

STABILITY PACT

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



FYR MACEDONIA
ENTERPRISE POLICY
PERFORMANCE ASSESSMENT

Prepared by

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

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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

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

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

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

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

This report has been jointly produced by the OECD Investment Compact Team and the EBRD Office of the Chief Economist in cooperation with expert regional consultants. It draws on the extensive experience and work of both organisations in transition economies including the countries of South East Europe. The Enterprise Policy Performance Assessment process, highlighting feedback from SMEs as a key element of the analysis and assessment, was instigated by Declan Murphy, Programme Director of the Investment Compact (OECD) with support from Antonio Fanelli, Principal Administrator (OECD, Investment Compact) and Ricardo Pinto (Administrator, OECD).

Background research and information was provided by Zivko Dimov / CPI OKO (Macedonia) and Magdalena Varshilova (CED), who prepared the first draft of the report. The analysis, assessment and preparation of the final report were undertaken by Ricardo Pinto (OECD), Francesca Pissarides (EBRD) and Peter Sanfey (EBRD) with advice from other colleagues in the OECD and EBRD. The final editing was undertaken by Declan Murphy, OECD and Georgiana Pop, OECD. The assessments and views expressed in this report are those of the Investment Compact Team of the OECD secretariat and the EBRD Office of the Chief Economist and do not necessarily reflect the views of the institutions participating in preparing this report or of OECD and EBRD member countries.

FOREWORD

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

This Enterprise Policy Performance Assessment (EPPA) of FYR Macedonia seeks to help address that challenge. The South East Europe (SEE) Compact for Reform, Investment, Integrity and Growth (Investment Compact), a key component of the Stability Pact, has consistently affirmed that the economic revitalisation of South East Europe is primarily dependent on private sector investment. Through the Investment Compact process, Stability Pact partners support and promote the structural policy reforms that will improve the climate for private enterprise and increase investment. This assessment aims to assist SEE countries in stimulating entrepreneurship and enterprise development. Measurable progress has been made recently in various areas, such the creation of a new Government-approved SME strategy, the preparation for a new SME Agency and the establishment the Council for Entrepreneurship and Competitiveness. Nevertheless, the report shows that the environment for creating and sustaining businesses remains underdeveloped in FYR Macedonia. Major problems remain with the business entry process; the business environment is characterised by numerous barriers to investment and high levels of unfair competition; the tax system is highly unstable and needs to be more attuned to the needs of the small enterprise sector, etc. Reforming and improving the environment for entrepreneurship remains a priority.

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

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



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TABLE OF CONTENTS

Chapter 1. SUMMARY CONCLUSIONS AND RECOMMENDATIONS	7
1.1. SUMMARY CONCLUSIONS	7
1.2. SUMMARY RECOMMENDATIONS	7
Chapter 2. INTRODUCTION	11
Chapter 3. INSIGHTS FROM SME OWNERS, MANAGERS AND REPRESENTATIVE BODIES	15
3.1. INTRODUCTION.....	15
3.2. INSTITUTIONAL FRAMEWORK FOR SME POLICY	16
3.3. RULE OF LAW AND REGULATORY ENVIRONMENT	19
3.4. TAX POLICY FOR SMALL BUSINESSES.....	23
3.5. FINANCIAL INSTRUMENTS FOR NEW AND SMALL BUSINESSES	25
3.6. ADVISORY SERVICES FOR NEW AND SMALL BUSINESSES	29
3.7. BUSINESS INCUBATORS	31
Chapter 4. ANALYSIS AND ASSESSMENT	33
4.1. IMPLEMENTATION OF THE INSTITUTIONAL FRAMEWORK FOR SME POLICY	33
4.2. IMPLEMENTATION OF THE RULE OF LAW AND THE REGULATORY ENVIRONMENT	37
4.3. IMPLEMENTATION OF TAX POLICY FOR SMALL BUSINESSES	40
4.4. IMPLEMENTATION OF FINANCIAL INSTRUMENTS FOR FOSTERING SMALL BUSINESSES	43
4.5. IMPLEMENTATION OF ADVISORY SERVICES TO NEW AND SMALL BUSINESSES	45
4.6. IMPLEMENTATION OF BUSINESS INCUBATORS	48
Chapter 5. INFORMATION SOURCES	51
Chapter 6. WEB SITES	53
Appendix 1. OBSTACLES TO DOING BUSINESS	55
Appendix 2. LIST OF CONTACTS	57

Boxes

Box 2-1. EPPA Methodology	12
Box 3-1. Obstacles to Doing Business (BEEPS, 2002)	16
Box 3-2. Business Regulations (BEEPS, 2002)	20
Box 3-3. Corruption (BEEPS, 2002)	21
Box 3-4. Legal System: Contractual Rights and Impact of Unforeseen Changes (BEEPS, 2002)	22
Box 3-5. Private Sector Perception of Lobbying Power of Various Entities (BEEPS, 2002).....	23
Box 3-6. Sources of Finance for SMEs' Needs (BEEPS, 2002)	28
Box 3-7. SMEs' Perception of Ease of Obtaining a Bank Loan for Working Capital/Investment Needs (BEEPS, 2002)	28

Box 4-1. Institutional Recommendations	35
Box 4-2. Business Simplification Recommendation	39
Box 4-3. Reform of the Role of Business Support Centres	47

Figures

Figure 3-1. Average Ratings of the Six Dimensions of Good Practice by SME Owners and Managers	15
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Tables

Table 3-1. Relative Importance of Main Financial Sources Accessed by SMEs	27
Table 4-1. SME Definitions	33
Table 4-2. Tax Rates in Macedonia.....	41
Table 4-3. EBRD Score for Financial Sector Reform.....	43
Table 4-4. Domestic Credit to the Private Sector (in % of GDP).....	43
Table 4-5. Credit Lines for Private Sector Development.....	44
Table 4-6. Micro Lending	45
Table 4-7. Providers of Business Advisory Services.....	45

SUMMARY CONCLUSIONS AND RECOMMENDATIONS

1.1. Summary Conclusions

In recognition of the growing importance of SMEs to the national economy, the Macedonian authorities are increasingly supporting the SME sector. This political support is reflected in developments such as:

- A new programme to stimulate domestic and foreign investment.
- A new strategy to support entrepreneurship and competitiveness of SMEs.
- A new Agency to support of entrepreneurship and competitiveness.
- A new co-ordinating Council for Entrepreneurship and Competitiveness, which includes participants from relevant ministries, private sector and other SME stakeholders.

This Enterprise Policy Performance Assessment (EPPA) highlights a number of issues, grounded on insights from SME owners and managers and builds on an OECD-EBRD report published in 2001. It identifies a number of actions needed in order to build further on the progress already made in improving the policy environment for SMEs. It should be noted that the focus group research for this report was undertaken prior to the change in Government in September 2002 and took place at the end of a long period of political instability and stalled economic reform. In overall terms, little progress was identified at the time that the research was carried out. Since then, however, the reform process has restarted and has been very dynamic. Although it is too early to make a judgement, the study finds that good progress has been made by the new Government of Macedonia in setting out and beginning to implement new policies to support the growth and development of SMEs.

In line with experience in other countries at a similar stage of transition to a market-based economy, issues are emerging relating to policy implementation. It will take a persistent and determined effort to ensure that implementation is kept on track and momentum maintained. The best way to do this is with regular progress reviews to obtain feedback to identify areas requiring renewed focus.

The main issues identified in this assessment can be summarised as relating to the practicalities of:

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

1.2. Summary Recommendations

Institutional Framework

SME Definition and Strategy

- Ensure greater compatibility with the EC's definition of SMEs to facilitate the process of harmonisation, now that the Stabilisation and Association Agreement (SAA) has been signed with the EU.

- Task the Ministry of Economy with ensuring that adequate resources (national and international) are secured to deliver all the recommendations contained in the new SME strategy.
- Ensure that the new SME strategy is widely disseminated, regularly reviewed and that the SME policy community remains involved in any changes to the SME strategy.

Council for Entrepreneurship and Competitiveness (CEC)

- Ensure that the Council for Entrepreneurship and Competitiveness (CEC) becomes an effective mechanism for co-ordinating government SME activity and dialogue and consultation with the wider SME policy community by:
 - Implementing monthly meetings, as the SME policy environment is changing rapidly.
 - Ensuring that there is an effective secretariat (staff, resources, experience, etc.) in order to generate a co-operative dialogue that benefits both government and business.
 - Ensuring that all papers, draft, proposals, etc. for discussion are prepared and circulated well in advance of meetings.

Agency to Support Entrepreneurship (ASE)

- Implement the ASE as soon as possible, ensuring that it is financed from the national budget for the medium to long term.
- Ensure that the ASE develops a detailed action plan related to the SME strategy, so as to ensure that it does not suffer the same fate as its predecessor.
- Ensure close and regular ties with the Ministry of Economy through regular meetings.
- Ensure a Board/Committee structure which is representative and built around sound principles of good governance.
- Ensure that the tasks assigned to the ASE are manageable, for example, in relation to their role with respect to the regional offices (see below) and closely related to the approved SME strategy.
- Prepare performance-based contracts between ASE and the Ministry of Economy to ensure accountability and transparency, and to incentivise effectiveness.

Technical Assistance

- Secure technical assistance for operational staff to ensure that they are capable of discharging their responsibilities at the Ministry of Economy, as well as the Agency to Support Entrepreneurship, business support centres and local authorities. The latter is a particularly important target group, given that the decentralisation reforms are expected to result in important new economic development responsibilities.

Regulatory Environment

Create an Action Plan for Business Simplification

This recommendation appeared in the previous OECD-EBRD report (2001, p.12) and remains unchanged:

- Various studies exist on the numerous remaining administrative and legal barriers to enterprise development and inward investment, as well as proposed solutions, including the latest FIAS (2003) study. This information needs to be assessed and integrated into an action plan presenting a government-approved set of actions which are prioritised, with allocated responsibility and identify deadlines for resolution.
- The Action Plan needs to be monitored on a regular basis in order to ensure progress across all the institutions that have responsibility to implement actions.

Registration, Licensing and Silent Consent

- Evaluate, simplify and publish the regulatory regimes that affect the setting-up or entry phase of businesses. The same applies to procedures for re-registering and terminating enterprises. Work towards reducing the time and cost associated with these procedures.
- Introduce a single code number for each enterprise, in order to save time and costs to entrepreneurs submitting the same basic information to different bodies.

- Move towards the creation of a “One-Stop-Shop” system throughout the country, as in the case of other SEE countries such as Romania (see OECD-EBRD, 2002).
- Take steps to ensure a greater focus on a “proactive” and “enabling” approach by introducing the principle of “silence is consent” as soon as practical (“silence is consent” is where if the relevant public body fails to answer within a prescribed period, it will be deemed that consent has been given).

Tax Policy for Small Businesses

Policy Principles

The Ministry of Finance, in co-operation with the Ministry of Economy and the international community, should work together to ensure that:

- Simplicity, stability and clarity are achieved in tax policy. The tax system is highly dynamic and complicated, imposing very large compliance costs on enterprises at present.
- Fiscal administration is made more sensitive to the needs of the SME sector. For example, the extensive degree of tax evasion / informal activity raises important issues for small enterprises relating to unfair competition.
- Tax laws, regulations and arrears are consistently and fairly enforced, regardless of firm size.
- Consultation with SMEs or their nominated representatives on tax issues is carried out regularly. The recent development of the draft Corporate Income Tax law is an example of what is possible to do and needs to be extended to other areas of fiscal activity directly affecting businesses.
- SMEs are able to obtain regular, simple and up-to-date information explaining the tax system to increase the levels of transparency.

VAT Refunds and Tax Inspections

- Design the VAT refund period to facilitate cash flow, using the international standard of one month. Firms currently have to wait 5-6 months for refunds.
- Evaluate the claim that requests for VAT refunds are correlated with “heavy-handed” treatment by tax inspectorates seeking to impose heavy fines for minor infringements.

Financial Instruments for Fostering New and Small Businesses

Improve Transparency and Corporate Governance of Banks

- Tighten regulations on the shareholding structure of banks (including stricter eligible criteria for banks’ shareholders) and related party transactions in order to prevent improper interference in banks’ business by shareholders. In addition, the authorities should eliminate political interference and reduce the degree of related party lending.
- The new anti-money laundering law became effective in March 2002, but the capacity of regulatory authorities needs to be strengthened.

Improve Banking Regulation and Supervision

- Public confidence in the banking sector has increased in recent years, and would be further enhanced through more effective supervision of banks. Particular areas for improvement/tightening are restrictions on connected lending, shareholders’ structure, anti-money laundering regulations, treatment of consolidated entities, internal audit, provisioning methodologies, market risk, liquidity risk and exchange risk.
- Regulations for problem banks should be strictly enforced, permitting an orderly exit where necessary.

Introduce/Improve Legislation to Enhance Access to Finance for Small Enterprises

- Areas that need attention include insurance and leasing. The new Law on Insurance Supervision became effective in April 2002, providing some harmonisation of the insurance regulations with EU regulation. However, further harmonisation is still required and the capacity of Insurance Supervision Department still needs to be strengthened.

- The Leasing Law was introduced in 2002, but needs further legislative improvement to address such issues as lack of conformity with other relevant laws and appropriate tax incentives, before leasing can be more actively used in the country.

Promote the Development of Mutual Guarantee Schemes

- Mutual credit guarantee schemes have the benefit of reducing the risk associated with small enterprises by pooling information on the enterprises to an institution (the local guarantee fund), thus providing an alternative to collateral in loan applications to banks. Local banks can participate in the fund by having a seat on the board, which would allow them to gain important information. The reduction of the asymmetry in information and the presence of a pool of funds that can be used instead of collateral can facilitate SME access to bank finance by reducing the perceived risk linked to enterprises and easing the collateral requirement for the borrowers.
- If a state credit guarantee fund is set up, steps should be taken to ensure that guarantees are non-distortionary and allocated according to market principles. This would be facilitated by allocating management of the fund to the private sector.

