Finance for Serbian SME – Development Hindrance

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***Abstract*: The financial support for SME in Serbia was and still is seen by entrepreneurs as a bottleneck for business start-up and further development. Financial global crisis fostered development hindrances more than expected. The national economy, SME included, suffered very much as all qualitative ratios deteriorated. The Government and the Central Bank introduced countercyclical measures, one of which was the raising of financial support for SME, but the results were disappointing. As the result of a deteriorating business environment and strong development hindrances, Serbia has been facing a zero rate of growth over the past six years.**

When it comes to the financial support for SME, the Central Bank has to change its attitude towards institutional liberalisation and development. Given the trend towards a stronger financial discipline and a lack of financial resources, the change is even more important. Similarly, both at the national and the local level new institutions and approaches towards more considerable and more sophisticated financial support are crucially important.

The aim of this paper is threefold: firstly, to shed light on the problem of finances as one of the main bottlenecks in the development of Serbian SME; secondly, to analyse the problem of SME financing during the crisis, including the relationship between investments and the SME development trend, and, thirdly, to highlight the potential for improvement in the domain of financial support for SME.

I. INTRODUCTION

Serbia began its market reforms in 2000 as the last among Eastern and Central European countries. Before the global economic crisis, its development had been very fast, and also stimulating for SME growth.

During the period of crisis, the national economy was facing strong development hindrances, among which high public debt and high international debt were the most serious. Thus a zero rate of overall growth was registered in 2009-2014. SME were suffering like all other companies due to a worsened business environment and a lack of opportunities. Only fast growing SME and the so–called gazelles continued to grow.

Although the development of SME had been encouraging until 2008, these companies were unfortunately not competitive abroad. As for quantitative measures, like the number of newly established companies and shops, their share in the total employment, and shares in the total gross value added (GVA) and exports, results were encouraging. However, if one considers qualitative ratios such as GVA per employee, productivity, and innovation, results were low compared to the EU average, economies in the region included, which indicates low competitiveness on both the macro and the micro level.

Investments are seen as a crucially important factor for improving productivity, the technological level of production, and the economy of scale. However, if the volume of investments before and after the crisis is compared, a decreasing trend will be noticed. At the same time investments per employee and investments per unit of GVA suggest that investment competitiveness is low. It means that in the future it will be important to raise investments and their efficiency as well.

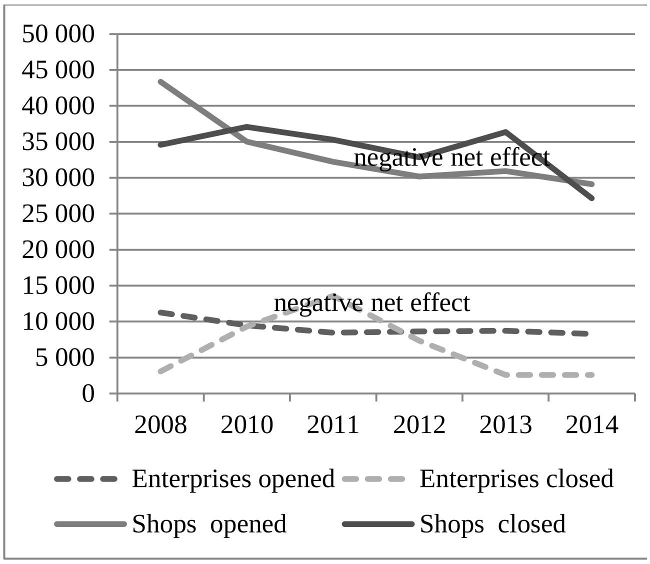
When domestic entrepreneurs are asked what problems they are encountering, the usual answer is that a poor access to finance is the most important one. One has to bear in mind that during the economic crisis the access entrepreneurs had to finance was limited due to problems within the banking sector mainly related to a high level of non-performing loans (NPLs). An additional problem in Serbia that is related to the institutional framework defined by the Central Bank is a lack of microfinance institutions.

This paper argues that the state financial support for small enterprises and entrepreneurship is desirable but of secondary importance, while the strengthening and restructuring of the banking sector and their balance sheets are essentially important. Liberalisation of the financial sector and development of microfinance and alternative institutions is seen as equally important.

II. BUSINESS DEMOGRAPHY

Business demography can be defined as a set of statistical data denoting the number of newly established legal entities (enterprises and shops) usually during a period of one year. It is a measure that can be useful for foreseeing the general business climate and the climate for SME development, and for analysing trends in the creation of new business opportunities and new jobs.

The business environment in Serbia has been worsening since 2008 due to an adverse impact of the global economic crisis. One can notice a declining trend in the number of newly opened enterprises and shops during this period, while the number of enterprises and shops that terminate their activities has been simultaneously increasing.



