



Small and Medium Enterprises (SMEs) and Foreign Direct Investment (FDI) development

Comparative Analysis
in Project Recipient IPA Countries

volume III



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***WP 3 - Road Map for Adriatic Governance:
Euroregion and Macroregion synergies and joint
initiatives***

***Comparative Analysis
in Project Recipient IPA Countries***

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Introduction

In the framework of WP3 of Project AdriGov (Adriatic Governance Operational Plan), INFORMEST – Service and Documentation Centre for International Economic Cooperation) has carried out this Comparative Analysis of the existing supporting measures (in territorial cooperation programmes and others international donor financing) for SMEs development and FDI attraction in Project Recipient IPA Countries. However, in order to obtain a more comprehensive picture it was considered appropriate to include the other Western Balkan Countries not participating in the Project (Former Yugoslav Republic of Macedonia – below FYR of Macedonia – and Kosovo¹). The Analysis is integrated by an overview of the new EU Regulations belonging to the Cohesion Package 2014-2020 providing recommendations on potential synergies between EU, National and Regional supporting measures for local development. On the basis of the findings of the comparative analysis was prepared a concise Report providing guidelines for an internationalisation joint strategy highlighting priority axis for FDI attraction and joint initiatives development in the Countries included in the comparative analysis.

The Analysis is divided in five sections; the first briefly presents the overall economic situation of the Western Balkans Countries, also taking into account the negative impact resulting from the current international economic situation due to the financial crisis erupted in late 2008 that has in some cases severely affected the Countries' economies, including the SMEs systems. The second section presents the situation of the SMEs, emphasizing their peculiarities, their role in national economic and productive systems, as a result of the still on-going economic transition processes, while the third part analyses the FDI inflows in the Region, with particular emphasis on the reasons that have caused a lower volume of foreign capital inflows in these Countries than in the of Central and Eastern Europe Countries (CEECs).

The sources for these sections are both international and national. The advantage of using international data is that the statistics are harmonised and comparable across Countries. The disadvantage is that for some Countries the data may be different from those published by national authorities. Consequently, for some Countries there may be some discrepancies on data on the "SMEs system" (i.e. number of companies, employees, turnover, etc.). Regarding the data on the inflow of FDI we have used the figures provided by the Central Banks of each country, as well as those provided by the national institutions responsible for the development of FDI.

In the fourth part is presented the general offer of the main international financial organizations active in the Project Recipient Countries (World Bank Group - WB, European Bank for Reconstruction and Development - EBRD, European Investment Bank – EIB and the European Union – EU), focusing on specific financial instruments designed to support SMEs in this Region, stressing on the prospective opportunity granted by such facilities that if fully exploited can contribute to the improvement of a better "business environment" in the Western Balkans Countries.

The last section of the Analysis presents a series of Surveys, one for each of the seven Countries analyzed, aiming at deepening the single-Country view for financial facility already offered by the IFIs in support of national SMEs, as well as the national instruments for improve the FDI inflows. We have delineated, in the occasion, as an introductory element, to characterize the role and the weight of SMEs in national economy, both in quantitative terms and in absorption of workforce. As reference of the status of national system development, it was chosen to relate to the formal evaluations produced by the European Commission, whereas possible, on the status of progress done in the EU integration process specifically referring to pursued industrial and SME policies. The recourse to the results of recent international surveys realized on an updated database set up by the WB in cooperation with the EBRD, allowed a view of the direct reactions of the entrepreneurs of the seven Project Recipient Countries arisen from the most problematic issues hindering the business activities, with a specific attention to the capacity to access to finance.

1 This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence.

Economic situation in Project Recipient IPA Countries

Recent developments (2012-2013)

In 2012 there was a mixed picture in terms of economic and social developments in the Western Balkans Countries. The impact of the economic crisis is being felt throughout this Region, with several Countries, albeit in different sizes, falling back into recession in conditions of low levels of competitiveness, income and investment and rising unemployment. The economic situation in these Countries reflected the weakening of growth which affected both advanced and emerging market economies. Labour markets improved in Countries which had positive growth (in particular, FYR of Macedonia and Montenegro) but further deteriorated in those where activity contracted. Further progress was generally achieved in the adjustment of internal and external macroeconomic imbalances. In 2012, only in Serbia and the FYR of Macedonia did both the current account and the budget deficits deteriorated. The situation was more heterogeneous as regards inflation. In spite of weak growth, weak domestic demand and a decrease in international commodity prices towards the end of 2012, the pace of consumer price inflation accelerated in many Countries in 2012, often reflecting the impact of increases in indirect taxation and administrative prices.

In general terms, the growth performance improved in 2013. GDP growth turned positive in the Western Balkan economies that had experienced recession in 2012 and gathered pace in the other Countries where it had slowed down. Albania might be the sole exception to this general pattern. Having picked up in the first semester, growth further increased in the third quarter in several countries (e.g. in Serbia). It was driven in several cases by an increase in exports, a positive development albeit supported by volatile factors such as favourable weather conditions. Higher growth generally translated into some improvements or a stabilisation in labour market conditions but unemployment remains at very high levels in all Western Balkan Countries. While employment grew in Albania, FYR of Macedonia and Montenegro, it remained depressed in Serbia and Bosnia and Herzegovina. But even where employment has recovered meaningfully since 2010, the gains were not broad-based and mostly concentrated in services growth will be too weak to support substantial gains in employment.

As export performance strengthened and imports declined, current account unbalances narrowed. The gradual recovery in the Euro Area helped the goods exports to grow, making a strong positive contribution to overall economic growth. Export growth picked up everywhere, propelled by new FDI-based export capacity. However, the sustainability of this high export increase is uncertain in view of the region's narrow export base and low competitiveness issues. Weak domestic demand depressed imports in all Countries but Serbia, where their rise was led by raw materials and parts used in export-oriented industries. FDI remained sluggish in the region, rising only by 0.7% of Gross Domestic Product (GDP), but its share of financing of the current account increased. Remittances from abroad continued to be resilient overall, but the Greek crisis began to take its toll, especially on Albania. A common pattern of reduction of some macro-economic imbalances prevailed. Consumer price inflation further decelerated in the third quarter and average annual inflation declined in all Countries in 2013. Similarly, the adjustment of external imbalances continued. On the other hand, fiscal consolidation offers a more differentiated picture. It proved challenging in Albania, Montenegro and Serbia where deficits are high and government debt keeps rising.

In conclusion, the Western Balkans Countries have a lot of common problems, but also some differences. All of them suffer from extremely high unemployment, especially among the young people, of widespread corruption, a growing public sector and, in general, of bad management of public finances. All of them are in one way or another affected by the crisis in Europe because their markets are to a lesser or greater extent integrated with the EU's single market. All the Western Balkans Countries suffer from a huge share of the informal economy, as in Bosnia and Herzegovina and Kosovo the situation is especially severe. The weak fight with corruption and the weak rule of law also pose a serious impediment for the economic development of the Countries in the region, as in all cases the Commission reports (see below) weak to some progress. It will be interesting to see how and whether there will be a change after the change of European Commission's approach to focus precisely on the rule of law and the fight against corruption throughout the entire negotiations process. This scheme debuted in Montenegro and is expected, in the end of January, to be

applied in the negotiations framework with Serbia, too.

From the enlargement process issue, 2013 has marked a new beginning in the EU's approach. With Croatia's EU accession on 1st July 2013 with an economy in a five-year-long recession, the need of change of approach toward the Candidate and Potential Candidate Countries became imperative. In its Enlargement Strategy for 2014 the European Commission envisages to introduce the European semester for the Western Balkan Countries (and Turkey). Although the Countries for the future EU membership had to fulfil the economic criteria approved by the European Council in Copenhagen in 1993² (existence of a functioning market economy and capacity to handle competitive pressures and the single market forces), 20 years later it became clear that they are insufficient, because almost all Western Balkan Countries have no market economy status yet. In 1997, after a progress review, the Commission proposed several sub-criteria that specify the fundamental ones. Those are a balance between demand and supply in a context of free interplay of the market forces³. It is precisely on the basis of these criteria that the Commission prepares the economic chapters in the Progress Reports of the Candidate and Potential Candidate Countries and also of those who aspire to set off on the path of European integration.

2 More precisely, the current EU's policy towards the Western Balkans is defined within the Stabilization and Association Process (SAP) launched in May 1999 by the European Commission. At the Zagreb Summit in November 2000, EU Member States and countries of the Western Balkans confirmed their commitment to the SAP. Responding to the future prospect of EU accession, The Western Balkans Countries have undertaken to meet the agreed political and economic requirements. These requirements, known as the Copenhagen Criteria, were agreed by the Council of the European Union in Copenhagen in 1993. They include: Political criteria: stable institutions guaranteeing democracy, the rule of law, human rights and respect for /protection of minorities; Economic criteria: a functioning market economy able to cope with competition and market forces in the EU; The capacity to take on the obligations of EU membership, including adherence to the objectives of political, economic and monetary union. The SAP is a progressive partnership, in which the EU offers a country a mixture of trade concessions, economic and financial assistance and contractual relationships. The progress achieved in the SAP leads to the establishment of the contractual relationship between a country and the EU known as the Stabilization and Association Agreement (SAA). The SAA is a tool that provides the formal mechanisms and agreed 'benchmarks' that allows the EU to work with BiH to bring it closer to EU standards. Since the signing of the SAA, BiH institutions have been obliged to ensure that its existing laws and future legislation are gradually made compatible with the EU *acquis*. BiH institutions are also obliged to ensure that all existing and future legislation is fully implemented. The main elements of the SAA are: promoting the free movement of goods; creating efficient institutions; developing a market economy; reducing crime and corruption; promoting higher education reform; developing democracy, human rights, and an independent media; improving the region's transport infrastructure.

3 Trade liberalisation; removal of barriers preventing the establishment of new firms and simplifying bankruptcy procedures; how does the legal system work in terms of property rights, how contracts are implemented and, generally, how does the judiciary work; macroeconomic stability, management of public finances; broad consensus on the main parameters of economic policy; condition of the financial sector.

State of play of Western Balkans Countries EU integration

Country/Membership Status	Current situation
Albania/Potential Candidate	<i>The Stabilisation and Association Agreement (SAA) was signed on 12th June 2006 and entered into force on 1st April 2009. In October 2012, Commission recommended that Albania be granted EU candidate status, subject to completion of key measures in the areas of judicial and public administration reform and revision of the parliamentary rules of procedures.</i>
Bosnia and Herzegovina/ Potential Candidate	<i>The SAA, signed in June 2008, has been ratified but has not yet entered into force.</i>
Croatia/Member State	<i>From 1st July 2013 Croatia is the 28th EU Member State</i>
FYR of Macedonia/Candidate	<i>the SAA was signed on 9th April 2001 and entered into force on 1st April 2004. In October 2009 the European Commission recommended opening negotiations for accession to the EU.</i>
Kosovo/ Potential Candidate	<i>Negotiations on the Stabilisation and Association Agreement between the EU and Kosovo, which were launched in October 2013, continued swiftly and a draft agreement is expected to be initialled in summer 2014.</i>
Montenegro/Candidate	<i>On 1st May 2010 entered into force the SAA, signed in October 2007. The accession negotiations started on 29th June 2012. On 18 December 2012, Montenegro opened and temporarily closed Chapter 25 (Science and Research), while Chapter 26 (Education and Culture) was opened and temporarily closed on 15 April 2013.</i>
Serbia/Candidate	<i>In March 2012 Serbia was granted EU Candidate status. In September the SAA entered in force. On 21st January 2014, the 1st Intergovernmental Conference took place, signaling the formal start of Serbia's accession negotiations.</i>

Source: European Commission

Perspectives for 2014

Growth in the Western Balkans Region will likely continue recovering in 2014 from the very low levels seen recently, helped by the nascent recovery in the Euro Area, as well as favourable weather conditions that buoyed agricultural and energy output and helped weaken inflationary pressures. In most cases, though, recovery will remain modest, and even the best performers have large question marks hanging over them, mostly due to political risk. According to the European Bank for Reconstruction and Development (EBRD), regional growth should reach an average of 2.2% in 2014 (1.6% in 2013). In 2014, real GDP of Croatia is forecast to grow by 1.5%, on current policies. Net exports of goods and services and investment are expected to be the main contributors to growth. The projected pick-up in investment in 2014 is expected to be led by the public sector, assuming increased recourse to EU funds. Growth in private investment is expected to remain constrained due to fragile domestic demand and ongoing bank deleveraging. Croatian exports are forecast

to benefit from the gradual economic recovery in the EU, but to a limited extent because of comparatively less favourable developments in Italy and Slovenia, two of the Country's major trading partners. Furthermore, goods exports will be held back by the narrow manufacturing base and still ongoing restructuring in some important industries. Private consumption is expected to contribute negatively to growth in 2014, due to a worsening labour market situation and ongoing deleveraging of households. Employment fell in the last part of 2013 and is expected to stagnate in 2014. Wage growth dynamics would remain weak in view of the muted recovery. However, low inflation is forecast to provide a partial cushion, limiting losses in purchasing power.

Serbia, the other big economy of the Western Balkans is expected to grow 2.0% in both 2013 and 2014 by the IMF. Again political risk stalks the country. Serbia has enjoyed a rare period of political stability and the application of a broad programme of market-friendly reforms, including encouraging FDI and clamping down on corruption. Albania is looking forward to a better 2014. It has a new government after the previous discredited and institutionally corrupt administration was dumped, despite its best efforts to fiddle the parliamentary elections earlier this year. The new reformist government has pledged to root out the endemic corruption that blights this Balkan Country's economic prospects. The World Bank expects the Albanian economy to recover in the coming years with a projected growth rate of 1.3% in 2014. The World Bank country director for Southeast Europe, Ellen Goldstein, suggests "Albania's economic growth will be slow, but sustainable." The IMF is more optimistic, forecasting the economy will expand by 1.7% in 2013 and 2.1% in 2014. Kosovo should be buoyed by the economic performance of Albania to the south and Serbia to the north. Relations with its former master dominate the new country's prospects, so the huge improvement this year in Serbian-Kosovan relations, overseen by the EU, is a big positive. FMI Staff forecasts real GDP growth to recover from the estimated 3.0% for 2013 to around 4% for 2014, consistent with expected developments in Germany and Switzerland, the main host Countries of Kosovo's Diaspora. Remittances and other Diaspora inflows would remain the main driver of domestic demand and growth, although staff's projections also incorporate a very gradual expansion in production capacity and exports, as efforts to enhance competitiveness bear some fruit. CPI inflation is expected to remain below 2% in 2014, in line with lower projected food and fuel prices. Another Balkan state still feeling the after-effects of the Balkan wars of the 1990s is Bosnia and Herzegovina. The economy is actually quite stable despite a political picture fractured along ethnic lines, which sees the Country divided into a Bosnian Serb Republic and a Muslim-Croat Federation. Bosnia's budget deficit is expected to come in at around 2% of GDP in 2013, while the ratio of public sector debt/GDP stands at less than 30%, i.e. half the level of Serbia and Croatia. The current account deficit is large at around 7% of GDP, but is underpinned by a range of FDI and financing from the IMF/EU. As such, the IMF predicts 0.8% growth in 2013 rising to 2.0% in 2014. FYR of Macedonia is forecast to continue its recovery in 2014, with growth reaching a sterling 3.0% according to the IMF. The EBRD says: "Macedonia has shown some signs of recovery... driven primarily by a continued strong rise in investment as well as some recovery of exports in the second quarter. Consumption meanwhile continues to be a drag on growth. Inflation has fallen in 2013. The Country continues to make strong efforts to improve the business environment and attract much-needed FDI, which should help growth prospects in the coming years". Finally, Montenegro, is seeing its economic recovery gather pace on the back of exports. The IMF sees growth of 1.8% in 2013 rising to 2.5% in 2014. However, the EBRD notes that the current account deficit, at close to 20% of GDP, remains the highest in the region. "The fiscal position has been weakened by payment of KAP guarantees, and public debt levels have risen sharply in recent years. Credit to the economy continues to contract and NPLs are high at close to one in five loans."

Real GDP growth (annual % change)

	2012	2013 (*)	2014 (*)
<i>Albania</i>	1.6	1.3	2.1
<i>Bosnia and Herzegovina</i>	-1.1	0.8	2.0
<i>Croatia</i>	-2.0	-0.4	1.5
<i>FYR of Macedonia</i>	-0.4	2.1	3.0
<i>Kosovo</i>	2.5	3.0	4.0
<i>Montenegro</i>	-2.5	1.8	2.5
<i>Serbia</i>	-1.5	2.0	2.0

(*) - Forecast

Source: World Bank staff projections

SMEs status in Project Recipient IPA Countries

The role of Small and Medium-sized Enterprises (SMEs) is perhaps the most important for the European economy as their number, employment capacity and value added constitute a large share of the EU Member States and Western Balkans Countries economic systems. In spite of differences, economies of the Western Balkans share common features. The importance of SMEs, which account for as much as 92% of all businesses in some Countries is, perhaps, the most salient of them. SMEs generate between 61%-81% of employment in private sector and make up the largest share of total value added. A slow recovery from the global economic crisis has affected SMEs severely. However, in the attempt to overcome the present situation, the Governments of Western Balkans Countries are focusing on effective short- and long term reforms to help SMEs to generate growth and new jobs.

Before going into the details of the “SMEs system” in the Region is important to make a methodological premise. At European level the current definition of SMEs is set out in the Recommendation of the Commission adopted on 6th May 2003, which came into effect as from 1st January 2005⁴. This definition up-dated and replaced the Recommendation 96/280/EC adopted in 1996⁵. The changes reflect economic developments since 1996, and a growing awareness of the specific hurdles confronting SMEs. The new definition is more suited to the different categories of SMEs and takes better account of the various types of relationships between enterprises.

SMEs EU standard definition

<i>Company category</i>	<i>Employees</i>	<i>Turnover or Balance sheet Total</i>	
<i>Micro</i>	< 10	< € 2 million	< € 2 million
<i>Small</i>	< 50	< € 10 million	< € 10 million
<i>Medium-sized</i>	< 250	< € 50 million	< € 43 million

Source: European Commission

The Recommendation is addressed to the Member States, the European Investment Bank (EIB) and the European Investment Fund (EIF – see below) and, as well as providing a framework for statistical definitions, has specific applications in EU policies that support SMEs (Structural Funds, Framework Programme for Research and Development, new programme for Competitiveness of Enterprises and SMEs – COSME, etc.) and in the rules governing State Aid.

In 2012, the EU-27 SMEs accounted for 66.5% of all jobs and for over €3.4 trillion value added against a total value added produced by the private non-financial sectors of approximately €5.9 trillion. A considerable contribution of SMEs was to the services and manufacturing sectors. Both sectors employed 74 million people and produced €2.9 trillion of value added, with 85.0% of all European SMEs working in these two sectors. The construction sector, the utilities sector and mining and quarrying contributed to the remainder. In 2012, the wholesale and retail sector comprised 5.8 million SMEs, 93.0% of which had less than 10 employees. Professional, scientific and technical services consisted of 3.3 million enterprises of which only circa 2,400 companies have 250 or more employees. The remainder of the service sector SMEs are distributed amongst the accommodation and food sector (1.7 million), administrative and support services (1.2 million), real estate activities (1.2 million), information and communication (0.8 million) and transportation and storage (1 million).

With regard to the specific situation of the Western Balkans Countries are taken into account the data of *International Finance Corporation - IFC* that give a fairly homogeneous framework of SMEs for the Western Balkans Countries. In particular, the *Micro, Small, and Medium Enterprises (MSMEs) Database* (last updated in

⁴ Commission communication - Model declaration on the information relating to the qualification of an enterprise as an SME, OJ C 118 of 20 May 2003..

⁵ For more details see: http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf

August 2010) drawn by IFC^c, that also considers the micro-enterprises reality, provides in the both the latest global snapshot and historic data back 20 years on the number of Micro and SMEs in 132 world economies. Within these data, we will consider the extracted data for the Western Balkans Countries, with the limit of the absence of data relating to Kosovo. Furthermore, MSMEs data are not always standardized across Countries and time, because data on MSMEs are gathered by various institutions using different methods. These institutions define MSMEs based on differing variables and scales and sometimes change their definitions. However, the overall picture can be considered enough exhaustive to present comparatively the peculiarities of the MSME sector in this Region. The database authors chose to consider micro-firms, together the weight of the smallest enterprises structures (family and non-employer) in transition economies, often linked to informal business, but relevant to the constitution of national wealth. In a single case (Albania), we have a different classification among Micro and Small firm dimension, but useful to better understand the reality of the Albanian fragmented business tissue and the drastic predominance of very small firms.

The MSME data varies considerably among the six Countries (excluding Kosovo) given their size and the economic structure. Only the Croatian MSMEs are classified in the “high” income group (US\$ 11,906 or more), while the Albanian MSMEs fall into the income category “Lower middle” (US\$ 976 - US\$ 3,855). The data structure reveal the high proportion of Micro-firms, with a range from 85.5% (Serbia) to 93.7% (Bosnia and Herzegovina), leaving a certain relevance to small enterprises (max 49 employees) only in Serbia (share of 11.6%) and Croatia (9.7%). A similar consideration is valid for the Medium firms (50-249 employees). The MSMEs weight is measured in density per 1,000 inhabitants, so giving a major density share in Bosnia and Herzegovina (42.7%) and Montenegro (37.5%). The relevance in creating employment in the different domestic markets emerges from the high average contribution of smaller enterprises to labor system with a share going from 62.6% in Bosnia and Herzegovina and 61.6% in Montenegro.

MSMEs database referred to the WB countries (data collected in August 2010)

Country (Year/source data)	Income group	MSME definition (n. of employees)			Structure of the MSME sector (% of all MSMEs)			MSME participation in the economy		
		Micro	Small	Medium	Micro	Small	Medium	Total MSMEs	MSMEs (*1,000 people)	MSMEs employment (% total)
Albania (2008/INSTAT*)	Lower Middle	1-4	5-19	20-79	92.2	6.3	1.6	68,779	21.9	15.4
B&H (2008/MVTEO**)	Upper middle	1-9	10-49	50-249	93.7	5.4	0.9	161,295	42.7	62.6
Croatia (2008/ECEI***)	High	0-9	10-49	50-249	88.1	9.7	2.2	82,268	18.6	26.8

6 For more details see: http://www.ifc.org/wps/wcm/connect/Industry_EXT_Content/IFC_External_Corporate_Site/Industries/Financial+Markets/msme+finance/sme+banking/msme-countryindicators

FYROM (2008/ECEI)	Upper middle	0-9	10-49	50-249	90.7	8.4	0.8	45,058	22.1	33.1
Kosovo (n.a.)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Montenegro (2008/ECEI)	Upper middle	0-9	10-49	50-249	89.2	8.9	1.8	23,332	37.5	61.6
Serbia (2008/ECEI)	Upper middle	0-9	10-49	50-249	85.5	11.6	2.9	81,006	11.0	20.9

* - National Statistics Institute

** - Ministry of Foreign Trade and Economic Relations of B&H

*** - European Commission/Enterprise and Industry/SME Performance Review 2009

Source: Micro, Small, and Medium Enterprises Database (2010)

Another interesting aspect is the general business environment that characterizes the Countries covered by this analysis. For this purpose we present the main conclusions of the report *Doing Business 2014* (DB 2014) prepared by the *World Bank*. In the report the economies are ranked on their ease of doing business, from 1 (best position: Singapore) to 189 (worst position: Chad). A high ranking on the ease of doing business index means that the regulatory environment is more conducive to the starting and operation of a local firm. This index averages the Country's percentile rankings on 11 topics, made up of a variety of indicators, giving equal weight to each topic. The rankings for all economies are benchmarked to June 2013. In particular *Doing Business* captures several important dimensions of the regulatory environment as it applies to local firms. It provides quantitative measures of regulations for starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency.

In the ranking on the ease of starting a business, Albania ranks in 76th place in the ranking of 189 Countries monitored by the *DB 2014*. Compared to last year, there has been a deterioration (68th place in the *DB 2013*, when Albania made starting a business easier by making the notarization of incorporation documents optional), mainly due to the fact that during 2013 were not made further reforms. Within the Western Balkans Countries, Bosnia and Herzegovina occupies the absolute worst position (174th place in the ranking *DB 2014*), a decrease compared to the previous year's report (164th). In fact, during 2013 there have been no further progress in facilitating the launch of a business (only in 2011 the Country made starting a business easier by replacing the required utilization permit with a simple notification of commencement of activities and by streamlining the process for obtaining a tax identification number).

Doing Business Survey

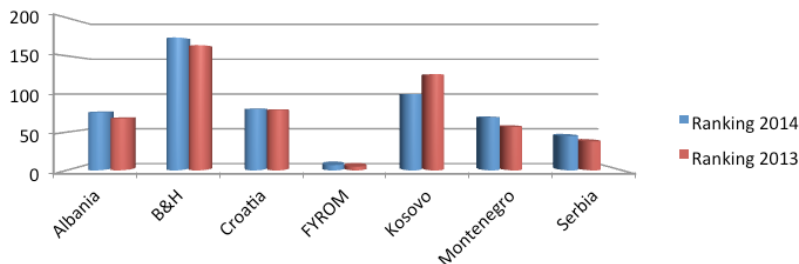
	Starting a Business	Ease of doing business	Dealing with construction	Getting electricity	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across	Enforcing contracts	Resolving insolvency
Albania	76	90	189	158	119	13	14	146	85	124	62
B&H	174	131	175	164	96	73	115	135	107	115	77
Croatia	80	89	152	60	106	42	157	34	99	49	98
FYROM	7	25	63	76	84	3	16	26	89	95	52
Kosovo	100	86	136	121	58	28	98	43	121	138	83
Montenegro	69	44	106	69	98	3	34	86	53	136	45
Serbia	45	93	182	85	44	42	80	161	98	116	103

Source: World Bank, Doing Business 2014

Croatia stands at 80th in the ranking of 189 economies on the ease of starting a business (79th in DB 2013). In particular, in 2010 Croatia eased business start-up by allowing limited liability companies to file their registration application with the court registries electronically through the notary public. In 2011-2012 no relevant reforms were measured by *Doing Business*, whilst in 2013 Croatia made starting a business easier by introducing a new form of limited liability company with a lower minimum capital requirement and simplified incorporation procedures.

On the contrary, FYR of Macedonia stands at 7th in the ranking of 189 economies on the ease of starting a business (5th in DB 2013). This good performance is due to the progressive reform to reduce the number of procedures (only 2) and days (only 2), started in 2005. The improvement of Kosovo in the ranking (100th in DB 2014 against 126th in DB 2013) is due to the fact that the Country made starting a business easier by eliminating the minimum capital requirement and business registration fee and streamlining the business registration process. Montenegro has instead worsened its position (69th in DB 2014, 57th the previous year), because in the last 2 years have not been adopted new measures to facilitate business (between 2009-2011 Montenegro eased business start-up by simplifying the post-registration process including the registration for taxes, social security and employment, eliminated several procedures for business start-up by introducing a single registration form for submission to the tax administration and made starting a business easier by implementing a one-stop shop). Finally, Serbia has also worsened its position in the ranking (45th in DB 2014, 38th the previous year): in 2012 Serbia made starting a business easier by eliminating the paid-in minimum capital requirement, but non further measures were adopted in the following year.

Starting a Business



Source: World Bank, Doing Business 2014

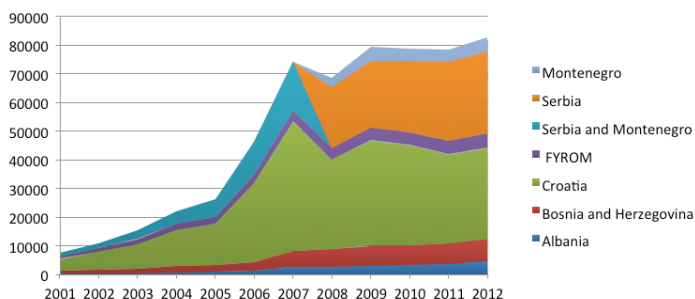
FDI inflows in Project Recipient IPA Countries

For small open economies, without adequate sources of domestic savings, the requirement to attract FDI becomes one of the key preconditions for future economic growth. This might be particularly important for the Candidate and Potential Candidate Countries of South East Europe which are aspiring to become EU members. The accession process itself incurs additional costs of catching up, and, as the Countries analyzed in this Analysis started their transition relatively later and facing greater difficulties than the more successful transition economies, the knowledge and technology transfer that might come through foreign investment seem to be almost as important as the capital.

The Western Balkans Countries attracted little FDI during the 1990s, because of the political risk the economic instability, as well as competition from more big and promising transition economies (CEECs - e.g. Poland, Hungary, Czech Republic, etc.). During the first half of the nineties, or the period characterized by war and serious political and economic instability, FDI inflows to South East Europe were particularly low. The situation improved after the signing of the Dayton Peace Accords in December 1995, although the Western Balkans Countries continued to lag behind the CEECs as FDI recipients. The international community also changed its policies towards the region after the end of the Kosovo conflict in mid-1999. The EU launched the *Stabilisation and Association Process* offering trade liberalization measures, a new financial assistance programme, contractual relations through the signing of *Stabilisation and Association Agreements*, and even prospects of EU membership. In the meantime, Bulgaria and Romania have joined the EU in 2007 and Croatia has become the 28th EU Member State in July 2013. FYR of Macedonia, Montenegro and Serbia are EU candidates, Montenegro has in mid-2012 started its accession negotiations, Albania and Bosnia and Herzegovina remain Potential Candidates, while Kosovo has special treatment (in part due to its non-recognition by some EU Member States).

As a consequence of the improving political and economic conditions, there was a significant increase in FDI to the whole Western Balkans Region after 2000. Still, by 2010, the SEE Countries had received only around a third of the volume of FDI that has gone towards the eight CEECs. Despite the fact that most SEE Countries started attracting FDI rather late, some only after 2003, the share of the eight SEE Countries in total inward FDI stock in the transition region increased from 9.4% in 2000 to 14.7% in 2010 (of which 5.8% in the Western Balkans and another 8.9% in Bulgaria and Romania), thus by 2010 representing almost double their relative share in population (7.7%) of the transition region. During the 2000s there have also been some changes in the share of FDI by Country of destination. All Western Balkans Countries have attracted significantly more FDI with respect to the 1990s, but the increase has been uneven. By 2010 the FDI inward stock, in comparison to ten years earlier, increased in Croatia by 12 times, in Albania by 17 times, while in Serbia by as much as 20 times (from only US\$ 1 billion to US\$ 20 billion). The only two countries that had a less impressive increase in inward FDI stock during the 2000s were Bosnia and Herzegovina (a sixfold increase) and FYR of Macedonia (an eightfold increase).

