

How to support investment activity in Serbian SMEs

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Abstract: Serbian economy during the last three years is in a good shape, with increasing GDP, the increase in industrial production, as well as in trade, construction, traffic, tourism. The Government introduced painful measures in order to consolidate public spending, which produce results stronger and quicker than expected. Also, some important steps forward in market reforms were made, by which Serbia improved its position on the different lists measuring the level of business conditions. Entrepreneurs reacted positively on those encouraging changes by increasing number of newly established companies and shops.

Especially important for further development is the increase in competitiveness and productivity. To do so it is necessary to push investments activity up, as it is on the low level, until now. According to entrepreneurs the access to finance is still problematic. The banks are almost the sole supplier of financial sources, which hesitate to cooperate with SME. Other financial institutions which could be helpful are simply missing.

The aims of the paper are to illuminate the problem of low investments activity of SME and to address the crucial steps to improve situation.

Keywords: SMEE, market reform, recovery, support

1 Introduction

After six years of stagnation Serbian GDP increased three sequencing years. Although, the increase is modest, it is a very positive signal for entrepreneurs and potential entrepreneurs, as it is based on the increase in personal and investments demand, with stable demand from abroad. Facing with the problem of high budget

deficit and the high level of public deficit in GDP, the Government introduced difficult measures for public consumption consolidation, among others the cut in pensions, and wages of those employed within public sector. The results produced were faster and better than expected previously, so the share of public debt within GDP started to decrease as well as the Budget deficit. This was an important reason for macro-economic stabilization, considering that the last several years the inflation rate is for the first time comparable to European standards. After a period of worsening business conditions, the market reforms got momentum. So, Serbia improved its position on different global lists for measurement whether business conditions are favorable or not. The rating agencies also accessed its credit rating as improved with better expectations.

All those factors influenced that entrepreneurs and potential entrepreneurs fill more comfortable than before. First of all, the number of newly established companies and shops is increasing stable, and more important this number is higher than the number of closed companies and shops. The employment in SME sector is increasing, although needs time to reach the level before the crisis. The economic results of SME sector is improving, which opens the room for survival of those and their development in the future.

When we come to the question of Serbian SME efficiency and their competitiveness on the global market, then one cannot be satisfied. Although improving, the productivity is still low and lower than comparing to other countries in transition and the EU average. SME are mainly oriented toward domestic market and to the service sector, although the second one is not marketable. Additionally, SME products are on the low technological level, generally speaking. If one wants to improve situation then the main task is to invest more, as the level of investments is still below the pre - crisis one. The financial system is of bank - centric character, which means that banks are almost sole supplier of financials. Moreover, they are very skeptic regarding crediting SME, especially new ones and micro companies. More sophisticated institutions which could help, like mutual funds, business angels, micro finance players, are almost missed. As a consequence there is a sharp discrepancy between demand and supply side of financial sources available for SME, their establishment and development.

2 Entrepreneurs feel that business environment is better

During the first phase of transition which Serbia started in 2000 the growth rate was impressive (5,4% increase in GDP on average p.y.), but after the global crisis start the rate of growth was zero in the period 2009-2014. So, the increase in GDP during the last three years, although modest is a very positive signal of a stable recovery [1].

	2013	2014	2015	2016	2017
GDP	2,6	-1,8	0,8	2,8	2,0
Industry	5,5	-6,5	8,3	4,7	3,9
Trade	-5,1	2,4	1,6	7,6	4,0
Traffic	4,0	22,1	5,9	11,1	5,9
Export	25,8	1,5	7,9	11,6	13,0
Import	5,1	0,1	5,8	4,2	14,2
Inflation	7,8	2,9	1,9	1,2	3,0

Table 1 Serbia - Key Macroeconomic Indicators (Increase %)
Source: [1]

The main contribution to the growth is related to increase in industrial production started from the last quart of 2014, out of which manufacturing industry, rubber production, pharmaceutical production, equipment and metal industry are the main. As can be seen from the table 1 all important sectors are in a good shape with respectable increase as well, like trade, traffic, tourism, construction. The recovery is based on increase in personal demand, as wages mainly in private sector increased, in investments demand, mainly due to high inflow of Foreign Direct Investments, while export demand remained stable.

