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SMEs & Entrepreneurship Policy Centre

Small Business Environment in Croatia

What do we know about small business environment in Croatia?

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Croatia is involved in several international surveys which collect information on business environment as a main focus (World Bank - Doing Business, from 2004), or as a part of other focuses (World Economic Forum - Global Competitiveness Report, from 2002; Global Entrepreneurship Research Association - Global Entrepreneurship Monitor, from 2002, Transparency International – Corruption Perception Index, from 2004). This overview will be mainly focused on information collected through the Global Entrepreneurship Monitor survey, with some complementing information from Doing Business and Global Competitiveness reports.

Global Entrepreneurship Monitor - GEM surveys entrepreneurial attitudes, attributes and activities of individuals across countries in the context of general macroeconomic¹ conditions and entrepreneurial² conditions in surveyed countries. Main areas within entrepreneurial conditions (out of 9 areas) where there is need for improvement are: education, government policies and R&D transfer to the small and medium enterprise sector.

GEM results are confirmed by other international surveys that analyse different aspects of national economies. Global Competitiveness Report identifies as the most problematic factors for doing business in Croatia: low efficiency of public administration, corruption, instability of policies, tax rates, restrictive labour legislation, access to financial resources, tax regulations and poor work ethics of national workforce.

Transparency International identifies corruption as a significant problem for functioning of Croatian economy. Croatian Corruption Perceptions Index³ keeps

¹ General macroeconomic conditions include openness of the national economy, financial market efficiency, level of investment in research and development, availability and the level of development of physical infrastructure, managerial competences, labour market flexibility and efficiency of legal and social institutions.

² Entrepreneurial conditions framework includes availability of financial resources for business venture start-up, government policies and programs, quality of education and training for entrepreneurs, openness of the internal market and competitiveness, R&D transfer, access to physical infrastructure, as well as cultural and social norms.

³ Out of 178 countries included in the survey in 2011 as much as two thirds have result lower than 5, which shows that corruption is a serious problem worldwide. Croatia is in 62nd place with corruption perceptions index value of 4.1. Slovenia (6.4) has the best result in the surrounding, and Bulgaria (3.6), Serbia (3.5) and Bosnia and Herzegovina (3.2) have lower levels of corruption perceptions index than Croatia. Croatia has been involved in this



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Croatia for years on the level of scores between 2.9 and 4.4. According to the scale from 10 (no corruption) to 0 (total corruption) those scores show that corruption is a serious problem.

World Bank survey Doing Business warns Croatia on several issues related to the quality of business environment: getting construction permits, protecting investors, registering property, trading across borders, resolving insolvency.

Obstacles to the development of the SME sector in Croatia

All mentioned worldwide studies in which Croatia is included identify the main obstacles to the development of entrepreneurship in Croatia:

- Administrative obstacles (long and expensive procedures for start-up and termination of an enterprise)
- Inefficiency of the judiciary system
- Long ownership registration procedures
- Low focus on entrepreneurial education
- Bad perception of entrepreneurship as a desired career choice
- Underdevelopment of non-formal financing forms in business ventures start-up.

Table 1: Entrepreneurial conditions framework, 2010 – average scores (Likert scale 1= lowest, 5= highest)

Components	Croatia	All GEM countries	The best
Access to Finance	2.42	2.39	3.43 Malaysia
Government Policy			
- general – SMEs, entrepreneurship	2.27	2.51	4.55 Tunisia
- toward regulations (ease, speed)	1.96	2.34	3.42 Tunisia
Government Programs	2.49	2.51	3.71 Germany
Education			
- primary and secondary	2.11	1.97	2.82 Latvia
- post-secondary	2.76	2.83	3.58 Mexico
R&D transfer	2.30	2.33	3.38 Switzerland
Intellectual Property Protection	2.62	2.70	4.24 Switzerland
Commercial and Services Infrastructure	2.83	2.95	3.66 Israel
Internal Market			
- dynamics	3.31	2.98	4.06 South Korea
- openness	2.17	2.46	3.07 Zambia
Physical Infrastructure	3.62	3.62	4.05 Iceland
Cultural and Social Norms	2.42	2.75	3.97 Israel

Source: CEPOR – GEM database



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In order to get insight in changes, Table 2 presents experts' scores for entrepreneurial conditions framework in Croatia from 2002 to 2010:

Table 2: Entrepreneurial conditions framework, Croatia, 2002-2010 – average scores (Likert scale 1= lowest, 5= highest)

