

**Study on
Micro-finance Support to Start-up in Serbia**

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1. SUMMARY

In comparison to other countries in transition, Serbia is not so successful in creating new businesses and new working positions. The share of self-employment in employment besides agriculture is about 5% in Serbia, while it is over 10% in Slovenia, Hungary, Poland and the Czech Republic, 14% in OECD countries and 15% in EU.

In the previous period, the Government has not done a thorough research on the basis of which it could identify “entrepreneur profile and market” in Serbia. Therefore, we do not possess any reliable assessment of entrepreneur potential and demand in Serbia.

However, based on certain activities and programmes the Government has implemented in the past years, some indirect evaluation of the scope of the demand can be made. Gathered and processed data lead to an indirect conclusion, that the available demand for financial support to start up is considerably larger than the current available offer.

Aims of the study:

- Describing the state of microfinance support to start up in Serbia, in relation to:
 - identifying the limitations from the point of view of legislation
 - the development of the existing institutional infrastructure
 - the level of financial support implementation in accordance with defining priorities of start up policies
- Defining recommendations for setting up a more efficient system of microfinance support for start up

Rating micro-financial environment in Serbia

According to the analysis, the state of micro-finance environment in Serbia is generally very unfavourable with an average rate barely somewhat over 2 (on the scale from 1 to 5) for 7 determined criteria.

Apart from relatively satisfactory, (very) well *established politics* of promoting entrepreneurship, combating unemployment, alleviating poverty and stimulating self-employment (graded 4) and only partly well established *active measures* for stimulating self-employment and entrepreneurship (graded 3), findings for other criteria is utterly unsatisfactory, with grades 1 or 2, (*entrepreneur environment*, *financial support* and *social care* are graded with 2, while *stimulating measures* and *legal environment* received 1).

Assessment of the legal environment and the opportunity to work of MFI

Legal regulations in this field in Serbia that relate to public, in other words government institutions are clear and precise, and they enable them to perform microcredit operations in accordance with their goals and/or interests within the scope of their activities.

On the other hand, legislation in this field is unambiguously regulated in a way that favourite banking sector monopoly and *forbids the freedom of entrepreneurship* through microcredit financing, as well as foundation and operation of private or non-for-profit microfinance institutions.

Current state of (dis)organization of the legal environment consequently has its MFI sector undeveloped, with the weak individual organization.

Assessment of development of the existing micro-financial institutional infrastructure

We seem to be able to draw a conclusion, based on the set of activities from the public sector, that there is a strong and organized system support to start up. However, if we consider the matter objectively (at what degree supply meet demand), a harmonized institutionalized system for creating and enacting policies for the development of start up, that would enable partnerships of different participants from all three sectors in Serbia, has not been established so far.

The existing financial institutional infrastructure is primarily a logical consequence of legal regulations and the need to attain the objectives of economic politics, as well as pragmatic motives of different political interests.

The starting point of our recommendations for establishing a more efficient system of micro-financial support to start up in Serbia is ***a motion for establishing necessary legal regulations***, which should clearly define the different possibilities to perform microfinance activities and ways in which micro-finance organizations act on financial market, with the necessity to clearly determine the following issues: supervision, control over business activities, evaluation of the effects of stimulating start up. That would help creating the conditions for significant improvement of financing start up with public sector funds and execute the necessary decentralization of financial support system, based on public, private and NGO sectors partnership.

The other recommendations presented in this Study should be perceived and estimated only within the context of providing adequate MFI legal environment as a prerequisite.

2. INTRODUCTION

The elaboration of this Study is part of the implementation of the second phase of the Project named *Social Finance for Support to Self-employment in Serbia from 2007 – 2009*, which is being realized in cooperation with the International Labour Organisation (ILO), the Ministry Of Labour, Employment and Social Affairs of the Republic of Serbia (MoLESA), and which is financed by the Republic of France.

In the following phases of the project the main implementing partner of the project activities will be the Ministry of Economy and Regional Development (MoERD), which is under the new Government formation responsible for the employment policy.

The goals of the second phase of this Project are the strengthening and advancing the integrated framework for supporting self-employment of the unemployed, as means of combating unemployment and fostering economic development.

Definition of start up and self-employment

There are no definitions of start up and self-employment in Serbia. For the requirements of this Study, we consider self-employment as one of the forms of starting one's own business, namely, start up. We define start up as an investment entrepreneur project primarily financed with the capital from the entrepreneur's own resources (his own savings or personal loan) and with acquiring the additional funds from the available external sources of financing, whose business goals an entrepreneur attains directly by founding a new economic subject.

As a consequence, every start up creates new net work positions, self-employs the entrepreneur, but opens the possibility of employing other persons, too, first of all family members, but others as well. Also, it is not necessary that the entrepreneur or the other persons, who get their job by realization of start up, have solely the status of the unemployed.

Therefore, start up is every new business endeavour which is realized by founding a new firm and self-employing the entrepreneur.

ILO Definition of the Self-employed workers:

The remuneration of the worker depends directly upon the revenue of its own work unit; the worker is responsible for the welfare of the enterprise (making decisions or delegating)

Employers, Own-account workers, cooperatives' members and Unpaid family workers

More precisely, the International Classification by Status in Employment (ISCE93) divides the group of employed in six subgroups, one concerning paid-employment jobs ("Employees"), four concerning self-employment jobs ("Employers", "Own-account workers", "Members of producers' cooperatives" and "Contributing family workers") and the last one corresponding to "workers not classifiable by status".

- *Employers*: persons working on their own account or with one or a few partners and who have engaged employees "on a continuous basis"¹ within the reference period;

¹ "To engage employees on a continuous basis": this notion is related to the definition of "employees with stable contracts", or employees who have had and continue to have a sustainable explicit or implicit contract of employment, or a succession of such contracts, with the same employer, for a period which is longer than a specified minimum depending on national criteria.

- *Own-account workers*: persons working on their own account or with one or a few partners and who did not have engaged employees “on a continuous basis” (but who could have engaged people, if not on a continuous basis) within the reference period.
- *Members of producers’ cooperatives*: persons working in a cooperative producing goods or services, who take part on an equal footing with other members to operational decisions affecting the structure.
- *Contributing family workers*: persons working in a market-oriented establishment operated by a related person living in the same household, but who cannot be considered as a partner because of their inferior commitment to the operation.

Methodology of the research and the making of the Study

For the requirements of this Study, the policy of supporting start up applied during 2005 and 2006 has been analyzed. Considering specific circumstances connected to forming new Government, the programme of supporting start up for 2007 has not been taken into account.

The methodology applied in the elaboration of the Study has been chosen in order to accommodate the need for establishing qualitative findings, of reference for grading the current status and creating recommendations for establishing more efficient policies and more efficient micro-financial support for start up in Serbia based on them. Methodology of work is created in order to establish phase-like (step by step) approach in the making of this document, without predefining the expected findings of the possible solutions.

Such an approach enabled the authors to fully perceive comparable experiences of the positive practice in EU and the countries of the region, with a critical perception of the existing state in this field in Serbia.

Phase I was directed at determining the framework and it included desk research, which meant collecting all relevant information for determining the key elements important for carrying out the research and making up the document.

Phase II included determining key policy makers and completing interviews.

During **phase III** findings were presented to the local politicians through panel meetings with specific topics in chosen regions, in order to do the necessary relevance, reliability and consistence tests of preliminarily formed opinions and evaluations of the existing policy of start up support in Serbia.

Phase IV is related to the making of the draft of the Study, which besides the evaluation of the current status also defines recommendations for advancing the policy of micro-financial support to start up in Serbia.

Phase V included additional direct consultations with the representatives of the ministry that grants resources and the ILO about the draft of the Study, and after that it was presented to the Task force for inciting start up and entrepreneurship of the Council for SME.

Phase VI was concerned with making the final version of the Study and delivering it to the key politicians and relevant participants in the process of implementing micro-financial support to start up in Serbia.

3. RELEVANT ENVIRONMENT

In comparison to other countries in transition, Serbia has not been so successful in creating new businesses up to now. According to the World Bank Report² the share of self-employment in Serbia is among the lowest in Central and South-east European countries. The share of self-employment in employment outside agriculture in Serbia is about 5%, while it is over 10% in Slovenia, Hungary, Poland and Czech Republic, and about 14% in OECD countries and 15 in EU. The data show slow advance in the field of self-employment in comparison to advanced transitional economies where these activities have an important role during the transitional period.

In the period from 2001-2004/5, based on the official data from the *Report on small and medium-sized enterprises and entrepreneurship during 2004*, issued by the Development Bureau of the Republic of Serbia, the number of active SME (with the status of legal entities) grew from 65,115 to 69,360 during 2004. After changing the registration system in 2005 over 10,000 enterprises applied for registration. Records for sole traders (physical entities) show an increase in numbers from 209,445 to 234,981 (in 2005). Total increase of the number of registered enterprises and businesses during the previous period is on a low level in comparison to other transitional countries and it is somewhat over 11% for the entire period in question. During 2006, there was re-registering of the entrepreneurs that have status of businesses, therefore those records were not taken into account.

In the previous period, the Government has not done a thorough research on the basis of which it could identify "entrepreneur profile and market" in Serbia. Thus, we do not possess any reliable assessment of entrepreneur potential and demand in Serbia. However, based on certain activities and programmes the Government has implemented in the past years some indirect evaluation of the scope of the demand can be made.

Over 30,000 would-be entrepreneurs applied to open competitions for financial support programmes for self-employment during 2004 and 2005, and nearly 13,000 were realized. Likewise, for the first time during 2005 the Fund for development of Serbia provided microcredit line for the unemployed that were preparing to start their own business. From the nearly 10,000 applications that were received, only 700 were realized under the limited available budget.

These data lead to an indirect conclusion, that the available demand for financial support to start up is considerably larger than the current available offer.