Source: [2]

Chart1. Serbia, opened / closed enterprises and shops

	Enterprises		Sole traders	
	birth rate	death rate	birth rate	death rate
2007	16.2	5	22.6	14.9
2009	11.3	4.1	17.4	16.1
2010	10.7	10.5	15.6	16.6
2011	9.3	15	14.1	15.4
2012	9.4	8	13.4	14.5
2013	7.9	2.3	14.5	17.1
2014	7.1	2.3	15	13.3

Source: [2]

Table1. Serbia, birth and death rates of enterprises and sole traders

In 2013 the number of newly opened enterprises moderately increased (by 0.2%), while the number of closed companies dropped (Chart 1.). In the same period the number of new shops was up by 3.1%, while the number of closed ones also increased, by 9.8%. Therefore, based on these figures one can conclude that there are some signs of modest recovery present [1].

However, the positive movements did not last very long. Namely, in 2014 the number of newly opened enterprises decreased compared to the year before by 4.6%, and the number of closed enterprises was down as well, by 1.4%. In the same year the number of new and closed shops decreased by 6.6% and 24.8%, respectively (Chart 1).

The net effect in business demography indicates chances for starting a business and further development. As regard to the net effect on enterprises, one can be satisfied since the number of enterprises has been continuously rising after the negative effect in 2011. On the other hand, there is a trend of a decreasing number of shops present over the past few years. In 2014 it was slightly above zero for the first time.

One can get an insight into the business demography from the ‘birth rate’ and the ‘death rate’ indicators as well. The ‘birth rate’ indicator calculates the share of newly opened enterprises/shops in the total number of active enterprises/shops. The ‘death rate’ indicator calculates the share of closed enterprises/shops in the total number of active entities (Table 1). Both trends are negative and result from negative effects of the global economic crisis, such as: a declining external and internal demand, a decrease in investments, higher risks and costs, and the fear of failure.

The density of SMEE is a useful indicator that indicates the number of SMEE per one thousand inhabitants. 44.1 SMEE operated per one thousand inhabitants of Serbia in 2013, of which 5.5 were newly established economic entities. If one analysed only active population (aged between 15 and 64), then there was 64.1 SMEE that operated per one thousand inhabitants, of which 8 were newly established. According to this indicator, in 2013 Serbia was at the EU average with 44.1 (the EU was at 41), Czech Republic reached the highest value of 90.2, while Romania had 26.6 SMEE per thousand citizens [3].

The rate of survival is another useful indicator for tracking the business climate. It points to the number of SMEE established during the year *n* that managed to survive through the year *n+2*. It shows whether an economic entity is appropriately adjusted to the economic circumstances and has found its room on the national market. If we compare the indicator values of 2007 and 2013, we will see that 62% of new entities survived the first two years and continued to operate. Clearly the rate was much higher in 2007 than in 2013. Companies had a higher rate of survival than shops (93%vs55%) [4].

III. LOW INVESTMENTS AND INVESTMENTCOMPETITIVENESS

Small and medium-sized enterprises and entrepreneurs (SMEE) are an important segment of the national economy given that they account for 99.8% of active economic entities (in terms of the number), 2/3 of the total employment, and 1/3 of GDP formation. They generate 64% of the total turnover and 56% of the total GVA. Although their share in the total number of exporters is 98%, the share of SMEE in the total value of export is only 43% [4].

During the crisis, SMEE were affected more than other companies. A slow recovery of these companies is obvious as GVA, employment, and productivity are still below the level reached in 2008. Their rapid growth and development prior to the crisis could be attributed to a very low starting point and one could claim now that SMEE failed to become a driving development force of the national economy.

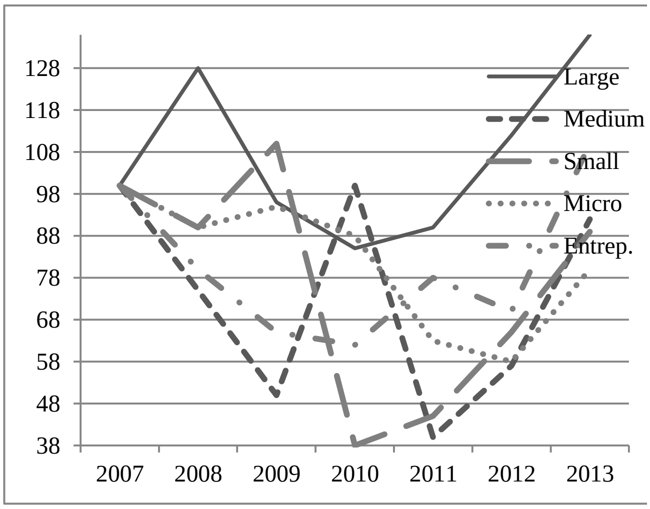
Serbian economy faced a zero rate of GDP growth in the period 2008-2014, and it dropped further in 2014 (-

1.5%) due to catastrophic flooding, low export demand, and low domestic demand. Main problems the economy encountered in 2014 were a high and increasing public debt of EUR 22.8 billion (70.9% of GDP), an external debt of EUR 25.8 billion (78.1% of GDP), and high unemployment (17%). A low inflation rate was the only bright spot (1.7%) [5].