During the crisis foreign trade balance fortunately has improved as foreign trade deficit is shrinking after its pick reached in 2008 (8 billion €). Competitiveness of the economy was improved, and export volume was increasing and stable in spite of external shocks. At the same time import was increasing but slower, so the covering of import value by export value is improving, and in 2017 was 79%. Balance of payment position was also improved due to stable and high value of remittances of our citizens living abroad (in 2017 was 2,6 billion € only) and high and increasing volume of Foreign Direct Investments, FDI (in 2017 1,7 billion €). As a result, domestic currency, dinar was stable for last several years, with high

volume of foreign currency reserves within the banking system (10 billion €) [2]. Although the stand – by arrangement with IMF worthy 1,2 billion€ was signed, it was not necessary to use those sources at all. Foreign debt was during 2017 paid back for 1 billion €, so the share of it in GDP decreased to 73 %from the pick reached in 2013 (82%of GDP) [2].

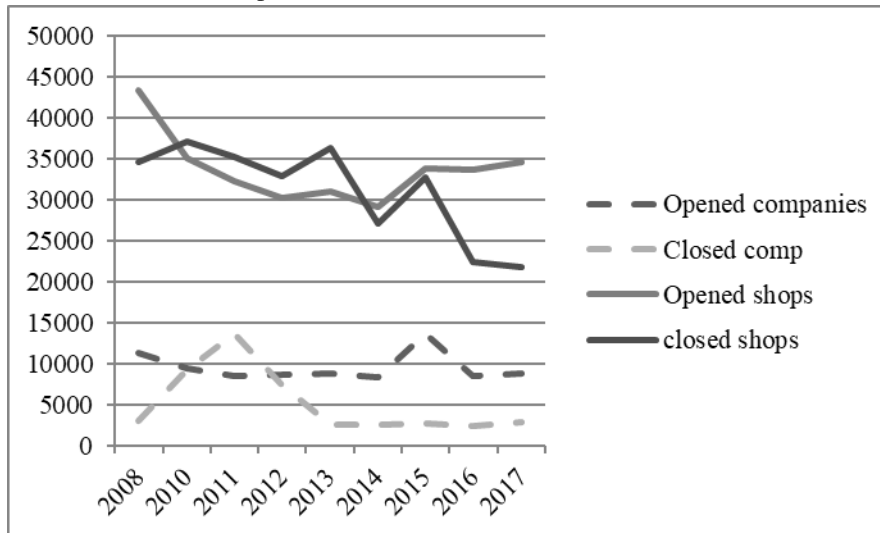
The Government introduced very painful measures for public spending consolidation, among others the cut in pensions and wages of those employed within public sector, both by 10%. Those measures resulted in dismantling the budget deficit (from 6,6% of GDP to 1,3% in 2017) and public debt as well (from 73% of GDP to 65% in 2017). The results were stronger and achieved quicker than expected [2].

The best prove of public consumption consolidation is low inflation rate for last several years, for the first time comparable to the euro- zone level. After years the monetary policy and its role in macroeconomic stabilization was supported by fiscal policy, so the Central bank could relax especially its interest rate policy and finally, put it to its historical minimum of 3,5% p.y. (the referent interest rate of CB was decreased for 7,75 p.p. from 2013). Moreover, CB could put down the corridor of the projected inflation rate from $3\pm 2\%$ to $2\pm 1,5\%$ [3].

After halting market reforms in the period after the global economic crisis start, the market reforms got momentum during the last several years. Some important issues were tackled, like fostering construction permit, cadastre registry and business registry as well. Due to those improvements Serbia was better placed by international authorities in measurement of business environment. Serbia was placed as the 43rd among 190 countries ranked by World Bank on its Doing List [4] Similar, Serbia improved its position for 12 places to 78th out of 138 countries on the Global Index of Competitiveness. According to the assessment Serbian economy improved 7 out of 11 indices (technological readiness and infrastructure were not improved), mainly in macro-economic environment (better position for 31 places)[5]. Serbia also improved its credit rating given by credit rating agencies like Fitch Rating from BB- to B+ , Moody's from B1 to Ba3, while Standard and Poor's did not changed its credit rating, but stated that expectations are positive[2].

Better look at the trends in SMEE sector development one can get from so - called business demography, as it covers data on new established companies ad shops, on the one side, and closed companies and shops, on the other side. As can be seen from the figure 1 it is clear that entrepreneurs have recognized better business environment during the recent years, as the trend of the increasing number of

closed companies and shops while decreasing number of those newly established was transformed into trend of the increasing number of new companies and shops while decreasing number of those closed one. More important is the fact that a negative demography (more closed than new opened) from the period 2011-2013 was transformed into a positive one.



Graph 1 Serbia – Business Demography
Source: Business Registry of RS

3 Low Competitiveness as a Consequence of Low Investments

Although the results in international trade are improving during the period of the crisis, as argued before, one can not be satisfied, because the Serbian export consists of the products with low technological level, mainly agricultural products, metal products, raw materials and semi-products. Above all, SMEs which share in total export is 40%, are mainly oriented toward domestic market and service sector. It is important to note that services are not marketable. Those are a consequence of low investments rates, which are still lower in comparisons to their pre-crisis level. So, the competitiveness and productivity of Serbian companies are behind competitors within the Region and in comparison to EU countries, as well.

