CHAPTER 21.

EU AND SERBIA: SME POLICY IN TIME OF CRISIS AND BEYOND

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Abstract

Small and Medium-sized Enterprises are recognized as the backbone of every economy and the key source of economic growth, dynamism and flexibility in advanced industrialized, as well as in transitional and developing countries. Policymakers are conclusive in attempt to promote the more dynamic development of SME sector by creating policies and consistently implementing the basic principles contained in the European Charter for Small Enterprises. The further course of the Serbian integration into the European Union will be primarily determinate by the development of the SME sector. The SME sector in the Serbian economy accounts for the largest part of total number of active companies, GDP, total export and import and for the majority of employment. Due to the fact that the world financial crisis has worsen the already vulnerable SME sector in Serbia, the government, by setting the adequate policy framework in which SMEs can operate, has provided economic benefits through the selection of business support instruments, the problems they address and the way they are delivered. Even though the importance of the role SMEs play is even more emphasized in times of crisis, these enterprises are facing significant problems when providing necessary financial resources and maintaining liquidity.

Key words: *small and medium-sized enterprises, economic growth, Serbia, EU, government, integration, policy, financial crisis*

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THE IMPACT OF CRISIS ON SME SECTOR

Over the last decade, the SME sector grew and developed dynamically across the EU countries. In the period 2002-2008, 9.4 million new jobs were created in the SME sector which stresses out that SMEs have been the job engine in the European economy. An increase by 2.4 million new SMEs was recorded and today they represent 99% of businesses in the EU, thus being a key driver for economic growth, employment, innovation and social integration. An impressive growth of the SME sector was partially slowed down by the financial crisis, which hit SMEs much more dramatically than the large ones.

SMEs are more vulnerable in times of crisis than the large firms for many reasons, among which the following ones are considered to be the most relevant [12]:

– it is more difficult for them to downsize as they are already small;
– they are individually less diversified in their economic activities;
– they have a weaker financial structure (i.e. lower capitalization);
– they have a lower or no credit rating;
– they are heavily dependent on credit and
– they have fewer financing options.

The crisis started to show its effects in the middle of 2007, and by the late 2008 a rapid decline of world trade and a loss in business confidence occurred, followed by decline in production, exports, investments and private consumption. There was barely any sector in the industry that was avoided by the crisis, and the recession particularly hit manufacturing, construction, transportation and automotive industry. The negative effects of the crisis have additionally emphasized the problems SMEs are often confronted with, which mostly refer to a lack of financial resources, followed by a lack of human resources, liquidity problems, administrative and legal burdens. Decline in production and trade in large enterprises consequently worsened the position of SMEs in supply chains, as they carried out a significant part of the burden of the large firms. SMEs faced an increase in payment delays which resulted in a shortage of working capital and in a decrease in liquidity. The public sector's payment delay deepened the problem of liquidity, thus reducing SME's investments. The short term impacts of the crisis on SMEs can be summarized as a decline in sales and profits, followed by more intensive competition in markets and limited access to finance. Because the crisis led to a less favourable balance of risks, the number of business start-ups was negatively affected. In light of the crisis, SMEs recourse to operating costs reductions and cuts down in inventories and investments, including innovation spending.

A drastic drop in demand for goods and services and a tightening in credit terms put in question the creation, survival and growth of SMEs across Europe. Due to the difficult access to capital, their liquidity positions and higher risks on collateral, the banks tightened the credit conditions for all their clients. In order to survive, banks and other financial institutions oriented towards keeping the strongest clients, while the practice of lending to SMEs deteriorated. Faced with difficult access to credits, SMEs are searching for other sources of finance, but access to venture capital and private equity seems to be limited as well.

Comparing to SME sectors in EU member states, SMEs in transitional countries were hit by the financial crisis more dramatically, mostly because they were already facing numerous financial and non-financial problems, they obtained lower level of development, and institutional support was less efficient. In Serbia, along with reduced inflow of foreign capital at the beginning of October 2008, the first effects of the crisis occurred imposing new business conditions characterized by a more rigid discipline in debt repayment. An increase in the price of capital, reduced amount of funding and loans, downturn in demand for goods and services, and reduced export and import activities affected the operation and development of SME sector.