Under such disappointing circumstances SME, however, achieved better economic results than large companies in 2014. The number of SME increased by 2.8% (8,000 more) as a result of 41,000 newly established companies and shops and 31,000 closed ones. Employment decreased by 0.9%. Their turnover increased by 2% (9% in medium-sized companies and 3% with entrepreneurs). GVA of the SME sector increased by 3.8% in 2014 and profit rose by 9.4%. The export volume also increased, by 8.2%, and the coverage of the import volume by export continued to rise, reaching 57% [4].

Investments into fixed assets are essentially important for development. Without investments it is not possible to raise employment, productivity, gross value added, and exports. In 2013(as the last year for which data are available) Serbian SME invested RSD 271 billion (EUR 2.4 billion) or RSD 858,000 (EUR 7.600) per company and RSD 352,000 (EUR 3.100) per employee. The ratio of investment/turnover was at 4.7% and the ratio of investment/GVA was at 28% in 2013 [4].

A better insight into investment activities of SMEE can be gained by comparing investment activities in 2013 and 2007 (Chart 2). Only investments into large companies and investments with entrepreneurs were higher in 2013 compared to 2007 (by 136% and 10%, respectively). All other types of companies invested less during the period of crisis [4].

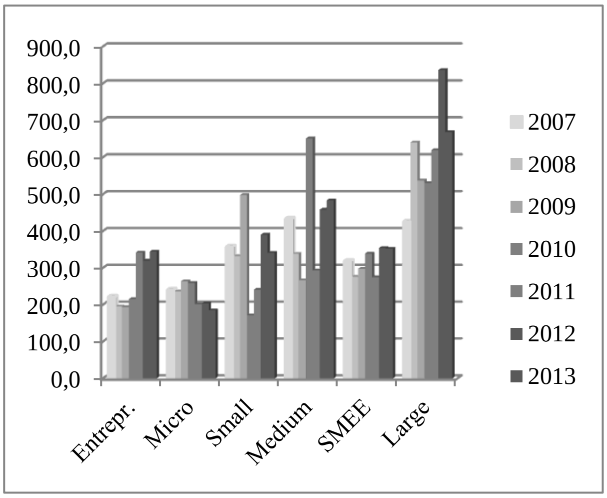


Source [5]

Chart2.Serbia, Investments 2007=100

If one tried to explain the decrease in investment activities of SMEE during the crisis, then several factors would seem to be determining. Firstly, the economic performance of SMEE during the crisis worsened and, consequently, they were unable to create room for investments. Secondly, the national banking sector is still biased towards large companies, which is a habit inherited from the past. Such a practice is further reinforced by a deteriorating economic performance of SMEE, which results in the worsening of their borrowing capacity when applying for a loan. The third likely factor is an underdeveloped institutional framework for the investment support for SMEE (which will be elaborated further in the paper).

Data on investments per employee and the ratio between investments and GVA provide an additional insight into investment competiveness. By the value of investments per employee (Chart3), SME registered a decreasing trend except for only medium-sized companies and entrepreneurs over the past two years.

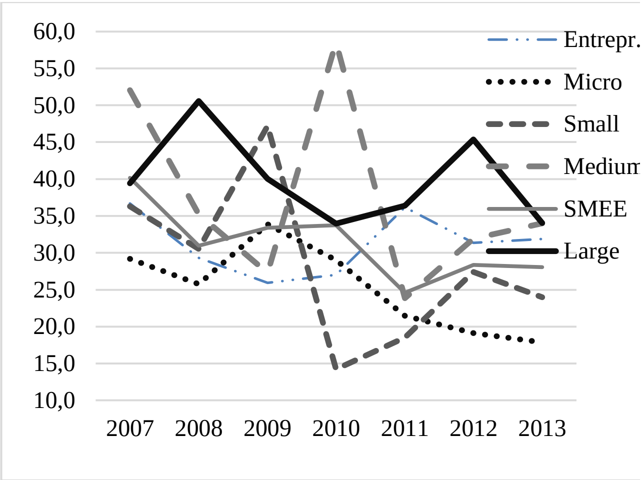


Source [5]

Chart3. Serbia, Investments per employee

(RSD 1,000)

Looking at the ratio of investments and GVA (Chart4), one could notice a decreasing trend that is a direct result of the so-called 'W' effect or, in other words, a new recession. As the economic performances deteriorated, companies reacted quickly by cutting investments. The latest available data (for 2013) show that SMEE on average invested 28% of GVA, of which micro enterprises invested the least (18% of GVA), the investment of small enterprises was low (24%), while medium-sized enterprises and entrepreneurs invested above the average (34% and 32%, respectively).



Source [5]

Chart4. Serbia, Investments/GVA (%)

IV. BANKING SECTOR IS FACING SERIOUS PROBLEMS

In Serbia the transition of the banking system began in 2000, later than in other Eastern and Central European countries. Taking into account severe problems that had existed before the start of market reforms such as a high foreign debt, a high public debt, low capitalisation, low confidence in banks, a low credit activity, and low deposits, the situation could have been characterised as catastrophic [6]. The National Bank of Serbia introduced a set of harsh but inevitable measures, including the closing of four major domestic banks and, simultaneously, opening of the room for the entrance of foreign ones. After a rapid development that was reflected in the increase in credits, deposits, and capitalisation, especially in the period 2004-2008, one could say that the first phase of the banking system transition was over. It seems that the actual breakthrough happened in 2005 when the national banking sector generated profit for the first time [7].

