial support to the SME sector increasing year by year will make its positive impact on strengthening the material and technical basis of SMEs;</p> <p>(vi) Joining the EU Eastern Partnership Agreement in March 2009 will support Azerbaijan for its economic integration into EU, and cause application of European development model of the SME sector in Azerbaijan;</p> <p>(vii) Possibility of becoming a WTO member in the near future.</p>	<p>(viii) The quantity of people, especially youth, wanting to deal with the entrepreneurial activity is considerably less than existing opportunities;</p> <p>(ix) Still oil and oil products occupy the main share in the GDP;</p> <p>(x) SMEs' competitiveness index is too low;</p> <p>(xi) Large companies, especially transnational companies are not interested in cooperation with SMEs;</p> <p>(xii) The 15 percent preference in the state procurement for SMEs is not applied;</p> <p>(xiii) "Shadow economy" is still growing. Due attention is not paid to business education, business ethics as well as factors impacting productivity growth in SMEs;</p> <p>(xiv) There are no mechanisms for the settlement of economic disputes;</p> <p>(xv) Credit terms are unfavorable for SMEs;</p> <p>(xvi) The majority of banks cannot attract long-term low-cost resources for subsequent SME refinancing;</p> <p>(xvii) Poor mutual understanding between banks and SMEs;</p> <p>(xviii) SME operations are not transparent, which force banks to incorporate the possible risks into the credit cost;</p> <p>(xix) Unsettled regional conflicts with Azerbaijan.</p>
STRENGTHS	WEAKNESSES
<p>(i) Political and economic stability;</p> <p>(ii) SMEs are the major locomotive in the private sector forming and development of regions of Azerbaijan;</p> <p>(iii) The necessary legal basis and state support are available in Azerbaijan for SME development;</p> <p>(iv) Easy enterprise registration procedure, implementation of one stop shop system;</p> <p>(v) SMEs play an important role in solving social problems, especially, poverty alleviation and increasing employment;</p> <p>(vi) Development of non-oil sector becomes the main priority area of governmental policy;</p> <p>(vii) A strong legal, finance, technical and information basis as well as human capital for the development of the SME sector in the Azerbaijan Republic;</p>	<p>(viii) Lack of free market economy knowledge and skills, and of experience in SMEs;</p> <p>(ix) Lack of new technology and lack of specialists, who can work with new technology;</p> <p>(x) Lack of interest in the implementation of innovation projects;</p> <p>(xi) Non-usage of international standards on protection of environment, OSH, etc.;</p> <p>(xii) Lack of cooperation between universities and SMEs;</p> <p>(xiii) Unfair competition and monopolism in trade sectors;</p> <p>(xiv) Low level of the share of the SME sector in export;</p> <p>(xv) Weak cooperation relations of MNC with SMEs;</p> <p>(xvi) Problem with the implementation of economical laws, absence of its mechanism;</p> <p>(xvii) Azerbaijan is not a member of WTO. Economical integration process into EU passes only through membership of WTO.</p>

Source: National Productivity and Competitiveness Centre of Azerbaijan Republic, Baku, 2011

**BULGARIA**

<b>WEAKNESSES</b>	<b>STRENGTHS</b>
<p>(i) Low innovation activity, and insufficient resources to finance the innovations, particularly among micro enterprises;</p> <p>(ii) Low degree of cooperation with the university and research centers;</p> <p>(iii) Low degree of internationalization, expressed in the small number of SME exporters, and the weak participation in clusters and international business networks;</p> <p>(iv) Small number of SMEs with registered trade marks and patents in the country and abroad, and lack of financial resources for these activities;</p> <p>(v) Small share of SMEs using actively the internet application for purchase and sales (e-commerce), and small number of SMEs with implemented information management systems;</p> <p>(vi) Low degree of the labor productivity in comparison with SMEs in other EU countries.</p> <p>(vii) Difficult access to financial resources – both private and public – during the crisis;</p> <p>(viii) Low quality of public institutions and general infrastructure;</p> <p>(ix) “Brain draining” especially among doctors, scientists, and young professionals.</p>	<p>(x) Application of the EU directions (SBA) in national strategies for encouraging the SME development;</p> <p>(xi) Growing number of SMEs, and their increasing share in the turnover, value added, and investments in long term assets;</p> <p>(xii) Increasing contribution to the employment during the crisis, particularly by micro enterprises, when big companies lost employees;</p> <p>(xiii) Availability of the qualified personnel and an augmentation of the employees’ training inside and outside SMEs;</p> <p>(xiv) Better strategic planning and marketing;</p> <p>(xv) Better access to information based on the ICT application;</p> <p>(xvi) Increased requirements for the employees’ performance and more strict accountability;</p> <p>(xvii) Improved macroeconomic environment;</p> <p>(xviii) Improved conditions for starting business and paying taxes (10% flat corporate and income taxes).</p>
<p><b>OPPORTUNITIES</b></p> <p>(xix) Expected economic recovery;</p> <p>(xx) The application of the SBA principles through the national strategy for SME development;</p> <p>(xxi) Comparatively high level of education among entrepreneurs;</p> <p>(xxii) Comparatively high share of entrepreneurs speaking foreign languages;</p> <p>(xxiii) Improving institutional environment due to the implementation of the trade registry and easier registration regimes;</p> <p>(xxiv) Increased opportunities for international cooperation and integration in the EU and other developed markets;</p> <p>(xxv) Better perspectives for SME exporters in the mid-term perspective.</p>	<p><b>THREATS</b></p> <p>(xxvi) Lack of markets for products/services realization;</p> <p>(xxvii) Increased inter-firms debts;</p> <p>(xxviii) Great part of the “grey economy” is in the SME sector;</p> <p>(xxix) Decreased public spending to encourage SMEs;</p> <p>(xxx) Decreased propensity to invest due to the assets depreciation;</p> <p>(xxxi) Diminishing SME spending on R&amp;D;</p> <p>(xxxii) Aging of a part of SMEs founders and problems with transferring business;</p> <p>(xxxiii) Impoverishment of a part of population and decreased level of demand;</p> <p>(xxxiv) Problems with bureaucracy, low quality of administrative services (particularly customs’ and judicial), and law enforcement.</p>

Source: BSMEPA 2011: 111-117, Bulgaria

## GEORGIA

<p><b>STRENGTHS</b></p> <p>(i) Growing SME sector (The number of SMEs increased by 15% in 2010 compared to 2009 in Georgia and by 35% compared to 2004)</p> <p>(ii) High SME ratio in the total number of enterprises (91.5%).</p> <p>(iii) Government liberality and support of SMEs (benevolence);</p> <p>(iv) High level of population involvement in SMEs;</p> <p>(v) Liberal Tax Administration;</p> <p>(vi) Simplified procedures provided by the New "Tax Code" (in 2011) for doing business and special incentives for Micro and Small businesses;</p> <p>(vii) Ease of starting business (In "Doing Business 2011", Georgia is ranked 8th overall for Starting a Business and is ranked 7th overall for Dealing with Construction Permits among the countries with good practices).</p>	<p><b>WEAKNESSES</b></p> <p>(viii) Small SME ration in the total employment;</p> <p>(ix) Small number of business incubators;</p> <p>(x) Lack of human capital in the terms of business skills (Professionals);</p> <p>(xi) Incentivizing SMEs might hinder their growth opportunities;</p> <p>(xii) Incompliance of local products with international quality standards.</p>
<p><b>OPPORTUNITIES</b></p> <p>(xiii) Further development of the country's economy;</p> <p>(xiv) Attractive tourism destination;</p> <p>(xv) Country's investment-friendly environment;</p> <p>(xvi) Georgia's promotion and going advance into international ratings;</p> <p>(xvii) Georgia's liberal trade regime with simplified trade procedures, no quantitative restrictions on export/import, no tariff quotas, double taxation avoidance agreement with 22 countries, country's membership in World Trade Organization (WTO), Ratified Commonwealth of Independent States (CIS) Free Trade Agreement and signed EU-Georgia European Neighborhood Policy Action Plan, Free Trade Agreement with Turkey etc. creates opportunities for the SME sector for foreign trade and especially for export.</p>	<p><b>THREATS</b></p> <p>(xviii) Possibility of finance accessibility reduction for SMEs;</p> <p>(xix) Dissatisfactory competitiveness;</p> <p>(xx) Lack of technology and innovation;</p> <p>(xxi) Lack of human resource development and insufficient strengthening of the professional education sector;</p> <p>(xxii) Decreased investment probability;</p> <p>(xxiii) Regional conflicts;</p> <p>(xxiv) Ecological catastrophes (which can harm agricultural products).</p>

