Economic Development – Policies for Small and Medium-Sized Enterprises

The purpose of the analysis which bears the title Economic Development – Policies for Small and Medium-Sized Enterprises is to present the characteristics, specificities and potentials of small and medium-sized enterprises in Bosnia and Herzegovina, as well as the limitations they face, in the absence of economic policy and country-wide development strategy. In addition, the analysis aims to present and propose solutions and measures to improve competitiveness of small and medium enterprises, which should benefit the country's competitiveness in general.

1.1. Definition of Small and Medium-Sized Enterprises (SME)

A single definition of small and medium-sized enterprises does not exist, since there are no common SME classification criteria (number of employees, income and turnover, capital). According to the EC definition, SMEs in the EU include enterprises which employ fewer than 500 employees and which have an annual turnover not exceeding 38 million Euros. The IFC defines small enterprises as having fewer than 50 employees and medium enterprises as having 50 to 200 employees. Likewise, there is no one single definition of SMEs in BiH. Entity level legislation offers different definitions and the respective entity laws regulate the activities in a different manner. It is disconcerting that, in addition to the lack of a state-level law on SMEs, which would ensure common classification of SMEs in BiH, the BiH MoFTER has not created an SME database (central business register) as of yet. Therefore, it is possible to discuss only the estimated number of SMEs in BiH. In 2009, the Agency for Statistics of BiH started developing the statistical business register at the state-level of BiH, including a common (new) classification of activities. The estimated number of for-profit and non-profit organisations in BiH exceeds 80,000. However, regarding the accuracy of the estimate, we need to take into account that the number of companies which are registered albeit inactive, and the number of which have closed down are not available. Significant numbers of companies operate in the “informal sector”, i.e. within the realm of the “grey” economy. The Agency for Statistics estimates that the total number of companies amounts to 32,000, including, predominantly, micro, small and medium-sized enterprises.

Table 1: SME structure in BiH

<table>
<thead>
<tr>
<th>Entity code in the SBR</th>
<th>Entity code</th>
<th>Entity</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Republic Srpska</td>
<td>28086</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Federation of Bosnia and Herzegovina</td>
<td>53349</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Brčko District</td>
<td>2602</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bosnia and Herzegovina</td>
<td>84037</td>
<td></td>
</tr>
</tbody>
</table>

Table 2: Number of active companies in BiH

<table>
<thead>
<tr>
<th>Classes of employees in the SBR</th>
<th>Total</th>
<th>RS</th>
<th>FBiH</th>
<th>BDBiH</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (0-9 employees)</td>
<td>23332</td>
<td>6996</td>
<td>15030</td>
<td>1306</td>
</tr>
<tr>
<td>2 (10-19 employees)</td>
<td>3227</td>
<td>1030</td>
<td>2111</td>
<td>86</td>
</tr>
<tr>
<td>3 (20-49 employees)</td>
<td>2669</td>
<td>850</td>
<td>1767</td>
<td>52</td>
</tr>
<tr>
<td>4 (50-249 employees)</td>
<td>1906</td>
<td>639</td>
<td>1239</td>
<td>28</td>
</tr>
<tr>
<td>5 (250 and more)</td>
<td>301</td>
<td>96</td>
<td>199</td>
<td>6</td>
</tr>
</tbody>
</table>

31435 | 9611 | 20346 | 1478

Source: Agency for Statistics of BiH

1.2. Small and medium-sized enterprises – characteristics, potentials and limitations

From the perspective of economic theory, there are various advantages to SMEs. SMEs have the flexibility to adapt to changing markets. This is why there is around 20 million SMEs in the EU countries (micro enterprises accounting for nine to ten million of the total number!), providing 67% private sector jobs (86.8 million) and constituting upwards of 99.8% of all enterprises. The Small Business Act and the European Charter for Small Enterprises have served to create an environment in which it has been possible to establish over 100,000 companies and reduce the time and costs of starting up a company (7 days and 399 Euro). In BiH, SMEs account for more than 99% of the total number of companies (out of the 31,435 active ones) and they generate over 60% of GDP. SMEs should, therefore, become the drivers of economic development in the country, as is the case in the EU. SMEs face a number of internal weaknesses and limitations, ranging from lack of knowledge about new technologies, problems in terms of access to finance, weak negotiating power, low productivity, to insufficient entrepreneurial skills and lack of knowledge of human resource management. An SME owner plays many different roles – those of a manager, leader, organizer, and more often than not it is the owner who performs additional tasks related to procurement, sales, marketing, finance and the like.

