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This report is prepared by CEPOR's experts SLAVICA SINGER (Ph.D., CEPOR - SME Policy Think Tank, Zagreb) and BORIS LAUC (M.Sc., Centre for Entrepreneurship, Osijek)

CIP - Katalogizacija u publikaciji
Nacionalna i sveučilišna knjižnica - Zagreb

UDK 334.71(497.5)

SINGER, Slavica

Small and medium-sized enterprises
development : national report : under The
Specific Grant Agreement RELEX 1-2 190202
REG 4-14 / Slavica Singer, Boris Lauc. -
Zagreb : CEPOR <i. e.> Centar za politiku
razvoja malih poduzeća, 2005.

Na vrhu nasl. str.: Support to promotion
of reciprocal understanding between the
European Union and the Western Balkans.

ISBN 953-99154-2-2

1. Lauc, Boris

I. Mala poduzeća -- Hrvatska

450330045

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Report is made with the support of the EUROPEAN INSTITUTE Foundation

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e-mail: info@europeaninstitute.net

www.europeaninstitute.net

Cover and design: BIG dizajn, Osijek

Printed in Osijek, Croatia, April 2005 by GRAFIKA, Osijek

Support to promotion of reciprocal understanding
between the European
Union and the Western Balkans

National report

SMALL AND MEDIUM-SIZED ENTERPRISES DEVELOPMENT

under

The Specific Grant Agreement RELEX I-2 190202 REG 4-14

SLAVICA SINGER (Ph.D., CEPOR - SME Policy Think Tank, Zagreb)
BORIS LAUC (M.Sc., Centre for Entrepreneurship, Osijek)

Last update December 2004

CEPOR
SME's Policy Think Tank Centre

Acknowledgements

This survey was prepared as a desk research, using all available studies and surveys of the SME sector in Croatia. Special thanks goes to Tajana Kesic-Šepic, State Secretary for SME's and Entrepreneurship at the Ministry of Economy, Labour and Entrepreneurship, who provided valuable information on government-supported programs. The authors are also grateful for valuable inputs provided by the World Bank Office Zagreb.

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Abbreviations:

AMC	- Association of Management Consultants
BDS	- Business Development Services
CARDS	- Community Programme for Assistance, Reconstruction, Development and Stabilisation
CEPA	- Croatian Enterprise Promotion Activity
CEPOR	- SME's Policy Centre
CTT	- Centre for Technology Transfer, Zagreb
EBRD	- European Bank for Reconstruction and Development
ECHO	- European Commission's Humanitarian Aid Office
EIB	- European Investment Bank
EU	- European Union
FDI	- Foreign Direct Investments
FIAS	- Foreign Investment Advisory Services
GDP	- Gross Domestic Product
GEM	- Global Entrepreneurship Monitor
GTZ	- Deutsche Gesellschaft fuer Technische Zusammenarbeit
HACCP	- Hazard Analysis and Critical Control Point
HAMAG	- Croatian Agency for Small Business
HBOR	- Croatian Bank for Reconstruction and Development
HGK	- Croatian Chamber of Commerce
HITRA	- Croatian Innovation Technology Development Programme
HOK	- Croatian Chamber of Crafts and Trades
HUP	- Croatian Employers Association
IBRD	- International Bank for Reconstruction and Development
IDA	- Istrian Development Agency, Pula
IFC	- International Finance Corporation
ILO	- International Labour Organization
IPO	- Initial Public Offering
IPR	- Intellectual Property Rights
ISO	- International Organization for Standardization
LEDA	- Local Economic Development Agency
NGO	- Non-Governmental Organization
NORAD	- Norwegian Development Agency
OSI	- Open Society Institute
PSO	- Dutch Program for Cooperation with Countries in Eastern Europe
REDEA	- Regional Development Agency, Čakovec
RIA	- Regulatory Impact Assessment

SAA	- Stabilisation and Association Agreement
SME	- Small and Medium-Sized Enterprises
TEA	- Total Entrepreneurial Activity
TIC	- Technology - Innovation Centre, Rijeka
UNDP	- United Nations Development Program
UPS	- Association of Management Consultants
USA	- United States of America
USAID	- United States Agency for International Development
USEA	- U.S. Energy Association
VAT	- Value Added Tax
WB	- World Bank

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Executive Summary

Despite the fact that small businesses are, and always have been, a very important part of Croatian economy, political attention was directed to that sector only recently. In the last 15 years, the SME sector in Croatia has played an increasingly important role in generating new businesses and employment. In 2002, the SME's sector contributed to the GDP with 48%, in employment with 56%, and in exports with 25%.

The major characteristics of the SME sector in Croatia are low entrepreneurial activity (measured by Total Entrepreneurial Activity Index - generated through the Global Entrepreneurship Monitor project), low share of growth-oriented businesses, huge administrative barriers, undeveloped financial market (over-dependency on traditional banking instruments), lack of education focused on developing entrepreneurial knowledge and skills. Business Development Services market is not developed. The Government mainly supports the development of the supply side of the BDS market. Appropriate ministries (Ministry of Crafts and SME, 2000-2003; Ministry of Economy, Labour and Entrepreneurship from 2004) have been very much involved in operational programs (loans, trainings). There is a quite well-developed infrastructure of institutions supporting the development of the SME sector, but there is too much overlap, which prevents them from cooperating more effectively. Many surveys confirmed such conclusions, like the surveys conducted by the SME Policy Centre - CEPOR (Global

Entrepreneurship Monitor project), the World Bank (Doing Business in 2005), OECD (Croatia: Enterprise Policy Performance Assessment), the Ministry of Economy, Labour and Entrepreneurship (through answering questionnaire related to the implementation of the European Charter for Small Enterprises).

