



**STABILITY PACT**  
FOR SOUTH EASTERN EUROPE



**INVESTMENT COMPACT**  
FOR SOUTH EAST EUROPE

**Proceedings Report**

**Workshop on Enterprise Development and Employment Generation:  
Tools to Facilitate Enterprise Development through Start-Up Support**

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**Stability Pact for South Eastern Europe**

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## EXECUTIVE SUMMARY

The Istanbul workshop organised by the Stability Pact addressed three themes which are of crucial importance in stimulating economic growth and employment generation generally, and facilitating enterprise development through start-ups specifically in South Eastern Europe (SEE), namely:

- Financial instruments: lending practices by commercial banks, micro finance banks and microfinance institutions.
- Non-financial instruments: one-stop shops for business registration, simplified tax systems such as the patent certificate, entrepreneurship education and active labour market measures.
- Tools for areas undergoing industrial restructuring: business incubation and wider experiences of stimulating enterprise and innovation in deprived areas of the EU.

The workshop brought together participants from two key Stability Pact initiatives, namely the OECD-led Investment Compact for South Eastern Europe (Investment Compact) and the Initiative for Social Cohesion (ISC). In each session, there were lively discussions, which could have continued beyond the time allotted for the workshop. A number of themes are worth highlighting:

- The discussions stressed the interrelated nature of enterprise development and employment generation, including the issues of finance, taxes, business simplification, education, training, support services, etc.
- The issue of the formal vs informal economy in the region was a recurring theme. The roles of the various partners were hotly debated, including government, banks, SMEs, international institutions etc. Given the very high levels of informal economy in the region (see Schneider, 2002), the time may be ripe for governments to make more strenuous and concerted efforts to harness it for the benefit of the economy through flexible and innovative policies.
- The informal economy was also debated in relation to the role of micro finance banks and microfinance institutions, both of which lend to small enterprises that may or may not be formally registered. It remains unclear whether such institutions fuel the informal sector or whether they impact positively on it. On balance, crediting enterprises appears to assist them to grow and become more formal over time.
- Education and training were highlighted as issues which need to be considered from the widest possible perspective, involving a long-term vision and a holistic approach (also involving the social partners), whilst also incorporating a sequence of short-term steps and objectives that deliver visible results. The region does not have the luxury of time, since very high levels of unemployment and brain drain are evident.
- The high and persistent level of unemployment, particularly youth unemployment, was a recurring theme. The presentations and discussions stressed the need for a greater focus on developing an entrepreneurial culture so that individuals, especially the youth, can succeed in business. This is particularly important since traditional forms of employment are not likely to be an option for them.

Based on the discussions and conclusions that took place during the workshop, it is recommended that the Stability Pact's Working Table II theme "Enterprise Development and Employment Generation" consider future events on the following themes:

- The role of the informal economy in stimulating employment / growth opportunities and policy measures for harnessing it as a potential source of economic development.

- The development of measures targeted at youth unemployment, since unemployment rates are exceptionally high and traditional forms of employment are unlikely to be available to this target group in the short- to medium-term.
- The development of an entrepreneurial culture, focusing on the integrated role of the enterprise sphere (Ministry of Economy, SME Agency), the education sphere (Ministry of Education, Schools, VET, Universities) and the labour market sphere (Ministry of Labour, Employment Agencies, Trade Unions, etc.).

## 1. INTRODUCTION

On the 7-8<sup>th</sup> of February 2006, the Stability Pact for South Eastern Europe (Stability Pact or SP) hosted a workshop on the issue of enterprise development and employment generation, with a particular focus on assisting the development of start-up and early growth enterprises. The workshop brought together participants from two key Stability Pact initiatives, namely the OECD-led Investment Compact for South Eastern Europe (Investment Compact) and the Initiative for Social Cohesion (ISC).

As part of its objective to facilitate sustainable economic development underpinned by strong social policies, one of the key tasks of Working Table II (WTII) of the Stability Pact is to ensure a convergence between traditional economic development activities and the necessity for social cohesion. Economic growth and political and social stability cannot be achieved without simultaneously addressing the persistently high unemployment rates in South Eastern Europe (SEE) and stimulating enterprise development. Therefore, WTII developed the umbrella theme "Enterprise Development and Employment Generation," which involves a series of activities that complement and enhance existing Stability Pact initiatives in areas such as the Investment Compact, the European Charter for Small Enterprises and the Bucharest Employment Process.

Under this theme, the Stability Pact provides a forum that brings together SEE and international experts from the economic and social worlds, allowing them to share experiences, exchange views and co-ordinate actions. Several events have already been organised, which have addressed issues related to entrepreneurship and employment creation such as:

- Conference on Entrepreneurship and Employment, Bucharest 26<sup>th</sup> May 2004.
- Seminar on Regional Aspects of Promoting Entrepreneurship and Employment, Skopje, 9<sup>th</sup> November 2004.
- Workshop on Training for Employability, Thessaloniki, 21<sup>st</sup> – 22<sup>nd</sup> April 2005.

Responding to recommendations made at previous events, the Istanbul workshop focused on how the high level of unemployment in the region could be addressed via various initiatives involving enterprise development and start-ups. The workshop was designed to facilitate dialogue between institutions responsible for enterprise development, such as Ministries of Economy and SME Agencies, and their social cohesion counterparts, such as Ministries of Labour, Employment Agencies, social partners, etc., concentrating on the following themes:

- Financial instruments: lending practices by commercial banks, micro finance banks and microfinance institutions.
- Non-financial instruments: one-stop shops for business registration, the simplified patent tax, entrepreneurship education and active labour market measures.
- Tools for areas experiencing industrial restructuring: business incubation and wider experiences of stimulating enterprise and innovation in deprived areas of the EU.

This aim of this Proceedings Report is to highlight the trends being experienced in the SEE region, provide an overview of the key information presented by each speaker, as well as a flavour of the discussions that took place. Policy tips are presented for practitioners (policy dos and don'ts), as well as recommendations to the Stability Pact for further activities in the field of enterprise development and employment generation (see

Executive Summary). All presentations made at the workshop referred to in this paper can be downloaded from [www.stabilitypact.org](http://www.stabilitypact.org).

## **2. FINANCIAL INSTRUMENTS TO SUPPORT NEW/SMALL BUSINESSES**

Access to finance is a prerequisite for the development of the enterprise sector. All firms require external finance at some stage of development, be it start-up, survival or growth. In theory, a large number of sources of finance are potentially available for enterprise development such as: internal funds including family and friends, retained earnings, commercial banks, stock markets, equity funds, remittances, leasing facilities, government sources, NGOs, donor programmes, informal sources, credit cards, etc. However, in practice, firms in the SEE region identify the lack of finance as being the principal barrier to growth and development. The first set of papers at the workshop therefore, addressed the following dimensions of SMEs' access to finance:

- The role of commercial banks, based on the experience of the EBRD.
- The role of micro finance banks, focusing on the ProCredit bank network.
- The role of Micro Finance Institutions (MFIs), focusing on Moznosti's experiences in Macedonia.

### **2.1 Commercial Banks**

The information below is based on the presentation made by Ms. Francesca Pissarides (Chief Economist's Office, EBRD) "Start-ups Finance," the discussions that took place, as well as the "Issues Paper" prepared for the Conference.

#### *Background*

The main source of funding for enterprise development, especially start-ups, is typically internal sources both in the SEE region and elsewhere. Commercial banks, as a rule, rarely consider new enterprise investments (start-ups) as potential clients. The main reason for this is that banks require a track-record so as to access risk and credit worthiness. Start-ups, by definition, have no history, no way of proving profitability and often limited collateral to offer. More generally, although the commercial banking sector plays an important role in relation to large enterprises (e.g. Bulgaria and Croatia), it meets a relatively small percentage of the funding needs of SMEs. The situation is beginning to change in the SEE region due to developments such as stronger competition following privatisation, participation of foreign banks and greater confidence in the banking sector leading to an expansion of deposits and lending. Much of the increased lending is being directed at households (easier to manage risk and more profitable), but is also leading to higher levels of domestic credit to the private sector, including the SME sector.