Source: Ministry of Economy and Sustainable Development, Tbilisi, 2011

## GREECE

STRENGTHS	WEAKNESSES
<p>(i) Undertaking of measures for the support and development of the Greek SMEs;</p> <p>(ii) Recent growth of exports;</p> <p>(iii) Increase of the productivity of employment and decrease of the increased growth rate of the employment cost;</p> <p>(iv) Progress in the development of infrastructure;</p> <p>(v) Emphasis on entrepreneurship;</p> <p>(vi) Improved infrastructure of research and technology;</p> <p>(vii) Potential for use of renewable sources of energy;</p> <p>(viii) High contribution of tourism in the GDP and the creation of employment. Well organized promotion of the Greek tourist product;</p> <p>(ix) Highly educated work force;</p> <p>(x) Flexibility of the Greek SMEs in terms of management, adaptation to dynamic environmental conditions and effective defense against entrepreneurial risks;</p> <p>(xi) Introduction of "new to the firm" and "new to the Greek market" products.</p>	<p>(xii) Problems in terms of financing;</p> <p>(xiii) Complex legal and tax system;</p> <p>(xiv) Deficient integration of professional management practices in Greek firms;</p> <p>(xv) Low exports as a percentage of GDP;</p> <p>(xvi) Low degree of attracting foreign investments in production;</p> <p>(xvii) Increased cost of production due to external factors;</p> <p>(xviii) Dualism in entrepreneurial structuring. Very small size of enterprises combined with low productivity;</p> <p>(xix) High levels of uncertainty avoidance of Greek entrepreneurs;</p> <p>(xx) Deficiencies in infrastructures supporting entrepreneurial activity;</p> <p>(xxi) Limited breadth of industrial specialization and small portion of high technology products;</p> <p>(xxii) Low levels of R&amp;D spending and inability to develop radically innovative products of high added value;</p> <p>(xxiii) Low use of information and communication technologies by a large number of enterprises;</p> <p>(xxiv) Deficiencies in contemporary information and communication technological infrastructure;</p> <p>(xxv) Weak intermediate mechanisms of technology transfer;</p> <p>(xxvi) Difficulty in finding specialized work force;</p> <p>(xxvii) Low level of penetration of renewable sources of energy in the Greek energy system;</p> <p>(xxviii) Delay in the liberation of the electrical energy market;</p> <p>(xxix) Low level of networking among enterprises;</p> <p>(xxx) Insufficient connection between research and entrepreneurial communities;</p> <p>(xxxi) Low performance in terms of life long education;</p> <p>(xxxii) High energy intensity. High dependence on imports;</p> <p>(xxxiii) Lack of connections with electrical and petrol supply;</p> <p>(xxxiv) Deficiencies in supply chain infrastructure.</p>

OPPORTUNITIES	THREATS
<p>(i) Activation of the National Strategic Reference Framework (NSRF) 2007-2013;</p> <p>(ii) Activation of the new Developmental Law;</p> <p>(iii) Promotion of the country as the link between European Union and third countries in the Balkans, the Mediterranean and the Black Sea;</p> <p>(iv) Increase of growth and demand in neighboring countries;</p> <p>(v) Increased trend toward more new products and services;</p> <p>(vi) International trend toward the extension of cooperation and networking;</p> <p>(vii) Opportunities created by the 7th Competitiveness and Innovation Framework Programme;</p> <p>(viii) Sensitization of enterprises regarding the production and use of research and technological development tools;</p> <p>(ix) Potential for research and technological penetration in the Balkans, the East Mediterranean and the Black Sea;</p> <p>(x) Liberation of the energy market to provide motives for private investments;</p> <p>(xi) Acknowledgement of the Greek tourist product and the continuous increase of the tourist demand;</p> <p>(xii) Increased demand for alternative tourism;</p> <p>(xiii) Increased demand for corporate social responsibility;</p> <p>(xiv) Upgrade of the energy role of the country in the South-Eastern Europe.</p>	<p>(xv) High cost of loans;</p> <p>(xvi) Lack of liquidity;</p> <p>(xvii) Reduced power of buyers and thus reduced consumption;</p> <p>(xviii) Vulnerability of Greek SMEs to the effect of the economic crisis;</p> <p>(xix) Potential enlargement of the European Union and entry of new country members enjoying lower production costs, higher productivity and extraversion;</p> <p>(xx) Capital outflow toward third countries and subsequent shrinkage of manufacturing;</p> <p>(xxi) Increased competition for SMEs;</p> <p>(xxii) Absorption of Greek SMEs by leading international companies;</p> <p>(xxiii) Leakage of highly educated work force to countries with better employment conditions;</p> <p>(xxiv) Inability to follow international technological advances;</p> <p>(xxv) Improvement of infrastructures in competitor countries.</p>

Source: European Profiles, 2008. European Innovation Scoreboard, 2009

## MOLDOVA

<p><b>STRENGTHS</b></p> <p>(i) Existence of a legislative basis regulating the main aspects of SME development;</p> <p>(ii) Realization of goal-oriented SME support state programmes;</p> <p>(iii) High share of SMEs in the national economy and contribution of SMEs to GDP and employment;</p> <p>(iv) Low price of the labor force compared to neighbor countries, which could be a competitive advantage;</p> <p>(v) Availability of fertile soil and favorable climatic conditions to raise agricultural crops; availability of qualitative raw materials for construction and experience and tradition of its processing;</p> <p>(vi) Good geographical position of the country, situated between the EU and CIS countries, taking into account the advantages of operating both in the EU and CIS markets;</p> <p>(vii) Positive attitude to SMEs by the population.</p>	<p><b>WEAKNESSES</b></p> <p>(viii) Political instability going on for a long time;</p> <p>(ix) Underestimation of SMEs' role in the national economy by politicians;</p> <p>(x) Inadequacy of the state's resources for SME financing;</p> <p>(xi) Structural disproportions in the SME sector development (sectoral, territorial);</p> <p>(xii) Limited resource base of SMEs and difficult access to financial resources;</p> <p>(xiii) Lack of qualified managers able to work in market economy conditions;</p> <p>(xiv) Significant bureaucratic barriers in the way of entrepreneurs;</p> <p>(xv) Lack of mutual trust between the entrepreneurs and public authorities;</p> <p>(xvi) Undifferentiated external sale markets and raw materials suppliers market, particularly of energy supply;</p> <p>(xvii) Low competitiveness level of enterprises both in internal and external markets;</p> <p>(xviii) Low level of development and introduction of innovation;</p> <p>(xix) Narrow internal market and low solvent population's demand;</p> <p>(xx) Corruption of functionaries. High share of the shadow economy.</p>
<p><b>OPPORTUNITIES</b></p> <p>(xxi) Growing interest of the state in the problems and needs of the SME sector;</p> <p>(xxii) High potential of the tourism sector;</p> <p>(xxiii) Pro-European vector of the country's development, presenting an opportunity to get EU support;</p> <p>(xxiv) The development of cross-border cooperation due to close contacts with citizens of neighbor countries – Romania and Ukraine;</p> <p>(xxv) Knowledge of foreign languages by Moldovan citizens as a chance for enterprises to establish and develop the international cooperation.</p>	<p><b>THREATS</b></p> <p>(xxvi) External and internal public debts;</p> <p>(xxvii) Territorial conflicts;</p> <p>(xxviii) Lack of young cadres, especially educated specialists, in the business sphere, including the SME sector.</p> <p>(xxix) Emigration, especially of the youth;</p> <p>(xxx) High level of poverty and considerable difference in living standards of different population groups, which is a potential source of conflicts in society;</p> <p>(xxxi) Splitting of the society on political and ethnic grounds, which provokes instability in the society;</p> <p>(xxxii) Unattractive image of the country as an extremely poor one characterized by political and economic instability – which hinders the attraction of investments</p>

Source: National Institute of Economy, Finance and Statistics of Moldova and State University of Chisinau, Republic of Moldova, 2011

## ROMANIA

STRENGTHS	WEAKNESSES
<p>(i) Qualification, adaptability and relatively low price of labor force and high educational level of the economically active population;</p> <p>(ii) National Council of Small and Medium-sized Private Enterprises in Romania – CNIPMMR – represents the interests of entrepreneurs against the Government;</p> <p>(iii) Access to European funds was simplified and there has been an increase of pre-financing rate;</p> <p>(iv) The quality of products/services offered;</p> <p>(v) Price-quality relation;</p> <p>(vi) Low price of the products/services offered;</p> <p>(vii) The institutional framework for the support of SMEs;</p> <p>(viii) Special pre-insolvency procedures in 2010 for distressed companies trying to avoid bankruptcy;</p> <p>(ix) 71.35% of entrepreneurs have university or post graduate degrees, 26.3% are high school graduates, and only 2.4% are with elementary school degrees.</p>	<p>(x) Less predictable macroeconomic conditions for SME growth, compared to those of EU;</p> <p>(xi) Only 5% of SMEs are competitive in the European market;</p> <p>(xii) Lack of new technologies and update equipment, low labor productivity and profitability, low competitiveness and absence of linkages between research institutes and the productive sector;</p> <p>(xiii) Low level of entrepreneurial curricula at secondary schools and universities;</p> <p>(xiv) In underdeveloped regions the entrepreneurial activity is missing;</p> <p>(xv) Need for consultancy and training for companies;</p> <p>(xvi) Large disparities between the development regions;</p> <p>(xvii) High level of corruption at state and regional/municipal level;</p> <p>(xviii) The uncertainty surrounding regulations is</p> <p>(xix) stalling business decision-making and planning;</p> <p>(xx) Registry for intra-community acquisition</p> <p>(xxi) increased the administrative burden on businesses;</p> <p>(xxii) Low level of EU funds absorption (only 8%);</p> <p>(xxiii) Romania has the highest number of taxes in Europe and the fourth highest number of taxes in the world;</p> <p>(xxiv) Companies' strategies are concentrated on reducing the costs of the factors and not on improving productivity;</p> <p>(xxv) The poor infrastructure is considered to be the biggest barrier in the building of a cluster policy;</p> <p>(xxvi) 69% of the total SMEs are concentrated on 11 activities of 82 existing activities.</p>
<p><b>OPPORTUNITIES</b></p> <p>(xxvii) Obtaining a grant – are EU funds to finance SME related initiatives and projects;</p> <p>(xxviii) Expanding service sector especially in ITC sector and increasing demand on the faster spread of results in information technology;</p> <p>(xxix) Increasing of the FDI investments in Romania;</p> <p>(xxx) Increasing of the SMEs export weight on EU market and concerning of the SMEs regarding the implementation of the EU standards and quality management systems;</p> <p>(xxxi) Increase of sales on the internal market;</p>	<p><b>THREATS</b></p> <p>(xxxvii) Entrepreneurs and managers are not prepared for the crisis;</p> <p>(xxxviii) The reduction of salaries in the public sector implies the reduction of demand for products and services;</p> <p>(xxxix) Decrease of export demand;</p> <p>(xl) Outflow of qualified workforce abroad;</p> <p>(xli) Excessive taxation;</p> <p>(xlii) Minimum tax (500 -10 000 Euros);</p> <p>(xliii) The poor management of human capital;</p> <p>(xliv) The depreciations and instability of the</p>