Recommendations are developed with the aim to make the SME sector a stronger employment generator, as well as a stronger contributor to the GDP and export capacity of Croatia, using the following goals as a benchmark:

- To intensify entrepreneurial activity by increasing the number of start-up on 100 adults from 3.6 (TEA index in 2002) to 10 (expected TEA index in 2014)
- To increase the productivity of SME's
- To increase export capacity of SME's

Recommendations are divided into short-term, focusing on specific chapters of the European Charter for Small Enterprises (education and training, cheaper and faster start-up, improving on-line access, taxation and financial matters, and successful e-business models and top-class support). Long-term recommendations are focused on developing policies based on the holistic view of the SME sector, on consistent and prioritised Government support activities and programs, and research activities in the field of entrepreneurship as a paradigm and scientific discipline.

1. Status of the SME sector

Despite the fact that small businesses are, and always have been, a very important part of Croatian economy, political attention was directed to that sector only recently. High unemployment rate, as

well as recognition of the EU that SME and entrepreneurship have strategic importance for catching up with the US competitiveness, forced Croatia to think about SME through a strategic perspective as well.

1.1. Criteria for defining the SME sector in Croatia and in the EU

The criteria used for defining entities in the SME sector in Croatia are determined by the Small Business Development Promotion Act¹. According to the provisions of the law, the SME sector is structured of individuals and legal entities who permanently and independently perform allowed business activities with the purpose of achieving profit on the market. Individuals and legal entities to be considered as parts of the SME sector must meet the following three conditions:

- Average annual employment of less than 250 employees;
- Being independent in managing the business (meaning that other private and legal entities do not hold more than 25% of the small enterprise);
- Total annual revenue up to 60,000,000 Kuna, or have the aggregate balance sheet - if they are profit tax payers, or long-term property owners if they are income tax payers - not exceeding 30,000,000 Kuna.

According to the size, the law recognizes micro, small and medium-sized entities of the SME sector.

- Micro entities are individuals or legal entities with average annual

employment of less than 10 employees.

- Small entities are individuals or legal entities which:
 - Employ on average, annually, less than 50 employees
 - Have annual revenue of up to 16,000,000 Kuna or up to 8,000,000 Kuna of aggregate balance sheet - if they are profit tax payers, or long-term property owners - if they are income tax payers.
- Medium-sized entities are individual or legal entities which:
 - Employ on average, annually, more than 51 and less than 250 employees
 - Have annual revenue in the span of 16,000,000 Kuna to 60,000,000 Kuna, or the aggregate balance sheet - if they are profit tax payers, or long-term property owners - if they are income tax payers, in the span of 8,000,000 Kuna to 30,000,000 Kuna.

Employment criteria are the same in Croatia and in the EU, but the value of turnover and equity/balance sheet reflects the differences in GDP level. To sum up those criteria, with local currencies converted in euro:

Table 1

Comparison of criteria

Type of entity	Number of groups		Turnover Million EUR		Balance sheet total Million EUR	
	EU	Croatia	EU	Croatia	EU	Croatia
Micro	0-10	0-10	2	-	2	-
Small	11-50	11-50	10	2.12	10	1.06
Medium	51-250	51-250	50	7.95	43	3.97

1 EUR = 7.54 Kn (Nov. 13, 2004)

Since craft businesses are not included in the legal framework defined by the Small Business Development Promotion Act, but by the special Act on Crafts, in this survey, only employment data will show craft and SME employment

jointly. In all other analyses, the focus is only on the SME sector, without taking into account the contribution of the craft businesses. Throughout the survey, micro businesses are included in the category of small businesses.

1.2. Place of the SME's in Croatian economy

Using three basic indicators (contribution to GDP, employment and exports), the significance of the SME sector can be assessed as follows (based on 2002 data):

Table 2

Size of enterprises and contribution to GDP, employment and exports, in 2002, in%

Economic condition	Size of enterprises		
	Small	Medium	Large
GDP	30.4	17.3	52.3
Employment	32.7	20.8	46.5
Exports	13.4	14.2	72.4

Source: EU Application 2003; for exports information: Croatian Chamber of Commerce

SME's constitute a large majority of Croatian enterprise sector, representing 99.6% of the total number of companies (June 2003). In the time

span of twelve years, the number of SME's in Croatia increased almost 6 times, with a shrinking number of large companies:

1. Small Business Development Promotion Act (Zakon o poticanju razvoja malog gospodarstva), Official Gazette No. 29/2002, Zagreb, March 2002.

Table 3

Changes in enterprise structure in Croatia, 1990-2001

	1990		2001	
	No. of entities	%	No. of entities	%
SME	10,259	94.47	56,416	99.00
Small	8,815		54,213	
Medium	1,444		2,203	
Large companies	600	5.53	571	1.00
Total	10,859	100.00	56,987	100.00

Source: Kovačević Z., Obadić A., The importance of small and medium enterprises for Croatian development, Split, 1999.

Informacija o poslovanju poduzetnika u 2001. godini, Hrvatska gospo darska komora, Sektor za malo gospodarstvo (Information on business performance in 2001, Croatian Chamber of Commerce, Department for SME's)

According to the census, the population in Croatia diminished in the period of 1991 to 2001, from 4,784,265 inhabitants in 1991 to 4,437,460 inhabitants in 2001². Due to these trends, SME's density per 1,000 inhabitants increased from 2.14 in 1990 (assuming that population in 1990 was the same as in 1991) to 12.71 in 2001, but it is far from encouraging.