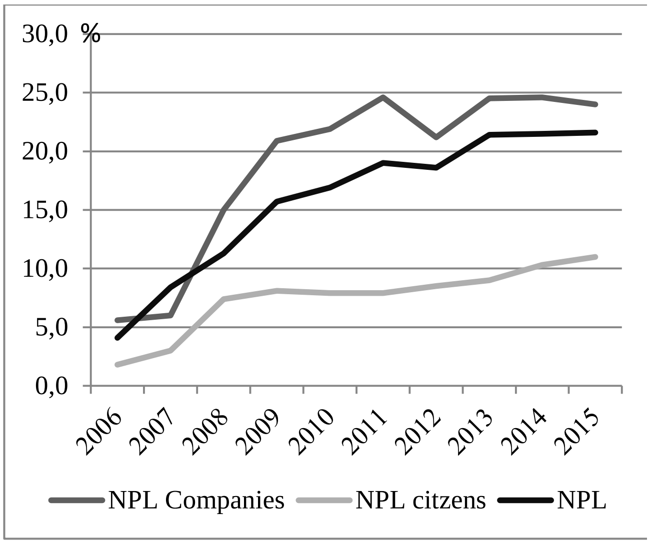
The global economic crisis first hit the Belgrade Stock Exchange in May 2008, when foreign investors simply left the market (as was the case with other financial markets in the region) and prices of securities dropped by 1/3 compared to their previous value. Another main shock to the national economy and banks occurred at the end of that year, when ‘mother banks’ (shareholders of domestic banks) started to encounter problems. It is important to note that foreign banks owned ¾ of Serbian banks, measured by the share in the total assets. Main owners were banks from Italy, Greece and Austria that suffered badly. Foreign direct investments (FDI) shrunk although prior to the crisis almost a half of credit funding had been related to the capital inflow. At this time, the capital flight started. Domestic saving deposits dropped (by more than one billion euro in just a few months) [7].

The domestic banking sector was not struck like in other neighbouring countries because it was highly capitalised (the capital adequacy ratio was as high as 28% due to the 12% legal requirement), much more than in countries within the region and other developed countries [7]. Additionally, one third of bank assets were in cash. Compulsory reserves (the part of banking deposits which have to be immobilised on accounts within the central bank) were very high – at the level of 40-45% for foreign currency deposits and 5-10% for deposits in domestic currency. Crediting was not risky as the recovery of credits issued was very high and the risk was low (92% for companies and as much as 95% for citizens) [7].

The central bank (National Bank of Serbia) and the Government introduced measures of support. The NBS relaxed compulsory reserves in order to raise the liquidity position of banks as some of them, mainly domestic ones, faced the problem of liquidity. In order to stop the outflow of citizens’ deposits, the amount of deposits guaranteed by the Deposit Insurance Agency of Serbia was increased from EUR 3,000 to EUR 50,000 per each deposit. The NBS also concluded the agreement with foreign shareholders of domestic banks, the so-called Vienna agreement, according to which the exposure of domestic clients would not be reduced. In spite of the habit of a majority of central banks to put down the interest rate to almost zero, the NBS surprisingly raised its key policy rate to 17.5% p.a. [8].

During the period of prolonged crisis, the banking sector encountered the following problems: the rising share of non–performing loans (NPLs) in the total portfolio, difficulties in the collection of claims, the decreasing capital adequacy ratio, and scarce and expensive foreign finance. The banking sector has been stagnant over the past few years given the level of capitalisation, deposits, and credit activities. Now one can recognise hindrances to a further rapid development of the banking sector in a weak and non-restructured public sector and the non–financial (company) sector [9].

As can be seen in Chart5, the share of non-performing loans (NPLs) in the total loans rose from 4% in 2006 to 11% in 2008, and then very rapidly to 22% in 2015. The high increase was due to the increase in NPLs of companies, since in the past the majority of credits was oriented to companies (2/3) and the NPLs rise was much higher for companies. NPLs for companies rose from 15% in 2008 to as high as 24% in 2015, which means that every fourth credit line is considered as non-performing or dubious. As regards citizens, one can see a moderate increase of NPLs from 7% in 2008 to 11% in 2015. All in all, the change was dramatic and, consequently, the Serbian banking system faced the highest rate of NPLs in the region.