Advisory Services Supplied to New and Small Businesses

ASE and Business Advice Centres

- Ensure that the new Agency to Support Entrepreneurship (ASE) works closely with the Regional Enterprise Support Centres (RESC) as well as the Enterprise Support Agencies (ESA) and other relevant business advisory centres, so as to ensure greater geographical coverage and reach.
- Ensure that the ASE role is backed by adequate long-term funds, so as to secure the financial sustainability of both ASE and the network of business advice centres.
- Define a monitoring and co-ordination role for ASE in so far as activities that are publicly funded are concerned, taking into account the largely independent status of the existing business support centres.
- Structure the relationship between the ASE and the regional network to ensure that innovation, effort and effectiveness are incentivised and rewarded with additional financial resources.

Quality Standards

- Introduce of a system of certification and accreditation of advisory bodies to set quality standards and improve confidence in the benefits of services. Certification and accreditation should be carried out by a credible representative body.
- Encourage business advisory centres to develop and publish customer charters, setting out the range of services provided, the costs and the standards they promise to adhere to. Entrepreneurs need to be informed of the potential gains from receiving professional advice before they become more willing to pay for them.

The Implementation of Business Incubators

National Policy

- Develop a policy with respect to business incubators, including responsibility for implementation, and secure commensurate national and international resources in order to promote them effectively.
- Disseminate information and promote the role of business incubators to ministries, local authorities, as well as leaders of business associations, such as Chambers of Commerce and others.
- Evaluate the effectiveness and financial sustainability of business incubators of less than 2,000 m².
- Evaluate the criteria for entry and exist from business incubators, enhance the governance structures to secure greater transparency in their operation and assess sectors with potential for new incubators.
- Develop training and education programmes for business incubator managers in order to ensure greater compliance with best practice in transition and OECD member countries.

Chapter 2.

INTRODUCTION

Private investment by Small and Medium-sized Enterprises (SMEs)¹ is a key generator of economic growth and social change in OECD member country economies. In most countries, over 90% of all enterprises are SMEs. It is now widely accepted that the contribution of SMEs to new jobs, exports, innovation and regional development is vital to national development. How to benefit from and maximise this contribution is a continuous challenge for all countries. This Enterprise Policy Performance Assessment seeks to help address that question for the Republic of Macedonia and highlight issues that require attention and priority action.

The State has a fundamental role to play in providing a favourable framework and environment for private sector development in OECD member countries. In the transition economies of South East Europe (SEE), where private investment levels lag behind those of developed countries, the necessity to create an enabling environment for SMEs and private investment is more urgent. Reform of the business and investment environment leading to the creation of a dynamic entrepreneurial culture is crucial to drive the process of change in industrial structures and the transition to market economy structures.

The OECD and the EBRD have undertaken a series of Enterprise Policy Performance Assessments (EPPAs) in all SEE countries in order to monitor the development of policies and infrastructures to support the SME sector. Substantial emphasis has been placed in eliciting the views of private SMEs on their past experience and perception of the key barriers to business and new investment, and their assessment of progress in implementing policies to encourage the development of SMEs.

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

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

Macedonia has gone through an intense period of democratic, economic and social transition. The Investment Compact, endorsed by the countries of SEE, including Macedonia, explicitly acknowledges that the revitalisation of the SEE region must rely primarily on private sector development and investment (Investment Compact Charter, OECD, 2001). This EPPA captures private sector insights measured against the above six dimensions of good practice. They present views on performance and progress made on the basis of good practice indicators developed for transition economies. They take into account other OECD and EBRD studies (see EBRD Country Strategy, 2002; OECD-EBRD, 2001).

The EPPA research provides a qualitative “snap-shot” of the SME perceptions of the business and investment environment. It highlights issues in need of policy attention and indicates a number of recommended actions. This report is presented as a contribution to enhance policy dialogue between the

key SME representative associations and the supporting State institutions. It will be up-dated on a regular basis, thus allowing a fuller picture of progress to be developed over time.

The methodology employed in the EPPAs is set out in Box 2-1.

Box 2-1. EPPA Methodology

- I. The EPPA methodology has been designed to provide insights and assessments of the performance in the *implementation* of policies to improve the investment environment for business. The EPPAs have been conducted on a standard basis in all countries of the region and provide a benchmark for (a) highlighting key reform issues (b) measuring private sector insights and assessments of the business environment (c) assessing progress on a country by country basis and (d) comparative cross-country review for the SEE region.
- II. The main components of the EPPA undertaken in Macedonia are as follows:
 - A question template was derived from extensive case study work on good practice in transition economies and OECD country experience (OECD-UNIDO, 1999) and used in the research.
 - Country-based experts/consultants were selected for their enterprise policy knowledge and experience.
 - Focus group research: focus group discussions were held with SME representatives.
 - Individual SME interviews: to validate the focus group research and to provide insights on key issues.
 - Expert interviews: to cross reference information from the focus groups and contribute to views.
 - Desk research: examination of existing reports, databases, documents, etc. for Macedonia.
 - Expertise from OECD, EBRD and experts from OECD member countries.
- III. Under the guidance of OECD, the focus group research with the private sector in Macedonia was carried out by local consultants, *CPI OKO General Business & Marketing Consultants Plc (CPI OKO)*, using a structured brief and template of questions developed by OECD and EBRD. The focus group research commenced in mid-2002 and other interviews and desk research extended into early 2003. It focused on six dimensions of good practice in the following policy areas:
 - The Institutional Framework for SME policy.
 - Rule of Law and the Regulatory Environment.
 - Tax Policy for Small Businesses.
 - Financial Instruments for Fostering New and Small Businesses.
 - Advisory Services Supplied to New and Small Businesses.
 - The Implementation of Business Incubators.
- IV. Three focus group discussions took place. Two in Skopje (the second including SMEs from beyond the capital city) and Gostivar. In all, 20 entrepreneurs took part in the detailed discussions, covering the following sectors of activity: manufacturing, services and trade-oriented companies. The participants included representatives of micro, small and medium-sized companies, ranging from start-ups to established firms. Standard templates were used for the discussion and the collection of ratings.
- V. Individual interviews with SME owners and managers and 11 local SME experts (including Chambers of Commerce, Associations, NGOs and business consultants) took part in the

Box 2-1. EPPA Methodology (Cont.)

research, allowing for a wider perspective than the focus group discussions and to cross reference the information that was obtained in the focus group discussions.

- VI. The findings from the focus groups and interviews were complemented with additional information provided by the EBRD. The EBRD's Office of the Chief Economist has assessed progress in structural and institutional reform across the region since 1994. The EBRD jointly with the World Bank launched the Business Environment and Enterprise Performance Survey (BEEPS) in 1999. The BEEPS asks enterprises to evaluate economic governance and state institutions and assess the extent to which the business environment creates obstacles to the operation and growth of their businesses. In 2002, a second stage of the BEEPS was undertaken, surveying close to 6,000 firms across 26 countries of the region.
- VII. The analysis in this EPPA is based on the information collected by the local consultants using the methodologies described above (focus group research, expert interviews, secondary data collection) and is complemented by the EBRD assessment and the BEEPS 2002 results. All information supplied by the local consultants has been analysed by the OECD and EBRD, resulting in the assessment presented in this EPPA.

NOTE

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

INSIGHTS FROM SME OWNERS, MANAGERS AND REPRESENTATIVE BODIES

3.1. Introduction

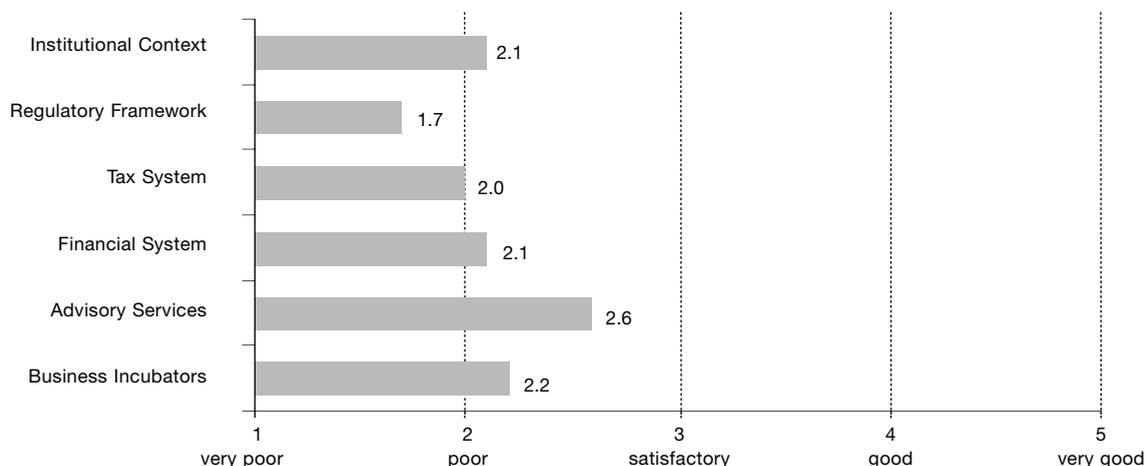
The analysis of the results of the research with the SME focus groups is presented under six framework dimensions of good practice for the business environment:

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

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

The average ratings per dimension of good practice are highlighted in figure 3-1. In general, the ratings are low, with the Regulatory Framework (1.7) rated the poorest of all. Business Advisory Services obtained the highest average rating (2.6 - i.e. approaching the “satisfactory” level), with the other dimensions of good practice around the “poor” rating. Once again, it should be noted that these ratings were derived prior to the change of government in September 2002.

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



The main points made by the participants during the focus groups are reported *verbatim* and the quotations most relevant to the analysis are highlighted. Each section concludes with a summary of the issues emerging from the research.

In addition, this chapter presents selected analysis of the Business Environment and Enterprise Performance Survey (BEEPS) 2002 survey. The BEEPS is a survey of Macedonian enterprises and, like the focus groups, was carried out in 2002. Of these, 153 were considered to be SMEs (of which 38% micro, 39% small and 23% medium-sized) according to the EU definition for employment (i.e. they had less than 250 employees). The results presented in this document refer only to the responses provided by the SME sub-sample. The BEEPS research is based on a sample survey and is not directly comparable with the focus group research. The BEEPS analysis is presented in separate text boxes (for example, see box 3-1. below) and a summary of main results is contained in Appendix 1.

Box 3-1. Obstacles to Doing Business (BEEPS, 2002)

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

3.2. Institutional Framework for SME Policy

The issues researched under this heading:

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

Organisational Responsibility

1. Has the government assigned clear organisational responsibility for the development of SME policy?	No
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The following analysis draws on focus group research which took place prior to the change in Government in Macedonia. The organisational responsibility of the various institutions for SME policy was not very clear to most of the SME managers and owners participating in the focus group discussions. As a rule the participants in the research argue that they are wary of Government statements of intent as far as SME policy is concerned:

“Given so many changes in policy, we are reluctant to trust government promises.”

The discussions reveal a general discontent among the SME focus group participants with regard to the overall treatment of the SME sector by the Government. Entrepreneurs are particularly concerned with the lack of co-ordination between the public and the enterprise sector, the result of which is a perception of an inadequate approach to SME policy formulation. An example of this was the exclusion of the enterprise sector from taking part in consultations with regard to the SME Development Strategy (July 2002) by the Ministry of Economy (see below).

Issues: Overall, there is a feeling that organisational responsibility has not been clearly assigned and that the Government is not sufficiently in tune with the needs of the small enterprise sector.

Effectiveness of the Organisation/s

2. Rating given to the effectiveness of the organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs	2.4
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Focus groups participants were extremely critical of the institutional set-up assigned to support SMEs. Almost none of the respondents in the focus groups from the business community had a clear understanding of the aims of the State in promoting small business development. Despite the customary statements by politicians of the importance of SMEs to the economy, the general impression among entrepreneurs is that the SME sector has not been addressed as a priority economic policy issue. The entrepreneurs are in agreement that there is little effectiveness in the policies to encourage entrepreneurship:

“To be an entrepreneur means to be completely on your own. Only naïve businesspeople expect something from Government.”

The activity of the National Enterprise Promotion Agency (NEPA), now operating on an interim basis (see below), the SME implementation agency at the time of the research and its network of Regional Enterprise Support Centres (RESC), were assessed by the majority of entrepreneurs as inadequate and insufficiently transparent. In addition, the SME owners and managers held the opinion that NEPA acts as:

“Yet another bureaucratic institution, operating under the patronage of government and foreign donors.”

A further perception was that NEPA only assisted start-ups rather than serving the entire small business sector, for example, by providing advice and guidance for accessing finance. Some criticism is also voiced with regard to NEPA's capacity, including the transparency of its procedures, to evaluate business plans submitted by SMEs seeking financial support. It should be noted that since the research was undertaken, the Government has stated its intention to replace NEPA with the Agency to Support of Entrepreneurship (ASE). Like NEPA, ASE will be the key body responsible for implementing the SME policy and strategy. It will also be connected with the network of existing Regional Enterprise Support Centres (RESCs) and others. The analysis and policy implications presented in this report remain equally valid as issues to be addressed by the new institution.

Issues: The effectiveness of the key organisations responsible for developing the level of entrepreneurship in Macedonia was rated as “poor” by entrepreneurs. Partly because of this perception, the agency for SMEs (NEPA) is in the process of being replaced, however, the policy messages remains that concerted action is required to revive trust in government action and in the organisation/s responsible for supporting SMEs.

SME Development Strategy

3. Rating given to the quality and effectiveness of the SME development strategy	2.3
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The entrepreneurs participating in the focus group discussion were unclear about how to respond when questioned about their opinion of the National SME Development Strategy adopted in July 2002 by the previous Government. Almost none of the participants in the focus groups had any idea of the existence or contents of the strategy, confirming the perception that there was little consultation (see below) and resulting in a “poor” rating. Doubts remain of the value of such an SME strategy:

“We have seen and heard about a lot about strategic documents addressing SME development; but there have been very few results.”

Issues: The SME strategy developed by the previous Government is largely unknown as far as SMEs are concerned. It was not considered to have delivered results “on the ground”. In the time since, the new Government has developed and approved a new SME strategy.