Faced with the crisis, the policy makers were forced to review and redefine the scope, the volume and the direction of their policy measures. In order to ease off the negative effects of the crisis, the majority of European countries adopted anti-crisis packages, which generally comprise of measures aimed at stimulating demand, credit enhancement measures (including recapitalisation of banks) and labour-market measures. Regarding the SME sector, a large number of short-term and long-term measures, ranging from tax reductions to structural and institutional changes, have been taken so far. Governments have put a lot of efforts into improving SMEs' access to finance, obtaining the scope of their business activities and preserving the level of their investments. Special attention has been given to the extension of loan and credit guarantee schemes, an introduction of public guarantee schemes with an aim to improve the capacity of banks to finance SMEs, as well to the maintenance or an increase of cash-flows. In some countries governments put pressure on banks to continue lending to SMEs. Belgium and France, for example, introduced a ″credit mediator″, whose role is to ensure that enterprises obtain credits from banks.

SME POLICY IN EU AND SERBIA

The development policy for the sector of small and medium-sized enterprises has for quite some time been one of the priorities of the European Union. The first steps to spur the SMEs development were undertaken as early as 1980s, however, they were predominantly oriented towards cutting the administrative constraints, bringing into accord the VATs in the EU member states, adjusting the conditions of financing to foster transparency of the pay systems, the harmonizing the social aspects of business operations of small firms, promoting the competitiveness of SMEs, etc.

The beginnings of the so-called “modern“ SME policy of the EU dates back to the year 2005, when the European Commission issued its Recommendation defining the micro, small and medium-sized enterprises, and when the document “Implementing the Community Lisbon programme - Modern SME policy for growth and employment“, based on Lisbon Strategy of 2000 was adopted [3].

The document highlighted 5 key areas: 1) Promotion enterpreneurship and skills, 2) Improving SMEs access to markets, 3) Cutting red tape, 4) Improving SMEs growth potencial, 5) Strengthening dialogue and consultation with SME stakeholders. Within these areas the goals were set that were supposed to contribute to a more effective implementation of entrepreneurship potential of Europe and giving impetus to the SME sector.

All these steps have considerably aided the development of the SME sector and created the background for the next document, known as the Small Business Act. The European Commission adopted the document in June 2008, and it can be said to present one of the major EU initiatives for the SMEs. The Small Business Act integrated all the initiatives known of at the time and proposed new measures necessary to support the SME sector. „Adopted in June 2008, the “Small Business Act” for Europe reflects the Commission's political will to recognize the central role of SMEs in the EU economy and for the first time puts into place a comprehensive SME policy framework for the EU and its Member States“[10].

The key element in pursuing the policy and decision making on all the levels in the European Union, according to the SBA, is the importance of the “Think Small First“ principle that states that the public administration should pay full attention to small and medium-sized enterprises.

The SBA is established on 10 principles meant to coordinate and regulate the activities related to the SME policy implementation by the Commission and the member-states [11]. The main goal of the SBA is to aleviate the administrative burden for the SMEs and cut the red tape that hinders the growth and a successful development of the SMEs. The SBA encourages a broader access and participation of EMSs in the EU programmes, in financing, as well as at the government tenders (the transparency and availability of information is to be increased). It also stresses the necessity that tax burdens be resolved and a competitive tax infrastructure be created.

The major priorities of the SBA are oriented towards creating a more favourable business environment, facilitating the access to the sources of information, developing inovations and R&D, achieving new opportunities through making use of the benefits of the Single Market, creating new jobs and a faster economic growth.

Until recently, SME policy received relatively little attention in transitional countries. The focus of governments was on consolidating macro-economic stabilization and on managing the restructuring and privatization of large companies. Only limited support was available for SME sector.

After a period of random establishment of SMEs in Serbia at the end of 1990s and at the beginning of this century, the main institutional bodies were established to guide the development of small and medium-sized enterprises and the constitution of SME policy. It is the Ministry of Economy and Regional Development that is responsible for the promotion and development of the SME sector in Serbia. A series of measures have been undertaken to foster SME development since the political changes back in the year 2000. Along with the growing awareness about the importance of SMEs for economic growth and development, the national Strategy for the development of SMEs and entrepreneurship 2003-2008 was adopted. The strategy outlined the key objectives and was based on the following five pillars: 1) Promotion and support of entrepreneurship and the establishment of new enterprises 2) Human resources for competitive SMEs sector 3) Financing and taxation of SMEs 4) Competitive advantages of SMEs in export markets 5) Legal, institutional and business environment for SMEs.