The Global Entrepreneurship Monitor project, in which Croatia has been involved since 2002, revealed very low entrepreneurial activity as measured by Total Entrepreneurial Activity index (TEA)³. With TEA index of 3.6 in 2002, 3.1 in 2003 and 3.73 in 2004, Croatia belongs among countries with low entrepreneurial activity. With the economy burdened with high unemployment rate (for years on the level of 17% as measured by ILO methodology), such low start-up activity is not contributing to erasing unemployment.

Not every business is a source of new employment-growing businesses are.

In Croatia, a very important bottleneck in creating new jobs is a very low share of growing small businesses. According to the GEM project, businesses with growth potential are identified as those with new products, using new technology not older than a year, and planning to have more than 20 people employed after 5 years of functioning. In all 41 surveyed countries in 2002 and 2003⁴, there were 2% of growing businesses, covering 12.3% of total employment. Croatia had 1.12% such businesses, with only 4.5% of employment in them. At the same time, in Slovenia, 17.1% of employment was in growing businesses. Such businesses are a minority everywhere, and governments are challenged to provide regulatory framework as well as access to information, and incentives for making this important breakthrough for those with growth potential. Many other stakeholders are responsible to support the development of businesses with growth potential, like the education sector. It is challenging that there are some initiatives to strengthen the

2. Statistical Yearbook, Bureau of Statistics, 2003, p. 90

3. Total Entrepreneurial Activity index is the number of entrepreneurially active people (combines the number of people who are trying to start their own business and the number of people who are owners/managers in an active firm not older than 42 months) per 100 surveyed inhabitants 18 to 64 years old.

4. GEM Croatia 2003-2004; CEPOR (in printing)

technological capacity of SME's (e.g. Croatian Innovation Technology Development Programme HITRA - under the Ministry of Science, Education and Sport).

Despite the small share of growing businesses, small businesses are the only

employment-generating part of Croatian economy. In the period between 1990 and 2001, employment in small businesses doubled, but this was not enough to compensate for halved employment in medium-sized and large enterprises:

Table 4

Changes in employment structure in Croatia, 1990-2001

Type of enterprises	1990		2001	
	Employed persons	%	Employed persons	%
Small	103,805	9.16	247,340	34.01
Medium	342,571	30.24	161,426	22.20
Large	686,390	60.59	318,467	43.79
Total	1,132,766	100.00	727,233	100.00

Source: Kovačević Z., Obadić A., The importance of small and medium enterprises for Croatian development, Split, 1999.

Informacija o poslovanju poduzetnika u 2001. godini, Hrvatska gospodarska komora, Sektor za malo gospodarstvo (Information on business performance in 2001, Croatian Chamber of Commerce, Department for SME's)

Employment in the SME sector has to be analysed through combining the number of entrepreneurs and the number of employees:

Table 5

Employment structure in the SME sector

Year	No. of entrepreneurs	No. of employees	Avg no of employees / entrepreneur
1993.	35.063	343.126	9.79
1994.	49.215	372.506	7.57
1995.	59.407	366.832	6.17
1996.	61.588	382.756	6.21
1997.	64.231	396.147	6.17
1998.	61.502	404.056	6.57
1999.	59.398	399.785	6.73
2000.	58.217	429.327	7.37
2001.	56.416	408.766	7.25
2002.	62.841	403.569	6.42

Source: Small Business, Croatian Chamber of Commerce, Small Business Department, Zagreb, 2004.