Micro-financial environment in Serbia

EU Definition of microfinance

For the purpose of this Study the authors have decided to use the definition of microfinance which is in line with the EU Commission documents. According to them, microcredit is defined as a loan of up to EUR 25,000 to new or existing enterprises³.

When assessing states of development of micro-financial environment, the following key factors have been established:

- Entrepreneur environment (institutional support to entrepreneurship)
- Financial support (source for MFI capital funds)
- Incentive measures (tax and income policies)
- Legal regulations (of activities such as micro-financing and the status of a micro-financing organization)
- Social care (for the poor and socially excluded groups)
- Active measures (self-employment, inciting entrepreneurship)

² Republic of Serbia: An Agenda for Economic Growth and Employment, World Bank, December 2004

³ Expert Group Report: The Regulation of Microcredit in Europe/ April 2007

Entrepreneurial environment (institutional support to entrepreneurship)

Process of creating institutional support for the development of start up and entrepreneurship in Serbia is not completed as it is projected

In the period from 2001 the Government of the Republic of Serbia has started the activities on reducing the barriers and establishing an entrepreneur-friendly environment⁴.

Within the framework of non-financial support, on a national level, Republic Agency for the development of small and medium-sized enterprises and entrepreneurship has been established in 2001⁵. The Agency coordinates the work of the network of regional agencies/centres, which, however, still does not cover the whole territory of the republic, nor are all of the activities on the regional level available in their full extent on the local level. Their primary role is to provide suitable non-financial support to potential entrepreneurs through informing and training.

Likewise, a network of entrepreneur centres functions through employment offices within the scope of NES. This network, too, does not cover the whole territory of the Republic. Its role consists of giving information, basic training of potential entrepreneurs without fee, as well as providing the terms of applying for financial support in the public sector for self-employment (NES and Fund for development).

It is necessary to mention that the part of their activities is commonly realized on the basis of the annual contract between the Republican agency for the development of SMEs and NES.

Still, it remains unclear whether and to what degree these two networks, both financed from the government budget, mutually coordinate their activities or overlap and represent a competition to each other.

It should be added that, the Programme for developing Business incubating centres in 15 municipalities in Serbia, is also being realized as a specific kind of support by Government of Serbia through National Investment Plan.

Financial support (sources of MFI funding)

The level of the existing microfinancial support to start up is low, considering that the needed specific financial structure has not been built. All available resources of financing are related to specialized credit lines of the Fund for the development of the Republic of Serbia and Autonomous Province of Vojvodina. Considering the great limitation of the range of those activities, individual initiatives for diversifying the offer in stimulating start up are developing in certain regions and municipalities. What all these programmes mentioned have in common is supplying "soft" start up loans based on competitions, which are available for a limited number of beneficiaries.

The existing legal regulations do not enable the establishment nor operation of specific microfinance institutions. Activities of a couple of NGOs that exist in Serbia, are being realized as commission business through banking sector.

⁴ Relevant for this context is that the Government has adopted the following strategic documents of the policy for development, such as: The Strategy of Development of SMEs 2003-2008, The Plan for Stimulating Development of SMEs 2005 -2007, National Strategy for Employment 2005-2010, National Action Plan for Employment 2006-2008, Strategy for Decreasing Poverty, Strategy of Regional Development 2007-2012, Programme of Developing Incubators and Clusters 2007-2012. Besides that, the following laws were passed during this period: the Law on Republic Agency for Development of SMEs, the Law on Trade Societies, the Law on the Agency for Economic Registers, the Law on the Guaranteed Fund, the Law on Leasing, the Law on Pounding, the Law on Mortgage, the Law on Bankruptcy, the Law on Investment Funds.

At the same time, Serbia is taking an active part in the process of applying the EU Charter about small enterprises.

⁵ Republic of Serbia Official Gazette No. 65/2001

The banking sector is not interested in officially crediting entrepreneur beginners and their start up projects, except through personal loans to owners of start up projects in cash. It should be mentioned that, activities related to financing start up in different ways and through various mechanisms of “risk capital“ are not present in Serbia.

Incentive measures (tax and income policies)

Existing tax and social contributions policies (pension, health and unemployment insurance) are not directed directly at supporting start up, nor has the appropriate analysis of the influence of those policies on stimulating start up been conducted. We can say that there is an indirect influence, considering that there are certain stimulating solutions for employing unemployed persons, especially for foreign direct investments, that can be applied to start up projects as well.

Legal environment (performing microfinance activities and status of micro-finance organizations)

Detailed analysis is given in section 4. of the Studies which is thematically dealing with this segment of the development of start up. In Serbia micro-credit financial organizations/institutions is not legally regulated by specific regulations.

Social care (for the poor and the socially excluded)

The Government of the Republic of Serbia has adopted the *Strategy of poverty alleviation* as far back as in January 2003. The development of entrepreneurship is marked as an important element of economic development of Serbia and the decrease of poverty. Self-employment and start-up, are defined as the key segments for developing entrepreneurship. The need for defining legal terms for developing microcredit, as one of the most important elements of financial support to the development of this sector, is identified in that respect.

Active labour market measures (stimulating self-employment)

NES has supported the self-employment process since the mid-nineties. Minimal assets were set aside from the budget for this kind of active labour market measure and the number of supported start up programmes has been relatively limited, somewhat over two thousand per year on average.

It is only from 2005 that significant budget allocation are set aside for these purposes. It should be mentioned that these assets are non-returnable and that the Programme is intended for unemployed persons – founders of the new economic subject which are able to employ other unemployed persons beside themselves, with the obligation to pay social security fees for all their employees according to this programme for at least two years.

However, we have to stress that neither within NES, nor in the ministry in charge, there is no analysis of the effect of this programme in terms of job creation, nor any other qualitative way of monitoring of help beneficiaries.

The problem of unemployment and social costs of support to start up

Unemployment is a social problem, and as such its solution has its social costs It should not be debatable that the active role of public sector is necessary in conducting the employment policy and financing measures and activities that ought to contribute to creating new jobs. The only remotely disputable thing is: what are the best, the most efficient ways and at what price, economically acceptable for the society.

Start up projects has, since their foundation and early growth, presented an important segment of creating new jobs.

According to some researches, in the period so far, over 90% of all start up projects is entirely financed by entrepreneurs, on the basis of their own savings and loans from their friends and family. About 5% is partially financed by supplier and buyer resources. All this leads to a conclusion that the start up projects in Serbia are financed by entrepreneur's private sources.

The need for rapid economic development and solving social problems, considerable unemployment being the most challenging among them, requires active role of the public sector and public finances. What would be its optimal role?

Development of small and medium-sized enterprises is one of the corner stones of economic development. When the social importance of their development is recognized, balance in financing start up between public and private sector should logically be established.

The basic tendency of the public sector is to support, to a great degree, the entrance of new entrepreneurs and their start up projects. Public sector has to pay the price of securing necessary funding for start up projects, but also to subsidize the costs of those necessary consulting services.

Specific-purpose financial funds for supporting start up are, as a rule, exceptionally "soft" according to the terms of use, but also very limited in their scope.

Therefore, there are only few and they are insufficient for satisfying total demand for start up capital from this source only. That is absolutely how it should be, except for the question of relation and complementarity of financial support to start up from public, private and non-profit making sectors.

The following table and radar diagram sum up the grade of the existing state of micro-financial environment in Serbia.

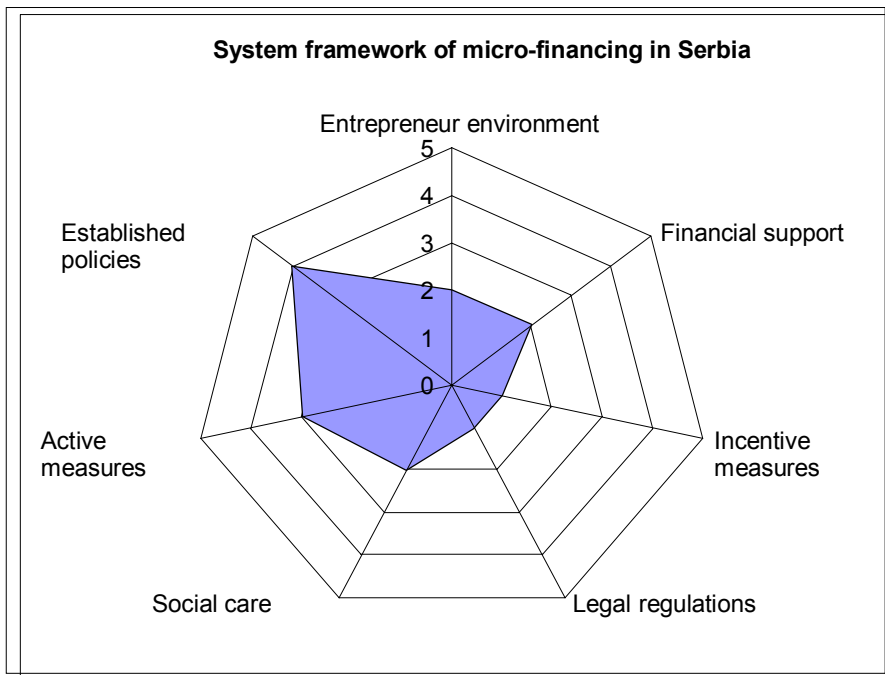
Table 1

Rating micro-finance environment

<i>Criterion</i>	<i>Rate</i>	<i>Issue</i>	<i>Explanation</i>
<i>Entrepreneurial environment</i>	2	What is the business and social environment; what is the institutional support to entrepreneurship?	The degree of development of institutional infrastructure is not satisfactory. Establishing agencies for non-financial support of the development of SMEs (Republican agency with the network of regional agencies/centres for the development of SMEs), but not on the whole territory of Serbia. Institutions for financial support are still in their initial stadium of defining and establishing. Economic-system legislative and other regulations do not know of any particularities in connection to business activities of microenterprises.