#### *Presentation*

Surveys illustrate that although the scale may vary the main problems that SMEs face are similar. The top three barriers to starting-up a business are typically access to finance, followed by fear of indebtedness, as well as fear of losing income and financial security since homes are typically the main asset that is mortgaged to finance start-ups.

The sources of finance that feature strongly when entrepreneurs wish to start-up include own savings (savings, mortgages, personal loans, credit cards, etc.), followed by friends and family, since they typically know the entrepreneur, can assess whether s/he is a safe proposition and typically offer easier terms and conditions than financial institutions. According to the Global Entrepreneurship Monitor (GEM, 2005), most entrepreneurs are still funded through the "4Fs" of informal investment, namely: founders, family, friends and foolhardy strangers. On average, founders supply 66% of their start-up financing. Venture capital is often discussed as a source of finance for start-ups, however, for every

new venture funded by venture capital, there are more than 10,000 financed from entrepreneurs themselves. This suggests that policy makers should pay much more attention to informal investors and less to venture capitalists. Remittances are also important in the SEE region, though they are mainly channelled into consumption, rather than start-ups. Grants may also be made available through governments and donors to stimulate banks to lend more to start-ups.

However, commercial banks typically do not lend to start-ups. The reasons are simple. Banks typically examine whether the gearing ratio (bank's contribution vs owner's) exceed 1:1 or not. But the key issue for banks is whether the borrower has the ability to repay the loan or not. The only way of knowing this is to look at the entrepreneur's history of repayment. Start-ups typically lack the latter. If it is not possible to prove credit worthiness, banks should not be encouraged to lend, as this would contravene good banking principles.

Entrepreneurs can do some things to increase their chances of obtaining funding such as: create a credible business plan, provide evidence of a successful track record in business (such as the establishment of a new company), provide security (collateral, personal guarantee, etc.), as well as provide a significant own contribution. Yet, banks find it difficult to lend to start-ups in the Stability Pact area because of issues such as:

- Firms do not know how to prepare business plans, especially very new or small firms.
- There are low entrepreneurship levels, so it is quite rare for an entrepreneur to have a previous business record (compared with countries of the European Union).
- It is difficult for banks to collect collateral or, in the absence of public registers of collateral, it is difficult to find out if collateral has already been pledged.

Nevertheless, there are some exceptions. For example, through micro finance banks (see below) EBRD funding is made available to very young companies (3-6 months old). This is typically for companies and/or business which are well-known to the lender, for example, in relation to the retail trade and where small amounts of finance are involved. Indeed, it is estimated that some 7-8% of all outstanding micro finance bank loans are to firms of this type. But, with some exceptions, commercial banks are not the best place to look for start-up finance.

### *Discussion*

- Domestic credit to the private sector as a percentage of GDP is increasing in the region, especially in Romania and Bulgaria. But in terms of who is benefiting from this increase, it is households (except Bulgaria and Croatia), which means that foreign owners prefer to focus on households first, since this is a safer bet than the enterprise sector and more profitable. Competition may lead to a greater focus on enterprises.
- Governments should not be encouraged to change banks' lending preferences through regulations. If a bank is not interested in lending to SMEs, it will not do so, however, EBRD and others can demonstrate to banks what is profitable or not, such as the fact that the micro finance banks are both viable and highly profitable in SEE.
- Remittances offer scope for start-ups and development. Work is underway to ensure that migrant workers' cash is converted into enterprise development however, this is a complex topic. Barriers include stringent money laundering regulations which means that only legal migrants can do these transfers through banks. Money transfers are also made through Western Union-type institutions, which charge low fees. However,

their exchange rates are very high, which means that a large proportion of funds transferred are lost through fees.

- Discussion revolved around the possibility of using guarantees to assist start-ups, for example in Kosovo where the government would take on 80% of the risk and banks 20%. However, the mortality of start-ups is very high, so banks would finance firms knowing that someone else (Government) would cover 80% of the risk. As a result, a lot of money is likely to be lost and Governments would need to assess the value of doing it. It was also discussed that there should be a fund especially to assist young people to start-up their own businesses.

### *Policy Tips*

- Access to finance: this remains the number one problem for firms (and not just in the SEE region), however, this is not a market failure as far as start-ups are concerned.
- Support to entrepreneurs: if business ideas are to come to fruition, the first thing for entrepreneurs to learn is how to create a realistic and credible business plan. Policy makers can help by developing demand-driven business development services. Entrepreneurs must also be trained to make effective use of their previous business record as the basis for persuading financial institutions to lend.
- Collateral regulations and registers: It remains difficult for commercial banks to collect collateral and, in absence of public registers of collateral, it is difficult to find out if collateral has already been pledged. Policy makers can assist by ensuring that such regulations and registers are put in place in the SP region.
- Grants for start-ups: governments and donors should not encourage banks to lend to start-ups, for example through highly subsidised loans / grants, as this may work against basic good banking principles.
- Venture capital: venture capital is much discussed but relatively unimportant for start-ups. In GEM countries, finance from entrepreneurs and informal investors pours 3.6% into GDP compared with only 0.1% from classic venture capital.
- Formal sources: instead, policy makers should focus on harnessing other sources of finance, such as effective ways of channelling remittances to start-ups, rather than consumption.
- Leasing: greater consideration needs to be given to alternative sources of finance for start-ups, such as leasing and microleasing for example, if equipment is important to enterprises.
- Guarantee schemes: policy makers should avoid state-funded guarantee schemes. Public employees are not loan officers and are not in a position to allocate scarce funds more effectively than financial institutions. If these are created, the proportion of risk taken by government should be at least the same as that taken by the banks (e.g. 50 / 50).

## **2.2 Microfinance Banks (MFBs)**

The information below is based on the presentation made by Ms. Elvira Lefting (Global Development Services) "Microfinance in Practice – Lessons Learned from Microfinance Banks," the discussions that took place, as well as the "Issues Paper" prepared for the Conference.

### *Background*

Microfinance typically relates to the provision of small loans (microcredit) to the economically active, thus assisting entrepreneurs to develop their small, usually micro, businesses. Traditionally, microfinance has been synonymous with a credit methodology that employs collateral substitutes to deliver and recover short-term, working capital loans to potential and existing micro entrepreneurs. The distinguishing characteristics of microfinance include an insistence on repayment via interest rates which cover the costs of credit delivery; a focus on creation of sustainable local microfinance institutions; and diversification of the range of instruments which enable clients to build assets and protect themselves against various risks. The target group is typically non-bankable clients, namely those who do not have access to commercial banks, such as the self-employed small entrepreneurs. In rural areas, this includes small farmers, small-scale food processors and petty traders; in urban areas activities are more diverse, including shopkeepers, service providers, artisans, street vendors, etc. In the Stability Pact countries, the most active MFB has been the ProCredit bank, which has now spread to all countries except Croatia and Moldova (Moldova has a ProCredit Finance Company, but this is in the stages of transforming into a bank). The ProCredit bank is growing rapidly in terms of loans, branches, products, etc., therefore, its experience is instructive in terms of the impact on start-ups and early growth enterprises.