	2002.	2004.	2006.	2008.	2010.
Access to Finance	3,21	2,32	2,68	2,78	2,42
Government Policy					
- general – SMEs, entrepreneurship	2,27	2,1	2,41	2,19	2,27
- toward regulations (ease, speed)	1,81	1,81	2,17	1,88	1,96
Government Programs	2,11	2,18	2,64	2,65	2,49
Education					
- primary and secondary	1,63	2,05	2,21	2,17	2,11
- post-secondary	2,01	2,63	2,86	2,79	2,76
R&D transfer	2,05	2,18	2,19	2,20	2,30
Intellectual Property Protection	2,36	2,52	2,63	2,66	2,62
Commercial and Services Infrastructure	2,43	2,6	2,92	2,74	2,83
Internal Market					
- dynamics	3,05	3,65	3,47	3,87	3,31
- openness	2,04	2,11	2,3	2,18	2,17
Physical Infrastructure	3,08	3,36	3,75	3,77	3,62
Cultural and Social Norms	2,2	2,17	2,45	3,29	2,42

Source: CEPOR – GEM database

Corruption and regulatory framework

Having in mind that corruption was reported in all mentioned surveys as one of the biggest obstacle in doing business in Croatia, the information that government policies toward regulatory framework have been evaluated with lowest scores in the period of 2002 to 2010 is worrying. Making regulatory framework for doing business simple and transparent will not only attract businesses but also eliminate many sources of corruption (complicated regulatory system is a fertile ground for corruption).

This finding is additionally confirmed through the World's Bank Doing Business survey for 2010⁴. To provide better insight into main regulatory obstacles connected with start-up and exit procedures in Croatia, below is an overview of regulatory framework quality indicators, as evaluated by Doing Business survey: regulations for enterprise start-up and enterprise termination:



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Table 3: Overview of selected regulatory framework quality indicators according to Doing Business research for 2010

Regulatory area	Indicator		
	Croatia	Best indicator (country)	EU (average)
Regulations for enterprise start-up			
Number of procedures	6	New Zealand	
Time (days)	7	1	6
Cost (% of income per capita)	8	1	14
Minimum capital (% of income per capita)	.	0.4	5.1
	6	0.0	15.9
	13		
	.8		
Bankruptcy			
Time of insolvency (years)	3	Japan	
Cost of insolvency (% of assets)	.	0.6	2.0
Recovery rate (cents per 1 USD)	1	4	10
	15	92.7	60.6
	.0		
	29		
	.7		

Source: Doing Business in 2011, Croatia – Country Profile, International Bank for Reconstruction and Development / World Bank

Also, it should be noted that some countries in close neighbourhood made very radical changes in the respect of making regulatory conditions for doing business more attractive for investors: e.g. while Croatia keeps in 2010 57th place regarding the complexity of regulatory framework for enterprise start-up measured by number of procedures and number of days required for enterprise registration, registration costs and minimal capital required for enterprise start-up, Macedonia is ranked on high 5th place. Namely, in contrast to Croatia, where the registration process lasts 7 days and requires 6 procedures, in Macedonia 3 days and 3 procedures are required for the same thing.

Access to finance

Another painful condition for SMEs in Croatia is quite limited access to finance. Abundance of banking loans are not the most appropriate for businesses either in their start-up phase or in high-growth phase, the two riskiest phases in the business life cycle.

Almost all banks offer loans to small and medium enterprises in a wide range of products/services (loans for tourism services, young people, women, new technologies, Croatian war veterans, export, investments, working capital, start-ups...).



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Lack of informal investors, like business angels and venture capitalists is an important obstacle, identified in the whole period of surveying entrepreneurial conditions in Croatia, using GEM survey. CRANE (CRoatian Angel NEtwork) - Croatian Association of Business Angels (www.crane.hr) is a non-profit association, which connects entrepreneurs that need capital for their business ventures (mostly start-ups) and business angels, since September 2008. From 2008 to 2010 CRANE had financed just a few projects which indicate poor development of this type of financing of business ventures in Croatia.

Venture capital funds have invested 13 million EUR in Croatia in 2010, which is, measured by share in GDP, one third of the European average⁵. Croatian Private Equity and Venture Capital Association – CVCA (www.cvca.hr) is active in this field, but still most of their activities are not focused on small businesses. Information about conditions of venture capital funds financing in Croatia is provided by the Croatian Private Equity and Venture Capital Association whose members are the following venture capital funds: Quaestus Private Equity d.o.o. (www.quaestus.hr), Alternative Private Equity d.o.o. (www.alternative-pe.hr), Nexus Private Equity Partners d.o.o. (www.nexus-pe.hr), Prosperus-Invest d.o.o. (www.prosperus-invest.hr), Honestas Private Equity Partners (www.honestas-pe.hr).