<i>Financial support</i>	2	What is support to microfinancial institutions like and what are its sources of capital?	Except setting aside public sector's specific-purpose funds from the Budget of the Fund for the development of Serbia and NES, as well the Fund for the development of AP Vojvodina, there are no other sources and ways of financing programmes for supporting start up and self-employment. Acquiring capital of MFI exclusively from non-returnable donations granted as humanitarian aid.
<i>Incentive measures</i>	1	What are the existing (tax and other) allowances and stimulations for self-employment, new employment and start up?	There are some financial stimuli for new employment, created according to the need for attracting foreign direct investments, without real effect on small investors and start up.
<i>Legal regulations</i>	1	What is the organization of legal regulations for business activities of micro-financial institutions?	There are no legal regulations for founding and managing business operations of microfinancial institutions. New Banking Law does not recognize "other financial institutions". Active MFIs in Serbia, strictly formally observed, are doing business de facto against the law, "appropriately" applying legal regulations in the field of financial transactions with the status of "citizen associations".
<i>Social care</i>	2	Which existing measures and activities are in function of solving problems of decreasing poverty and for then socially excluded?	The scope of measures and low intensity of social care for the poor and the socially excluded groups is markedly small, due to lack of necessary financial resources, owing to budget limitations and absence of other sources of financing.
<i>Active measures</i>	3	What active measures for stimulating self-employment and entrepreneurship are in force?	NES conducts a program of active measures for self-employment, but only of the <i>unemployed</i> , and that is with insufficient total budget and low individual amount of recourses for these purposes.

<i>Established policies</i>	4	How are the policies relating to stimulating self-employment, decreasing poverty and solving unemployment are defined?	Numerous strategies that define policies in a certain field have been made, only some of which have done their operationalisation through defining annual action plans and programmes of realization, with a general assessment that the implementation is missing due to some deficiencies (undefined and/or unsecured) necessary instruments for their implementation.
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4. ANALYSIS OF LEGAL ENVIRONMENT

In Serbia the field of microfinancing, in other words, position and business transactions of microcredit financial organizations/institutions is not legally regulated by specific regulations.

Implementation of existing legal regulation in field of financial system is as follows.

Law on the National bank of Serbia⁶ and the function of NBS

This law regulates the position, organization, authorisations and functions of the National bank of Serbia, as the central credit-monetary and financial institutions.

Consequently, NBS is defined as independent in performing its functions, with the appropriate, authorisations for passing legislations and taking measures and other activities from legally defined fields⁷ without any external limitations of authority.

General legal framework and sub-legal regulations in this area

(1) Banking Law⁸

Banking Law prescribes that only banks can deal with the deposit operations (collecting savings) and credit financing (extending credit and borrowing), as their core activity.

Other financial organizations and institutions can perform duties of credit financing only in line with the other special legislations and regulations or special approval (permission) of NBS.

It is necessary to note that passing this new law, which replaced the previous **Law on banks and other financial organizations**, eliminated legal possibilities for the existence of other (non-banking) forms of financial organizations. Consequently, in line with the prescribed liabilities of other financial organizations to adjust with the new law (*that is only by means of transforming into a bank or fusion*), the total of 8 MFIs were closed down and one was transformed into savings bank. Whatever legal solutions for, *other financial organizations* may be adopted in future, one thing remains certain, they are *financial institutions* and they are necessary to our economy and our citizens. Accordingly, NBS cannot get away from its liability for defining the status of MFI, as well as regulating the issues of their foundation and doing business.

At this point, it is extremely important to point out that *de facto* existing micro-financial institutions from NGO sector do their business illegally because they are not defined as MFIs by Banking Law or by any other law, and in line with that makes them *de iure* out of NBS jurisdiction.

By-laws directly derived from the Banking Law (*Resolution on mandatory reserve with NBS*), as well as other relevant laws (*Resolution on ways and conditions of using financial credits* for the purposes stated in article 21. motion 3. of the Law on foreign exchange transactions, *Resolution on the liability of leasing grantor* to keep reserve funds and so forth), limit and regulate inflow of funds from abroad and their application on domestic financial market.

These laws state that the inflow of funds for the purpose of credit financing can go only through banks. Likewise, *Resolution on classification of balance sheet assets and off-*

⁶ Republic of Serbia Official Gazette, No. 72/2003, 55/2004, 85/2005

⁷ Citation: "National bank of Serbia, in performing its functions, will not accept or ask for directions from the Government or other persons".

⁸ Republic of Serbia Official Gazette No. 107/2005

balance sheet items of the bank established setting aside of mandatory reserve on all assets earmarked for crediting, which additionally increases the price of assets.

(2) Law on commercial societies⁹

Law on commercial societies regulates the issue of form and the way of founding and organizing economic subjects (founded in order to gain profit through doing business) and it does not deal with conditions and ways for performing certain activities, but in that sense refers to special laws and acts that regulate that.

Therefore, it does not anticipate the possibility that the commercial societies are dealing with credit financing, unless it is regulated by special acts.

(3) Law on Fund for the development of the Republic of Serbia

(4) Law on Credit Guarantee fund

(5) Law on employment and *insurance in case of unemployment* (National Employment Agency)

(6) *Law on acquiring and using foreign resources for financing the increase of employment and the employment of those who had worked abroad (Fund for financing the increase of employment in economically undeveloped and exceptionally emigrational areas of Serbia)*

The listed laws regulate founding, organization and work of public institutions they refer to, and as such, they are of no consequence for the aspect of legal regulations of MFI.

They treat these issues in the sense of stimulating the increase of employment and self-employment and since they are public institutions, they deal with microcrediting by a special permit.

(7) Law on investment funds¹⁰

Newly passed ***Law on investment funds*** could indirectly have more important influence on microfinancial market capital. However, since this law has been enacted in Serbia only for several months, it is difficult to realize its possible impact at this moment.

Still, it remains to be seen whether and to what degree will possible investment funds be influential as one of the potential external sources for replenishing (funding) credit funds of MFI. Our assessment is that it is possible, on the condition that the position of MFI be legally regulated.

With the current legal status of MFI, accommodation of finance of investment funds in MFI would be more than high-risk, and in accordance with the following regulations that regulate this field they, not really possible.

(8) Laws on citizen associations of SFRY and the FRY¹¹

Both of these laws are outdated both in form and essence, and there is no need to comment on them separately.

A new bill is being drafted which limits citizen associations, namely non-governmental and non-profit making organizations so that they cannot perform activities on financial market. Likewise, which can present an even bigger problem, associations cannot connect in any way with other ways of organizing, except with other non-governmental organizations. In that case their connecting with banks would be forbidden, unlike the current situation.

⁹ Republic of Serbia Official Gazette No. 25/2004

¹⁰ Republic of Serbia Official Gazette No. 46/2006

¹¹ SFR Official Gazette, No. 42/1990; FRY Official Gazette, No. 24/1994, 28/1996, 73/2000

In the event of closing or ceasing operation of the association (non-governmental organization) all the assets are left i.e. passed to the local community.

(9) Law on cooperatives

According to the current law, associations of the physical entities are treated for doing joint business activities, but not on the financial market.

(10) Other laws

Law on financial leasing¹², Law on security rights to forregistered movables¹³ and Mortgage law¹⁴ are acts that can certainly have their own appropriate positive application in business activities of MFI, but they are undoubtedly without any real influence on organization of their own status position in the current legal environment.

Legal status of organizations that deal with microfinancing in Serbia

All organizations, outside the public and banking sectors that deal with microcredit financing are registered as citizen associations that, among other things, deal with economic support to the socially excluded and their self-employment.

Their legal position is, in the field of microfinancing they are involved in, according to the legal regulations – illegal (article 5 of the Banking Law explicitly states that none but banks can extend credit, as well as in article 136. extending credit without permission of NBS, or being authorized by the Law, is a felony).

On the territory of Serbia there are three organizations that are engaged in this activity and they are: Fund for micro development, and Microfins, both registered as citizen associations and Agroinvest Fond, registered as a trade society with a limited liability. All of them have been implementing partners of international humanitarian organizations that have worked on economic and humanitarian support for the socially excluded citizen groups.

They perform their credit activities through banks giving them their liquid financial assets on commission, pay credits, and all they do is the service of finding a client and technical processing of a claim according to the specific Contract with the bank (organizations do all the work, and the bank appears only as loan grantor/the creditor).

Assessment of legal environment and possibilities of work of MFI

Legal regulations in this field in Serbia that relate to public, in other words government institutions are clear and precise, and they enable them to perform microcredit operations in accordance with their goals and/or interests within the scope of their activities.

On the other hand, legislation in this field is unambiguously regulated in a way that favourite banking sector monopoly and *forbids the freedom of entrepreneurship* through microcredit financing, as well as foundation and operation of private or non-for-profit microfinance institutions.

¹² Republic of Serbia Official Gazette, No. 55/2003, 61/2005

¹³ Republic of Serbia Official Gazette, No. 57/2003, 61/2005, 64/2006

¹⁴ Republic of Serbia Official Gazette, No. 115/2005

That, undoubtedly, rules out any possibility for private or NGO sector to do microcredit transactions through commercial arrangements or in any other way by possible appropriate application of legal regulations.

Such current status of the legal environment consequently has implications that MFI sector remain undeveloped, with their weak individual organization.

Therefore, the following negative **characteristics** are present:

- Firstly, the legal position of MFI on financial market is illegal (Citizen association);
- The form of their acting through commission contracts with banks has so far been tolerated by NBS;
- Ownership over the credit capital they manage has not been defined¹⁵;
- Managing boards in those organizations are not qualified enough to manage a financial institution;
- Qualification structure of employees and their training also do not meet requirements of a financial institution management,
- Risk management and firm procedures are, likewise, a weakness of these organizations.