Inward FDI stock 2001-2012 in Western Balkans Countries (US\$ Mln.)



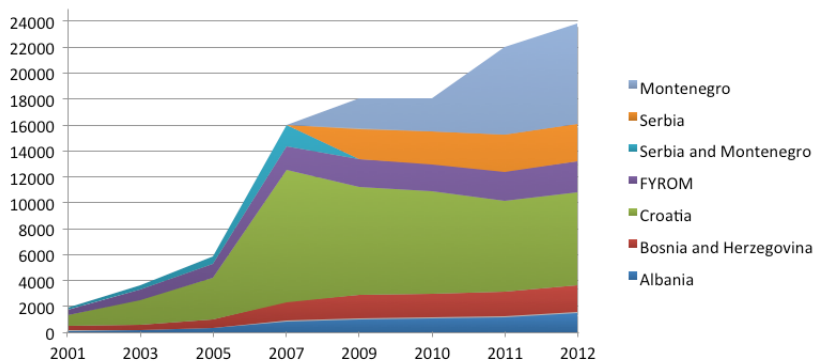
US Dollars at current prices and current exchange rates

Source: INFORMEST elaboration based on UNCTAD data

In general terms, the increase of FDI inflows was more frequently related to the privatization process, and repeatedly to service sector privatization, while the greenfield investment share was rather low. However, privatization cannot be the orientation for future FDI attraction in the Region, as the volume of the remaining available projects is, at least in some countries, relatively low. In particular, Croatia and FYR of Macedonia began their privatization projects in the early to mid 1990s, while the other analyzed Countries started to participate in the 2000s. The latecomers, like Serbia, still had few relatively large privatization projects to realize in the face of the coming crisis, although most of the projects had to be postponed for more favourable international conditions. However, in order to benefit from foreign investment, the structure of foreign investment should change towards export-promoting and technology-improving activities.

A more appropriate overview of FDI inflows, however, must also take into account the size of each Country that, in the case of Western Balkans Region, varies considerably – e.g. according to the Census 2011 data, Montenegro has only 620,029 inhabitants, while Serbia has 7.23 mln. inhabitants -. In particular, according to data on inward FDI stock per capita, Montenegro as the smallest country is ahead of all the others in FDI per capita terms (US\$ 7,715), followed closely by Croatia (US\$ 7,205). Instead the other Countries have a volume of FDI per capita significantly lower (e.g. Albania – US\$ 1,514 -, Bosnia and Herzegovina – US\$ 2,076). In comparison with the CEECs, Montenegro in terms of FDI stock per capita comes close to Hungary and Slovakia but remains behind the Czech Republic, while FDI per capita in Bulgaria and Croatia is comparable to that of Slovenia. Although in the ranking of 13 countries from SEE and CEE in FDI per capita terms, Montenegro ranks third while five SEE countries occupy the bottom places, this indicator may be misleading because larger countries generally attract more FDI.

Inward FDI stock (selected years) in Western Balkans Countries (per capita US\$ thous.)



US Dollars at current prices and current exchange rates

Source: INFORMEST elaboration based on UNCTAD data

The stock of inward FDI as a percentage of GDP is considered also a good indicator of foreign capital penetration in a domestic economy. In the period 2004-2010 foreign capital as a share of GDP played an increasingly important role, on average, in the Western Balkans Countries representing, on average, 36.7% of GDP of the six Countries here analyzed (no data are available for Kosovo) in 2008, increased to 61.7% in 2010. However, the average figure hides large disparities among single Countries. In fact, the figure is distorted by the particular case of Montenegro.

Inward FDI stock as a percentage of GDP

	2004	2005	2006	2007	2008	2009	2010
Albania	11	12	15	23	22	29	37
B&H	28	28	33	44	39	45	43
Croatia	31	33	56	77	45	57	57
FYROM	41	36	42	46	42	48	48
Kosovo	-	-	-	-	-	-	-
Montenegro	-	-	-	-	74	124	138
Serbia	-	-	-	-	35	44	47

Source: UNCTAD

When the Western Balkans Countries are analyzed according to the criteria of where the most FDI comes from, it can be noticed that the largest share is from the EU. This can be attributed to at least three factors. The first is geographical proximity. The geographical factor is favourable for foreign investors relocating part of their production to Countries where labour is less expensive than in their home Country. The second motive for foreign investors might have been the possibility to expand their own market either by just organizing production in other Countries (and thereby reducing the transport costs) or by using the organized production as a platform for market expansion to even further Regions. This market expansion argument is related to yet another factor, which is the fact that all the Countries in the Western Balkans Region have made clear their intention to join the EU. This implies that the investors would have the advantage of entering segments of the future common market prior to its actual integration. The third factor is related to the accession process, which gradually introduces a familiar business environment and familiar standards in SEE, thereby enabling foreign investors to have business conditions more similar to their own than in locations which are not so "close to home".

Inward FDI stock by country (latest available year)

	Reference Year/Source	Country of origin (in % of total FDI stock)
<i>Albania</i>	2011/Bank of Albania	Canada (18.6), Greece (17.3), Austria (15.5), Italy (12.3), Turkey (9.3)
<i>Bosnia and Herzegovina</i>	2011/ Central Bank of Bosnia and Herzegovina	Russian Fed. (25.2), Austria (18.7), Serbia (17.3), Slovenia (8.1), Turkey (5.8)
<i>Croatia</i>	2011/ Croatian National Bank	Austria (21.2), Hungary (13.9), Germany (13.7), Netherlands (8.6), Luxembourg (5.4)
<i>FYR of Macedonia</i>	2012/National bank of FYR of Macedonia	Netherlands (28.8), Austria (11.7), Greece (11.6), Slovenia (9.7), Hungary (9.2)
<i>Kosovo</i>	2012/ Central Bank of the Republic of Kosovo	Germany (18.0), Switzerland (15.5), Austria (9.7), Slovenia (7.3), Turkey (7.1)
<i>Montenegro</i>	2011/ Central Bank of Montenegro	Russia (15.4), Italy (11.8), Switzerland (9.0), Hungary (8.4), Cyprus (8.2)
<i>Serbia</i>	2011/ National Bank of Serbia	Austria (17.1), Netherlands (10.1), Greece (9.6), Germany (9.1), Norway (8.4)

Data on FDI inflows by Country of origin show the top five Countries by value of investment in each of the Western Balkans Countries. The five major source economies together typically account for more than 50% of inward FDI stock (from 54.3% in Serbia to 75.1% in Bosnia and Herzegovina). Among the major investors in the Western Balkans Countries we find Austria (a top investor in all countries except Montenegro), Greece, the Netherlands and Germany has been among the top five investors in only 3 Countries, as well as Hungary Turkey and Slovenia. Among Countries that represent the major investors in only two Countries are Italy (in Albania and Montenegro) and the Russian Federation (in Bosnia and Herzegovina and Montenegro).

In conclusion, due to the above mentioned historical and institutional factors in the past, there were significant obstacles to movement of capital to the Western Balkans economies. Balkan Countries faced shortage of capital at the early stages of transformation of their economic systems. Their enterprise sectors needed restructuring: financial, technological, etc., in order to be viable and ready to face the new challenges of market economy. Differences in attitudes towards FDI among Countries in the Region remain and are determined by various factors (cultural, ethnic, social, etc.). Fundamental changes have taken place in virtually every Country as reforms go forward. Despite this fact, the inflows of FDI are still comparatively low, even in the Countries that have moved quickest on reforming their economies. However, the Western Balkans Countries' Authorities recognized the fact that the FDI are very important, and have created a favorable legal framework for attracting FDI. In the period 2000-2002 a FDI increase was recorded in the Region, although with differences as individual Countries. Much of this increase has been attracted by progress in cash privatization, in particular in the banking and telecommunications sectors and by relatively favorable investment climates.

The key issue of the post-privatization era will be how to attract FDI into greenfield ventures and into privately owned assets. While the attractiveness of existing industrial and commercial assets will depend on their valuation in secondary markets, foreign investors who consider greenfield investments need to take into account the cost of new plant and equipment, the business environment and market potential. Of particular importance is the security provided to investors by the existence of enforceable contracts, standardized product classification and business practices, and customs and other regulations designed to regulate commercial transactions. Moreover, the experience of the transition economies and other emerging markets shows that FDI tends to be closely linked to rising bilateral trade flows. In this respect, the prospect of stability resulting from the removal of barriers to market entry and integration into the EU also helps to attract FDI. A general conclusion could be drawn that so far there has not been a significant inflow of foreign capital in the Western Balkan Countries, compared to the CEECs. Having in mind the population and territory, the global amount of the FDI are much less than in the other Countries in transition. Some of the reasons for this situation are:

- Stability (or more precisely – instability in the region as a whole): *the instability has got a very strong negative impact on the FDI.*
- Market size: *the interest of the foreign investors during the last decade shifted from the search of lower costs (especially lower labor costs), towards the search of new (bigger) markets. No one can dispute the fact that size does matter.*
- Potential candidates for Mergers and Acquisitions. *During the last decade, the FDI came in the form of M&A, unlike before, when FDI were mostly in the form of green field investment. It seems that the potential of good enough companies for M&A in the selected Balkan Countries is quite limited.*
- Internal factors: *reforms. The reforms in these countries are lagging behind the same processes in the other countries in transition (for instance: Slovenia, the Czech Republic, Poland, Baltic Countries, etc.).*

Main International Finance Institutions Instruments for SMEs

The European Union

Despite the EU cannot be defined as an international “financial” institution in the true sense of the word, the EU supports SMEs in the Member States and in the Western Balkans Countries through various sources ranging from the implementation of its institutional policies to the action of its financial bodies. Therefore, in this section are presented the main European policies and programmes dedicated to the SMEs directly by the *Directorate-General for Enterprise and Industry* of the European Commission, the programmes covered by the new programming period 2014-2020 of the Cohesion policy and the action of the Community Financial Institutions in favor of SMEs.

The European Commission's *Directorate-General for Enterprise and Industry* has the mission to promote a growth-friendly framework for European enterprises. It has a key role in the Europe 2020 Agenda of “smart, sustainable and inclusive growth”, also encouraging the growth of SMEs and promote an entrepreneurial culture. In this context, the *Small Business Act for Europe - SBA*⁷, adopted in June 2008, reflects the Commission's political will to recognise the central role of SMEs in the European economy. The SBA aims to promote SMEs' growth by helping them tackle the remaining problems which hinder their development. In November 2011 the Commission presented a new approach to ensure that the EU responds better to the needs of small businesses. From now on, the European Commission will seek wherever possible to exempt micro-enterprises from EU legislation or introduce special regimes so as to minimise the regulatory burden on them. To achieve this objective, the Commission has prepared a new program for the period 2014-2020, replacing the one on the previous programming period:

COSME (Competitiveness of Enterprises and SMEs): COSME is the new EU programme for the Competitiveness of SMEs running from 2014 to 2020 with a planned budget of €2.3bn⁸. The COSME programme is open to the participation of third Countries, including Candidate and Potential Candidate Countries. COSME will support SMEs in the following areas:

- **Better access to finance for SMEs**: COSME will facilitate and improve access to finance for SMEs through two different financial instruments:
 1. *The Loan Guarantee Facility*: the COSME budget will fund guarantees and counter-guarantees for financial intermediaries (e.g. guarantee organisations, banks, leasing companies) to help them provide more loan and lease finance to SMEs. By sharing the risk, the COSME guarantees will allow the financial intermediaries to expand the range of SMEs they can finance. This will facilitate access to debt finance for many SMEs who might otherwise not be able to raise the funding they need. From 2007 to date, more than 240,000 SMEs have already benefited from a guaranteed loan or lease thanks to the CIP, the former programme supporting business competitiveness.
 2. *The Equity Facility for Growth*: The COSME budget will also be invested in funds that provide venture capital and mezzanine finance to expansion and growth-stage SMEs in particular those operating across borders. The fund managers will operate on a commercial basis, to ensure that investments are focused on SMEs with the greatest growth potential.

⁷ For more details: Commission of the European Communities “Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions - “Think Small First” - A “Small Business Act” for Europe Brussels, 25.6.2008, COM/2008/0394 final.

⁸ COSME replaces the former “Competitiveness and Innovation Framework Programme – CIP” 2007-2013, The CIP supported innovation activities (including eco-innovation and use of information and communication technologies), provides better access to finance and delivers business support services in the regions. The CIP was divided into three operational programmes: the Entrepreneurship and Innovation Programme (EIP), the Information Communication Technologies Policy Support Programme (ICT-PSP) and the Intelligent Energy Europe Programme (IEE).

- Access to markets: All businesses have access to the services of the Enterprise Europe Network and can freely approach the local partner in their region. Over 600 partner organisations in 54 countries have built a capacity to reach out to more than 2 million SMEs. The services offered include: information on EU legislation and participation in EU programmes (Horizon 2020, regional funds); Assistance to find a business partner abroad: in the EU or worldwide; Advice on EU access to finance; Support for innovation and technology transfer; Obtaining SME's opinion on EU legislation.
- Supporting entrepreneurs: promotion of entrepreneurship is therefore one of the main objectives of COSME. The Entrepreneurship 2020 Action Plan is a decisive call for joint action at European, national, regional, and local level. Initiatives under the Action Plan include improvements in entrepreneurship education (exchanges among European educators and trainers), in business environment knowledge (recommendations on legal and fiscal issues) and in outreach to specific groups (young people, women or senior entrepreneurs).
- More favorable conditions for business creation and growth, through: reduction of administrative and regulatory burden (lightening the administrative burden by removing unnecessary reporting and information requirements); identification and exchange of best practices among national administrations to improve SMEs policy (initiatives at national, regional and local level will be launched); analytical tools for better policy (to facilitate the preparation of new legislation at EU and national level, and compare performance of different policies in Member States, conferences and analytical tools will be supported).
- Sectorial actions such as tourism.

Cohesion Policy 2014-2020: in November 2013 the European Parliament voted in favour of the EU's Multiannual Financial Framework (MFF) for the period 2014-2020, paving the way for the final approval by the Council (December 2013); two and a half years of negotiations, since the Commission had tabled its proposals on 29th June 2011, have been completed. Through the European Regional Development Fund (ERDF) and the European Social Fund (ESF) the new Cohesion Policy 2014-2020 will make available more nearly € 352 billion (i.e. 32.5% of the total EU budget) to invest in Europe's regions, cities and the real economy, including the system of SMEs. It will be the EU's principle investment tool for delivering the Europe 2020 goals: creating growth and jobs, tackling climate change and energy dependence, and reducing poverty and social exclusion. This will be helped through targeting the ERDF at key priorities such as support for SMEs where the objective is to double support from €70 to €140 billion over the next 7 years. This increased investment will help SMEs to:

- *Access finance with grants, loans, loan guarantees, venture capital, etc.*
- *Tap into business know-how and advice, information and networking opportunities including cross-border partnerships.*
- *Improve their access to global markets and mitigate entrepreneurial risk.*
- *Exploit new sources of growth such as green economy, sustainable tourism, health & social services, and cultural and creative industries.*
- *Train entrepreneurs, managers and workers to be adaptable to new challenges.*
- *Invest in human capital and in organisations providing practice-oriented vocational education and training.*
- *Forge valuable links with research centres and universities to promote innovation.*
- *New simplified and common rules and measures make it easier for SMEs to access Cohesion Policy Funds in 2014-2020 (online reporting of how the Funds are used; clearer eligibility rules; more targeted and less frequent audits for small operations; wider scope and simplification of the set-up and access to financial instruments).*

The Regulation 1303/2013 on common provisions⁹ establishes that each Member State shall submit its Partnership Agreement (PA) to the Commission within 4 months from the entry into force of the Regulation. The Commission shall in turn make observations within 3 months of the date of submission of the PA by the Member State and shall adopt the Agreement no later than 4 months from its submission, provided that the Member State has adequately taken into account the observations made by the Commission. This means that as a general rule, PAs should be adopted by end of August 2014 at the latest. The Regulation establishes that Operational Programmes (OPs) shall be submitted by Member States at the latest 3 months following the submission of the PA. The Commission shall make observations within 3 months of the date of submission of the OP and adopt the OP no later than 6 months from the date of its submission, provided that the Member State has adequately taken into account the Commission observations. As a general rule, therefore, OPs should be adopted by end of January 2015 at the latest.

From the point of view of the total financial allocation for 2014-2020, the European Commission has just published the final figures for individual Member States. In general, the total budget for the Cohesion Policy 2014-2020 which is implemented by the European Structural and Investment funds was already fixed in December 2013. The amount for 2014-2020 reaches €351.9 billion in current prices and is 1.3 % higher than in the previous programming period.

Financial allocation of EU Cohesion policy 2014-2020 in CEECs

	<i>Total allocation (€ million)</i>	<i>Total allocation per capita (*) (€)</i>	<i>Average annual allocation (€ million)</i>	<i>Average annual allocation per GDP (**)</i>	<i>GDP per capita as the EU average (***)</i>
<i>Bulgaria</i>	7,588.4	1,041.7	1,084.1	2.7%	47%
<i>Czech Republic</i>	21,982.9	2,090.4	3,140.4	2.1%	79%
<i>Croatia</i>	8,609.4	2,020.0	1,229.0	2.8%	61%
<i>Hungary</i>	21,905.9	2,210.8	3,129.4	3.2%	65%
<i>Poland</i>	77,567.0	2,103.0	11,081.0	2.9%	66%
<i>Romania</i>	22,993.8	1,148.5	3,284.8	2.5%	49%
<i>Slovakia</i>	13,991.7	2,585.9	1,998.8	2.8%	75%
<i>Slovenia</i>	3,074.8	1,493.5	439.3	1.2%	82%
<i>Total CEECs</i>	177,713.9	1,836.4	25,386.8	2.5%	65%
<i>Total EU-28</i>	351,854.2	693.7	50,264.9	0.4%	100%

(*) – Population as the 1st January 2013.

(**) – GDP for 2012.

(***) – GDP per capita in 2012.

Source: European Commission

⁹ Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

The eight Member States of Central and Eastern Europe (Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania Slovakia and Slovenia) with earmarked €177.7 billion will get about half of the total allocation. Comparing with 2007-2013 period it is 11% more. The total allocation for Croatia is €8.6 billion, which is almost ten times the amount of the EU financial support provided to the Country during the whole pre-accession period. It means annually €289 per capita (€2,020 in the overall period) and 2.8% of GDP. The satisfying absorption level in CEECs should lead to the faster convergence. If the European funds are used effectively for investments that spur the growth, the pace of development should accelerate. The EU funds should have bigger impact on less developed Countries (such as Romania) and smaller influence on more developed Countries (such as Czech Republic). If the Countries are successful in utilization of EU funds, the differences in stage of development between the Countries should steadily diminish and distinction into the developed and emerging economies of the EU will no more follow the former “Iron Curtain”.

As of 2012, it was only the Czech Republic and Slovakia from CEE-6 that beat some of the old Member States (namely Greece and Portugal) in terms of economic performance. If the potential of EU funds is fully utilised, we can estimate that other CEECs (especially Poland and Hungary) have potential to surpass the struggling economies of the southern periphery of the Euro Area by 2020 as well. Romania and Croatia have the longest path ahead on their convergence trip. If they overcome all the obstacles from the 2007-2013 period in utilizing resources from EU funds they will by 2020 achieve the same level of economic performance as the current leaders among the CEECs.

To fully utilize the potential of resources from the European Structural and Investment funds, lots of work needs to be done. In order to increase the absorption capacity of these Countries, a set of measures is recommended. Most of them will need to be adopted on the national level: a significant decrease of bureaucracy, a more transparent process of projects selection to avoid (a suspect) of corruption, higher quality of performance of public administration, simplification of the implementation system with a smaller number of operational programmes and shorter deadlines in accessing and contracting the projects, wider cooperation with co-financing commercial banks. But we can identify some proposals for absorption improvement also on the cross-border level (more intensive cooperation between Countries in the Region) and the EU level (more public information on the absorption rates in individual Member States).

In particular, to utilize the full potential of the EU funds in 2014-2020 Croatia and, in the future, the Candidate and Potential Candidate Countries should learn the lessons from the past programme period of 2007-2013 and adopt some changes and measures:

- *Although the EC gathers all the relevant information regarding the absorption in individual Member States, there is no regular assessment report on this policy being published. If the EC on a monthly basis produced a report on EU funds absorption in all EU Member States, the Countries with the poorest results could be more under “public pressure” to eliminate their obstacles and improve their absorption.*
- *The CEECs need to tackle similar problems, and therefore they should benefit from higher cross-border cooperation in the region through methods as more frequent sharing of experience, sharing of best practices and benchmarking (i.e. comparing their absorption rates and outcomes with the best outcomes among CEE countries)*
- *Too many Operational Programmes run by the too many managing authorities make the whole system too complicated to final recipients and discourage some potential applicants from applying for a subsidy.*
- *Decrease general bureaucracy closely linked to the previous issue, as too complicated of an implementation system often equals high and widespread bureaucracy. Therefore, in some Countries the low absorption is linked to the high bureaucratic burden associated with the project. Complicated bureaucratic procedures are probably the most common disincentive to start the application process in the first place.*
- *In some Countries there appeared serious doubts about the fairness of EU subsidies allocation to final recipients and somewhere even some criminal activities regarding the distribution of EU funds. Making the project selection process more transparent and fair will improve the image of all EU cohesion policy instruments in individual Member States and will lead to realising only the best projects.*
- *The long periods of time spent on project assessment and contracting is another challenge for some CEECs for the*

future programme period 2014-2020. It could be achieved by higher performance of relevant State Authorities.

- *The private banks play an important role in the whole process of implementation because they provide the EU subsidy recipients with bank pre- and co-financing. If the projects do not receive bank financing they will not be realised. The EU subsidies should be granted only to the subjects with viable projects from the private banks' perspective.*

In Croatia, several segments where to put the money from European Structural and Investment funds could be identified as the key ones. But according to our analysis we would like to highlight investment into the transport infrastructure, most notably railways and ports. Another big topic in Croatia for the programme period 2014-2020 will be energy efficiency and renewable sources of energy. We see huge potential also in support of ICT, especially in development of IT infrastructure such as extending the broadband Internet coverage or projects such as e-Healthcare or e-School. The last but not least area deserving investment from EU funds involves the broad topic of competitiveness & employment, i.e. supporting SME, promoting R&D, education and active employment policies.

The European Commission has recently presented Croatian authorities with a *Position Paper on the development of the Partnership Agreement and programmes for the period 2014-2020*¹⁰. The document will serve as framework for dialogue and negotiation between Brussels and Zagreb. The Position Paper outlines Croatia's most pressing challenges and proposes four complementary and mutually reinforcing funding priorities:

- 1) *Strengthening the competitiveness of the economy:*
 - *Strengthening Croatia's innovation profile through smart specialization;*
 - *Supporting the modernisation and competitiveness of enterprises;*
 - *The extension and upgrading of the transport and ICT infrastructure.*
- 2) *Increasing labour market participation, ensure better education and skills and reduce poverty taking into account regional differences:*
 - *Significantly enhance the labour market participation of the most vulnerable groups, particularly women, older workers, and the long term unemployed;*
 - *Increase the employment of young people;*
 - *Improve the level of skills of the population, address the challenge of matching labour market demand with supply, improve vocational education and training outcomes;*
 - *Reduce discrimination and improve social inclusion of the most vulnerable groups, including elderly, children, persons with disabilities and Roma;*
 - *Ensure high quality, accessible and decentralized social and health services and invest in basic services for the rural population.*
- 3) *Preserving and maintaining a healthy environment and protecting the natural resources and heritage, and adapting to climate change.*
- 4) *Strengthening the administrative capacity, enhancing an efficient public administration and increasing the involvement of civil society and social partners:*

10 Position of the Commission Services on the development of Partnership Agreement and programmes in the Republic of CROATIA for the period 2014-2020.

http://ec.europa.eu/regional_policy/what/future/pdf/partnership/hr_position_paper.pdf

- *Develop and effective and efficient public administration;*
- *Strengthen the capacity of social partners and civil society organisations to be involved in policy-making and policy delivery.*

In particular, among the first priority “Strengthening the competitiveness of the economy - Supporting the modernisation and competitiveness of enterprises”, the Cohesion Funds should be invested in entrepreneurship, access to finance for SMEs and further development of higher value-added business support services. Enterprises should be supported in the start-up stage and during their lifecycle aiming at an increased productivity and competitiveness, development of new products and processes, up-taking of ICT and achieving more efficiency in terms of energy and resource consumption involving innovative and greener production processes. Modernisation and restructuring of enterprises should be pursued through introducing of up-to date technologies, providing training, re-skilling and up-skilling, upgrading the management and organisation systems in the supply chain, as well as improving the market organisation to drive competitiveness and value-adding capabilities. Targeted business support could be developed in industrial areas under reconversion in view of creating conditions for new investment in new activities. Competitiveness should also be particularly addressed in the wider context of the EU Strategy for the Danube Region where Croatia is co-coordinator of the priority area. In rural areas, the local development should be fostered and economic diversification should be supported. There is a considerable potential to increase productivity through restructuring and modernisation of agricultural sector and measures to increase value added through processing and marketing of agricultural products and diversification into non-agricultural sectors. Fisheries and aquaculture sectors offer potential for the future development of the Croatian blue economy. The creation of new aquacultures farms and the modernisation of the existing ones should facilitate the increase of fisheries production, the products diversification and the increase of sanitary and environmental standards. Insufficiently consolidated sector organisation should obtain proper support to develop producer’s groups.

Beyond the specific case of Croatia, the only Western Balkan Country to benefit from the structural funds for the next seven years, for all the other Countries considered here, the European Commission has raised the specific instrument for pre-accession assistance already operating in the period 2007 – 2013:

Instrument for Pre-accession Assistance (IPA II): through IPA the EU supported reforms in the “Enlargement Countries” with financial and technical help. IPA funds make political and economic reform easier in the beneficiary Countries and prepare them for the rights and obligations that come with EU membership. For the period 2007-2013 IPA had a budget of some €11.5 billion; its successor, IPA II, will build on the results already achieved by dedicating €11.7 billion for the period 2014-2020. The beneficiary countries was: Albania, Bosnia and Herzegovina, Croatia, FYR of Macedonia, Iceland, Kosovo, Montenegro, Serbia, and Turkey¹¹.

The most important novelty of IPA II is its strategic focus. Country Strategy Papers are the specific strategic planning documents made for each beneficiary for the 7-year period. These will provide for a stronger ownership by the beneficiaries through integrating their own reform and development agendas. A Multi-Country Strategy Paper will address priorities for regional cooperation or territorial cooperation. IPA II targets reforms within the framework of pre-defined sectors. These sectors cover areas closely linked to the enlargement strategy, such as democracy and governance, rule of law, growth and competitiveness. This sector approach promotes structural reform that will help transform a given sector and bring it up to EU standards. It allows a move towards a more targeted assistance, ensuring efficiency, sustainability and focus on results. IPA II also allows for a more systematic use of sector budget support. Finally, it gives more weight to performance measurement: indicators agreed with the beneficiaries will help assess to what extent the expected results have been achieved.

11 The “first” IPA replaced the previous instruments for pre accession: PHARE, ISPA, SAPARD, the pre accession instrument for Turkey, and the financial instrument for the Western Balkans, CARDS.

More in particular, the innovative elements of IPA II compared to the previous programming phase are the following:

- o Make the assistance more coherent, strategic and results-oriented, through multiannual country strategy papers, reflecting the political priorities of the enlargement strategy and including, sector by sector, all the necessary measures to develop institutional compliance with the acquis;*
- o Strengthening the co-financing of sectoral strategies that contribute to the policy objectives, rather than individual projects;*
- o More systematic multi-annual programming for the strategic objectives pursued through the transition assistance and institution-building;*
- o More direct subordination of financial assistance to the governance improvement and greater responsibility by the beneficiary countries;*
- o Make the assistance-delivery more flexible and adapted to the needs, through an undifferentiated access to assistance (regardless of the status of a Candidate or Potential Candidate), albeit with a different scope and intensity;*
- o More progressive setting, in phases, of the financial assistance management;*
- o Increase in flexibility between priorities, for supplying assistance more focused on results;*
- o Make the deployment of assistance more efficient and effective through further identification and use of innovative financial instruments, which have a leverage effect able to mobilize private funds;*
- o Enhancement of cooperation at the strategic level with other donors, international institutions and other financial institutions;*
- o Continuation of support for regional projects/programs;*
- o Rationalization of the rules governing the award of contracts under twinning.*

The IPA II regulation came into force on 16th March 2014 and is applicable retroactively from 1st January 2014. The IPA II Regulation 231/2014¹² is followed by the Common Implementing Regulation (CIR), which is a set of simplified and harmonised implementing rules and procedures for all external action instruments.

The allocation of EU preaccession funds helps translate the political priorities of the enlargement strategy into concrete actions. Through IPA II, the EU reinforces its guidance to the aspiring Countries on the priorities necessary for aligning with EU standards and legislation. IPA II beneficiary Countries have very different funding needs. IPA II is designed to meet these different needs flexibly, and provide a tailor-made funding solution through the following channels

Assistance under IPA II shall pursue the achievement of the following specific objectives according to the needs of each of the beneficiaries, as well as their individual enlargement agenda:

1) support for political reforms, through:

- o strengthening of democracy and its institutions, including an independent and efficient judiciary, and of the rule of law, including its implementation;*
- o promotion and protection of human rights and fundamental freedoms, enhanced respect for the rights of persons belonging to minorities, including lesbian, gay, bisexual, transgender and intersex persons, promotion of gender equality, non-discrimination and tolerance, as well as freedom of the media and respect for cultural diversity;*

12 Regulation (EU) No 231/2014 of the European Parliament and of the Council of 11 March 2014 establishing an Instrument for Pre-accession Assistance (IPA II).

http://ec.europa.eu/enlargement/pdf/financial_assistance/ipa/2014/231-2014_ipa-2-reg.pdf

http://ec.europa.eu/enlargement/pdf/financial_assistance/ipa/2014/236-2014_cir.pdf

- *regional cooperation and good neighbourly relations;*
 - *promotion of reconciliation, peace-building and confidence-building measures;*
 - *the fight against corruption and organised crime;*
 - *strengthening of public administration and good governance at all levels;*
 - *capacity-building measures for improving law enforcement, border management and implementation of migration policy, including the management of migration flows;*
 - *development of civil society;*
 - *improvement of social dialogue and strengthening of the capacities of social partners.*
- 2) support for economic, social and territorial development, with a view to smart, sustainable and inclusive growth, through:
- *the achievement of Union standards in the economy, including a functioning market economy, as well as fiscal and economic governance;*
 - *economic reforms necessary to cope with competitive pressure and market forces in the Union, while contributing to the achievement of social and environmental goals;*
 - *fostering of employment and labour mobility, promotion of quality job creation and development of human capital;*
 - *promotion of social and economic inclusion, in particular of minorities and vulnerable groups, including persons with disabilities, refugees and displaced persons;*
 - *fostering of an inclusive and integrated education system and preservation and restoration of cultural heritage;*
 - *development of physical capital, including improvement of infrastructure, and connections with Union and regional networks;*
 - *strengthening of research, technological development and innovation capacity.*
- 3) strengthening of the ability of the beneficiaries to fulfil the obligations stemming from EU membership by supporting progressive alignment with, and adoption, implementation and enforcement of, the Union acquis, including preparation for management of Union Structural Funds, the Cohesion Fund and the European Agricultural Fund for Rural Development.
- 4) strengthening regional integration and territorial cooperation involving the beneficiaries, Member States and, where appropriate, third Countries.