There is no special legal provision for microfinance institutions, though some of credit unions have microfinance programs. They are confronted with issues of territorial restrictions, guarantees, inadequate financial products and services, demanding documentation, too high interest rate and lack of information among users regarding financial products.⁶

Both, GEM and Global Competitiveness Report outline the access to finance as an obstacle, lack of adequate guarantee schemes and the inefficiency of the judicial system. The World Bank also confirms this, using the following indicators (Table 4):

- Registering property: ownership transfer regulation
- Protecting investors: corporate management.

⁵ Source: SME Report for Croatia 2011, CEPOR, Zagreb, 2011

⁶ Source: SME Report for Croatia 2011, CEPOR, Zagreb, 2011 – based on information collected through the Microfinance Workshop, jointly organized by



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Table 4: Overview of regulatory environment quality indicators related to credits market according to Doing Business research 2010

Regulatory area	Indicator		
	Croatia	Best indicator (country)	EU (average)
Registering property			
Number of procedures	5	Saudi Arabia 2	5
Time (days)	104	2	32
Cost (% of property value)	5.0	0.0 Georgia	4.8
Protecting investors			
Extent of disclosure index (0-10)	1	New Zealand 10	6

Source: Doing Business 2011, Croatia – Country Profile, International Bank for Reconstruction and Development /World Bank

The index moves in the range of 0-10 where the highest value indicates a high level of corporate management transparency, and it includes 5 aspects of corporate management transparency.

Education

In contrast to 2002, when Croatia was rated below the GEM average (1.63 compared with 2.06 as the average value of GEM countries) in the field of education and training (for entrepreneurship) at primary and secondary education level, in 2010 Croatia has above-average values (2.11) in relation to other GEM countries (1.97). However, at the tertiary education level Croatia had below-average results both in 2002 and 2010 (Table 5).

Table 5: Perception of quality of education supporting SME development in 2010

	Score 5 shows:	Average	Croatia
Education and training – (primary and secondary education level)	Primary and secondary education level encourages creativity, independence and proactivity; it gives information about market principles and puts emphasis on entrepreneurship	1.97	2.11 (2.17 in 2008)
Education and training – (tertiary education level)	There are enough university courses about entrepreneurship; business education is at the global level; vocational, professional and continuous education give a good basis for self-employment	2.83	2.76 (2.79 in 2008)

Source: CEPOR, GEM database



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In primary school education entrepreneurship still isn't recognized as knowledge and skill for achieving competency of initiative and it is only sporadically mentioned in the curriculum and is promoted depending on teacher's and/or principal's preferences and knowledge.

In secondary school education entrepreneurship is recognized as a set of knowledge and skills only in vocational schools. In 2003, Ministry of Science, Education and Sport began to systematically promote spreading the idea of "training firm", by joining the ECO NET⁷ project, and now it is a quite popular elective course.

The first entrepreneurial programs at the tertiary level of education were started in 2000 at the J.J. Strossmayer University of Osijek, Faculty of Economics, at the postgraduate level⁸ (www.pspofos.hr) and at the Vern Polytechnic in Zagreb (www.vern.hr), but it is still not recognized as an infrastructural competence, and that it should be offered to all students across campus.

Entrepreneurial activity in Croatia

Entrepreneurial activity in Croatia reflects not only individual intentions, but it results from interaction of individuals with entrepreneurial conditions in the country (regulatory framework, access to finance, education and others as listed in table 1).

In such context following information should be interpreted:

Table 6: Basic information on entrepreneurial activity in Croatia – GEM survey

	2002.	2004.	2006.	2008.	2010.
TEA – CROATIA	3,62	3,73	8,58	7,59	5,52
TEA – AVG	7,99	9,42	9,43	10,49	11,72
TEA - OPP	2,18	2,04	4,41	5,43	3,52
TEA OPP – AVG	5,62	6,81	6,82	7,15	7,80
TEA NEC	0,85	1,57	3,81	2,16	1,78
TEA NEC – AVG	1,95	2,34	2,35	2,88	3,52
OPP/NEC – motivational index	2,56	1,3	1,16	2,51	1,97
OPP/NEC – motivational index - AVG	5,73	5,55	6,06	4,29	3,40
TEA MALE	5,4	5,76	12,35	10,76	7,15
TEA MALE – AVG	10,26	11,61	11,38	12,97	13,71
TEA FEMALE	1,83	1,74	4,87	4,47	3,91
TEA FEMALE – AVG	5,69	7,18	7,51	8	9,65

Source: GEM database, CEPOR, 2002-2010

⁷ It is a good example how NGOs activities as well as some bilateral government initiatives helped to bring such novelties in curricula. From 2000 to 2006 Norwegian non-profit organisation Business Innovation Program (BIP) in cooperation with the Center for Entrepreneurship in Osijek conducted the tender for the best business plan among pupils of 5 high schools. The program was funded by the Norwegian Development Agency (NORAD). Project ECO NET (www.econet-see.com) is jointly implemented by the Government of the Republic of Croatia (through the Ministry of Science, Education and Sport, i.e. Agency for Vocational Education and Training and Adult Education) and the Government of the Republic of Austria. Government of the Republic of Austria is represented in this project by: Ministry for Education, Arts and Culture, association KulturKontakt Austria and Austrian Agency for International Cooperation – ADA.