OPPORTUNITIES	THREATS
(i) Obtaining a grant – are EU funds to finance SME related initiatives and projects;	(xi) Entrepreneurs and managers are not prepared for the crisis;
(ii) Expanding service sector especially in ITC sector and increasing demand on the faster spread of results in information technology;	(xii) The reduction of salaries in the public sector implies the reduction of demand for products and services;
(iii) Increasing of the FDI investments in Romania;	(xiii) Decrease of export demand;
(iv) Increasing of the SMEs export weight on EU market and concerning of the SMEs regarding the implementation of the EU standards and quality management systems;	(xiv) Outflow of qualified workforce abroad;
(v) Increase of sales on the internal market;	(xv) Excessive taxation;
(vi) Penetration of new markets;	(xvi) Minimum tax (500 -10 000 Euros);
(vii) Assimilation of new products;	(xvii) The poor management of human capital;
(viii) Creation of a business partnership;	(xviii) The depreciations and instability of the national currency;
(ix) Use of new technology;	(xix) Delays in bill payment by private companies;
(x) Export increase.	(xx) High credit costs;
	(xxi) Inflation;
	(xxii) Difficult access to credits;
	(xxiii) Increase of salary expenses level;
	(xxiv) Competition from imported products;
	(xxv) Excessive controls;
	(xxvi) Unpaid bills by state institutions.

Source: Dr. Zsuzsanna Katalin Szabó, Petru Maior University, Targu Mures, Romania, 2011

**RUSSIA**

<p><b>STRENGTHS</b></p> <p>(i) High level of education, gender structure, and industry distribution;</p> <p>(ii) High potential of further developments based on large number of technology driven companies and traditionally close relationship with large companies geographically located in the same area, which is lowering transaction costs for the small businesses;</p> <p>(iii) High level of female involvement in entrepreneurship activities;</p> <p>(iv) The necessity-driven and opportunity-driven entrepreneurs are rather stable in Russia even during the crisis.</p>	<p><b>WEAKNESSES</b></p> <p>(v) The SME sector still has an inefficient structure with less than 1% of SME companies in science and research;</p> <p>(vi) The SME sector does not use a potential of high educational level up to its limits yet.</p>
<p><b>OPPORTUNITIES</b></p> <p>(vii) Easier access to foreign suppliers, products and markets;</p> <p>(viii) Easier customs regime with several countries;</p> <p>(ix) More respect to Russian companies from foreign counterparts and reliable business partners;</p> <p>(x) Higher S&amp;P investment rating for Russia;</p> <p>(xi) Large companies successfully operating in domestic and international markets could be considered as a positive factor for SME companies who work as suppliers and partners for these large ones.</p>	<p><b>THREATS</b></p> <p>(xii) Global crisis, budget shortages, limited support from international investors due to their low interest in the areas other than high-technology and telecommunication.</p> <p>(xiii) Inefficient structure of the economy as a whole;</p> <p>(xiv) Political factor is also critical, as well as high level of corruption in Russia;</p> <p>(xv) Governmental support and simplification of administration regimes including taxation and book-keeping are also crucial;</p> <p>(xvi) Lack of financial resources for SMEs;</p> <p>(xvii) The reluctance of the Russian banking industry in general and other financial institutions to work with small companies.</p>

Source: Irina Naoumova and Alexandr Vatolin, 2011

**SERBIA**

<p><b>STRENGTHS</b></p> <p>(i) Ability to survive in difficult times – High level of adaptability and flexibility;</p> <p>(ii) Long entrepreneurial tradition in comparison with other transitional economies and experience in certain industries;</p> <p>(iii) Strong entrepreneurial spirit;</p> <p>(iv) Growing share of the SME sector in the country's GDP and other macroeconomic indicators;</p> <p>(v) Relatively good financial outlook of the existing SMEs;</p> <p>(vi) Creation and operation of new clusters (3rd and 2nd phase);</p> <p>(vii) Introduction of new methods in business.</p>	<p><b>WEAKNESSES</b></p> <p>(viii) Limited availability of financial resources and limited access to financial resources;</p> <p>(ix) High indebtedness and liquidity problems;</p> <p>(x) Insufficient orientation towards exports and low level of internalization and export potential;</p> <p>(xi) Limited number of large enterprises to cooperate with;</p> <p>(xii) Low level of technological improvements and innovativeness;</p> <p>(xiii) Lack of market information;</p> <p>(xiv) Low level of education, lack of entrepreneurial skills;</p> <p>(xv) Regional and sector concentration;</p> <p>(xvi) Underdeveloped quality management system;</p> <p>(xvii) Insufficient usage of IT in business;</p> <p>(xviii) Difficulties in attracting highly qualified labor.</p>
<p><b>OPPORTUNITIES</b></p> <p>(xix) Joining supply chains of large enterprises and development of the domestic market;</p> <p>(xx) Significant support (financial and non-financial) to the development of the SME sector by the EU institutions;</p> <p>(xxi) Policy and measures undertaken by the Government of the Republic of Serbia to promote the SME sector and entrepreneurial spirit;</p> <p>(xxii) Possibility to export to the following countries CEFTA, Russia, Turkey – with which Serbia signed free trade agreements;</p> <p>(xxiii) Production of automotive components for large companies, such as Fiat.</p>	<p><b>THREATS</b></p> <p>(xxiv) Still "sensitive" political situation – few open issues, such as Kosovo;</p> <p>(xxv) Liberalization of foreign trade and stronger competition on the domestic market;</p> <p>(xxvi) Monopolies of big companies in some industries;</p> <p>(xxvii) Very slow and complicated procedures of issuing construction permits and registering property;</p> <p>(xxviii) Decreasing demand in the domestic market;</p> <p>(xxix) Legislative and administrative limitation;</p> <p>(xxx) Burdensome tax regulations and procedures.</p>

Source: Eric Dejan, Institute of Economic Sciences, 2011

## TURKEY

STRENGTHS	WEAKNESSES
<p>(i) The importance and role of SMEs in economic and social development is well-known by the Government;</p> <p>(ii) Source of employment;</p> <p>(iii) Critical role for regional and national development;</p> <p>(iv) Flexible structure;</p> <p>(v) High entrepreneurial spirit;</p> <p>(vi) Openness to the innovation</p> <p>(vii) Close relationship between managers and employees;</p> <p>(viii) Close relationships with buyers;</p> <p>(ix) Specialization.</p>	<p>(x) Insufficient working capital and capital accumulation for RTD activities and innovation;</p> <p>(xi) Low level of utilization from ICTs, modern marketing and business techniques as well as production techniques;</p> <p>(xii) Insufficient awareness of the opportunities, incentives and supports provided by several resources;</p> <p>(xiii) Lack of project preparation and management experience;</p> <p>(xiv) Insufficient level of institutionalization and networking activities;</p> <p>(xv) Deficiency in quality and branding;</p> <p>(xvi) Limited openness to the collaboration and cooperation;</p> <p>(xvii) Lack of sufficient resources including financial resources for participation in public tenders;</p> <p>(xviii) Insufficiency in development of business ethics based on efficiency;</p> <p>(xix) Problems in providing collateral for bank guarantees;</p> <p>(xx) Insufficient generalization of e-state activities.</p>
OPPORTUNITIES	THREATS
<p>(xxi) Several national and international incentives and supports.</p> <p>(xxii) Policy documents</p> <p>(xxiii) New market opportunities</p> <p>(xxiv) Relatively positive trend in the macroeconomic indicators</p> <p>(xxv) Acceptance of Small Business Act by public institutions</p> <p>(xxvi) Lesson learnt from the crisis</p> <p>(xxvii) Increasing capacity and capability of intermediary (e.g. consultancy firms) firms</p> <p>(xxviii) Increasing role of general, sector and regional professional organizations</p> <p>(xxix) Increasing absorptive capacity of SMEs</p> <p>(xxx) Young population</p>	<p>(xxxii) High tax and social insurance payments;</p> <p>(xxxiii) Insufficient cooperation between knowledge resources and SMEs;</p> <p>(xxxiv) Political and economic uncertainty and instability in the neighboring countries;</p> <p>(xxxv) Widespread informal and unregistered activities;</p> <p>(xxxvi) Insufficient statistical data for policy makers;</p> <p>(xxxvii) Deficiency in qualified human resources;</p> <p>(xxxviii) Delays in payments among the SMEs.</p>