Progress towards achievement of these specific objectives shall be monitored and assessed on the basis of pre-defined, clear, transparent and, where appropriate, country-specific and measurable indicators that cover *inter alia*:

- *progress in the areas of strengthening democracy, the rule of law, respect for human rights, including the rights of persons belonging to minorities and vulnerable groups, fundamental freedoms, gender equality and women's rights, the fight against corruption and organised crime, reconciliation, good neighbourly relations and refugee return, and in particular, the establishment of track records in those areas;*
- *progress in socio-economic and fiscal reforms, addressing structural and macro-economic imbalances; the soundness and effectiveness of social and economic development strategies; progress towards smart, sustainable and inclusive growth and the creation of an inclusive and integrated education, quality training and employment, including through public investment supported by IPA II; progress towards creating a favourable business environment;*

- progress in aligning the body of legislation with the Union acquis, including a track record of its implementation; progress in Union-related institutional reform, including transition to indirect management of the assistance provided under this Regulation;
- progress in building up and strengthening good governance and the administrative, institutional and absorption capacities at all levels, including adequate human resources, needed to adopt and enforce the acquis-related legislation;
- regional and territorial cooperation initiatives and the evolution of trade flows.

The European Investment Bank – EIB

The EIB, founded in 1958 under the Treaty of Rome, is the bank of the EU. It operates in the 28 EU Member States and more than 130 other Countries. In 2013, it signed loans totalling €71.7bn, with 93% of its financing for projects within the Member States, EFTA, Candidate and Potential Candidate Countries. Outside the EU, the Bank supports projects that contribute to economic development in Countries that have signed association or cooperation agreements with the EU or its Member States. It does so at own risk to its balance sheet, under mandates from the European Parliament and the Council of the European Union or using budgetary funds provided by Member States or by the EU budget. It is the largest supranational borrower and lender in the world and the only international financial institution politically accountable to EU policymakers and institutions. The European Investment Bank continues its strong support for SMEs and Mid-cap companies in the EU. The Bank also puts strong emphasis on investments in innovation. In March 2014 the EIB's Board of Directors approved loans worth up to €5.6 billion for the benefit of SMEs and Mid-Caps. This brings total EIB support for SMEs and Mid-Caps so far in 2014 to €6.8 billion. In the field of innovation and broadband infrastructure the Board approved loans for projects worth up to €1.4 billion to strengthen the competitiveness of European business. Regarding other key priorities of the bank, loans of up to €700 million were approved for strategic infrastructure projects. Up to €455 million will go to the area of renewable energy. At the European Investment Fund, the Board of Directors approved on 12 March 11 new operations through which the EIF will further reinforce its support for SMEs. These deals represent EIF commitments of €388 million and are expected to leverage €1.2 billion of capital. With these new approvals, the number of EIF deals approved in 2014 amounts to 17, with commitments in the order of €487.5 million and an expected overall leverage of €1.5 billion. The total volume of EIB Group, comprising EIB and EIF, in support of SMEs in 2014 amounts to €7.3 billion.

The EIB is the largest international financier in the Western Balkans and has been active in the region since 1977. Over the past 10 years, the Bank has financed projects totalling €6.6 billion. Last year the EIB signed financing contracts amounting to €656 million in the Western Balkans, stable compared to 2012 (€671 million). Total disbursements were €719 million, close to the record level reached in 2011 (€859 million). In the late 1990s, EIB financing in the Region focused on urgent reconstruction and repairs to damaged infrastructure in line with the Countries' priorities at the time. Over the last six years, the EIB has diversified its lending activity into new sectors such as health, education, R&D and FDI. In 2010 the EIB opened a new regional representation office in Belgrade in order to facilitate the development of EIB activity in the Western Balkans Region, while underlining the commitment of the European institutions to supporting the Candidate and Potential Candidate Countries of the region in their journey along the road towards the EU.

The Western Balkans Investment Framework (WBIF) was launched in 2009 as an initiative aimed at facilitating the preparation and financing of priority projects in the framework of the EU's Pre-Accession process. The WBIF is implemented jointly by the EIB with the European Commission, the EBRD and the CEB as well as EU Member States and other multilateral and bilateral institutions and blends available grants and loans for priority projects in the Region. The WBIF approved 24 operations in 2013, amounting to €22.0 million worth of grants, of which €8.5 million from the Commission, €13.5 million from donors to the European Western Balkans Joint Fund, which now also includes the European Commission and the EIB alongside 18 bilateral donors. WBIF grants were blended with some €343 million of loans from partner IFIs and Kreditanstalt für Wiederaufbau. In addition, the WBIF has allocated a second grant of €30 million, already

decided in principle, to the EDIF (see below) and procurement was launched for the €14.4 million consultancy contract decided at the end of 2012.

The Western Balkans Enterprise Development and Innovation Facility (WB EDIF) is an EU funded initiative which aims at increasing the financial resources made available to SMEs based in the Western Balkans, as well as technical assistance for strategic investments, particularly in infrastructure, energy efficiency and private sector development, to support socio-economic development and EU accession across the Region. WB EDIF was launched in December 2012 by the EC, the EIF, the EBRD and the EIB, acting as co-lead international financial institutions. The €145 million of initial capital pulled together under WB EDIF will translate into over €300 million of finance benefitting SMEs based in all the Western Balkan Countries. WB EDIF does not support entrepreneurs directly but makes available loans and guarantees through local financial intermediaries - e.g. venture capital funds, guarantee schemes including mutual guarantee organizations, micro-finance institutions and any other financial institution providing finance to SMEs established and operating in one or several of the Western Balkan countries mentioned above.

WB EDIF, which is coordinated by the EIF, consists of 4 pillars:

- *WB EDIF Guarantee Facility*: WB EDIF GF provides guarantees to local Financial Intermediaries to encourage them to build up new portfolios of SMEs loans and thereby improving access to finance. WB EDIF GF is managed by the EIF. Eligible Financial Intermediaries (financial or credit institutions, guarantee schemes including mutual guarantee organizations, micro-finance institutions and any other financial institution committed to SME financing) established and operating in one or several Western Balkan countries) interested to apply for a SME Loan Guarantee are being selected on the basis of a Call for Expression of Interest.
- *Enterprise Innovation Fund (ENIF)*: this Fund supports innovative SMEs in the Western Balkans in their early and expansion stage by providing equity finance through local funds management companies. Eligible Financial Intermediaries are being selected on the basis of a Call of Expression of Interest.
- *Enterprise Expansion Fund (ENEF)*: ENEF supports the expansion of SMEs with a high-growth potential established in the Western Balkans.
- *Technical Assistance Facility*: Governments of the Western Balkan countries can obtain technical assistance under WB EDIF to implement policy reforms in order to create a favourable regulatory environment to benefit innovative and high-growth SMEs in the region.

European Bank For Reconstruction And Development – EBRD

The EBRD was established in April 1991 (less than two years after the fall of the Berlin Wall) to support the transition process from centrally planned to market economies of CEECs. Since it was established, it has provided over €78.9 billion (of which €8.9 bln in 2012) to support the transition process in 34 Countries. In 2012 over €9.5 billion (12.6 % of the global investment) have been provided to the Western Balkans Countries.

EBRD annual business volume (€ million)

	2012	2011	Cumulative 1991-2012
<i>Albania</i>	69	96	732
<i>B&H</i>	125	94	1,474
<i>Croatia</i>	210	158	2,749
<i>FYROM</i>	157	220	1,085
<i>Kosovo</i>	5	n.a.	66
<i>Montenegro</i>	39	43	323
<i>Serbia</i>	269	533	3,106
Total WB Countries	874	1,144	9,535
<i>Central, other South-eastern Europe and Baltic States</i>	1,863	1,768	22,974
<i>Eastern Europe and Caucasus</i>	1,500	1,851	13,817
<i>Central Asia</i>	871	470	6,891
<i>Russia</i>	2,582	2,928	22,943
<i>Turkey</i>	1,049	890	2,576
<i>Southern and eastern Mediterranean</i>	181	n.a.	181
TOTAL	8,920	9,051	78,917

Source: EBRD

One of the EBRD's key aims is to support the development of micro and SMEs; to do this, EBRD may make equity and loan financing available to SMEs through a range of intermediaries throughout the Countries of operations. These intermediaries include banks in which the EBRD has an equity stake or with which it has signed a loan, and investment or venture capital funds in which the EBRD has made an investment.

Providing sustainable lending and universal financial services to the MSME sector is a key element of financial sector development, considering that financial institutions and markets are underdeveloped in EBRD's countries of operations. Technical assistance, which supports the intermediaries' ability to provide efficient and quality financing on a sustainable basis, has been central to the Bank's support to the MSME sector and made possible the broad reach of the programme across international and local commercial banks, as well through the establishment of greenfield microfinance banks, and through non-bank financial institutions. Through technical assistance, the Bank has been able to accompany its capital resources with significant institution building support, addressing all aspects of banking to the MSME sector including inter alia; credit methodology; information technology, universal banking services; rural and agricultural lending; and corporate governance. As well as providing technical assistance for intermediaries, the Bank strengthens individual MSMEs, pre- and post- financing through the TAM/BAS Programme. TAM/BAS both develops pipelines for financing and helps protect financing already in place, by improving management and business skills. The strategy aims to provide support for MSMEs across all of the Bank's countries of operations,

strengthen the financial sector infrastructure dedicated to financing growth of MSMEs of all sizes, improve the business environment for MSMEs, and develop the skill sets of entrepreneurs. In this context, the strategy will continue to be structured around the three pillars established in its 2000 Strategy 'Promoting SMEs in the Transition', namely, Finance, Policy Dialogue and Business Support.

The World Bank Group/IFC

The World Bank (WB) is a vital source of financial and technical assistance to developing countries around the world. The WB is made up of two development institutions owned by 187 Member Countries: the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). Each institution plays a different but collaborative role in advancing the vision of inclusive and sustainable globalization. The IBRD aims to reduce poverty in middle-income and creditworthy poorer Countries, while IDA focuses on the world's poorest countries. Their work is complemented by that of the International Finance Corporation (IFC – see below), Multilateral Investment Guarantee Agency (MIGA) and the International Centre for the Settlement of Investment Disputes (ICSID). Together, they provide low-interest loans, interest-free credits and grants to developing countries for a wide array of purposes that include investments in education, health, public administration, infrastructure, financial and private sector development, agriculture and environmental and natural resource management. More specifically, MIGA guarantees cover projects in a broad range of sectors and subsectors, with projects in the financial sector accounting for the largest share (52%). Other priority focus for the Agency are the infrastructure sector, agribusiness, manufacturing, services and energy. MIGA also offers other services as part of its overall effort to encourage FDI the developing world.

The International Finance Corporation (IFC) is a WB branch fostering sustainable economic growth in developing Countries (including transition Countries) by financing private sector investment, mobilizing capital in the international financial markets, and providing advisory services to businesses and governments. Therefore, IFC can have a direct impact on SME creation and development. IFC does not lend directly to MSMEs or individual entrepreneurs, but many of its investment clients are financial intermediaries that on-lend to smaller businesses. A company or entrepreneur seeking to establish a new venture or expand an existing enterprise can approach IFC directly by submitting an investment proposal. After this initial contact and a preliminary review, IFC may proceed by requesting a detailed feasibility study or business plan to determine whether or not to appraise the project. Although IFC is primarily a financier of private sector projects, it may provide finance for a company with some government ownership, provided there is a private sector participation and the venture is run on a commercial basis. Although IFC does not accept government guarantees for its financing, its work often requires close cooperation with government agencies in developing Countries.

Country Surveys

ALBANIA

SMEs and FDI status

The most recent data from the *Albanian Statistic Institute (INSTAT)* give a picture of the domestic enterprise tissue for 2012, confirming its specific structure based on micro and small enterprises, while medium and large private enterprises are *de facto* negligible. In particular, according the *Results on Structural Survey of Economic Enterprises* at the end of 2012, were active 80,722 enterprises (increase of 2.9% compared to 2011, +14.8% compared to 2008). By economic activity, the share of enterprises that operate in trade sector is 46.8%, while enterprises with 1-4 employed are those which prevail with 91% of the total. In all enterprises were employed 295,922 persons, where those with 20 and more employed have 46% of the total number of employed. Enterprises in industry sector provided occupation for about 30% of the total number of employed. In 2012, compared to 2011 the number of total employed increased by 5.4%.

Albania: enterprises size classes by economic activity ()*

	Groups by number of employed persons				
	1-4	5-19	20-79	50+	Total
Number of enterprises (in numbers)	73,297	5,738	1,328	360	80,722
Enterprises by economic activity					
○ Industry	7,493	1,199	453	176	9,322
○ Construction	1,678	1,224	338	45	3,295
○ Trade	35,624	1,861	249	41	37,775
○ Transport & Communication	7,919	287	67	29	8,301
○ Services	20,584	1,165	221	69	22,039

(*) - Not included: Public Administration, Non Profit Organizations, International Organizations.

Source: Business Register 2012 - Statistics Institute (INSTAT)

The 2013 *SBA Factsheet* data released by the European Commission (Enterprise and Industry Policy)¹³ confirm the overall situation presented by *INSTAT*. However, it should be provided that the data for Albania were collected according to the NACE Rev. 1.1 classification system and, therefore, not directly comparable with EU situation. In spite of this methodological issue, according to the Commission the importance of SMEs for the Albanian business economy is larger than in the EU, since about 80% of all persons employed work in SMEs, generating about 68% of the value added in 2011. Using the value added as proxy, the most important sectors in the Albanian business economy are wholesale and retail trade, construction and manufacturing with share of 25%, 17% and 16%, respectively, where SMEs have a dominant role as they generate about 98%, 94% and 63% of the sectoral value added.

Large Enterprises (LEs), nonetheless, do play an important role in the mining, the electricity, gas and water sectors, as well as in the transport and communication. On the other hand, the hotel and restaurant sector is almost entirely in the hands of SMEs. Until 2010 there was not even a single large company active in this

¹³ The Small Business Act (SBA) Fact Sheets are produced by DG Enterprise as part of the SME Performance Review (SPR), which is its main vehicle for economic analysis of SME issues. They combine the latest available statistical and policy information for the 28 EU Member States and nine non-EU countries which also contribute to the EU's former CIP, now COSME. Produced annually, the Fact Sheets help to organise the available information to facilitate SME policy assessments and monitor SBA implementation.

sector. In fact, the importance of SMEs is due to the current structure of the tourist industry. In Albania there are no large touristic resorts. Many hotels and other tourist related enterprises are family businesses or small firms. This is also reflected in the share of micro firms in value added and employment, which is 79% and 98%, respectively.

The Albanian economic development over the 2008 to 2011 period was overall positive, however, with marked difference between LEs and SMEs. The number of LEs increased from 52 in 2008 to 88 in 2011, or an increase of 58%. The number of SMEs also grew, starting from a much broader base, about 6% between 2008 and 2011. A positive picture can also be observed for the number of employees, with growth rates of about 21% and 9%, respectively for LEs and SMEs. The development of value added, however, deviated from this pattern: while SMEs increased their value added by about 23%, LEs experienced a reduction by about 25%. This was caused by severe losses of one-third or more in the LE-dominated sector of electricity, gas and water supply as well as in transport and communication. A similarly poor performance in the construction sector for LEs is quite surprising, since SMEs active in this sector did well in the same period and, due to the sharp drop in value added generated by LEs, the entire sector experienced a decline of about 7%. Another strikingly divergent development in value added between SMEs and LEs was observed in the manufacturing sector. This sector was hit hard, as elsewhere in Europe, in the 2008 to 2009 period. However, the recovery was rather significant in the following period. But while SMEs just managed to reach the pre-crisis level of 2008, LEs actually grew by 19% compared to 2008. The different performance is partly explained by the structure of this industry. The micro and small enterprises, especially in the garment and shoes industry, manufacture only specific parts of the whole product or limit themselves to hand-made parts with low productivity. In contrast, LEs are enjoying high productivity. Moreover, the manufacturing sector, and more specifically its garment and shoes subsector, depends on foreign demand, especially from Italy and Greece whose demand was reduced due to the economic crisis. On contrast, LEs, even in the shoes and garment sector, have more diversified markets and export within and outside Europe.

Overall, the business demography in Albania is positive, thanks partly to administrative reforms. A deep reform was carried out in 2007 in order to reduce the administrative barriers for market entry and exit, as of which the *National Register Centre (NRC)* was put in place as a one-stop-shop (see below). However, the crisis had, and still has, an impact business life, as the dynamics for registrations and de-registrations is quite volatile. In 2008, according to the National Register Centre, 17,733 firms were registered and only 3,597 deregistered. Just a year later, in the crisis year of 2009, registrations dropped to 13,233 while de-registrations increased to 5,156. In 2010, the numbers are almost back to the pre-crisis level with 16,433 and 3,786, respectively. Since then, the number of de-registrations has constantly increased, reaching 4,449 in 2011. Over the same period, registration numbers fell significantly, dropping to 13,376 in 2012. Although the trend is negative, the net effect in 2012 was still positive.

A further monitoring of the economic climate in which operate SMEs is given by the *Progress Report of the European Commission for Albania* (October 2013)¹⁴. In this Report, according to the European Commission "as regards enterprise and industrial policy principles, Albania continued implementing the principles of the Small Business Act (SBA). The legal and regulatory framework continued to improve with some progress in the areas of bankruptcy and second chance for SMEs and of company registration and business start-up. Some steps were taken to implement the inspectorate reform by adopting amendments to sector laws, implementing legislation on the organisation and structure of the General Inspectorate and the code of ethics of its employees. The Business and Investment Development Strategy for 2014-20, which takes into consideration the principles of the SBA, has not yet been adopted. There was no progress as regards legislative alignment on late payment. In the area of enterprise and industrial policy instruments, financing to SMEs continued through the credit guarantee fund and the European Fund for South-East Europe but SME access to finance remains an issue. The Albanian Investment and Development Agency (AIDA) promoted the business relay innovation center and the Innovation and Competitiveness Funds. AIDA's capacity to implement SME promotion mechanisms needs to be further increased. Under the Competitiveness and Innovation Programme 2007-13, Albania joined the European Network of Female Entrepreneurship Ambassadors and the European Network of Mentors for Women Entrepreneurs. As regards sector policies, the Law on tourism was amended, clarifying the legal status and

¹⁴ Albania 2013 Progress Report, Commission Staff working Document, SWD(2013) 414 final, Brussels, 16.10.2013.

scope of activity of the Tourism Service Offices. Albania adopted in February the 2013 mining plan, and legislation on mining was amended”.

Considering the inflow of FDI it should be pointed out that the first free election of the year 1991 marked the beginning of the difficult transition from a centralized to a market economy. Albania has experienced challenging initial conditions, recurrent political crises, and chronically poor economic management. Since the beginning of the transition, Albania has opted for an extremely outward-oriented model of economic development, which is however hampered by deep structural problems. A positive change has regarded the privatization of agricultural sector, the introduction of financial autonomy of state enterprises, liberalization of prices and the signing of bilateral treaties on investment aid, creating a favourable climate for foreign investments. Despite the efforts made and measures taken by the Albanian Governments since the early 1990s, Albania still remains a Country which attracts a low level of FDI compared to the other Countries in the Region, while it has interesting natural and human resources.

Before 2006 FDI flows have been greenfield investments, in total absence of privatizations. Despite the global economic crisis, after 2008 FDI inflows in Albania continued to increase and during the period 2008-2010 FDI have mostly been attracted by the various privatization initiatives in sectors such as banking, telecommunication, manufacturing, and increasingly energy sector, especially the hydroelectricity.

The most important privatizations, concessions or outright private investments affecting the level of FDI include, among others, the sale of part of the shares in the second largest mobile company AMC to the Greek group *Cosmote* (now part of *Deutsche Telecom*); the sale of a majority stake in the distribution arm of KESH (Albanian power company) to the Czech group ČEZ, a.s.; investments in the energy sector by *Statkraft* (Norway - hydropower development), *EVN* (Austria – electricity production and distribution) and *Verbund* (Austria - hydropower development); investments in the cement industry undertaken by *Antea Cement Sh.a.* (TITAN – Greece), *Colacem Shqiperia Colacem* – Italy), and *Cementos Aguila (Grupo Aricam* – Spain). In recent years, an important development in targeting investors has been the establishment of the Law on Concessions (Law 9663 of 18th December 2006) which aims at creating a favorable framework for promoting and facilitating the implementation of privately financed concession projects in the development of infrastructure and public service areas in a wide range of sectors. Further, several structural reforms have been undertaken so as to simplify and lower start-up investment costs. In particular, in May 2009 the *National Licensing Center* was established mirroring the establishment of the *National Registration Center*. This Center is a sort of “one-stop-shop” for issuing licenses and permits reducing efforts for obtaining a license by local businesses to a minimal level.

As emerged before and as is usual with small Countries, Albania receives a large part of its FDI from neighbouring Countries. FDI from Greece (€3.2 billion) accounted for 20.7% of the FDI stock in the period 2007–2010, with a peak of €601 million in 2010. Greek FDI focuses on telecommunications (i.e. *AMC* and *Vodafone*) and financial intermediation (e.g. *ALPHA Bank* and *NGB Bank*). The second largest source-country for FDI in Albania is Italy, with 13.8% of the stock in the period 2007 - 2012. Investments originating from Italy focus mainly on manufacturing and construction (e.g. *Moncada Costruzioni*). While they are also present in the services sector (e.g. *CONAD* in retail trade), mainly in financial intermediation (e.g. *Gruppo Intesa San Paolo*), finance is still under-represented in Italian FDI in Albania, compared with FDI from other major investor Countries. Another peculiar feature of Italian investment is that there are many SMEs among the investors. Austria is the third most important source with 11.9% in the referred period. Almost all of the Austrian investment is in the banking sector, mainly as a result of the purchase of the *Savings Bank of Albania* by *Raiffeisen International*, the largest bank in Albania with 30% of the banking assets in the country (2009). Canada is fourth in the ranking of investing countries in 2007-2010, partly due the *Bankers Petroleum Ltd.*, a Canadian-based oil and gas exploration and production company developing large oil and gas reserves in the country. The presence of Turkish investors has also important (share of 7.9%) in several activities. Dutch, Swiss and German investors that normally rank among the first five in importance in other CEECs play a more marginal role in Albania.

FDI in Albania by main countries of origin (In € million)

	2007	2008	2009	2010	2011	2012	Cumulative total 2007 – 2012
<i>Greece</i>	521	566	560	601	507	451	3,206
<i>Italy</i>	220	321	348	387	427	434	2,137
<i>Austria</i>	147	186	221	354	444	498	1,850
<i>Canada</i>	1	8	102	270	529	706	1,616
<i>Netherlands</i>	274	188	207	223	253	243	1,388
<i>Switzerland</i>	14	137	108	68	544	507	1,378
<i>Turkey</i>	154	190	235	187	188	263	1,217
<i>Cyprus</i>	34	54	50	60	129	134	461
<i>Germany</i>	52	66	74	84	84	84	444
<i>Kuwait</i>	90	84	71	71	8	5	330
Total (including others)	1,830	2,061	2,261	2,436	3,400	3,503	15,491

Source: Bank of Albania (Data released on 31th March 2014)

Their limited presence could be due to the relative lack of investment opportunities in medium-higher technology manufacturing. Due to financial instability in the main source economies of FDI in Albania, efforts are necessary to diversify to new sources of FDI. But the Country may also benefit from an eventual capital flight from Greece if companies leave that Country due to diminishing demand and increasing tax burden.

The composition of FDI stock by economic sector of destination underwent significant changes in the years 2007- 2012. During this period the FDI stock in services remained almost unchanged while it expanded in some other economic activities. The main beneficiary was mining. The share of mining sector FDI increased from negligible 0.5% in 2007 to 23.1% in 2012 of the FDI stock (this is the result of the new concession policy of the Government). Manufacturing was the second more dynamic sector (in particular, in the manufacture of other non-metallic mineral products, i.e. construction materials), with a share of only 12.4% in 2007 increased to 25.5% in 2012

FDI in Albania by main sectors of destination (In € million)

	2007	2008	2009	2010	2011	2012	Cumulative 2007 – 2012
<i>Financial intermediation</i>	588	548	614	700	715	749	3,914
<i>Manufacturing</i>	227	439	408	416	952	892	3,334
<i>Transport, storage and communication</i>	590	383	357	400	389	402	2,521
<i>Mining and quarrying</i>	10	29	147	311	612	810	1,919
<i>Wholesale and retail trade; repair of motor vehicles, motorcycles and personal household goods</i>	99	271	253	240	217	189	1,269
<i>Construction</i>	132	196	189	-1	11	80	607
<i>Electricity, gas and water supply</i>	10	18	95	118	247	102	590
<i>Hotels and Restaurants</i>	94	94	79	76	70	69	482
Total (including others)	1,830	2,061	2,261	2,436	3,400	3,503	15,491

Source: Bank of Albania (Data released on 31th March 2014)

Another interesting picture on the presence of foreign entrepreneurs in Albania is given by the *Business Register* of the *Statistics Institute* according to which, at the end of 2012, the 2.3% of the total active enterprises was totally foreign-owned and another 0,9% was represented by joint-ventures with foreign dominance, especially in the trade, manufacturing and construction sectors.

Active enterprises by economic activity and ownership (end of 2012)

Economic activity	Total	Albanian	Foreigner	Joint-Ventures	
				Albanian dominance	Foreign dominance
Total (of which:)	104,275	100,464	2,417	428	966
○ <i>Agriculture & Fishing</i>	1,777	1,749	9	5	14
○ <i>Industry</i>	10,003	9,232	437	108	226
○ <i>Construction</i>	4,469	4,057	270	33	109
○ <i>Trade</i>	45,273	44,029	769	144	331
○ <i>Hotels, Coffee, Restaurants</i>	16,888	16,740	125	7	16
○ <i>Transport & Communication</i>	10,351	10,155	119	30	47
○ <i>Other Services</i>	15,514	14,502	688	101	223

Source: *Business Register 2012 - Statistic Institute (INSTAT)*

However, the most interesting result concerns the concentration of the foreign presence in SMEs, and especially in micro-small enterprises. In fact, out of a total of 3,811 firms with total or minority/majority foreign control, the 71.8% is concentrated in micro enterprises (1–4 employees) and another 12.2% in small enterprises (5-9 employees). This pattern is particularly evident in the trade, industry and construction sectors.

Foreigner and Joint-Venture active enterprises by economic activity and size

Economic activity	Groups by number of employed persons				
	1-4	5-9	10-49	50+	Total
Total (of which:)	2,737	464	386	224	3,811
○ <i>Agriculture & Fishing</i>	21	1	6	-	28
○ <i>Industry</i>	420	110	126	115	771
○ <i>Construction</i>	278	74	47	13	412
○ <i>Trade</i>	1,027	115	87	15	1,244
○ <i>Hotels, Coffee, Restaurants</i>	117	23	5	3	148
○ <i>Transport & Communication</i>	139	22	21	14	196
○ <i>Other Services</i>	735	119	94	64	1,012

Source: *Business Register 2012 - Statistic Institute (INSTAT)*

Foreigner and Joint-Venture active enterprises by country and size

Countries	Groups by number of employed persons				
	1-4	5-9	10-49	50+	Total
Total (of which:)	2,737	464	386	224	3,811
○ Italy	1,037	156	155	112	1,460
○ Greece	389	84	71	34	578
○ Turkey	202	37	29	12	280
○ Kosovo	174	27	8	2	211
○ Macedonia (FYROM)	118	23	13	1	155
○ Germany	93	13	10	8	124
○ U.S.A.	75	17	13	2	107
○ United Kingdom	65	10	4	2	81
○ Austria	47	11	12	7	77
○ Other Countries	537	86	71	44	738

Source: Business Register 2012 - Statistic Institute (INSTAT)

Main international financial facilities

European Union: Pre-accession financial assistance is provided under the IPA (Components I - Transition Assistance and Institution Building and II - Cross-border Cooperation). In the period 2007-2013, the EU allocated a total of approximately €594 million for Albania which included approximately €81 million in 2012 and €82 million in 2013 for the national programme under IPA Component I. The 2011-2013 multiannual indicative planning document for IPA Component I provided a sectoral approach with the focus on justice and home affairs; public administration reform; transport; environment and climate change; social development; agriculture and rural development. Under IPA Component II, Albania participates in the management and implementation of three programmes in Montenegro, FYR of Macedonia and Kosovo). It participated in one bilateral cross-border cooperation programme with Greece and three multilateral programmes including other EU Member States (i.e. the transnational programmes *South-East Europe, Mediterranean* and the *Adriatic* regional programme). For the period 2014-2020, the Government of Albania and the Commission discussed needs and capacities for future assistance, under the new instrument IPA II. Albania also participated in the following EU programmes: the *Seventh Framework Programme for research, technological development and demonstration activities* - FP7, *Entrepreneurship and Innovation* under the CIP, *Lifelong learning* programme, *Europe for citizens*, *Culture and Customs 2013*. Albania made some progress in the area of regional policy and coordination of structural instruments. In view of the accreditation, management and control systems of IPA structures need to be further strengthened to minimise risks of delays and decommitments. Programming capacity needs to be improved, with particular regard to the preparation of a solid projects pipeline. Overall, preparations in this area are moderately advanced.