Source [9]

Chart5. Serbia, NPLs total, NPLs of citizens, NPLs of companies (%)

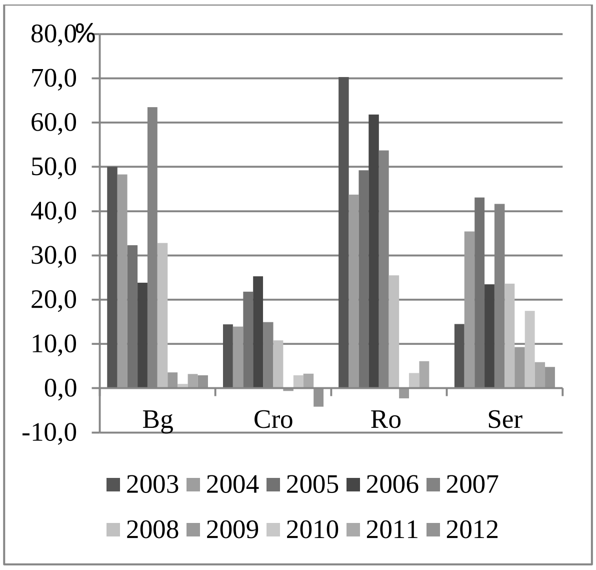


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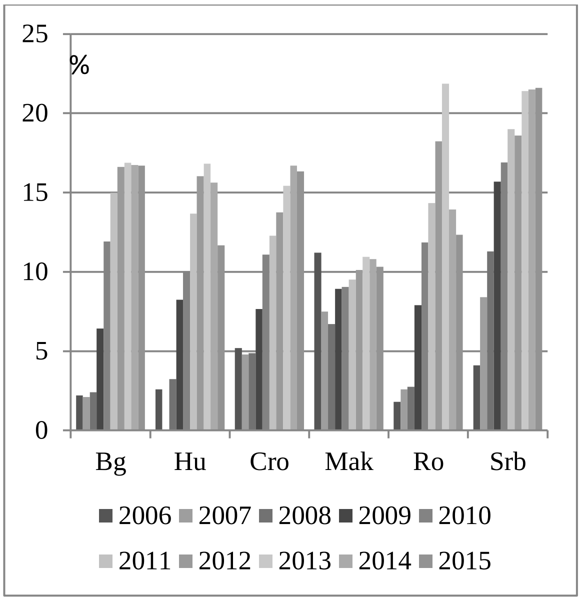
Chart6. Crediting, growth in real terms (%)

The crisis has negatively affected more or less all countries in the region, and one of the main problems has been a high rate of NPLs. After more than a decade of transition toward market economies, the economies of Southeast Europe have become more stable than before. During the period before the crisis they had experienced a high rate of growth of GDP and, simultaneously, a rapid increase in crediting activities. Credit activity had pro-cyclical characteristics, which means that it was induced by the speeding up of business activities that, in return, accelerated the rate of GDP growth. The increase in extended credits resulted from a high inflow of foreign investments owing to the opening of foreign banks, the increase in deposits and the increase in remittances from abroad [10]. The increase in credit activities resulted from the increase in demand, which then accelerated crediting. As can be seen from Chart 6, Serbia had had the highest rate of growth of credit activity prior to the crisis, which can largely be attributed to late start of the transition process. Romania had a very high rate of crediting growth prior to the crisis, of more than 40% per year. Bulgaria, on the other hand, saw a drop in crediting even before the crisis had started.

During the crisis countries in the region faced a decline in GDP and credit activities. The higher the increase was before the crisis, the deeper the drop was afterwards. The boom in credit activities before the crisis had very often been linked to non-efficient allocation of financial resources, misbalances, and the increase in credit risk, which during the crisis additionally adversely affected economies altogether.

As can be seen from Chart 6, the credit activity decreased heavily after 2008 and the rate of growth became one-digit almost as a rule. Romania and Croatia faced a negative rate of growth even. At the same time Bulgaria was an example of an economy with a modest increase before the crisis, whereby the slowdown was also modest. Serbia experienced a decreasing trend of credit activity after the crisis had started but the credit activity continued to increase, although moderately.

The crisis did affect countries in the region of Southeast Europe. The crisis resulted in the increase in NPLs in all the countries considered. The increase in NPLs was higher in those countries that had experienced a more intense credit boom before the crisis; they faced a more substantial decrease in economic activities and credit issuing during the crisis years.

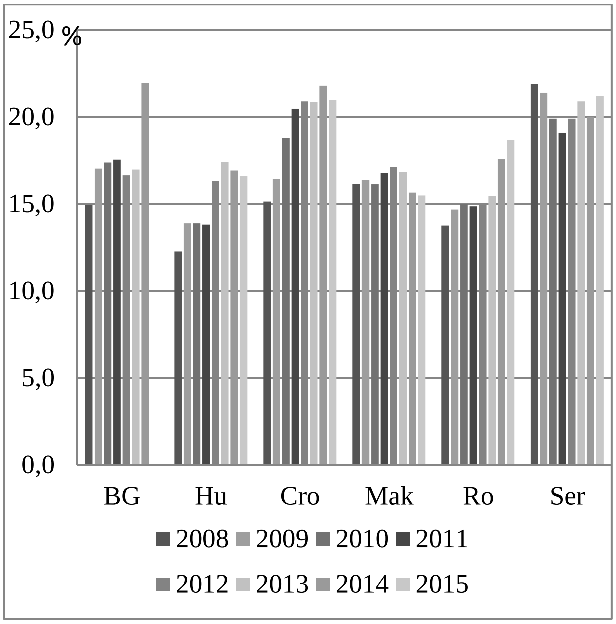


Source [11]