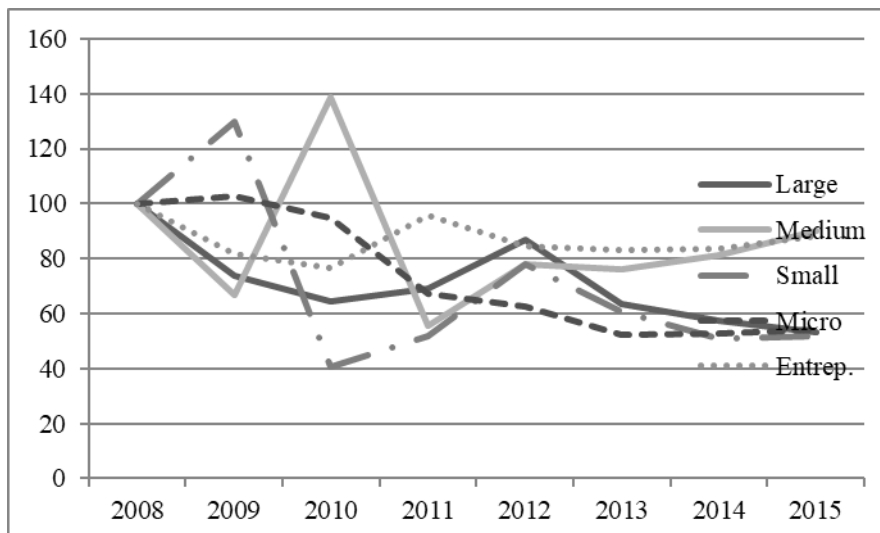
Serbian SME produced 56% of total GVA (Gross Value Added) in 2016 (9,9 billion €), out of which 22% micro companies, 16 % small and 20% medium

companies. If we compare figures in 2012 and 2016 than one can conclude that the growth was the most intensive for micro and small companies 1,5 p.p. (percentage points). If we look at sectoral structure of GVA than one can see that the best result was achieved by real estate trade, energy sector and production and distribution of water [6].

GVA per employee was increasing slowly, as it was higher 2,4% only in 2016 in comparison to 2012 and reached 13.856€ in non - financial sector, out of which 11.856€ in SME. It means that productivity of SME is 14% lower than the average, or 33% in comparison to most advanced large enterprises.

The problem is that there is no room for investments, considering that GVA is low, although modestly increasing during the last several years of economic recovery. Low level of GVA also points low level of international competitiveness. GVA in non – financial sector was 13.856 € per employee in 2016. It was 8% higher than the year earlier, but at the same time was only 2,5% higher than in 2012. The highest productivity was related to large companies (28% higher than average), while SME were 14% below the average. Among SME medium scale companies were better than SME average (22%) and small companies (14%).

The efficiency of SME is improving, but slower than large companies. SME in 2016 generated 65% of total turnover and 51% of total profit of non – financial sector. The main players, contributor were medium companies, as their share in total turnover was 31% and 36% of total profit.



Graph 2 Serbia – Investments, 2008 =100
Source: [6]

The main finding related to investments activity of all Serbian economy including SME is that investments are still on the low level, and more important, lower than in the pre – crisis period, as can be seen from Graph 2. Total investments were 47% lower in 2015 than in comparison to 2008 (2,5 billion € in comparison to 3,6 billion €, respectively), among which micro and small companies were mainly affected (46% and 48% less, respectively), sole entrepreneurs (-12%) and the least affected were medium companies (-9%) [6].

The low level of investments activity for all companies, especially for SME, can be derived from Table 2. Investments were 7.652 € per company for all SME in 2015 only, while at the same time more than 4 million € per large company. The better insight can be obtained from the derived ratios, like the ratio of value of investments to turnover, which means that SME on average invested in development in 2015 less than 5% of turnover realized, or 27% of GVA, only.