European Investment Bank (EIB): since 2000, the EIB has lent €344 million to Albania, focusing its activities in key transport infrastructure, including Trans-European Transport networks. A €40 million loan was granted towards improving thermal energy supplies, and municipal water services have been supported with €27 million, as well as the credit lines to assist smaller businesses. In particular, in December 2009 the EIB and *Tirana Bank* (local financial intermediary) signed a €10 million loan targeting SMEs and infrastructure projects promoted by local authorities in Albania. This was the first EIB loan for SMEs in Albania in the fields of industry, infrastructure improvements, environmental protection, health and education, energy efficiency as well as services including tourism. A minimum of 70% of the loan was allocated to the SMEs sector. In June 2011 was signed an agreement for the financing of small and medium-scale projects carried out by SMEs (total amount: €5 million). In May 2013 was signed an agreement for the financing (amount: €3.4 million) from European Fund for South East Europe (EFSE) to micro and small scale enterprises, rural and housing loans through qualified financial intermediaries. EFSE aims to complement financial support provided by the

local financial sector and by the development finance institutions active in the region through the sustainable provision of additional finance to micro and small enterprises.

European Bank for reconstruction and Development (EBRD): The main focus-areas of the EBRD in Albania are supporting the financial sector and small-medium production enterprises, improving infrastructure, and developing natural resources. As of end-2011, the Bank had signed a total of 56 projects in Albania with a cumulative EBRD investment value of €667 million since the start of its operations in 1992. On average, every €1 of EBRD investment has attracted €2.5 of investment by other partners, implying a total project value of €2.33 billion. The portfolio stock is allocated 37% to infrastructure, 33% to energy, 22% to industry, commerce and agribusiness and 7% to financial institutions. This distribution broadly represents the investment needs and opportunities in the Albanian economy over the past two decades. The Bank signed a total of 12 projects in Albania in 2012, totalling €69 million, 70% of which were in the private sector. In the transport sector, the EBRD provided additional financing of €7.5 million for the completion of the new road between the cities of Levan and Vlore in south-western Albania. To improve the safety of the power infrastructure the Bank signed a €12.7 million loan to support KESH's investment plan for the safety upgrade at the Komani hydropower dam, the largest hydropower plant in Albania. This project is part of an overall investment programme co-financed by the World Bank, the German Kreditanstalt für Wiederaufbau (KfW) and the Swiss State Secretariat for Economic Affairs (SECO). The EBRD continued to support private sector investment in renewable energy through the Western Balkans Sustainable Energy Direct Funding Facility (WeBSEDF). In 2012 the Bank extended a €6 million loan to finance the construction of the Ternove hydropower plant in north-east Albania and a €5.2 million loan for the construction of the Verbe-Selce hydropower plant near the city of Korçë in south-east Albania. In 2012, the Bank continued to support the Albanian financial sector by providing long-term funding to micro-credit institutions aiming at increasing the role of non-bank financial institutions, supporting their lending to SMEs and improving corporate governance and credit management procedures. The Bank committed a €5.0 million "SMEs credit line" to Veneto Banca, €1.3 million credit line to NOA Bank, €1.1 million credit line to Fondi Besa and €1.0 million credit line to Credins Leasing. In the natural resources sector the EBRD extended the second tranche of €19.2 million to Bankers Petroleum to support in the remediation and redevelopment of the Patos-Marina oilfield, the largest in Albania. In the construction materials sector the Bank provided additional equity support of €4.4 million to Antea Cement Factory, a greenfield cement plant built two years ago with capacity to produce 1.5 million tonnes of cement annually and located about 30 km north of Tirana.

World Bank Group/IFC: the World Bank Group Country Partnership Strategy (CPS) for Albania covers the period 2011-2014, the first CPS to be presented following Albania's graduation from International Development Association (IDA) in mid-2008. Albania enters the new CPS period having weathered the global financial and economic crisis reasonably well - maintaining positive, albeit significantly reduced, growth rates in 2009 and a sound banking sector -. The key challenges to improving Albania's growth prospects in this environment include: the early resumption of a sound medium term fiscal framework and further strengthening of public expenditure management; improving implementation of Albania's already broad program of regulatory reforms to boost competitiveness and investment levels; continuing to close the infrastructure gap in a fiscally sustainable manner; deepening the private sector access to credit. Meanwhile, the slow recovery is likely to take its toll on the most vulnerable necessitating a renewed attention to improving the effectiveness of social protection systems and accelerating progress on social indicators. Finally, Albania is rapidly coming to terms with its climate change challenge - as the second most vulnerable Country in Europe and Central Asia - primarily relating to the management of its water resources on which the Country is heavily dependent for energy and agriculture. The joint Bank Group program presented in this CPS focuses on the implementation of a large ongoing program in Albania that is already supporting the above mentioned challenges, while selectively introducing new International Bank for Reconstruction and Development (IBRD) lending of around US\$2.75 million, and increasing IFC financing for the private sector to a level of US\$120-150 million. IFC will also mobilize other funds especially for private participation in infrastructure through its advisory services. Albania became a shareholder and member of IFC in 1991. Since then, IFC's investment in Albania totaled \$621 million, including \$180 million in loans, in 25 projects across a variety of sectors. The committed investment portfolio in Albania as of 30th June 2013 is US\$213 million. In particular, the IFC Strategy in Albania, through a combination of investment and advisory services, focuses on strategic sectors crucial for country's long-term

sustainable development, with a particular interest in:

- *Further improvements in business environment;*
- *Improvements in infrastructure sectors with larger participation of the private sector, including at the municipality level;*
- *Facilitation of private sector participation in a sustainable and “green” growth of the economy by investing in energy efficiency/renewable energy and cleaner production projects;*
- *Strengthening banks’ capitalization and providing specialized product for energy efficiency/renewable energy projects and micro, small, and medium enterprises, contributing to the development of microfinance institutions.*

National Instruments for FDI development

Albanian Investment Development Agency (AIDA): the Agency was founded and operates on the basis of Law no. 10303 dated 15 July 2010 “*On the creation and organization of Albanian Investment Development Agency.*” AIDA’s main objectives are attracting FDI, increase the competitiveness of the Albanian economy through the support for SMEs, as well as innovation. AIDA is an operational public partner for both Albanian SMEs seeking to enlarge their export markets, and foreign SMEs searching for local partnership in the Country. Its staff assists not only with market analysis, potential sectors for investment, but also with advice on finding suitable properties and locations, as well as helping to identify new and existing projects. AIDA helps more specifically through, studies, research on the business climate; information about business conditions and opportunities in Albania; contacts within national and regional government agencies - links with potential partners; detailed statistical and survey data about Albania and its key sectors; identification of sites and buildings; project management support throughout the investment cycle. AIDA also offers additional aftercare services aiming to successfully fulfill the demands of foreign investors even after the successful completion of projects. In particular, the Agency’s objective is to strengthen SMEs’ competitiveness by providing free support through:

- *Market analysis Identification of international trade flows, major importers, tariff barriers;*
- *Networking Identification of foreign partnerships/importers/new technologies; national leader for Enterprise Europe Network (EEN: www.een.al);*
- *Special grant for Albanian companies Competitiveness Fund Financial participation in export related activities;*
- *Innovation Fund Grant for innovative technologies and audit;*
- *Managerial support Templates for business plans and starts-ups, facilitation of training in management, innovation audit;*
- *Administrative procedures Identification of certifications needed to export; export and customs legislation, contacts of public agencies & ministries;*
- *Event management Promotion of B2B events, international fairs, donors’ initiatives, supporting business associations.*

In addition to offering these services, the Agency manages the *Innovation Fund*, created in 2007 on the basis of the *Business and Investment Development Strategy for the period 2007 to 2013*, and amended. This Fund is designed to serve MSMEs and assist firms in the form of subsidies for experts to audit their needs for innovation and technology as well as the enterprises themselves to identify providers and technology partners in other Countries. Cost Sharing Grant Scheme (CSGS) provides subsidies for costs related to the approved activities on the basis of cost sharing. This means that the grant does not cover all costs, but only a part of them, while the rest is financed by the grant beneficiary (in this case, the Albanian company). The purpose of the grant is not to replace what the company will finance its resources, but is added to the budget of the company, serving as an incentive for MSMEs to audit their needs for innovation and technology, and to identify technology

suppliers and partners in other countries, enabling a more informed choice for an optimal development.

AIDA will publish the status of availability of funds for this CSGS when appropriate and in the opening or closing periods of the submission of applications. The scheme will reimburse approved costs in accordance with the following guidelines:

- *A company can take a maximum of 400,000 Lek for a project.*
- *The scheme covers 30% -50% of the costs received within the above limit.*
- *In one year, 1 audit may be assisted and/or 1 internationalization project.*
- *Companies applying for the second time for the audit must submit results reached after the first audit.*
- *Subsidy payments are made at the end of the project, upon the declaration of the incurred expenses bill*

the Agency also manages the *Competitiveness Fund* designed to serve SMEs, focused on exports. Typical projects can be website development or participation at foreign exhibitions.

SMEs and FDI status

In comparison to other Western Balkans Countries in Bosnia and Herzegovina there is an even more marked delay in development process of SMEs, mainly due to historical causes. The main reason is the fact that throughout the pre-war period the Country's economy had been based on LEs and complex integrated business systems of the former "planned" economic model. Another evident fact that has negatively affected SMEs development is the slowness of the transition of Bosnia and Herzegovina to market economy and of the privatization process. The third, but not less important factor, is linked to the inconsistency of economic policy and legislative measures at "national" level, because the strategic approaches, legal frameworks and other instruments of SME development have so far been established exclusively at the entity levels, without adequate coordination and agreement at the State level. Under Constitution established through the Dayton Accords, Bosnia and Herzegovina is divided into two "entities," the Federation of BiH (the Federation) and the Republika Srpska (RS)¹⁵. The Federation is further divided into ten cantons, each with its own government and responsibilities. Each entity also has municipalities. As a result, the Country has a multi-tiered legal and regulatory framework that is often duplicative and contradictory (e.g. RS adopted "*SME Development Strategy*" for period 2006 to 2010, and the Federation adopted "*Small Economy Development Programme*" in 2007). The size of the grey economy is a separate issue. There are various estimations about the grey economic in Bosnia and Herzegovina, and the conclusion is that it could be anywhere from 20 to 50%. According to the estimates done by the European Commission and the World Bank, the grey economy encompasses some 36% of the total economy in the Country.

Taking into account this very specific situation, the SMEs structure in Bosnia and Herzegovina is estimated on the basis of no precise data, because there is no a SME definition on the state level, and different institutions (statistics and tax institutions, Pension fund, etc.) present SMEs data in different ways. Also please note that the Country is not yet monitored by the *SME Performance Review*, the main tool the European Commission to assess countries' progress in implementing the *Small Business Act (SBA)* on a yearly basis and is not covered by the Eurostat statistical *Business Registers*. The only available data from national source. In particular, according to the *Statistical Business Register* (as of 30th June 2013)¹⁶ in Bosnia and Herzegovina the classification of enterprises by employment size classes, shows that micro enterprises (0-9 persons employed) create the largest share of the total number of classified enterprises, even 73.8%. Small enterprises (10-49 persons employed) create 18.8%, medium enterprises (50 – 249 persons employed) create 6.1%, while the share of large enterprises (250 and more persons employed) is only 0.9%. The largest number of micro enterprises, 38.2%, are classified in the wholesale/retail trade and repair, followed by manufacturing) with 13.5%, professional, scientific and technical activities) with 9.6%, construction with 6.6% and transportation and storage with 6.6%.

15 A third, smaller area (493 km²), the Brčko District in northeastern Bosnia and Herzegovina, operates under a separate administration.

16 *Statistical Business Register* is a register kept and maintained by the Agency for Statistics of BiH in cooperation with the Federal Office of Statistics for the Entity of BiH, Republika Srpska Institute of Statistics for the Entity of BiH and Branch office of the Agency for statistics of BiH in Brčko District.

B&H: enterprises size classes by economic activity (as of 30th June 2013)

<i>Economic activity:</i>	<i>Small and Medium sized enterprises (SMEs)</i>				<i>Large (250+)</i>	<i>TOTAL (*) (in numbers)</i>
	<i>Total SMEs</i>	<i>Micro (0-9)</i>	<i>Small (10-49)</i>	<i>Medium (50-249)</i>		
<i>A – Agriculture, forestry and fishing</i>	867	714	136	17	7	881
<i>B - Mining and quarrying</i>	202	146	44	12	12	214
<i>C – Manufacturing</i>	4,716	3,136	1,179	401	87	4,803
<i>D – Electricity, gas, steam and air conditioning supply</i>	181	151	20	10	14	195
<i>E – Water supply, sewerage, waste management and remediation activities</i>	361	155	139	67	4	365
<i>F - Construction</i>	2,220	1,539	557	124	10	2,230
<i>G – Wholesale and retail trade; repair of motor vehicles and motorcycles</i>	10,705	8,861	1,602	242	34	10,751
<i>H – Transport and storage</i>	1,922	1,528	346	48	9	1,932
<i>I – Accommodation and food service activities</i>	764	590	147	27	1	766
<i>J – Information and communication</i>	959	758	169	32	6	966
<i>L – Real estate activities</i>	396	352	37	7	0	396
<i>M – Professional scientific and technical activities</i>	2,583	2,235	310	38	1	2,588
<i>Total (including other sectors)</i>	30,981	23,183	5,891	1,907	300	31,409

() – Including active enterprises with unavailable data.*

NOTE: further 30,278 enterprises are not recorded in the administrative registers, and not submitted financial reports.

Source: Agency for Statistics of Bosnia and Herzegovina - Statistical Business Register, September 2013.

Similarly, the largest number of small enterprises (27.2%) are classified in wholesale/retail trade and repair. Small enterprises are also represented by a larger number in the following sections: manufacturing (20.0%), construction (9.5%), education (8.6%) and transportation and storage (5.9%). Out of the total number of medium enterprises, the majority (22.4%) are classified in education activities, then in manufacturing (21.0%), wholesale/retail trade and repair (12.7%), public administration and defence; compulsory social security (10.7%) and human health and social work activities (7.0%)¹⁷.

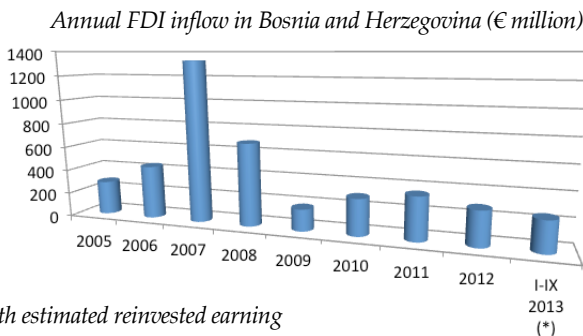
The classification of enterprises by turnover shows that 87.4% of enterprises generate the turnover less than €2 million annually, 5.7% of enterprises generate turnover between €2-10 million and only 1.5% of enterprises have turnover of €10 million KM and more. Observed by the economic activities, the highest revenue in 2012 were realized in the wholesale and retail trade; repair of motor vehicles and motorcycles (39.7%), then follows the manufacturing (19.6%) and public administration and defense; compulsory social security (10.5%). Observed by the size of enterprises by revenues, total share of micro enterprises in total revenue is 20.9%, small enterprises is 22.9%, medium enterprises is 23.6%, while the share of large enterprises is 32.6%. In 2012, considering the economic activities, majority of persons employed (19.9%) were employed in manufacturing, then follows the wholesale/retail trade and repair (16.9%) and public administration, defense and compulsory

17 Out of the total number of LEs, 29.0% are classified in manufacturing, 15.0% in public administration and defence; compulsory social security, 11.3% in wholesale/retail trade and repair, 11.3% in human health and social work activities and 6.3% in financial and insurance activities.

social security (13.0)%. Observing enterprises based on criteria “number of persons employed”, 38.5% were employed in LEs, 29.5% in medium, in small enterprises were employed 20.8% and 11.2% in micro enterprises.

As in the case of the other Candidate and Potential Candidate Countries, a comprehensive monitoring of the economic climate in which operate SMEs in Bosnia and Herzegovina is given by the *Progress Report of the European Commission* (October 2013)¹⁸. In particular, according to the main findings of this Report in the Country “there has been no progress on industrial policy. The State-level coordination, a country-wide strategy and statistics remain to be established for the harmonised implementation of the policy measures by the Entities. Regarding SME policies, there is no official definition of SMEs at the State-level; the two entities use their own SME criteria based on Entity laws. Bosnia and Herzegovina has not yet introduced regulatory impact analysis (RIA). Republika Srpska introduced a draft of a new SME Law which aims to harmonise SME definitions with the acquis. It incorporates the Small Business Act principles and clarifies competencies by improving its coordination with local development agencies. Bosnia and Herzegovina has made little progress in implementing the Small Business Act (SBA). The formally established SME consultative committee, bringing together all the key actors in SME policy, is still not yet fully operational. The SME Council for Development and Promotion of Entrepreneurship continued to be inactive. Some reforms have been initiated towards introduction of a countrywide unified business register and one-stop shops to simplify doing business in both Entities. However, the business registration and start-up process remains cumbersome and costly. No steps to remedy this have been recorded since 2009. The issue of double registration has not been solved. New enterprises are still required to register with the local court and with the municipality and to take care of all notification procedures themselves, although there are simplified procedures for craft registration. The policy framework for business support services remains underdeveloped. The State-level SME strategy mentions business support services, but no policy has been implemented. Regional and local agencies receive financial support from a range of donors and the local public sector, but the overall choice and quality of SME support services is still limited. Republika Srpska continued with the adoption of by-laws for tourism and the catering industry. Similar legislative harmonisation has yet to follow in the Federation. The Federation strategy on tourism development for 2008-2018 has not yet been adopted. Overall, there was little progress in the area of industrial and SME policies. A comprehensive countrywide industrial policy and SME strategy have still to be adopted. The regulatory environment remains complex and the regulatory burden on SMEs heavy. Enterprises continue to face obstacles and administrative barriers to conducting business across Entities. Policy actions have been fragmented and uncoordinated. Attempts to move towards greater coordination have not yet succeeded in bringing about any significant results.

Bosnia and Herzegovina still struggles to attract Foreign Direct Investments. Although open to foreign capitals, investors from abroad continue to face a number of serious obstacles including: multiple complex legal and regulatory frameworks and government structures; non-transparent business procedures; corruption; poor infrastructure; insufficient protection of property rights; and weak judicial structures. In addition, the country's political environment, coupled with the pressures of the global economic downturn, has stalled many key economic reforms. Moreover, the lack of a single economic market throughout Bosnia and Herzegovina creates difficulties for companies trying to do business across the entire Country.



(*) - Preliminary data with estimated reinvested earning

Source: Central Bank of Bosnia and Herzegovina

¹⁸ Bosnia and Herzegovina 2013 Progress Report, Commission Staff working Document, SWD(2013) 415 final, Brussels, 16.10.2013.

FDI inflows in Bosnia and Herzegovina in 1994-2012 totaled € 5.6 billion. In the structure of FDI equity and reinvested earnings were €4 billion and other capital (inter-company loans, bonds, money market instrument, trade loans and other loans) was €1.6 billion. In the referred period the major sector-recipient of FDI has been manufacturing (35%), followed by banking (21%), telecommunication (15%) and trade (12%). The first five most important investing Countries were Austria (24%), Serbia (17%), Croatia (13%), Slovenia (9%) and Russian Federation (8%).

Stock of FDI by main sectors of destination (€ million)

	2009	2010	2011	2012
<i>All sectors</i>	4,802.8	4,965.0	5,425.7	5,604.20
<i>Manufacture of food products and beverages</i>	348.5	328.7	337.5	371.9
<i>Manufacture of wood and of products of wood and cork, except furniture</i>	59.1	55.9	56.5	56.9
<i>Manufacture of coke, refined petroleum products and nuclear fuel</i>	374.0	385.1	407.4	415.4
<i>Manufacture of chemicals and chemical products</i>	129.2	115.8	125.5	148.7
<i>Manufacture of other non-metallic mineral products</i>	209.3	225.0	219.4	218.1
<i>Manufacture of basic metals</i>	60.0	84.2	71.1	56.2
<i>Manufacture of motor vehicles, trailers and semi-trailers</i>	84.3	505.8	81.0	85.9
<i>Wholesale trade and commission trade, except of motor vehicles and motorcycles</i>	502.4	991.8	438.7	422.6
<i>Retail trade, except of motor vehicles and motorcycles, repair of personal and household goods</i>	109.2	114.5	117.7	150.6
<i>Post and telecommunications</i>	817.4	824.6	836.1	834.4
<i>Financial intermediation, except insurance and pension funding</i>	1,045.2	998.8	1,172.1	1,207.6
<i>Real estate activities</i>	96.2	111.9	343.6	341.1
<i>Other sectors</i>	966.4	1,134.2	1,219.1	1,281.4

Source: Central Bank of Bosnia and Herzegovina

In 2007 the Country attracted more than €1.3 billion which is absolutely the highest amount recorded in the last 20 years mainly thanks to the privatization of large State-owned enterprises (e.g. Telekom Srpske sell to Telekom Srbija, oil refinery Rafinerija Nafta AD Bosanski Brod, lubricant producer Modrica, and fuel retailer Petrol a.d. Banjaluka to Russia's Zarubezhneft). These projects was, however, concentrated on the Republika Srpska, while the Federation of Bosnia and Herzegovina not made substantial progress in privatising state-owned enterprises. In 2008 FDI inflow was €684 million EUR, without the expected privatization, can be considered as satisfied, especially from its positive structure (investment in production sector and high contribution of Greenfield investments). In 2009 the global economic crisis hit the inflow of FDI (only €180 million) and although the gradual increase in inflows in the following years was encouraging (€316 million, the average between 2010-2012), it was also still significantly lower than in the period before the global crisis. In this period he inflow of investments was mainly in non-financial sectors of economy and in the production of basis metals and wholesale trade in particular.

Stock of FDI by main Countries of origin (€ million)

	2009	2010	2011	2012
<i>All Countries</i>	176.0	299.9	347.1	278.8
<i>Serbia</i>	1.7	20.3	50.6	- 0.3
<i>Austria</i>	39.8	30.0	69.2	65.8
<i>Russia</i>	64.6	44.6	70.1	76.5
<i>Croatia</i>	62.6	42.6	14.5	59.0
<i>Slovenia</i>	29.4	- 11.4	31.1	- 27.5
<i>Germany</i>	- 4.6	17.1	18.1	20.2
<i>Italy</i>	1.9	8.0	4.5	7.0
<i>Netherlands</i>	- 8.3	23.9	8.2	0.9
<i>Turkey</i>	9.0	23.2	18.3	- 2.7
<i>Switzerland</i>	- 61.1	41.8	- 2.9	3.8
<i>Other Countries</i>	40.9	59.6	65.4	76.1

Source: Central Bank of Bosnia and Herzegovina

In terms of geographical distribution of investment inflows a significant change was recorded in 2011 and 2012, because the most investments were from Russian Federation. Also in 2012, increased investment was recorded from Saudi Arabia and Kuwait. Russia, as the biggest investor country in 2012, invested €76.5 million, followed by Austria with €65.8 million and Croatia with €59 million. At the same time, the decline of investments was recorded from some Countries, which used to be the major investors in the previous years. The biggest share of investment in 2012 has been in the manufacturing sector (41%), banking sector (23%) and trade (21%).

The Central Bank published preliminary FDI data, available within statistics on balance of payments for first nine months of 2013. In particular, FDI (net incurrence of liabilities and estimated reinvestment earnings) in the first nine months of 2013 amounted to €252 million, which is significantly more than in the same period last year when (€221 million). The biggest investor countries in the first nine months of 2013 were: Russian Federation (€97 million), United Kingdom (€69 million), Cyprus (€20 million), Austria (€15.5 million), Germany (€9 million), Luxembourg (€8.7 million), Slovenia, Serbia (€8.4 million each), the Netherlands (€7.1 million) and Turkey (€5.9 million).

Main international financial facilities

European Union: the Country received financial assistance under IPA and the implementation of the 2008-2012 national IPA programmes is ongoing. However, the national authorities have made no progress towards establishing the necessary structure for decentralised management of EU funds. The multiannual indicative planning document for the period 2011- 2013 has identified the following priorities for IPA support: strengthening the rule of law; improving the capacity and efficiency of the public administration and supporting social and economic development. The IPA national allocation for 2013 was €103.5 million. It included the draft IPA 2013 national programme (€87 million), which covers support for the judiciary, law enforcement, transport, education, refugees and displaced persons, and demining. Disputes about the division of competences between the State and the Entities continue to impede the efficiency and effectiveness of EU financial assistance to Bosnia and Herzegovina. On 10 September 2013 the Commission had to cancel two agriculture projects worth €5 million due to the failure of the authorities in Bosnia and Herzegovina to agree on the structures to channel EU agriculture and rural development assistance (IPARD). Implementation of cross-border cooperation programmes 2007-2013 between Bosnia and Herzegovina and Croatia, Montenegro and Serbia is ongoing. The government and the Commission are currently preparing a comprehensive Country Strategy Paper for the period 2014-2020, which will provide a coherent and strategic framework for financial assistance under the new IPA II. The IPA II programming will be launched as soon as an effective coordination mechanism on EU matters is in place. As regards participation in EU Programmes, Bosnia and

Herzegovina continues to participate as a full member in the *Seventh Framework Programme (FP7)* and in the *COST* and the *EUREKA* networks, the *Culture 2007-2013 Programme* and the *Europe for Citizens Programme*. It has started to participate in the *MEDIA 2007 Programme*.

European Investment Bank (EIB): since 2000 the Bank has lent over €1.6 billion to support projects in Bosnia and Herzegovina. Of this total, €570 million has been used for credit lines to develop SMEs and midcaps. A further €582 million has been destined to the development of the Country's transport infrastructure, both regional projects and Trans European Transport Networks. The Bank has also contributed €163 million to rebuild and improve the reliability of Bosnia and Herzegovina's energy transmission networks. Between October and November 2009 the EIB granted three separate loan contracts for a total amount of EUR 110 million aimed at boosting the economy of Bosnia and Herzegovina and supporting the country's economic recovery efforts: €10 million via *LOK Microcredit Foundation Sarajevo* for small and micro-enterprises, including start-ups in the sectors of agriculture, trade, manufacturing, and services; €50 million via *Intesa Sanpaolo Banka d.d.* for SMEs and priority projects; €50 million via *IRBRS Investment-Development Bank* for SMEs and local infrastructure projects. In December 2009 and January 2010 The EIB approved two financing (€40 million and €20 million) of small and medium scale projects promoted by SMEs as well as industrial investment projects promoted by the municipal entities, for investment in the field of environmental protection, energy efficiency, infrastructure, industry, services and tourism (local financial intermediaries: *Reiffeisen Leasing d.o.o.* and *Volksbank BH d.d.*). Between August 2011 and December 2013 the bank signed further agreements for the financing of projects addressed to the SMEs sector with the following financial intermediaries: *ProCredit Bank* (€25 million), *Intesa Sanpaolo Banka d.d.* (€60 million) and *Sparkasse bank d.d* (€20 million).

European Bank for reconstruction and Development (EBRD): during the current strategy period the Bank signed 46 projects for a total of €466.3 million, and mobilised co-financing of €1,0 billion as of 31th December 2013. Since the start of operations in August 1996, the total cumulative business volume reached €1.7 billion and mobilised co-financing €2.0 billion. 46% of cumulative business volume to date is in Infrastructure, 29% in the financial sector, 14% in the industry, trade and Agribusiness and 11% in energy. The active portfolio as of end December 2013 comprised 61 projects totalling €985 million. The Bank made good progress with the implementation of large infrastructure projects signed in the previous strategy period, with disbursements reaching €487.2 million during the current strategy period. As a result, the undrawn ratio improved from 53.1% at the end of 2010 to 40% at the end of December 2013. Implementation of a few public sector projects remains however significantly delayed (Railways Restructuring, Sarajevo Water and Wastewater Rehabilitation), and one large sovereign project signed during the previous strategy period, Sarajevo Airport expansion, had to be cancelled because of the adverse impact of the economic crisis on airport operations. The value of impaired assets declined from €7.1 million (1.6% of operating assets) at the time of approval of current strategy in October 2010 to €2 million (0.3% of operating assets) in December 2013. The portfolio ratio improved from 35.8% private sector in October 2010 to 37.4% in December 201. During this period the Bank signed 36 private sector operations and 10 public sector projects, with average size €4.6 million and €29.9 million, respectively. However, the current active public sector portfolio continues to be dominated by the large post-war reconstruction projects in the public sector signed during the last 15 years. The share of public sector projects is likely to remain significant, given the large scale of potential projects (and the comparatively small average size of projects in the private sector) to support stronger regional linkages and reform of public utilities. The Bank will however pursue greater private sector participation in such projects, subject to market conditions, and focus on expanding its activities with private companies. This approach should result in gradual rebalancing of portfolio ratio in the medium to long term in line with the Bank's Portfolio Ratio Policy.