Final comments and suggestions for the way this matter should be regulated

Microcredit financing connects to undeveloped countries and countries in the process of development and dates since the seventies from Asia. In development so far, it has yielded good results in supporting the most socially excluded layers in their economic integrating in the environment and their becoming independent.

One of the basic characteristics of microfinancing is relatively easy approach to assets without complicated administrative procedures, since it is believed that these services are used only by those clients who are prevented from approaching banking resources due to their insufficient financial strength or owing to their lack of information and low educational structure.

The field of micro-finance should be solved by a specific law on non-deposit micro-financial institutions, which would be a part of a set of laws which relate to the development of entrepreneurship, employment and regional development.

This law should particularly process institutional capacity of the potential microcredit organization (managing, book-keeping, planning, information, internal affairs, accounting, market research, procedure, human resources and education systems).

This is important for the client, but also for the creditor, donor, and investor.

Transparency is especially important in the work of these organizations.

The statute of an organization, beside mandatory legal norms, also has to contain mission of the organization, clearly defined jurisdictions and management liabilities, basics of organizational structure, basics of the system of internal affairs and revisions, targeted clients, defined non-governmental character of the organization.

Investors, creditors and donors' representatives must have their appropriate place in the managing system of these organizations, in their assemblies, as well as their managing and supervisory boards.

The essential task of these organizations is to obtain their long-term self-sustainability and development through servicing the needs of clients who have no access to the commercial sources of financing.

¹⁵ Although these organizations have contracts with capital owners (donors) and their assets are being transferred for disposal and managing, it remains unclear who has the title of ownership: association founders, all employees from the beginning of work up to now, all the members of that association or the third party. That raises the question of what happens to the capital in case the association is closed or if it changes the form of organizing. The current solution in the normative acts of associations is that it is upon Association's Assembly to decide.

Law on microcredit financing ought to clearly define this part of financial services and the influence of these organizations on financial market.

The law must clearly define who controls the activities of organizations that deal with microcrediting and in what way.

The subject of microcredit financing is complex, but important, especially in the countries that have a need for faster development, higher employment rate, even regional development and solving problems of the poor and the socially excluded, and such is the case in Serbia.

Suggestion for the starting basis of legally organizing positions and business operations of the MFIs

The name of the law:	Law on Non-Banking Financial Institutions (NBFI)
Status:	Non-profit making and non-deposit microfinancial organization
Activity:	Mediating in the placement of microcredits on the behalf of someone else and for their benefit It cannot operate (borrow) on its own on financial markets on its own behalf and for its own account
Conditions for founding:	Similar to solutions for NGO, with the preliminary agreement for providing sources for microcredit assets In the event of closing, ceasing existence, after paying the creditors, all remaining assets go to local self-management
Registration:	Ministry of Finance or Ministry of civil services and local self-management
Supervision:	Responsible (registering) Ministry, Tax administration office and NBS
Special condition:	One of the members of the MFI supervisory board is appointed by territorially authorized local unit of tax administration office, as well as at least one more member by NES
Funds and sources:	Necessary funds for founding and starting business are obtained by MFI founders and donators Clear differentiation of sources and purpose of MFI's own business assets and fund assets for microcredit financing The sources of microcredit loans funds are limited on donations and soft loans
Business operations:	Non-for-profit making, earned revenue can be used solely to cover current expenses and business operations improvements Loan rate is not source of retain capital or assets increase Income is made from commission, BDS

5. INSTITUTIONAL INFRASTRUCTURE

In this Study the attention of the authors is primarily focused on the perception of the development of the financial system in accordance with the needs of economy and priorities of economic development, with the special attention to needs of the analysis of micro-financial market capital.

Establishing institutional infrastructure usually presents a part of the process of realization of adopted policies, in this case policies for stimulating development of SME sector and start up within that sector. Is that the case in Serbia as well?

”What are the examples of support of public sector for self-employment in Serbia?” and ”Action plan for stimulating self-employment” studies were developed within the scope of realization of the first phase of the ILO project, which aims at establishing more efficient system of creating and conducting policies for stimulating development of start up.

Conclusions of the study stopped at the viewpoint that development of entrepreneurship and self-employment in Serbia should become one of the levers in solving problems of unemployment and creating new work positions. The Study underlines the need for defining responsibility for taking over agreed liabilities of all the participants in the process of creating and conducting development policies.

Findings of the study are that political support for self-employment, namely start up should be based on:

- Identifying the role of different participants and forming partnerships between public, private and non-governmental sectors;
- Improving legal environment for microfinancing;
- Strengthening existing and establishing missing non-financial and financial infrastructure;
- Further development of non-financial support;
- Identifying and providing adequate financial resources for microfinancing.

Action plan for stimulating self-employment defined the measures and activities that should contribute to further improvement of conditions for stimulating self-employment and start up in Serbia. The plan contains four fields of activities and they are:

- Plan of activities in the field of legislation and institutional infrastructure,
- Plan of activities in the field of financing self-employment and start up,
- Plan of activities in the field of communications (promotions),
- Plan of activities in the field of developing entrepreneur awareness of non-financial support.

Even beside all clear attitudes and recommendations disclosed in the mentioned Study and action plan, so far in the process of creating policies for stimulating development entrepreneurship and self-employment, a consensus has not been reached nor has the partnership of the public, private and NGO sectors, and to a great degree a dialogue with trade unions and employers associations are missing. It, simultaneously, lacks the process of defining instruments of conducting policies, which would create conditions for more significant stimulating and development of self-employment and start up. It is only at the beginning 2007 that a Task Force for start up and entrepreneurship was established within the scope of the council for SMEs, that aimed at establishing unified policy and conducting a system support for the development of start up.

As a result of such a status in the process of policy creating and implementing, potential entrepreneurs have no way of getting all the necessary non-financial and financial support at one place for starting their own job.

Therefore, in the period from 2003 up to now, the Government of the Republic of Serbia has taken certain measures for the purpose of creating conditions for faster and cheaper start up. An Agency for registering economic subjects was formed and a procedure for

founding enterprises simplified and accelerated. The amount of necessary founding capital for creating an enterprise and sole traders was decreased. The total amount of funds available for financing the programme of self-employment was increased within the scope of National Employment Agency. Likewise, microcredit line was provided through the Fund for the development of Serbia for credit financing start up. Non-financial support for entrepreneur beginners was intensified through a network of Republican agencies for SME and network entrepreneur centres of the NES. However, even though it can be concluded that there is a set of activities for supporting start up, so far unified institutionalized system creating and conducting policies for the development of start up, that would provide partnership of different participants from all three sectors, has not been established.

Overview of the existing support – examples taken from practice

Option 1

- An unemployed would-be entrepreneur goes to the subsidiary of the NES
 - Gathers necessary information
 - He may attend some basic training for starting his business
 - After the business has started he can apply for the announced competition for granting financial aid within the scope of active labour market measures

Option 2

- A would-be entrepreneur goes to the Regional agency for SMEs
 - Gathers necessary information
 - He may attend some basic training for starting his business
 - He may attend some basic training for drawing up his Business plan in order to start his business
 - After the business has started he can apply for the announced competition for granting financial aid within the scope of active labour market measures

Option 3

- A would-be entrepreneur goes to the NGO that grants microcredits
 - Gathers necessary information
 - He passes the basic training
 - He obtain microcredit which insufficiently covers his financial needs for starting a business

All would-be entrepreneurs may take part in the open competition of the Fund for the development of the Republic of Serbia or AP Vojvodina, on the basis of the announced competition, for obtaining microcredits for starting their own business. We have to remark that the funds are not available the whole year round, but only once or twice a year. Likewise, would-be entrepreneurs may also go to bank Opportunity International for obtaining loans for start up.

All that was mentioned confirms that there is no unified package of services for stimulating start up as a result of system support that provides a connection between non-financial and financial policies and which is realized through partnership of public, private and NGO sectors. An effective process of creating, and then implementing the adopted policies, presents a complex process which requires participation from many parties. So far, institutional infrastructure has not entirely been built and it does not meet the requirements of the current development of the SME sector, and especially start up.

Institutional infrastructure relevant for financial support to start up in Serbia consists of:

I - Public sector:

- Fund for the development of Serbia
 - Fund for the development of AP Vojvodina
 - Fund for the development of Municipality of Leskovac
- National Employment Service

- *Republic agency for the development of SMEs*¹⁶
- Credit guarantee fund (RS)
 - Credit guarantee fund AP Vojvodina
 - Credit guarantee fund "Alma Mons", Novi Sad
 - Credit guarantee fund Municipality of Leskovac
- Fund for increasing employment (SFRY)

II - Private sector:

- banking sector
- leasing companies
- investment funds
- other

III - Non-profit making sector

- NGO
- regional and donator initiative
 - *network of regional agencies/centres for supporting development of SME*

Existing financial institutional infrastructure is primarily a logical consequence of regulatory rules and the need for executing the goals of economic politics, as well as pragmatic motives of different political interests.

Fund for the development of the Republic of Serbia and Credit guarantee fund are established in accordance with current legal regulations (on the basis of *sui generis* law), while the other mentioned similar regional and local public institutions are established *ad hoc* on the basis of decisions of (non)legislative bodies of local self-management or AP Vojvodina¹⁷, except the Fund for increasing employment which is a relict from the former SFRY¹⁸.

We believe that the degree of development of financial system we reached is not sufficiently synchronized with the economic structure as well as its needs and possibilities for development. Economic structure of Serbia is 98% SME, 99% of which are micro-enterprises.

Banking sector dominates over the financial system in Serbia, with the outstanding monopoly of banks in all financial markets.