Chart7. Non–performing loans, NPLs (%)

One can see from Chart 7 that Serbia was faced with the highest increase in NPLs during the crisis, from 4% in 2006 and 11% in 2008 up to 22% in 2015. Such a development can be explained through a very intense credit boom before the crisis and a drop in economic activities during the crisis. One can also notice that the level of NPLs in Serbia has stabilised over the past few years (at around 22%). Other countries in the region like Hungary, Romania, and FYR Macedonia managed to reduce the NPLs level owing to measures that were introduced. Just like in Serbia, in Bulgaria the NPLs level seems to have stabilised over the past few years although at a much lower level (16%). FYR Macedonia is an example of stable and low-levelled NPLs both before and during the crisis (10%).

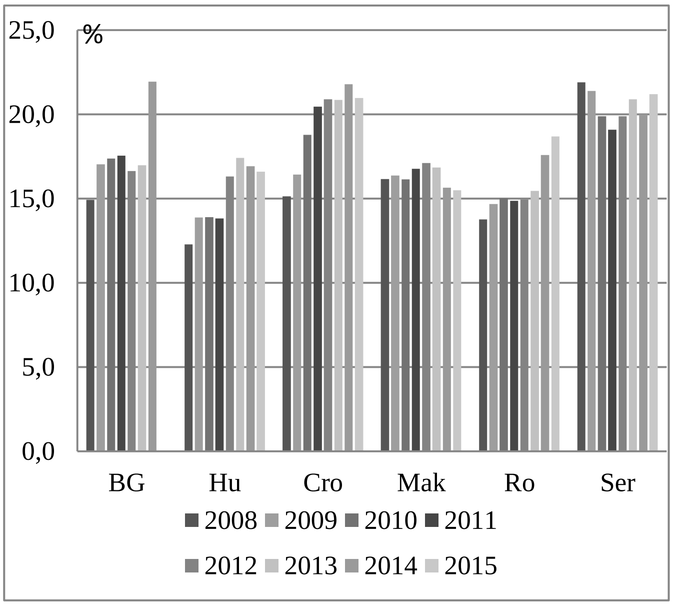
Factors which led to the NPLs increase need to be looked into if one wants to introduce measures for tackling the serious problem of banking sectors. The main factors are the following: business cycles that demonstrated a high increase before the crisis and a heavy drop during crisis, the deterioration of performances of companies, the foreign exchange risk, the structure of credit portfolio, and the rise in unemployment [12]. NPLs adversely affect the performances of the banking sector because NPLs require the increase in banks' reserves thus putting down the profit rate and, simultaneously, raising the fear of failure in banks, opening room for aversion from the risk, dismantling credit activity, and affecting the slowdown in overall economic activity.



Source [11]

Chart8. Capital Adequacy Ratio (%)

As can be seen from Chart 8, the regulatory capital-to-risk weighted assets ratio (CAR) deteriorated as a clear consequence of the crisis, particularly in Bulgaria, FYR Macedonia and Serbia, while the CAR improved even during the crisis in Hungary and Croatia. A more important fact is that the CAR is still highest in Serbia (at 21% in 2015), which can be linked to high capitalisation of Serbian banks. This is also down to the legal requirement (at 12%) that is higher than the CAR required by the international banking standard fixed by the Basel Committee for Banking Supervision, the so–called First Basel Accord (8%). High capitalisation of Serbian banks before the crisis helped to easier overcome the negative effects of the crisis.



Source [11]

Chart9. Return on Assets, RoA (%)

From Chart 9 it can be inferred that all the national banking sectors in countries of Southeast Europe faced deterioration of banking performances during the crisis. As it was stated earlier, NPLs and their increase require an increase in reserves to cover them. The reserves are a part of the bank capital, thus inducing a decrease in bank profitability.

All countries within the region encountered a decline in profitability, as measured by the Return on Assets-ROA ratio (profit after tax/total assets). Bulgaria and FYR Macedonia are examples of a declining but stable profitability, which can be deemed a result of a modest economic and credit rise prior to the crisis and a moderate decline in economic activity and crediting during the crisis. A more dramatic deterioration of profitability happened in Hungary, Romania and Croatia, where the negative value of the RoA was present for several years. The Serbian banking sector became profitable in 2005 for the first time in decades but during the crisis profitability was low and decreasing. By profitability the Serbian banking sector was in the negative zone in 2013 as a consequence of a high volume of NPLs in three banks that lost their licenses [13].

V. BANKING SYSTEM IS KEY TO BETTER FINANCIAL ACCESS OF SMEE

If we wanted to examine the relationship between domestic banks and SMEE, one would first have to bear in mind that the Serbian financial system is bank-centric which means that, like in other emerging economies including those undergoing transition toward market economy, banks are the main suppliers of financial assets to the non–financial sector. According to their contribution to GDP of the total financial sector, the share of banks in Serbia is at above 90% while the financial market, insurance, leasing and funds total less than 10% [8].Therefore, banks are still seen as the main suppliers of investments for SMEE today and in the future.