World Bank Group/IFC: the Country joined the World Bank in 1996, with membership retroactive to 1993. Since the end of the conflict, the World Bank has approved 68 projects in the total amount of about US\$1.745 billion (interest-free IDA Credits, US\$1.4 billion; IDA grants, US\$25 million; GEF grants, US\$18.3 million; and International Bank for Reconstruction and Development [IBRD] loans, US\$295 million). The World Bank engaged early and extensively in the postwar reconstruction of Bosnia and Herzegovina: in fact, during the period of intensive post-conflict reconstruction (1996–2002), the World Bank supported repairs to over 20,000 public apartment units and about 2,000 private houses. Hundreds of kilometers of power and water lines, transmission stations, and thermo and hydropower plants were rehabilitated. Roughly 2,300 kilometers of roads, 41 bridges, three tunnels, and Sarajevo's International Airport were rebuilt. 82 primary schools were

reconstructed, and 24 medical facilities equipped. About 200,000 jobs were created or sustained under the two microfinance projects. The World Bank currently supports 11 operations in the Country. The total value of these projects, which are in various stages of implementation, is US\$420.4 million, about 33% of which has been disbursed to date. Areas of support include agriculture, environment, health, social safety and employment, wastewater and solid waste management, and private sector development. The World Bank is currently preparing a development policy operation to support reforms of the business environment and investments to improve the energy efficiency of public institutions, restore the navigability of the Sava River, and help increase local access to financial protection from the losses caused by climate change and natural disasters. Through the Analytical and Advisory (AAA) Program the World Bank's analytical work contributed significantly to the policy dialogue in BiH in several key sectors. The 2012 Public Expenditure and Institutional Review (PEIR) found that public expenditure reforms remain a high priority for BiH, especially in the context of the post-crisis recovery. Ongoing technical assistance on pensions and planned technical assistance on public health financing stem directly from the PEIR recommendations. With regard to the support from the IFC, since 1996 the overall investment in the Country has totaled US\$376 million, including US\$23 million in loans in 44 projects across a variety of sectors. IFC is focusing its investment services on foreign and domestic investments in the real sector and infrastructure, with a particular focus on climate solutions and renewable energy and financial markets. IFC has also invested in the health sector, municipal infrastructure, agribusiness, construction, and general manufacturing. IFC's committed investment portfolio in Bosnia and Herzegovina as of 30th June 2013 was US\$100 million. Priorities include improvements in the investment climate, manufacturing, agribusiness, infrastructure, and climate change. IFC is also focusing its efforts in BiH to support private sector participation in infrastructure development in roads, health, and renewable energy. Recent investment projects in BiH include:

- €24 million in financing to Sisecam Soda Lukavac, a soda ash producer, including €7.5 million from the IFC-Canada Climate Change Program, to enhance competitiveness and cleaner production
- €8 million loan to Bekto Precisa, a local supplier of plastic and metal products for the automotive and electrical industries, to expand and become more competitive. The investment will allow the company to handle larger orders, and facilitate the partial refinancing and restructuring of its existing debt.
- €15 million to Sisecam Soda Lukavac to enhance its competitiveness
- US\$4 million GTFP line to Raiffeisen Bank
- US\$8.9 million loan to EKI microcredit foundation, to enable it to continue serving its microfinance clients in rural areas
- US\$5.6 million in financing to Mi Bospo microcredit foundation, including a local currency guarantee
- US\$6.4 million to BH Heart Center to support the first privately owned and managed health care facility in BiH
- US \$29.5 million to CIMOS B to support a Slovenian car part production company to develop new production capacities in four cities of BiH
- US\$14.2 million to Nova Banka to support a credit line and straight equity, as well as to AS, one of the more successful, domestically owned commercial banks
- US\$3.8 million to the Economic Credit Institution (EKI) to support its transformation from not-for profit status to a commercially oriented, regulated, non-deposit-taking financial organization
- US\$32 million to Sisecam, the largest Turkish producer of glass, soda ash, and related chemicals, that has purchased an 80 percent shareholding in Sisecam Soda Lukavac (SSL) through a privatization transaction. The project helped the company to preserve 783 out of 792 jobs, and created opportunities for expansion and new jobs.

National Instruments for FDI development

The *Foreign Investment Promotion Agency (FIPA)*, a state body established in July 1999 by the Council of Ministers, is responsible for promoting and attracting FDI. With links at various levels of Government and industry, it provides information on legislation and investment opportunities to potential investors, and assists them in establishing joint ventures or greenfield operations. More in detail the mission of the Agency is:

- *Attract and maximize the flow of FDI into Bosnia and Herzegovina, and encourage existing foreign investors to further expand and develop their businesses in the Country;*
- *Facilitate the interaction between public and private sectors, and have an active role in policy advocacy in order to contribute to continually improving environment for business investment and economic development;*
- *Promote a positive image of Bosnia and Herzegovina as a country that is attractive to foreign investors..*

The sectoral studies, elaborated by FIPA's experts and independent consultants, ensure that investors are fully aware of the opportunities of the Country. Moreover, FIPA works alongside the Embassies and Diplomatic Missions of Bosnia and Herzegovina that can also help to explore investment opportunities. FIPA provides data, information, analysis and advice on the business and investment environment, including:

- *the legal framework for FDI;*
- *investment incentives;*
- *economic and business trends;*
- *FIPA identifies and presents available investment opportunities:*
- *investment projects in the development-phase or ready for implementation;*
- *companies in the process of privatisation;*
- *local companies seeking foreign partners;*
- *effective networking with both the public and private sector;*
- *linking with governmental and non-governmental institutions to facilitate investment and business development;*
- *cooperation with local, regional and international organisations to promote and enhance the investment environment.*

CROATIA

SMEs and FDI status:

Croatia has made significant progress in transition but the process remains unfinished. Although the country is assessed as quite advanced in certain areas, it still faces significant transition challenges in key sectors. The economy is broadly liberalized and exhibits a relatively high degree of sophistication in financial services. There has also been progress over the years on infrastructure reform. The banking sector weathered the financial crisis well and remains sound and liquid. However, the role of the State remains large compared with many other transition Countries. Major reforms are still pending in areas such as public administration, labor market flexibility, and land registry. The Croatian SMEs sector continues to be affected by the economic crisis, in terms of decrease in employment and in added value. In previous years, Croatia, already the best performer in 2010-2011, showed the highest level of policy convergence, especially in the policy areas covered by the European *acquis communautaire*, although its progress has slowed¹⁹. However, Croatia's accession to the EU means also that the government needs to further upgrade its SME policy, taking EU levels as its benchmark rather than regional performance, and to monitor the Country's "lower-than-EU-average" productivity in the tourism and construction sectors. Its main priority should be to improve the business environment by tackling administrative and judicial weaknesses. The main difficulties here lie in weak framework conditions for entrepreneurial activity and cumbersome administration with excessive regulation and costs of registration. In particular, the government should resume the programme of regulatory simplification which it started with well-targeted measures in 2007, but which has stagnated since 2009. In this area, the predictability of the business environment could be improved by better enforcing the regulatory impact assessment, and increasing the transparency of decision making, particularly at local level.

According to the Croatian Bureau of Statistics at the end of 2012 almost 99.7% of Croatian firms are to be considered as SMEs (97.8% are classified as micro enterprises), absorbing 64.9% of the total persons employed. The 29.1% of Croatian SMEs is active in wholesale/retail trade and repair of motor vehicles and motorcycles sector, followed by the manufacturing (15.5%), construction (15.3%) and professional scientific and technical activities (13.6%).

Croatia: enterprises size classes by economic activity

	Small and Medium sized enterprises (SMEs)				Large (250+)	TOTAL (in numbers)
	Total SMEs	Micro (< 10)	Small (10-49)	Medium (50-249)		
<i>Enterprises (in numbers)</i>	143,482	140,928	10,419	1,915	425	143,907
<i>Enterprises by main economic activity:</i>						
<i>B - Mining and quarrying</i>	293	224	54	15	4	297
<i>C – Manufacturing</i>	22,047	18,715	2,652	680	169	22,216
<i>D – Electricity, gas, steam and air conditioning supply</i>	325	278	33	14	6	331
<i>E – Water supply, sewerage, waste management and remediation activities</i>	701	405	190	106	11	712
<i>F - Construction</i>	21,948	20,151	1,551	246	39	21,877
<i>G – Wholesale and retail trade; repair of motor vehicles and motorcycles</i>	41,751	38,696	2,689	366	83	41,834
<i>H – Transport and storage</i>	9,780	9,223	457	100	35	9,815

¹⁹ See: *SME Policy Index: Western Balkans and Turkey 2012 - Progress in the Implementation of the Small Business Act for Europe*. OECD, 2012.

<i>I – Accommodation and food service activities</i>	18,300	17,175	996	129	24	18,324
<i>J – Information and communication</i>	5,822	5,337	420	65	13	5,835
<i>L – Real estate activities</i>	4,782	4,658	116	8	1	4,783
<i>M – Professional scientific and technical activities</i>	19,567	18,558	904	105	9	19,576

Source: Croatian Bureau of Statistics – Yearbook 2013.

According to the *SBA Fact Sheet*, Croatia's SME sector, in terms of its share of the total number of firms and of general employment, is in line with the EU average. Only the share of value added is slightly less than the EU average, in particular for micro enterprises. The sectoral distribution seems to be broadly similar to the EU average, but some specificities appear again in terms of added value, in both the construction sector and tourism. Croatian SMEs seem to be less productive than their counterparts elsewhere in the EU, especially in the two traditional SME-relevant sectors mentioned above, but also in high-tech manufacturing and knowledge-intensive services. The crisis had a considerable negative impact on the growth prospects of both SMEs and LEs, which have not yet recovered to pre-crisis levels. The main reason for their overall poor performance is that the EU market is a crucial export market for all of them. In terms of entries, despite the small size of the Country, regional discrepancies are rather marked, according to the annual report of CEPOR (the SMEs and Entrepreneurship Policy Centre): generally speaking Adriatic Croatia performs better than continental Croatia, but the latter's performance is very patchy. In fact, continental Croatia contains very diverse regions, with the highest (Zagreb) and lowest (Sjeverna Hrvatska and Slavonija i Baranja) economic dynamics.

SMEs in Croatia – basic figures

	<i>Number of enterprises</i>			<i>Number of employees</i>			<i>Value added</i>		
	<i>Croatia</i>		<i>EU27</i>	<i>Croatia</i>		<i>EU27</i>	<i>Croatia</i>		<i>EU27</i>
	<i>Number</i>	<i>Share</i>	<i>Share</i>	<i>Number</i>	<i>Share</i>	<i>Share</i>	<i>Million €</i>	<i>Share</i>	<i>Share</i>
<i>Micro</i>	140,801	91.8	92.1	310,322	30.5	29.7	4	18.0	21.1
<i>Small</i>	10,334	6.7	6.5	194,606	19.1	20.4	4	18.2	18.3
<i>Medium</i>	1,872	1.2	1.1	191,613	18.8	17.3	4	19.5	18.3
<i>SMEs</i>	153,008	99.7	99.8	696,540	68.4	65.5	11	55.7	57.6
<i>Large</i>	404	0.3	0.2	321,766	31.6	33.5	9	44.3	42.4
<i>Total</i>	153,412	100.0	100.0	1,018,307	100.0	100.0	21	100.0	100.0

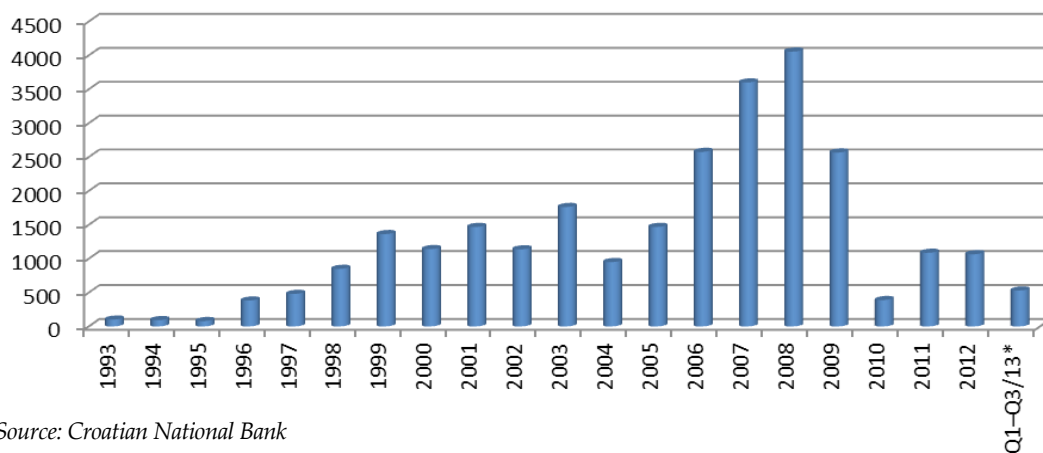
Source: SBA Factsheet 2013

Because of the already successful accession of Croatia to the EU (1st July 2013), unlike the Candidate or Potential Candidates Countries, in the fall of 2013 the European Commission has ruled Croatia from the list of countries included in the regular 2013 *Progress Reports*. Therefore it is not available the Commission's assessment on Chapter 20 - Enterprise and Industrial Policy²⁰.

²⁰ However, in the Report 2012 the Commission stated that "in the field of enterprise and industrial policy principles alignment has further advanced and is almost complete. Excessive regulation in some areas and the cost of registration prevent expansion of the SME sector. Administrative and judicial weaknesses continue to affect the

Foreign Direct Investments, as well as domestic investments are of great importance for the development of the Croatian economy. The potential impact of FDI in Croatia is reflected in relation to the regional development, jobs creation, technology transfer, and associated domestic investments. Croatian economy became quite friendly for FDI only from 1993, as soon as political and military situation became more or less stable. However, continuous and real rise in the FDI was recorded from 1996, after the military “Operation Oluja” (Storm). The year 2008 was the peak of FDI inflows with nearly €4.2 billion which is almost 40 times more than the same indicator in 1993 (€101 million). After sharp falling in 2009-2010 caused by the international financial crisis, the level of FDI began to grow again in 2011. FDI in Croatia declined again in 2012 and in the first nine months of 2013 amounted to €530.5 million, slightly less than in the same period of 2012. FDI in the first three quarters of 2013 were half the FDI value in 2012 and 2011, when they amounted to €1.1 billion, and they were slightly higher than in 2012, when they totalled €389.1 million. The Central Bank’s statistics show that ownership investments in the first nine months of 2013 amounted to €299.9 million, retained profits totalled €154.2 million, while other investments amounted to €76.4 million. According to *Croatian National Bank*, in the period 1993 – I/IX 2013 FDI in Croatia amounted to slightly more than €27.14 billion.

FDI inflows in Croatia (in € million)



Source: Croatian National Bank

business environment. Croatia needs to continue taking action to further improve the conditions for doing business, by increasing the predictability of the business environment, particularly at local level. Croatia has further advanced in developing administrative capacity in enterprise policy. Alignment of the definition of SMEs with the EU recommendation has been completed with the amendment of the Act on SME Support. Croatia needs to complete alignment with the EU Directive on combating late payment in commercial transactions. In the area of enterprise and industrial policy instruments, Croatia has established appropriate instruments and is in advanced stage of implementation”. For more details see: Comprehensive Monitoring Report on Croatia’s state of preparedness for EU membership, Commission Staff working Document, SWD(2012) 338 final, Brussels, 10.10.2012.

FDI in Croatia by main sectors of destination (In € million)

<i>NACE Class.</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>I-IX 2013</i>	<i>Cumulative total 1993 – I-IX 2013</i>
65 <i>Financial intermediation, except insurance and pension funding</i>	56.4	256.3	39.2	30.3	8,814.5
51 <i>Wholesale trade and commission trade, except of motor vehicles and motorcycles</i>	50.4	-146.8	112.0	16.1	2,662.5
70 <i>Real estate activities</i>	198.2	252.5	110.6	114.1	2,049.9
64 <i>Post and telecommunications</i>	-65.3	53.5	-47.2	-28.4	1,717.5
23 <i>Manufacture of coke, refined petroleum products and nuclear fuel</i>	-0.7	68.0	12.5	2.3	1,680.6
74 <i>Other business activities</i>	287.6	44.0	570.1	56.5	1,405.9
24 <i>Manufacture of chemicals and chemical products</i>	-440.7	241.9	-47.9	-6.0	1,364.6
52 <i>Retail trade, except of motor vehicles and motorcycles; repair of personal and household goods</i>	108.6	24.8	59.6	51.9	1,344.1
26 <i>Manufacture of other non-metallic mineral products</i>	-56.7	56.0	-6.7	-8.3	814.5
55 <i>Hotels and restaurants</i>	6.2	-25.0	47.6	40.5	706.2
<i>Total (including others)</i>	<i>389.1</i>	<i>1,087.1</i>	<i>1,066.0</i>	<i>530.5</i>	<i>27,144.6</i>

Source: Croatian National Bank

Most of the investments (more than €8.8 billion), were made into the financial/banking sector, followed by wholesale trade (€2.6 billion), real estate transactions (nearly €2 billion), postal and telecommunication services and the oil industry (about €1.7 billion each), etc. In the same period, investors from Austria invested €7.3 billion in Croatia, investors from Germany invested €3.3 billion, those from the Netherlands made €3.2 billion worth of investments, Hungarian companies invested €2.4 billion, while those from Luxembourg invested €1.7 billion. Companies from France, Italy and Slovenia invested more than € 1 billion.

FDI in Croatia by main countries of origin (In € million)

	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>I-IX 2013</i>	<i>Cumulative total 1993 – I-IX 2013</i>
<i>Austria</i>	-82.9	209.6	699.0	181.6	7,275.6
<i>Germany</i>	92.0	223.6	-111.8	66.4	3,313.7
<i>Netherlands</i>	-264.3	250.3	-228.0	18.6	3,194.1
<i>Hungary</i>	-10.3	103.0	40.3	-53.5	2,404.2
<i>Luxembourg</i>	110.7	162.6	184.4	45.1	1,745.4
<i>France</i>	4.5	5.4	2.7	16.1	1,374.2
<i>Italy</i>	140.3	22.1	38.9	40.9	1,326.0
<i>Slovenia</i>	88.3	14.4	-11.4	30.3	1,200.9
<i>Netherlands Antilles</i>	8.9	-1.1	-2.0	-0.4	875.0
<i>Belgium</i>	121.6	17.6	11.7	36.8	606.2
<i>Total (including others)</i>	<i>389.1</i>	<i>1,087.1</i>	<i>1,066.0</i>	<i>530.5</i>	<i>27,144.6</i>

Source: Croatian national Bank

According to the *Croatian national Bank* the drop in ownership investments was partly due to a takeover transaction in the second quarter, when *Crodux Derivati* took over *OMV Croatia*, a subsidiary of the Austrian oil company *OMV*, but that the low value of investments in new and current projects had the biggest impact. They underlined that as in the previous quarters, the bulk of investments was made into real estate transactions (€114.1 million), followed by ownership investments into real estate (€103.2 million), and investments into food and beverage production (€66 million), other economic branches (€56.5 million), retail trade (€51.9 million), wholesale trade (€16.1 million), construction (€43.2 million), and the hotel and restaurant industry (€40.5 million). The leading investors in Croatia in the first three quarters of last year were companies from Austria (€181.6 million), Germany (€66.4 million), Luxembourg (€45.1 million), and Italy (€40.9 million).

Main international Financial Facilities

European Union: Overall, the financial assistance provided to Croatia under the pre-accession programs is more than €1.3 billion. Only the PHARE and IPA programs include several hundred projects, worth in excess of €1.1 billion. Some of the pre-accession programs have already been completed (for instance PHARE 2005 and PHARE 2006, IPA 2007) while some are still currently under implementation (mainly IPA 2008-2010) – part of them are still in the preparatory phase. With regard to assistance in 2012, the IPA totalled € 156 million. This assistance has been focused on institution-building and preparing for implementation of the EU's common agricultural policy and cohesion policy. Overall, Croatia has demonstrated that the decentralised implementation system under the IPA functions satisfactorily, although some delays were encountered in implementation. Concerning regional policy and the coordination of structural instruments, Croatia was able to demonstrate that it fulfils the conditions for the waiver for ex-ante controls for all IPA components. Croatia needs to step up building the administrative capacity in the relevant structures, finalise investment strategies and intensify the preparation of a pipeline of high quality and mature projects as the numbers of co-funded projects, of sectors touched and of interlocutors will substantially increase over the time. A fully functioning management, monitoring and evaluation system needs to be established for the future European Structural and Investment Funds. Croatia needs to ensure that all relevant and necessary procedures are put in place to ensure an effective, regular and transparent use of the European Structural and Investment Funds, especially as far as public procurement is concerned.

European Investment Bank (EIB): the Bank has been operating in Croatia since 2001 in order to help the country integrate into the EU by meeting the accession criteria and coming into line with the Union's economic development. Up until July of 2013, EIB lending commitments amounted to some €3.5 billion. The EIB's lending portfolio in Croatia covers all of the country's economic sectors, ranging from basic infrastructure to manufacturing and services, including support for SMEs through local financial institutions - almost half of the EIB's lending in Croatia to date (48%) consists of support for SMEs - . With its accession to the EU, Croatia also became a shareholder of the Bank and has become eligible for EU grants. In addition, Croatia is the first Country to have benefited from the technical initiative which helps Countries in preparing projects for EU grant financing *Joint Assistance to Support Projects in European Regions (JASPERS)*. JASPERS is a technical assistance initiative provided jointly with the European Commission, the EBRD and *KfW*, which helps with the selection and preparation of projects financed by EU grants. In 2012, the Bank signed financing contracts in Croatia amounting to €300 million. This support went mostly towards SME investments, with new SME credit lines established with local financial institutions and public sector projects in line with the priorities of the government. Over the coming years, the Bank intends to step up its financing of railway projects in Croatia, as well as to continue expanding lending to municipalities and local authorities for infrastructure improvements in the environmental, health and education sectors. The EIB will also increase its support for SMEs, and increase their access to long-term financing. Operations in Croatia will also be extended to the environmental and human capital sectors, in close cooperation with the Commission. Furthermore, the *European Investment Fund (EIF)*, which is a subsidiary of the EIB, provides risk financing solutions to financial intermediaries to support SMEs and foster innovation in Europe. The EIF signed a guarantee agreement under the Competitiveness and Innovation Programme supporting micro-enterprises that will generate a portfolio of new loans worth EUR 30 million. It has also committed EUR 1.8 million in guarantee transactions, as a result of which EUR 22.5 million of new loans for SMEs could be made available. The EIB lent €250 million

to the *Croatian Bank for Reconstruction and Development - HBOR (Hrvatska Banka za Obnovu i Razvitak)* in July 2014, to finance projects promoted by SMEs, mid-cap companies and municipalities in Croatia. EIB funds will support undertakings in the areas of industry and services, including tourism, and small and medium-scale infrastructure schemes promoted by local authorities. There is high demand for HBOR's loans: in the first 6 months of 2013, loan approvals rose by 11% compared to the same period of 2012 which had been a record year in terms of both the number and amount of approved loans.

European Bank for reconstruction and Development (EBRD): As of 31 December 2012 the Bank signed 148 projects for an aggregate amount of €2.74 billion. During the same period, the Bank implemented €7.14 million in donor-funded technical co-operation projects through its *Legal Transition Programme*, *Enterprise Growth Programme (EGP)*, *Small Business Support (SBS)* and other programmes. In the Strategy period 2010-2012, the Bank's engagement in Croatia signed 34 projects for a cumulative amount of €755 million. The average transaction size was €18 million, excluding the largest transaction of €150 million for the modernisation of refineries at INA. During the Strategy period, EBRD's operating assets have grown to €1.057 billion. The Bank's current portfolio of projects is well diversified with 29% in the industry, commerce, agribusiness sectors, 15% in the energy sector, 30% in the financial institutions sector and 27% in the infrastructure sectors. The private sector share in the portfolio has not changed materially during the Strategy period (67% in 2009 and 65% in 2012). EBRD co-operation with the World Bank Group, EIB as well as with the European Union from 2013 to 2016 will focus on competitiveness enhancement and on strengthening the capacity of relevant Croatian public and private sector counterparts to leverage the benefits of EU accession. In the private SME sector, EBRD will boost its actions through the new SME platform devised together with the EU and EIB for the Western Balkans and Croatia and approved under the WBIF, the Enterprise Development and Innovation Facility (EDIF), through which a set of financing mechanisms and TC for structural reforms in the areas of private equity and innovation will be made available to the region. Within EDIF, a new fund, the Enterprise Expansion Fund (ENEF), will be created as a vehicle to co-finance equity driven projects with LEF, thus representing a key element to the co-operation with all other institutional players in the region.

World Bank Group/IFC: The World Bank has been focusing its assistance on helping Croatia prepare for successful EU integration and implement structural reforms that would boost competitiveness and mitigate the impact of the financial crisis. The World Bank has prepared a new Country Partnership Strategy (CPS) for Croatia, covering the period of July 2013-June 2017. The CPS is a key document that sets out the framework of cooperation between the World Bank Group and the Government of Croatia, and describes the World Bank Group's planned program in the country. The new Strategy was designed to commence with Croatia's accession to the EU, and as such, focuses on assisting Croatia in maximizing the economic benefits of membership and speeding up Croatia's convergence with the EU. In line with Croatia's new status, the nature of the Bank's assistance will gradually change, moving away from funding specific projects, as these are expected to be funded through EU funds, and focusing more on providing technical assistance to the country's institutions in order to better absorb EU funds and implement reforms needed to boost the economy. The Strategy prioritizes aspects of the Europe 2020 'smart, sustainable, and inclusive growth' strategy and the Government's new reform agenda that focuses on the fundamentals of economic management, state institutions, the business environment, and responsibility toward shared regional resources. This is coupled with supporting Croatia in making good use of large amounts of EU grants that will come with membership. In line with Croatia's priorities, from 2013 until 2017 the World Bank Group's support will concentrate on three thematic areas: (i) public finance – supporting fiscal consolidation to speed up sustained growth, with an emphasis on expenditure rationalization to ensure fiscal sustainability over the medium-term, (ii) competitiveness – improving Croatia's competitiveness, centering on the needed structural, institutional, and governance reforms, so that Croatia can catch up with its EU peers, (iii) EU Membership – helping Croatia maximize the economic benefits of becoming an EU member state by increasing the country's capacity to implement harmonized policies, to absorb the large increase in EU Funds, and help use these resources effectively. Over the next four years, IFC will continue to significantly increase its program and strengthen its support to the Croatian private sector, for private sector development is critical for achieving Croatia's goals and supporting stable and sustainable economic development. The focus of IFC will be on export-oriented companies, investments in energy efficiency and renewable energy projects, and on encouraging the inclusion of the private sector in the development of Croatia's infrastructure. The new CPS has been prepared in close

partnership with the Croatian authorities under the leadership of the Ministry of Finance, and in consultation with key stakeholders, including the European Commission, the Delegation of the European Union in Zagreb, members of Parliament, the private sector, think-tanks, academia, the diplomatic community, international organizations, civil society, and media.

National Instruments for FDI development

The Croatian government re-established the *Agency for Investments and Competitiveness - AIK*. Furthermore, apart from this Agency whose scope of activities focuses mainly on large investments, the Government also established *HAMAG Invest* whose tasks include promotion and attracting small and medium-sized investments, stepping up the activities related to the field of internationalization as well as strengthening the international competitiveness of the Croatian companies in the European common market as well as other markets.

Beside the established institutional investments framework, in 2012 the Croatian Government adopted the new *Act on Investment Promotion and Enhancement of Investment Environment* (OG 111/2012, 28/2013) which offers generous incentives for foreign and domestic investors. The AIK and HAMAG Invest websites offer Incentives calculators for large, as well as SME investors. The incentive measures are aimed at strengthening production activities and the use of new technologies, supporting research & development activities and stimulating employment.

This Act provides the following incentive measures:

- *Tax incentives,*
- *Customs incentives,*
- *Employment incentives,*
- *Incentives for education and training,*
- *Incentives for the capital expenses of investment projects,*
- *Incentives for labor intensive investment projects.*

Incentive measures can be used by enterprises registered in the Republic of Croatia investing in fixed assets in the minimum amount of:

- *€ 50,000 and 3 new jobs created for micro enterprises*
- *€ 150,000 and 5 new jobs created for small, medium and large enterprises.*

Potential investors can find an 'incentives calculator' for their intended investments: For what is categorized as a 'large company' investors, AIK is the right point of contact while for investors from the SME sector, HAMAG Invest is the place to request further information and guidance.

FYR OF MACEDONIA

SMEs and FDI status

The picture of the situation of SMEs in FYR of Macedonia, does not differ much from that of the other Western Balkans Countries. In fact, according to the data of the *State Statistical Office* the number of total active business entities in the Republic of Macedonia in 2012 was 74,424 of which 99,7% was made up of SMEs. Among the SMEs, the sectors with the highest share in the structure of business entities were: wholesale and retail trade; repair of motor vehicles and motorcycles with 36.8% and manufacturing with 11.0%, whereas the least represented were the sectors electricity, gas, steam, air conditioning supply and mining/quarrying (0.2% each).

FYR of Macedonia: enterprises size classes by economic activity (2012)

	<i>Total SMEs</i>	<i>Small and Medium sized enterprises (SMEs)</i>				<i>Large (250+)</i>	<i>TOTAL (**)</i>
		<i>0 (*)</i>	<i>Micro (1-9)</i>	<i>Small (10-49)</i>	<i>Medium (50-249)</i>		
Agriculture, forestry and fishing	3,070	290	2,678	69	33	2	3,072
Mining and quarrying	178	24	103	42	9	4	182
Manufacturing	8,194	607	6,059	1,176	352	57	8,251
Electricity, gas, steam and air conditioning supply	131	58	61	7	5	3	134
Water supply, sewerage, waste management and remediation activities	314	39	200	48	27	7	321
Construction	4,534	465	3,564	438	67	7	4,541
Wholesale and retail trade; repair of motor vehicles and motorcycles	27,294	1,879	24,140	1,168	107	13	27,307
Transport and storage	6,438	299	5,795	307	37	7	6,445
Accommodation and food service activities	4,609	278	3,922	389	20	2	4,611
Information and communication	1,508	338	1,037	108	25	7	1,515
Real estate activities	492	119	331	37	5	1	493
Professional scientific and technical activities	5,705	531	4,956	200	18	2	5,707
Administrative and support service activities	1,424	428	872	102	22	14	1,438
Total (including other sectors)	74,223	7,158	61,053	4,732	1,280	201	74,424

(*) – 0 persons employed or no data available

(**) – Including enterprises with unascertained number of employees

Source: State Statistical Office - Statistical Yearbook 2013

The data on the structure of active business entities according to the number of persons employed show that the highest share of 82.2% belongs to business entities with 1-9 persons employed, followed by business entities with no persons employed (or entities did not provide information about persons employed) with 9.6%, and entities with 10-49 persons employed with 6.4%, those with 50-249 persons employed participated with 1.7%, while entities with 250 or more persons employed had a share of only 0.3%.

SMEs in FYROM – basic figures (2011)

	Number of enterprises			Number of employees			Value added		
	FYROM		EU27	FYROM		EU27	FYROM		EU27
	Number	Share	Share	Number	Share	Share	Million €	Share	Share
<i>Micro</i>	71,797	95.5	94.2	121,998	44.8	29.7	602	26.8	21.5
<i>Small</i>	2,850	3.8	6.5	55,059	20.2	20.6	578	25.7	18.6
<i>Medium</i>	493	0.7	1.1	44,266	16.2	17.2	350	15.6	18.3
SMEs	75,139	99.9	99.8	221,323	81.2	67.5	1,530	68.1	58.4
<i>Large</i>	88	0.1	0.2	51,092	18.8	32.5	716	31.9	41.6
Total	75,227	100.0	100.0	272,415	100.0	100.0	2,246	100.0	100.0

Source: SBA Factsheet 2013

The data for 2011 cover the NACE Rev. 1.1. sections C to H and K, including mining and quarrying, manufacturing, electricity, gas and water supply, construction, wholesale and retail trade, hotels and restaurants, transport, and real estate sectors.