### *Presentation*

From a historical perspective, the situation confronting small enterprises in the 1990s was much worse than today, with very high levels of inflation, poverty, political instability, etc. This volatile situation meant that financial institutions had a risk aversion to almost all clients, especially SMEs. The commercial banks could not conceive of lending to SMEs due to the legacy of banks channelling state funds to industry, the limited lending skills / credit technology and the fact that lending decisions were based on collateral security, connections, size and significant administrative requirements. Moreover, the combination of risk aversion to lending to small businesses generally and relatively easy money to be made on non-credit operations meant that funds were channelled into instruments such as Treasury bonds. This was compounded by the fact that Government and donor credit guarantee programmes and subsidised credit lines often misdirected resources and/or delivered poor results, thus reinforcing commercial banks' views of SMEs as high risk investment propositions.

The MFB approach (ProCredit Bank) devised with EBRD input was to:

- Provide sustainable access to financial services to small enterprises not catered for by the formal financial sector (working capital for recurring needs, longer term investment capital and other financial services e.g. remittances, deposits, etc.).
- Provide loans in line with the real finance gap, namely with micro loans (\$10 - \$10,000), small loans (\$10,000 - \$200,000), with an average loan size of < \$8,000 and average "express-micro" size < \$1,000.
- Provide loan products and requirements to the needs of small enterprises (i.e. lending decisions based on cash flow not assets, on merits not business plan/paper trail and sometimes first-time borrowers without a formal credit history). The focus was on cash-flow not assets, brains not connections.

This resulted in new MFB institutions (ProCredit) combining the following characteristics:

- Transparent ownership and political independence.
- Clear mission and mandate to focus on development of small enterprises.

- Credit technology adapted to the specifics of small enterprises (analysis of reality of businesses).
- Loan processing / monitoring to handle inherently higher transaction costs.

As of December 2005, the main effects of MFBs in the SP countries were:

- Loans outstanding to small enterprises: 156,000 loans worth \$875 million (expected to reach \$1.5 – \$1.8 billion by the end of 2006).
- Monthly lending to small enterprises in SEE region: 15,000 loans worth \$118 million.
- Branches/outlets: currently 170 but expected to be 350 by end of 2007.

In terms of who benefits from ProCredit loans, the following information is available:

- 92% are first time borrowers in the banking sector, suggesting that there is significant demand which few financial institutions are catering for.
- Average age of financed small enterprises is about 1-2 years.
- Average loan maturity is 12-24 months (compared with 4-5 months in the past).
- Mortgages account for only 15% of loan security, with loans typically secured by personal guarantees, assets, working capital, etc.
- Economic sectors obtaining funding: 10% agriculture; 20% industry/production, 10% transport/tourism and 60% trade/other/mixed. Agriculture has gone from a very low base (0.5%) to become an increasingly important part of the portfolio.

Other side benefits include the fact that MFBs are fuelling competition in the banking sector, increasing the relevant information base for credit bureaux/registries, pushing improvements in the legal and regulatory framework for small enterprises, contributing to IT innovations (e.g. on-line banking), improved payment/settlement systems, etc. Moreover, MFBs will grow regionally, especially in rural areas and other banks are following.

As a result of the MFBs, many small enterprises in the region have become bankable and lending to the small enterprise sector is no longer stigmatised. Nevertheless, financial institutions still need to be careful in lending to small firms. MFBs have resulted in greater competition, which in turn has impacted on the interest rates and maturity lengths for small firms. ProCredit banks do assist some start-ups (businesses as little as 3 months), but firms still need previous experience, to contribute at least 30% of costs and have realistic business plans. MFBs do not focus specifically on start-ups. This will not change.

### *Discussion*

- There has been year-on-year growth of about 100% in MFBs, growth in deposit taking (e.g. in rural areas); good rates of return are being achieved; and there is no reliance on donor funding any more, unlike NGOs.
- It is unclear whether MFBs fuel the informal sector (since they lend to both registered and non-registered firms) or whether they impact positively on it (since by obtaining loans they are more likely to register formally). The issue of fighting the informal economy is principally the role of government, not the role of banks. ProCredit attempts to help enterprises to become more formal, rather than exclude them from accessing finance from the beginning. Access to finance may enable, for example, street traders to become motivated to formalise their businesses as they grow.

- Some institutions charge what some consider to be usurious interest rates (an MFI charges 48% interest rate in Montenegro due to lack of competition) raising the question of whether such institutions should be allowed to do this. What is clear is that banks must provide finance to the SME sector on a commercial basis, otherwise they will close down. Interest rates will be driven down by greater competition.
- Although it is hard to assess what is the real cause of employment generation, MFBs have contributed to it. An EBRD survey shows that borrowers who have repeat loans have increased employment over time by about 30%. 400,000 loans have already been made to 300,000 firms. On average such firms started off with 4-5 employees but now have 7-8 employees.
- The survey of 4 countries (those who receive a loan and those that did not, involving a sample of 13,000 firms) proves that there was net job creation but this is not very important for small loans. Loans of \$5000 – \$30,000 have a bigger net impact on employment generation. If the loans are larger than \$30,000, they may lead to employment substitution as equipment that replaces labour.

### *Policy Tips*

- MFBs fund start-ups, but rarely. Such businesses need to have realistic plans and assumptions and have access to sufficient collateral. Although this will not change because of the risks involved, MFBs are funding very young firms (3 months old), though these are likely to be in the trade sector, rather than production.
- Lending to small enterprises is not risky: less than 1% of payments are overdue for more than 30 days across all sectors and sizes of small enterprises. With appropriate loan technology, MFBs attain better repayment performance than commercial banks.
- Unlike the normal assumptions, small enterprises are not interest rate sensitive but see loan application processing time and entry barriers as key factors. They want quick and simple access.
- Small enterprises require a full range of financial services (deposit taking, international transfer, etc.) rather than only access to credit.
- MFBs' high transaction costs can be lowered but not overcome. MFBs will always be more expensive since they need to establish a close relationship with clients to get/retain business.
- Deposit mobilization and capital market funding are crucial to enable MFBs to grow in line with existing demand from small firms, since there is 100% year-on-year asset growth. Donors must think big if they want to have nation-wide impact for a wide range of businesses.
- Although commercial banks are aware of the impact of MFBs, they are failing to draw the lessons. They still will not lend to new enterprises and are not interested in clients below \$3,000 - \$5,000. But they are happy to take on the new bankable clients and employ MFB-trained staff. Commercial banks are profit maximising; MFBs are not and should not be.

### **2.3 Microfinance Institutions (MFIs)**

The information below is based on the presentation made by Mr. Ilija Belevski ("Možnosti" Savings House) "Complementary Role of NGO Micro-Finance Facilities: Case Study on Macedonia", the discussions that took place, as well as the "Issues Paper" prepared for the Conference.

### *Background*

As far as both new and small businesses in the SEE region are concerned, an important development has been the establishment of Microfinance Institutions (MFIs), usually in the form of Non-Governmental Organisations (NGOs), as a dedicated mechanism of financing small enterprises. Such MFIs have traditionally used donor grants and soft loans to target various forms of non-bankable client with varying degrees of success. However, as such sources of funding begin to dry-up and the commercial pressures from both commercial banks and MFBs increase, the ultimate goal of MFIs is transforming into financially sustainable financial organisations that become a permanent feature of the financial system. A typical goal is to be able to take deposits and draw down commercial funding sources, thus enabling MFIs to expand their activities and outreach, whilst not losing their traditional focus and target groups, especially those established for the more vulnerable groups.

### *Presentation*

The Macedonian banking system consists of 9 banks and 13 saving houses, most of which deal with small enterprises, typically charging interest rates of 7%-19% and requiring collateral in the form of property. There are also two saving houses, namely Moznosti and Fulm. "Moznosti" was the first Macedonian MFI, having been founded in 1996 as a non-profitable NGO. Its mission is to help people start or develop their businesses in order to create income and to create new jobs. As such the key target groups include: private enterprises / legal entities, individual producers (agriculture & craftsmen), women entrepreneurs and the self-employed. These fall squarely into the "non-bankable" client category.