Local and Regional Governments

4. Rating given to the local and regional governments’ mandate and resources (funding, people and skills) to promote SME development	2.2
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The focus group participants argued that they have no idea whether local authorities have a mandate to deal with SME development issues. The general impression is that, due to the vacuum arising from the prolonged reform of local self-rule in Macedonia, in part delayed by the political upheavals in parts of the country, the interaction between local government and the small business community remains underdeveloped. In any case, entrepreneurs argue that local government lacks the capacity (human resources, facilities, etc.) to really assist SME development. The entrepreneurs share the opinion that local government has neither legal power nor resources, financial or otherwise, to deliver effective SME support. One commented: ***“They are a bit like airplanes without engines.”*** The local government reform is expected to significantly increase the local economic development remit and responsibilities of local authorities, including enterprise development.

Issues: Entrepreneurs were not aware of whether local government has a role to play in promoting enterprise development in their territories, but they were convinced that they are ill-equipped to do so, lacking the financial resources and staff with appropriate skills.

Information and Awareness

5. Rating given to the information provided and awareness of the government’s institutions, policies, programmes to support new entrepreneurs and develop existing SMEs	2.4
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The overall experience of entrepreneurs with regard to government institutions, policies and programmes was negative. The focus group participants argue that there is a lack of adequate forums to generate that awareness (rating: 2.2). The information provided was rated slightly better (rating: 2.6) but the existing mechanisms, such as the National Chamber of Economy, seen as being either obsolete or lacking in visibility. The entrepreneurs in the focus groups expressed general discontent with the low level of awareness in the business community of the availability of institutions, policies and programmes addressing SME-related issues.

Issues: Despite the existence of a number of SME support programmes and facilities for private sector development promotion, the average entrepreneur typically had a very low level of knowledge and information on what is on offer to the SME sector.

Consultation between Government and the Private Sector

6. Rating given to the quality and regularity of consultation between government and the private sector on SME policy and its performance	1.1
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The entrepreneurs were extremely critical of the quality and regularity of consultation between government and the private sector, which was rated as being “very poor”. They stressed in the discussions that the entire small business sector:

“... suffers from chronic neglect by Government, despite its vitality and contribution to growth.”

“All the SME development strategies are still drafted in the offices of ministers or are conceived by people with neither experience nor understanding of the world of enterprise and entrepreneurship.”

The lack of tradition of Government-Business consultation was identified as a serious deficiency of the current system that undermines efforts to build a comprehensive national strategy for SME development and promotion. Entrepreneurs admit that: **“the existing forms of representation are weak, in the making, or inadequate”**, and therefore fail to fulfil their intended objectives. The key instrument that they have recourse to, is lobbying the relevant institutions, although this is not always an option for small firms.

Issues: The regularity and quality of consultation between Government and the private sector on SME policy obtained almost the lowest rating possible, equating to “very poor”. Good practice elsewhere suggests that this is both relatively easy to develop and can be effective in ensuring that business views are incorporated into the policy-making process.

3.3. Rule of Law and Regulatory Environment

The issues researched under this heading:

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

Company Registration

7. Rating given to the company registration procedure	2.3
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The commentary on this subject is dealt with below in conjunction with number 8.

Licenses, Permits and Certificates

8. Rating of procedures for obtaining licenses, permits and certificates	2.4
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The overall assessment of the focus group participants, SME representatives and experts alike, is that the environment confronting the enterprise sector in Macedonia, not least company registration and the procedures to obtain permission to start operating, is highly over-regulated. The complexity, rapidity of change and the wide scope for interpretation and discretion hinder enterprise development and contribute to the persistence of the informal economy.

The company registration procedure was rated as “poor” by the participants. SME owners and managers pointed out that registration procedures for start-up enterprises remain the most noteworthy bureaucratic problem in the country and that the long anticipated “One-Stop-Shop” registration system has yet to materialise. The “clumsy” bureaucracy company registration procedures are perceived to result in time-consuming and costly exercises, the benefits of which are mostly enjoyed by:

“... lawyers with good connections in the registration courts.”

“Every bureaucrat has his own rules and own methods.”

Business regulation issues identified in the BEEPS survey are discussed in box 3-2.

Box 3-2. Business Regulations (BEEPS, 2002)

According to the BEEPS, the aspects of the business environment for SMEs pertaining to regulation (labour regulations, customs and trade regulations, title or leasing of land, access to land and business licensing and permits) are considered in general to be a less severe obstacle than the focus groups analysis suggests. However, the rating of various aspects of the regulatory environment is significant, with issues related to customs and trade regulations and business licensing seen as the most difficult for entrepreneurs, followed by issues related to titles or leasing of land, to access to land and to labour regulations.

Some of the problems go further than the usual concerns about complexity, delay, bureaucracy, etc.:

“... for us, ethnic Albanians living outside Skopje, it is even more difficult to communicate with the administration. Maybe part of it is our own fault, but there always seems to be something missing in our documents....”

Issues: Although there are signs of improvement, the regulatory environment in Macedonia is in urgent need of reform in line with international best practice in the spheres of enterprise registration and procedures for obtaining licenses, permits and approvals for operation. The new Government has indicated its commitment to tackling this agenda through its new Programme to Stimulate Investment.

Simplification Programme

9. Rating given to the efficiency of the programme for reducing administrative barriers for business	1.4
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Most of the entrepreneurs were not aware of the existence of a programme, official or otherwise, for reducing administrative barriers for business and expressed little confidence in the likelihood of change:

“All Governments promise a reduction of administrative barriers. Nothing is done.”

The efficiency of the programme for reducing administrative barriers for business was rated as being “very poor” as it did not exist when the research was undertaken. In addition to the extreme level of bureaucracy and the preponderance of unclear procedures resulting in delays and extra costs, entrepreneurs pointed out that urgent improvements are needed in several regulatory issues such as: company registration, access to land, labour laws and corruption, to mention some of the more pressing issues discussed.

Frequent amendments of legislation pertaining to the enterprise sector are a constant source of irritation to businesses and often result in additional compliance costs, for example, to obtain legal advice to ***“harmonise the latest regulatory requirements.”***

Entrepreneurs complained that they are often forced to recruit additional staff or contract with specialist accountants and lawyers, in order to comply with the complicated and time-consuming

paperwork. Another option frequently resorted to are specialist “advisory services” who act as “intermediates” connecting their client with “influential people” willing to “help” for a certain “fee”.

It should be noted that in the time since the research was undertaken, the new Government has been developing plans to simplify the business environment, though it remains to be seen whether these will be implemented and how effective they will be, since:

“It is in the interest of corrupt bureaucrats [for the system] to stay as it is.”

Issues: The respondents failed to identify any perceptible instrument for the reduction of administrative barriers to business. As a result, entrepreneurs have very low expectations with respect to Government promises of reducing administration barriers to business. The new Government’s proposals for reform have to achieve concrete results in order to overcome the current lack of confidence and to motivate businesses to become more engaged in the process of reform.

Anti-Corruption Programme

10. Rating given to the quality and effectiveness of the Government’s programme for reducing the impact of corruption	1.3
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There was consensus among the participants concerning bribery, corruption and other forms of “informal incentives”. They feel that they have little choice but to accept that this is how the system works and that this is the only means of “facilitating” the operation of their businesses. Both entrepreneurs and experts agreed that corruption is most extreme in certain sectors of State administration, such as customs, health and police. There was a belief that the enterprise sector has traditionally had a good record in this respect, but is now being seriously affected by “unethical and criminal practices.”

“Corrupt individuals are too smart to get caught. If one works ‘professionally’, there is no chance of being caught for bribery.”

The entrepreneurs participating in the research express a readiness to support all Governmental efforts geared to fight corruption. At the same time, they remain sceptical about the Government’s commitment in this respect, resulting in a “very poor” rating for such activities. In the time since the research was undertaken, the new Government has introduced a renewed focus on anti-corruption which could lead to better results, but this will need to be assessed in future EPPAs.

The constantly changing regulatory environment dealt with above contributes to this situation by creating ambiguity and uncertainty, thus generating scope for rent-seeking activities (see also box 3-3).

Box 3-3. Corruption (BEEPS, 2002)

Evidence of corruption affecting the SME sector also emerged from the BEEPS analysis. It found that SMEs pay 0.8% of total annual revenues in unofficial payments/gifts to public officials. This percentage is lower than the one recorded by the 1999 BEEPS (1.4). Also, a smaller percentage of firms is affected by corruption with respect to 1999, according to the same sources. In 1999, 33% of those interviewed admitted to having made frequent bribe payments, whereas in 2002, 22.7% of firms did so. Corruption is however ranked high (6th from the top) among the 21 obstacles to doing business listed in the survey and is rated 2.6 (i.e. between minor and moderate).

Issues: At the time of the research, SME representatives were fully committed to anti-corruption initiatives, but sceptical about the effectiveness of Government policies in this respect. They welcome vigorous efforts to tackle this important barrier to business activity.

Consultation between Government and the Private Sector

11. Rating given to the quality and regularity of consultation between government and the private sector on draft legislation and regulations that affects business	1.1
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A lack of communication was a recurring theme in the focus group discussions. This applies to Government-business sector dialogue, as well as consultation between authorities responsible for preparing draft legislation and regulations. The consequence is that quality and regularity of consultation received almost the lowest rating possible:

“ ... I have never been asked by anybody, anywhere, anyhow, about my opinion. I only feel an ‘invisible’ hand constantly lifting money from my pocket...”

The government's lack of “habit” in communicating with the enterprise sector, in order to encourage debate and obtain feedback on both existing and regulatory issues under consideration, was perceived as preventing the SME sector from taking a more active role in the shaping of the regulatory framework for SME promotion. Participants in the focus groups shared the opinion that at present, informal communication and lobbying are the only instruments at the disposal of business to influence government policy.

The BEEPS survey examined two other aspects of relevance. Box 3-4 deals with issues to do with contractual rights and changes to the legal system.

Box 3-4. Legal System: Contractual Rights and Impact of Unforeseen Changes (BEEPS, 2002)

Entrepreneurs asked to what degree they agree with the following statement: “I am confident that the legal system will uphold my contract and property rights in business disputes”, mostly tended to disagree as can be seen from the table below.

Strongly disagree	12%
Disagree in most cases	16%
Tend to disagree	40%
Tend to agree	25%
Agree in most cases	3%
Strongly agree	1%
Don't know	2%

Also relatively more entrepreneurs found that an unforeseen change in laws and regulations would occur in 2003 and would have a significant impact on their business. The following table shows the specific results for the SMEs interviewed.

Extremely unlikely	5%
Highly unlikely	10%
Fairly unlikely	10%
Fairly likely	27%
Highly likely	34%
Extremely likely	10%
Don't know	3%

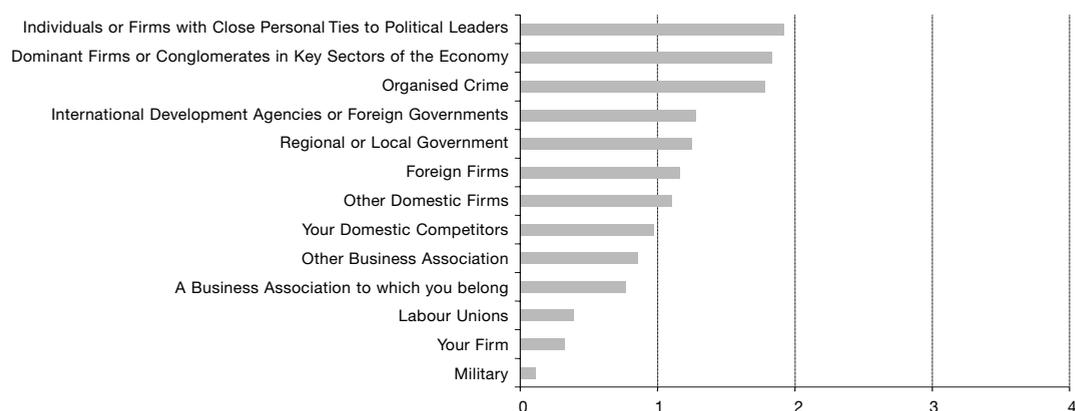
Note: Data add up to 99% due to rounding.

Box 3-5 examines the private sector's perceptions of the lobbying power of various organisations on the making of laws and regulations.

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

The entrepreneurs were also asked about the link (in terms of lobbying power) between the legislative powers and regulatory authorities with various organisations and economic agents (the scores can be interpreted as follows: 0 = no impact; 1 = minor influence; 2 = moderate influence; 3 = major influence; and 4 = decisive influence). As can be seen from the chart below, firms with ties to political leaders, large firms and conglomerates in key sectors of the economy, and organised crime, and to a lesser extent international development agencies or foreign governments, regional or local government and foreign firms are believed to be able to exercise, some sort of lobbying power on the legislative and regulatory authorities. The entrepreneurs interviewed in the BEEPS believe that SMEs have almost no impact on the making of laws and regulations.

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



Issues: As in the preceding discussions on institutions, entrepreneurs consider that there is little or no discussion or dialogue between Government and the enterprise sector. The perception is that this contributes to the creation of inadequate or flawed laws, rules and regulations.

3.4. Tax Policy for Small Businesses

The issues researched under this heading:

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

Encouragement of Enterprises

12. Rating given to tax policy in terms of the encouragement, support and ease of use that it provides to new and existing SMEs	2.8
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Overall, the Macedonian tax system has witnessed a marked improvement in recent years. The tax reforms are resulting in a less onerous and more transparent system. However, based on the discussions, the immediate consequences for the private sector, small business in particular, are not necessarily very beneficial. The SME owners and managers argue that “double standards” are applied by the tax administration (tax authorities, courts, etc.) in the sanctioning of large enterprises as compared to small ones. SMEs feel that they are immediately exposed to stringent mandatory measures for delays and failure to pay taxes due whereas large companies are treated with leniency.

Bearing in mind the equal treatment of enterprises irrespective of turnover and size, the respondents argue that the existing taxation policy neither fostered SME development nor created conditions for new jobs. Nevertheless, most of the SME representatives participating in the focus groups maintained that the tax system was now “***largely manageable***”, resulting in an almost “satisfactory” rating. Entrepreneurs from the small business sector pointed to two issues which were of particular concern: VAT and income tax.