Figure 1
Number of entrepreneurs, 1993-2002

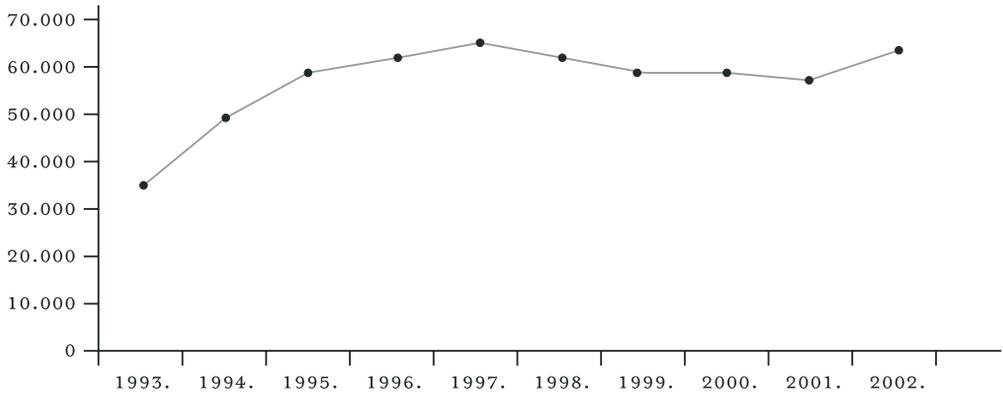


Figure 2
Number of employees in SME's, 1993-2002

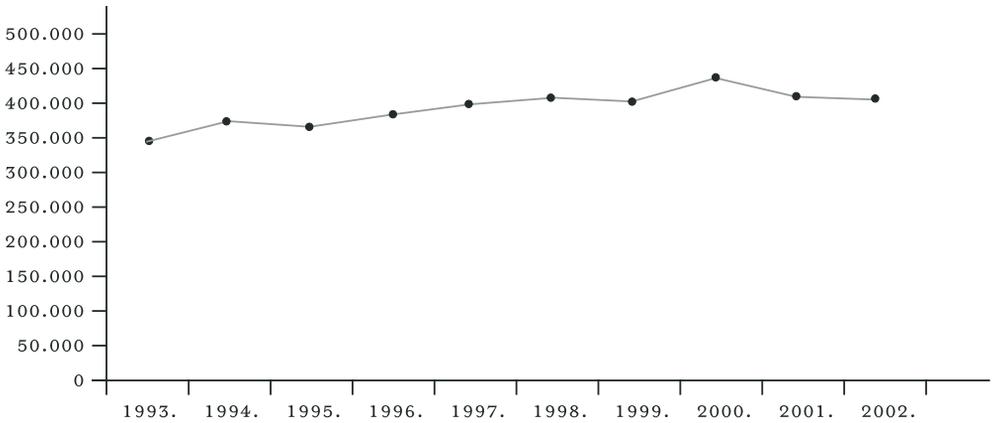
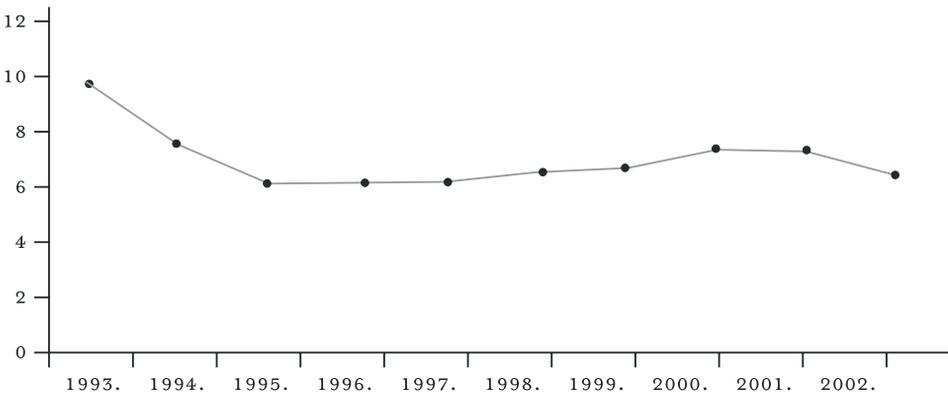


Figure 3
Average number of employees per entrepreneur



Using the more recent statistics for 2002 and 2003, some indicators about the structure of enterprises, employment struc-

ture in SME's, and financial efficiency of SME's, will provide additional insight in the role of the SME sector in Croatian economy:

Table 6 Number of enterprises according to size

Enterprises	2002		2003	
	Number	%	Number	%
Small	60,562	95.3	64,698	94.9
Medium	2,279	3.6	2,597	3.8
Large	720	1.1	889	1.3
Total	63,561	100	68,184	100

Source: FINA

Table 7 Employment structure

Enterprises	2002		2003	
	Number	%	Number	%
Small	246,854	32.7	262,844	33.0
Medium	156,715	20.8	158,971	19.9
Large	350,617	46.5	375,084	47.1
Total	754,186	100	796,896	

Source: FINA

Table 8 Financial efficiency (consolidated result: profit - loss)

Enterprises	2002		2003	
	Mil Kuna	%	Mil Kuna	%
Small				
Profit	3,848	17.1	4,345	21.7
Loss	5,447	46.7	4,523	36.7
Consolidated result	-1,599		-178	
Medium				
Profit	2,817	12.6	3,206	16.0
Loss	2,483	21.3	3,150	25.5
Consolidated result	334		56	
Large				
Profit	15,758	70.3	12,443	62.3
Loss	3,728	32.0	4,663	37.8
Consolidated result	12,030		7,780	
Total				
Profit	22,423	100	19,994	100
Loss	11,658	100	12,336	100
Consolidated result	10,765		7,658	

Source: FINA

In 2002, income generated through export was on the level of 7.24% of the total income for the SME's sector (6.11% for small enterprises, 8.79% for medium-sized businesses) compared with 15.04% for large enterprises.⁵

Croatian SME sector is characterized by enormous regional differences. The

highest concentration of businesses is in Zagreb, the capital of Croatia. The GEM data on Total Entrepreneurial Activity (new businesses not older than 42 months in 100 randomly surveyed adult population) for 2002 and 2003 (2004 data will be available in January 2005) indicate the widening those differences between regions, from 1:2 in 2002 to 1:4.3 in 2003:

Table 9

Regional differences in entrepreneurial activity

Region	2002		2003	
	TEA	Rank	TEA	Rank
Istria	4.47	1	3.05	2
Zagreb	4.38	2	4.30	1
Dalmatia	3.45	3	2.43	3
North Croatia	2.83	4	1.99	4
Lika and Banovina	2.18	5	1.78	5
Slavonia and Baranja	2.11	6	1.00	6

Source: GEM Croatia, 2002; GEM Croatia 2003-2004 (in printing); CEPOR

Regional differences in entrepreneurial activity are consistent with the differences in unemployment and GDP per capita, but also accompanied by differences in attitudes and beliefs, which should be taken into account when designing government policies and programs focused on

closing regional development imbalances. Comparing the most and least entrepreneurial intensive regions, Zagreb vs. Slavonia and Baranja, the following differences in attitudes and beliefs among surveyed adults were revealed in Croatia GEM 2003 survey:

	Zagreb	Slavonia and Baranja
Intent to start a business?		
See business opportunity?	9.6%	2.5%
Have knowledge needed to start a business?	20.4%	10.3%
Entrepreneur - a good career?	41.5%	16.9%
Media being supportive to developing entrepreneurial culture?	60.3%	43.8%
	45.2%	31.4%

5. Croatian Chamber of Commerce, SME Department, November 2004.

1.3. Major obstacles in the development of the SME sector in Croatia

Several surveys⁶ conducted in the period between 2001 and 2004 confirmed as major obstacles in enterprise development in Croatia:

- Administrative obstacles (long and expensive procedures for start-up stage, especially in liquidating stage: time of insolvency, cost of insolvency, recovery rate)
- Non-efficient court system
- Registering property
- Education not focused on entrepreneurship and issues relevant to SME's
- Getting credit (cost to create collateral, legal rights of borrowers and lenders, credit information availability)

The Global Entrepreneurship Monitor project examines relationships among general macroeconomic conditions and entrepreneurial framework conditions on which the national economic growth depends. General macroeconomic conditions include the role of the government and financial institutions, level of investment into research and development, quality and strength of the physical infrastructure in the country, efficiency of the labour market, and the efficiency of legal and social institutions. The entrepreneurs' framework conditions include availability of financial resources for starting new business ventures, government policies, and programs to support new business ven-

tures, the quality of education and training for those who wish to be or already are entrepreneurs, access to professional support services and physical infrastructure, internal market openness, as well as cultural and social norms.

Despite the short period of running the project (four years), there are some indications, confirmed through statistically significant correlations, that changes in the economic structure and market processes within a country leading to economic growth may occur more quickly when an active entrepreneurial sector is available to implement such changes⁷. For that reason, it is important to identify the entrepreneurial capacity of Croatian economy.

In all three years surveyed (2002-2004), the GEM project revealed the least favourable entrepreneurs' framework conditions (out of nine surveyed) as:

- Education
- Government policies
- R&D transfer

In Table 10, all nine entrepreneurs' framework conditions are presented with indicators for all countries participating in the project in 2003, indicating min and max values, as well as values for Croatia. For supporting the conclusion about the least favourable conditions in Croatia, indicators from 2002 GEM survey are presented in brackets.

6. Such as the FIAS Report, 2001; Global Entrepreneurship Monitor project 2002, 2003,2004; Overview of the SME Sector in Croatia, 2003; Competitiveness Report, 2003, 2004; The Quality of the Business Environment: Early Warning System - Europe and Central Asia, 2004 ; European Charter for Small Enterprises - Questionnaire 2004, Republic of Croatia; Doing Business in 2005.

7. Reynolds, P.D. at al: Global Entrepreneurship Monitor: 2002 Executive Report, Babson College, London Business School and Ewing Marion Kauffman Foundation, 2003, pp.21-22

Table 10

Assessment of Entrepreneurs' Conditions in an International Perspective - 2003

Entrepreneurs ' conditions	Avg N=31	Min	Max	Croatia	Score 5 indicates:
1. Financial support	2.61	1.59 Venezuela	3.57 US	2.72 (2.17)	There are sufficient equity funds, debt funding, government subsidies, private individuals, venture capitalist funds, and IPO are available.
2.a Government policies	2.60	1.53 Venezuela	3.59 Thailand	2.03 (2.27)	Public procurement favours new firms, support for new firms is high priority for policy on the national and local government level, support policies are effective
2.b Government policies	2.43	1.32 Brazil	4.26 Hong Kong	1.87 (1.81)	New firms can get permits in a week; taxes are not a burden; regulations are predictable and consistent
3. Government programs	2.62	1.20 Venezuela	3.52 Ireland	2.40 (2.11)	Government assistance is obtained through single agency; parks and incubators support; numerous government programs exist, government people are competent and effective, programs are effective
4.a Education and Training	2.06	1.38 France	2.76 US	1.59 (1.63)	Primary and secondary level of education stress creativity, self-sufficiency, initiative; provide instruction in market principles; and adequate attention to entrepreneurship

Table 10 - Continuation

Entrepreneurs' conditions	Avg N=31	Min	Max	Croatia	Score 5 indicates:
4.b Education and Training	2.79	1.89 Greece	3.81 US	1.97 (2.01)	Enough university courses on entrepreneurship exist, business education in world class; vocational, professional and continuing education provide good preparation for self-employment
5. Research and Development Transfer	2.49	1.63 Uganda	3.47 US	2.11 (2.05)	Knowledge is efficiently transferred from universities and research centres; new and established firms have equal access to research; new firms can afford latest technology; adequate subsidies for acquisition of new technology exist; world class technology is present in at least one area; support for engineers and scientists for commercialisation of their ideas is good
6. Commercial and Professional Infrastructure	3,23	2,55 Brazil	4.21 US	2.75 (2.43)	Subcontractors, suppliers, consultants, professional legal and accounting services exist; firms can afford them; they are of high quality
7.a Internal Market Openness	2,81	1,85 Canada	3.95 China	3.49 (3.34)	Markets for consumer and business products and services change dramatically from year to year

Table 10 - Continuation

Entrepreneurs' conditions	Avg N=31	Min	Max	Croatia	Score 5 indicates:
7.b Internal Market Openness	2.75	2.10 Brazil	3.42 US	2.23 (2.04)	Anti-trust legislation is affective, new firms can easily access the market without unfair blocks, and with no high cost of entry
8. Access to Physical Infrastructure	3.95	3.13 Uganda	4.74 Hong Kong	3.55	Physical infrastructure, access to communication infrastructure is good, inexpensive and fast
9. Cultural and Social Norms	2.76	1.74 Sweden	4.59 US	2.15	Culture is supportive, emphasizes self sufficiency, initiative; risk-taking; creativity; responsibility of the individual

Source: GEM Croatia, 2002; GEM Croatia 2003-2004 (in printing); CEPOR

Some of the nine identified areas of entrepreneurs' conditions are described in more detail due to their complexity. Government policies are observed through support policies on the local and national level, and through the tax burden, stability, and number of administrative procedures for business start-ups. Education is evaluated separately, as primary, secondary, and tertiary education. Market change velocity and the possibility for new firms to enter the market are taken as indicators of internal market openness, which indicate competitive conditions present on the national market.