The success of Moznosti's early activities led to the enlargement of the range of loan products and services available to target groups, resulting in the creation of the Savings House "Moznosti" in 2000. It now has 56 employees working in 9 branches and during 1996 - 2005 disbursed over 17,000 loans (over Euro 50 million). This is estimated to have contributed to sustaining 18,000 jobs, as well as creating 6,000 new ones.

Moznosti's portfolio of business loans is typical of the MFI sector, including:

- Loans for working capital and turnover assets for small enterprises (up to Euro 100,000; term of up to 12 months; grace period up to 3 months).
- Long-term loans for agriculture producers (loan up to Euro 12,500; term of up to 60 months; grace period up to 36 months).
- Other products: consumer, housing, student, revolving loans, personal / group loans.

In December 2005 Moznosti had 5,300 active clients, a loan portfolio of Euro 13,2 million, client deposits worth Euro 1 million and credit lines worth Euro 6,9 million. Its operational sustainability is estimated at 125 % and its loan loss ratio (reserve/portfolio) is 5.2%.

### *Discussion*

- MFIs are finding it increasingly difficult to access donor funding and it is essential for MFIs to access other sources such as mobilising savings. More generally, MFIs are becoming more commercially oriented. Moznosti is moving in this direction.
- Financial markets are getting stronger but unemployment is still increasing, for example, in Bosnia and Herzegovina. 95% of the banks are foreign owned, but they

continue to lend to consumers rather than businesses, which may be partly due to the poor business environment.

- EBRD is providing MFB support and credit lines for enterprises. 90% of MFB loans are under \$10,000 and go to small firms, and a relatively large number of loans go to medium sized firms. The average size of SME loans is much larger (up to \$1 million) and tends to be accessed by medium sized firms. EBRD also had various products to support enterprise development such as equity finance, leasing and investment.

### *Policy Tips*

- MFIs play an important role in crediting non-bankable clients.
- MFIs can make decisions much more quickly than commercial banks (3 days).
- MFIs are very flexible and open for co-operation on any level.
- MFIs accept different types of collaterals than just property.
- There is direct client contact through regular field visits (not only paper records).
- Continuous follow up of clients and feedback are essential for successful MFIs.
- MFIs typically provide technical and financial assistance for at least 6 months to ensure success of start-ups.
- The experience with crediting start-ups is positive (e.g. small traders have started with market stalls and have become registered and expanded their activities).
- Commercial pressure is forcing MFIs to transform into financially sustainable financial organisations that become a permanent feature of the financial system.

### **3. NON-FINANCIAL INSTRUMENTS TO SUPPORT NEW/SMALL BUSINESSES**

SMEs account for 98.1% of all enterprises in the SEE region, which is not very different from the situation in the EU-19 region (Union 15 + Iceland, Liechtenstein, Norway, Switzerland), with an average of 99.8%. However, the region lags significantly behind in relation to other indicators: the SME density is extremely low (13.7 per 1,000 inhabitants Vs 52.8 in the EU-plus countries); SMEs are less important employers (average of 47% of total employment Vs 66%); and the share of the private sector in GDP is still relatively low (ca. 60% - OECD, 2003). The evidence is that in addition to access to finance, small firms, especially start-ups, require other forms of support if the current levels of entrepreneurship are to be exceeded. Numerous barriers confront small enterprises in the SEE region such as the onerous tax system, the excessive burden of bureaucracy, the lack of adequate infrastructure, the extent of corruption and bribery, the unfair competition from the informal economy, etc. Therefore, the second part of the workshop focused on four dimensions of non-financial support to small enterprises:

- The necessity to enhance business start-ups through simplified procedures such as the one-stop shop system of business registration and re-registration.
- The necessity to streamline the tax system through measures such as the patent tax, which delivers a clearer and simpler tax for small enterprises.
- The necessity to enhance the entrepreneurship culture in the region, and in particular to establish a model for innovative enterprise learning.
- The necessity to reduce the very high levels of unemployment, especially long-term unemployment evident in the region through active labour market measures.

#### **3.1 Active Labour Market Measures**

The information below is based on the presentation made by Mr. Nick Maddock (UNDP Regional Office, Bratislava) "Government support for employment generation: the role of active labour market programmes," the discussions that took place, as well as the "Issues Paper" prepared for the Conference.

##### *Background*

The unemployment rates in SEE are very high despite recent economic growth in the region. Recent analyses of unemployment statistics illustrate that there is a high level of long-term unemployment (usually over 70% have been unemployed for longer than one year). Moreover, youth, women, minorities and the less well-educated are disproportionately affected. Even allowing for the countervailing influence of the informal economy, the unemployment situation is exceptionally problematic. It is, therefore, necessary for policy makers to consider interim solutions to the chronic unemployment, pending the expected upswing in labour markets, such as providing work experience to the long-term unemployed and/or other groups most seriously affected by unemployment. This can facilitate reintegration into labour markets and generally reduce social tensions in areas exhibiting high unemployment and poverty rates.

Active Labour Market Policies (ALMPs) support employment creation in two basic ways: directly (job-creation measures such as public works and enterprise creation, as well as hiring subsidies), which is the focus of the workshop discussion, and indirectly (improving employability through training and by ensuring efficient labour exchanges that provide better labour market information and enhanced job matching). However, as in the case of EU countries, including the new member states, SEE countries are experiencing varying degrees of success in relation to the direct approaches. It is generally recognised that

although ALMPs are important weapons in the fight against unemployment and poverty, they produce mixed results. It is thus necessary to compare experiences to ensure that ALMPs become more effective.

### *Presentation*

The unemployment rate in the SP countries is very high, of long duration and disproportionately affects the young and ethnic minorities. There are limited within country disparities in job creation and destruction but large within country disparities in unemployment, reflecting regional differences in downsizing and restructuring in the initial years of the transition. Private sector job creation performance is better than that of the public sector and smaller firms do better than larger firms but the job creation rates in the region are very low in comparison with, for example, the CEE region at a similar stage of its transition. Reasons for this include:

- A business environment which constrains firm formation and expansion.
- Employment protection legislation which constrains job creation.
- Comparatively high average wages (high minimum wages) limit competitiveness.
- High tax wedges on employment reduce job creation.

There is also evidence of skill and spatial mismatches (i.e. workers in the wrong place with structural limitations on job-related mobility) and inappropriate skill-sets. This means that, despite steady economic growth, the impact of job creation is muted because firms hire within industries and regions and labour-shedding firms accept lower staff levels.

In this context, there is a role for ALMPs in combating unemployment - although ALMPs do not create jobs (except via temporary job creation schemes) they do help correct market failures. Furthermore, their impact tends to be more positive when there is economic growth. It is estimated that there are still relatively low expenditures (0.25% of GDP) on ALMPs in transitional countries compared with OECD countries (0.75% of GDP). Further increases in ALMP spending in OECD countries are likely as the on-going shift from active to passive labour market measures takes effect. The typical measured are discussed below.

### *Emergency measures*

- Short-term job creation through public works: provide a safety net in areas where unemployment spikes are sharpest, with secondary benefits in labour intensive, low technology clean-up and infrastructural rehabilitation, sometimes linked to other measures such as personal employment planning. These have been extensively used in post-combat areas as emergency interim measures pending an upswing in the labour market. The general experience has been very high unit costs, with the consequence that donor part-funding is normally essential. Although it has the lowest overall net impact of all ALMPs, there are significant positive net impacts for the long-term and older unemployed, those with low education and those living in areas of very high unemployment. Generally there is no evidence of increased labour force attachment or increased probability of employment, although there is evidence of enhanced employment for the poorest groups. Evaluations in Slovakia, Slovenia, Ukraine and Macedonia suggest a positive impact on transition into employment immediately after the programme ends, but no positive effects if a job had not been found within 3 months. It also has negative impacts on earnings and employment, with youth employment particularly negatively affected by participation.