Entrepreneurs were frustrated about the VAT refund period, which typically lasts five months. This affects the cash flow situation and can jeopardise viability in certain cases. According to the discussions, entrepreneurs feel discouraged from filing VAT refund requests since by so doing, their companies may be exposed to “harassment” by the tax authorities. A request for a tax refund is invariably followed by a visit by the tax authorities, resulting in a very thorough inspection of their records. As a rule, this leads to a heavy fine, even for minor “oversights”. According to the discussants, the fines typically prove to be considerably higher than the requested refund, thus discouraging entrepreneurs from claiming their rights. Nevertheless, some of the participants were of the opinion that:

“Is it better to ask for the VAT refund and to suffer a 'heavy-handed' financial inspection [to check for irregularities] than to give up the refund.”

Without exception, the entrepreneurs expressed discontent with the income tax and associated social contributions, which were argued to be excessive. This is believed to be the main reason why some businesses seek to avoid registering employees, boosting the unemployment rate (about 32%):

“...with all these taxes, it is more profitable to work in the grey economy.”

Issues: Improvements were noted by the SMEs participating in the research, however, they also perceived that the tax system is not supportive of them. The argument goes beyond the overall tax burden or the lack of fiscal incentives. There are perceptions of discrimination by tax authorities, as well as punitive actions for attempts to claim legitimate VAT refunds. The salary-related costs were considered to discourage employment generation in the formal economy.

Stability and Transparency

13. Rating given to the stability and transparency of the tax system for small enterprises	2.3
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Although the focus group participants approved of the government's attempts to generate greater tax discipline, they also pointed out that the lack of incentives and tax differentiation between small and large enterprises constrain SME development. They also complained that the “exhaustive” and complex tax paper work is a costly and time consuming activity which, in particular, affects small businesses due to their relatively limited human resources.

Focus group participants stressed that they face difficulty in both monitoring and responding to the frequent changes in tax policy, sometimes introduced in the middle of the fiscal year, giving companies little or no adjustment time. Nevertheless, SMEs perceived the stability of the tax system as being nearly “satisfactory” (rating: 2.8), mainly because the Corporate Income Tax (CIT) rate had stabilised at 15%. By contrast, a much lower rating was obtained for the transparency of the tax system (rating: 1.7):

“The only clear [transparent] thing in running my businesses is that I must use ‘grease’ [bribes].”

Issues: The tax system was considered to have become more stable, as the CIT has converged around 15%, however, taxes are still introduced late in the fiscal year and other problems remain, such as an extreme perception of lack of transparency, which adds to business risk and cost.

Consultation and Communication on Tax Policy

14. Rating given to the communication between government and the private sector on tax rates and incentives for enterprises	1.4
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The level of communication between government and the private sector on tax rates and incentives for enterprises was rated as being between “very poor” and “poor”. This is primarily due to the fact that entrepreneurs feel that there is a lack of forums where private businesses can interact with Government on taxation issues, or indeed general policy and regulations. Entrepreneurs feel that even though they are major generators of employment and wealth, they remain: “... **neglected by Government.**”

“How can we generate new jobs if the Government is unwilling to grant us any kind of incentives for business expansion? The worst thing is that we are never asked to express our point of view.”

Issues: Entrepreneurs consider themselves to be largely neglected by Government as far as being consulted, indeed, being informed about tax changes is concerned. This lack of good communication has implications not just for businesses but the efficiency of the tax system.

Co-ordination of Tax Policy

15. Rating given to the tax policy co-ordination with the overall government policy	1.8
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Most of the entrepreneurs participating in the focus group discussions became animated when discussing co-ordination of Government policy, though few had clear opinions about this issue. There was a general conviction that the tax policy is an independent policy area which is not co-ordinated with general economic policy, such as for example, employment policy. As a result this issue is rated as being fairly “poor”.

According to the 2002 BEEPS, the two aspects of the business environment for SMEs pertaining to taxation, tax rates and tax administration are rated as moderate obstacles to doing business. Tax issues are seen as the third and fourth most severe obstacles in doing business, second only to macroeconomic instability and economic policy uncertainty.

Issues: Lack of stability in the system, poor communication as well as the absence of co-ordination between tax policy and other aspects of economic policy relating to SME development was thought to be inadequate and this is detrimental to enterprise policy.

3.5. Financial Instruments for New and Small Businesses

The issues researched under this heading:

16. The stability, competitiveness and services of the banking system.
17. The commercial banks’ interest in extending credits to the SME sector and lending attitude with respect to the SME sector.
18. The SME access to the following main sources of finance:
 - Own/family capital.
 - Micro finance.
 - Venture capital/Equity.

- Repatriation capital (from family / friends abroad).
 - Commercial banks.
 - Leasing.
 - Credit reference sources.
 - Bank personnel skills.
 - Others (e.g. credit unions).
19. The availability of finance for SMEs at local and regional level.
20. The availability of funding for all sectors including technology companies.

Stability, Competitiveness and Services

16. Rating given to the stability, competitiveness and services provided by the banking system	2.5
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The participants in the focus groups gave a positive overall assessment of the stability of the banking sector in Macedonia. There was a general perception that the stability of the banking system is now “satisfactory” (rating: 3.0) in relation to most private commercial banks. The participants wavered in their response as far as the competitiveness of the banking system is concerned (rating: 2.2):

“I’m not quite sure what exactly it means to have a competitive banking system. But, what I do know is that with such banks we shall not get far.”

A similar opinion applied regarding their perceptions of whether the banking system provides the necessary services to small enterprises (rating: 2.3):

“My impression is that the bank personnel are well educated, but they are bureaucrats instructed to be blind to the needs of small businesses.”

Issues: After a period of instability in the banking sector, greater confidence has been restored. Private commercial banks are considered to be satisfactorily stable, however, the degree of competitiveness and services provided remains “poor” as far as small entrepreneurs are concerned.

Banks’ Interest / Attitude to SMEs

17. Rating given to the commercial banks interest in developing SMEs and their lending attitude to the SME sector	2.5
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The fairly positive general perception of the banking sector translates into a rating between “poor” and “satisfactory” with respect to the general philosophy of commercial banks with regard to their credit policy for the SME sector. This rating is not entirely consistent with the discussions that took place. In other words, the entrepreneurs argued that most commercial banks are reluctant to make more credit available and extend the range of financial products to suit the needs of small businesses. They maintained that the process for obtaining credit is a time-consuming and frustrating exercise as they rarely obtain credit for their enterprises. Another source of criticism was the perception that local banks predominantly focus on a few large businesses and show little interest in the SME sector, despite being assigned considerable foreign donor and Government funds for small business development:

“In business, risk and profit go together. Commercial banks are only interested in turning a profit without incurring risk. It is not possible to work this way.”

In their view, this translates itself into limited access to bank credit for small enterprises:

“... banks have built a Wall of China ... [between themselves and] clients from the small business community.”

Issues: Although entrepreneurs rate commercial banks' interest in the SME sector and lending attitude to approach the "satisfactory" level, they are critical of the general lending attitude, which is perceived to restrict access to credit by small enterprises relative to larger firms.

Access to Finance

18. Rating given to the access to key sources of finance and guidance on financial matters to small businesses	2.8
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Concerning access to the key sources of finance, a mixed situation arises. Access to such sources of finance is generally rated as being between "poor and "satisfactory", however, it is clear from the discussions that own and family capital is the principal source (rating: 4.2) available to small enterprises, as in the case of other countries. The traditional way of raising money is through family and friends. Moneylenders (the so-called "grey" banks) do supply credit, typically at interest rates of 3-4 % per month. Based on the discussion, various entrepreneurs have fallen victim of such lending practices and the media frequently feature stories of difficulties connected with raising credit in the informal sector. Access to repatriation capital is rated as being satisfactory (average 3.3) and plays an important role for the development of SMEs.

Micro-financing activities are praised and rated as being above "satisfactory" (3.5). The increased scope to access micro-finance is attributed to the activity of six international micro-lending schemes operating in Macedonia. Several participants in the focus groups acknowledge that micro-lending schemes were the first financial instrument at the disposal of sole proprietors, micro and small business start-ups:

"... God bless micro-finance. If we'd remained at the mercy of our banks, we would have remained unemployed."

Table 3-1. Relative Importance of Main Financial Sources Accessed by SMEs

Financial Sources	Rating	Rank
Own/family capital	4.2	1
Micro-finance	3.5	2
Repatriation capital	3.3	3
Venture capital/Equity	3.0	4
Leasing	2.6	5
Others (e.g. credit unions)	2.0	6
Commercial bank credit	1.3	7
Credit reference sources	1.8	
Bank personnel skills	2.8	

Note: The ratings used to represent the views of the entrepreneurs range from 1 to 5 and can be read as follows: 1 = very poor, 2 = poor, 3 = satisfactory, 4 = good and 5 = very good.

By contrast, and as implied by the preceding quotation, access to commercial bank crediting is rated close to "very poor" (rating: 1.3). Entrepreneurs argue that it is difficult and expensive to produce business plans, prepare complex documents and obtain assistance from business consultants. The commercial banks' loan security requirements are considered to be overly restrictive by entrepreneurs. By contrast, the skills of bank personnel are assessed by the respondents as being close to "satisfactory" (rating: 2.8):

"We don't blame branch managers as much as the top managers for the lack of interest in the SME sector."

The focus group discussions suggest that small entrepreneurs have very little knowledge of such sources of finance as venture capital, credit unions, leasing and credit referencing. The combination of a lack of tradition and inadequate legislative framework mean that leasing operations are not assessed by the participants in the focus groups as reaching the "satisfactory" level. By contrast, access to equity finance received a slightly better rating (3.0) since a select portion of businesses claim to make use of this financial instrument.

Boxes 3-6 and 3-7 examine respectively the sources of finance for SMEs' needs and their perception of the ease of obtaining bank loans.

Box 3-6. Sources of Finance for SMEs' Needs (BEEPS, 2002)

According to the BEEPS, the two aspects of the business environment for SMEs pertaining to finance (cost of and access to capital) are rated between modest and moderate obstacles to doing business. They are ranked fifth and eighth in the set of 21 potential obstacles to doing business. Overall, the survey results highlight that the relative severity of the cost of capital obstacle appears to be secondary to macroeconomic instability, economic policy uncertainty and tax issues. Supporting this finding, an analysis of the sources of finance used by the Macedonian entrepreneurs in the past to finance both their working capital needs and new investments, shows a high reliance on internal funds and loans from family and friends (internal sources of finance account for 66.9% of working capital finance used and 63.9% of finance utilised for new investments). In particular local and foreign banks play a very modest role in providing finance to SMEs (1.3% for working capital and 0.1% for new investment). However, only 73% of all firms interviewed managed to obtain finance (either internal or external) to fund new investments, whereas all enterprises could access finance to fund their working capital needs. The following table presents the relevance of sources of finance used by interviewed entrepreneurs for working capital needs and to finance new investments in percentage of total.

Source of Working Capital		Source of New Investment	
Internal funds	66.9%	Internal funds	63.9%
Private local banks	10.0%	Family/Friends	12.9%
Family/Friends	9.6%	Private local banks	11.1%
Supplier credit	5.4%	Supplier credit	3.6%
Other	2.2%	Other	3.2%
Customer credit	1.7%	Customer credit	2.0%
Foreign banks	1.3%	Leasing	1.3%
State-owned banks	1.1%	Government	0.9%
Money lenders	0.7%	Money lenders	0.6%
Government	0.6%	Credit cards	0.4%
Equity	0.2%	Foreign banks	0.1%
Leasing	0.2%	Equity	0.0%
Credit cards	0.0%	State-owned banks	0.0%

Box 3-7. SMEs' Perception of Ease of Obtaining a Bank Loan for Working Capital/Investment Needs (BEEPS, 2002)

A further question was asked regarding the entrepreneurs' perception of the ease with which they would be able to obtain a loan from a commercial bank for both working capital needs and for financing a new investment. The answers from this hypothetical question still point to difficulties in dealing with the banking sector. Only 42% of entrepreneurs think it would be easy to obtain a bank loan for working capital needs and 14% are of the same opinion as regards obtaining finance for new investments. It is worth noting that SMEs believe that accessing bank loans for the financing of new investments is more difficult than accessing working capital loans from banks. The entrepreneurs' responses to this question are presented below in percentage of total.

Accessing Bank Loans for	Working Capital	New Investment
Impossible	1%	12%
Very Difficult	21%	35%
Fairly Difficult	27%	27%
Fairly Easy	39%	11%
Very Easy	3%	3%
N/A	9%	12%

Issues: In terms of evaluating alternative sources of finance, the respondents cited family (and friends) capital as the principal source of finance for their business activities. The commercial banking sector is not yet perceived to be responding to the needs of small business and access to finance is very poorly rated among small businesses, unlike micro-finance. The scope for SME finance is generally considered to be limited in Macedonia.

Access at Local and Regional Levels

19. Rating given to the access to finance at local and regional levels	1.2
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Finance at both local (municipal)/regional level is extremely scarce due budgetary limitations imposed on these institutions. Entrepreneurs do not believe that the situation will improve in the near future, despite the proposed reforms to local government.

Access by Sector

20. Rating given to the access to financial sources for all sectors including technology companies	1.3
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The focus group participants rate access to financial sources by all sectors, including technology companies, as “very poor”. In theory, all sectors have equal access to finance but the practice is perceived to be very different:

“Privileged large and medium-sized companies with links to high political circles can ‘leverage’ their access.”

3.6. Advisory Services for New and Small Businesses

The issues researched under this heading:

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

Range of Advisory Services

21. Rating given to the satisfaction with the range of advisory services available to new entrepreneurs and SMEs	3.0
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Most respondents are basically “satisfied” (rating: 3.2) with the range of advisory services available to new entrepreneurs and existing SMEs, though the quality of the range of advisory services is rated a little lower (2.7). Although the respondents express a general satisfaction with the growing business advisory and consulting industry, there are reservations about the overall quality of domestic advisory services. The participants in the focus groups explain this by the fact that although local consultants tend to be active in such areas as: business plans, financial audit, IT, technology, etc., few are familiar with issues of growing importance to local entrepreneurs, such as strategic management, globalisation, enhancing competitiveness, industrial clusters, technology parks, etc. and a range of other more sophisticated or specialist services. Entrepreneurs argue that business consultants need to broaden their range of services, in order to better assist firms:

“I expect from advisors knowledge that I can apply, not fairy tales.”