Besides valuable insights in the quality of entrepreneurs' environment in Croatia, it is very indicative that in 7 cases out of 12 examined conditions, the USA ranked as a country with the most favourable conditions, followed by Hong Kong (2), Ireland (1), Thailand (1) and China (1).

Based on such assessment of the conditions which determine entrepreneurial activities in Croatia, expected outcomes are low perception of entrepreneurial opportunities and the gap between entrepreneurial opportunities and entrepreneurs' capacity to take advantage of them:

Table 11

Perception of entrepreneurial opportunities vs. entrepreneurs' capacity - 2003
(2002 indicator for Croatia is in brackets)

Item	Avg N=31	Min	Max	Croatia	Score 5 indicates:
Entrepreneurial opportunity	3.19	2.20 Venezuela	4.00 US	3.11 (2.93)	Opportunities are abundant; good and increasing; information on business opportunities can be easily obtained
Entrepreneurial capacity I	2.48	1.76 France	3.37 US	2.16 (2.43)	Creation of a new business is easy; many people know how to manage and are experienced in starting a new firms, many people can react quickly and have the ability to organize resources for new business
Entrepreneurial capacity II	3.38	2.49 Sweden	4.64 US	2.89 (2.99)	Entrepreneurship is a desirable career choice, with high status and respect; with high positive media coverage; perception of entrepreneurs as competent and resourceful individuals
Protection of Intellectual Property Rights Index	3.12	1.55 Uganda	4.05 Canada	2.44 (*)	IPR is comprehensive; efficiently enforced; pirates sales are not extensive; IPR's are respected; inventors' rights are expected to be respected.

*not evaluated in 2002//Source: GEM Croatia, 2002; GEM Croatia 2003-2004 (in printing); CEPOR

A very specific issue in encouraging people to enter self-employment or to pursue an entrepreneur's career is the participation of women. In all surveyed GEM countries, men are 1.8 times more often active in start-up activities than women⁸. In Croatia, overall participation in entrepreneurial activities, according to GEM surveys, shows a huge gap between male and female participation, measured through

TEA index (persons with start-up activities per 100 adults between 18 to 64 years old)⁹:

2002.	Women 1.58	Men 5.12 (3.2 times more often)
2003.	Women 1.42	Men 3.69 (2.6 time more often)

These differences are challenges for policy makers to eliminate obstacles which specifically prevent women from entering entrepreneurial life. The problem is identified in the GEM 2003 survey, where Croatia was identified as a country with the lowest support for women wishing to be entrepreneurially active:

Table 12

Perception of support for women in entrepreneurship - 2003

Item	Avg N=31	Min	Max	Croatia	Score 5 indicates:
Support for Women in Entrepreneurship Index	3.34	2.78 Croatia	4.18 Thailand	2.78	Women can work even after starting a family, entrepreneurial career is acceptable; women are encouraged to start new businesses; women have the same knowledge and skills as men to start a business

Source: GEM Croatia 2003-2004 (in printing); CEPOR

The GEM project is the only international project focused on entrepreneurship and the role of start-up and new businesses in national economies. Many findings identified by the GEM project are confirmed by other international projects analysing different aspects of national economies. Three international surveys will be referenced here to support the conclusion of low entrepreneurial capacity of

Croatian economy and obstacles identified by the GEM project:

- Competitiveness Report, the World Economic Forum
- Corruption Perception Index Report, Transparency International
- Economic Freedom Report, Heritage Foundation

8. ibidem, pp. 25-28
 9. GEM 2002 and GEM 2003, CEPOR

Competitiveness Report:

Growth Competitiveness Index Rank (quality of macroeconomic environment, public institutions and technology transfer and innovations)

2003. 53rd rank

2004. 61st rank

Business Competitiveness Index Rank (quality of national business environment and sophistication of company operations)

2003 62nd rank

2004 67th rank

Diagnosis:

- Inefficient bureaucracy
- Corruption
- Tax regulations
- Inadequate educated workforce
- Access to financing
- Tax rates
- Unsustainable growth of GDP, generated through high public and

- private consumption
- Low FDI
- High manufacturing costs
- Low capacity for technological transfer and innovation
- Low level of entrepreneurial activity, measured by start-ups
- Low share of businesses with growth potential

Recommendations:

55 recommendations, grouped in the following 7 clusters:

- education for growth and development
- rule of law, compatible with the EU
- cost and price competitiveness
- innovation and technology development
- strengthening the SME sector
- regional development and clusters leadership mindset

Corruption report:

Corruption Perception Index (perception of corruption among public servants and politicians)

Croatia's rank:

2003 59th out of 133 countries

2004 67th out of 145 countries

Economic Freedom report:

Economic Freedom Index (measuring the absence of government intervention in manufacturing, distribution or consumption of goods and services above the level needed to preserve civil rights)

ation of market economies. Subject to a minimal level of government involvement to provide safety and a stable legal foundation, legislative or judicial acts that inhibit this right reduce economic freedom.

Economic freedom is the right of individuals to pursue their interests through voluntary exchange of private property under the rule of law. This freedom forms the foun-

Croatia's rank:

2003 89th out of 166

2004 82nd out of 155, but still in the "mostly unfree" group of countries

2. Institutional and legislative framework

Institutional and legislative framework define the distribution of competences for enterprise policy formulation and implementation between governmental organi-

zations (ministries and agencies), the way how (if) the SME national and regional policies are developed, and the availability of consulting services for businesses.