### *Correcting skill and spatial mismatches*

- Employment information services: aim to provide the unemployed with information on jobs (labour market information) and help with job search, thus shortening unemployment spells. Variants include job clubs, vacancy / job fairs and special assistance programmes for vulnerable groups, typically provided by the local employment office. The evidence from OECD countries is that organised support of this nature can be crucial in helping the unemployed to find the next job. There have generally been positive results, especially if there is economic growth, except in areas of rising unemployment. The unit costs have been found to be low, albeit with some deadweight losses. The main impacts are on unemployment duration, including groups which have longer unemployment spells. It helps all the unemployed get jobs, but the strongest effects are with women and single parents, and much less for prime age men and older workers.
- Vocational training: aimed at the individual unemployed, retraining workers in mass lay-offs and retraining for young workers. Some countries allow sacked workers to choose between training and severance pay. There have been positive employment impacts, especially in transition countries, and some positive earnings effects, although with some deadweight losses. There are low costs per additional job. Training with a guaranteed job at the end works best for those with low education, while training without a job works best for youth. There are no significant net impacts for those with higher education. The impacts are more positive for young people and the middle-aged, and in areas of high unemployment.
- Retraining workers after mass layoffs: there is limited evaluation evidence in this area, but very positive results have been recorded from support to demobilised soldiers in BiH, with significant positive impacts for all sub-groups regardless of age, gender or level of education.

### *Reducing labour costs*

- Wage subsidies: a temporary measure inducing employers to recruit additional workers. Evaluations from transitional countries are generally negative, in other words there was no net employment or earnings gains. However, better results have been established in OECD countries where subsidies were used as a way of screening workers. In Bulgaria, there was a positive net impact across all education, gender and age categories except the older unemployed. Poland recorded positive and lasting impacts, especially when programmes lasted longer than 6 months, however, no lasting impact has been recorded in the Czech Republic and there were even negative impacts in Turkey and Hungary. Generally, it can be argued that it works better for those with primary and secondary education.

### *Stimulating self-employment*

- Self-employment schemes: these usually commence with compulsory attendance at an orientation seminar, followed by training and counselling to improve applicants' entrepreneurial skills (e.g. business planning, marketing, legal matters, tax and accountancy). Support is provided for the development of a business plan and subsequent support is normally delivered through business advisory services. The evidence is that the take-up is generally low (usually up to 5% of the unemployed) and beneficiaries are primarily male (very few female participants) who are well educated, in their 30s and recently unemployed. Benefits, therefore, accrue to a small sub-set of potential beneficiaries, with screening of applicants justified in order to maximise benefits. The emphasis is normally on self-screening based on requirements for a detailed application, a preliminary business plan and training. This measure is, however, associated with high rates of business survival. Strong positive

impacts have been recorded on employment in some countries. For example, the probability of employment increased by 43% in Bulgaria, but was much lower in others countries (6% of participants in Macedonia set up their own business). It has a slightly greater impact on the long-term unemployed.

### *Discussion*

- A new policy package is emerging which focuses on business environment reform (firms still find it difficult to be registered and develop) and employment protection legislation reform (it is expensive and difficult to fire people). A new balance is being struck between job security and ability of firms to adjust the labour force in response to circumstances. For example, Macedonia has become much more liberal (short term contracts, private employment agencies, etc.). Reform of payroll taxes is also important since they are very high and act as a disincentive for employment.
- Macedonia started working on ALMPs in 1996. Independent analysis in 2002 showed that the net impact of ALMPs is reasonable, resulting in new government measures. ALMPs are a crucial tool for Government in fighting unemployment. Packages of services were introduced: job counselling, on-the-job training, vocational training, public works (quite expensive - \$7000 per person), direct consulting services and business incubation providing real support.
- Structural factors limit the scope of ALMPs. For example, an analysis of the gross monthly wages compared with productivity per worker suggests that SEE countries are much more expensive and have much lower productivity levels than many central European countries. Therefore, unless productivity is increased or wages are reduced, it will be difficult to increase employment in the SEE region.

### *Policy Tips*

#### *ALMPS:*

- Ensure sufficient funding at the outset so that ALMPs are not terminated early.
- Assess and screen applicants in order to limit deadweight losses / increase cost effectiveness.
- Commission frequent net impact evaluations.
- Encourage partnerships of key stakeholders at the local level, involving municipalities and education/training institutions.
- Concentrate expenditure on public employment services and vocational training, especially if there is evidence of skill and/or spatial mismatches emerging.
- Enable private employment agencies to supplement or replace public employment service functions and provide a private sector job matching service.
- If possible, contract out ALMP activities on performance-based contracts.
- Target expenditure on short term job creation in areas where unemployment spikes are sharpest, there is a danger of social unrest and where safety nets are non-existent. These have very high unit costs and are increasingly becoming unpopular with donors.
- High returns to support to self-employment make this attractive, but needs to be supported by 'after-care' through business support agencies and availability of credit for start-ups.

#### *General Labour Market:*

- Accelerate privatisation, with attention to resolution of accumulated contingent liabilities

(unpaid wages, severance pay, unpaid pension and health insurance).

- Relax employment protections (to facilitate the reallocation of jobs away from less to more productive firms), but improve compliance so that core rights are protected.
- Review minimum wage rate policies (e.g. Macedonian minimum wage currently at 65% of average wages compared to 24% in Slovakia and 33% in Slovenia).
- Introduce lighter employment legislation for smaller firms.
- Allow temporary contracts for longer total durations.
- Introduce apprenticeship terms and lower minimum wages for apprentices / young people.
- Make it easier to do business in order to encourage firm entry and expansion, and reduce the non-business risks on firms.

### **3.2 Entrepreneurship Culture and Learning**

The information below is based on the presentation made by Mr. Anthony Gribben, (European Training Foundation) “Entrepreneurship Learning: Obstacles and Opportunities,” the discussions that took place, as well as the “Issues Paper” prepared for the Conference.

#### *Background*

Progress is being made in the SEE region to develop a culture of entrepreneurship, but the education systems are not yet fully capable of promoting entrepreneurship. For example, activities targeted at promoting entrepreneurship at primary and secondary level mainly take the form of optional and extra-curricular courses, and although some national initiatives exist, these are primarily donor-supported. At post-secondary level, some courses are offered by public and private universities. As for enhancement of the levels of entrepreneurship of the adult population outside the formal education system, actions currently focus mainly on “how to create a new business” and on providing training and consultancy services to managers of existing businesses. These tend to be organised by networks of local/regional business centres and employment services, often supported by donors. These and similar initiatives are encouraging, but SP countries can do more to incorporate entrepreneurship into the educational system in a comprehensive manner. As noted in the EC report on the Charter for European Small and Medium Enterprises (January 2004) for the Western Balkans and Moldova, developments in all these fields are gradual and need to be further and systematically promoted. Part of the workshop was, therefore, devoted to the issue of enterprise learning.

#### *Presentation*

Entrepreneurship learning is defined in the EU Charter for Small Businesses as what happens in the education system (chapter 1) what happens inside businesses (chapter 4) and technological issues (education environment contributing to business opportunities - chapter 8). This is about developing a mind-set which contributes to growth, as well as knowledge, such as business skills captured for the development of business. Although it is not well understood, something has to happen early on in people’s education that creates interest, motivation, risk-taking, etc., all important components of what make a successful entrepreneur.

Much effort is going into vocational training but insufficient attention is paid to the costs and benefits of these activities. The evidence is that investment in the wider education system may be more effective, however, there is a strong culture of short-termism in Europe. For example, many SP country policies are being driven by international organisations, which may have a short-term focus due to the system of annual programming involved.