The following two strategic documents are considered to be the essence of the Serbian SME policy – the above mentioned Strategy for the development of SMEs and entrepreneurship and the Plan for stimulating the development of SMEs and entrepreneurship 2005-2007, whose implementation is limited by the absence of appropriate budget.

Serbia has adopted a medium-term approach to SME development. The solid policy framework has been established by implementing reforms in the field of company registration and tax policy. The system for export promotion has been significantly improved and is considered to be among the best ones in the Western Balkan countries. Serbia is the only country in the Second group that systematically applies Regulatory Impact Analysis (RIA) to new legislation and regulations and develops a pro-active profile on innovation policy.

Along with the adoption of the European Charter for Small Enterprises in 2003, under the framework of the Lisbon Agenda, the institutional support for SMEs in Serbia was given a significantly new perspective. Since then, the Charter's policy guidelines have become a key reference for enterprise policy development in Serbia [7].

The assessment of the progress that Serbia achieves in respect to the development of SME policy is being made by using the common evaluation framework – SME Policy Index. The most significant progress has been achieved in the following areas: 1) Education and training for entrepreneurship 2) Cheaper and faster start-up 3) Better legislation and regulation 4) Availability of skills 5) Improving on-line access 6) Getting more out of the single market 7) Taxation and financial matters 8) Strengthening the technological capacity of small enterprises 9) Successful e-business models and top-class business support 10) Developing stronger, more effective representation of small enterprises.

According to the latest evaluation of the policy results, it can be stated that significant step forward has been made. However, the process of policy implementation is still relatively limited. Certain procedures improved considerably over the last two years. Serbia has already conducted a comprehensive reform of the company registration process, thus reducing significantly the amount of time needed for business registration. Satisfactory improvements were made in respect to the taxation and financial matters dimension. SMEs have better access to soft loans through credit guarantees and to governmental funds aimed at supporting exports, start-ups and innovation. The dimension related to legislation and regulations was improved, as well.

Less favorable performances were achieved in the field of entrepreneurial education. Several pilot projects have been introduced so far, but the Strategy on entrepreneurship teaching in vocational schools has not been adopted yet. The strategy is expected to introduce entrepreneurship as a key competence at all levels of formal education. The concept of entrepreneurial education and training has just started developing in the whole region, and it is still confined to traditional business areas. There is a considerable gap between a supply of skills and a demand for skills on the market. Serbia has not yet established systematic tracking of training requirements relative to market demand [8].

Further policy initiatives are necessary concerning technological co-operation, intellectual property rights, business incubators and clusters. Clusters are related to economic development by providing an environment that is conductive to innovation creation, vertical integration and specialisation and pressure for competition which enables SMEs to increase their productivity, operational efficiency, export performances and competitiveness. Clusters are recognized as one of the key factors for strengthening SMEs. Today there are only 20 operating clusters and 10 cluster initiatives in the Serbian economy. The majority of the existing clusters still haven't reached the sufficient level of development. The survey of the problems of Serbian clusters suggests that there is a lack of programs and policy measures designed to address the needs of specific clusters. More dynamic cluster development requires the strengthening of cooperation and networks among governmental institutions, universities, research institutions and private sector. In order for the Serbian SMEs to benefit from EU market, additional support is needed in introducing EU quality and technical standards.

Before the crisis, the Serbian government was primarily focused on putting the SMEs at the forefront of decision making, on strengthening their potential to create jobs and foster economic growth, on improving their access to finance, as well as on promoting competitiveness and innovativeness. Significant number of written documents was adopted by the government in order to create legal and institutional framework for the development of SME sector, and to improve the conditions for doing business. Serbia is still far away from reaching EU standards in the quality and scope of institutional support for SMEs.