Source: Umut Yılmaz Çetinkaya, Middle-East Technical University, Ankara, 2011

## UKRAINE

<p><b>STRENGTHS</b></p> <p>(i) Creativity of entrepreneurs in the face of adversity in order to survive;</p> <p>(ii) Legislative base for SMEs has been constantly adapted to EU legislation;</p> <p>(iii) Growing domestic customer demand for local products;</p> <p>(iv) Political and ethnic stability;</p> <p>(v) SME associations became an active force in society;</p> <p>(vi) Due to partly compensation of interest rates with budget funds, SMEs in agro sector can use relatively cheap loan resources.</p>	<p><b>WEAKNESSES</b></p> <p>(vii) Burden of numerous controlling bodies;</p> <p>(viii) Heavy taxation and lousy tax reporting system;</p> <p>(ix) Difficult access to credits for SMEs;</p> <p>(x) Limited opportunities of managerial education for SMEs;</p> <p>(xi) Low level of advantages for SMEs in the legislative system;</p> <p>(xii) Sensitivity of SMEs to economic changes (inflation, rising prices, taxes, reduction of credit) due to small "reserve stability";</p> <p>(xiii) Poor social protection (health care, retirement) for SMEs.</p>
<p><b>OPPORTUNITIES</b></p> <p>(xiv) Ukraine's steps towards association with the EU and creating free trade zone provides growing opportunities for trade with EU members;</p> <p>(xv) Membership of Ukraine in WTO;</p> <p>(xvi) GDP growth in Ukraine;</p> <p>(xvii) Growing purchasing power and growing trust in local producers;</p> <p>(xviii) Creation of business incubators and technological parks;</p> <p>(xix) Opportunities in the tourism sector, construction and hotel industry in connection with the European football championship in 2012.</p>	<p><b>THREATS</b></p> <p>(xx) Continuous disability of changing governments to put in practice the adopted SME-supporting legislation;</p> <p>(xxi) Strong oligarchic lobby;</p> <p>(xxii) Limited options for long-term financing;</p> <p>(xxiii) High level of corruption and bureaucracy, weak administrative capacity;</p> <p>(xxiv) Instability of the political situation;</p> <p>(xxv) Unfavorable investment climate.</p>

Source: Oksana Dugert, Business Consultant, Konsulttitoimisto Seppo Hoffrén Oy Consultancy, Kyiv, Ukraine

**Annex 1.****MAP OF THE BLACK SEA COUNTRIES**

Source: MY Travel Guide, <http://www.mytravelguide.com/travel-tools/maps/Black-Sea-map.php>

## Annex 2.

### SME STATISTICS IN THE BSEC COUNTRIES

#### ALBANIA

#### ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN 2009 & 2010

Economic unit	Agricultural farmers	Self-employed (Individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	Incorporate Enterprises With juridical personality with 1-149 employees	Other economic units considered as SMEs	Total number of economic units
2007	369,598	69,602		17,882		457,082
2008	357,027	84,097		20,652		461,776
2009	353,486	86,017		20,460		459,963

#### NUMBER OF SMEs

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with			>250
		0-9 employees	10-49 employees	50-249 employees	
2008	461,776	458,232	2,803	617	125
2009	459,963	455,925	3,238	667	133

#### EMPLOYMENT

Year	Total number of Employment		Unemployment	
	in SMEs	in all type of economic units in the country	number	as % of the total employees
2008	195,481	974,067	141,495	12.68
2009	193,733	899,278	143,340	13.75
2010	199,800	916,919	143,040	13.49

## ARMENIA

**ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL  
PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN  
2009 & 2010**

Economic unit	Agricultural farmers	Self-employed (individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	LLC	Other economic units considered as SMEs	Total number of economic units
2008	232	72,720	1,172	39,445	52,545	125,265
2009	232	81,762	1,159	41,467	54,246	136,008

**NUMBER OF SMEs**

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		Micro	Small	Medium
2008	125,265	92,696	22,923	6,764
2009	136,008	103,230	22,849	6,800

**EMPLOYMENT**

Year	Total number of employment		Unemployment rate
	in SMEs	in all type of economic units in the country	%
2008	471,394	1,119,700	6.3%
2009	465,761	1,103,700	6.9%

## AZERBAIJAN

**ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL  
PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN  
2009 & 2010**

Economic unit	Agricultural farmers	Self-employed (individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	Incorporate Enterprises With juridical personality with 1-149 employees	Other economic units considered as SMEs	Total number of economic units
2009	2409-as legal entity, 2571 –as individual.	230,000		84,939		314,939
2010	-	290,000		91,657		381,657

**NUMBER OF SMEs**

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		0-9 employees	10-49 employees	50-249 employees
2009	84,939			
2010	91,657	na	75,636	na

**EMPLOYMENT**

Year	Total number of Employment		Unemployment	
	in all type of economic units in the country	in SMEs	number	as % of the total employees
2009	4,118,000 ; 1,149,700- in state sector. 2,968,300- in non-state sector	2,159,100- in private sector, 1,160,900-in SME	41,100	0.95
2010	4,329,100 1,142,700-instate sector, 3,186,400- in non-state sector	2,313,300-in private sector, 1,078,900 –in SME	38,966	0.90

**BULGARIA****ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN 2009 & 2010**

Economic unit	Agricultural farmers/ only registered ≠ SMEs	Self-employed (individual entrepreneurs/ sole proprietors and crafts)	Partnerships, working teams without juridical personality	Incorporate enterprises with juridical personality with 1-149 employees	Other economic units considered as SMEs	Total number of economic units
2008	91,443	259,900	-	-	-	323,003
2009	100,195	259,400	-	-	-	368,229
2010	na	na	na	na	na	na

**NUMBER OF SMEs**

Year	Total number of enterprises (economic units)	Total number of SMEs	Micro-, small and medium enterprises with		
			0-9 Employees	10-49 employees	50-249 employees
2008	323,003	322,172	289,981	26,752	5,439
2009	368,229	367,463	335,929	26,463	5,071
2010	na	na	na	na	na

**EMPLOYMENT**

Year	Total number of Employment		Unemployment	
	in SMEs	in all type of economic units in the country	Number	As % of the total employees
2005	1,243,363	2,980,000	334,200	10.1
2008	1,523,804	3,360,700	199,700	5.6
2009	1,543,410	3,253,600	238,000	6.8
2010	na	3,052,900	348,000	10.2

## GEORGIA

### ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN 2009 & 2010

Economic unit	Agricultural farmers	Self-employed (individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	Incorporate Enterprises With juridical personality with 1-149 employees	Other economic units considered as SMEs	Total number of economic units
2009	451.3 <sup>1</sup>	1,059.0 <sup>2</sup>	na	35,324 <sup>*</sup>	na	38,187 <sup>**</sup>
2010	448.1 <sup>1</sup>	1,007.1 <sup>2</sup>	na	34,565 <sup>*</sup>	na	39,017 <sup>**</sup>

### NUMBER OF SMEs

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		0-9 employees	10-49 Employees	50-249 employees
2009	38,187 <sup>**</sup>	32,193	4,667	1,156
2010	39,017 <sup>**</sup>	33,102	4,606	1,140

### EMPLOYMENT

Year	Total number of Employment		Unemployment	
	in SMEs	in all type of economic units in the country	Number	as % of the total employees
2009	615,584 <sup>***</sup>	1,856.1 <sup>3</sup>	335.6 <sup>4</sup>	16.9 <sup>5</sup>
2010	598,772 <sup>***</sup>	1,628.1 <sup>4</sup>	316.9 <sup>4</sup>	16.3 <sup>5</sup>

\* Currently operated enterprises with employed from 1 to 149 persons;

\*\* Currently operated enterprises totally;

\*\*\* Annual average number of employees in SME (included agriculture)

1. Number of households (thousand) with at last 1 person employed in sector of agriculture
2. Number of self-employed (thousand);
3. Employment totally (thousand);
4. Unemployment (thousand)
5. Level of unemployment (%).

Source: Statistical figures are according to the National Statistic Office of Georgia [www.geostat.ge](http://www.geostat.ge); Data for 2010 are preliminary

**GREECE****NUMBER OF SMEs**

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		0-9 employees	10-49 employees	50-249 employees
2009	849,820	820,021	25,789	3,579
2010	na	na	na	na

**EMPLOYMENT**

Year	Total number of employment		Unemployment	
	in SMEs	in all type of economic units in the country	number	as % of the total employees
2009		4,508,700	471,100	9.5
2010		4,388,000	628,700	12.5

## MOLDOVA

### ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN 2009 & 2010

Economic unit	Agricultural farmers	Self-employed (individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	Incorporate Enterprises With juridical personality with 1-149 employees	Other economic units considered as SMEs	Total number of economic units
2009	301,229	na	na	na	43,658	44,633
2010	299,389	na	na	na	45,625	46,04

### NUMBER OF SMEs

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		0-9 employees	10-49 employees	50-249 employees
2009	43,658	33,805	8,264	1,589
2010	45,625	35,385	8,659	1,581

### EMPLOYMENT

Year	Total number of employment		Unemployment	
	in SMEs	in all type of economic units in the country	number	Rate % of the total unemployed
2009	316,200	735,058	81,000	6.4
2010	308,600	728,862	92,000	7.4

## ROMANIA

### ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN 2009 & 2010

Table presents the newly registered economic entities (without SMEs) in 2009 and 2010

Economic unit	Agricultural farmers	Self-employed (individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	Incorporate Enterprises With juridical personality with 1-149 employees	Other economic units considered as SMEs	Total number of economic units
2009	36,583	324,734	39,433	na	na	491,793
2010	36,689	256,595	na	na	na	381,652

Source: NIS 2010, Echipa MIMMCTPL, Ministerul Economiei si a Finantelor, 2008, ONRC, 31 December 2010.