2. Institutional, Legal and Regulatory Framework for Operation of SMEs in BiH

Bosnia and Herzegovina has not created institutional, legal and regulatory preconditions for providing support to the SME sector. The process of implementation and establishment of institutions has come to a halt. Thus far, the SME Department within the MoFTER and the Forum for Development and Promotion of Entrepreneurship (2011) have been established. The Law on State Aid of BiH was adopted in 2012; however the Agency for State Aid has not become fully operational. Thus far, The Law on SMEs and the new SME Development Strategy have not been adopted nor has the existing Strategy been implemented, and the SME Agency and the SME Fund have not been established. The central business register does not exist. No new draft bills have been introduced and there have been no amendments to existing legislation. At the same time, entities are adopting laws which are not harmonised, and attempts have been made to transpose the EU acquis. Therefore, there are dozens of laws governing entrepreneurship at all levels in BiH.

By and large, responsibilities for the legislation and incentives rest at the entity level. In the Federation of BiH, financial incentives for SMEs include grants in the amount of 3.5 million, awarded annually for the period 2013-2016 by the Federal Ministry of Development, Entrepreneurship and Crafts, co-financing the loans approved by FBiH Development Bank in the amount of 18% of the loan value, as well as the special credit line of the Development Bank. Considerable financial resources are made available to SMSs through the Foundation for Sustainable Development

4 As suggested in Martinović Danijela, Šunjć-Beus Mira, Karšik Jasmina: Potencijali i ograničenja u razvoju poduzetništva u BiH sa posebnim osvrtom na sektor malih i srednjih poduzeća, Ekonomskia misao i praksa, Sveučilište u Dubrovniku, Dubrovnik, god XXI (2012.), No. 1.

Macroeconomic indicators and the World Economic Forum’s annual Global Competitiveness Report generally provide the best insight into the business environment of any country.

Macroeconomic indicators: In terms of macroeconomic indicators, the following table provides an overview of the most significant indicators achieved and projected for the period 2013-2016.

### Table 3 Macroeconomic Indicators for BiH for the Period 2013-2016

<table>
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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Nominal GDP (million KM)</td>
<td>28,023</td>
<td>29,118</td>
<td>30,621</td>
<td>32,339</td>
</tr>
<tr>
<td>Nominal growth (in %)</td>
<td>1.9%</td>
<td>3.9%</td>
<td>5.2%</td>
<td>5.6%</td>
</tr>
<tr>
<td>Consumption (m KM)</td>
<td>29,353</td>
<td>30,484</td>
<td>32,011</td>
<td>33,659</td>
</tr>
<tr>
<td>Investments (m KM)</td>
<td>5,324</td>
<td>5,784</td>
<td>6,382</td>
<td>7,311</td>
</tr>
<tr>
<td>Current account balance (m KM)</td>
<td>2,482</td>
<td>2,588</td>
<td>2,707</td>
<td>2,916</td>
</tr>
<tr>
<td>Nominal import growth (%)</td>
<td>4.1%</td>
<td>7.4%</td>
<td>8.8%</td>
<td>11.2%</td>
</tr>
<tr>
<td>Nominal export growth (%)</td>
<td>3.1%</td>
<td>7.3%</td>
<td>8.8%</td>
<td>11.3%</td>
</tr>
</tbody>
</table>

Source: FBiH, the Government: Framework Budget Document, 2014-2015, the World Economic Forum has, based on analysis of 100 indicators grouped in 12 pillars of competitiveness and aggregated into the global competitiveness index, ranked BiH 87th out of 148 world economies. As far as individual indicators are concerned, the lowest ranked indicators include financial market development (ranked 113th), business sophistication (ranked 110th), and goods market efficiency (ranked 104th). The most problematic factors affecting competitiveness of BiH are: access to finance, policy instability, high tax rates and government instability. The best ranked indicators include innovation, institutions, infrastructure and labour market efficiency. The following figure includes an overview of key obstacles to doing business.