Secondly, in approving credit requests of clients, banks are biased towards large companies compared to other legal entities because of a better credit rating and a longer history. In addition, bank officers simply find it easier to deal with fewer clients than to analyse numerous credit requests. Nonetheless, when being asked, entrepreneurs usually point to a difficult access to financial resources as one of the main bottlenecks for establishing and developing business. At the same time, SMEE are not really favoured by banks, particularly the start–ups (beginner entrepreneurs). As there is no data on the history between banks and these potential entrepreneurs, banks consider them to be too risky clients. Finally, banks are also aware that half of these beginners are highly unlikely to continue their operating after five years.

Thirdly, there are few micro-finance institutions, which are financial institutions by the strategy and methodology specialised in offering financial services to SMEE [14]. The NBS proposed legal changes (through the Law on Banks) in 2006 under which, among other things, all non-banking financial institutions coping with deposits and credits had to upgrade their capital requirement to 10 million euros just like banks or to be closed or merged to other banks. Thus small-scale financial institutions like credit–deposit institutions, associations and cooperatives simply disappeared.

Darvas stated that the problem of access to finance is not universal in the EU. Earlier European initiatives managed to support only a tiny fraction of SME, therefore these programs were unlikely to result in a breakthrough. The claim that the state support policy, especially the financial one, cannot make a breakthrough when it comes to the SMEE recovery is a strong one. In other words, although it is important, the state financial support is of secondary importance. The banking system is seen as a key factor for better financial access of SMEE, and a precondition for their recovery and future development.

Moreover, he argued for the restructuring of the bank balance sheet and overall economic recovery as preconditions for a better access to finance for SME. He additionally suggested that central bank lending is the best vehicle for a bank balance sheet clean–up and advocated increased European Investment Bank lending for securitisation of SME loans [15].

VI. HOW TO SOLVE THE NPL PROBLEM AND ENSURE BETTER ACCESS TO FINANCE FOR SMEE

It has been demonstrated here that the problem of non-performing loans (NPLs) is the most serious problem for banks in the EU, especially in transition countries, including countries within the region of Southeast Europe. The strategy for coping with NPLs involves the classification of claims according to the credit risk, namely: non-risk, low risk, standard risk, and non-performing loans. Generally speaking, there are three possible solutions for NPLs: 1) to increase the total credit portfolio, which will result in a decreasing level of NPLs in the total volume of loans, 2) to overcome NPLs on a case by case basis, and 3) to sell them to specialised financial companies.

We can see that during the crisis banks in the USA, Great Britain, and Japan were supported by heavy financial restructuring programs, including the cleaning up of dubious claims and balance sheets of banks that was financed partially by central banks and partially by ministries of finance. When classical measures of expansive monetary policy failed to produce satisfactory results, non-standard measures were introduced [16]. The European Central Bank had not followed these non–standard measures until March 2015, when measures of a similar sort started.

However, banks from countries undergoing transition cannot expect this kind of support. This is particularly not possible in Serbia as it is facing an external debt and a high level of public debt (in late 2015 the public debt was at 24.8 billion euros or 75.5% of GDP, and the external debt was at 26.3 billion euros or 80.2% of GDP) [17]. So, banks are to find a solution rather within themselves, if not the financial then the coordinative and the advisory one, and that jointly with debtors and with the support from the central bank and the ministry of finance.

As it has become clear from the picture of NPLs in banking sectors of countries in Southeast Europe, Serbia is a country with minimal efforts made to solve the problem. Such a conclusion can be drawn from the fact that level of NPLs, although highest, has been stable over the past few years, while in other countries some improvement has been made.

If we wanted to take a look in to why only small efforts were made within the banking sector in Serbia to overcome the high level of NPLs, we would not be blaming the Government and the central bank for that because of a clear lack of financial sources, but there are still several dominant factors [18]:

- there is no readiness with banks to face the real picture of balance sheets as these NPLs are treated as lost;
- considering that the majority of banks (up to 3/4) are owned by foreign banks from Italy, Austria and Greece, these mother-banks are not ready to clean up the balance sheets of banks in Serbia as this would result in deterioration of balance sheets at the level of their groups;
- with no financial sources to support banks faced with problems, the central bank hesitates to cope with NPLs directly;
- the legal framework was improved only partially and only in relation to changes in the management of banks facing severe problems and several issues still require changes.

The first model to solve the problem of NPLs is to put down their level simply by raising credit activity as the NPLs ratio is calculated by dividing the volume of non-performing loans with the total credit volume. As there were moderate signs of economic recovery in Serbia in 2015, the environment for this solution is promising. There are modest signals of recovery in the Serbian banking sector as well. After the stagnation period of 2009-2014, credit activities started to go up again in 2015 (1.7%). The rise could be accounted for by the overall economic recovery (GDP rose by 0.8%) that is a result of external demand (the export increase, investment on the basis of FDI) and, at the same time, a lowering interest rate. Since September 2013 the key policy rate regulated by the NBS has decreased by 7.5 p.p. (to 4.25%in February 2016) [17].