⁸ Graduate Program in Entrepreneurship was started in 2000 at the Faculty of Economics in Osijek with financial support of the Open Society Institute



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Averages values are related to all countries involved in GEM survey in the specific year.

Legend:

TEA – total entrepreneurial activity (number of adults 18-64 year old, starting own business in last 42 months)

TEA Opportunity – total entrepreneurial activity – those who started their own business because of identified opportunity

TEA Necessity – total entrepreneurial activity – those who started their own business because of necessity (being forced to enter selfemployment, e.g. they lost job...)

OPP/NEC – motivational index showing the ratio between those starting the business because of opportunity recognition and those who were forced to do it (necessity)

In all surveyed years, entrepreneurial activity in Croatia was lower than in all countries participating in GEM survey. But, the more disturbing information is very low motivational index showing that the number of those who started the business out of opportunity or necessity is almost the same. Benchmark information is that in Slovenia such ratio is 6.9, and in Norway 20 – i.e. in Slovenia there are 6.9 times more opportunity based entrepreneurs or in Norway even 20 times more. Opportunity based entrepreneurs are more optimistic, they look at their venture in longer horizons than necessity based entrepreneurs. From the policymaker's side, it is important to provide such a climate in country to have more opportunity based entrepreneurs than necessity based entrepreneurs.

Along this discussion it is important to identify some features of entrepreneurs in Croatia:

Table 7: Features of entrepreneurial capacity of individuals in Croatia, 2010

Features	Croatia	All GEM countries	The best
Entrepreneurial capacity (knowledge, skills)	2.28	2.41	3.54 Iceland
- knowledge, skills	2.28	2.41	3.54 Iceland
- motivation	2.97	3.45	4.35 Israel

Source: CEPOR – GEM database

There are three other source of entrepreneurial activity in a country, which should be recognized especially by policymakers, educational institutions and researchers: small businesses with growing potential, innovations and women:



Table 8: Specific sources of entrepreneurial activity in Croatia, 2010

Sources of entrepreneurial activity	Croatia	All GEM countries	The best
Growing small businesses	2.59	2.91	4.02 Ireland
Valuation of innovation			
- from the company's point of view	2.74	3.12	3.94 Taiwan
- from the consumer's point of view	3.43	3.57	4.09 Iceland
Public attitude toward female entrepreneurs	2.83	3.13	4.42 Iceland

Source: CEPOR – GEM database

Recommendations: monitor, benchmark, evaluate, change

Croatian policies and programs related to SMEs must be aligned with the Small Business Act for Europe defined by EU in 2008, which reflects the political will of the European Union to recognize the key importance of small and medium enterprises in the EU economy, because its relevance for employment and generating GDP. SBA Fact Sheet⁹ for Croatia in 2010/2011 shows that Croatia reaches the European Union in two of six areas (for which data were available out of ten in total), and these are *Responsive Administration* and *Skills and innovation*. In eight of ten areas Government of the Republic of Croatia is implementing changes in regulatory framework in order to harmonize it with principles of the *Small Business Act*. In comparison with previous periods Croatian progress in the process of harmonization is visible in almost all policy areas in which Croatia lagged in comparison with the European Union. However, there are areas where progress was minimal, which necessarily demand greater intensity of changes: *Second chance* (speed and cost of bankruptcy), *Think Small First* (pressure of regulatory framework on enterprises) and *Internationalisation* (bureaucracy as obstacle for exporters)¹⁰.

In 2010 the GEM project identified lack of consistent government policies focused on issues of small and medium enterprises as one of the biggest weaknesses of the SME sector during all years of implementation of GEM survey in Croatia. Lower grade of Government policies (1.96 in 2010) than the grade given to Government programs (2.49 in 2010), as well as in all previous years, only confirms the need for urgent reaction and development of consistent policies focused on the SME sector.

Therefore, there is a need to implement consistently and continuously the chain of activities: monitoring, benchmarking, evaluating and acting accordingly, i.e. performing needed changes.

⁹ SBA Fact Sheet represents European Union's annual report that analyses changes in trends in the environment and regulatory framework on the national level for the small and medium enterprise sector. Areas of analysis are: Entrepreneurship, Second chance, Think Small First, Responsive Administration, State aid and Public procurement, Access to finance, Single market, Skills and innovation, Environment and Internationalisation.



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