Investment funds are at the starting point, last year a law and the supporting regulations were passed, but it is only recently that establishing institutions has started and it remains to be seen to what degree it will influence micro-financial market capital.

There is no doubt that the real sector should primarily service financing from private, in the first place banking sector. That is truly necessary, but it is not enough for accelerated economic development, which primarily counts on the important role of SME sector.

For the requirements of this study we have analyzed the development of financial institutional infrastructure concerning:

- degree and quality of satisfying the requirements of the immediate beneficiaries of micro-financial support for start up;
- the need for carrying out the policy for combating poverty, decreasing unemployment and stimulating entrepreneurship;
- efficiency of application of funds, that is to say social "cost price" of financial support for start up.

¹⁶ The Republic agency for SMEs with a network of regional agencies/centres is an important capacity of non-financial infrastructure for supporting start up. The Republic agency is a public institution whereas regional agencies and centres are with the specific individual legal status.

¹⁷ In that respect APV do not have the appropriate legislative authorisation.

¹⁸ Socialistic Federal Republic of Yugoslavia

Recommendations for more efficient start up policy

Discussion conducted by the panels in the regions leads to the following ratings and conclusions concerning direction in which policies of support for start up be created and realized:

- The necessity for continuing organized and coordinated common activities of key policy makers on the national and local levels in the direction of further system elaboration on defining advanced policies on microfinancial support to self-employment and start up was emphasized;
- Microfinancial support to start up which is realized through the Fund for the development of Serbia has some disadvantages, the most prominent of which are the following: (a) availability of funds is not continuous (on the basis of open competition, once a year); (b) limited availability for beneficiaries, (c) centralized approach in handling requests and decision making; (d) absence of coordination with non-financial support; (e) absence of monitoring and effect analysis.
- Decentralization of support programme is required. That implicates not only yielding information, processing and submitting documents "out of Belgrade", but also making decisions on local/regional level (*An exemple*: RC for the development of SME "Zlatibor" along with 9 municipalities of Zlatibor county is preparing a programme on economic development for the next three years up to the level of projects. With a view to as efficient work as possible, programme committee has been appointed and it consists of municipal representatives in charge of economic development who make decisions on the most important issues).
- Using existing organizations on local level for realizing that programme, including raising their capacity in accordance with the need, but not founding new institutions where others already operates.

6. FORMS OF FINANCIAL SUPPORT

Effects of past financial support to start up by public sector

It is very difficult to give a precise opinion about effects of past financial support, considering that the process of monitoring according to the start up credits placed within the public sector is not established. Likewise, none of the researches within the public sector has been realized, that would aim at clearly establishing effects of financial aid supplied by the Government.

We can draw certain conclusions only indirectly, based on process, criteria, as well as the number and amount of realized credit arrangements.

Processes of assigning loans from the Development Fund and from NES are being realized on the public call basis and take place autonomously within resource institutions, without cooperation with other relevant institutions. Public calls are announced once or perhaps a couple of times a year. That means that assets are not available potential entrepreneurs the whole year round. As a consequence of such a system, those who answer competitions focus on the possibility of receiving financial assets, not on starting businesses. Basic criterion for assigning assets is larger number of newly employed, which very often contradicts the nature of start up projects. The problem of collateral often arises with approved credits, and the number of credits realized is smaller than the number approved.

When granting funds, people disregard the necessary for connection between non-financial and financial support. Harmonized relationship between non-financial and financial support is an example of the best support to start up projects practice of developed countries in transition.

Elements of the necessary micro-financial support to start up

In this context basic questions which should be answered are the following:

What are the demands that must be met in the process of creating and conducting policies of support to start up? What should an institutional infrastructure that would optimize the forms and mechanisms of support to start up be like? Is the division necessary or is the complementarity of the roles of all three sectors possible?

Essential conditions for financial support to start up are:

- Effective cost price of capital below real average profit margins;
- other conditions (extent of resources, repayment period, grace period and other.) flexibly designed in order to adapt to clients' needs;
- the base for obtaining loans, should be in accordance with assessments of reliability and capability of an entrepreneur, feasibility of a business plan, and as the most important – with the objectified projection net cash flow;
- providing coordinated non-financial support, that should be present during loan recovery, beginning with the preparatory phase, through starting and lasting at least during the first year of business operations.

Optimal set of ways of supporting start up should include the following:

- soft specific-purpose loans from public sector;
- public sector credit guarantees for commercial credits (including leasing arrangements);
- subsidizing commercial banks' interests for start up credits;
- grant for new employment (non-returnable funds for every newly-created work position, including that of an entrepreneur);

- vouchers for subsidizing non-financial support (in the range from 30-70% for service expenses, and depending on the type and phase) in public - private - NGO sectors partnership;

Financial and non-financial supports are equally important for success of start up projects, especially for surviving during the first year of doing business.

Running business operations of a start up project poses numerous and very complex demands for potential entrepreneurs, that include market analysis and marketing, managing suppliers and buyers, conducting numerous and very complex business administration properly (for example: the procedure of employing workers, applying tax and other business operations regulations), while it is extremely critically efficient finance managing, especially for the initial period.

From the social point of view, it is not enough only to provide the necessary financial support, but also to ensure as much as possible the appropriate subsidized non-financial support in order to "ensure" financial aid from bankruptcy of the business project due to beginner's mistakes and limitations that can efficiently be corrected or significantly diminished with the appropriate non-financial support. Unless that happens and would-be entrepreneurs are left on their own, efficiently used financial support will be devalued to a great degree.

Consequently, subsidiary costs of offering appropriate non-financial support have to be calculated and built into the cost price of start up projects' financial support, as their integral part.

How to provide the optimal use of funds, in such a way that the financial support should go to the best entrepreneurs, or, more precisely, those who have the most prominent entrepreneur qualities, whose projects are the least risky and have the greatest potentials for growth and development?

Public sector should promote development and functioning of the appropriate framework for functioning of microfinancial institutions and market, as well as *intervene* should there be a need for it, for making a balance between offer and demand, form and conditions of financing with requirements and abilities of beneficiaries (for instance: through **funding** MFI), but in such a way that it **does not distort** financial market.

Definition of indicators for rating microfinance

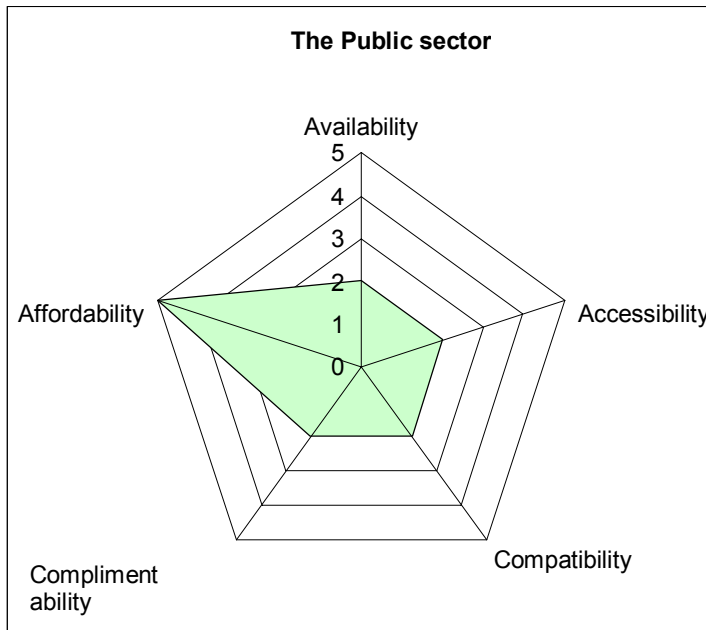
- **Availability** – in what form and in what degree financial support exists, as well as whether it is always present, that is to say if it coincides with the requirements of a beneficiary and in what degree. – ***Does it always exist and is it sufficient?***
- **Accessibility** – how present is the offer in the immediate environment and whether it is adapted to the abilities of a beneficiary to use it relatively quickly and simply, namely, how accessible is it for the clients objectively (for instance: from the point of view of procedure complexity and time required) – ***Is it at hand?***
- **Affordability** – in what degree are the conditions and criteria for using financial support in accordance with the need and abilities of beneficiaries, that is to say in what degree are the forms of financial support economically truly acceptable for beneficiaries they are intended for (for instance: from the point of view of the extent of funds, interest, repayment period, the type of guarantee and other.) – ***Does it have an acceptable price?***

- **Compatibility** – is financial support compatible with other source of financing and to what degree beneficiaries do have the opportunity to combine them for their own benefit with other different sources (for instance: from the point of view of possibility for creating weighted financial assets from public, private and non-profit making sectors) – **Is it compatible and does it have its advantages or is it limited in practice?**
- **Complimentability** – is financial support conditioned by using non-financial support, in what way and what are the conditions (is it subsidies or not) – **Are there any additional advantages or costs?**

Network diagram for public, banking and non-for-profit sector

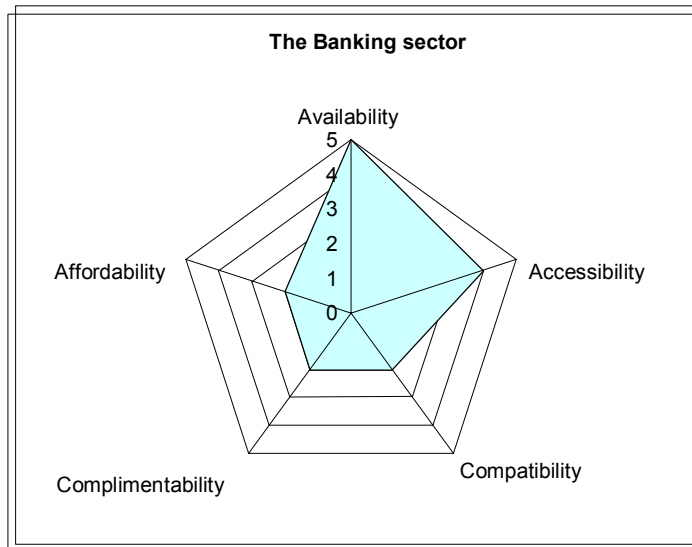
Public sector

Criterion	Rate	Explanation
Availability	2	Funds are not available the whole year round; they are marketed periodically announcing an open competition, in accordance with annual fund programmes. It is not predictable when a public call would be announced, procedure accomplishes and money could be actually available.
Accessibility	2	Competition procedures are complex and centralized, with weak influence of the local institutions on decision making or without any. Except NES, which is territorially well covered, others are away from the user residence.
Compatibility	2	Credit instruments are strictly earmarked, flexibility of use and financial management are reduced.
Complimentability	2	Consulting services are low and mostly limited to formal requests in connection with the competition procedure. Disproportionally ample costs are conditioned by the centralized procedure.
Affordability	5	The price of the capital is subsidized, below the inflation rate.