Based on the Charter reports, a number of key obstacles to entrepreneurship learning can be identified:

- There is a lack of common understanding or vision among key stakeholders on how the education system can underpin economic growth.
- There is currently a patchwork of singular policies (e.g. education, research, employers, etc.) and a scatter of activities which hinder development.
- There are excellent examples of good practice, especially in the secondary education system, which are typically donor-supported, but these are rarely mainstreamed.
- Early start: there is a need to sow the seeds of the entrepreneurship culture from an early age.
- The educational curriculum and teacher training needs to be rethought to reflect the economic values and ambitions of the country in question.
- In the EU a key theme is 'core competences' and entrepreneurship is such a competence. Skills such as innovative ideas, time-keeping, teamwork, problem solving, etc. are qualities that employers look for in their staff.

There are also opportunities if policy makers look at the process in a holistic manner:

- Broader policy frameworks are developing and there is a need to create a national perspective.
- Create an alliance on entrepreneurship learning, with a single vision and objective.
- The reform process in the education sector is on-going.
- Countries need to take note of the EU (Lisbon) process so that employment becomes part of the efficiency and equity agendas, leading to more balanced development.

### *Discussion*

- There is indeed a need for a long-term vision but there is also a need for results in the short-term. Treading a middle path may be the way forward. For example, universities are beginning to show results in terms of entrepreneurship programmes such as in Osijek University, but only after 5 years of hard work.
- It is crucial for an entrepreneurship culture to be developed in the SP countries. This is clearly linked with the issue of unemployment, the key theme of this workshop. The very high level of long unemployment, particularly youth unemployment, is not simply an issue of economic development. It is also about social development and there is a need for a greater focus on developing an entrepreneurial society so that individuals, such as the youth, can succeed in business. Donors should focus on this issue in the Western Balkans.
- There was once a high quality education system, but due to the break up of the former Yugoslavia and the associated conflicts, a generation has missed out on their education and they are now becoming parents. Evidence suggests that if parents have not benefited from education, there will be knock-on effects on their offspring.

There is a need for policy makers to consider “second chance” education for that generation.

- There is a lot of interest in vocational education but there is increasing evidence that investment in the broader education system may actually have a better pay-off. For example, in BiH those benefiting from vocational education are more likely to be unemployed or in informal sector than those exiting the secondary education system. This raises the question of whether there needs to be more investment in the general education system, rather than on vocational education.

### *Policy Tips*

- Drop the idea of short-termism. The vision needs to be reset and entrepreneurship will be an important part of the overall competitiveness agenda.
- Policy makers must come ‘out of their boxes’ and set a holistic agenda for entrepreneurship learning.
- Focus on early education – early start pays off, as per experience in Ireland.
- Self-employment is a policy “blind-spot” which needs to be addressed through the education system. Lifetime employment is no longer an option for all, therefore, certain groups such as ethnic minorities and youth would benefit from a greater focus on self-employment.
- Build in measures, indicators and statistics to measure performance.
- Do not import all models and solutions suggested by donors. Manage donors to attain results.
- Do not waste resources by having different organisations working on the same issues.
- School / enterprise cooperation through Schools Boards helps educational establishments to connect to the wider economic environment through its governance arrangements.
- University science and technology streams, R&D activity, etc. need to rethink in terms of focusing on business opportunities.
- Look at the national framework to decide how entrepreneurship learning can better contribute to competitiveness and equity agenda.

### **3.3 Simplified Start-ups: the one-stop shop**

The information below is based on the presentation made by Ms. Raluca Martin (National Agency for SMEs and Cooperatives) “One Stop Shop for Business: Romanian Achievements,” the discussions that took place, as well as the “Issues Paper” prepared for the Conference.

#### *Background*

Entry and exit obstructions and other administrative obstacles may be mere irritants to small enterprise development in general, but in the SEE region these may represent a major barrier to doing business, restrict the number of business start-ups and/or have an impact on the size of the informal economy. One of the most comprehensive analyses of regulations and barriers to starting and operating a business is the World Bank’s Costs of Doing Business (2005). This reveals that the costs, complexity and time involved in starting a business in the SEE region are high:

- Procedures (number): ranges from 5 in Romania to 13 in Macedonia.

- Time (days): ranges from 28 in Romania to 54 in Bosnia and Herzegovina.
- Cost (% of income per capita): ranges from 7.4 in Romania to 46.2 in Bosnia and Herzegovina.
- Minimum capital (% of income per capita): ranges from 0 in Romania to 120.3 in Serbia and Montenegro.

The key approach being considered, if not necessarily implemented, in the SEE region is the single access point for business, otherwise known as business help centres or “one-stop shops.” Where this has been tried, this has often resulted in a “one-more-stop shop,” actually increasing delays and problems. However, a single point of access bringing together representatives of various agencies could simplify matters. The World Bank estimates (2005, p.22) that it typically takes less than half the time to register a business compared with countries without such a system.

### *Presentation*

The Romanian one-stop shop system was established in 2001 primarily because of the excessive time and cost involved in the process of registration. It was initially created under the auspices of the Romanian Chamber of Commerce and Industry and subsequently transferred to the Ministry of Justice in 2003 (National Trade Register Office). This was mainly because of uneven progress which meant that not all counties had implemented the system and the legislated targets were not being met.

The one-stop shop system was specifically designed to target future entrepreneurs, foreign investors and current business people. It operates at two levels:

- National Trade Register Office (NTRO) at the national level.
- 42 county offices co-ordinated by the NTR attached to the local law courts.

Its broad tasks include:

- Recording the legal and financial status of all businesses.
- Providing economic, commercial and statistical information.
- Simplifying procedures for incorporation and authorising companies.
- Informing and assisting businesses on issues related to the trade register activities.

In order to further improve the legal framework, and in consultation with businesses, Law no. 359/2004 was passed requiring registration in the trade register and the authorization of firms within 3 days (rather than 10 days hitherto), involving the following operations:

- Verification of the application form and supporting documents, registration, entering data in the Trade Registry computer.
- Authorization issued by the delegated judge.
- Registering with the Trade Registry (within 24 hours judge's conclusions).
- Sending the data to the firm, unique registration code, fiscal certificate (8 hours).
- Publication in the Official Journal of Romania.
- Registration certificate and other documents issued.

Authorisations then follow, although in some cases, such as where environmental issues are involved, this may take longer.

Registration within 10 and now 3 days has reduced the costs for entrepreneurs to about Euro 60. The one-stop shop has been welcomed by entrepreneurs and has contributed directly to an improved business environment in Romania. For example, in 2003 there were 356,710 registered SMEs, but this increased to 402,996 in 2004. The additional 46,286 companies are considered by the National Agency for SMEs to be the direct result of the greater efficiency of the legal framework, combined with improvement of the Romanian business environment.

#### *Discussion*

- The companies can begin trading immediately, before further checks are made. The deadline of 3 days applies irrespective of whether it is a domestic or foreign firm (national treatment).
- There are discrepancies between the World Bank's estimates of the number of days that it takes to register a company (28 days according to the latest report) and the previous target (10 days). The inconsistency is related to the timing of the research by the World Bank, as well as the definition of exactly what is being measured in estimating the amount of time for company registration.
- Efforts have been made to include as many aspects as possible in relation to registration of firms. Other issues are not included in the estimates, such as opening bank accounts.
- Romania is considering introducing on-line registration, but since more than 50% of Romanian SMEs do not have access to computers this has not yet been prioritised.