“I expect consultants to help me turn a profit. I am ready to pay them a success fee.”

Although businesspeople appreciate the growing business advisory services, an ambivalent attitude prevails in the sense that they happy to take advantage of the services on offer but are not very willing to pay market rates for those business services. Moreover, commercially sensitive information tends to be restricted to close business associates and is seldom shared with outsiders. The impression remains that entrepreneurs hesitate to use professional advice for the strategic development of their businesses. The typical explanation for this during the focus group discussions is that:

“I know my business better than anybody else.”

Issues: Business advisory services are a relatively new economic sector in Macedonia. Entrepreneurs perceive that there is increasing need for specialist business advisory services, but are still reluctant to pay for specialist professional advice.

Efficiency of Advisory Services

22. Rating given to the efficiency of advisory services available to SMEs	2.4
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As with the range and quality of the services on offer, their efficiency is not rated very positively by the entrepreneurs. A large number of the participants in the focus group discussion did not seem to have a good grasp of the role of business advice and consultancy services and only about half had experience of using business consultants, resulting in comments that:

“Business consultants cannot be very efficient when banks do not provide enough money to support SMEs.”

The above quotation, which says more about the banking system than about the efficiency or otherwise of advisory services, illustrates the general problem. Entrepreneurs are still relatively inexperienced at using these services and may have unreasonable expectations with respect to business consultants. Examining the issue from the opposite perspective, a business advisory representative thinks that:

“...we draft business plans diligently but if our clients’ bank loan applications are rejected for whatever reason, the blame is allocated entirely to us. Client never asks ‘what is the real reason for this unsuccessful application?’ It is easier to say that the advisor was ‘inefficient’ and our image is affected.”

Issues: The efficiency of the business advisory services is rated as being “poor”, however, the discussion suggests that awareness and understanding of the potential offered by business advice needs to be raised. This may also help increase the willingness to use business advisory services and to pay market rates.

Responsiveness to Demand

23. Rating given to the responsiveness of advisory services to demand and needs	2.4
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The extent to which the business advisory services available actually respond to enterprises’ demand and needs is also rated as “poor”, partly as previously discussed, because the range of services on offer are perceived to be quite limited:

“The business plans are OK, but sometimes we need much more [than that]. For example tax protection, quality assurance, support for export activities, etc.”

In addition, entrepreneurs highlight the following areas as being in demand: human resource management; access to international markets, distribution channels, management skills and quality (e.g. ISO) certification, etc.

Issues: Advisory services need to be expanded and the level of specialisation needs to be increased in order to more fully reflect the changing needs and priorities of SME owners and managers.

Human Capital

24. Rating given to the skills, experience and quality of the staff providing advisory services	3.0
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With regard to the rating of the skills, experience and quality of the staff providing business advisory services, the respondents opt for a “satisfactory” rating. Nevertheless, based on the focus group discussion, most entrepreneurs try to obtain free consulting services whenever possible, since this is feasible through a number of donor-funded initiatives. Few of them consider “paid consultancy” to be better or more professional than what is available through donor-funded initiatives. Nevertheless, the discussion indicates that there is a willingness to pay:

“... for business advisory services with tangible results.”

“Nothing is for free in life. Let them [business advisors] be paid ... but I want to see results from their work.”

Continuity of Provision

25. Rating given to the continuity of advisory services available	2.4
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There was little discussion about continuity of business advisory services. Entrepreneurs feel that they obtain results in accordance with how much they pay, however, the notion of trying to develop a long-term relationship with clients is yet to be established, resulting in a relatively “poor” rating:

“We expect continuous work and follow-up but, they [consultants] are always running for new clients.”

“Consultants are aware that it pays to maintain and retain old clients. However, fearing a lack of work, they devote too much time and effort searching for new prospects.”

3.7. Business Incubators

The issues examined under this heading were:

26. Experience with business incubators and importance to new entrepreneurs and existing SMEs.
27. The efficiency of the government policy and programme encouraging business incubators.
28. The state of the business incubators’ governance structures.
29. The locations, the infrastructure and facilities of business incubators.
30. The extent to which the business incubators’ activities are focussed on the needs of the local entrepreneurs.
31. The extent to which the operating conditions, services and charges are transparent and clear.

Experience of Business Incubators

26. Rating given to the business incubators’ importance to new entrepreneurs and existing SMEs	3.7
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Generally, both the private sector representatives participating in the focus group discussions and experts that were interviewed recognise the importance of business incubators, and this is reflected in a high rating of their importance. It is worth noting that most of the interviewed entrepreneurs had little direct knowledge and experience of business incubators. Very few of the participants have used or worked with business incubators. Consequently, despite a fairly extensive experience with business incubators in Macedonia, as compared with other SEE countries, entrepreneurs had a superficial understanding of the philosophy, objectives and the functioning of business incubators.

Issues: Entrepreneurs grasp the potential value and importance of business incubators, however, have very little knowledge and direct experience of them.

Government Policy

27. Rating given to the efficiency of the government policy encouraging business incubators	1.5
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There is a perception that that Government has not yet defined a clear policy or strategy regarding business incubators. Moreover, the discussion with the experts focused on the role of the almost defunct Agency for Privatisation, for the poor implementation of a Work Bank programme seeking to develop business incubators in Macedonia:

“They [the Agency for Privatisation] spoiled a very useful initiative.”

The owners and managers’ opinion of the role of the Government policy in encouraging the creation of business incubators is quite negative. Most of the participating entrepreneurs think that Government is not willing to stimulate either business incubators or other initiatives, such as technology parks:

“Our Government ... does not dare to do something ambitious with business incubators.”

Issues: Entrepreneurs perceive a lack of effective policy with respect to business incubators, leading to a belief that Macedonia has lost an opportunity to enhance its network of business incubators.

Locations, the infrastructure and facilities

29. Rating given to the location, infrastructure and facilities of the business incubators	2.0
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The current state of the facilities within the Macedonian business incubators is assessed as “poor”. The buildings are considered to be obsolete, the infrastructure such as water supply, electricity and heating is viewed as being poor and the equipment available outdated. According to the participants, the funds for maintenance are either lacking or mismanaged. What is on offer is considered to be:

“... far below European standards, resembling small business operations in a third world country.”

Issues: The facilities and infrastructure available in the existing business incubators do not meet entrepreneurs’ expectations, affecting their image and calling into question their potential.

Focus on Needs

30. Rating given to the extent to which the business incubators’ activities satisfy the local entrepreneurs’ needs	1.5
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Regarding the extent to which the business incubators satisfy the local entrepreneurs’ needs, the rating obtained lies between “very poor” and “poor”. Many entrepreneurs would like the opportunity of participating in business incubators, if given the chance:

“... well, it sounds as if a quarter of our businesses should be in business incubators!”

Governance Structures and Transparency

Due to the lack of specific knowledge by participants no feedback was obtained on this question.

Chapter 4.

ANALYSIS AND ASSESSMENT

This chapter presents the OECD-EBRD analysis and assessment of the six dimensions of good practice for the business environment to complement the analysis of the discussions with the owners and managers of SMEs presented in the preceding chapter of this report. It reviews the current situation in each of these areas; takes into account other OECD and EBRD studies and analyses of good practice; and the private sector views, based on the preceding qualitative research with the owners and managers of SMEs. The assessment of the current situation leads to a series of recommendations by the OECD and EBRD, presented in Chapter 1.

4.1. Implementation of the Institutional Framework for SME Policy

The Situation on the Institutional Framework

The institutional framework covers such issues as policy design, national strategy, implementation agency and consultation mechanisms. A previous OECD-EBRD country report (2001) covers these issues in greater detail. This section provides a brief sketch of the main issues and developments since then. Although the research was undertaken prior to the election of the new Government in Macedonia, an attempt has been made to up-date the analysis as much as possible.

Table 4-1. below sets out the definition of *micro, small and medium-sized enterprises*, as determined by Macedonian law. Due to the specific local conditions, this definition is not compatible with the EU's recommended definition.

Table 4-1. SME Definitions

Criteria	Micro	Small	Medium
Number of employees	Less than 10	11 - 30	30 - 250
Annual income (average monthly gross salary per employee in denars)	n/a	Less than 8,000 average gross salaries	Less than 40,000 average gross salaries
Average value of assets (average monthly gross salaries per employee in denars)	n/a	Less than 6,000 average gross salaries	Less than 30,000 average gross salaries

Source: Ministry of Economy

Note: Average gross monthly salary is estimated to be MKD 19,000 or about €300.

The *Ministry of Economy (MoE)* is the key government institution responsible for SME development. Within the MoE, it is the *SME Department's* role to elaborate SME policy formulation and implementation. The SME Department, which has limited staff, has four main functions, namely to:

- Create the institutional infrastructure to support of entrepreneurship and competitiveness.
- Optimise the business environment to encourage start-up businesses.
- Promote entrepreneurship and deliver support to entrepreneurs.
- Maximise SMEs' access to financial support.

Several *other ministries* exert considerable influence over SME policy issues, not least Finance, Transport, Communication and Communal Affairs and the Privatization Agency (in the process of being phased out), which used to be the body funding part of the budget for the SME implementing agency. The co-ordination of the major institutional stakeholders responsible for SME support and policy implementation has not always been very effective. In addition, there are a number of other national level institutions and agencies with responsibilities touching upon entrepreneurship and enterprise development issues, such as: National Employment Office, National Chamber of Economy, Agency for Development and Investment and Agency for Free Trade Zones. The general lack of strategy, focus and co-ordination means that the role of these institutions with regard to SME support is unclear (OECD-EBRD, 2001).

Some improvement has been generated, to the extent that the Ministry of Economy started to be supported in early 2003 by a co-ordinating and consultative body, the *Council for Entrepreneurship and Competitiveness*. The CEC consists of the Minister of Economy, five representatives from other ministries and about 10 representatives from the Chamber of Commerce, various associations, private sector, financial institutions and trade unions. Meetings are held every three months and the MoE acts as the secretariat to the Council. The capacity to perform its co-ordinating and consultative role, varies according to the skills and commitment of the participants. Given that it was recently created, it is not possible to assess its effectiveness.

Since gaining independence from the former Yugoslav federation in 1991, the Macedonian Government has relied heavily on the international community for resources to promote small enterprise development. The Government has acknowledged the importance of the SME sector to the economy in the long run and various measures have been undertaken to strengthen of the relevant institutions. The SME Department, in co-operation with the Ministry of Finance and the National Bank, keeps a record of all financial inputs for SME sector development. It is estimated that between 1995 - 2000, Macedonia received €100 million from different foreign sources (donors, IFIs, EC PHARE, etc.) for SME sector development, including specialised credit lines. The budget assigned to private enterprise development is split 80-20 between the foreign creditors / donors and the domestic implementing agencies, mostly commercial banks.

The *National Enterprise Promotion Agency (NEPA)* was established in 1997 with support from the EU PHARE programme with the objective of promoting the SME sector across a broad range of government activities, including working with the international donor community. NEPA managed a PHARE micro credit line for small enterprises and start-ups disbursed by local financial intermediaries. In addition to implementing the SME strategy, it carried out income-generating advisory services for SMEs, however, it is generally recognised (see OECD-EBRD, 2001) that the organisation was failing to meet its primary objective vis-à-vis SME policy implementation and that its credibility was being eroded. It should be noted that since the focus group research was undertaken, the new Government has initiated a process to replace NEPA with the *Agency to Support Entrepreneurship (ASE)*. The ASE will be responsible for implementing SME policy and strategy, and like NEPA, will be connected with the network of existing Regional Enterprise Support Centres (see section 4.5). The analysis presented in the report may provide useful indications for the establishment of the new institution.

In 2002 the SME Department drafted the *National Development Strategy for Small and Medium Enterprises*. The draft involved public debate in June and was adopted in July 2002. However, given that it was written with a general election pending, it was considered to be more a “wish list” than a strategy with assigned targets, responsibilities and resources. With the arrival of the new Government in September 2002, a new SME strategy was initiated in December 2002 and adopted in April 2003, called the *Programme of Measures and Activities to Promote Entrepreneurship and Competitiveness of SMEs*. This document was not in existence at the time of the focus group research, however, it is seen as an improvement on the 2002 SME Strategy in so far as it focuses on such issues as competitiveness, industrial clusters, innovation, etc. though the fundamental problem of resources to meet to commitments remains.

Due to the complex political environment and the lack of progress concerning improvements to the legislation pertaining to local, *local authorities* do not possess distinctive powers and have few responsibilities and resources to stimulate enterprise development. This is expected to change once the new law is approved by Parliament.

There is little tradition of *dialogue and consultation* between the private and public sectors, with the consequence that the channels of communication between government and SME stakeholders such as business representatives, NGOs and entrepreneurs remain largely informal or non-existent (OECD-EBRD, 2001). The previously discussed Council for Entrepreneurship and Competitiveness is a positive step towards routine and regular consultation between the institutions responsible for the formulation and implementation of SME policy, including business sector representatives.

Assessment

Following an analysis of the SME environment in Macedonia, a previous OECD-EBRD study (2001, pp.43-49) made a number of recommendations for the institutional framework, namely:

- Establishment of an SME Policy Co-ordination Forum.
- Establishment of an SME Advisory Forum.
- Capacity-building for the SME Department of the Ministry of Economy.
- Reform of the Role of the National Enterprise Promotion Agency (NEPA).

The present research, based on focus group research undertaken prior to the election of the new Macedonian Government in September 2002, has underlined the continuing need for these reforms. At the national level, the institutional environment is considered to be unclear and the institutions in place are not considered to be very effective. Neither the Ministry of Economy (MoE) nor its implementing agency (NEPA) is viewed positively by the entrepreneurs participating in the research. Entrepreneurs have little information or awareness of the institutions, policies and programmes to support SME development and the level of consultation between Government and the business sector is considered to verge on the non-existent. This analysis connects with and validates the recommendations previously made by the OECD-EBRD, as reproduced in box 4-1 below.