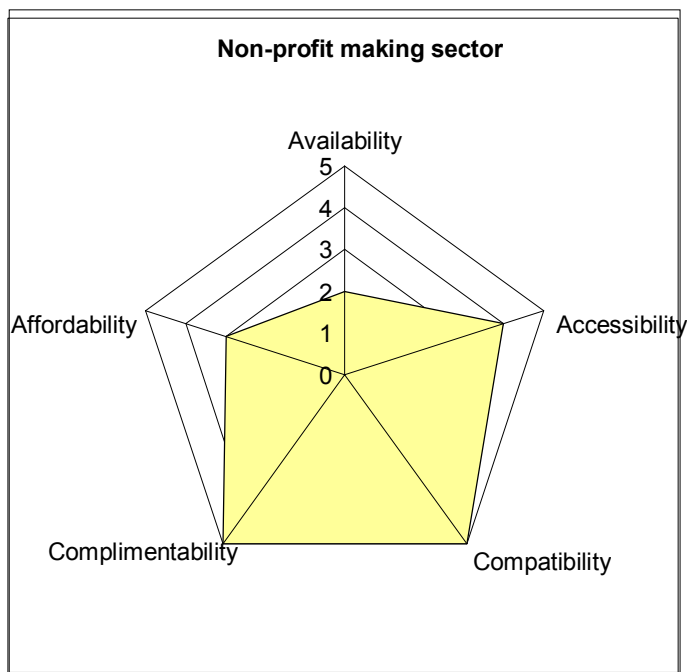
Banking sector

Criterion	Rate	Explanation
Availability	5	Credit offer is big and always present
Accessibility	4	A network of subsidiaries is dense and there is good territorial coverage.
Compatibility	2	Credit is conditioned with the client having to be bank's customer.
Complimentability	2	Some banks offer technical support for making up a cash flow, business plan, etc., for the requirements of assessing bank risks and it, generally, does not include any remotely important consulting services for the client.
Affordability	2	The price of capital is too high, effective interest rates exceed profit margin.



Non-profit making sector

<i>Criterion</i>	<i>Rate</i>	<i>Explanation</i>
Availability	2	Liquid assets volume is limited and far below demand.
Accessibility	4	Credit officers go to the client and establish direct communication.
Complimentability	5	Credit offer is earmarked according to the needs of the client. Flexible use of credit, accorded with the current state of finance and current state of finances and business operations of the client.
Compatibility	5	Consulting service is versatile, which includes cash flow projection, managing finance, informing oneself concerning business, making connecting and so on.
Affordability	3	Price of the capital is relatively high, but it is within the scope of profit margin.



Observations after the panel meetings can be summarized into following notes:

- The need for additional financial initiatives, which could be implemented with easier and simpler administrative procedures, was emphasized;
- The need for enforcing better monitoring over spending assets allotted with a view to self-employment was expressed whereas the need for mentoring was stressed;
- Start up requires wider support, with the full understanding of entrepreneurship as a whole, within which it should not amount only to only support and encouragement of employment of the unemployed:
- It is necessary to have compatibility of financial support where it cannot be satisfied from one source only, which points out the necessity for such legal regulations where one form financial support to start up and entrepreneurship will not, automatically, exclude the possibility of receiving other financial assets intended for the same purpose (an example: pilot project where municipality Šabac subsidies start up through interest payments on assets taken with commercial banks)
- Greater complementarity of non-financial and financial support is required;
- Consulting services are necessary after starting business in order to decrease possible risk from bankruptcy due to not enough knowledge or inadequate financial support, where we should also set aside and greater additional funds after certain period for further development of enterprises and their further consolidation on the market

Analysis of possibilities for establishing an integrated model

Is it possible to achieve the model "all at one place"?

It is not possible if the financial support is in question, but it is possible and desirable to achieve such a principle when we talk about non-financial support, therefore, all technical support and consulting should be **coordinated, but not necessarily provided** at one place.

- Providing information and advice on issues of the existing available sources, forms and conditions of obtaining financial support (who and under which conditions offers microfinancial support);

- Training entrepreneurs and consulting for making up a business plan and cash flow
- Creating investment portfolio and “building up” a financial construction;
- Providing technical assistance with procedures for submitting claims for funds, banks, NES, and other.
- Supervising the realization of projects and initial business operations, with consulting services (monitoring and mentoring)
- Managing finances

Primary interests of the public sector are to maximize the realization of the goals of its policies; in this context it should create more new businesses and new jobs with the available (limited) funds.

Private sector should decrease the risk and increase the profit margin in microcrediting start up as much as possible.

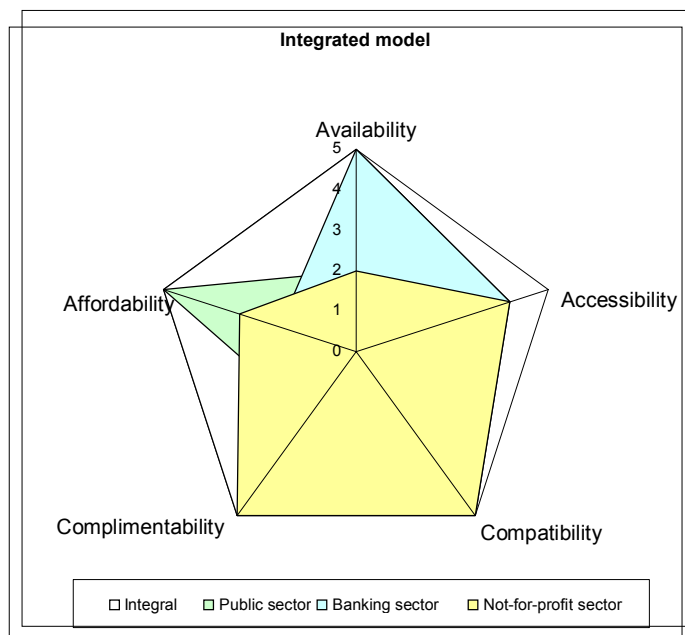
And finally, the interest of non-for-profit sector is to supply its own (financial) sustainability by contributing to realization of social interests and goals.

Is such an integral or interactive model possible, based on partnership of all three sectors, as a result of complementarily and comparative individual advantages of each of the three sectors.

What would vector diagram of interests of all three sectors on the plan of microfinancing be like?

According to our perception – it is synergetic.

Integrated model



In this context *authors* have some dilemmas concerning real feasibility of such an approach and they feel free to pose this *direct question* first of all to the experts, but also to the policy makers and SME community as well:

Is it legally possible (in accordance with the current regulations) and is it well founded, from the point of view of social rationality and economic efficiency, to market freely a significant part of surplus available financial assets of Pension Fund for self-employed through banks and non-profit making MFIs with the intent of supporting start up, self-employment and creating new jobs.

7. EXPERIENCE OF THE NEIGHBOURING AND NEW MEMBERS EU COUNTRIES

The Western Balkan Countries

In Croatia microfinancing died down relatively quickly although it was legally regulated, and it was swallowed by the banking network primarily because of its weak organization. There are some traces of it, but such organizations mainly still have not found their place.

Montenegro regulated this matter legally by the end of the nineties and enabled its non-governmental organizations to deal with microcredit financing. Likewise, they were enabled direct debit with international financial institutions. There are several microfinancial organization there that do their business successfully.

Bosnia and Herzegovina developed this field well, it regulated the status and the position of microcredit organizations legally on the financial market and determined their further development entirely.

Macedonia also regulated this matter legally, but it still wonders in the development of this sector because of its insufficient assets and weak structure in microcredit organizations.

The New Members EU Countries

Bulgaria

State financial incentives for SMEs

The major instruments for direct government financial support to SMEs envisaged in SMEA are as follows:

- Access to public procurement regulated by the Public Procurement Act;
- Foundation of an Encouragement Bank AD for priority lending to SMEs;
- Development and implementation of programmes on SMEs;
- Securing part of the credit risk on credits provided specifically for SMEs;
- Participation of SMEs in the privatisation of state and municipal enterprises (repealed, SG, issue 28/2002) and rental of realties constituting state and municipal property under preferential conditions.

Credit guarantee Funds

The Fund was founded with a budget of 20 million BGN. The project started on a pilot basis on 26.12.2001 in 18 municipalities on the territory of 9 districts and in August 2002 it covered the whole country. The project is unique with the following features:

- Access of SMEs to lending resources; unemployed persons, craftsmen, cooperatives and farmers who currently cannot meet the general bank requirements;
- Access to credits of start up businesses;
- Subsidized interest rates for persons with reduced capacity to work;
- Provision of cash compensation amounting to up to 100% of the principal;
- Project scale in terms of resources, territorial range and target groups.