### Figure 1: Global Competitiveness Index for BiH


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6 Centre for Policy and Governance, Report on SME Policies in Bosnia and Herzegovina (Izveštaj o politikama malih i srednjih preduzeća u Bosni i Hercegovini), September 2010, pp.16-21.


entities, the process of company registration in FBiH will be simplified and reduced to five days. This will happen almost simultaneously with the same process taking place in the RS. According to the new legislation, courts shall issue registration decisions within five days, while the tax identification number shall be issued within three days. The number of documents delivered to courts when registering a company or altering the status of an existing company is also reduced. These modifications constitute a step forward in the implementation of e-government and e-business projects, yet this is still a far cry from registration procedures as they are implemented in the EU or the BRIS system. 11 Legislation in BiH, until 2012, did not undergo significant modification; however the efficiency in implementation of legislation was improved. Consequently, in terms of issues of starting a business and doing business (ease of doing business), BiH was ranked 110th out of 183 national economies in 2012; in 2013 BiH was ranked 130th, and we are looking at being ranked 131st out of 189 world economies in 2014. 12 The plunge down the ranking list is not necessarily the result of absence of implementation of legislation or lack of progress; rather, to a large degree, this is due to the fact that the other analysed countries are making swifter progress in terms of adoption and implementation of legislation and economic reforms.

![Figure 2: BiH's ranking according to Doing Business indicators](image)

Source: Doing Business 2014, p. 8

Compared with the other neighbouring countries, yet again BiH has the poorest ranking. Montenegro is ranked 44th, Kosovo ranks 86th, Croatia is ranked 89th, whereas Albania holds 90th position in the ranking.

In addition to having a poor overall environment for doing business, BiH lacks regulations that would take into account the specific characteristics and needs of small and medium size enterprises and enable creation of a more favourable environment for the SMEs’ operations. Moreover, harsh and often unfair competition, which results from a significant degree of market liberalisation – an open and unregulated domestic market, constitutes yet another major problem for our companies. Also, the State does not provide adequate export incentives and, when exporting, the companies face a series of non-tariff barriers. Due to the failure to establish the quality and risk management systems in food production, our companies are not eligible for export to the EU. Small and medium size enterprises, due to size, have difficulties in attracting investments and obtaining loans. There is a high concentration of BiH SMEs in low added-value industries. The SMEs are also challenged by considerable limitations in terms of human resources – lack of a skilled labour force, inadequate professional skills of managers and weak specialist knowledge. In addition, the companies are disadvantaged by poor mobility of labour, resources and capital. Furthermore, SMEs are exposed to changes in regulatory environment – new requirements such as fiscalisation have resulted in 63,692 companies’ bank accounts being frozen and over 38,920 businesses being blocked, due to failure to meet their tax and other liabilities. 13 The SMEs account for the majority of these companies. The state lacks proper mechanisms to help the companies struggling in this situation. It is necessary to remove the identified disadvantages and obstacles. The gathering of small and medium size companies into clusters and business incubators, cross border cooperation of SMEs within the IPA projects, and internationalising strategically important SMEs may hold a considerable potential. At the moment, there are 12 business incubators in BiH, aimed at supporting start-ups, i.e. providing support to start up business. The business incubators provide logistical and expert support to the tenants – such as space, IT equipment, administrative personnel, consultants and experts. Unfortunately, most of these incubators have failed, to date, to achieve the set goals in an adequate manner; on the one hand, due to unsatisfactory support provided by the authorities, and on the other hand due to the random approach in establishing the majority of the incubators. The availability of financial resources is viewed as problematic by companies in BiH, in particular the SMEs. In BiH, this problem is reflected in a rather immature money and capital market, and hyper-liquidity of the banking sector which holds a dominant position in the financing sector. In addition, outstanding debt of the public sector hampers, to a large extent, liquidity of the real economy sector. Although liquid, banks are reluctant to approve larger, long-term loans for the real economy sector, due to the risk for their investments. A series of requirements need to be fulfilled regarding the guarantees and other forms of financial instruments. In general, bank lending to the real economy sector is characterised by high interest rates, short loan repayment periods (primarily for SMEs), high collateral rates, mortgages and various debt collection instruments. This situation forces SMEs to often borrow funds from microcredit organisations at high interest rates. Given the needs of our economy, IGA and development banks lack sufficient potential to issue guarantees, provide financial services such as factoring, etc. Throughout the world, there is a wide range of financial support instruments created to support small business development: micro-crediting, seed capital support, business angel investors, electronic financing, venture capital funds, venture (risk) capital – venture capital funds, debt (bond) market, grants, loans, guarantees, leasing, factoring. 14 Regarding administration and law enforcement, we have to mention that insolvency procedures in BiH (bankruptcy proceedings) take approx. 3.3 years. 15 In the FBiH, unlike in Republika Srpska, commercial courts that would deal specifically with business legal disputes and liquidation of companies are non-existent. Unfortunately, the instruments of out-of-court settlement and seizure of company’s assets are inadequately practiced in BiH. Also, the instrument of pre-bankruptcy proceedings is neglected in our practice, whereas the Law on Execution Procedure is characterised by considerable vagueness.