Box 4-1. Institutional Recommendations

The establishment of an *SME Policy Co-ordination Forum* recognises that there is little or no co-ordination between ministries and agencies of government with respect to their policies, programmes and proposed future activities which impact upon the enterprise sector. The report called for a consultative SME Co-ordination Forum to be created, headed by a senior politician, with the aim of prioritising and co-ordinating SME-oriented policies and initiatives by all relevant ministries and agencies. In addition, the Forum should have an advisory role as well as a monitoring and review role, in order to evaluate the effectiveness of enterprise policy. In this regard, it was pointed out that the OECD/UNIDO guidelines on best practice on entrepreneurship and enterprise development provide a useful framework for wider examination of SME policies.

Capacity-building for the SME Department of the Ministry of Economy recognises that the experience of the staff and the need to develop complex policies and strategies mean that the SME Department requires capacity-building to perform its role more effectively. This effort should focus on the national SME strategy, working towards the removal of administrative barriers, development of legislation and co-ordination of the SME policy network.

The *reform of the role of the National Enterprise Promotion Agency (NEPA)* recognises that the institutional structure for SME support in Macedonia is weak and in need of strengthening, in particular the role of NEPA. The following changes were required urgently:

Box 4-1. Institutional Recommendations (Cont.)

- Creation of closer ties between NEPA and the Ministry of Economy through regular consultative meetings.
- Reform of NEPA's existing committees, as these were not operating effectively.
- Securing NEPA's long-term future by means of a decision on its post-EC funding and preparation of performance-based contracts with the Ministry of Economy.
- Reorientation of NEPA away from financial services and towards its core role, namely implementing the SME strategy determined by the Government.
- Further technical assistance for staff with regard to their monitoring and co-ordination role.

The establishment of an *SME Advisory Forum* recognises the lack of consultation in the creation of new laws, regulations and taxes affecting the enterprise sector can lead to externalities such as unnecessary compliance costs, non-compliance and unintended consequences. The proposed SME Advisory Forum would have the task of providing independent advice, assessing existing and/or draft regulations/laws/taxes, consulting businesses and citizens; identifying problems, and proposing solutions to government. (OECD-EBRD, 2001)

The analysis in this report reinforces the recommendations made in 2001, however, it must be recognised that since the arrival of the new Government, major reform progress has been made which tackles a number of the recommendations previously made, focusing on four issues, as reflected in the recommendations made in Chapter 1 of this report.

A new SME strategy has been prepared and approved, which is an improvement on the previous situation. It remains to be seen how well this strategy has been communicated, whether the resources, staff as well as finance, will be available to implement the strategy in co-operation with the SME policy community.

The Council for Entrepreneurship and Competitiveness (CEC) has been created, chaired by the Minister of Economy, which is effectively a combination of the OECD-EBRD recommendations of creating an SME Policy Co-ordination Forum and an SME Advisory Forum. The CEC is a major step forward in the process of co-ordinating SME policy at the governmental level (ministries, agencies, etc.), as well as the wider SME policy community via representatives from the Chamber of Commerce, NGOs, private sector, financial institutions and trade unions. Once again, it remains to be seen as to whether this will prove to be an effective organisation. It will serve a wide range of purposes, meet four times per year and may not prove to be useful unless it is adequately serviced through a secretariat, the information for discussion circulated in advance of meetings, it is representative of the business community, especially SMEs, etc.

Following a period of uncertainty, during which NEPA's role was far from clear and decisive reforms did not materialise, the new Government has opted to replace NEPA with the Agency to Support Entrepreneurship (ASE). Once ASE is created, it will assume largely same role as NEPA. It will implement the SME strategy and be involved with the network of existing Regional Enterprise Support Centres (see section 4.5) as well as other business advisory centres. Therefore, the major policy issues which NEPA failed to address will be of concern to the new institution. The Ministry of Economy must ensure that the mistakes do not recur and that the implementation of the ASE benefits from the extensive good practice in this field in SEE, not least the necessity to secure financial sustainability for the Agency and the regional support network.

Capacity building for the Ministry of Economy (as well as the new Agency to Support Entrepreneurship, business support centres and local authorities) on a wide range of enterprise development skills remains as necessary today as it was in 2001, especially in the case of local government, which is ill-prepared of its reinforced economic development role.

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

The Situation on the Rule of Law and the Regulatory Environment

The previous OECD-EBRD country report (2001) covered the regulatory framework affecting SMEs, therefore, this section seeks only to provide a brief sketch of the main issues and developments since then.

The *registration procedures* in order to start-up new enterprises remain among the most noteworthy bureaucratic problems in Macedonia. The legal requirements for company registration include:

- Court decision for inclusion of the company in the Register of Companies.
- Certificate of company “uniqueness” issued by the National Statistical Office.
- Registration with National Social Security Institute.
- Registration with the Territorial Tax Administration.
- Registration with the Customs Authority (international trade in goods and services).
- Association agreement by founding parties, including organisational form and distribution of equity.

The basic capital for the incorporation of a limited liability company (LLC) may not be less than €2,500 (down from €5,000, except in the case of foreign firms) in the form of money, property or rights. An authorised appraiser prepares a mandatory evaluation of the founding capital. The set of documents is then submitted to the Registration Court, with proof that all registration fees have been paid and that the start-up capital and/or assets amount to €2,500. The customary expenditures for *company registration* (court fees of about €100-€120, lawyer, notary, bank account costs, etc.) exceed €300 for a LLC, according to lawyers involved in the process. The fees are somewhat higher for joint stock companies, joint ventures and other company forms.

A number of reports have highlighted the legal and regulatory problems, including those associated with the licensing and permits (EC, 1999 and 2000; Ministry of Development, 1999; FIAS, 1998 and 2003). The Ministry of Development (now Agency for Development) and Ministry of Economy initiated steps to simplify registration procedures by setting-up the *Committee for the Simplification of Registration Formalities*, whose main proposal was the introduction of a “one-stop-shop” system. Despite much debate and activity in this direction, little progress has been made. One of the roles of the Council for Entrepreneurship and Competitiveness (see section 4.1) is to establish inter-ministerial working group to harmonize the relevant laws. The “one-stop-shop” concept is a flagship initiative to simplify the business environment. The intention is to:

- Reduce the unclear, contradictory and complex procedures for numerous regulations.
- Eliminate widespread corruption in issuing permits and licenses.
- Encourage exit from the “grey economy”.

Implementation will not be straightforward, covering reform of several laws (such as Trade Associations, Handicrafts, Occupational Safety, Sanitation, Fire Protection etc.) that are under the jurisdiction of at least four Ministries. This process of business simplification should include close collaboration with the small business sector, with the assistance of international financial institutions and donors, as is the case in other SEE countries.

With respect to *access to land*, there are on-going reforms, such as the Law on Land for Construction (2002), which introduced the concept of land as a good that can be bought-sold, transferred, leased, etc. More improvements are expected in order to harmonise with EU legislation.

The *customs formalities* in Macedonia are a cumbersome, time and money consuming exercise hindering enterprise development. The general impression of businesses is that there is a lack of both information and advice about the customs formalities resulting in opportunities for rent-seeking and

leading to demand from the business sector for a system with simple and transparent procedures. In April 2003, Macedonia became an official member of the World Trade Organisation (WTO), with the consequence that new and lower tariffs are to be implemented, combined with a more forceful anti-corruption campaign focusing on the Customs Office.

It is widely accepted that there remain numerous obstacles to business activity that must be addressed urgently, not least because areas where arbitrary decisions can be made invite corrupt activity. A report by the International Crisis Group for Macedonia (2002) reveals the presence of extensive corrupt practices at every level of Macedonian society. Corruption is very much present in the customs authorities, and is particularly pronounced in the export/import of tobacco products, medical equipment and drugs, etc.

The new Macedonian Government, with the support of the media and the international community, has introduced a renewed anti-corruption campaign since the focus group research was undertaken. These anti-corruption activities are led by the *State Commission Against Corruption*, an independent body appointed by Parliament. For example, politicians are now required to publicly disclose their assets and several former politicians are under investigation for corruption and bribery, resulting in a more positive dynamic. An extensive Action Plan to reduce in the impact of bribery and corruption has recently been developed and received government approval (SCAC, 2003). It is anticipated that the State Commission Against Corruption will prove to be a more effective mechanism than previous initiatives. Other initiatives include the reduction of discretionary power of state officials and reform of the custom service.

The *judicial system* and, in particular, the Macedonian courts are perceived as an inefficient and overburdened institute with a huge number of outstanding civil and criminal disputes. The handling of arbitration agreements and bankruptcy proceedings, as well as settlement of outstanding payments is widely considered in business circles to be ineffective, seriously undermining enterprise development. Since a typical commercial dispute can last 2-3 years and enables debtors to avoid legal procedures without obvious consequences, many entrepreneurs conclude that the judiciary is corrupt. "Friendly phone calls" and "grease" to lubricate the judiciary process are common practice to speed-up and/or to postpone court cases.

A Permanently Elected Court (PEC), attached to the Macedonian Chamber of Economy, was formed in 2000. This arbitration court (substituting the now abolished "commercial courts") was established in order to resolve contractual disputes. The majority of cases filed are disputes from contractual relations with a foreign component. SMEs rarely use this institute to settle commercial disputes, partly due to the negative perception of the performance of the Chamber of Economy.

Following considerable public and media pressure, the Government drafted a Law on Public Procurement, recently modified in March 2003, however, many small entrepreneurs remain unconvinced that the *public procurement* practices have improved. There is a strong perception that the public procurement process is now over-regulated and that it is almost exclusively to the advantage of larger companies with well established financial track-records and deeper financial pockets. The same procurement procedure applies, regardless of the size of the public contracts involved.

The share of the *informal economy* in Macedonia is estimated to be about 30 to 35% of GDP (World Bank estimate). Following the implementation of the VAT system in 2001, it is anticipated that the share of the informal economy will decline. The overall environment confronting the enterprise sector is over-regulated. The complexity, rapidity of change and the wide scope for local interpretation and discretion hinders enterprise development and contribute to the persistence of the informal economy.

Assessment

Following an analysis of the SME environment in Macedonia, the OECD-EBRD has previously (2001) made a recommendation for the legal and regulatory framework, namely the establishment of a comprehensive reform agenda of the legal and administrative barriers, as highlighted in box 4-2.

Box 4-2. Business Simplification Recommendation

One of the areas in which Macedonia has made the least progress has been the removal of legal and administrative barriers to enterprise development. There is no lack of evidence of the plethora of issues which still need to be tackled in order to create a more business-friendly environment which encourages start-ups and expansions while at the same time reducing the incentives for bribery, corruption and continued operation in the grey economy.

There are numerous studies and proposed recommendations on these issues, such as EC/PHARE reports, the FIAS report on foreign direct investment, and the Macedonian Government report on stimulating investment by removing barriers to trade and investment. There is little to be gained in adding to these studies and recommendations, but there is a need to *carry out a comprehensive assessment* of these reports to enable the preparation of a government-approved prioritised set of actions and timescales. This action plan would be designed to tackle the issues associated with, for example, registering enterprises/one-stop shops, simplifying or reducing the number of permits, creating functioning land registration and spatial planning systems, and removing the courts from the business registration process. Various ministries and agencies should be assigned responsibility for implementing the action plan within specified timescales, which could then be monitored by the SME Co-ordination Forum... [in the time since the study was undertaken, a Council for Entrepreneurship and Competitiveness has been created]. Such a development would provide Macedonia with a sound basis for aligning itself with those countries already making progress in accession negotiations with the EU. (OECD-EBRD, 2001, p.47).

The research in this report re-emphasises the urgent necessity to tackle all the issues which were discussed in the preceding OECD-EBRD analysis, namely to streamline the company registration (as well as re-registration and deregistration) and the process of awarding licenses, permits and certificates enabling enterprises to operate under law. After several false starts, entrepreneurs have developed a sceptical attitude to the capacity of Government to improve the business environment. In the mean time a further FIAS study (2003) has reconfirmed the necessity for urgent reform.

In addition to what was previously proposed by the OECD and EBRD, there are other elements of good practice that ought to be emphasised, not least the validity of the concepts of “silence is consent” and “one-stop-shop”. The latter has been much discussed and researched in Macedonia with little visible effect as far as entrepreneurs are concerned.

It should be noted that in response to the severity of the barriers to doing business and the necessity to increase the levels of foreign and domestic investment, the new government has recently created a Government-approved Programme to Stimulate Investment (Ministry of Economy, 2003), which involves major reform commitments in this area. It remains to be seen whether these will be translated into effective change on the ground.

4.3. Implementation of Tax Policy for Small Businesses

The Situation on Taxation Policy for Smaller Businesses

The *Ministry of Finance* is responsible for formulating tax policy and drafting tax legislation. The Government proposes laws to be adopted by Parliament, which may amend proposed laws but cannot propose laws itself. The budget is prepared by the Ministry of Finance and annual budgets explain and clarify fiscal objectives and their sustainability. Fiscal projections are made in co-operation with the National Bank of Macedonia and the State Statistics Bureau. They are not subject to independent review and no estimate is made of tax expenditures.

The Ministry of Finance is responsible for *tax administration*, with a Public Revenue Office divided into a general directorate, regional directorates and tax departments. Sub-central levels of government currently do not have taxing powers but assist in the administration and collection of some taxes, notably the property tax. In 2000, the legal framework for financial control was revised with the introduction of new legislation, including a Law on Budgets. The State Audit Bureau is the supreme auditing institution and examines internal ministry audits and the use of state expenditures. There is no provision for statutory audits and taxpayers are audited at random. Fines may be imposed and tax evasion may be punished by imprisonment for up to five years (OECD, 2003, pp.131-132).

With the move towards a market-based economy, the process of developing a tax system that is compatible with the market economy has increased in importance. Although tax policy has improved over the last two years, resulting in a less onerous and more transparent taxation system, it is widely acknowledged that Macedonia lags in terms of enacting and implementing a modern tax system.