Remarks:

\* On 30 April 2009 the total number of economic units is 1,117,251 from which 324,734 are self-employed (PF persoana fizica autorizata).

In 2007 were 145,609 self-employed (ONRC) and 39,433 familial associations<sup>110</sup>.

In 2010 the total number of active economic units was 888,583 (ONRC, 31 December 2010), with 20% lower than in 2009. The number of self-employed was 256 595 (PFA). (Source: ONRC, 31 December 2010 and with juridical personality was 631,989<sup>111</sup>).

In 2005 the ministry of Agriculture announced that the number of individual farmers (agricultor) were 4 462,221, the majority over 70 years old people and the number of agricultural farmers with juridical personality was 22,672.

### NUMBER OF SMEs

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		0-9 employees	10-49 employees	50-249 employees
2009	625,458	573,299	43,724	8,435
2010	na	na	na	na

### EMPLOYMENT

Year	Total number of employment		Unemployment	
	in SMEs (private sector)	in all type of economic units in the country	number	as % of the total employees
2009	7,496,000	9,243,000	681,000	6.9
2010	7,679,000	9,488,000	729,000	7.2

Source: CD, NIS 2011, ISSN 1842-3116, Forta de munca in Romania, Ocupare si somaj, Romania in cifre 2009, 2010, NIS; CD, ISSN 2066-4079

## RUSSIA

**ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN 2009 & 2010**

Economic unit	Agricultural farmers	Self-employed (individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	Incorporate Enterprises With juridical personality with 1-149 employees	Other economic units considered as SMEs	Total number of economic units
2008		2,742,000				
2009		2,653,300				

**NUMBER OF SMEs**

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		1-15 employees	16-100 employees	101-250 employees
2008	Na	1,065,016	1,347,667	14,170
2009	na	1,374,661	1,602,491	15,547

**GENERAL DATA ON SME SECTOR IN RUSSIA, 2008 and 2009**

	Medium sized	Small	Micro-firms	2005 (All SMEs) – for comparison
Number of companies	14,170 15,547	1,347,667 1,602,491	1,065,016 1,374,661	979.3 979.3
Number of employees (thousands of people)	2,176.4 1,976.3	10,436.9 10,247.5	4,219.8 4,526.9	8,045.2 8,045.2
Number of employees in partnerships, agreements (SME employees are not included), (thousands of people)	52.1 51.1	284.7 276.4	68.3 85	258.1 258.1
Turnover, RUS billion	3,105.2 3,030.5	18,727.6 16,873.1	8,634.1 8,067.2	9,633.6 9,633.6
	Share in total number (%)			
Number of employees	4.4 4.2	21.1 21.7	8.5 9.6	16.7 16.7
Number of employees in partnerships, agreements (SME employees are not included)	4.2 4.2	22.7 22.8	5.4 7.0	22.8 22.8
Turnover	4.3 4.4	25.8 24.5	11.9 11.7	26.4 26.4

Remark: the upper row refers to year 2008, while the lower one - to 2009

**EMPLOYMENT**

Year (end of the year)	Total number of Employment		Unemployment	
	in SMEs (thousands of people)	in all type of economic units in the country (thousand)	Number including students/registered as unemployed (thousand)	as % of the total employees
2008	12,613.3	66,474	5,289.2/1,521.8	6.3
2009	12,223.8	66,995	6,162.4/2,147.3	8.4
2010				7.6 (estimation) (www.indexmundi.com)

**SERBIA****ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN THE COUNTRY IN 2009 & 2010**

Economic unit	Agricultural farmers	Self-employed (individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	Incorporate Enterprises With juridical personality with 1-149 employees	Other economic units considered as SMEs	Total number of economic units
2009	778,891 *	226,241	na	na	na	315,365
2010	na	na	na	na	na	na

**NUMBER OF SMEs**

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		0-9 employees	10-49 employees	50-249 employees
2009	314,827	302,484	9,873	2,470
2010	345,000 **	na	na	na

**EMPLOYMENT**

Year	Total number of employment		Unemployment	
	in SMEs	in all type of economic units in the in the country ***	Number ****	as % of the total employees
2009	872,540	2,616,437	502,982	19.22
2010	850,000 *****	2,396,244	568,723	23.73

## Remarks:

\* Statistical office of the Republic of Serbia, Agriculture 2009

\*\* Estimate of the National Agency for Regional Development

\*\*\* Republic Statistical Office, Survey about working power 2009

\*\*\*\* Republic Statistical Office, Survey about working power 2010

\*\*\*\*\* Estimate of the author and expert team of the Institute of Economic Sciences, Belgrade 2011

**TURKEY****NUMBER OF SMEs**

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		0-9 employees	10-49 employees	50-249 employees
2009 *	3,225,462	3,084,183 (% 95.62)	121,746 (% 3.77)	16,204 (% 0.50)
2010 **	3,003,116	na	na	na

**EMPLOYMENT**

Year	Total number of Employment		Unemployment	
	in SMEs	in all type of economic units in the in the country	number	as % of the total employees
2009	17,021,600	21,277,000	3,471,000	14.0
2010	17,600,726	22,594,000	3,046,000	11.9

Remarks:

\* 2009 Turkish Statistical Institute

\*\* 2010 Turkish Statistical Institute

## UKRAINE

### ACTIVITIES OF ECONOMIC ORGANIZATIONS INCLUDING ALL PUBLIC AND PRIVATE UNITS AND SMEs IN UKRAINE IN 2009 & 2010

Economic unit	Agricultural farmers	Self-employed (individual entrepreneurs/sole proprietors and crafts)	Partnerships, working teams without juridical personality	Incorporate Enterprises With juridical personality with 1-149 employees	Other economic units considered as SMEs	Total number of economic units
2009	43,410	2,982,250	1,137,122	143,149	na	3,380,960
2010	42,446	3,028,576	1,330,432	147,443	na	3,749,657

### NUMBER OF SMEs

Year	Total number of Enterprises (economic units) in the country	Micro-, small and medium enterprises with		
		0-9 employees	10-49 Employees	50-249 employees
2009	3,431,818	3,074,833	332,200	23,100
2010	3,513,429	3,139,896	351,470	20,378

Remark: 1,685 of big enterprises both in 2009 and 2010 are taken into account when calculating "total number of economic units".

### EMPLOYMENT

Year	Total number of employment		Unemployment	
	in SMEs	in all type of economic units in the country	number	as % of the total employees
2009	4,223,500	7,050,918	900,600	12.8
2010	4,996,100	8,274,800	505,200	6.1

**BASIC INDICATORS FOR SMALL ENTREPRENEURSHIP ENTITIES  
IN 2009 BY TYPE OF ECONOMIC ACTIVITY**

	Share of small enterprises number in total number of economic entities [%]	Number of persons engaged, [x1,000]	Number of employees [x1,000]	Total salary paid, [UAH m]	Average salary of employees, [UAH]	Volume of sold products (operations, services), [UAH m]
Total	93.7	2,152.0	2,067.8	27,725.4	,1117.35	45,6667.8
including						
Agriculture, hunting, forestry	80.6	146.4	142.7	1,428.2	834.01	12,462.2
Industrial production	87.4	375.2	366.2	4,464.1	1,015.82	45,406.8
Construction	95.5	259.9	250.3	3,376.4	1,124.07	34,121.0
Trade; repair of motor vehicles, household appliances	95.9	55.9	530.4	6,838.3	1,074.42	273,335.2
trade in motor vehicles and motorcycles, maintenance and servicing	94.9	57.2	54.4	632.1	968.01	19,111.7
wholesale trade and sale intermediation	96.1	354.0	337.7	463.7	1,142.82	233,441.3
retail trade; repair of household appliances and personal demand items	9.,5	145.7	138.3	1,574.5	949.19	20,782.2
Activity of hotels and restaurants	95.7	71.7	69.1	628.1	758.06	3,251.8
Activity of transport and communications	92.5	126.8	121.8	1,603.8	1,096.77	17,495.8
Financial activity	94.2	25.6	24.5	621.7	2,115.88	8,202.7
Real estate activities, renting, engineering and provision of services to entrepreneurs	96.7	459.5	437.2	7,281.4	1,387.94	56,686.6
Education	95.0	15.8	15.2	207.7	1,139.99	579.4
Health care and provision of social aid	94.2	34.2	33.0	359.0	906.84	1,336.1
Provision of communal and individual services; cultural and sporting activity	93.5	75.1	72.8	878.6	1,005.55	3,639.8

Remark: The data does not include activities of banks, farms and state institutions.