2.1. Distribution of competences for enterprise policy formulation and implementation between governmental organizations - ministries and agencies

Despite the fact that SME's have always dominated Croatian economic structure, the more formal attention to developing appropriate institutional and legislative framework started in mid 1990's. In 1996, a small office focused on SME issues was established at the Ministry of Economy. Its attention was directed to the identification of SME issues as well as on formulating SME policy. Being the only governmental group working specifically on SME issues, they established the conference on SME's, a very good instrument for collecting information about problems which SME's were facing as well as an excellent tool for promoting entrepreneurship and the role of the SME's in Croatian economy. The first conference "Nacionalno savjetovanje o malom gospodarstvu" (National

Conference on SME's) was organized in Pula in 1998, bringing together local administration officials, government officials, representatives of SME supporting institutions (such as centres for entrepreneurship, business incubators), financial institutions, universities.

The Government elected in 2000 immediately established the Ministry for Small and Medium-sized Enterprises. In June 2002, Croatian Agency for Small Business, HAMAG, was established, taking over Croatian Guarantee Agency, which was established in 1994. The Government elected at the end of 2003 brought the authority for SME policy formulation back to the Ministry of Economy, Labour and Entrepreneurship, with HAMAG (www.hamag.hr) as the implementing agency, according to the Small Business

Development Promotion Act, which defines the role of HAMAG.

In 2004, the distribution of competences for enterprise policy formulation and implementation between governmental organizations is as follows:

- Ministry of Economy, Labour and Entrepreneurship, with its SME unit, is responsible for policy formulation, but practice shows that the Ministry is very much involved in operating programs. In 2004, the Ministry announced more than 40 different programs, from loan programs, programs for supporting implementation of new technologies, programs to subsidize participation in trade fairs, to training programs.
- HAMAG, as implementing agency should be more active in implementing government programs than it is now. In 2004, HAMAG operates the program for certification of consultants, and guarantee programs for government loan programs for

start-ups, working capital, businesses with growth potential, for business projects in agriculture and in war-devastated regions.

- Croatian Bank for Reconstruction and Development is active in their own loan programs, even in training programs for start-up entrepreneurs, but they are not operating loan programs of the Ministry of Economy, Labour and Entrepreneurship.

In 2004, the Government announced the establishment of two new agencies, InvestCroatia and EnterpriseCroatia. InvestCroatia is planned to provide services for potential FDI's. EnterpriseCroatia should focus on promoting growth- and export-oriented SME's, using EnterpriseIreland and US Small Business Administration as benchmarks. Those agencies should help in better profiling the Ministry of Economy, Labour and Entrepreneurship as a policy and regulatory body, through re-allocation of duties and responsibilities between the Ministry and program implementing agencies.

2.2. SME national and regional policies

The Global Entrepreneurship Monitor project identified the absence of consistent governmental policies focused on SME issues as one of the three major weaknesses of Croatian SME sector in all the years of implementing this project in Croatia (2002-2004). Even more important is that government policies are less

valued than the value of government programs, which clearly indicates the need for developing a consistent policy focused on SME. Not much higher scores for government programs require thorough evaluation of the efficiency of government programs before offering new ones:

Table 13

Perception of quality of government policies and programs focused on SME's - 2003
(2002 indicator for Croatia is in brackets)

Item	Score 5 indicates:	Avg	Croatia
2.a Government policies	Public procurement favours new firms, support for new firms is high priority for policy on the national and local government level, support policies are effective	2.60	2.03 (2.27)
2.b Government policies	New firms can get permits in a week; taxes are not a burden; regulations are predictable and consistent	2.43	1.87 (1.81)
3. Government programs	Government assistance is obtained through a single agency; parks and incubators support; numerous government programs exist, government people are competent and effective, programs are effective	2.62	2.40 (2.11)

Source: GEM Croatia, 2002; GEM Croatia 2003-2004 (in printing); CEPOR

There are three major documents defining the framework for SME policy activities in Croatia on all levels:

- Development Programme for Small Entrepreneurship 2003-2006, which defines the government's SME strategy, setting out to further increase the importance of SME's in the national economy,
- Small Business Development Promotion Act, 2002 - regulatory framework for implementing the strategy
- EU Charter for Small Enterprises, which Croatia endorsed in 2003

The Ministry of Economy, Labour and Entrepreneurship is too involved in operational programs and there is a need to

transfer such activities to implementing agencies such as HAMAG, and free the Ministry for policy engagement. There is no evidence that the signing of the EU Charter for Small Enterprises had any impact on updating the strategic document, Development Programme for Small Entrepreneurship, nor on any other policy document, e.g. in education, innovation etc.

There are several organisations the roles of which should be more emphasised and visible in developing SME policy:

- Croatian Employers' Association (www.hup.hr), with its SME chapter, representing the interests of the employers' and owners' side of the SME sector.

- Chamber of Commerce (www.hgk.hr), representing the interests of the of the SME sector
- Chamber of Crafts (www.hok.hr), representing the interests of the craft businesses
- UHIP, association of institutions supporting the development of the SME sector, representing views of the supply side of the consultation services market
- CEPOR (www.cepor.hr), SME policy centre, the only institution in Croatia exclusively focused on policy issues of the SME sector.

The lack of reliable sub-national statistics on SME's prevents better insight in regional differences. Therefore, it is very difficult to develop effective regional policies. This ineffective "random walk" in policy design contributes to lowering regional trust in own ability and power to make changes, which should be changed. Sub-national statistics on SME's as well as on other important indicators (primarily GDP, its structure, etc.) are basic conditions for effective decentralization, so much needed to identify the potential for growth as well as pockets of ineffectiveness on regional and lower local administration levels.