At present, *all enterprises* are subject to the following taxes: VAT (replacing the sales tax) profit tax, property tax, excise tax, personal income tax, social benefits, state and local fees, custom duties and a number of other less significant taxes. The tax on financial transactions, the so-called "war tax", expired at end-2002 and was not renewed. A company established by foreign investors has the same tax status and enjoys the same rights and obligations as a domestic company. The overall level of taxation and of government expenditure is considered to be moderate by European standards. A recent OECD report indicated that the projections for 2002 were that revenues would amount to 33.4% of GDP, and that expenditures would be 36.8% (2003, p.131).

The *personal income tax* bands were 23%, 27% and 35% but these have been reduced and streamlined to 15% and 18% in 2002. Domestic and foreign taxpayers have been given equal treatment, which means that Macedonia has moved some way towards greater compatibility with modern tax systems.

The *corporate income tax* on profit is 15% (down from 30% in 1996) and applies to legal entities such as banks, trading companies, joint stock companies and public enterprises. Properties used for business activities are not subject to taxation.

VAT was introduced in April 2000 and has been designed to be compatible with the EU's 6th Directive. There are two rates. The standard rate is 18% (reduced from 19% in April 2003) and the reduced rate of 5% applies to basic food and agricultural products. The minimum annual turnover for obligatory VAT registration of a company is about €25,000 and is voluntary for companies with a lower turnover.

In terms of *tax administration*, it is worth noting that most tax forms (registration, returns, exemptions, etc.) are distributed free of charge. Despite progress in tax reforms, significant improvement has not been made in the circulation of advance rulings and/or interpretations to enterprises, partly because fiscal authorities continue to refine the system, resulting in numerous changes. Not even the most competent tax experts can be fully aware of the changes and their implications. This state of affairs continues to create compliance problems and costs, especially to smaller firms.

The Macedonian tax system is basically neutral. There are no tax incentives and instruments for the support of SMEs. The exception relates to start-ups which are granted a corporate profit tax holiday during the first year of operation. In addition, as part of the employment generation scheme, enterprises are exempted from labour taxes on any new employment generated. This incentive appears to be principally taken-up by SMEs and is estimated to create some 45,000 new jobs annually. Parliament recently passed *Branko's Law 1993* (after the Prime Minister, Mr. Branko Crvenkovski) which states that SMEs willing to employ people from the Labour Office can receive certain incentives, such as a refund of the contributions to the health and pension funds for a period of four years, in the expectation that this will generate new employment and/or impact on the informal economy.

Table 4-2. Tax Rates in Macedonia

Type of the tax	Rate in %	Remark
General VAT	18	General rate is applied to all products, except reduced rates
<i>Reduced VAT</i> List reduced 1.4.2003	5	Food products (except alcohol, beer and soft drinks), agriproducts and animal food, gas, coal, firewood, medical supplies, detergents, soaps, books and some publishing-printing services, pay reduced VAT
<i>Free from VAT</i>	0	Military, health and education services
Profit taxes		
Corporate tax on profit	15%	Paid annually
Health-care tax on profit	1.8%	Paid annually
Excises		
	5-130 %	Depending on product (tobacco, alcohol and luxury goods)
Property tax	varies	Paid annually
Real estate tax	0.1%	Of the market value of the real estate
Motor vehicles	0.05 %	Of the market value
Sale of property	3 %	Of the market value
Personal income tax		
	15%, 18%	Relative to the level of net personal income; monthly payments
Social benefits		
Health care	9.2%	Of gross salary
Additional health care	0.5%	Of gross salary
Tax for employment	1.6%	Of gross salary
Retirement fund	21.2%	Of gross salary
Chamber of Commerce	0.12%	Of gross salary

Source: Official Gazette (2003)

The tax rules apply to all firms, regardless of size. There is a perception that the rules are not always fairly applied in practice. To give an example, if an SME fails to pay contributions on salaries for three consecutive months, it will be penalised and bankruptcy procedures will commence, but this is not always the case with large enterprises. This also applies in other fields, such as arrears for utility payments.

Assessment

Previous OECD-EBRD work has recognised that some progress has been made in recent years towards the creation of a more neutral and broad tax base (2001, pp.33-35). The tax system is reasonably well designed. The recent reduction in the corporate income tax rate is a positive development, which is acknowledged by the owners and managers of SMEs.

Although the private sector is grateful for the recent tax reforms, entrepreneurs point to the extensive degree of tax evasion, which raises important issues not least to do with fair competition. The key issues of concern include a perception that the overall tax burden is too high, a view which is echoed throughout SEE region and beyond. On a more worrying note, there is a strong perception that there are too many taxes, that they change often and thus assist in creating an unstable tax environment, and that they are complex and lack transparency. This creates an environment which potentially inhibits the creation of new enterprises, adds to the compliance costs of existing enterprises and increases the scope and attraction of operating in the informal economy.

The unstable tax system increases uncertainty and made it very difficult for enterprises to plan their tax liabilities. This leads to lower investment and affects job creation. To avoid further discouraging entrepreneurship and SME business development and encourage reduction in the “grey economy”, the

Government should continue to widen the tax base by relentlessly tracking down undeclared income. The VAT refund period, currently three months, should be designed to facilitate cash flow, such as the international standard of one month.

Businessmen, especially the SMEs, fear and mistrust tax authorities. There is pervasive perception that the tax administration is both non-transparent and unfair in its operation as far as small enterprises are concerned. Since the tax rules are complex, change frequently and overlap, this makes it problematic for firms to work with the inspection service. As a result, inspections are seen by businesses to be intrusive, time consuming and punitive. For example, they point to the penal inspections, such as immediately following the submission of claims for VAT refunds. Efforts should be made to amalgamate and reform the tax inspectorates, build capacity, introduce clear procedures and rules and generally stamp out unfair and corrupt practices.

The extensive degree of tax arrears and tax evasion raises important issues relating to fair competition: between state owned enterprises and private firms, between large and small firms, between legal and illegal firms, etc. The large, mainly state owned companies, are perceived to be in a privileged position compared to private SMEs regarding the tax authorities' policy towards them, either because of corruption or other reasons such as public concerns over bankruptcy or down-sizing if they are forced to repay tax arrears. Renewed efforts must be made to ensure that tax procedures are applied consistently to all firms, regardless of size, and to reduce the level of tax evasion.

There is almost no consultation between enterprises and the Government on tax policy and its administration. The absence of mechanisms for consultation means that unexpected or aggravated cash flow problems can jeopardise start-ups or investment plans. Experience elsewhere suggests that both Government and the business sector would benefit from a mechanism allowing for more effective, regular and timely consultation on proposed changes. Representatives of SMEs pointed out that the tax policy has to be focused on creating a simple, clear and stable tax system. The Government should consider establishing via the Ministries of Finance/Economy/Industry/Trade, in co-operation with SME supporting institutions and networks, the tools for regular consultation with the business sector on proposed tax changes. A start has been made in relation to the preparation of the draft new Corporate Income Tax but much more needs to be done. Regular promotion of the expected benefits of tax changes, as well as information and training provision, are needed.

4.4. Implementation of Financial Instruments for Fostering Small Businesses

The Situation on Financial Instruments

Overall, the operating environment in Macedonia with regard to access to finance for enterprises has improved significantly over the past six years, following a period of lack of confidence by the public in the financial system due to a series of liquidation and bankruptcies of domestic savings institutions. The triggered legislative reforms therein, together with the entry of foreign banks, have led to a considerable improvement of the image of the banking sector, reflected in the transition scores reported in table 4-3. However, access to long-term finance, for small businesses in particular, remains almost exclusively the preserve of international financial institutions. The banking sector coped well with the crisis in 2001, but the quality of banks' loan portfolios deteriorated during that year. The situation improved significantly during 2002, and by end-year the number of credits classified as C, D or E was 20.5% of total credits, a reduction by 17.7% relative to end-2001. The regulatory environment for banks is among the best in SEE, but further improvement is required in related party lending rules and the supervision of market risks.

Macedonia has quite a large number of banks relative to the size of the country and economy, but the majority of assets are concentrated in a small number of banks. At the end of 2002 there were 21 commercial banks, and 17 savings houses in the country, the same numbers as at end-2001. Two banks, Stopanska Banka and Komercialnja Banka, accounted for 54.1% of total net assets of the banking sector,

Table 4-3. EBRD Score for Financial Sector Reform

Financial Sector		1997	1998	1999	2000	2001	2002
Banking Financial Institutions	Banking reform & interest rate liberalisation	3.0	3.0	3.0	3.0	3.0	3.0
Non-banking Institutions	Securities markets & non-bank financial institutions	1.0	1.7	1.7	1.7	1.7	1.7

Source: EBRD

and 64.8% of total deposits. The share of privately owned bank capital had risen slightly to 85.9%. Eighteen banks have a full licence for foreign payment operations. The share of foreign capital in the total was 44.4%. Competition among banks for business remains limited and the low level of domestic credit to the private sector (see table 4-4) is reflected in relatively high annual nominal interest rates, typically around 16-17%.

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

1996	1997	1998	1999	2000	2001	2002
26.5	27.3	15.7	14.5	15.1	15.5	16.4

Source: EBRD and National Bank of Macedonia.

Key areas requiring attention in the banking sector are consolidation, the strengthening of corporate governance, increased efficiency and further improvement of the regulatory/supervisory environment. With most of the banks' capital now owned by the private sector, increasing competition already led to several mergers and acquisitions in recent years as well as the establishment of a new bank with foreign capital. Entry of foreign banks in the sector would further increase competition and improve the sector's corporate governance. While the regulatory environment for banks is now generally satisfactory, further improvement is required in related party lending rules and the supervision of market risks.

The development of non-banking financial institutions is still at a very early stage, although a number of reforms have been initiated. The Central Securities Depository and the Central Share Registry have been established, and a national payment card system is scheduled to be introduced soon. A controlling stake of "ZOIL Macedonia", a state-owned insurance company, was sold to a foreign strategic investor in March 2000. Legislative reforms to create a three-pillar pension scheme have already begun and privately managed pension funds are scheduled to be introduced in 2004. The Leasing Law was enacted in January 2002 to provide comprehensive legal framework to leasing activities. It still needs to be followed by relevant amendments, already prepared but not yet passed by parliament, to the accounting rules.

The arrival of the major international donor institutions has been an important development with regard to the supply of capital for the Macedonia SME sector, especially long-term credit. A number of international credit line operations have been established so far (see table 4-5). The international donor financed credit lines are aimed mainly at supporting manufacturing enterprises and attempt to spread the resources geographically throughout the country. Some domestic commercial banks are involved in the management of international credit lines and it appears that these credits have been used as a substitute for the use of their own resources for the SME sector.

Micro lending has proved to be a popular and efficient instrument for SME finance, achieving impressive results in a relatively short period of time (see table 4-6. below). There are several micro-lending institutions, such as Moznosti and KfW, operating in the country which lend from €3,000 - 10,000

Table 4-5. Credit Lines for Private Sector Development

Programme	Credit lines for private sector (both to SMEs and large firms)					1995-1999	Remark	
	Financial Institution or Government / Year	Amount in million EUR	Approved to final users, in million EUR	Disbursed in million EUR	[%] used loans	Number of loans	Average per loan, in EUR 1000	Beneficiary
EBRD, 1995		20.2	19.9	18.3	92.0	111	179	SMEs
IBRD, Phase 1, 1996		23	19.2	18.3	95.3	130	148	Medium & Large firms
IBRD, Phase 2, 1997			3.8	3.8	100.0	7	543	Medium & Large firms
Germany, through DEG, 1995		5.1	4.5	4.2	93.3	15	300	Medium & Large firms
Gov. of RM & Almako Bank		5.1	5.1	5.1	100.0	111	46	SMEs
PHARE Programme for SME Support, 1998		12.7	9.8	9	91.8	478	21	SMEs
IFAD (Agribusiness Development), 1997		8.4	4.2	2.5	59.5	736	6	Micro lending scheme
ICDF from Taiwan, 1999		12.2	10.8	9.8	90.7	58	186	SMEs
Commodities & Equipment Credit, Government of Italy, 1999		12.5	0.1	0.02	20.0	1	100	Credit line for SMEs
Development Bank of the Council of Europe, 1999		5.1	2.6	2.6	100.0	14	186	SMEs
		104.3	80.0	73.62		1661	44	

Source: Ministry of Economy of the Republic of Macedonia - Information on Available Funding for Private Sector Development, 2002

to sole proprietors, start-up SMEs, individual farmers, retailers, groups of citizens, with the objective to stimulate self-employment, SME development, support of farmers, alleviate poverty, etc. The Pro-Business Bank started its lending operations in mid-2003 and is expected to make a significant impact on the volume of micro-lending in the country.

Table 4-6. Micro Lending

Year	Total available funds	Disbursed funds	Beneficiaries	Average loan	Remark
2000	52.7 million €	24 million €	3,166	7,600 €	SMEs only
2001	48.6 million €	27 million €	2,405	11,200 €	SMEs only

Source: MEDF, 2002.

Assessment

A healthy, profitable financial sector is the key pre-requisite for providing access to finance for SMEs on a sustainable basis. Profitable private financial intermediaries are the necessary link between domestic savings and investment by private sector enterprises, in particular SMEs, and the only way to ensure sustainable SME access to finance and other financial services. Reflecting the perception of the private sector, the aggregate data on the banking sector show a low degree of bank intermediation. Potential borrowers, especially in the SME sector, are faced with high collateral requirements and high real interest rates, reflecting the cautious outlook of commercial banks. Coupled with the underdevelopment of the non-banking financial sector, this leaves micro-finance programmes and dedicated credit lines as the major formal source of external finance for the SME sector.

4.5. Implementation of Advisory Services to New and Small Businesses

The Situation on Advisory Services

A previous OECD-EBRD analysis (2001, pp.23-28) has discussed in detail the necessity for co-ordination of activities and financial sustainability of the business advisory services in Macedonia. These remain as significant in 2003, as they were in 2001.

Business advisory services constitute a relatively new domain of professional activity in Macedonia. There is very little tradition of using these services, compounded by limited local expertise in the delivery of such services. Moreover the situation is complicated by low levels of public awareness of the potential and value of such services and a history of “stop-go” institutional support.