Source: State Committee of Statistics of Ukraine, 1998-2011, Latest modification: 20/10/2010

### Annex 3

#### INDEX OF SME DEVELOPMENT IN THE BSEC COUNTRIES

In order to evaluate the development and achievements of the SME-sector, the UNECE introduced an Index of SME Development, which is a complex economic indicator that incorporates the share of the whole SME-sector in the overall performance of the national economy based on three economic parameters such as

- i. The share of private ownership,
- ii. The share of SMEs in GDP, and
- iii. The share of the labor force of SMEs in the total labor force of a country.<sup>112</sup>

#### ALBANIA

Year	Share of Private Sector in Total Economy [%]	Share of SME sector in Gross Domestic Product (GDP) [%]	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole [%]	Gross Domestic Products (GDP) <sup>113</sup> [USD/capita]	Index of SME Development [USD/SME]
2007	75	64	19	3,393	305.37
2008	80	70	20	4,098	459
2009	82	73	21.5	3,836	493.7
2010	82	73	21.8	3,616	471.9

#### ARMENIA

	Share of private ownership in economy [%]	Share of SMEs in GDP [%]	Share of the labor force of SMEs in the total labor force of the country [%]	GDP per capita [USD]	SME Development Index [USD/SMEs]
2002	81	34.4	28.2	739.9	58.1
2003	83	36.5	31.0	873.4	82.0
2004	84	38.6	32.9	1104.4	117.8
2005	84	39.8	34.0	1513.0	172.0
2006	84	40.3	35.1	1996.0	237.2
2007	84	41.0	40.7	2844.0	398.6
2008	84	41.7	42.1	3689.0	544.0
2009	84	42.5	42.2	2686.0	404.7

Remarks: An estimation of the hidden economy according to ADP 2010 report, informal economy reached 11.2% during the year of economic crisis in 2009.

According to OECD estimations, in 2008 non-observed economy contributed about 25% of the total GDP.

**AZERBAIJAN**

Year	Share of Private Sector in Total Economy	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
2005	60	11	17	1,577	17.7
2008	70	13	21	5,508	105.3
2010	75	15	25	6,008	169

Source: Share of private sector from EBRD

Data for GDP from Economy Watch [http://www.economywatch.com/economic-statistics/Azerbaijan/GDP\\_Per\\_Capita\\_Current\\_Prices\\_US\\_Dollars/](http://www.economywatch.com/economic-statistics/Azerbaijan/GDP_Per_Capita_Current_Prices_US_Dollars/)

**BULGARIA**

Year	Share of private sector in total economy	Share of SMEs sector in GDP/GVA	Share of number of employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products	Index of SMEs development
	[%]	[%]	[%]	[USD/capita]	[USD/SMEs]
2005	81.2	22.5/27.3	41.7	3,513	267.6
2007	84.0	31.0/37.8	43.4	5,162	583.4
2008	85.0	33.9/41.3	45.3	6,548	854.7
2009	84.0	33.3/39.8	47.4	6,223	825.1

Remark: An estimation of the hidden economy according to Association of Industrial Capital in Bulgaria is about 30-37% of the GDP.

**GEORGIA**

Year	Share of Private Sector in Total Economy	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
2005	78	10	36	1,483.5	47.5
2008	89	12	37	2,921.1	105.2
2010	91	15	37	2,629.0	189.3

Remark: An estimation of the shadow economy according to the National Statistics Office of Georgia is approximately 18% of the GDP.

**GREECE**

Year	Share of Private Sector in Total Economy	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
2005	na	na	na	na	na
2008	na	na	na	na	na
2010	60	27	60	27.300	2.653.6

Source: Share of private sector from <https://www.cia.gov/library/publications/the-world-factbook/geos/gr.html>

**MOLDOVA**

Year	Share of Private Sector in Total Economy*	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
2005	89	22.4	55	831.3	91.2
2006	89	35.0	58	950.6	171.7
2008	89	31.9	57	1,696.3	274.5
2009**	89	28.9	59	1,524.2	231.3

Source: Calculated by the authors on basis of the statistics data.

Remarks:

\* Share of private enterprises in the total number of enterprises, reporting to Statistics Office.

\*\* For lack of 2010 data (which will be presented by NBS in June 2011), data of 2009 are given.

An estimation of the hidden economy according to NBS is as it follows:

- 24.2 % of the GDP in 2005; 22.1% in 2006; 22.1% in 2008; and 22.4% in 2009.

## ROMANIA

Year	Share of Private Sector in Total Economy	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
2005	74.4	70.1	60.6	4,572.05	1,445.0
2008	80	71.7	66	9,299.74	3,520.7
2010	81	78.8	70.1	7,902	3,535.6

Sources: CD, NIS 2011, ISSN 1842-3116, Forta de munca in Romania, Ocupare si somaj

<http://www.mediafax.ro/economic/pib-pe-locuitor-al-romaniei-la-paritatea-puterii-de-cumparare-va-creste-cu-42-pana-in-2015-6073953>

Comisia Nationala de prognoza 20 febr. 2007 [http://www.cnp.ro/user/Capital\\_social\\_/cifra\\_de\\_afaceri](http://www.cnp.ro/user/Capital_social_/cifra_de_afaceri)

<http://search.worldbank.org/data?qterm=gdp%20per%20capita%20romania&language=EN>

### Remarks:

On the basis of the energy consumption method (Enste and Schneider, 2000) share of informal or underground economy was estimated as 20% of GDP.

Using the monetary approach (French, Balaita and Ticsa, 1999) was obtained more than 45%. NIS increased due to the changes of methodology from about 5% in 1992, to 18% in 1997 and to 20-21% in 2000-2001. Adding to these 7% of the GDP representing the estimated average level of self- consumption in the case of rural household, legally not registered but informal results, the informal economy accounted for 25-28% of the national economy<sup>114</sup> The shares of underground economy decreased to 24.8% in 2007 due to the growth of the official registered income. (Romanian Journal of Economic Forecasting, 2/2010)

In 2010 the underground economy in Romania has a share of 30.2% in the GDP. The average for EU-27 is 20% of GDP, Hungary 24%, Bulgaria 32.9%. (Friedrich Schneider estimates-The underground economy in EU member states in 2010) Theoretical and Applied Economics, Volume XVII (2010), No. 11(552), pp. 91-102.

Romania is perceived as one of the most corrupt countries in the EU, with Greece and Bulgaria (Annual reports of transparency International in 2009 and 2010 Corruption Perceptions Index CPI). For Romania the CPI is 3.8 in 2008; 3.8 in 2009 and 3.7 in 2010.

**RUSSIA**

Year	Share of Private Sector in Total Economy	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
2007	65	45	40	6,856	802
2008	na	na	na	na	na
2010	85	40	35.5	15,900	1,919

**SERBIA**

Year	Share of Private Sector in Total Economy	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
2005	64.4	54.1	59	3,391	697
2008	60 **	35	43.2	6,647	603
2010	na	na	na	na	na

Sources:

\* World Bank, <http://data.worldbank.org/country/serbia>\*\* EBRD, <http://www.ebrd.com/downloads/research/economics/serbia.pdf>

**TURKEY**

Year	Share of Private Sector in Total Economy	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
2007	80	27.3	76.7	5,408	906
2008	na	38 *	na	na	na
2010	93	40 * *	77.9	12,300	3,240

Remarks:

\* Yapi Kredi paper held in January 2008 in Vienna

\* \* Estimation by the ERENET

**UKRAINE**

Year	Share of Private Sector in Total Economy	Share of SME sector in Gross Domestic Product (GDP)	Share of Number of Employees in all SMEs compared to total number of employees in the economy as a whole	Gross Domestic Products (GDP)	Index of SME Development
	[%]	[%]	[%]	[USD/capita]	[USD/SME]
2007	65	18.1	62.4	6,721	493.4
2008	65	16.3	59.9	7,500	476
2009	60	15	60.4	6,933	376.9

Remark: Supposing that the hidden economy in Ukraine is about 50%, Index of SME Development can be stipulated as following:

2007: 740

2008: 741

2009: 565

## **INDEX OF AUTHORS**

### **ERENET AS TEAM LEADER:**

#### **Dr. Antal Szabó**

UN retired Regional Adviser, Scientific Director of ERENET, Corvinus University of Budapest, Hungary

### **ALBANIA:**

#### **Tefta Demeti, MBA**

Head of Business & SME unit in Ministry of Economy, Trade & Energy, and

**Arber Demeti**, PhD candidate, Credit Risk Management, Raiffeisen Bank

### **ARMENIA:**

#### **Tigran Sukiasyan**

National Economic and Environmental Office, OSCE Yerevan Office, and

**Dr. Aleksander Poghossian**, Principal Consultant and the Managing Director of Alpha Plus Consulting

### **AZERBAIJAN:**

#### **Dr. Alakbar Mammadov**

Professor at the Khazar University on Business and Contract Law, President of the National Productivity and Competitiveness Centre of Azerbaijan Republic

### **BULGARIA:**

#### **Dr. Zhelyu Vladimirov**

St. Kliment Ohridski Sofia University

### **GEORGIA:**

#### **Eteri Mamukelashvili**

Chief Specialist, Ministry of Economy and Sustainable Development, Tbilisi

### **HELLENIC REPUBLIC:**

#### **Irini Voudouris**

Assistant Professor, Department of Management Sciences and Technology, University of Economics and Business, Athens and

#### **Dr. Ioanna Deligianni**

Athens University of Economics and Business, Greece

**MOLDOVA:****Dr. Valentina Veverita**

Superior Lecturer at the State University of Moldova, Director of Small and Medium – Sized Enterprises Development Policies and Liberal Profession Department, Chisinau, and

**Dr. Elena Aculai**

Scientific Research-coordinator, Institute of Economy, Finance and Statistics of Moldova

**ROMANIA:****Dr. Zsuzsanna Katalin Szabó**

Dean of the Faculty of Economics, Law and Administrative Sciences, Petru Maior University, Targu Mures

**SERBIA:****Dr. Erić Dejan**

General Manager of Institute of Economic Science, at Belgrade Banking Academy

**RUSSIAN FEDERATION:****Assoc. Prof. Irina Y. Naumova**

Associate Professor at University of Hartford, USA and

**Alexandr Vatolin**

Institute of Management and Business, Nizhniy Novgorod, Russian Federation

**TURKEY:****Umut Yilmaz Çetinkaya**

Ph.D. Candidate, YNR Consulting, Science and Technology Policies Research Centre, Middle East Technical University, Ankara