### 4. SME-related EU Obligations Assumed by BiH

In 2003, BiH signed the European Charter for Small Enterprises. In 2008, BiH signed the Stabilization and Association Agreement (it has not yet entered into force). BiH has endorsed the European Charter for Small Enterprises, thus assuming the obligations in 10 key areas: education and training for entrepreneurship, cheaper and faster start-ups, better legislation and regulation, strengthening the technological capacity of small enterprises, availability of skills, improving online access, making use of successful e-business models and developing top-class small business support, taxation and financial matters, getting more out of the Single Market, and developing stronger, more effective representation of SMEs’ interests at the EU level. Under the SAA and European Partnership agreement, BiH has assumed obligations to meet a series of requirements pertaining to the entrepreneurship sector; however it has failed to implement the majority of them. The European Partnership requirements have not been updated since 2007. EU is monitoring the implementation of the relevant principles of the Small Business Act, and BiH is in the early stage of implementation. During the sessions of

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Interim Sub-Committee for Trade, Industry, Customs and Taxation, the participants have defined the SME priorities in BiH18, which are reflected in the need to have an official, single definition of SMEs in BiH, to adopt SME Development Strategy, to coordinate and harmonise the regulations governing entrepreneurship with an emphasis on SMEs, and to transpose the relevant Acquis. However, due to the lack of progress in this area, the SME issue was not considered at the fifth (the most recent) session of the Interim Sub-Committee. Bosnia and Herzegovina 2013 Progress Report states that no progress was recorded in BiH economic policy due to the lack of coordination and strategic orientation, and failure to develop adequate accompanying statistics. Bosnia and Herzegovina has not completed implementation of the regulatory impact analysis (RIA). The regulatory environment remains complex and the regulatory burden on SMEs heavy. Economic policy actions have been fragmented and uncoordinated. BiH has made little progress in implementing the Small Business Act (SBA). The BiH Forum for Promotion and Development of Entrepreneurship continues to be inactive, whereas the SME consultative committee is still not yet fully operational. The entrepreneurship support service has not been implemented. Certain progress has been made by initiating the introduction of a countrywide unified business register and one-stop shop system. The registration procedures have been somewhat simplified. However, the EC deems that the business registration and start-up process continue to be cumbersome and costly.19