The 2013 SBA Factsheet figures (year of reference: 2011) for FYR of Macedonia released by the European Commission confirm the overall situation presented by the *State Statistical Office*. In fact, one of the most important SME sectors is wholesale and retail trade. It accounts for about 45% of all SMEs, almost one-third of all employees working for SMEs and about one-third of the overall value added by SMEs, whereas on average in the EU only about one-third of all SMEs are in this sector and they account for about a fifth of all SME employment and value added. SMEs account for the bulk of value added within sectors compared with large enterprises (LEs), with the exception of the electricity and gas and information and communication sectors. They account for more employment than LEs in most sectors, except the electricity and gas and the business support services sectors. Compared with the EU average, SMEs are particularly dominant in transport, manufacturing and wholesale and retail sectors. In wholesale and retail, SMEs accounted for more than 90 % of all employees and more than 90% of the sectoral value added, which is about one third higher than the EU average for both. SMEs are more important in this sector because of privatisation in the FYR of Macedonia (and more generally in the Western Balkan Region) following the disintegration of medium-sized and large industries when economic conditions changed drastically with the division of the Yugoslav market. This division left the domestic market of the FYR of Macedonia with 2 million domestic consumers, down from 24 million. Moreover, in the 1990s, setting up a one-person business became popular, as witnessed by the entrepreneurial intent among the population, as highlighted in the below section on entrepreneurship. Between 2009 and 2011, SMEs fared well on the whole, increasing employment and value added by about 15%. In contrast, the number of employees employed by LEs increased by only about 5%. In different sectors, the picture is more mixed. In the manufacturing sector, SMEs experienced negative growth rates and their number and value added fell by about one fifth, but employment remained stable. In the construction sector, SME-generated value added rose by more than a fifth and SMEs' workforce by almost 15%. With this remarkable growth, SMEs outperformed LEs active in the same sector, which only kept employment more or less stable and increased their value added by only 13%. Expectations about the business climate, both for start-ups and for existing businesses, are less optimistic against the background of the on-going crisis, which is reflected in a significant drop in domestic demand, restricted access to capital and generally low liquidity. The number of total active businesses has increased, since 2011, by 1,306, reaching 74,424 in 2012. As an indicator of the business climate, about 61 % of businesses started in 2008 were still active in 2011. Of those started in 2009, 70% were still there in 2011. Of those started in 2010, however, 66% survived until 2011.

The FYR of Macedonia is also characterised by a strong regional divide between the center and the periphery. The most developed region is the Skopje Region, around the capital, which covers only 7% of the country's area but accounts for about 44% of total GDP and about 30 % of total population, with the highest GDP per capita (2010 data). It is home to one third of all active companies in the country (62% of companies with more than 250 employees and one third of all micro firms registered — 2011) and it has the most advanced transport infrastructure and most of the industrial, trade and service capacity.

The SME sector in the FYR of Macedonia was little affected by the crisis and actually outperformed large enterprises (LEs) in terms of employment. It in fact grew, in number of enterprises, employees and added value, except for the manufacturing sector, in which SME employment was stable. However, expectations about the business climate both for start-ups and for existing businesses are less optimistic as the crisis lingers. In this context, the new government should continue the efforts made in recent years to bring its SME policy into line with Small Business Act (SBA) principles, especially as it concerns internationalisation, the environment and skills & innovation, in order to meet EU standards.

Another recent watch at the evolution of the framework in which operate SMEs is given by the end-year Progress Report drafted by the European Commission for FYR of Macedonia as candidate country; last EU October 2013 Report²¹ within the Chapter 20 - Enterprise and industrial policy, confirmed the limited improvement of the business environment for SMEs in FYR of Macedonia.

“As regards enterprise and industrial policy principles, the government has shown good results in simplifying current legislation and has implemented the measures of the third phase of the regulatory guillotine. The country is implementing the Small and Business Act principles. It has also made progress in implementing regulatory impact analysis (RIA). Concerning enterprise and industrial policy instruments, the company registration system is organised as a one-stop shop and companies are assigned a single identification number, valid for all interactions with the public administration. Access to finance for SMEs remains an issue. There are currently no public credit guarantee schemes in operation and other sources of finance, such as leasing and risk capital, have declined due to the unfavourable environment. Measures taken by the Ministry of Economy and the SME Agency to develop the private sector are still limited in volume and scope. An SME portal was created, providing information on various national, EU and other donor programmes to support local companies. The government adopted a strategy for innovation for the period up to 2020, and an action plan for its implementation from 2013 to 2015. Construction permits are now issued only online, and two more technological industrial development zones have started up, making a total of four. The government has several programmes to support export promotion, largely co-financed by international donor community. A strategy specifically supporting the export of IT services was adopted. Acts were adopted to alleviate the fiscal burden on companies in distress. Preparations in the area of policy instruments are moderately advanced. As regards sector policies, a Law on the Establishment of Free Zones for Tourism was enacted and a Special Committee for Tourism, chaired by the Prime Minister, was set up.

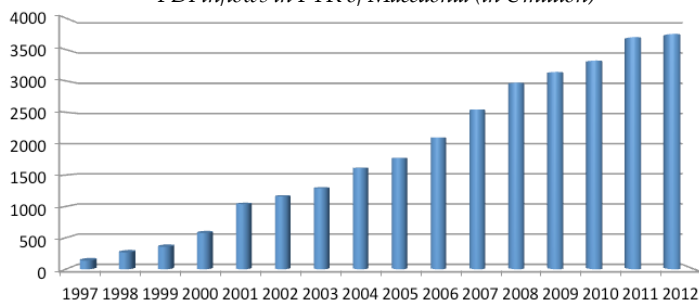
In conclusion, there was some progress in the field of enterprise and industrial policy. While progress has been made in policy making, challenges remain in the provision of SME support services, innovation and access to finance. Preparations in this area are moderately advanced”.

As a small economy, FYR of Macedonia continues to take active steps to attract Foreign Direct Investments, although follow-through and rule of law issues remain concerns. The Country has enacted legislation that not only ensures a generally equal footing for foreign investors with their domestic counterparts, but also provides numerous incentives to attract such investment (see below). However, challenges remain for foreign and national investors alike, including corruption, lack of capacity and communication in and among bureaucracies, and concerns about the rule of law. As for the other Western Balkans Countries FDI inflows in FYROM were very small until 1998 (stock of only €141.2 million). Between 1998 and 2007, the increased FDI flows were larger due mostly to the privatization of State-owned firms, and acquisitions of major companies and banks by foreign investors. The sale of the national telecommunications operator to *Magyar Telekom*, the Hungarian affiliate of *Deutsche Telekom* in 2001, has so far been the largest FDI transaction, explaining the peak in inflows in 2001. In 2008 and 2009, FDI dropped again, largely due to a deteriorating international environment. Until 2008, 38% of the total FDI (equity capital) was attracted in greenfield projects (including

21 FYROM 2013 Progress Report, Commission Staff working Document, SWD(2013) 413 final, Brussels, 16.10.2013.

projects in the free economic zones). In the 2000s, FDI inflows were concentrated in the services sector, in particular in financial intermediation, as well as in electricity, gas and water supply and manufacturing.

FDI inflows in FYR of Macedonia (in € million)



Source: National Bank of FYR of Macedonia

In particular, several big international companies have started operations in the country, both as green-field projects and through different types of asset acquisition and privatization. Some of the significant foreign investors include *Johnson Matthey* (chemicals - UK), *Mobilkom Austria* (Austria), *EVN* (Hydropower - Austria), *Deutsche Telecom* (Germany), *Kromberg & Schubert* and *Dräxlmaier Group* (both automotive - Germany), *Van Hool* (buses manufacturer - Belgium), *Société Générale* (banking - France), *Johnson Controls* (automotive - USA), *KEMET Corporation* (electronics - USA), the *National Bank of Greece*, *Hellenic Bottling Company S.A.* (Greece), *QBE Insurance Group Limited* (UK), *Mittal Steel* (Netherlands), *Duferco* (steel - Switzerland), and *Titan Group* (cement - Greece).

Apart from the above cases linked to the investments of large corporations, the inflows analysis by country of origin reveals the dominant role of Netherlands which accounts a share of 20.8% of the total stock until the end of 2012. Austria is the second largest investor with a share of 11.7% of the total stock, followed by Greece, Slovenia and Hungary: together, this “top five” investor Countries accounted nearly 63% of the total FDI stock. However, it should be emphasized, that even for FYR of Macedonia is relevant the phenomenon of foreign investments made by subsidiaries with registered offices in one state, but with parent company with headquarters in another state. This is also the case of companies registered in some *off-shore* Countries, better known as “*tax havens*”. In the Table below is evident the case of Saint Vincent and Grenadines (member of the British Commonwealth) who occupies the 5th place in the ranking of the best investors with a share of 3.0%, as well as the case of the British Virgin Islands (stock of €81.5 million and share of 2.2%).

FDI stock in FYR of Macedonia by main countries of origin (In € million)

	2008	2009	2010	2011	2012
<i>Netherlands</i>	435.6	523.6	550.4	740.4	783.0
<i>Austria</i>	334.6	362.6	371.7	416.8	441.6
<i>Greece</i>	450.7	380.3	431.2	442.9	436.2
<i>Slovenia</i>	262.8	391.2	398.7	405.7	363.2
<i>Hungary</i>	410.6	388.8	346.9	346.6	346.4
<i>Turkey</i>	43.0	49.7	48.3	117.2	145.3
<i>Bulgaria</i>	86.5	92.3	117.3	120.3	142.8
<i>France</i>	13.0	26.2	129.5	131.5	134.8
<i>Saint Vincent and Grenadines</i>	62.1	48.0	94.6	139.2	112.9
<i>Croatia</i>	53.2	55.5	72.1	77.6	85.5
<i>Total (including others)</i>	2,968.8	3,141.4	3,322.3	3,695.0	3,746.4

Source: National Bank of FYR of Macedonia

As emerged before, the cumulative FDI inflows by economic sector of destination reveals the absolute prevalence of the financial intermediation (i.e. banking sector) with a share of 23.4%, followed by the wholesale/retail sector (11.2%) and the basic metals and fabricated metal products (10.5%).

FDI stock in FYR of Macedonia by main sectors of destination (In € million)

	2009	2010	2011	2012
<i>Financial intermediation, except insurance and pension funding</i>	842.7	819.2	898.2	876.2
<i>Wholesale/retail trade, except of motor vehicles and motorcycles</i>	331.9	351.3	366.6	418.8
<i>Basic metals and fabricated metal products</i>	0.4	334.0	433.9	392.7
<i>Activities of holding companies</i>	440.3	395.0	401.7	364.7
<i>Food products, beverages and tobacco products</i>	249.8	261.7	293.0	261.1
<i>Motor vehicles, trailers and semitrailers</i>	79.1	152.3	238.4	252.8
<i>Construction</i>	129.0	133.8	137.0	157.1
<i>Mining and Quarrying</i>	89.3	133.0	179.4	156.4
<i>Telecommunications</i>	169.8	185.4	95.8	129.1
<i>Textiles and wearing apparel</i>	37.3	46.7	76.6	74.4
<i>Total (including others)</i>	3,141.4	3,322.3	3,695.0	3,746.4

Source: National Bank of FYR of Macedonia

Main international Financial Facilities

European Union: pre-accession assistance is provided under the IPA. The *Multiannual Indicative Planning Document (MIPD)* for the period 2011-2013 identified the following priority areas for financial support: public administration reform, justice, home affairs and fundamental rights, private sector development, agriculture and rural development, transport, environment and climate change and social development. Under the last National Programme within the IPA component I, the Commission earmarked €56 million for the years 2012 and 2013 and adopted new allocations of €148 million for operational programmes under Components III, IV and V. FYR of Macedonia also continued to benefit from various regional, cross-border cooperation and horizontal programmes. In the period 2007-2013 the Commission has committed over €610 million for projects to be implemented in the Country. Of this, the national authorities has been directly responsible for managing over €480 million under the *Decentralised Implementation System (DIS)* for four out of five IPA components. There are, however, concerns that limited national capacity to programme and absorb IPA funds under the DIS may increase the risk of decommitments. The national management and control systems remain uneven and need strengthening. A number of measures have been taken by the national authorities to improve capacity and performance and implementation of all IPA programmes is slowly making progress, but the backlog of projects continues to pose problems. Greater commitment is required from the authorities to accelerate implementation and increase the impact of financial assistance. The Government and the Commission are currently preparing a comprehensive *Country Strategy Paper* for the period 2014-2020, which will provide a coherent and strategic framework for financial assistance under the new IPA II. The FYR of Macedonia participates in the following EU Programmes: the *Seventh Research Framework Programme (FP7)*, *Progress*, the *CIP*, *Culture*, *Europe for Citizens*, *Fiscalis 2013*, *Customs 2013* and the *Intelligent Energy Europe Programme*. Limited progress was made in the area of regional policy and coordination of structural instruments. Contracting need

to be accelerated to address very significant delays in implementing IPA programmes. Urgent efforts are needed to overcome shortcomings in the capacity of the relevant institutions to carry out programming tasks and to demonstrate commitment to financial management, control and audit functions. Overall, preparations in the area of regional policy and coordination of structural instruments are not very advanced.

European Bank for reconstruction and Development (EBRD): The Bank has been operational in FYR of Macedonia since 1993. As of 30 November 2012, the Bank has signed 80 projects with net cumulative business volume of €1.1 billion, mobilising additional investment in the same amount. Nearly 36% of cumulative commitments are in the infrastructure sector, 28% in the financial sector, 20% in the energy sector and 16% in industry, trade and agribusiness. The active portfolio at end-November 2012 comprises 48 projects totalling €587 million. The current private/public portfolio ratio on a 5-year rolling basis is calculated for the period 2007-2011 and it stands at 43% private/57% public. In this period, the Bank signed 40 private (89% of total) and only 5 public sector projects in the Country. However, due to the small average size of the private sector projects (€4.5 million), in volume terms the ratio favours the public sector. At end-2012, the portfolio ratio stands at 38% private/62% public. In this period, the Bank signed 45 private (87% of total) and 7 public sector projects, with average size of €4.5 million and €49 million respectively.

Despite these figures, large investments in transport and energy infrastructure are crucial for strengthen the competitiveness of local companies, the country's further regional integration, as well as attract foreign direct investments. The needs for infrastructure investments are significant and could only be funded by IFIs, given the current lack of private sector interest to invest in large infrastructure projects in FYR of Macedonia. Because of the size of local economy, private sector operations are much smaller in size than the average sovereign infrastructure projects. This suggests that the private/public portfolio ratio will, at least in the short term, continue to weigh in favour of public sector projects. In terms of number of operations, however, it is worth noting that the majority of deals signed by the Bank in the country is already composed of private transactions, mostly reflecting the strong efforts to reach out to the local corporate sector directly (LEF), small renewable and industrial energy efficiency deals (WeBSEDFF) and MSMEs through local financial intermediaries. Over the medium and long term, the Bank expects to see a gradual rebalancing of its volume signings towards the private sector.

The key transition challenges and strategic directions for the next Strategy period are:

- Enhancing competitiveness and facilitating private investment in the corporate and municipal sectors: the authorities have made significant efforts in recent years to enhance FYR Macedonia's competitiveness and attractiveness as a business-friendly environment. The Bank will continue to assist in attracting and supporting foreign investment, thereby promoting productivity improvements through new skills and processes. In parallel, the Bank will seek to assist local corporates in improving their competitiveness. Private sector involvement in the municipal sector and the provision of utility services is essential to attracting investment and improving quality of services, and the Bank will seek to enable greater participation by the private sector, as well as adoption of best industry practices across the municipal sectors.
- Promoting energy efficiency and sustainable energy: Significant transition gaps remain in the energy sector in terms of moving tariffs towards cost-recovery levels, strengthening the capacity of the regulator and developing renewable sources of energy. The Bank will continue to play a critical role in helping to close the gaps, and will use its expertise to further promote and strengthen energy efficiency in the private and public sectors, as well as the development of renewable energy projects.
- Advancing regional integration: The Bank will work closely with the authorities, other IFIs and, where possible, private sector investors to help improve transport networks, thereby facilitating greater cross-border trade and investment. Developing further links with the regional energy market is also key to attracting private investment, encouraging competition and diversifying the sources of energy supply. The Western Balkans Investment Framework (WBIF) will provide the ideal policy dialogue platform for regional integration, as all players and countries in the region are associated with and represented in it. Regional projects will be prioritised and approved under the WBIF.

European Investment Bank (EIB): the EIB launched its lending in the Country in 1977, with a €3 million loan

to the energy sector. The total amount of financing provided to the Country since 1998 is approximately €330 million. EIB financing has aimed, in particular, at promoting economic activity and fostering balanced regional economic prosperity through the expansion of transport and energy infrastructures. Efforts have also been made by the EIB in supporting the local economy through the network of local commercial banks. The most important project so far, totalling on its own €100 million, was signed in 2009 between the EIB and the *Macedonian Bank for Development Promotion (MBDP)*. This operation was aimed at supporting SMEs and investments in the fields of the knowledge economy, energy and environmental protection throughout the Country. In 2010, the EIB signed another €50 million loan with the government for financing water and wastewater investments. This operation represents a continuation of the EIB's support for FYR of Macedonia and is fully in line with the EIB's lending priorities. Over the coming years, the EIB expects to continue its financing of projects in the Country, with the aim to support the country in its path towards European integration. More recently (July 2012) The EIB and the *MBDP* signed in Skopje a €100 million loan for the support SMEs and industrial investment of any size in the fields of the knowledge economy, energy, environmental protection and services. A minimum of 70% of the loan amount will be allocated to SME projects. *MBDP* will allocate the funds through selected local commercial banks. *MBDP* is a financial institution fully owned by the Government, whose mission is to support national economic strategies and objectives. The EIB financing could cover up to 100% of the total cost of the investment, with a maximum of €12.5 million per project, in line with the EIB's standard criteria. The EIB's financing operations in the Country serve to facilitate the processes of integration with the EU and are aimed at helping the SME sector, which is suffering from a lack of funding, particularly as regards long-term borrowings. In providing financial support for SMEs, the loan will reduce unemployment levels and improve the quality of life of the country's citizens. *MBDP* will undertake to pass on the advantage of the EIB resources to final beneficiaries via intermediary banks through lower interest rates and longer maturities. Over the past eleven years, four global loans have been signed in the country for a total amount of EUR 190m and have been fully disbursed. This is the Bank's third operation with *MBDP*.

World Bank Group/IFC: FYR of Macedonia joined the World Bank in 1994 and graduated from International Development Assistance (IDA) in 2003. Since then, the World Bank has provided more than US\$1.2 billion in loans and grants to support the Country's transition to a market economy and its efforts to build effective institutions. The current *World Bank Country Partnership Strategy (CPS)* for 2011–2014 is coming to an end, and a new Country Strategy is under preparation. The objective of the current CPS (six loans, totaling US\$299 million) is to provide selective and targeted financial support and knowledge and advisory services in support of faster, more inclusive, and greener economic growth. Because FYR of Macedonia's future growth and development depend fundamentally on the pace of EU accession, virtually every intervention in the CPS is designed to help the country prepare for EU membership. The current program aims to help the Government cope with the consequences of the European crisis and to support the country's economic transition, the Government and the Bank approved three budget support operations with objectives to: strengthen the sustainability of public finances; improve the performance of social protection; improve the competitiveness of the economy; and strengthen the resilience of the financial sector. The new CPS for FYR Macedonia is under preparation, and will focus on two pillars: growth and competitiveness, and human capital and inclusion. A tentative list of planned new lending operations includes the Energy Efficiency Fund project, a second Roads Rehabilitation Project, the ICT-Based Jobs project, a project with the Ministry of Environment, and another Competitiveness DPL. In infrastructure, the *Regional and Local Roads Program Support Project* (US\$105 million) helps with the rehabilitation of regional and local roads and provides institutional support to improve the management of roads. Another infrastructure investment operation, under preparation within the current CPS, is the *National and Regional Roads Rehabilitation Project* (US\$70 million), which aims to enhance the connectivity of selected national and regional roads, primarily to Corridors 10 and 8. The World Bank finances the energy sector through the *ECSEE APL3 Project* (US\$44 million) to improve the transmission grid, including an interconnection with Serbia. Local development is assisted through the *Municipal Services Improvement Project* (US\$75 million), which is helping to improve the transparency, financial sustainability, and delivery of targeted municipal services in selected municipalities. The Bank is negotiating with the European Commission a co-financing for this project of US\$21.2 million in order to use IPA funds for rural infrastructure investments through the existing project mechanisms. The World Bank is also active in the human development sector through two operations: the *Conditional Cash Transfer Project* (US\$25 million), which provides subsistence to poor families

whose children attend school regularly; and the Skills Development and Innovation Support Project (US\$24 million), whose objective is to improve higher education resource allocation transparency, as well as promote accountability, enhance the relevance of secondary technical vocational education, and support innovation capacity in the Country. FYR of Macedonia became a shareholder and member of the IFC in 1993. Since then, IFC's investment in the Country totaled US\$245 million, including US\$37.5 million in loans in 38 projects across a variety of sectors, and its committed investment portfolio as of 30th September 2013 was US\$207 million. IFC's advisory services aim to improve the investment climate and the performance of private sector companies, and to attract private sector participation in the development of infrastructure projects.

Through a combination of investment and advisory services, IFC will continue to partner with clients in strategic sectors crucial to the country's long-term sustainable development, with a particular focus on:

- *The financial sector, with a special emphasis on small and medium-sized enterprises (SMEs) and energy-efficiency lending*
- *Climate change, including investments in the infrastructure and energy sectors*
- *Agribusiness, with an emphasis on food retail*
- *Value-added manufacturing*
- *Business infrastructure, with a focus on logistics and distribution*
- *Health and education*

Recent investment projects include:

- *US\$10 million trade finance line to Ohridska Banka Société Générale, signed in August 2013*
- *US\$13.4 million long-term loan to Ohridska Banka Société Générale, a mid-sized bank, to support the SME sector*
- *US\$4.6 million long-term loan to support EVN Macedonia, the sole electricity supply and distribution company in the Country*
- *Under its Global Trade Finance Program, IFC provided a trade finance line to:*
 - *NBG Stopanska Banka, a bank with growing presence across retail, corporate banking, and SME lending*
 - *NLB Tutunska Banka, part of the Slovenian NLB Group*
 - *Unibanka, a tier-two local bank with a special focus on the SME sector*
 - *Ohridska Banka, part of Société Générale*

IFC has also invested in two regional projects (Titan Cement and Vino-Zupa) that have significant operations in the Country. In addition to investments, IFC has an active advisory program in FYR Macedonia.

National Instruments for FDI development

The Agency for Foreign Investments and Export Promotion (*Invest Macedonia*) of the FYR of Macedonia is the primary government institution which is in charge of attracting new foreign investments in the country and supporting the expansion of the foreign companies with already established operations. In addition to the investment function, Invest Macedonia is also engaged in promoting the national companies on foreign markets and supporting them in the process of increasing their exports abroad. Is a full service agency prepared to guide the investors throughout the decision-making process. Investor Servicing will lead through the initial inquiry phase and arrange a visit in the Country. Once present, the visit will culminate with an objective evaluation of the potential success of the project based on the current business climate. Invest Macedonia interact on company behalf with central and local Government authorities and aid through the process to ensure that an open exploratory dialog takes place. Investor Servicing along with Export

Promotion department will facilitate appropriate meetings and strive to meet all of entrepreneurs requests. Invest Macedonia is also dedicated to help Macedonian companies increase their exports and grow their business in international markets. Invest Macedonia's Export Promotion Department helps companies by generating leads that could potentially result in a sale, through our Business Development services. Business development services include trade fairs, trade missions and B2B meetings. In addition, Invest Macedonia offers market information services that are aimed at providing the most timely industry information, analysis, events, and contacts in order to leverage your business on the market.

SMEs and FDI status

Kosovo, as a Country that declared its independence quite recently (17th February 2008), inherited several problems from its recent past, which also relate to numerous institutional obstacles. Most of these obstacles result from the lack of experience of the newly produced staff with the low professional level in governmental institutions, lack of adequate laws and their uncertainty, as well as difficulties that result from ineffective implementation of applicable laws. Since 1999, Kosovo's economy has been driven mainly by international aid and remittances. The role of the private sector, in particular SMEs, has been relatively weak. For these reasons, SMEs in Kosovo continue to face institutional barriers and other obstacles created by the business environment, including complex and inefficient regulations, difficulties in accessing financial resources, lack of quality education, poor knowledge and lack of experience in the use of new technologies, and difficulties in placing the goods in local, regional and international markets.

Registered Businesses in Kosovo by number of employees - 2010

<i>Company category</i>	<i>Employees</i>	<i>Enterprises number</i>	<i>Share (in %)</i>
<i>Micro</i>	1 – 9	102,070	98.4
<i>Small</i>	1 – 49	1,406	1.4
<i>Medium</i>	50 - 249	221	0.2
<i>Large</i>	250 +	58	0.1
<i>Total</i>		103,755	100.00

Source: Business Registration Agency of Kosovo

According to the *Business Registration Agency* of Kosovo in 2010 out of a total of 103,755 enterprises, 102,070 (or 98.4%) was micro-enterprises, 1,406 (1.4%) small, 221 (0.2%) medium and only 58 (0.1%) classified as large. In terms of sector breakdown, SMEs are concentrated mainly in: retail trade (50%), transport, storage and distribution (14%), food products, beverages and tobacco (9%), hotels and restaurants (9%). The impact of SMEs in Kosovo is quite large. Based on data from the *Tax Administration of Kosovo* (TAK), the total turnover of SMEs in 2010 was nearly €1.7 billion or 43.3% of GDP (in 2011, the total turnover of all businesses was €2,2 billion or 56.8% of GDP).

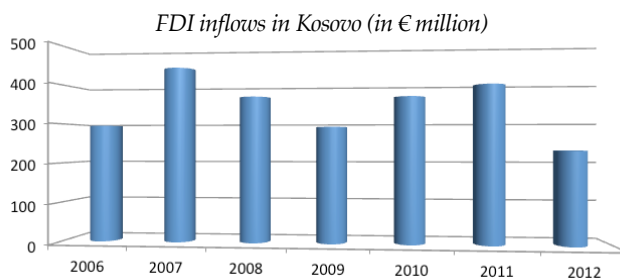
According *Statistical Repertoire of Enterprises* in Kosovo released by the Statistical office of Kosovo, during the second quarter of 2012 there are recorded a total of 2,736 new companies, while in the previous quarter there have been 2,543 of them. There is a difference of 193 enterprises between the quarters, or expressed in percentages we have increased new enterprises to 7.6 %. Also, there are 31.7% of new businesses compared to the same quarter of the previous year. During this period, the most favorite economic activities was: 842 trade enterprises (30.8%), processing industry 302 (11.0%), hotels and restaurants with 301 (11.0%), real estate and leasing with 264 (9.6%), construction with 255 (9.3%), other social and personal 240 (8.8%), agriculture, hunting and forestry with 235 (8.6%), transport, storage and communication with 199 (7.3%), while the other activities participate in very small scale.

A comprehensive monitoring of the climate in which operate SMEs in given by the *Progress Report of the European Commission for Kosovo* (October 2013)²². In this Report, according to the European Commission, "as regards industrial policy and SMEs, Kosovo has continued the simplification of its legislation. In February, the Assembly adopted a law on economic zones. The law defines the role of the government and municipalities in establishing free economic zones, referring in particular to free zones, industrial parks, technological parks and business incubators. In March, the government adopted a strategy on private sector development 2013 – 2017 aimed at developing a competitive private sector.

²² Kosovo 2013 Progress Report, Commission Staff working Document, SWD(2013) 416 final, Brussels, 16.10.2013.

To this end, the strategy identifies strategic industrial sectors and prioritises for alignment with EU rules in the area of free movement of goods and trade. Company registration fees are inexpensive and company registration certificates are issued within a few days. Kosovo has eliminated business registration fees and minimum capital requirements for limited liability companies. Minimal capital requirements for joint stock companies have been reduced from €25,000 to €10,000 and the business registration process has been streamlined. Compliance costs remain quite high. The protection for investors has increased with the introduction of a requirement for shareholder approval of related-party transactions. Regular meetings of trade policy-related working groups have contributed to better coordination and cooperation among agencies for SME development, investment promotion and chambers of commerce. Other actors such as the broader business community still need to be more involved in policy setting. Bankruptcy legislation is in place. It is not systemic and its implementation is at an early stage. The business environment in Kosovo remains challenging. Access to finance is considered one of the main obstacles hindering SME development. Weak legal enforcement of contracts and business regulation hinder further growth. Online company registration is only possible at 28 'one-stop-shops' or municipal business centres. Elsewhere, companies need to comply with notification procedures and obtain a municipal license to start a business. Overall, the business environment has been improving over the past few years. However, it remains a challenge, especially for SMEs. The government needs to introduce regulatory impact assessment. Kosovo needs to focus more on enforcing contracts, reducing unnecessary business regulation and creating an environment that facilitates access to finance. The authorities need to continue developing the institutional framework for SME policy implementation. Implementation of the SME development strategy and action plan needs to continue and needs to be better monitored.

Despite a growing inflow of Foreign Direct Investments in recent years, the current levels are not sufficient to fully meet the country's economic needs. As mentioned before, Kosovo faces a number of social and economic problems, including: unstable political situation and, consequently, difficult borrowing from international financial institutions, limited banking system, decline of foreign financial assistance and financial remittances from immigrants, undeveloped infrastructures, high rate of unemployment, etc. The situation in the energy sector, telecommunications and transport can also be regarded as factors in limiting development. Investment activity of private businesses in the postwar period has generated significant economic growth and employment, but so far there are signs of recessions. In these conditions, economic policy makers are challenged with the need to promote new investments. Only FDI cannot accelerate appropriate activities. The goal should be to make FDI an important resource and complementary to other funding sources. During the period 2006 – 2012 the cumulative stock of FDI reached nearly €2.4 billion, although with marked annual variations. As a result of global financial crises, during 2008 - 2009, FDI recorded a significant decline, while in 2010-2011 the value of these investments started to increase again although with a slow trend. Meanwhile, the trend deteriorated significantly in 2012. This deterioration of trend proves the sensibility that FDI has against developments in the economy of Euro Area Countries, which at the same time represent the main resource of FDI in Kosovo. FDI in Kosovo are basically concentrated on sectors, such as real estate with 31.7% of total FDI, construction (20.8%), manufacturing (12.1%), financial sector (10.4%), followed by transport and telecommunication sector with a share of 7.9%. The 2012 was characterized by changes regarding the FDI structure by sectors. The value of investments in real estate was almost the same as in the previous year, yet due to the decline of investments in construction and manufacturing sector, it was noticed a larger share of this sector to total FDI. Financial sector which in the two previous years is found to have recorded a significant decline in total FDI, in 2012 recorded a slight increase and it is also expected to increase in 2013, as a new bank commenced its operation in Kosovo's banking system.