	Entr.	Micro	Small	Medium	SME	Large
Investments/company	2.776	3.157	4.976	509.214	7.652	4.083.404
Investments/employee	2.735	1.677	2.487	4.975	3.099	4.818
Investments/turnover(%)	7,5	2,3	3,2	6,3	4,8	7,6
Investments/GVA(%)	29,9	17,9	19,5	36,3	27,4	30,3

Table 2 Serbia – Investments Derived Ratios (2015)

Note: Investments in 000 €

Source: [6]

The promising fact is that investments is increasing during last several years, due to better business environment, especially in SMEE sector. Total investments in SME sector reached 2,5 billion € in 2015, which is 7% higher than the year earlier in the real terms. It is worth noting that investments in large companies were stagnant (0,2% increase in real terms). The main contributor to this growth was related to medium scale companies with growth of 11%, while investments in micro and small companies increased by 2% and sole entrepreneurs by 6%[6].

The cost competitiveness is also improving during the last several years. In 2016 GVA increased by 13% in the non – financial sector and in SME sector by 10% in real terms, the costs of work force by 4% and 3% in SME sector, while productivity increased 4% and in SME sector 3%. The industrial competitiveness had the main influence to total productivity of the non – financial sector. Within manufacturing industry the dominant position still have those sectors with low technological level and low productivity. Those companies with high and medium technological level in 2016 had the share of 9% of total manufacturing industry, 15% of total number of employees and created 20% of total GVA of the

manufacturing industry [6]. Those figures point that the proces of restructuring of the industry and industrial companies is on the way.

Total international trade in 2016 reached 30 billion €, out of which export was 13 billion € and import 17 billion €. The main contributor to international trade was manufacturing industry with the share of 74% in export value and 50% in total import value. According to the size of companies the main players within international trade were large companies with contribution of 70% in total export and 64% in total import. It is worth noting that SME position is also improving, as during the last three years export value of SME sector increased by 7% while import increased 6% on average p.y. In the post – crisis period (2009-2016) export of SME sector increased by 53%, while import value staid almost the same (-1%).

The comparative analysis of development level of Serbian SME sector with SME in countries within the Region and EU, pointed out that Serbian SME still leg behind both groupes of countries [6]. Considering number of employees Serbian SME had 2,5 workers per company (2016), while EU average was 4 employees, Slovenia and Hungary 3,3 employees, Romania 6 and Bulgariua 4,6 workers. At the same time according to productiity (GVA per employee) Serbian SMEs realized 11,8 thousands € (2016), while in Bulgaria reached 9,2, Romania 12,1, Hungary 16,2, Croatia 16,1 and Sloveina 28,8 thousands € per employee.

4 The Problem of Acces to Finance for SMEs

The analysis was performed in ordert to assess the discrepancy between total demand and supply for financing SMEs creation and their development in Serbia, including its structure by different financial sources It was based on telephone survay of almost 100 thousands of SMEE, literature review and stakeholders interviews, namely banks, international financial institutions, government officials. The main finding is that there is a sharp discrepancy between demand and supply of different financial sources, due to market weaknesses, lack of institutions, scepticism toward SMEE generally speaking, especially toward micro companies and start –ups [7].

The Serbian financial sector is of bank- centric character like in other less developed coutries and countries in transition, which means that banks are still the main players and main suppliers of services. In total assets of financial sector total banks' assets in 2016 had the share of 92%, while 6% was related to insurance companies, 2% to leasing companies and 1% to (private) pension funds[8]. As Serbia started the process of transition to a market economy, as the last among cuntries of Central and East Europe,the banking system is still underdeveloped,

measuring by the share of total assets within GDP (banking sector 78% of GDP and whole financial sector 85% of GDP in 2016).

The structural problem of financial institutions in Serbia is related to changes of the legal environment of banking sector in 2006, Law on Banks by which institutions such as saving - credit cooperatives, saving – credit organizations and saving organizations were abolished [9]. In order to control easy the whole financial sector National Bank of Serbia proposed banks as the sole players. It is very important to note that National Bank of Serbia is responsible for control banks, insurance companies, leasing companies, pension and other funds. Practically NBS is the supervisor (control body) for the whole financial system, which is a unique solution worldwide and obviously too powerful and danger at the same time. It means that small financial institutions, which are appropriate suppliers of financials for SME sector, have no legal basis for existence any more. By the Law on Banks those companies had to increase their capital basis to 10 million € and became a bank or to join some other banks.

The institutional infrastructure for financial support of SMEE development in Serbia consists of: The Development Funds of RS (280 million € of loans in five years), The Agency for Export Insurance and Financing (AOFI serviced SMEs with 106 million of loans plus 115 million by factoring)[7], Development Agency of RS, Ministry of Economy, National Agency for Employment and Innovation Agency. All those institutions are governmental type and can be criticized from the point of view of sources available, too small volume considering problems which the Budget is facing with, and more important, too administrative procedures, which is often inappropriate for entrepreneurs and also important, massive misusing, due to high level of corruption present.