**UKRAINE:****Oksana Dugert**

Business Consultant, Konsulttitoimisto Seppo Hoffrén Oy Consultancy, Kyiv, Ukraine

**Dr. Oleh Levchuk**

Senior Fellow, Presidium of the Academy of Sciences in Ukraine



# INTRODUCTION

- 1| *Commission of the European Communities: COM (2007) 160 final, Brussels, 11.04.2007.*
- 2| <http://www.eommex.gr/Article.aspx?id=11761>
- 3| <http://www.bsec-organization.org/aoc/smes/Pages/reports.aspx>
- 4| See at <http://www.doingbusiness.org/features/Reform2007.aspx>.
- 5| <http://www.doingbusiness.org/reports/global-reports/doing-business-2011/~media/FPDKM/Doing%20Business/Documents/Annual-Reports/English/DB11-Chapters/DB11-About.pdf>
- 6| <http://www.doingbusiness.org/reports/global-reports/doing-business-2011/~media/FPDKM/Doing%20Business/Documents/Annual-Reports/English/DB11-Chapters/DB11-RefSum.pdf>
- 7| <http://www.doingbusiness.org/reports/global-reports/doing-business-2011/~media/FPDKM/Doing%20Business/Documents/Annual-Reports/English/DB11-Chapters/DB11-EW.pdf>
- 8| *Klaus Schwab: The Global Competitiveness Report 2010-2011, World Economic Forum*
- 9| *This methodology was developed by Dr. Antal Szabó, Regional Adviser on Entrepreneurship and SMEs, jointly with Dr. János Árvay, Regional Adviser of Statistics of the UNECE.*

- 10| *Friedrich Schneider - Andreas Buehn - Claudio E. Montenegro: Shadow economies all over the World. Policy Research Working Paper 5356, The World Bank, Human Development Economic Unit, July 2010.*
- 11| *SMEs in Russia and China: A Comparison. [http://www.acg.ru/english/smes\\_in\\_russia\\_and\\_china\\_a\\_comparison](http://www.acg.ru/english/smes_in_russia_and_china_a_comparison)*
- 12| *Evaluation by the authors since the Institute of Statistic, INSTAT does not provide this data.*
- 13| *INSTAT, data from the Business Register and Business Survey are referring to non agriculture private sector.*
- 14| *Specification: The data shown for the Services sector include also the Transport sector.*
- 15| *People employed in the construction sector compound 8.4% of the total employment force, according to the data of the Labors Questionnaire for 2008, published by INSTAT.*
- 16| *The high level of employment in this sector (approximately around 52.5%, during 2006-2009), shows the high support that this sector has had toward the households.*
- 17| *India, China, Mexico, the Philippines, and France.*
- 18| *UNDP NHDR 2009.*
- 19| *Yordanova (2010) found that owner-managers in Bulgarian family firms have informal approach to succession planning and leave important aspects of the succession process to chance.*
- 20| *<http://www.nytimes.com/2011/01/09/travel/09where-to-go.html?pagewanted=all>*
- 21| *Sources: The Greek Economy. Terminally Report March 2011. Foundation for Economic and Industrial Research., Currency Policy Report 2008. Bank of Greece, Hellenic Statistics Authority.*
- 22| *The index of economic climate is computed based on the indices of entrepreneurial expectations regarding the industry, the retail, the construction and the service sectors and the index of consumer trust.*
- 23| *Sources: Commission Staff Working Document on the Implementation of Commission Recommendation of 6 May 2003 concerning the Definition of Micro, Small, and Medium-Sized Enterprises 2009. European Commission., Small Business Act Fact Sheet Greece 2009. European Commission Enterprise and Industry.*
- 24| *Hofstede G (1991) Cultures and Organizations: Software of the Mind. London: McGraw.*
- 25| *Sources: Newspaper Kathimerini, 13/03/2011, isotimia.gr, 28/04/10*
- 26| *Inno-Policy TrendChart- Innovation Policy Progress Report, Greece 2009, European Commission, Enterprise Directorate-General*

- 27| *Inno-Policy TrendChart- Innovation Policy Progress Report, Greece 2009, European Commission, Enterprise Directorate-General*
- 28| *Sources: Doing Business 2011. Greece. Making a Difference for Entrepreneurs. World Bank and International Finance Corporation, Doing Business 2011. Full Report. Making a Difference for Entrepreneurs. World Bank and International Finance Corporation.*
- 29| *Inno-Policy TrendChart- Innovation Policy Progress Report, Greece 2009, European Commission, Enterprise Directorate-General*
- 30| *In 2009, the structure and responsibilities of the Ministries changed reshuffling all Secretariats. The resulting structure is not yet stable.*
- 31| *Source: National Onomatology of Financial Activities 2008. Ministry of Economy.*
- 32| *Source: [http://epp.eurostat.ec.europa.eu/portal/page/portal/nuts\\_nomenclature/introduction](http://epp.eurostat.ec.europa.eu/portal/page/portal/nuts_nomenclature/introduction)*
- 33| *Source: The Greek Economy. Terminally Report March 2011. Foundation for Economic and Industrial Research.*
- 34| *Note of the joint Commision/ECB/IMF mission to Greece (3 May-2 June 2011)*
- 35| *Source: Lioukas, S. 2011, "The Greek companies in the post-crisis era: Strategies for international competitiveness", Eds. Union of Greek Banks, forthcoming.*
- 36| *European Innovation Scoreboard, 2009.*
- 37| *Calac, 2010*
- 38| *E. Aculai. Conditions for Enterprise Creation and Development: Gender Analysis, Statistica Moldovei, UNDP, UNIFEM. "Nova Imprim" SRL, Chisinau, 2010. [http://undp.md/presscentre/2009/Statistics\\_24Dec/block\\_Bussines\\_ENG\\_29-03-2010\\_NEW.pdf](http://undp.md/presscentre/2009/Statistics_24Dec/block_Bussines_ENG_29-03-2010_NEW.pdf).*
- 39| *This idea and terms were suggested by David Smallbone from UK.*
- 40| *U.T.A. = unitate teritorială autonomă*
- 41| *Visinescu S, Micuda D, 2011*
- 42| *See for more the study realized by MIMMCTPL, with NIS the Ministry of Economy and finance coordinated by Jose Cervera-Ferri, Despina Pascal, Jose Vila, Monica Bergamini*
- 43| *Chiriac2009*
- 44| *[http://www.onrc.ro/statistici/sr\\_2009\\_06\\_eng.pdf](http://www.onrc.ro/statistici/sr_2009_06_eng.pdf), ONRC, 31 December 2010*
- 45| *Visinescu S, Micuda D, 2011*
- 46| *The \* represent the number of active SMEs, <http://www.postprivatizare.ro/romana/raportul-anual-al-sectorului-imm-2010/>*
- 47| *Romania in figures 2009, NIS*
- 48| *See the "White Charter of Romanian SMEs", July 2009*

- 49| *Published in the Official Journal of Romania no. 301 in 1997.*
- 50| *Published in the Official Journal of Romania no. 293 on 3 May 2007.*
- 51| *Chiriac 2009*
- 52| *See study realized by MIMMCTPL, with NIS the Ministry of Economy and Finance coordinated by Jose Cervera-Ferri, Despina Pascal, Jose Vila, Monica Bergamini*
- 53| *Visinescu S, Micuda D*
- 54| *Nicolescu O, Nicolescu C, 2010*
- 55| *R.G. Hodorogel, 2011*
- 56| *See R.G. Hodorogel, 2011*
- 57| *Remarks by the World Bank Country Manager in Romania, Mr. Benoit Blarel, at the Romania Conference on Growth, Competitiveness and Real Income Convergence, 21 April 2008 [www.worldbank.org.ro](http://www.worldbank.org.ro)*
- 58| *See: <http://rt.com/news/prime-time/small-businesses-dying-breed/>*
- 59| *<http://www.doingbusiness.org/economyrankings/>*
- 60| *See <http://rt.com/news/prime-time/small-businesses-dying-breed/>*
- 61| *MAP, Institute of Economic Sciences, Belgrade, 2011*
- 62| *Remark from the Editor: The Serbian Government uses the term SMEE for SMEs and Entrepreneurship*
- 63| *Dr Dilek Cetindamar, Umut Yilmaz Cetinkaya, Dr Dejan Eric, Dr Alakbar Mamadov, Dr Irina Y. Naumova, Dr Anna Petrosyan, Dr Antal Szabo, Istanbul, 2007, pp. 129-130*
- 64| *Report on SMEE 2009, The Ministry of Economy and Regional Development of the Republic of Serbia*
- 65| *It cannot be found on MERR website, but it has its own web site <http://www.ssc.rs/about.php>*
- 66| *Report on SMEE 2009, The Ministry of Economy and Regional Development of the Republic of Serbia*
- 67| *Report on SMEE 2009, The Ministry of Economy and Regional Development of the Republic of Serbia*
- 68| *Report on SMEE 2009, The Ministry of Economy and Regional Development of the Republic of Serbia*
- 69| *RASMEE: Current state, needs and problems of SMEs in Serbia, Belgrade, 2009, page 28*
- 70| *[http://www.aod.rs/levimieni/pravni\\_okvir/5.html](http://www.aod.rs/levimieni/pravni_okvir/5.html)*
- 71| *[www.merr.gov.rs](http://www.merr.gov.rs) Program of credit support to the economy and citizens for 2010, January 2010*
- 72| *Official web site of the Serbian Government*
- 73| *[www.merr.gov.rs](http://www.merr.gov.rs) New Bankruptcy law, March 2010*
- 74| *Small and Medium Enterprise Development Organisation*