Source: Central Bank of the Republic of Kosovo – Annual Report 2012

EU Countries continue to represent the key resource of FDI in Kosovo. Unlike last year when the largest part of FDI originated from United Kingdom (20.3% of total FDI), in 2012 Turkey represents the Country where the majority of FDI in Kosovo came from (28.3%). Investments from this Country in 2012 were mainly designated to the transport and telecommunication sector (53.8%), financial services (19.6%) and manufacturing (14.2%). There was also a significant growth of FDI from Switzerland, which during this period represents the third country in terms of the FDI amount in Kosovo (18.9%). Unlike Turkey, FDI from Switzerland during 2012 was mainly concentrated on real estate (66.1%) and construction (18.5%). From the majority of EU Member States, including Germany, there was a decline of FDI, yet due to the fact that the decline of FDI from United Kingdom was quite high, some other Countries recorded a growth of the share in FDI structure.

FDI in Kosovo by main Countries of origin (In € million)

	2007	2008	2009	2010	2011	2012	Cumulative total 2007 – 2012
<i>Germany</i>	48.1	44.0	75.2	91.5	66.6	49.5	374.9
<i>Switzerland</i>	116.2	36.6	6.2	38.9	80.1	43.8	321.8
<i>Austria</i>	56.2	44.3	50.8	34.0	16.2	0.3	201.8
<i>Slovenia</i>	35.4	51.3	15.5	21.1	19.6	9.2	152.1
<i>Turkey</i>	5.4	23.8	14.5	4.9	34.7	65.5	148.8
<i>United Kingdom</i>	9.7	32.1	22.7	35.1	30.9	14.3	144.8
<i>Albania</i>	3.4	21.9	23.3	20.3	11.2	4.7	84.8
<i>Netherlands</i>	41.2	22.5	15.1	14.5	14.2	- 26.0	81.5
<i>USA</i>	8.8	4.8	11.8	12.6	14.3	10.7	63.0
<i>France</i>	8.6	3.5	8.0	3.8	0.2	5.2	28.3
<i>Total (including others)</i>	440.7	366.5	287.4	365.6	394.6	232.0	2,083.7

Source: Central Bank of the Republic of Kosovo – Annual Report 2012

Based to the latest preliminary report from the *Central Bank of Kosovo*, during the year 2013, FDI has increased, reaching an estimated value of €258.5 million (€232.0 million in the previous year). According to this report, the investments during the year 2013 have mainly come from countries, such as: Turkey, Switzerland, Germany, Albania, USA, Austria, Italy, Slovenia, and United Kingdom. Furthermore, those investments have mostly flown towards the sectors of real estate, construction, transport and telecommunication, financial services, energy, production, trade services and mining.

Main Financial Facilities

European Union: Kosovo receives financial assistance under the IPA and other sources of funding. In 2013, a total of €71.4 million was allocated to Kosovo under the IPA annual programme. EU pre-accession assistance is focusing on support for the rule of law, the economy, trade and industry, and public administration reform. The Kosovo Government and the Commission are currently preparing a comprehensive *Country Strategy Paper for the period 2014-2020*, which will provide a coherent and strategic framework for financial assistance under the new IPA II. As a follow-up to the Commission Communication “*Kosovo - Fulfilling its European Perspective*”, the Council authorised the Commission to negotiate a framework agreement with Kosovo to enable it to take part in EU programmes. In April 2013, following Kosovo’s acceptance of the text of the framework agreement, the Commission adopted a proposal to sign and conclude this agreement. In 2012, the EU rule of law mission, EULEX, was reconfigured. EULEX’s mandate has been extended to June 2014. The mission was downsized by some 25% and currently operates with two sections: an Executive Division,

which works on the mission's executive mandate; and a Strengthening Division, which concentrates on monitoring, mentoring and advising the Kosovo authorities. Overall, during the reporting period, Kosovo has maintained good cooperation with EULEX. It has also continued to be fully supportive of the Special Investigative Task Force investigation, consistent with their previous commitment in this regard. It thereby met the pertinent short-term priorities specified in the feasibility study. Kosovo needs to continue actively supporting implementation of the mandate of the mission, including that of the Special Investigative Task Force.

European Investment Bank (EIB): the total amount of loans granted by the EIB in Kosovo amounted to €107 million broken down as follows: in July 2007 a €10 million credit line (financial intermediary: *Raiffeisen bank Kosovo*) for financing of limited scale projects of small and medium enterprises and local infrastructure projects of local authorities. In August 2008 a €87 million financing (financial intermediary: *Ipko Telecommunications LLC*) for the launch of a second GSM network in the territory of Kosovo. In November 2013 the EIB and *ProCredit Bank* signed a credit line worth €10 million which will support very small, small and medium sized enterprises in Kosovo. The credit line marks the EIB's first operation in Kosovo after the ratification of the new *Framework Agreement*, which was signed in June 2013 and will provide financing to businesses that contribute to development and employment in the country. The credit line will be disbursed to ProCredit Bank business clients who are active in the production, trade and service sectors, and who comply with the bank's ethical social and environmental standards.

European Bank for reconstruction and Development (EBRD): Kosovo became a member of the Bank on 7th December 2012. However, private sector projects in Kosovo were eligible for EBRD support since 1999, via dedicated externally managed regional funds and projects and via the Bank's regional facilities for the Western Balkans. Within this scope, since 1999 the Bank had signed a total of 29 projects in Kosovo with a cumulative EBRD investment value of €66 million. The current portfolio stock is allocated 34% to financial institutions and microfinance companies, 60% industry, commerce and agribusiness and 6% to energy and natural resources. All projects to date are in the private sector. The sector distribution broadly represents the investment requirements of the private economy in Kosovo over the past few years. The launch of the *EBRD-Italy Local Enterprise Facility (LEF)* in 2006 allowed the Bank to increase its financing activities in Kosovo significantly, in part due to the growth of the private sector that followed the 2008 declaration of independence, but also due to the lack of alternative project-tailored sources of funding to serve the growing demand. The number of the financed operations in Kosovo has grown steadily, although with modest business volume achievable under the delegated facilities. On average, the Bank signed 4-6 new operations every year during the period 2008-2012. In 2012, the Bank signed 5 new transactions with a total volume of €5.3 million, all in the private sector.

Until now, the Bank did not have a dedicated Strategy for Kosovo but identified in 2007 several key priorities for its activities since 1999. These priorities were:

- *In the enterprise sector*, to target support towards smaller-scale local export oriented companies demonstrating good corporate governance, by providing loans, guarantees or making equity investments, including through LEF; to support strategic investors, who have privatized enterprises in Kosovo. In close co-ordination with the LEF Team, for the Small Business Support (SBS) team to continue to work directly with individual enterprises, providing assistance in restructuring of the business, improving products, technical and environmental upgrades, quality certification, advising on market positioning and helping to develop business planning skills at management level.
- *In the financial sector*, to focus on: providing banks with funding and institutional support to assist in developing new products and improving corporate governance; channelling more funding to MSMEs through commercial banks and microfinance institutions, including through the implementation of LEF, the Western Balkans SME Finance Facility, and the MSME Finance Framework for Western Balkans and Croatia; exploring potential equity investment in local banks, including through the implementation of the EBRD-Italy Western Balkans Local Enterprise Facility; seeking ways to support sustainable commercialisation of profitable non-bank microfinance institutions.
- *In the infrastructure sector*, to continue to identify possible ways to support corporatised publicly-owned enterprises – the Pristina International Airport (PIA) and the telecoms company. To explore potential projects in support to the railways, district heating and the energy utility (KEK), which were incorporated in 2006.

World Bank Group/IFC: the World Bank Group has been working with Kosovo since 1999 and has provided and/or managed around US\$400 million through more than 30 operations. Kosovo receives credits from the International Development Agency (IDA), with commitments of about US\$76 million during the fiscal years 2012–15. The World Bank Group is now engaged in helping Kosovo forge an economic growth path that sustainably creates more opportunities and high-quality jobs for the country's growing, youthful population. On 29th May 2012, the World Bank Group endorsed the first *Country Partnership Strategy* for Kosovo, calling for a highly-selective lending program during 2012–15. The CPS focuses on two strategic areas: accelerating broad-based economic growth and employment generation; improving environmental management.

With technical and financial support provided under these two pillars, the World Bank Group is focusing its support on accelerating broad-based growth and employment generation as well as improving environmental management. Against the backdrop of the socio-economic costs from (i) the highly polluting and inefficient energy generation (conflicting with Kosovo's commitments made vis-à-vis the EU as signatory to the Energy Community Treaty); and (ii) frequent power outages (generally viewed as the single most significant obstacle to attracting direct investments), the World Bank Group's emphasis is placed on the energy sector. With comprehensive support and lending commitment aimed at (i) cleaning up toxic legacies; (ii) supporting a state-of-the-art replacement investment for Kosovo's 50-year-old power plant; (iii) fostering energy efficiency and renewable energy investments; and (iv) ensuring water security in central Kosovo, the World Bank supports the government in its efforts to address Kosovo's energy crisis in a comprehensive way and to reach the three key objectives (energy security, energy affordability, and minimal socio-environmental externalities). As such, every effort is made to take into account environmental considerations and mitigate adverse impacts.

The World Bank portfolio in Kosovo consists of six projects of US\$70 million in commitments and two Trust Funds with total commitments of US\$9 million. In addition, the International Finance Corporation (IFC) is providing Kosovo with US\$40-50 million in the form of direct financing to the private sector, as well as additional funds for advisory services. The Multilateral Investment Guarantee Agency (MIGA) plans to provide political risk guarantees in support of the energy sector. Under the current portfolio, the main areas of engagement are—above energy and the environment—public administration, agriculture, education, employment, social services, finance, and competitiveness.

National Instruments for FDI development

The *Investment Promotion Agency of Kosovo (IPAK)* is the primary Government Institution supporting foreign investment in Kosovo. IPAK provides a wide range of support programmes to help international businesses achieve their relocation objectives and the Agency is also charged with the promotion of exports. In particular, the services offered by IPAK are:

- 1) Pre-investment services
 - *Presentations on potential investment opportunities;*
 - *Information on Kosovo's fiscal system, employment laws and FDI-related legislation;*
 - *Operation cost analyses;*
 - *Specific industry macroeconomic information and sector perspectives and opportunities in Kosovo, including overviews of the sector dynamics and main players;*
 - *Regional and national data on social and economic context for the market and business environment;*
 - *Overview of Kosovo's competitive advantages, including the national supply of logistic infrastructures, transport systems, and regional attributes*
 - *Project consultation, including preliminary evaluation of the business idea, technical, financial and market feasibility, and necessary bureaucratic procedures*

2) Investment set-up services

- *Assistance with company establishment, including registration, obtaining work permits, paperwork review, acquiring office space, etc.*
- *Identifying locations for greenfield projects and finding existing facilities for brownfield investment*
- *Matchmaking with joint venture partners;*
- *Facilitating contacts with national and local authorities and management of all relevant permits that may involve local authorities;*
- *Location evaluations, including an overview of various location opportunities, organizing site visits, and support during the evaluation process;*
- *Legal assistance, including emerging business support, merger & acquisitions advising, and general legal counsel;*
- *Contact assistance with recruitment and local placement agencies;*
- *Support for the selection of and application for available financial tools.*

3) After care services

- *National and local bureaucracy assistance*
- *Expansion, research development, and reinvestment support*
- *Application assistance, including work permits, visas, and foreign citizen residency*
- *Advice for business service providers, including banks, leasing companies, law offices, consulting firms, real estate agencies, etc.*
- *Network establishment, involving meeting creation and coordination with representatives of state administration, self-government bodies, and public institutions*
- *Conference, event, and seminar organization*
- *Submission of investor proposals to the Kosovo Government for legislative change and investment environment development*
- *Assistance in seeking suitable industrial zones and business properties*
- *Financial advising on drawing investment incentives and project co-financing from EU structural funds*
- *Local supplier partnership creation and coordination*
- *Human resources support*
- *Promoting cooperation between investors and secondary schools, vocational colleges and universities*
- *Negotiation coordination with local authorities, state administration bodies and public institutions*
- *Specialized workshops, working breakfasts with top officials, round tables and social event organization*

In order to accelerate the completion of investor's projects, IPAK networks with all FDI-related public and private sector bodies, including governmental ministries and agencies, municipal, tax and custom authorities, statistical and logistical bureaus, national and regional chambers of commerce, and the Central Bank of Kosovo.

MONTENEGRO

SMEs and FDI status

Montenegro has made important advances in transition, but more remains to be done. Montenegro scores highly in areas such as price liberalisation, small-scale privatisation and trade and foreign exchange liberalisation. Some progress has also been made in large-scale privatisation, but there are a few major enterprises that still remain in state hands. The largest transition gaps remain in the areas of competition policy and governance and enterprise restructuring. Montenegro has undertaken a series of reforms to strengthen the business environment in recent years (e.g. in improving businesses' access to credit, reducing the tax burden on businesses, etc.). However, challenges in the business environment remain. The SMEs sector, together with inflows of capital from abroad, restructuring and privatisation, have a significant influence on the economic development of Montenegro and contribute significantly to the Country's transition process and help to create the conditions for the future EU membership. By the end of 2009, the international financial crisis had led to a drop in the level of economic activity in Montenegro bringing about a decline in several macro-economic indicators, above all in the levels of GDP, industrial productivity, import and export. There were some positive indicators in the period between 2007-2009 such as a rise in employment and a higher inflow of FDI.

According to the *Central Registry of the Commercial Court* of Montenegro, at the end of 2009, there were 42,018 registered enterprises in Montenegro and the number of active SMEs was 15,229. Within the SME sector, the share of micro companies was 78.0% of the total number of SMEs, followed by small enterprises (9.8%) and then entrepreneurs (9.3%), while medium enterprises had the smallest share in the total number of SMEs (2.8%). The SME sector employed 105,038 individuals and medium sized enterprises accounted for the largest number of employees (share of 39.4%), followed by micro enterprises (29.4%), small enterprises (28.4%), while entrepreneurs had the smallest number of employees (2.8%). By taking a comparative look at the period from 2006 to 2009, it can be concluded that the number of active enterprises increased from 11,522 to 15,229 or by 32.2%. The number of employed persons in the SME sector also increased from 85,065 to 105,038 or by 23%.

According to the most recent data released by the *Department for Registers (Montenegro Statistical Office)* the number of business entities in Montenegro in the 4th quarter of 2012 was 22,351, which means a decrease of 6% if compared to the previous quarter of 2012.

The division of business entities by size class in Montenegro (4th quarter 2012)

<i>Company category</i>	<i>Employees</i>	<i>Enterprises number</i>	<i>Share (in %)</i>
<i>Small</i>	10 – 49	22,058	98.7
<i>Medium</i>	50 - 249	255	1.1
<i>Large</i>	250 +	38	0.2
<i>Total</i>		22,351	100.00

Source: Montenegro Statistical Office - Department for Registers

Unfortunately, the data broken down by economic sector do not distinguish SMEs from LEs, however, given the marginal role of the latter, the following data are still very indicative. In particular, in Montenegro businesses are concentrated in the same areas previously reported for other Western Balkans Countries. In fact, in the 4th quarter of 2012 a percentage of 38.8% of business entities was concentrated in wholesale/retail trade and repair of motor vehicles and motorcycles, 11.3% in accommodation and food service activities, 9.1% in the building sector and 8.8% in manufacturing.

Business entities in 4th quarter 2012 and 2011, breakdown by sections

	4 th quarter 2012		2011	
	Number	Share (in %)	Number	Share (in %)
<i>B – Mining and quarrying</i>	58	0.3	56	0.3
<i>C – Manufacturing</i>	1,936	8.8	1,709	8.0
<i>D – Electricity, gas, steam and air conditioning supply</i>	38	0.2	25	0.1
<i>E – Water supply, sewerage, waste management and remediation activities</i>	47	0.2	37	0.1
<i>F – Construction</i>	2,027	9.1	1,854	8.7
<i>G – Wholesale and retail trade; repair of motor vehicles and motorcycles</i>	8,697	38.8	8,880	42.0
<i>H – Transport and storage</i>	1,610	7.2	1,456	6.8
<i>I – Accommodation and food service activities</i>	2,518	11.3	2,241	10.6
<i>J – Information and communication</i>	482	2.2	450	2.1
<i>L – Real estate activities</i>	780	3.5	788	3.7
<i>M – Professional scientific and technical activities</i>	1,855	8.3	1,694	8.0
<i>N – Administrative and support service activities</i>	780	3.5	626	2.9
<i>Total (including other sectors)</i>	22,351	100.0	21,127	100.0

Source: Montenegro Statistical Office - Department for Registers

The 2013 SBA Factsheet data released by the European Commission (Enterprise and Industry Policy) for Montenegro is less complete than those of the other Countries due to a substantial lack of statistical data and other information. Consequently there is no complete SBA profile for Montenegro. However, according to the Commission the catching-up progress in terms of SME policy needs to be pursued vigorously and broadened to include more policy areas such as internationalization and environment. There is still a need for a dedicated and coherent SME strategy to improve the administrative environment for SMEs. In 2012 and the 1st quarter of 2013, new technical committees were launched to monitor the implementation of EU and international standards and the adoption of the Law on Competition. Moreover, in line with many EU counterparts, the Montenegrin Government has pursued the removal of administrative burdens also through the consolidation of an on-line registration portal for companies.

Another regular monitoring of the economic climate in which operate SMEs is given by the Progress Report of the European Commission for Montenegro October 2013)²³. In particular, according to the European Commission "in the area of enterprise and industrial policy principles, action plans for 2013 were adopted for the strategies for life-long entrepreneurial learning 2008-2013, for the development of small and medium-sized enterprises (SMEs) 2011-2015 and for improving competitiveness at the micro level 2011-2015. Montenegro implements the Small Business Act and made progress in simplifying legislation and using regulatory impact analysis. A new electronic portal for business licences (www.licenca.me) was launched in December 2012 providing all available information on business licensing, including the application forms, fees, information on documents needed, and contact points in the relevant institutions. While public-private consultations are held on a regular basis, there is as yet little evidence that stakeholders' feedback is effectively and systematically taken into consideration. As regards enterprise and industrial instruments, Montenegro's Investment and Development Fund signed a credit arrangement with the European Investment Fund to

23 Montenegro 2013 Progress Report, Commission Staff working Document, SWD(2013) 411 final, Brussels, 16.10.2013.

provide direct credit support to SMEs. Overall, available public sector support for SMEs remains low. SMEs still find it difficult to access credit, with other sources of finances, including risk capital, guarantee schemes, and venture capital, being in the early stages of development. Under the national programme for encouraging cluster development in the northern region and less-developed municipalities, financial support was provided for three clusters. Sixteen companies received support under the voucher scheme project for innovative SMEs.” In conclusion, “there has been little progress in the area of enterprise and industrial policy. The lack of administrative capacity and fragmented strategies impede the effectiveness of the instruments that have been put in place. A strategic effort to promote skills at all levels in sectors where Montenegro has significant trade with the EU will be important to improve competitiveness and ensure preparedness for competitive pressures and market forces within the Union.”

As emerged in the first part of this analysis FDI inflows are one of the most important drivers of economic development in Montenegro. Prior to 2005, Montenegro was not an attractive destination for the foreign investors, however, after the independence (June 2006), it became one of the most attractive destinations among the Western Balkans Countries. Results of this process are evident - the biggest inflow of foreign direct investments per capita in Europe for three years continuously (2010-2012) -. Still, in spite of the above mentioned, the practice shows that the regulatory system is far away from being perfect and disadvantages should be removed in order to enable bigger inflow of the FDI in the future period. FDI inflow in Montenegro took place within the framework of the adopted privatization plans, in which planned privatization of bigger companies represented most of the total FDI influx in Montenegro. Thus, for example, in 2002 the FDI influx was €73.8 million (where 75% of the influx was realized through the privatization of *Jugopetrol* - in October 2002, 54.5% of the Company was acquired through *Hellenic Petroleum*). During 2004 there has been an FDI influx of €50.5 million, through the privatization of *Montenegro bank A.D.* (€23.9 million), sale of the hotel and tourist company *Budvanska Rivijera* (€12.2 million), etc.

In 2005, there was a FDI inflow of €382,8 million, out of which €114,0 million were achieved through privatisation of *Crnogorski Telekom* (*Deutsche Telekom Group* through its controlling owner *Magyar Telekom*) and €70,7 million through privatisation of the *Kombinat Aluminijuma Podgorica* (Cyprus-based *Central European Aluminum Company - CEAC*, a subsidiary of Russia's *En+ Group*), etc. In the same year, FDI through greenfield projects amounted 47,6% (€182 million or 11,1% GDP), while 52,5% (€201 million or 12,2% GDP) was the level achieved through the privatisation process. Since 2005 Montenegro has been recording a very high inflow of net FDI and it is placed among the top European transitional economies. In order to attract foreign investors, Montenegro has created an attractive legal framework that includes “national treatment of foreigners” and other measures that are encouraging investors to invest in Montenegro. In the period 2001 - September 2008, inflow of FDI in Montenegro amounted cumulatively €2.89 billion. Arrival of the *Erste Group* in Montenegro was legalized in March 2009, when *Erste&Steiermaerkische Bank d.d.* acquired 100% of share capital of *Opportunity Bank AD Podgorica*. In 2011, Montenegro attracted €495 million, down from €652 million in 2010. Total FDI inflow in Montenegro in 2012 amounted to €634 million. FDI in the form of equity investment accounted for 69.3% of the total inflow over the review period. Total FDI inflow in Montenegro in 2013 slowed again and amounted to €479.2 million.

FDI in Montenegro by main countries of origin (in € million)

	2010	2011	2012	2013 (*)
<i>Russian Federation</i>	90.4	112.0	161.6	136.4
<i>Slovenia</i>	34.4	19.6	58.3	47.4
<i>Switzerland</i>	64.7	26.7	40.2	38.0
<i>Luxembourg</i>	1.8	26.1	1.9	33.1
<i>Netherlands</i>	16.8	9.5	125.6	27.2
<i>Germany</i>	11.2	8.1	14.6	22.7
<i>Turkey</i>	3.3	0.1	25.0	22.6
<i>British Virgin Islands</i>	4.1	7.1	1.5	14.8
<i>Serbia</i>	81.8	27.8	26.6	14.4
<i>Austria</i>	57.7	11.5	9.4	12.2
Total (including others)	652.8	494.7	633.7	479.2

(*) - Preliminary data

Source: Central Bank of Montenegro

Considering the FDI inflow in Montenegro the following can be concluded: Predominant FDI are still those related to the privatization process, while the greenfield investments are still relatively small; a significant share of the FDI inflow relates to the real estate (particularly in 2006 and 2007); highest amount of FDI were in the area of tourism, banking, industry and telecommunications; Structure of FDI has been recovering gradually in 2008, with the decrease of the FDI share in the real estate sector and the increase of the FDI in the real sector.

Main Financial Facilities

European Union: Montenegro has been receiving financial assistance from the EU since 1998. Overall, between 1998 and 2010 the EU committed over €408.5 million to Montenegro. From 1998 to 2006, this included the former CARDS assistance worth €277.2 million. In 2007, CARDS assistance was replaced by the IPA which extends to 2013. In particular, in the period 2007-2013, IPA allocation totalled €235.7 million. The IPA National Programme 2012-2013 amounts to €21.3 million and was adopted by the Commission in December 2012. This programme addresses the priority sectors identified in the Multi-Annual Indicative Planning Document, in particular the rule of law, public administration reform, the environment and climate change, as well as agriculture and rural development. The programme also supports the alignment of national legislation to the EU *acquis* in areas such as free movement of services, competition, food safety, veterinary and phytosanitary standards. EU financial support has also been provided for the development of civil society under the *Civil Society Facility* as well as for regional and horizontal IPA programmes. Montenegro benefits from support under the IPA multi-beneficiary and regional programmes. Moreover, it is participating in five cross-border cooperation programmes with neighbouring Western Balkan Countries, as well as in transnational cooperation programmes with Member States under the *European Regional Development Fund* and the *IPA Adriatic* cross-border programme. Montenegro's preparations for the decentralised implementation of IPA programmes by the national authorities have further advanced, Montenegro having submitted application packages for the conferral of management for IPA Components I-IV. Montenegro and the Commission are preparing a comprehensive Country Strategy Paper for the period 2014-2020, which will provide the strategic framework for the support to Montenegro under the new IPA II. Montenegro is participating in the following EU programmes: the *Seventh Research Framework Programme* (FP7), the *Entrepreneurship and Innovation Programme* and the *Information Communication Technologies Policy Support Programme 2011*, both under the CIP, *Culture 2007-2013*; *Life Long Learning* and *Customs 2013*. In the area of administrative capacity, the insufficient number of staff in place in IPA bodies and institutions, the organisational set-up and financial independence of the audit authority are major outstanding issues. The organisational set up still needs to be completely aligned with the audit findings and recommendations. Preparations in this area are now moderately advanced.

European Investment Bank (EIB): EIB lending activities in the Country amount to over €260 million. In 2009, the Bank signed a €90 million umbrella guarantee with the government, covering EIB loans with locally licensed banks, and supporting working capital and investments for SMEs, as well as small scale municipal investments. The bank supported two loans worth €45 million in 2012, one in favour of the Investment and Development Fund, and the other to repair flood damages. The loan signed by the EIB and the Investment and Development Fund of Montenegro (IDF) concerns the first EUR 25 million tranche of a total EUR 50 million loan aimed at supporting small and medium-sized enterprises (SMEs) and other projects in the country. The operation will finance small and medium sized projects carried out by SMEs as well as final beneficiaries of any size and ownership, including local authorities, in the fields of the environmental protection throughout the country, in compliance with EIB eligibility criteria. A minimum of 70% of the loan amount will be allocated to SME projects. IDF is the fully State-owned development bank of Montenegro and benefits from an explicit State guarantee in its founding law. IDF started its activities in 2010. The operation will increase the availability and maturity of funding for SMEs, a key driver for economic and social progress in Montenegro. In the present market environment, the EIB activity will also permit longer maturities of the loans, with a reduction of the overall financing costs. The current loan is the second largest operation in the country in favour of SMEs sector: a first EUR 100 million loan was approved in 2009 and disbursed via 8 domestic commercial banks.

European Bank for reconstruction and Development (EBRD): as of 31st December 2012 the Bank has signed 34 projects in Montenegro, including debt and equity finance, for an aggregate amount of €323 million. In the Strategy period 2010-2012, the Bank's involvement in Montenegro led to 21 signed projects for a cumulative amount of €216 million. The Bank's current portfolio of projects includes 15% in the industry, commerce, agribusiness sectors, 14% in the energy sector, 27% in the financial institutions sector and 44% in the infrastructure sectors. The private sector share in the portfolio has increased nearly twofold during the Strategy period (from 23% in 2009 to 42% in 2012). At end-2012, the portfolio ratio stands at 42% private/58% public; however, in terms of the number of projects signed, this ratio is in favour of the private sector. The Bank's active portfolio consists of 15 private and 12 public sector projects with an average size of €8 million and €14 million respectively. Investments in transport and municipal infrastructure and the energy sector are generally larger in size and crucial for the country's further growth, attraction of foreign direct investments and strengthening of the private sector. Also, due to size of the local economy, private sector operations are much smaller in size than the average public infrastructure projects. This implies that the private/public portfolio ratio will, at least in the short term, continue to weigh in favour of public sector projects.

World Bank Group/IFC: Montenegro has been engaged in activities with the World Bank Group since 2001 and became a member in 2007. More precisely, a program of lending and analytical work began soon after the State Union of Serbia and Montenegro joined the Bank in 2001. The Bank's engagement during the pre-independence period was focused on supporting Montenegro's efforts to build a market economy and re-establish growth after a period of regional conflict and intense instability and new investments – especially in energy and water management.

In mid-2007, the WBG and the Government of Montenegro developed the Country's first post-independence Country Partnership Strategy (CPS) covering FY07–FY10 and, in January 2011, the Board approved a US\$216 million new CPS for FY11–14. This current CPS is client-driven, and reflects Montenegro's status as an upper-middle-income client with well-defined development priorities. This CPS focuses on two strategic priorities:

- 1) strengthening institutions and competitiveness in line with EU accession requirements
- 2) improving environmental management, including reducing the costs of environmental problems

This strategy is designed to simultaneously help the country recover from the 2009 recession and advance longer-term goals. The centerpiece of the WBG's engagement have been three financial-sector and public-sector development policy loans – which aim to support the banking-sector strengthening and fiscal stabilization program, bring regulations in line with EU norms, and encourage resumption of credit growth. New investment lending is also planned for an environmental clean-up project and a regional catastrophe risk insurance facility. The current portfolio also includes lending in the education, energy, land administration and agriculture sectors. Overall, over the last 10 years the World Bank has helped improve people's lives in Montenegro by financing 10 projects in the total amount of about US\$100 million. Additionally, the IFC has worked with Montenegro since 2007. The IFC's current portfolio in Montenegro stands at US\$46 million and focuses on increasing access to finance by supporting the development of local financial institutions, particularly ones that lend to small and medium enterprises (SMEs). The IFC's advisory services in Montenegro aim to improve the investment climate and the performance of private sector companies, and to attract private sector participation in the development of infrastructure projects.

National Instruments for FDI development

The *Montenegrin Investment Promotion Agency* (MIPA) is the national investment agency set up by the Government of Montenegro in 2005 to promote foreign investments and facilitate economic development in Montenegro. The mission of MIPA is to partner with foreign and domestic investors; the public and private sector; international organizations and private individuals in order to boost business opportunity and overseas investments in Montenegro. Therefore, MIPA promotes business ventures of particular interest to foreign investors and brings such projects to the attention of the international marketplace.

MIPA helps you find business opportunities in Montenegro by:

- *Business cooperation and business Start-up services.*
- *Providing information on local investment within the institutional framework.*
- *Consulting in local customs and laws.*
- *Assisting in gaining permits and licenses on national and local levels.*
- *Developing specific strategies for specific sectors and countries*
- *Assisting in the location of Greenfield and Brownfield site options according to specific requirements.*
- *Providing initiatives while supporting cooperation with domestic supplier companies and other local partners.*
- *Maintaining an investment database.*
- *Identifying potential challenges to business cooperation in Montenegro and alerting local official to make the necessary systematic changes.*
- *Promoting business ventures by connecting local companies with foreign investors.*

SERBIA

SMEs and FDI status

Serbia has made considerable progress in advancing transition over the past two decades particularly in the areas of price liberalisation, reforms in the trade and foreign exchange system and small-scale privatisation. Progress has also been made in large-scale privatisation, but some major enterprises still remain in State ownership (see below). Serbia has undertaken a series of reforms to reduce the regulatory burden on businesses in recent years. These include measures to make starting a business easier by setting up a one-stop-shop for business registration in 2010 and by eliminating the paid-in minimum capital requirement for new businesses in 2012. Serbia has also made progress on insolvency resolution mechanisms. Reforms have also been implemented to facilitate property registration and contract enforcement. As reported for the other Western Balkans Countries, also for Serbia the importance of MSMEs for entire national economy is very relevant in terms of number, employment and value added. The vast majority of MSMEs are concentrated in wholesale and retail trade, in manufacturing and in the construction industry, indicating a certain lack of diversification. However, despite numerous Government efforts, MSMEs continue operating in a difficult business environment and competition from the extensive informal economy and insufficient access to finance are remain main obstacles for growth.