POLICY RESPONSES TO CRISIS IN EU AND SERBIA

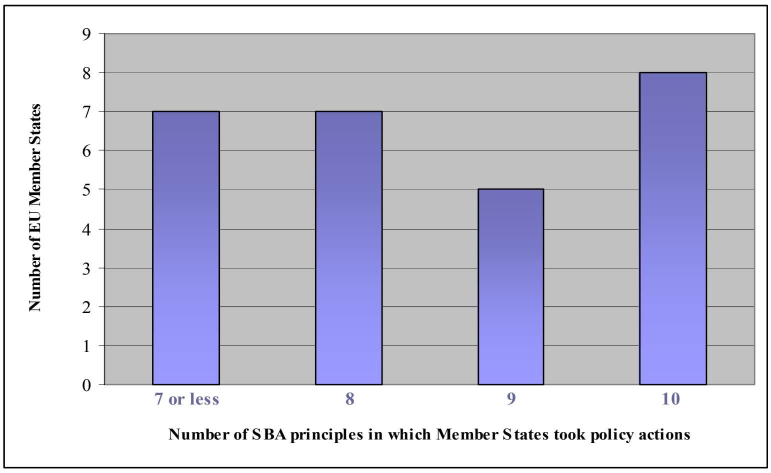
The world economic crisis created a demand for designing and pursuing a comprehensive and sophisticated SME policy in the EU. As a result, in December 2008, the European Council adopted the SBA Action Plan of measures, a significant priority for the needs of SMEs in the global crisis. The measures are designed to facilitate the access to finances, the access to markets of both the EU and the third countries, to improve the business environment and cut administrative constraints. The European Parliament also addressed the member states and invited them to commence the implementation of the SBA as promptly as possible. The Parliament insisted that the SBA is a document of vital importance for the recovery of SMEs, as well as that a prompt and efficient execution of the activities listed in the SBA can help reduce the impact of the crisis. It simultaneously focused upon the necessity for the implementation of the measures stated in the European Economic Recovery Plan adopted in November 2008.

In 2009, the European Commission made considerable efforts to achieve the goals set in order to reduce the negative effects of the financial crisis upon the SME sector. According to the Report on the Implementation of the SBA data, the Commission adopted 5 proposals. A new General Block Exemption Regulation was introduced that aided governments to ensure financial support for the SMEs. On 1st June, 2009 a proposal to reduce the VAT rate was enacted, which allowed for the member states to intensify their economic activities. The three remaining proposals have not been enacted yet, however, the European Council and the European Parliament are working hard on adopting these in a shortest possible time.

The EU member states also strongly support the European Commission initiative. However, individual approaches in the implementation of the SBA and the results achieved differed from state to state. In Belgium, for example, the government adopted the Plan including 40 measures that cover the basic goals of the SBA. The governments in Italy and Ireland formed working groups to monitor the implementation of 10 major SBA principles. The UK, Romania, Finland, France and the Netherlands reported on the methods of the SBA implementation in their National Progress Reports of 2009. In other member states only concrete measures designated as priority measures in the SBA were adopted.

It is interesting to see the data from the "European SMEs under Pressure" report on the SMEs according to which 500 measures were imposed within the 10 SBA principles implementation in the 2007 – 2009 period.

Graph 1: SBA principles coverage by national policy measures



Source: [4]

According to the report, one fifth of all the activities within the framework of the SBA implementation in the member states were conducted in the "Access to Finance" category (about 20%). The categories that followed were "Skills and inovation” with 16%, “Enterprenurship” with 14%, “Responsive Administration” (11%), “Internatiolization” (10%), “Public procurement and State aid” (9%), “Think Small First” (6%), “Environment” (5%), “Single market” (5%), “Second chanse” (4%), respectively [4].

Within the activities in the SBA implementation, positive results were achieved in cutting administrative constraints. In the member states, for example, the average space of time required to start up a firm in 2009 was reduced by one day and amounted to 8 days. The costs were also reduced from € 463 in 2008 to € 417 in 2009 [5].

In addition to simplifying the rules to gain access to state aid, the European Commission adopted the framework for state aid for 2009/2010, thus enabling the member states to secure the subsidized loans, credit guarantees, and direct state aid to SMEs in an easier manner. An important role in facilitating the access of SMEs to finances in 2009 belongs to the European Investment bank, which raised the amount of credits for the SMEs up to €11.5 billion (in 2008, loans amounted to € 8.1 billion).

A majority of member states adopted the policy of implementing measures for facilitating the access of the SMEs to the sources of financing, especially by bank loans, by creating and expanding credits and credit guarantees for the SMEs.

The next initiative that could help Europe return to the path of sustainable development and economic growth and create even more favourable conditions for the SME business is the Europe 2020 strategy, adopted in June 2010 (to replace the Lisbon Strategy (2000-2010)). The new strategic goal of the Europe 2020 Strategy is exiting from the crisis, ensuring a high living standard, and boosting employment, productivity and social cohesion [6].