The support for SMEE is also possible through network of international financial Institutions like, European Investment Bank (the fifth credit line amounted 500 million €), European Investment Fund, European Bank for Reconstruction and Development (during the whole transition period from 2000 on, it invested almost 4,4 billion € in more than 200 programs)[7], German Development Bank (KfW), Italian credit line, European program called COSME, HORIZON 2020 and related programs. Available sources for SMEE support through those institutions can be assessed as too low and problematic, considering that they usually use the banking system as a vehicle for intermediation. So, the scenario is as follows: domestic banks get long - term credit lines from those institutions, for SME support especially, but not use them for SME, but rather for general purpose instead. This can be a partial explanation that there are no available data about structure of crediting SME through banking system. Although NBS statistics is very informative with plenty of specific information, data related to crediting by structure consists of two sorts of clients, companies and citizens, only.

Banks are not opened toward SMEs generally speaking, especially toward micro companies and start – ups. Firstly, banks are too big for small clients like sole

entrepreneurs or micro companies. Secondly, there are often missing data, or not so good financial results of those companies, good enough from the point of view of credit risk assessment. Thirdly, there are no differentiated specific, for SME appropriate, products. Fourthly, entrepreneurs are not qualified to prepare business plans and other necessary additional information. Fifthly, start – ups are not welcomed, as they have no business history. Sixthly, the analysis found that there are no guarantees for SMEs, rather personal guarantees only [7].

During the transition of the financial system better results were achieved in consolidation and development of the national banking system and in the opening for the rest of the world, (meaning for the entrance of foreign players), but so little results were achieved in establishing and development of financial market. The privatization process was slow, public companies are not restructured and privatized, so there are neither serious players on the market, nor well developed different sorts of financial instruments, securities. There was no single initial public offer. After the crisis start foreign players disappeared from the market, Belgrade Stock Exchange, prices felt down and volume of the trade is still several times lower in comparison to the pre –crisis period [11]. During the last several years governmental bonds are the main financial instruments in which banks and foreign financial institutions invested mainly.

There is a lack of specific, especially sophisticated products and institutions within financial market in Serbia. It was already argued that institutions, like saving organizations, and saving cooperatives are missing, as more appropriate to SME financial support. NBS is not ready to propose the law on micro financial institutions. So, there is no legal basis for their development, but in spite of that four micro financial institutions are operating: The Micro-Development Fund, Agroinvest, Integra and Microfunds-S [10]. Equity market is not developed, as there are a few players present, although equity market in Serbia is assessed to 35-40 million worthy[7]. There are no business angels at all.

As the analysis concluded SMEs are completely dependent on the banking system, so they are very vulnerable to environment and its possible external shocks when happened. Additionally, there is a huge hidden demand for financial sources in the market by SME sector [7]. Finally, there is a sharp discrepancy (a gap) between supply of different financial sources and assessed demand for those products by SMEs, as can be seen from the table 3.

	Demand Potential	Supply Estimated	Financing Gap
Short – term	429-474	196-217	233-257
Medium and Long term	1.293-1.904	589-651	705-779
Total	1.722-1.904	785-668	938-1.036

Table 3 – Serbia – Potential Financing GAP for SMEE

Source: [7]

Conclusion

The general economic situation in Serbia is on the stable track during the last three years. Although modest the growth is an important positive signal for entrepreneurs and potential entrepreneurs, as it is based on the increase in personal and investment demand and stable foreign demand. The market reforms got momentum in some important fields. Due to those positive signals the number of newly established companies and shops is increasing, while the number of those closed is decreasing, with a positive difference.

Considering the competitiveness and efficiency of SMEs, although improving, it is still on the low level, and lower comparing to other countries in transition and the EU average, as well. One can see positive changes in foreign trade, as export is increasing faster than import. However, exporting products are mainly raw materials, semi – product with low value added. Asking for the reasons for the still unsatisfied situation one can blame low level of investments, which is still lower in comparison to pre – crisis period, low investments volume per company, per employee and measuring by the share in GVA and turnover, as well.

To increase investments in SME sector is difficult task, as it is necessary to close huge discrepancy between demand side and existed supply of financials. The financial sources available through governmental institutions and foreign suppliers are important, but those sources can be seen as a residual in volume and as the magnet for other market sources. The point is to open room for institutional and legal changes in which more by number and more sophisticated and appropriate institutions for SME financing will start their activities, like micro finance institutions, saving organizations and saving credit cooperatives. It is also necessary to support development of the financial market, by volume and especially by broadening the list of financial instruments available. Additionally, the support of government and foreign institutions for establishment and development of advanced institutions, like business angels, guarantee schemes, venture capital suppliers, would be also important.

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