Target groups for the project are:

- Newly-established and existing micro-enterprises;
- Newly-established and existing cooperatives;
- Agricultural producers;
- Craftsmen and craft cooperatives;

The Guarantee Fund guarantees 70% of the loans for operating enterprises and 100% - for start up enterprises. The basic interest rate is under 10%.

Small business microfinancing from non-bank financial institutions

There is no legal framework in Bulgaria specially designed to regulate microfinancing activities in the country. Micro finance by definition is an activity providing financial

services to small and medium-sized enterprises in a given country. Currently the legal entities providing financial services to SMEs in Bulgaria are banks, cooperatives and mutual funds (kasas). The overall activities of the banks, including those providing financial services to SMEs are regulated in the Banking Act. and liquidation.

Legal framework

Unfortunately the legal system in Bulgaria is not favorable for the development of micro financing – on the contrary, it creates barriers to the institutions providing micro financing. Currently the *Banking Act* excludes the cooperatives from the range of its provisions.

The Czech Republic

Legal framework for micro-finance providers

There is no usury rate in the Czech Republic. The civil code prohibits disproportionately high rates of interest but law does not fix the height of the interest rate. Non-banks can lend money. For example, the Provident Financial has been operating in the Czech Republic since 1998 offering personal cash loans.

Financial bridge for the socially excluded

Financing of micro-enterprises, start-ups and new project seem too risky for commercial banks and there doesn't seem to be any provision of micro loans to the self-employed.

Funding for micro-credit providers

There does not appear to be any micro-credit providers in the Czech Republic. A spokesperson from the Ministry of Trade and Industry claims that NGOs limit themselves to business support/consulting services because of lack of funds. An NGO worker said that: "The Czech Republic is a wasteland in regards to microfinance opportunities." More research is needed to ascertain why this is. It is unclear whether this is primarily driven from a lack of enabling policy environment or a lack of funds.

Practice in the Czech Republic

Concerning the Credit guarantee system in the Czech Republic was set up through a bank, the Czech and Moravian Guarantee and Development Bank – CMGDB with 49% state holding and the remainder in the hands of the major banks in the country. CMGDB was one part of a network of supporting institutions for SME, which included various funds as well as regional consulting centres and business innovation centres. These institutions received considerable support through the PHARE programme of the European Union.

Hungary

Legal framework and policy

In Hungary there is no specific law that regulates the matter of microfinancing, namely, doing microcredit business or founding and business activities of MFI.

This matter is regulated in such a way that the integral part of the Strategy for the development of SME of all previous Hungarian Governments, that is realized through activities of institutions of the public sector supported by EU funds.

Micro-financing to SMEs and start ups

Formal efforts to promote self-employment among the unemployed in Hungary and Poland began in the 1990s only after changes in laws regulating ownership of an enterprise. In the nineties, the financing of the small and medium-sized entrepreneurial sphere through loan facilities of the commercial banks did not live up to expectations. The sum of restart loan was very low and, due to the increased risk of the sphere, the commercial banks offered their loans demanding many hundred per cent collaterals. The same problem occurred in relation with other loans too. Under such circumstances it was necessary to provide loans through enterprise development centers. The Micro Loan

Program started with the support of the European Union in 1992. First, it started as an experiment, in six counties, later it was continued all over the country. The necessity and success of the program is illustrated by the fact that after a number of adaptations it still functions today and thousands of entrepreneurs avail of it. The adaptations are related first of all to the sum available; EUR 12,340 in 2000 and EUR 24,680 in 2001 and to the increasingly favourable system of requirements for the entrepreneurs. On a national level about EUR 82,583 thousand loans was provided for about 18 thousand enterprises.

Hungary is one of the advanced associated CIT that has attempted to develop a distinct micro credit programme. The maximum micro credit is approx US\$ 5,000. The loan can be used to purchase machinery, equipment and other fixed assets. No more than 30% of the loan can be used to finance current assets. Loan applications were submitted through the Local Enterprise Agencies. By mid 1997 almost 8,000 such micro loans had been disbursed for a total of US\$2.25m - average loan size US\$ 2,810.

These amounts indicate a larger size of micro credit than is usual in most micro finance programmes in other countries but this is partly explained by the higher limit of the definition of such businesses in Hungary.

The micro-credit scheme in Hungary has been run by Hungarian Foundation for Enterprise Promotion and its network and financed by the PHARE and the Government, while as such falls into the category of subsidized micro-credits. There were also other organizations funding micro-credits to the businesses such as The Hungarian-American Enterprise Fund, the Budapest Chamber of Commerce and Industry and Budapest Municipality but not so worthwhile as those conducted by the HFEP.

In Hungary there are three credit guarantee institutions issuing guarantees for credits guaranteed to small businesses, the Credit Guarantee Company (CGC), the Rural Credit Guarantee Foundation (RCGF) and the Start Credit Guarantee Fund. If the credit has a rural or agricultural client, the bank will use the RCGF. If it is for a start-up, it will use the Start CGF, which is operated by the Hungarian Foundation for Enterprise Promotion (HFEP). In all other cases the bank will use the CGC, which is, in fact, the largest of the Hungarian credit guarantee schemes. CGC can guarantee maximum 90 % of the credit up to HUF 10 million. Over this amount the limit of the guarantee is maximum 80 %. The average extend of guarantee is around 60 %.

Some government agencies and commercial banks in Hungary have held the view that the CGC is not using all its guarantee capacity and is over-cautious in issuing guarantees. Fees of the CGC and the HFEP are also considered too high. There are complaints that the CGC changes its conditions too often. Also it takes only five days to obtain a guarantee approval from the RCGF while the CGC takes 30 days for the approval of long-term credit and 15 days for a short-term credit guarantee. By international standards however, these delays are reasonable. The proportion of credit leading to guarantee claims is highest for the Start Credit Guarantee Scheme and lowest for the CGC. There is some feeling in Hungary that the Start Credit Guarantee Fund has been an over-costly programme.

In sum for the period up until Hungarian accession to the EU, operating micro credit program financed by the EU PHARE program and the Hungarian government failed to reach the critical mass providing only 17 thousand loans in 11 years, having outstanding loan portfolio of 35 million dollars. Interest rates were subsidized, operational costs and the donors continuously covered losses coming from bad loans. NGO are almost incapable of running micro crediting activities since the cost too stringent and high.

Poland

In Poland a unique micro finance schemes called Fundusz Micro was established in 1994 by the Polish-American Enterprise Fund. Based on the results of the pilots, it has, since February 1996, built a nationwide network of 11 branches and 1 main office (Headquarters). As of February 1998, it had a loan portfolio of over \$8 million and served

over 8,000 clients. In September 1999, Fundusz Micro reached operational break-even. As of December 1999, it had disbursed over US\$ 50 million and serves 18,060 clients. The Star-up loans are limited to US\$ 1,200 and for a period of six months. This loan is secured by personal guarantee of three co-signers, who form a group of borrowers. In addition, the beginner entrepreneur has to fulfil all the requirements prescribed by the Agency. Fundusz Micro has been developed an innovative, computerized loan portfolio risk assessment system, or tool, which is used to control default risk at a time when Fundusz Micro is undergoing rapid expansion of its lending operations.

Policy for micro-enterprises

The fostering of self-employment and the support of micro-enterprises with micro-finance instruments became an issue recently on the agenda of the Polish Government, but only in the broader perspective of general SME support. A coherent national strategy for the improvement of the financial support for micro-enterprises and the fostering of self-employment is still lacking. Local development initiatives to support the creation and survival of micro-enterprises and self-employment are widespread in Poland, but with strong regional differences and no deep interconnections. A very popular form of local micro-enterprise support is the establishing of loan funds by public authorities. In 2002 a national government programme to build an integrated system of regional and local financial institutions for SMEs, was launched. Other programmes like the 'First Job' programme that aims at enhancing the employability of school-leavers and stimulating graduates to establish their own business sound more promising, but its outreach is low so far (since 2002 around 600 start-up loans were granted). There is no national programme focusing on fostering self-employment in special groups of socially excluded people. Efforts have been made to shorten the registration procedures necessary for setting up a business. At the moment the average duration is 31–60 days, which is acceptable, compared to the other countries. But according to interviewed experts, the costs are still very high. Overall the policy for micro-enterprises is not very supportive and below average.

Legal framework for micro-finance providers

There is no special legal regulation for micro-finance providers in Poland. The banking legislation offers enough freedom: Bank status in Poland is focused on deposit banking. In terms of lending, the Banking Law differentiates between credits and loans. Almost anybody can give loans to almost everybody. The levels of interest rates can be chosen freely as there is no usury law in place so far. For the Polish MFIs, this means they can charge enough interest to make their business financially sustainable but it. Overall the legal framework for micro-finance providers is very liberal and allows the allocation of loans without restrictions regarding interest rates and the legal status of the loan provider.

Financial bridge for the socially excluded

The commercial banking sector in Poland is highly concentrated and not very SME/micro-enterprise minded. Although the commercial banks are starting to be interested in SME lending and are starting to implement SME lending centres, so far micro-enterprises and socially excluded people are not a target group. There is a very strong credit union movement with a focus on private clients, but without a specific SME or micro-enterprise product policy. So for microenterprises and solo-entrepreneurs, the access to start-up loans or structured business lending is a big problem. As a result, Polish micro-entrepreneurs very often use consumption credits to finance their businesses. The strong NGO MFI-sector delivers the majority of financial services to micro-entrepreneurs. It consists of five MFIs of which *Fundusz Micro* is the largest organisation with a stock of 7,500 borrowers, 56,239 loans granted, and a loan portfolio of €12.2 million (end of 2002).