When the first effects of the crisis occurred in Serbia, the government had to react promptly in order to avoid the collapse in the SME sector. In January 2009, a set of measures were adopted by the government in order to lessen the negative effects of the crisis. The aim was to help SMEs with their liquidity/solvency problems, increase the amount of funds and loans available to them, preserve the level of employment and prevent the further fluctuations of foreign exchange rate and reduction in import and export activities.

Along with the introduction of the Program for stimulation of production, export and liquidity of the economy in February 2009, the subsidized loans for maintaining liquidity and financing durable current assets were introduced by the government, as well as subsidized consumer loans and financial leasing for domestic commodity goods purchasing. In 2009 the total of 480 million Euros was assigned to crediting SMEs. Foreign credit lines were introduced and credits were provided by domestic banks at more favourable terms.

Because preserving financial stability was recognized as a top priority assignment, the National Bank of Serbia adopted measures directed towards improving the foreign currency liquidity of banks. In the last trimester of 2008, the amount of ensured deposit has increased from 3000 to 50 000 Euro. In order to increase and stimulate domestic savings, the income from interest on foreign currency savings was exempted from tax as from January 1, 2009. Additional measures were adopted for keeping loan making activities and helping companies get more favorable loans with the subvention of the state for liquidity and investment.

FUTURE PERSPECTIVES

Having in mind the role of the SME sector in the European economy, addressing future policy recommendations is not an easy task. Recent concerns have predominantly been related to anti-crisis measures aimed at helping SMEs survive. The realization of SME's growth potential in the future requires an advanced approach oriented towards promoting entrepreneurship and creating friendlier environment for small businesses. Governments should focus on medium and long-term policy actions that will foster more dynamic and innovation-led growth of the SMEs, rather than on short-term measures for their survival.

SMEs have been in the focus of EU policy makers' attention much before the crisis. Within the framework of the Small Business Act for Europe, a broad policy affecting SMEs and entrepreneurship is being implemented by both the European Commission and member states. A set of mechanism, such as networks and business support measures, are introduced in order to deliver support to SMEs. The emergence of the global financial crisis has deepened the already existing problems and brought new challenges regarding the future SME policy directions.

Decisive policy aimed at strengthening legal and regulatory framework and introducing mechanisms under which SMEs will be able to increase their capital, as well as at fostering the development of innovative, fast-growing enterprises is necessary.

Policies in the future will have to focus on creating more efficient systems of SME finance. A lack of appropriate financing is a key obstacle to the creation and dynamic development of innovative SMEs. Innovations provide the basis for future technological progress and economic growth of nations, and due to SME's flexibility and inclination to undertaking and risk, they tend to be more innovative than the large companies. In that sense, further development of venture capital markets and business angel networks is necessary. Venture capital should be provided greater support by the governments, in terms of increasing guarantees for risk capital, more co-investments and various fiscal incentives. The equity financing needs to be emphasized as an option that can enable enterprises avoid concerns about qualifying for a loan and repaying the loan from the profits. The SME landing by banks has to be encouraged, and banks' loan portfolios designed to meet the specific needs of the SME sector.

The most fundamental role of the government is related to entrepreneurship education. The government needs to be more actively involved in promoting entrepreneurship within society. Considering that entrepreneurial education is essential for further development of SMEs, people should be encouraged to start and develop their own businesses. A new approach to education system at all levels is necessary. Entrepreneurship education must be an integral part of the curriculum of gradual and vocational schools and universities. Evidence suggests that in most European countries this extremely important governmental role is still insufficiently developed. Unless the awareness about the importance of this issue is raised, greater contribution of the SME sector to social and economic development of European countries will not be possible.

In comparison to EU member states, the SME policy in Serbia is still underdeveloped. Significant step forward has been made in recent years, but too many challenges remained. SME sector in Serbia is characterized by high mortality rates, lack of strategic marketing approaches, low labor productivity, costly and time-consuming administrative procedures, and limited access to finance, expensive loans and low equity/debt ratio. Looking further ahead, SME policy in Serbia will have to focus on developing efficient system of SME finance. The low availability of various types of financing is recognized as one of the key problems of SMEs in Serbia. Future perspectives will certainly depend on the ability of the government to develop policy and create measures that will address the specific problems and needs of SMEs, not only in regard of financing, but of legal and regulatory framework, business environment, entrepreneurial education and the concept of life-long learning, management skills, innovation capacity, clustering and internalisation, as well.

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