In total EUR 26 million of IPA funds available for SME and trade sectors was earmarked for BiH in the period 2007 – 2013. Most of those funds are intended for entrepreneurial learning projects, support to local development, strengthening business zones and business infrastructure. The projects that were approved in the previous years are still being implemented. Under IPA I, BiH is given an opportunity to participate in the Western Balkans Investment Framework (WBIF), which has developed a new instrument to EDIF, an Entrepreneurship and Innovation Support Programme in the Western Balkans (EDIF). EDIF, which is still in the implementation stage, will consist of four pillars: Enterprise Innovation Fund (ENIF), Enterprise Expansion Fund (ENEF), WB EDIF Guarantee Facility, and Technical Assistance Facility. WB EDIF aims to establish risk and venture capital funds for financing of innovative SMEs which are still in the embryonic stage of development. Approximately EUR 145 million of initial capital was pulled together under WB EDIF. BiH has one representative in EDIF. In addition to this, BiH under the IPA pre-accession assistance, BiH has an opportunity to participate in various EU programmes. BiH SMEs are eligible to participate in the Seventh Framework Programme for Research and Technological Development (FP 7), which aims to support cooperation between the business community and research and development institutions. With regard to IPA II funds that BiH should start absorbing as of 2014, it is necessary to draw attention to two aspects of the problem. On the one hand, there is a political problem of the lack of coordination, mechanism and consensus over the projects to be financed by pre-accession funds. Due to this, BiH is at a palpable risk of losing EUR 80-90 million under the IPA II (2014 – 2020). On the other hand, BiH has insufficient absorption capacities. Specifically, programming for IPA II assistance requires a different approach and methodology. For IPA II programming, a country is expected to have developed adequate structures; to have adopted the EU legislation; to have consolidated and harmonised the programmes and precisely defined goals founded on economic and industry policies (sectoral strategies) and indicators for assessing progress in implementation of key areas under the Small Business Act. As of 2014, under the IPA II programme, the emphasis should be placed on integrated local economic development.

5. Recommendations and Conclusions

We may reach the conclusion that instruments of support for SMEs include a plethora of measures which should be guided by the “think of the small first” principle. Business environment and regulations have to be tailored to the specific needs of SMEs and help them address their internal and external weaknesses. Also, when designing the SME support mechanisms, one should take into account the developmental stages gone through by businesses. Only through coordinated action at all levels, aided by participation of all relevant actors – representatives of legislative, executive and judicial power, entrepreneurs, development agencies, financial institutions, trade unions, international community, domestic and foreign investors, academia, and research and development institutions, can BiH achieve concrete progress in development of its economy. Any foreign investor and domestic entrepreneur will certainly be discouraged by the partial solutions, non-harmonised regulations, lack of single economic space, overlapping of competencies, uncoordinated activities, low institutional development, inadequate implementation, implementation control and punitive mechanisms, costly and time-consuming process of starting up a business, corruption, unfair competition and high ratio of shadow economy, political instability and uncertainty of investments, heavy fiscal and para-fiscal charges, underdeveloped business infrastructure, poor road infrastructure, etc. If budget stability and budget revenues are viewed as a primary goal by decision-makers, this may be detrimental in the long-term perspective. The suffocation of the private sector, resulting from the lack of the developmental aspect of the aspect which has been transformed into a social and administrative one, undermines the entire economic system. The problems, in the long run, cannot be tackled by privatising the profitable companies, selling off the national valuable assets and loan reprogramming. These solutions should be avoided by any country.

18 Directorate for European Integration: Information on EU legislation, EU financial aid and the obligations of BiH in European integration process concerning small and medium size enterprises – working materials, Joint Committee on Economic Reforms and Development, Parliamentary Assembly of BiH, page 2


About FPI BH: The Foreign Policy Initiative BH (FPI BH; www.vpi.ba) is a BiH, nongovernmental and non-profit organization founded in Sarajevo in 2004, which is dedicated to analysing international relations and Euro-Atlantic integration processes of BiH. The goal of the FPI BH is to offer assistance to state institutions in removing weaknesses and promoting values present in those processes in order to increase the efficiency of BiH institutions in fulfilling the upcoming obligations.