#### *Policy Tips*

- The experience of countries such as Romania is that the creation of a simple business entry procedure, such as one-stop shops, is an important issue since it encourages start-ups and assists the development of the overall economy.
- Creating one-stop shops can significantly improve the business environment. Countries with such a system typically take less than half the time to register a business compared with those without one.
- However, it is not easy to establish one-stop shops. If they are to avoid becoming one-*more*-stop shops, it is essential that they enjoy strong government commitment and adequate resources for effective implementation.
- The experience of countries such as Romania shows that once the one-stop shop system is in place, it is possible, over time, to gradually reduce the number of procedures, time and cost.
- The use of information technology can greatly accelerate the process of registration, re-registration, permitting, licensing, etc.

### **3.4 Streamlining Taxation: the Patent Tax**

The information below is based on the presentation made by Mr. Eugen Osmochescu, USAID/BIZPRO “Simplified Tax Policies: Patent Tax – the Moldovan Experience,” the discussions that took place, as well as the “Issues Paper” prepared for the Conference.

#### *Background*

The design of the tax regime and the quality of the tax administration are of critical importance to small enterprises, both new and established. The creation of a tax system that is stable, clear and simple is essential for businesses with limited capacity to navigate onerous fiscal compliance procedures. Entrepreneurs highlight a series of problems common to the SEE countries: chronic instability due to frequent and often sudden changes of the tax laws and regulations; the lack of transparency, lack of internal consistency and co-ordination between local and national regimes; the poor quality of the tax administration, which is often viewed by the entrepreneurs as inefficient and inflexible, partly because there is little consultation and training, and the high levels of corruption (OECD, 2003).

Several countries have sought to introduce new taxation regimes for small enterprises and individual entrepreneurs, such as an SME tax in Albania and the patent taxes in Bulgaria and Moldova. The experience of Moldova is worth noting in that it appears to have been well received and may have contributed to reducing the level of the informal economy.

#### *Presentation*

Moldovan legislation does not formally identify the “patent tax” or patent certificate within the fiscal system. Nevertheless, in February 2004, the Government adopted a Decision on the Concept of Fiscal Reform which stressed the need for further economic development, simplicity, equity and efficient administration. A commission and working group started to revise the fiscal system, including the patent tax, even if the Concept contains no express clauses regarding SMEs in general, and the patent tax, in particular.

The Law on Entrepreneurial Patent was adopted in 1998 and involved the following:

- Collaboration between the budget and social funds, so as to stabilize the economy.
- Provision of social assurance for SME employees.
- Strict price control, with an impact on market competition.
- Protection of national production via antidumping measures using taxes and fees.

53 economic activities fall within the scope of the patent certificate: 5 in the retail / trade sector and the remainder in the commodities, services, etc. sectors. Amendments have been proposed by Government, such as a reduction in retail activities (to 2 economic activities) and reduction of the rest to a mere 4 other economic activities, thus resulting in a consolidation of the fiscal system through a significant reduction in the scope of the patent tax.

The Moldovan patent tax is basically a unified single tax or fee, which reduces the burden on taxpayers by allowing them to focus on their business, rather than dealing with the state bureaucracy. The Moldova system only allows legal persons to register under the patent tax. The patent certifies the right to develop an indicated type of activity by a

qualified natural person for a time-limited period. Firms have basically two options in Moldova:

- Either to establish a firm and thus be able to employ staff, with the usual liabilities,
- Or to act on the basis of the patent, thus benefiting from simplified taxation but not to employ staff, not make import-export transactions, etc. Since there are no VAT deductions, it is attractive to operate in the retail and service sectors.

The number of patents issued grew systematically during 1999 – 2003/4 to around 40,000. The revenues raised from the patent tax jumped five fold during that period, reaching USD 3,6 million in 2006. The private sector is in the process of being established in Moldova and the early indications are that the patent tax has contributed to this process. However, other initial results are more mixed:

- Retail: the simplified bookkeeping and cash operations may lead to infringement of consumer rights, requiring state monitoring and control to protect these rights.
- Services: medium and large enterprises may be abusing the provisions. For example, employers oblige employees to take a patent and work on the basis of a service agreement, rather than a labour contract. This reduces job security and benefits.

These concerns have led to proposed modifications to the patent tax, focusing on issues such as lowering the price for issuing the patent; protection of consumer rights; better monitoring of patent holder activities, etc. The patent tax is in transition, but it does lead to higher levels of entrepreneurial activity and many firms have progressed to become legal entities. Further measures are being implemented to assist the process of developing a greater entrepreneurial culture in Moldova, such as the introduction of income tax exemptions for SMEs for a time-limited period (Tax Code Modification in 2004), further consumer protection measures and the development of an SME Strategy. Other measures which need to be implemented in Moldova include:

- Continuing reduction of the tax burden. Annual reductions in tax have delivered a consistent increase in tax revenues generated by the state.
- Greater access to finance, including the establishment of credit bureaux.
- Creation of new measures such as business incubators, technological parks, training based on special programmes, etc.

### *Discussion*

- Participants from the ex-Yugoslavia are familiar with the patent system, otherwise known as partial taxation for sole traders which had similar benefits and disadvantages. It was confirmed that health, pension, etc. insurance is included in the patent tax in Moldova.
- Income exemption for legal persons (SMEs) focused on income taxes, although some companies with large turnovers also appear to be eligible for such exemptions.
- The patent tax may have had a significant impact on the informal economy since they have to register to be eligible for the patent tax. The state is working actively in disbanding informal operations. In future patent tax holders are expected to decline further as they become registered as legal entities instead.
- The revenue generated is still quite low (\$ 3,6 million) through the patent tax, however, the key benefit is that a more business-like culture is starting to be established in Moldova.

### *Policy Tips*

- The creation of a tax system that is stable, clear and simple is essential for small businesses with limited capacity to devote to onerous fiscal administration procedures.
- The patent tax is a simplification that has been utilised in numerous transition countries such as Moldova, Ukraine, Kyrgyzstan, etc. with some success, since the burden of registration and associated cost is minimal.
- The experience in countries which have introduced the patent tax is generally positive in terms of increasing the number of registered economic activities. Moreover, these have generally led to an increase in the tax revenue generated.
- The patent tax can also have a positive effect in terms of encouraging small scale informal operations to formalise their activities. Given the very high levels of the informal economy in transition economies, this is a particularly useful policy aspect of the patent tax.
- However, the patent also brings disadvantages. The tax revenues remain relatively low, since the patent costs, by definition, are low. Moreover, there may also be unintended consequences, such as encouraging economic activities to remain small, stimulate firms to encourage employees to take up patents (instead of contracted employment), thus avoiding paying social contributions, etc.
- Over time, countries operating the patent tax have to consider reforms to the system in order to generate greater tax revenues and stimulate enterprise development and growth.

## **4. ENTERPRISE SUPPORT AS A TOOL TO REDUCE THE IMPACT OF INDUSTRIAL RESTRUCTURING**

### ***4.1 European Experiences – Enterprise and Innovation in Deprived Urban Areas***

The information below is based on the presentation made by Ms. Emma Drever, Greater London Enterprise, The Learning Network (LNet) “Sharing European Experiences – Enterprise and Innovation in Deprived Urban Areas,” the discussions that took place, as well as the “Issues Paper” prepared for the Conference.

#### *Background*

Dealing with industrial change and restructuring is a complex and multi-dimensional challenge. Much of the international investment attracted through privatisation, while highly desirable, leads in the short- to medium-term to reduced employment and a period of ‘downsizing’ with consequential serious impact on local employment and the local economy. In the longer term, more competitive and vibrant companies will re-emerge, but this process may take years.

Much restructuring takes place in cities and towns that are dependent on a few traditional industries and the subsequent unemployment can have a negative impact on large areas. Several EU countries including UK, Italy and Germany have extensive experience of trying to support enterprise development in deprived urban areas and a review of this experience using a mixture of financial incentives, incubators and targeted education and training can provide valuable ideas for the SEE region.