- 75| *Law No 5331, "By-Law on Definition, Characteristics and Categorisation of Small and Medium Sized Enterprises" (Official Gazette: 18 November 2005, 25997)*
- 76| [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm)
- 77| *The Scientific and Technological Research Council*
- 78| *TTGV is the abbreviation of the Technology Development Foundation of Turkey*
- 79| *For further information.: <http://www.invest.gov.tr/enUS/investmentguide/investorsguide/Pages/Incentives.aspx>*
- 80| *Ministry of Industry and Trade*
- 81| *State Planning Organisation*
- 82| *Technology Development Centres*
- 83| *Undersecretariat of Foreign Trade*
- 84| *The Union of Chambers and Commodity Exchanges of Turkey*
- 85| *Confederation of Tradesmen and Craftsmen of Turkey*
- 86| *University-Industry Joint Research Centres*
- 87| *Export Promotion Centre*
- 88| *Development Agency*
- 89| *Credit Guarantee Fund*
- 90| *KOBİ Venture Capital Investment Trust Inc. Co.*
- 91| *Asheim, B., Cooke, P. & Martin, R., 2006. Clusters and Regional Development: Critical Reflections and Explorations, Routledge.*
- 92| *In fact, there are several studies done related with sectors, clusters, region, etc. Latest resources summarizing all studies can be found in following address: <http://www.dpt.gov.tr/DocObjects/Download/10376/tez-falsac.pdf> (Turkish)*
- 93| <http://islenmisgida.clusterturkey.com/EN/islenmisgida/BelgeGoster.aspx?17A16AE30572D313AAF6AA849816B2EFAD2159C2926A9E50>
- 94| *Latest information related with this cluster can be found at the following address: <http://www.stps.metu.edu.tr/tekipol/index.php?option=content&content=1&task=view&id=124&Itemid=95>*
- 95| *Public institutions including universities form the most important factor for the development of software sector in Ankara.*
- 96| *Latest information related with this cluster can be found at the following address: <http://www.stps.metu.edu.tr/tekipol/index.php?option=content&content=1&task=view&id=31&Itemid=114>*
- 97| *"TURQUM®, a mark of quality is a registered mark affixed to products manufactured by the Turkish machinery sector. This mark is granted to the manufacturer upon approval through a "Certification Process" that a machine*

- comply with the predetermined product standards and technical specifications” (<http://www.turqum.com/en/what-is-turqum>)*
- 98| *Attractiveness of Bodrum as a tourist destination is the most important factor in terms of related and supporting industries; however, changing tourist profile (from high to low-income) undermines this unique advantage.*
- 99| *Turkey Investment Climate Assessment, From Crisis to Private Sector Led Growth, May 2010, World Bank (Report No. 54123-TR) See at <http://www.yoikk.gov.tr/dosya/up//ICA-e.PDF>.*
- 100| *This part is written benefiting from the official web site <http://www.invest.gov.tr> dedicated to increase investments in Turkey.*
- 101| <http://sagm.sanayi.gov.tr/ServiceDetails.aspx?dataID=107>
- 102| <http://www.tubitak.gov.tr>
- 103| <http://www.ttg.gov.tr/en>
- 104| <http://sagm.sanayi.gov.tr/DocumentList.aspx?catID=245&lng=tr>
- 105| *Turkish Employment Agency*
- 106| <http://www.dtm.gov.tr/dtmweb/indexen.cfm>
- 107| *Russia, Ukraine, Poland, Romania, Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia, and the average for the entire ECA region*
- 108| *Coordination Council for the Improvement of the Investment Environment*
- 109| *Ability to adopt and use knowledge*
- 110| [http://www.fonduristructurale-europene/pndr/deyvoltare-afaceri\\_turism.html](http://www.fonduristructurale-europene/pndr/deyvoltare-afaceri_turism.html))
- 111| [http://www.financiar.ro/articol\\_40816/](http://www.financiar.ro/articol_40816/), [www.soim.ro/story.php?title](http://www.soim.ro/story.php?title))
- 112| *This methodology was developed by Dr. Antal Szabó, Regional Adviser on Entrepreneurship and SMEs, jointly with Dr. János Árvay, Regional Adviser of Statistics of the UNECE.*
- 113| *GDP with current price*
- 114| *Lucian Liviu Albu, Institute for Economic Forecasting, 2004; The tax evasion, Underground Economy and Fiscal Policies in Candidate Countries (Case of Romania)*

# KONRAD-ADENAUER-STIFTUNG - LIST OF AVAILABLE PUBLICATIONS

## **German:**

- Zukunft der Zeitungen im Internet-Zeitalter, 2001
- Strukturprobleme der deutschen und türkischen Wirtschaft und deren Lösung, 2004
- Politisch-Strategische Lage im Mittleren Osten, 2004
- 19. Deutsch-Türkisches Journalistenseminar – Medien im Wettbewerb, 2005
- Die Türkei als Energiebrücke zwischen Zentralasien und Europa, 2007
- Der Islam und das Christentum – Ein Vergleich der Grundwerte als Basis für einen Interreligiösen Dialog, 2007
- 21. Deutsch-Türkisches Journalistenseminar - Die Rolle der Türkei als Vermittler zwischen Ost und West, 2007
- Chancen und Herausforderungen im Kaukasus – Die Rolle der Türkei als regionaler Stabilitätsfaktor, 2007
- Wirtschaftliche und Sozialpolitische Strukturreformen in Deutschland und der Türkei, 2008
- Migration und Integration – Das Verhältnis von Minderheit und Mehrheit in Deutschland und der Türkei, 2008

- 1. Deutsch-Türkischer Sicherheitsdialog: Die Türkei in ihrem geostrategischen Umfeld, 2008
- Die Schwarzmeersynergie zwischen geopolitischen Sensibilitäten und energiewirtschaftlichen Kooperationsmöglichkeiten, 2008
- Die Türkei zwischen aktuellen Herausforderungen und historischem Erbe, 2010
- Senioren und Alterspolitik in Deutschland und der Türkei, 2010
- Integration und Dialog der Religionen in Deutschland und der Türkei-Beispiele und Probleme, 2010
- 3. Deutsch-Türkischer Sicherheitsdialog: Sicherheitspolitische Aspekte der Entwicklung im Iran aus deutscher und türkischer Sicht, 2010
- 24. Deutsch-Türkisches Journalistenseminar – Die Deutsch-Türkischen Beziehungen im Lichte aktueller Entwicklungen, 2011
- Soziale Marktwirtschaft und deren Perzeption im Islam, 2011
- 4. Deutsch-Türkischer Sicherheitsdialog: Neue sicherheitspolitische Herausforderungen – Das Strategiekonzept der NATO, 2011

### **Turkish:**

- Gazetecinin El kitabı, 2000
- Gazeteciliğe Giriş, 2002
- 20. Alman-Türk Gazetecilik Semineri – Medya Merceğinde Almanya ve Türkiye, 2006
- Başörtüsü – Bir simgenin örtüsünü kaldırmak (Araştırma), 2006
- Avrupa ve Orta Asya Arasındaki Enerji Köprüsü Türkiye, 2007
- Fransa ve Almanya Örneğinde Belediye Birlikleri ve Türkiye, 2007
- 21. Türk-Alman Gazetecilik Semineri - Türkiye'nin Doğu ve Batı arasındaki Aracılık Rolü, 2007
- Kafkasya'da Beklentiler ve Olanaklar – Bölgesel Güç ve garanti etkeni olarak Türkiye'nin Rolü, 2007
- Türkiye'de ve Almanya'da Ekonomik ve Sosyopolitik Yapısal Reformlar, 2008

- Göç ve Entegrasyon – Almanya’da ve Türkiye’de Azınlık-Çoğunluk İlişkileri, 2008
- 1. Alman-Türk Güvenlik Diyalogu: Türkiye’ye Jeostratejik bir Bakış, 2008
- Jeopolitik Duyarlılık ve Enerji İşbirliği açısından Karadeniz Bölgesi, 2008
- Tarihi Miras ve Günvel Beklentiler arasındaki Türkiye, 2010
- Almanya ve Türkiye’de Yaşlılar ve Yaşlılık Politikaları, 2010
- Almanya ve Türkiye’de Entegrasyon ve dinler arası diyalog-örnekler ve sorunlar, 2010
- 2. Alman-Türk Güvenlik Diyalogu: Türk ve Alman Bakış Açısından İran’daki Gelişimin Güvenlik Politikası Boyutları, 2010
- 24. Türk-Alman Gazetecilik Semineri - Güncel Gelişmeler Işığında Alman-Türk İlişkileri, 2011
- Sosyal Piyasa Ekonomisi ve İslam’daki Algılanışı, 2011
- Enerji Platformu 2010 - Avrupa’nın Enerji Güvenliğinde Türkiye’nin Rolü, 2011
- 4. Türk-Alman Güvenlik Diyalogu: Uluslararası güvenlikte yeni sorunlar – NATO’nun değişen güvenlik konsepti, 2011

**English:**

- Women Entrepreneurship, 1999
- Standardization, Quality Control and Quality Assurance Systems for SMEs, 2001