With a rising credit activity banks can cope with the problem of NPLs much easier. The easiest way to decrease the share of non–performing loans in the total loans is to increase the total portfolio. However, in times of recession this is not an easy task whatsoever (the rate of growth of Serbian economy in the period 2009-2014 was zero) due to a low credit demand and worsening credit rating of potential lenders. So, as the first signals of recovery appear, the room for the increase in the portfolio grows. It would be easier to attract crediting if banks lowered their interest rates and interest margins [19]. On the other hand, it is important for banks to insist on a strict credit policy, which means that the credit rating cannot be relaxed.

The second line of activities is cutting the value of NPLs by restructuring them and activating collateral instruments at sight. This task is much more complicated and time-consuming and asks for serious efforts and different approaches of the bank itself. In banks the so-called work-out departments should be established and well-equipped to cope with NPLs directly, on a case by case basis. Their role would be to asses and classify the total bank portfolio from the point of view of a different risk weight. As for NPLs, the bank should be quick and flexible enough to find an adequate solution and realise it. The best way is to relax the position of the debtor that faces repayment problems by restructuring the credit line. This involves the relaxation of the payment period, relaxation of other conditions, and making room for the debtor to recover easier, and thus the bank can benefit from its recovery. Essentially important for credit restructuring is to complete information about the client that is facing problems and constantly monitor it.

If restructuring is not viable or it fails, the bank should introduce harsh measures like activating the collateral. Usually the pledge and/or the mortgage are collaterals which can be sold. However, during recession it is difficult to sell real estate or equipment, and certainly not possible to do so at the initial price. More importantly, it is a time-consuming process. It can get really complicated if the bank has to start the court procedure to sell the real estate or the pledge.

The third line of activities in addressing NPLs is to put dubious claims out of the bank by selling them to specialised financial institutions that by-sell claims. Over the last few years the NPLs market has been developing step by step. Serbia is considered to have viability but time is needed to realise serious acquisition [20].

As it has been argued, the banking sector is seen as crucially important for supporting the SMEE recovery in times of recession. With a view of making banks capable of financing the recovery of credit activity, it is again important in solving the problem of NPLs. On the other hand, to get this financial support SMEE need to create a better access to finance.

From an institutional point of view, it seems to be important to re–establish small credit–deposit institutions or, rather, to create the legal framework for microfinance institutions. Otherwise, entrepreneurs would be out of the banks' focus [19]. In Serbia there are only two banks, namely the Microfinance Bank and the Opportunity Bank, which specialise in the cooperation with SMEE, and four micro finance institutions, namely the Micro-development Fund, Agroinvest, Integra and Microfunds-S, which have limited resources, on the one hand, and high demand, on the other [14] [21]. In countries within the region the legal environment for the development of microfinance institutions is well established, which has already produced positive effects for SME recovery and growth.

As it has been explained, unlike the situation in the EU, the Serbian Government and the central bank are in a difficult position to financially help the banking sector to overcome NPL problems because of the limited resources, linked to a high public debt and the external debt. Instead, over the past three years four banks have gone bankrupt. However, it is possible and desirable to strengthen the credit guarantee schemes with modest own sources coupled with the support from the EU and international financial institutions. In this way it would be possible to overcome financial intermediation limitations and supply additional issues through risk sharing instruments such as credit guarantee schemes [19]. In times of recession this canal has to be a part of a counter-cyclical public policy [22].

For a better and a more efficient access to finance, Serbian SMEs need the development of a network of public and private institutions conducive to general SMEE development [23]. For instance, it is a fact that both the formal venture capital and the business angel activity are scarce, not only in Serbia but in Southeast Europe in general [24]. A lack of capital and a limited access to finance is not unique to Serbian SME but rather a universal characteristic. So, it would be useful to copy the best practice, such as the British Regional Venture Capital Funds [25].

VII. CONCLUSION

During the period of the global economic crisis, Serbian SMEE faced a recession trend. Their investment activities slowed down as a consequence of deteriorated business performance. The main finding of this paper is that the negative trend limited the recovery of this sector, its role for the national economy, and its competitiveness abroad. This paper argues that in order to recover SMEE and strengthen them, measures of support on the government and the local level will be necessary. Microfinance institutions are scarce indeed, so the NBS has to liberalise the legal framework for their development. It is also important to support credit guarantee schemes on both the national and the local level. The Government should be supportive of advanced and sophisticated institutions, like business incubators, angels, and venture capital funds. Essentially important for the recovery and development of SMEE is a sound banking system. So, the main problem of Serbian banks –NPLs asks for a three-track approach: to recover crediting while insisting on a strict credit policy, to address each NPL case separately by restructuring them and/or activating collateral instruments, and to sell them to financial institutions that specialise in the matter. The NBS and the Government are faced with the task of overcoming a huge public debt, so banks have to solve NPLs by relying on their own abilities and resources. Having said that, the support from the Government and the central bank, through coordination and advice, is possible and desirable.

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