#### *Presentation*

The Learning Network (LNet) covers five cities (Amsterdam, Hamburg, London, Milan and Prague) actively developing and implementing policies to promote enterprise in deprived urban neighbourhoods. It is part-funded by the EC and aims to share best practice about innovation and entrepreneurship in deprived urban areas, develop common approaches to realising the economic and social potential of deprived urban areas, and practical tools to support enterprise in these areas.

Innovation is an underlying concept of LNet and is defined as follows:

- Businesses involved in the commercial exploitation of new ideas.
- Products and processes.
- Public policy itself can be innovative.

LNet’s starting position is that entrepreneurship is a necessary mindset for stimulating innovation and that entrepreneurship and innovation, when combined, can be tools for the regeneration of deprived areas. However, there are notable barriers in deprived urban areas, such as:

- Poor infrastructure.
- Problems accessing finance.
- Lack of interchange between businesses.
- Human resource shortages.
- Poor linkages between knowledge resources and businesses.

Nevertheless, opportunities do exist in deprived urban areas, and two examples were presented as to how problems are being tackled in London:

- The first example was “The Innovatory,” a business incubator located in a deprived part of London focusing on the digital media sector and providing both accommodation and business advice.
- The second example presented was the “Jump Start”, a project for promoting innovation and entrepreneurship among disadvantaged groups by giving people skills and confidence to innovate, including support through workshops, mentoring and networking opportunities.

#### *Discussion*

- It was noted by several participants that within the SEE region, there is too much of a focus on the attainment of financial sustainability in initiatives such as business incubators and business centres within 1-3 years. This is not the case in more advanced European economies, where government (national, regional or local) is typically expected to provide on-going financial support in areas where there is acknowledged market failure.
- It was noted that there is similarly pressure on initiatives to achieve financial sustainability in countries such as those covered by LNet. There are no conclusive lessons or policy tips that can be given, but all initiatives should aim to achieve financial sustainability, since public funds are limited.

#### **4.2 The Experience of the BIOS Business Incubator: Osijek, Croatia**

The information below is based on the presentation made by Professor Slavica Singer, Centre for Development Policy for Small Enterprises “Role and Contribution of Business Incubators and Centres for Entrepreneurship: the Osijek Experience,” the discussions that took place, as well as the “Issues Paper” prepared for the Conference.

#### *Background*

Business incubators are an established policy instrument for economic and employment development - over 4,000 are already in operation throughout the world. Incubators essentially provide the conditions to foster new business ideas and innovation, as well as providing the environment and facilities to ensure implementation. Incubators can help tackle challenges such as: how to stimulate new enterprise; how to support early stage businesses and enable them to survive and grow; how to promote more local and regional development; and how to nurture technology development and the application of academic research, etc. Incubators have often been established in response to industrial restructuring such as downsizing and plant closures (often associated with State Owned Enterprises), in partnership with local municipalities, companies and communities. They have also been used to promote enterprise in vulnerable groups such as women entrepreneurs, as well as certain ethnic groups where the level of entrepreneurship is perceived as being inadequate.

It is estimated that there are 30-40 incubators in the SEE region. All countries appear to have established something that is, or at least resembles, an incubator (OECD, 2003), however the nature of the incubators varies dramatically and few resemble the original conception of incubators. Most appear to have been established prior to 2000, when many SEE countries experienced severe industrial restructuring, often associated with the process of privatisation. Indeed, quite a few incubators appear to have already closed down and the rate of establishment of new incubators has slowed down. Therefore,

although incubators offer the prospect of responding to industrial restructuring, many do not appear to be sustainable in the region.

### *Presentation*

Professor Singer's presentation covered a wide range of issues, such as the role of employment generation as a means of eradicating poverty and the need to develop an entrepreneurial society in Croatia. The experience of Osijek was then presented, which involved the following:

- Creation of the NOA microcredit institution (1996).
- Establishment of the Centre for Entrepreneurship (1997), followed by the Franchise Centre and the Family Business Forum in 2003.
- Creation of the university based Graduate Programme in Entrepreneurship in 2000.
- Establishment of the SME Policy Centre in Zagreb (2001).
- Establishment of the BIOS business incubator (2002).

Turning specifically to the BIOS business incubator, although it had been established in 1995 by the local authority, it actually had no tenants and was not operational. Once the Centre for Entrepreneurship became involved, emphasis was placed on appointing dynamic, entrepreneurial management and the first tenants started renting accommodation in 2003, supported by the Open Society Foundation.

Part of BIOS's success is that it has scope for fairly significant operations. There are 9,000 m<sup>2</sup> of space available, 1,000 m<sup>2</sup> of which are currently covered. Plans are currently being prepared to create an additional 2,000 m<sup>2</sup> of covered business incubation space. This level of available space is significantly higher than is typical in other SP countries.

Furthermore, unlike many other business incubators, strong emphasis has been placed on recruiting a mixture of activities with potential for rapid development and growth:

- 50% of firms are in the advanced technologies.
- 50% of firms are in the manufacturing business.

As a consequence, BIOS currently has 16 firms employing 50 people, with plans for significant expansion of activities once additional space is available. BIOS tenants have also benefited from training, support as well as micro finance made available through NOA, CEPOR, etc.

### *Discussion*

- Various participants expressed their appreciation of the presentation, which was wide ranging, covering various issues in addition to the business incubator experience.
- The suggestion was made that part of BIOS's success, unlike many other business incubators in the SEE region, may be due to the fact that the it is much larger, in terms of space standards, than average and that the focus on high tech enterprises means that there is a greater likelihood that firms will graduate from the business incubator.
- Discussion revolved around whether, in future, business incubators in the SP countries should focus less on poverty alleviation / redundant workers and more on accepting high tech, high growth firms, so as to ensure a higher level of effectiveness

and sustainability. The decision would depend on the nature of the problems experienced in the locality but there does appear to be scope for both types of initiatives in the SEE region, as illustrated by the business incubators aiming to support returnees in countries such as in Bosnia and Herzegovina.

#### *Policy Tips*

- Employ high quality, entrepreneurial staff to manage business incubators.
- Develop a greater focus on hi-growth, hi-tech enterprises, which harness the skills of ambitious and innovative entrepreneurs.
- Ensure that the minimum space standards comply with international benchmarks (minimum rentable space of 2,000m<sup>2</sup> – 4,000m<sup>2</sup>; 20-30 tenants; and occupancy rates of 85%) so as to be financially sustainable.
- Develop links and joint ventures with universities and research institutes as a means of capitalising on R&D, thus capturing the benefits of innovation.
- Develop links between business incubators and other business development services and finance, so as to deliver adequate support to tenants.

## 5. CONCLUSION

Based on the discussions and conclusions that took place during the workshop, it is recommended that the Stability Pact's Working Table II theme "Enterprise Development and Employment Generation" consider future events on the following themes:

- The role of the informal economy in stimulating employment / growth opportunities and policy measures for harnessing it as a potential source of economic development.
- The development of measures targeted at youth unemployment, since unemployment rates are exceptionally high and traditional forms of employment are unlikely to be available to this target group in the short- to medium-term.
- The development of an entrepreneurial culture, focusing on the integrated role of the enterprise sphere (Ministry of Economy, SME Agency), the education sphere (Ministry of Education, Schools, VET, Universities) and the labour market sphere (Ministry of Labour, Employment Agencies, Trade Unions, etc.).

Finally, as was evident from animated discussions and conclusions that took place, the participants agreed that the workshop had been worthwhile attending and that they had obtained a number of policy insights which they could seek to introduce in their own policy environments. It was recommended that future events should involve fewer presentations to enable more detailed discussions to take place. Other than this, the WTII's umbrella of theme "Enterprise Development and Employment Generation" was considered to be useful and timely.

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