Funding for micro-credit providers

The sources of support for micro-credit programmes and self-employment schemes in Poland have changed over the last decade. While the local loan funds are supported mainly by governmental agencies, the MFI-sector was supported for a long time by foreign private donor organizations. This form of support granted the local MFI sector a lot of freedom in developing their structures and strategies and can be seen as a central key to the success story of the largest Polish micro-lender Fundusz Micro. Since the private donor organizations have retreated from Poland, some support for MFIs is delivered through governmental agencies. But thanks to the absence of a usury law and with an average interest rate of 7 per cent over base rate, the MFIs are able to develop sustainable operations. The co-operation of commercial banks with micro-finance providers is weak and selective.

Romania

Two lessons can be learned from Romania's experience with the creation of an effective regulatory framework for microfinance.

First, a clear, coherent and supportive legal framework is necessary for the development of the microfinance sector.

Prior to 2000, the Romanian microfinance sector was not regulated at all. It was then well-regulated for a short period in 2005 following the enactment of the Micro Finance Companies Law. However, since the 2006 enactment of Government Ordinance 28, the sector has been over-regulated. It has been supervised strictly by the NBR and the Ministry of Finance, based on rules that were designed for the banking sector rather than the microfinance sector.

Another lesson learned is the importance of continuously lobbying stakeholders to make them aware of the sector's most important characteristic: efficient financial services with positive social and developmental impact.

This awareness-building will be helped by the participation of representatives of the Romanian microfinance sector in the EU-funded project called, "From Exclusion to Inclusion through Microfinance: Learning from East to West and from West to East."

The Romanian representatives are learning from their Western European peers how to assess the social impact of microfinance activities and how to maintain the social mission of microfinance by improving and diversifying the financial and business development services offered.

Slovenia

The small business development fund was established by the State for the purpose of promoting and developing small business units. It allocates specific forms of assistance and support including loans, co-investment, investment in and financing of the construction of promotion centres, and free entrepreneurial and trade zones. It gives guarantees for investment loans by banks and other financial organizations, subsidies of real interest rates for investment credits, and premiums for the founding and development of small businesses.

Municipal Authorities sponsor the development of small businesses and crafts. The funds are mainly intended for the start-up and expansion of activities performed by sole traders and small businesses, which invest and operate at the municipal level. Credits are provided via local banks, which also provide credit insurance. Interest rate subsidies are the most popular form of municipal support for the development of small businesses. Other interesting tools are *Microcredits*. They have been met with a very positive response in the local environment. They are intended primarily for financing the start-up of companies and for creating new jobs. The basic principle is as follows: credits are

approved on the basis of a deposit amounting to 50 % of the total amount of credit for which the company has applied. Microcredits approved through five regional developmental agencies have created 548 new jobs. *SME development centre Goriska* established in 1992, is a good example. It unifies the financial resources of five municipalities. Loans are allocated to the entrepreneurs directly (without bank intermediation), which enables greater flexibility in supporting start-up entrepreneurs, self-employed persons and enterprises carrying-out ecologically and technologically acceptable projects. The reimbursement of the loan is gradual, thus creating the potential for financing new loans. In the ten existing *regional guarantee schemes*, the state and local communities provide public funds. Companies and other organizations also provide their contribution. The funds are intended as guarantees for companies that take out bank loans. Via these guarantee plans companies are provided with the opportunity to partly insure their liabilities to the bank. The guarantee plans insure credits using faster procedures and lower costs for company owners, merging the dispersed funds contributed by the state, local communities and companies and reducing the degree of guarantee risk and hedging risk by distributing it among several partners. The plans are carried out in Regional agencies in Zagorje.

Credit guarantees in Slovenia are provided through a scheme operated by the Small Business Development Fund (SBDF) nationally and also a range of regional guarantee funds (RGF) are operated through the Regional Business Centres. The RGF in practice are the main instruments for providing guarantees for SME lending, receiving their funding both from the SBDF and from local resources.

The RGF in Slovenia provide a 50% guarantee of credit with the bank covering the risk, either from its own resources or through equivalent securities from the borrower. Credit amounts through the Regional Development Centres that can obtain a 50% guarantee from the RGF are for amounts of US\$ 6,000 up to US\$ 60,000. Repayment periods are from one to five years and the interest rates aim at a real level of 6%. The credits are subject to a guarantee period of 6 months and a further US\$18 is paid out for the costs of the guarantee fund to deal with the application. The maximum period, from the date of application submitted to the guarantee fund to the conclusion of a credit agreement will be 2 months although efforts are made to shorten this period. In general, based on the resources available to credit guarantee funds, each fund is able to issue approximately 200 guarantees per year. RGF operate generally with a fund of US\$2 m.

Sum up of the best practice

In commonly in the most countries the role of microcredit financing gave positive results concerning opening new jobs through business development or through self-employment. It also had positive effect on economic local and regional development.

But based on learned experience from other countries the best practice in microfinance to start up and self-employment the only one answer comes up – the single simple end easy solution to adopt could not be found.

Romanian experience in defining legal framework for MFI is significant. Still remains uncertain which approach provide friendlier environment for MFI operation, to be or not to be specifically legally defined. In answer to that seems that policymakers are requested to find balance base on well tuned legally regulated status of MFI with their role in start up and self-employment policy implementation.

Poland similarly regulated this matter legally, but as far as they are concerned it is important to stress that they especially engaged on the development of microfinancing in Europe and that they work on connecting and education of microcredit organizations in the whole Europe, in middle and south-east in particular.

Lessons learned provide us guidelines:

- (1) Efficient microfinance support to start up conditioned / determined by:
 - (Ir)regulation of legal environment for establishment and microfinance institutions operations;
 - Developed institutional infrastructure for corresponding non-financial and financial support to SMEs;
- (2) Effects of microfinance support would be significantly stronger, if:
 - ✓ It is integrally built-in into enterprise development policy;
 - ✓ MFI sector is open for free entrepreneurship.

8. CONCLUSIONS AND RECOMMENDATIONS

Standpoints:

- *Existing microfinance support in Serbia does not satisfy the demand and it does not realize the goals of the defined policies of supporting start up;*
- *Existing institutional infrastructure is not rounded, or fully defined, or even developed;*
- *Microfinance support within the frame of the public sector is centralized and fragmentary;*
- *There is no adequate relationship between the financial and non-financial support to start up;*
- *Microfinance support to start up is also characterized by absence of equity, royalty and venture capital, including business angels;*
- *Microfinance sector in Serbia is undeveloped;*
- *Local initiative support to start up improvises due to disorganization of the legal framework;*
- *Legal regulations limit possibilities of the development of the necessary microfinance infrastructure;*

Recommendation:

- *It is necessary to define legal framework, by passing a Law on MFI, namely, on non-deposit financial organisations/funds;*
- *Providing sources (funding) for financial assets necessary for microfinance support to start up is a responsibility of the public sector;*
- *Developing institutional microfinance infrastructure should be based on partnership of the public, private and the not-for profit sector;*
- *Establishing principles of decentralization in the process of conducting microfinance support to start up, while utilizing of the available capacities on regional and local level;*
- *System of efficient support to start up should establish overall, coordinated and rounded relation of financial and non-financial support, from informative in preparation to monitoring and mentoring in the process of realization;*
- *Designing and setting up of an integrated model for more efficient and effective microfinance support to start up is possible and desirable, based on competencies and comparative individual advantages of each of the three sectors.*

Recommendations for advancement of the existing forms of public sector's support to start up

Realization approach, in comparison to the previous period, it was necessary to unify activities of the public institutions applying the following principles:

- partnership of the institutions of the public sector,
- functional relationship between non-financial and financial support,
- decentralized approach to credit decision making,
- introducing "financial agent" into the process of allocating funds,
- connecting credit instruments with the funds designed for active measures of employment,
- establishing monitoring

Concept, the division of roles, who is supposed to do what:

- Fund for the development, Republican agency for the development of SME (RASME) and National Employment Service (NES) are making joint annual Programme for supporting start up;
- RASME is conducting a training and mentoring programme for making up a BP, as well as monitoring activities, through a network of regional agencies/centres for development of SME (RAs);
- NES, via network of subsidiaries, is primarily informing potential beneficiaries, gathers and processes loan applications of the Fund, ranks the received application applying defined criteria in cooperation with local Ras;
- The Fund makes decisions and administers loans, through the board of creditors among whose members are the representatives of RASME.

Types and conditions for financial support that entrepreneur beginners can count on:

- Subsidizing training and consulting services before and after starting their business,
- grant for every newly employed person (including entrepreneur),
- "soft" loans,
- Exceptionally, credit guarantees of the Credit Guarantee Fund for "big" start up projects.

An example of implementing the procedure

Client-beneficiary of financial support that wants to start his own business takes the following steps:

1. He/She goes to the local subsidiary of NES
 - gets information about the things he can count on (the types of non-financial and financial help), and the way to accomplish that
2. He/She goes to RAs where he becomes a part of the "scheme" support
 - attains the course for beginners
 - makes up **his own** business plan
3. He/She goes to NES and applies for financial support, and thus specifies, on the basis of his BP, the forms of financial support he is applying for and what is its extent.
4. On a municipal/regional level, "credit board" established for that purpose, handles the received claims, assesses and rank them, and then sends them to the Fund for final decision.

Key factor in making and assessment a Business plan is market feasibility - Not a cheap funding source.

APPENDIX

Abbreviations used

AP	Autonomous Province Vojvodina
BDS	Business Development Services
EMN	European Microfinance Network
ILO	International Labour Organisation
MFI	Microfinance institution
MoERD	Ministry of Economy and Regional Development of the Republic of Serbia
MoLESA	Ministry of Labour, Employment and Social Affairs of the Republic of Serbia
NBFI	Non-Banking Financial Institution
NES	National Employment Services of the Republic of Serbia
NGO	Non-Governmental Organisation
RDB	Republic Development Bureau of the Republic of Serbia
RZS	Statistical Office of the Republic of Serbia
SFRY	Socialistic Federal Republic of Yugoslavia
SMEs	Small and Medium Enterprises

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