The international donors, as well as other high profile international organisations, have set-up various projects and operations in Macedonia, seeking to stimulate an improvement in the overall business environment. At the present time, the structure of the business advisory services in Macedonia comprises the services highlighted in table 4-7.

Table 4-7. Providers of Business Advisory Services

1. Independent Consultants (individuals and/or legal entities):

- 78 firms (8 outside Skopje).
- All are micro-firms (26% of them see consultancy as their core business; for 46% it is their secondary activity).
- Their target markets are SMEs (74%) and international assistance programmes (62%).
- Their average fee rate is €100 - €150 per day.

2. “Big Five”:

- Arthur Andersen (now Grant Thornton), Ernst & Young, PricewaterhouseCoopers, KPMG, Deloitte & Touche.

3. “Internal” Consultants:

- Defined as performing business consulting work in a non-consultancy organisation.
- Typically based in state administration, large companies, research institutes, public institutions, etc.
- Well educated, young, speak foreign languages and have often received training abroad.
- Many operate as freelance consultants.

4. Business Support Centres:

- Regional Enterprise Support Centres (RESC) network is expected to be tasked with implementing the SME policy determined by the MoE.
 - Enterprise Support Agencies (ESA) centres located in the western part of Macedonia (Tetovo, Gostivar and Ohrid), increasingly operating on a for-profit basis.
 - Macedonian Business Resource Centre (MBRC) has finished its USAID-funded activities and continues operating as a for-profit consultancy.
 - Others: Dutch Macedonian Enterprise Development Foundation (Skopje), Swiss Business Support Centre (Prilep).
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Sources: GTZ, 2001; OECD-EBRD, 2001

Over and above the providers of business advisory, services, a number of organisations are actively providing enterprise support in Macedonia:

- Southeast Europe Enterprise Development initiative (SEED), established by the World Bank and IFC, provides consultancy support, mainly to medium-sized firms with growth potential.
- Business Advisory Services (BAS), established by the EBRD's and Central European Initiative (CEI), provides financial support for SMEs and already engaged with 45 projects after 12 months of operation.
- The Management Consulting Association-2000 (MCA-2000) is the first such association with some 50 members (consulting firms and individuals experts) covering management consulting, SME promotion and development, marketing, etc. Members have initiated a project, linked with the

Ministry of Economy, leading to Certified Management Consultant status, an internationally recognised certification by the International Council of Management Consulting Institutes.

- Others: such as GTZ - Private Sector Promotion, providing support for certification of Macedonian consultants; USAID implementing a project to raise Macedonian competitiveness (Booz, Allen & Hamilton and Harvard Business School); and the “Giant” industrial clusters initiative providing support to local business consultants.

A large number of small domestic consulting firms render a range of advisory services to domestic and foreign clients alike. These include accounting and audit, legal advice, marketing economic research, advertising and product promotion. To a lesser extent, it includes specialised advisory services such as strategic planning and various forms of professional guidance, including human resource training and development. Some niche advisory services, such as head-hunting, are also beginning to develop in the market.

Assessment

The research highlights the fact that Macedonia has experienced a significant expansion of international donor-funded as well as other advisory services with a view to promote start-ups and growing SMEs in last ten years. In addition to about 10 business centres/agencies, there are numerous other private sector providers of business advice, training and other, more specialised skills and services. It is expected that a network of EC Euro-Info Centres will also be created in Macedonia in the near future, probably hosted by the Chamber of Commerce network.

There remains a major concern about the extent to which the donor-funded initiatives are likely to be financially sustainable. Many started by providing services free of charge and now that international subsidies are no longer available, are finding it difficult to persuade entrepreneurs to pay commercial rates. The SMEs participating in the research view quite critically the efficiency, responsiveness and continuity of the business advisory services on offer. In addition, the range of services and the quality of the human capital (business advisors and consultants) available, including the assistance received from international consultants, is rated as being below “satisfactory”.

This suggests that the market is likely to correct itself, as donor funding is reduced in the next few years. Competition between service providers is likely to become more intense, placing a premium on quality and price. Good practice suggests that introducing standards with respect to advisory services (qualifications, membership of relevant bodies, confidentiality principles, charging policies and other quality standards such as service charters) could go some way towards generating greater confidence and thus willingness by the private sector to use and pay for such advisory services in Macedonia. In this context, the efforts by the Management Consulting Association-2000 to create a Certified Management Consultant certificate (internationally recognised certification by the International Council of Management Consulting Institutes) is a timely initiative and is supported by the Ministry of Economy.

The above analysis links up with a previous OECD-EBRD study of the SME environment in Macedonia that made two main recommendations for the improvement of the business advisory services, namely reform of the Role of the National Enterprise Promotion Agency (NEPA) and reform of the Role of the Business Support Centres (see box 4-3).

The expected abolition of NEPA and the creation of the Agency to Support Entrepreneurship (ASE) have been discussed previously. The key point to note is that ASE will also have responsibilities for the network of regional business support agencies. At the point of writing, ASE's exact remit *vis-à-vis* the RESC and other business support agencies is not clear, except that it will have responsibilities for co-ordinating them by offering public resources for the delivery of services which would otherwise not be available. To that extent, a number of principles remain as valid today, as when they were presented in 2001:

Box 4-3. Reform of the Role of Business Support Centres

A number of policy recommendations would assist in improving the operation of this network and in securing sustainability once donor funding has ended.

1. Long-Term Funding: There has to be recognition that the original plan, namely that these organisations would become independent of donor funds, is not going to be achieved within the timescale foreseen. This means that although income generation activities (such as business planning, training and advisory) will continue to be important to the business support centres, it should be recognised that they are unlikely to be able to fulfil this objective as well as their wider remit (such as information services and outreach work). The decision needs to be made now as to whether they will continue to be partially funded through public support (as often happens in OECD Member countries) or whether they should be freed up to seek survival by competing in the private consultancy market. If they are to be supported further to perform services which are of a public service nature, then the planning process must begin now for state, local government or other financial support once donor funding has ceased. Such a decision would ensure that the centres' future is secure, that the business advisors already invested in do not leave, and that these institutions can work on a more secure basis than at present. Becoming independent and sustainable organisations must be their long-term focus.

2. Monitoring and Co-ordination: As long as the business support centres receive public support, there is a role for the SME Agency to monitor and co-ordinate these organisations in order to ensure that resources are being used effectively and transparently. This formal relationship currently applies to the RESC network, which receives support from Phare, but is not the case for those organisations supported by bilateral donors. This monitoring and co-ordination function is currently weak, and both SME Agency and the RESCs would benefit from *SME Agency representation (non-voting status) on the managing board of each RESC*. This involvement would enable the SME Agency to understand the priorities and functioning of each RESC and would allow the RESCs to build a more fruitful relationship with SME Agency through regular contacts.

Overall, SME Agency would be able to perform its monitoring and co-ordination role in an effective manner, thus generating greater accountability in the system. Although the RESCs are independent foundations, they are likely to respond positively to this suggestion if it is coupled with the prospect of a more financially secure and long-term relationship. Similar moves should be initiated with the remainder of the business support centres. These centres are currently operated through donors, but the logic and added-value of an integrated network of business support centres would be persuasive arguments.

3. Performance-Related Contracts: Each RESC operates on the basis of a contractual agreement with SME Agency - the contract and the associated monthly payment is on a flat-rate basis. This means that all RESCs are paid regardless of output, innovation, success and effort. This type of contract rewards non-performers and under-performers and penalises the others, and as a result motivation and effectiveness are reduced. It would be more effective to move towards *longer-term, performance-related contracts*. Such contracts would be negotiated with each RESC to undertake a specific package of services, thus building the capacity and expertise of the RESCs as well as offering on-the-ground support to SMEs. This arrangement would result in a more customised set of priorities and services per region and in a long-term SME perspective for the RESCs. The SME Agency would gain by being able to influence the package of services and, through regular monitoring of performance, ensure that services are being delivered to SMEs (OECD-EBRD, 2001, pp.46-47).

- The business support centres are not financially sustainable on their own. If ASE is to co-ordinate the regional network, it must have a clear role, supported by an adequate long term budget to enable the network to undertake services which would otherwise not be delivered through the market. This role must take into account the fact that these business support centres have either been operating as independent foundations or with very little government involvement or oversight in recent years.
- If public funds (national and/or international) are to be used the ASE will need to monitor and co-ordinate the activities of the network to ensure accountability.

- Finally, the relationship with the regional network should be structured in such a manner that outputs, innovation, success and effort are incentivised and rewarded.

The latest information suggests that the OECD-EBRD recommendations made in 2001 will form the basis for the interaction between the new ASE and the RESC/ESA, etc. network of business support centres being planned by the Ministry of Economy.

4.6. Implementation of Business Incubators

The business incubator is a particular form of business service that offers potential in transition economies. Business incubators are generally defined as special areas for new and young developing businesses that provide such businesses with premises, infrastructure, a comprehensive range of services and support that can improve their ability to initiate and run their operations during the early developmental period. The combination of physical facilities, focus on start-ups and SMEs and “soft” advisory and support services provided are what distinguish business incubators from other industrial centres or industrial estates (OECD-UNIDO, 1999, pp.51-53).

The Current Situation on Business Incubators

The World Bank has allocated funds for the establishment of business incubators in municipalities throughout the country. The implementation of the business incubator programme was originally assigned to the almost defunct Privatization Agency as part of the Project for Social Reforms and Technical Assistance. The project made credit available on attractive terms and conditions. In addition to about €10 million for social reforms, about €14 million was planned for the business incubator programme.

The first beneficiaries of this assistance in the 1990s were the municipalities of Prilep, Stip, Makedonska Kamenitsa, Delchevo and Krushevo. Two others, larger in size (about 2,000 m²), were established in Bitola and Veles, urban areas with growing levels of unemployment following company restructuring and layoffs. These SME support nuclei formed part of the World Bank's strategy of counteracting the social consequences restructuring and downsizing. The primary function of the business incubators is to provide premises for start-up businesses under preferential terms and conditions, including basic advisory services and guidance. Their role is to deliver:

- Basic services (accounting, administration, offices, telephone, etc.).
- Soft services (consulting services with tailored training programmes for education, development of business ideas, leading of future entrepreneurs toward their goals, legal advisory, etc.).
- Management assistance, for example, in searching for financial support for promising start-ups.

Although little published information is available, the general perception is that Macedonia has not made the most of the large amount of assistance from International Financial Institutions (IFIs) available for the development of business incubators. In the absence of a clear concept and policy for the development of business incubators, the task was transferred to the Agency for Privatization with little follow-up of the implementation of the project. The new SME strategy aims to develop a further four additional business incubators during the period 2003-2006 with domestic and international support amounting to €1 million. However, it is unclear at this stage what will become of the existing business incubators, whether the funds and technical assistance will be available, whether there is an intention of making use of the body of best practice that has built-up in Macedonia, SEE region and OECD member countries, etc.

Assessment

Despite the lack of Government policy and strategy with respect to business incubators, the availability of substantial amounts of IFI funds to mitigate the social consequences of industrial downsizing meant that Macedonia has made substantial progress in implementing business incubators.

Seven business incubators exist at the time of writing nevertheless, it is far from clear that these have been developed effectively. It is anticipated that a further four may be developed between now and 2006.

The responsibility for the development of business incubators was initially assigned to the Privatisation Agency, though its focus was very different in nature. In the time since, the Agency for Privatisations has been earmarked to be abolished and it is important to identify the organisation that will take over this responsibility. An initial assessment of this situation, given that the new SME strategy calls for the implementation of additional business incubators, suggests that this could be allocated to the Ministry of Economy and ASE, the new SME implementation body. Yet it is far from clear that the Ministry of Economy has developed an analysis of:

- How the existing seven business incubators will be handled.
- How the additional four business incubators will be funded.
- The sectors of activity to be targeted (such as agribusinesses, high-tech, services, etc.).
- The optimal size of the proposed new incubators, since small ones raise sustainability concerns.
- How best to introduce best practice with such issues as governance structures, entry and exit policies.

The research highlights other issues of concern. Despite a relatively long track-record with business incubators and the fact that SMEs participating in the research recognise their importance, they remain largely unaware of their objectives, functioning and general effectiveness. Very little information of this nature gets through to the enterprise level, despite the strong expectation that business incubators offer great potential to assist start-ups in the Macedonian economic context.

Chapter 5.

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Chapter 6.

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GTZ (technology transfer project): <http://www.gtztechno.com.mk>.
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Macedonian Bank: <http://www.makbanka.com.mk>.
Macedonian Information Agency: <http://www.mia.com.mk>.
Macedonian Legal Resource Centre: <http://www.mlrc.org.mk>.
Macedonian Privatization Agency: <http://www.mpa.org.mk>.
Macedonian Stock Exchange: <http://www.mse.org.mk>.
MCA-2000 (Management Consulting Association): <http://www.mca2000.org>.
Ministry of Foreign Affairs: <http://www.mnr.gov.mk>.
Ministry of Information: <http://www.sinf.gov.mk>.
National Bank of Macedonia: <http://www.nbrm.gov.mk>.
National Information Centre for Commercial Law (NICCL): <http://www.mbla.org.mk>.
Regional Chamber of Commerce Skopje: <http://www.regcom.org.mk>.
Skopje Municipality: <http://www.skopje.gov.mk>.
Stopanska Banka Skopje: <http://www.stb.com.mk>.
Tutunska Banka Skopje: <http://www.tutunskabanka.com.mk>.
World Bank: <http://www.worldbank.org>.

Appendix 1.

OBSTACLES TO DOING BUSINESS

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

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

Macroeconomic instability	3.5
Economic policy uncertainty	3.3
Tax rates	3.2
Tax administration	3.1
Cost of financing	2.9
Corruption	2.6
Business licensing and permits	2.5
Access to financing	2.5
Customs and trade regulations	2.5
Organised crime	2.4
Street crime	2.4
Contract violations by customers and suppliers	2.3
Anti-competitive practices of other producers	2.3
Functioning of the judiciary	2.1
Skills and education of workers	1.8
Access to land	1.8
Title or leasing of land	1.7
Transportation	1.6
Labour regulations	1.6
Electricity	1.4
Telecommunications	1.3

Source: EBRD

Appendix 2.

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

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