In particular, according to the data published in the *Yearbook 2013* by the *Statistical office of the Republic of Serbia*, in 2011, out of a total of 84,690 enterprises, 99.4% was SMEs and 86.3% was micro enterprises (with less than 10 employees)²⁴. On the contrary, LEs cover a share of only 0.6% of the total number of enterprises. The more representative economic sector of MSMEs is the wholesale/retail trade and repair of motor vehicles and motorcycles (share of 39.2% for SMEs and 35.5% for micro enterprises), followed by manufacturing (20.1% for SMEs and 15.9% for micro enterprises). Within the manufacturing sector the number of MSMEs prevails in the production of food products (17.6%), fabricated metal products, except machinery and equipment (11.8%), wood and products of wood, cork and straw, except furniture (8.9%), rubber and plastic products (6.4%), computer, electronic and optical products (6.3%) and wearing apparel (6.0%). Other relevant sector for MSMEs are the professional, scientific and technical activities (12.5% - mainly activities of head offices and management consultancy activities) and the construction sector (8.6% - mainly specialized construction activities and buildings construction).

In 2011, out of nearly 1.02 million persons employed in the total number of enterprises, MSMEs employed more than 614,000 workers with a share of 34.2% in micro enterprises. The distribution of employed labour force in MSMEs by economic sector is very similar to the distribution by the number of enterprises: in fact, 30.7% of employed persons works in manufacturing sector (of which 6.5% in the food products sub-sector), 28.6% in the wholesale/retail trade and repair of motor vehicles and motorcycles sector, 9.5% the constructions and 9.2% in professional, scientific and technical activities.

²⁴ In addition, Serbia is host to some 215,000 unincorporated enterprises (sole traders), which brings the total SME count to 300,000 units.

Serbia: enterprises size classes by economic activity (2011)

	Small and Medium sized enterprises (SMEs)				Large (250+)	TOTAL (in numbers)
	Total SMEs	Micro (< 10)	Small (10-49)	Medium (50-249)		
<i>Enterprises (in numbers)</i>	84,203	73,108	8,990	2,105	487	84,690
<i>Enterprises by economic activity:</i>						
<i>B - Mining and quarrying</i>	297	241	39	17	9	306
<i>C – Manufacturing</i>	16,982	13,482	2,634	866	217	17,199
<i>D – Electricity, gas, steam and air conditioning supply</i>	412	344	42	26	15	427
<i>E – Water supply, sewerage, waste management and remediation activities</i>	765	490	151	124	30	795
<i>F - Construction</i>	7,228	6,118	887	223	52	7,280
<i>G – Wholesale and retail trade; repair of motor vehicles and motorcycles</i>	33,199	30,034	2,758	407	71	33,270
<i>H – Transport and storage</i>	4,870	4,179	580	111	31	4,901
<i>I – Accommodation and food service activities</i>	2,474	2,077	317	80	6	2,480
<i>J – Information and communication</i>	3,906	3,411	422	73	18	3,924
<i>L – Real estate activities</i>	780	730	41	9	-	780
<i>M – Professional, scientific and technical activities</i>	10,533	9,554	869	110	8	10,541
<i>N – Administrative and support service activities</i>	2,757	2,448	250	59	30	2,787

Source: Statistical office of the Republic of Serbia – Yearbook 2013.

These data confirm the picture given by the 2013 *SBA Factsheet* of the European Commission. In particular, according to the *Enterprise and Industry General directorate*, the Serbian business economy was hit hard by the macroeconomic shock at the end of 2008 and in 2009. Interestingly, this shock has left its marks on the employment and value-added produced by firms, much more than on the number of enterprises, which managed to keep operating despite a reduction in business activity. Thus, the number of active enterprises was largely unaffected as it grew from less than 82,000 in 2008 to more than 84,000 in 2011. At the same time, the employment and economic value added accounted for by the SME sector were lower in 2011 than at the beginning of the crisis, in 2008. Thus, between 2008 and 2011, some 46,000 jobs got lost in Serbian SMEs. A majority of this job loss occurred in the manufacturing SMEs (-28,000), followed by wholesale and retail trade (-15,000) and construction (-7,000). Employment in the SMEs operating in service sectors such as information and communication, professional, scientific and technical activities, etc. was more resilient, registering either stagnation or positive – albeit modest – growth during the same period. The output of Serbian SMEs, as measured by the gross value-added also dropped by approximately 10% during the same time frame. About half of this decline occurred in the wholesale and retail sector, with the remaining loss being largely

concentrated in the manufacturing and construction sectors.

SMEs in Serba – basic figures

	Number of enterprises			Number of employees			Value added		
	Serbia		EU27	Serbia		EU27	Serbia		EU27
	Number	Share	Share	Number	Share	Share	Million €	Share	Share
<i>Micro</i>	72,995	86,3	92.2	210,101	20.5	29.7	1,885	13.1	21.5
<i>Small</i>	8,984	10.6	6.5	181,033	17.7	20.6	2,576	17.9	18.6
<i>Medium</i>	2,103	2.5	1.1	223,367	21.8	17.2	2,808	19.5	18.3
SMEs	84,082	99.4	99.8	614,501	60.0	67.5	7,269	50.4	58.4
<i>Large</i>	488	0.6	0.2	410,403	40.0	32.5	7,144	49.6	41.6
Total	84,570	100.0	100.0	1,124,904	100.0	100.0	14,413	100.0	100.0

Source: SBA Factsheet 2013

A further monitoring of the climate in which operate Serbian SMEs is given by the *Progress Report of the European Commission*. According to this Report²⁵, in the area of Enterprise and Industrial Policy, “preparations for the new strategy for competitive and innovative SMEs for 2014-2020 continue. Information about upcoming public-private consultations (PPCs) is publicly available and registration is open to all interested participants. The SME Council did not increase its activity and staffing levels remain to be increased. In March, the law on limiting payment deadlines entered into force, setting a 45-day payment deadline for public sector debts to private businesses and a 60-day deadline for payments between companies in the private sector. This is not yet in line with the EU directive on late payments. In the field of enterprise and industrial policy instruments, Serbia continues to implement the Small Business Act and to participate in projects under the European Entrepreneurship and Innovation Programme (EIP). Its SME definition is in line with that of the EU in terms of company size. Legislation affecting the business environment has been reviewed and simplified. The regulatory guillotine process has now been extended to secondary business-related legislation with an impact on SMEs. Mandatory regulatory impact assessments (RIA) are applied systematically for new laws and regulations. The legal framework for access to finance has improved. The Development Fund provides small credit-guarantee schemes and public start-up funding. However, the number of market participants and the value of equity transactions remain low. Further efforts are needed in relation to company registration, business incubators and access to finance for SMEs. No new development took place in sector policies”. In conclusion, “some progress was made in the area of enterprise and industrial policy. The institutional framework for SME policy and SMEs access to finance improved. Measures taken to improve the business environment, in particular on the business impact assessment for new legislation is a welcome development. Serbia continues to implement the Small Business Act in an appropriate manner. Overall, preparations in this area are on track.”

Due to political and economic changes, Serbia has seen a growth in **FDI** only since the year 2000, especially after 2002, when the new Law on Foreign Investments was adopted. This Law equalizes the rights and obligations of both foreign and domestic investors in Serbia. The combination of legal framework, privatisation process and customs regime ensure that foreign capital has considered the Country as a new economic system of interest. In particular, from year 2000 until 2013, Serbia has attracted €22.4 billion of inward FDI.

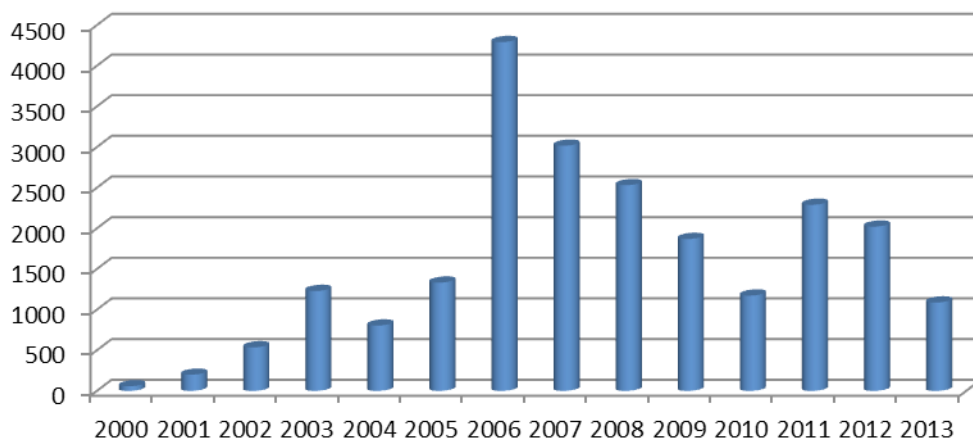
From 2000, the highest inflow of FDI in Serbia originated from the EU Member States, as well as from the USA and Russian federation, especially in the sectors of finances, telecommunications, energy, cement, oil, and tobacco industries. The highest inflow of FDI in 2006 (€4.3 billion) is not likely to reappear in the near future, because it was the consequence of privatizing the mobile telecommunications operator *Mobtel*, purchased by Norwegian *Telenor*, followed by *Philip Morris* (acquisition of *DIN Fabrika duvana a.d. Niš*), and the greenfield investment of the mobile operator *Mobilkom Austria* (exclusive of *Vodafone* in Serbia) and others.

²⁵ Serbia 2013 Progress Report, Commission Staff working Document, SWD(2013) 412 final, Brussels, 16.10.2013.

Due to the political instability, the inflow of FDI to Serbia decreased to €3.0 billion in 2007 and €2.5 billion in 2008. Significant decrease in FDI occurred in 2009 with the appearance of the world economic crisis: in the first semester of 2008, the inflow of FDI was 75% higher than in 2009. The difference would have been even more significant, but in February 2009 Russian group *Gazprom* bought *Naftna Industrija Srbije*, with a 50% share in total FDI in 2009. The inflow of FDI to Serbia decreased to nearly €1.7 billion in 2009. As an effect of the global economic crisis, the inflow of FDI in 2010 was only €1.2 billion. The most important foreign investor countries in 2010 were the Netherlands with USD 264 million, Austria with USD 193 million, Slovenia with USD 108 million, and the USA with USD 77 million. Civil engineering and agriculture are still deficient in foreign capital inflow. Despite the convenient natural conditions for the development of agriculture, and experience for the intensive growth of this sector, it is still without FDI. Since the onset of economic reforms, Serbia has grown into one of the premier investment locations in Central and Eastern Europe. A list of leading foreign investors is topped by world-class companies and banks such as FIAT, Telenor, Stada, Microsoft, Coca-Cola, Delhaize, Michelin, Gazprom, Bosch, Siemens, Intesa Sanpaolo, Mobikom Austria, and many others. Serbia's strong FDI track-record is substantiated by internationally recognized awards for local Greenfield investors. Between 2004 and 2006, Greenfield projects in Serbia were awarded by the OECD as the largest investments of this type in South East Europe. The first Award was presented to Ball Packaging Europe (headquartered in USA), followed by METRO Cash & Carry (Germany), and Israeli Africa-Israel Corporation/Tidhar Group for their Airport City Belgrade real estate project. In terms of the country structure, as of year 2005 investors from the European Union top the list. The leading spot on the country list is held by Netherlands, followed by Austria, Greece, Norway and Luxembourg, while major investor countries also include Germany, Italy, Slovenia, and the Russian Federation.

In the period 2004-2013, service sectors have proven to be the most attractive to international investors. Banking and insurance recorded the largest FDI inflow of €5 billion. Manufacturing industries held the 2nd spot with €4.8 billion, followed by wholesale, retail and repair of motor vehicles and real estate activities.

FDI inflows in Serbia (in € million)



Source: National Bank of Serbia

Net FDI in Serbia () by main countries of origin (in € million)*

	2009	2010	2011	2012	2013	2005-2013
<i>Austria</i>	234.1	145.8	154.7	55.3	40.6	2,388.5
<i>Norway</i>	-0.5	1.6	0.9	3.5	3.5	1,311.4
<i>Luxembourg</i>	6.0	6.7	812.8	64.4	22.6	1,2396
<i>Germany</i>	40.1	32.9	76.6	43.4	48.4	1,151.8
<i>Italy</i>	167.4	42.3	128.1	81.7	43.9	972.4
<i>Netherlands</i>	172.3	200.1	240.8	1.4	131.1	962.0
<i>Greece</i>	46.7	24.4	10.0	-296.1	29.0	939.7
<i>Russian Federation</i>	419.8	7.0	74.2	18.5	45.3	598.8
<i>Slovenia</i>	34.3	80.9	-108.4	52.6	24.5	522.9
<i>Switzerland</i>	62.9	50.6	47.7	78.4	49.0	483.1
<i>Total (including Others)</i>	1,372.5	860.1	1,826.9	241.9	768.5	13,288.0

(*) - As the National Bank of Serbia obtains data on FDI in cash from commercial banks, these data are classified by Country of payment and not Country of investment.

Source: National Bank of Serbia

2004-2013 cumulative FDI inflows by sector of destination (in € million)

<i>Sector</i>	<i>Investment value</i>
<i>Financial intermediation</i>	4,968
<i>Manufacturing</i>	4,766
<i>Wholesale, retail and repairs</i>	3,167
<i>Real estate activities</i>	2,459
<i>Transport, storage and communication</i>	2,456
<i>Construction</i>	586
<i>Mining and quarrying</i>	544
<i>Agriculture, forestry and fishing</i>	194
<i>Other sectors</i>	538

Source: National Bank of Serbia

Main Financial Facilities

European Union: the EU is by far the biggest donor to Serbia with more than €2.6 billion (as of January 2014) in grants provided over the past 13 years in all fields. The main financial assistance is provided through the Instrument IPA (Component I - Transition Assistance and Institution Building; Component II - Cross-Border Cooperation) which aims to help Serbia to prepare for assuming and effectively implementing obligations of its future EU membership. Member States provided substantial bilateral assistance too. The assistance follows a sector-based approach focusing on the following sectors: justice and home affairs; public administration reform; social development; private sector development; transport; the environment, climate change and energy; and agriculture and rural development. In addition, the Country continues to benefit from various regional and horizontal programmes. Cross-border cooperation is also used to promote capacity building and dialogue between the local and regional authorities of neighbouring Countries, namely Bulgaria, Hungary, Romania, Bosnia and Herzegovina, Croatia and Montenegro. For the period 2007-2013, the Commission has earmarked €1,384 million for IPA projects to be implemented in the Country. The Government and the European Commission are currently preparing a comprehensive Country Strategy Paper for the period 2014-2020, which will provide a coherent and strategic framework for financial assistance under

the new instrument IPA II. Under IPA II for 2014-2020, the European Commission together with Serbian Authorities is focusing on the fact that only strategically important and mature projects will be considered for funding under the sectoral approach. The Serbian authorities need to create the legal and institutional structures that allow to more efficiently and effectively absorb EU and other donor funds (including loans by international financial institutions), especially in infrastructure projects. Serbia participates in a number of EU programmes: the *Seventh Framework Programme for research and technological development (FP7)*, *Progress*, the *Competitiveness and Innovation Programme*, the *Culture Programme*, the *Europe for Citizens Programme*, the *Customs Programme* and the *Fiscalis Programme*. There has been progress in the area of regional policy and coordination of structural instruments. Serbia is in the process of acquiring valuable experience in the management of EU funds under the Decentralised Implementation System (DIS), as it is in the final stage for the conferral of management for two IPA components. Adequate implementation capacity needs to be ensured under the decentralised implementation system. Programming needs to be improved, especially in terms of preparing a solid investment project pipeline based on relevant strategies. Overall, preparations in this area are moderately advanced.

European Investment Bank (EIB): the Bank is increasingly active in Serbia, with total approvals from 2001-2013 amounting to €4.3 billion, out of which €317 million were approved in 2013. The main focus has been on transport projects (including Trans-European Networks) to provide better links for the Country and the Region. SMEs have also been a priority objective. EIB has lent over € 750 million to the manufacturing and services industries to help boost growth and job creation. The portfolio includes upgrading of Serbia's road transport network, projects financing SMEs in the knowledge economy, energy, environmental protection, industry, health, education and services. EIB also invested in FIAT Serbia for the modernization and expansion of production capacity of the existing *Zastava* auto motive plant in Kragujevac. The EIB announced plans in January of 2014 to loan €150 million to SMEs in Serbia, funds aimed at helping the Country improve infrastructure as it integrates more closely with the EU. The loan is the first installment of up to €500 million that the EIB has set aside for lending to companies involved in energy, health, industry, tourism, trade and services.

European Bank for reconstruction and Development (EBRD): during the current strategy period the Bank has signed 166 projects for a total of €2.58 billion, and mobilised co-financing of €908 million as of 31 December 2013. Since the start of operations in 2001, the total cumulative business volume has reached €3.503 billion and mobilised co-financing €1.5 billion. 36.9% of cumulative business volume to date is in infrastructures, 29.0% in the financial sector, 21.4% in industry, trade and agribusiness and 12.7% in energy. The active portfolio as of end-December 2013 is comprised of 129 projects totalling EUR 2.490 billion. Disbursements reached EUR 1.864 billion during the current strategy period. As a result, the undrawn ratio improved from 48.5 per cent at the end of 2007 to 40.8 per cent at the end of December 2013. However, implementation of a number of public sector projects remains significantly delayed (Serbian Railways, Roads of Serbia, Srbijagas and the Electrical power company "EPS"). The value of impaired assets increased from nil at the time of approval of the current strategy in 2007 to EUR 41 million (2.9 per cent of operating assets) at the end of December 2013. The private sector portfolio ratio remained stable at 44% as of December 2013. During this period the Bank signed 149 private sector operations and 17 public sector projects with the average size of EUR 9.51 million and EUR 69.1 million, respectively. The current active public sector portfolio continues to be dominated by large infrastructure projects in the public sector signed since opening of the office. The share of public sector projects is likely to remain significant, given the large scale of potential projects to support infrastructure needs in the country, but it is expected to decline over time. The Bank will pursue greater private sector participation in such projects, subject to market conditions, and focus on expanding its activities with private companies. This approach should result in gradual rebalancing of portfolio ratio in the medium to long term. Support to the private corporate and MSME sector was provided both directly, including through the Local Enterprise Facility (LEF) and Small Business Support (SBS) activities, and indirectly through local commercial banks. The Bank was particularly active in financing the high-potential agribusiness sector. The Bank helped the regional expansion of the juice company *Nectar* through financing their landmark cross-border acquisition of *Fructal*, Slovenia. The Bank supported the expansion of large agribusiness companies such as *Victoria Group* and *MK Commerce* through debt and equity financing. The Bank also supported a number of SMEs through LEF such as the leading furniture producer *Forma Ideale*, an investment which was supported with *Technical*

Cooperation funds aimed at improving corporate governance and financial management. The Bank assisted in the balance sheet restructuring of corporates in the manufacturing and services sector. However, recovery proved to be more challenging than anticipated, which coupled with financial mismanagement of some of the corporates, resulted in several impaired investments currently being worked out.

World Bank Group/IFC: in May 2001, Serbia (together with Montenegro) assumed membership in the World Bank. Since 2006, Serbia has been a World Bank Member as an independent Country. Up until October 2013, the Bank has provided financing for 14 projects in various sectors, totaling almost US\$1.5 billion of IDA credits and grants and BRD loans. According to the Bank Serbia needs to become more competitive and increase productivity. As detailed in the 2012 *Country Economic Memorandum (CEM)*, this will require attraction and adoption of new technologies, which will in turn depend on a supportive business environment, capable institutions, a skilled labor force and high quality infrastructure. The lending envelope for the ongoing *Country Partnership Strategy (CPS)* for fiscal year 2012 – 2015 could reach US\$800 million, with the possibility of financial assistance divided evenly between investment operations and development policy lending. This program, plus the allocation of an additional US\$200 million for budget support to respond to the economic crisis in the country, signals the Bank's commitment to Serbia. This CPS has been designed in close cooperation with Serbia's development partners to build on these investments and advance its EU accession and is closely aligned with the EC's *Europe 2020 Growth Strategy*. It has also been closely informed by the EC's Annual Progress Reports and the Multi-annual Indicative Planning Document (MIPD), the primary strategic planning instrument for assistance to Serbia in the framework of IPA. Finally, it reflects expanding dialogue between Bank Group and EC staff and management in Brussels and Belgrade. This is increasingly important given, as noted above, the significant financial resources with which the EU is providing Serbia. The EC monitors progress in each potential candidate country along three key areas: political criteria; economic criteria; and ability to assume the obligation of membership in various sectors, and issues annual reports on the progress achieved.

With the overall objective of supporting Serbia's European integration this CPS will: (i) support economic growth by tackling some of the bottlenecks to improved productivity and competitiveness; and (ii) strengthen the efficiency and outcomes of Serbia's social sector spending. The CPS recognizes that the goals of competitiveness and improved social sector spending and outcomes are often fundamentally interrelated.

Serbia became a shareholder and member of the IFC in 2001. Since then, IFC's investment in Serbia has totaled US\$1.9 billion, including US\$578 million in loans in 52 projects across a variety of sectors. IFC's committed investment portfolio in Serbia as of 30th June 2013 was US\$671.5 million. In the second half of 2013, IFC invested US\$398.5 million in Serbia, including US \$274.4 million in syndicated loans. IFC's priorities in Serbia include crisis response, agribusiness, climate change, and improvements in the investment climate. IFC expects to provide financing of US\$600-800 million to the private sector from fiscal year 2012-2015. IFC seeks to improve Serbia's competitiveness through its investment and advisory service products, targeting competitive and export-oriented companies as well as the under-served segments of the economy such as the SMEs and agribusiness sectors, energy efficiency and renewable energy, and municipalities and rural areas. Also, through its regional programs, IFC will help Serbia to make further progress in improving the business environment. IFC is also focusing its investment services on increasing access to finance by supporting the development of local financial institutions, especially those that concentrate on SMEs. IFC's advisory services aim to improve the investment climate and performance of private sector companies, and to attract private sector participation in the development of infrastructure projects. Recent IFC investment projects in Serbia include:

- €57 million loan to Victoria Group to support the development of the private sector in Serbia, where revitalizing agribusiness is essential for creating jobs.
- €50 million loan to Atlantic Group to support the development of agribusiness and cooperation in the region (including Serbia), which is still recovering from the crisis.
- €12.5 million loan to Serbia's beverage maker VINO ZUPA to support the development of agribusiness in the country.

- €50 million for a minority stake in Titan Cement Cyprus, owned by Greek cement manufacturer Titan Cement. The investment will support Titan's subsidiaries in the Western Balkans: Cemertara Kosjeric in Serbia, Cementarnica USJE in FYR of Macedonia, and SharrCem in Kosovo.
- €70 million loan to the Serbian unit of Société Générale to finance agricultural development.
- €45 million loan to MK Group, a Serbian food producer, to modernize and expand production.
- €20 million loan to PMC Automotive Serbia, a joint venture between Italian automotive suppliers CLN Group and PROMA Group.
- €50 million loan to UniCredit, equally divided between a housing line (focus on low income households) and an agribusiness line supporting one of Serbia's key sectors

IFC has also invested in the following Serbian banks and companies: Banca Intesa, Cacanska Banka, Continental Bank, EFG, Komercijalna Banka, Unicredit Bank, Vojvodjanska Banka, ProCredit Bank and ProCredit Leasing, Farmakom, Kronospan, and Porr.

National Instruments for FDI development

The *Serbia Investment and Export Promotion Agency (SIEPA)* is an investment promotion agency, established on 28th February, 2001 by the government of Serbia, the agency promotes foreign direct investment (FDI), and supports companies seeking to set up or expand their business operations in Serbia. SIEPA networks with all FDI-related public and private sector bodies, including government ministries and other governmental bodies, municipal authorities and local self-government, building land agencies, tax and customs authorities, statistical bureaus, chambers of commerce and the National Bank of Serbia. In addition, SIEPA expert staff offers information packages about law, industries, sectors, business practices, and general doing business in Serbia. SIEPA publications and materials on doing business in Serbia, as well as detailed sector analysis and studies are available in hard copy and can be downloaded at www.siepa.gov.rs. The SIEPA website is currently available in English, Serbian, French, Italian and Russian languages. SIEPA is a member of the World Association of Investment Promotion Agencies (WAIPA), as well as the World Trade Promotion Organizations (WTPO), a part of the International Trade Centre (ITC).

Key services SIEPA offers to prospective and existing investors are:

- 1) Pre-investment services
 - *Information on FDI-related legislation;*
 - *Macroeconomic data and profiles of specific industries;*
 - *Operation costs analyses;*
 - *Other information requested;*
 - *Business opportunities presentations.*
- 2) Investment set-up services
 - *Assistance with company establishment (registration, work permits, office space etc.);*
 - *Identifying locations for Greenfield projects;*
 - *Finding existing facilities for Brownfield investment;*
 - *Organizing site visits;*
 - *Matchmaking with Joint Venture partners;*
 - *Facilitating contacts with national and local authorities.*

3) Post-investment services

- *Assistance in dealing with bureaucracy at both national and local levels;*
- *Advice on business service providers (banks, leasing companies, consulting firms, law offices, real estate agencies etc.);*
- *Linking with local suppliers.*

To help potential investors speed up the completion of their projects, SIEPA networks with all FDI-related public and private sector bodies, including ministries and other Government bodies, municipal authorities and local self-government, building land agencies, tax and customs authorities, statistical bureaus, national and regional chambers of commerce and the National Bank of Serbia.

4) Export related services

- *Identifying local partners and suppliers, including meeting facilitation,*
- *Maintaining investment and exporters databases,*
- *Delivering sector analysis and studies,*
- *Helping Serbian exporters service international markets,*
- *Assisting in promotion of domestic products at international fairs,*
- *An effective cost-sharing development grant program which enhances the competitiveness of Serbian companies.*

Conclusions

The Western Balkans Countries differ significantly in size, income level and economic performance. They are also in varying stages of the EU accession process. In spite of differences, economies of the region share common features. The importance of small- and medium-sized enterprises (SMEs), which account for as much as 92% of all businesses in some economies is, perhaps, the most salient of them. SMEs generate between 61%-81% of private sector employment and make up the largest share of total value added. A sluggish recovery from the global economic crisis has affected SMEs and entrepreneurs severely. In order to overcome the present difficult conditions, the Governments of the Western Balkans are focusing on effective short- and long-term reforms to unleash the potential of SMEs to generate growth and new jobs. Economies have made good progress further to reforms aiming to simplify administrative and company registration procedures, strengthen institutions that support SMEs and increase inter-agency cooperation. They have also been successful in facilitating access to finance through reforms to legal and regulatory frameworks and support for entrepreneurial learning. However, progress has been uneven across the region and the pace of reform is slowing. Varying levels of economic development and the fact that some economies are further advanced in the EU accession process have affected economies' capacity to develop and effectively implement SME policies in a consistent and coordinated way. Furthermore, the global financial crisis has shifted government attention away from structural SME policy reform toward short-term support measures.

Croatia shows the highest level of policy convergence, especially in the policy areas covered by the EU acquis, although its progress has slowed. Serbia has made good but incremental progress across a wide range of policy dimensions, restructuring its SME policy and redesigning its main policy tools. Albania has an advanced system of company registration, with one-stop services for registration, license and permits, but it is in the process of re-organising its SME support activities and targeted services remain limited. The FYR of Macedonia has improved its registration systems and introduced regulatory impact analysis on new legislation, but is only now drafting an innovation strategy, and its support services mainly target start-ups. Montenegro is also making progress in company registration and regulatory reform but its progress on entrepreneurial learning has lost momentum, and it still suffers from policy gaps in the areas of innovation and SME support services. There is no coherent policy framework linking the state level and political entities in Bosnia and Herzegovina. Positive policy experiences are not being translated from the local to the state level. Kosovo has made progress with its policy framework for supporting SMEs and in developing skills, but is still too reliant on donor assistance.

Although basic business support services are available across the Region, only Croatia, Montenegro and Serbia have integrated them into national strategies including measurable targets. The range and quality of support services available to SMEs have improved only marginally since 2009 except in Croatia and Serbia. In most cases, services are provided on an ad hoc basis and through donor-sponsored initiatives. The financial crisis has made it more difficult to access external finance. After banking, microfinance and leasing are the most developed sources of finance across the Region; alternative financial instruments such as venture capital and private equity remain limited in scope. Public support for SMEs and start-ups is limited and has decreased in some economies.

There were significant obstacles to movement of foreign capital to the Western Balkans economies. Balkan Countries faced shortage of capital at the early stages of transformation of their economic systems. Their enterprise sectors needed restructuring: financial, technological, etc., in order to be viable and ready to face the new challenges of market economy. Differences in attitudes towards FDI among Countries in the Region remain and are determined by various factors (cultural, ethnic, social, etc.). Fundamental changes have taken place in virtually every Country as reforms go forward. Despite this fact, the inflows of FDI are still comparatively low, even in the Countries that have moved quickest on reforming their economies. However, the Western Balkans Countries' Authorities recognized the fact that the FDI are very important, and have created a favorable legal framework for attracting FDI. In the period 2000-2002 a FDI increase was recorded in the Region, although with differences as individual Countries. Much of this increase has been attracted by progress in cash privatization, in particular in the banking and telecommunications sectors and by relatively favorable investment climates.

The key issue of the post-privatization era will be how to attract FDI into greenfield ventures and into privately owned assets. While the attractiveness of existing industrial and commercial assets will depend on their valuation in secondary markets, foreign investors who consider greenfield investments need to take into account the cost of new plant and equipment, the business environment and market potential. Of particular importance is the security provided to investors by the existence of enforceable contracts, standardized product classification and business practices, and customs and other regulations designed to regulate commercial transactions. Moreover, the experience of the transition economies and other emerging markets shows that FDI tends to be closely linked to rising bilateral trade flows. In this respect, the prospect of stability resulting from the removal of barriers to market entry and integration into the EU also helps to attract FDI.







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