2.3. Consultation of business

The market of business development services (BDS) is very weak: the supply side is in its developing stage, the demand side is wakening. The Government decided in mid 1990's to support the development of the supply side of the market, through training consultants for work with the SME's. Some 300 consultants were trained through train-the-trainers programs until 1999. Foreign donors were also involved in this process (Dutch PSO program PSO98/CR/2/1 "Support to the Development of Small Business Sector in Croatia", budget 428,131 EUR). Some of those trained consultants joined centres for entrepreneurship, some of them tried to start their own consulting businesses, but the majority of them stayed with their original employment, because of the low demand for their services.

A survey conducted by the USAID Croatia Enterprise Promotion in 2003 revealed a broad agreement on the need for certification stemming from both supply

and demand shortfalls (e.g. consultants lack relevant knowledge for working with SME's, SME's not aware of the benefits of using consultants).¹⁰ Furthermore, there was general agreement on the need for education and training of consultants in relation to the skills and functional knowledge for working effectively with SME's.

The market of business development services is chaotic, since the market segmentation is neglected by institutions providing financial subsidies for users of such services.

On the demand side¹¹, there are two types of market segmentation: one based on the clients' ability to pay for consultation services, and one based on the type of services. Using the clients' payment ability criterion, three clients' segments can be identified:

- Non-paying segment
- Partially paying segment
- Fully paying segment

Using type of BDS criterion, basically three segments can be identified:

- Services needed by people interested in self-employment
- Services needed by owners of start-up businesses, up to three years of functioning
- Services needed by owners/managers of growing businesses

Based on the statistics provided by one of the most successful centres for entrepreneurship in Croatia¹², the following matrix can be derived:

This segmentation is recognized by the BDS providers, but not by the Ministry of Economy, Labour and Entrepreneurship, nor by foreign donors who provide subsi-

dies for BDS services. In most cases, Government subsidies are used to subsidize costs of services, i.e. for suppliers of such services, regardless whether they serve non-paying, partially paying, or fully paying segments. Such subsidies are not contributing to further profiling of the market, but, on the contrary, they distort the market: those who can pay get subsidized service; for those who cannot pay, even such subsidized service is beyond reach.

At the end of 2004, the Government started subsidizing fees for clients. A client who bought a BDS (especially if he/she was a woman, young person, or an entrepreneur wishing to introduce a new technology) could get refunded for the fees paid, in full or partially.

Table 14

Structure of clients according to type of services required - case of Centre for Entrepreneurship in Osijek

Clients	BDS	Score 5 indicates:	Score 5 indicates:	Score 5 indicates:
Non-paying clients		1.600	500	20
Partially paying clients		400	300	80
Fully paying clients		50	50	200

Source: internal evidence about clients, 1997-2003

In 2004, HAMAG initiated work on the development of an appropriate program for the certification of consultants working with SME's in Government-funded programmes¹³, with the support of the USAID Croatia Enterprise Promotion. It is expected that certification will contribute to the standardization of the quality of busi-

ness development services and to lower the chaos on the supply side.

In order to increase the quality of consultation services, a specialized university course Counselling to Small Business was developed by the J.J. Strossmayer University in Osijek as a part of the Master's degree

10. Towards a Certification for SME Consultants in Croatia (position paper), produced by USAID Croatia Enterprise Promotion in co-operation with the Association of Management Consultants (UPS), March 2004

11. Lauc, B.: "Tržište usluga za poticanje poduzetništva u Hrvatskoj" (Business Development Services Market in Croatia), (master thesis), J.J. Strossmayer University in Osijek, Graduate Program in Entrepreneurship, Osijek, 2004

12. Centre for Entrepreneurship in Osijek, established in 1997, www.poduzetnistvo.org

13. Towards a Certification for SME Consultants in Croatia (position paper), produced by USAID Croatia Enterprise Promotion in co-operation with the Association of Management Consultants (UPS), March 2004

Program in Entrepreneurship. The course has been developed using the best practice approach: Durham Business School (UK) and the Curtin Business School (Australia) were recognized as benchmarks. Interest for the topic was confirmed, because this elective course has already been taken by 43 students. From 2005, a separate Diploma program in Consultation for SME's will be offered. The purpose of the program is to introduce consultants-to-be to theoretical concepts and practical experience of providing management advisory services to small and medium-sized businesses. Lectures and discussions will guide the participants through the process of building a

relationship with the client to provide advisory services in an effective way.

The supply side can be additionally strengthened through Government recognition of market segmentation, resulting in differentiated programs supporting those institutions which are dominantly included in the non-paying or partially paying segment.

On the demand side, the Government could introduce a vouchers system in order to strengthen the competition among suppliers for clients, based on the quality of BDSs.

2.4. Regulatory environment

Regulatory environment in Croatia is not very friendly toward the needs of SME's. It is confirmed through many surveys, such as Global Entrepreneurship Monitor reports, Competitiveness reports, World Bank surveys, EBRD surveys. All those surveys identified the length and complexity of regulatory procedures as a major obstacle in encouraging start-up activities. Such obstacles are not isolated in their impact in discouraging entrepreneurial activities, but they have domino-effect consequences, such as rising corruption. The complicated regulatory framework is also a source of expensive government structure needed to support such environment.

A recent survey conducted by the World Bank and presented in the study "Doing Business in 2005" provided a more

detailed insight in the quality of regulatory environment in 145 countries, using factual information about the basic business transactions which start-up entrepreneurs as well as already established small and medium-sized companies are facing. For the purpose of presenting the major regulatory obstacles related to starting the business and doing business in Croatia, the following regulatory items from the World Bank survey are presented here:

- Starting a Business: Entry Regulations
- Hiring and Firing Workers: Employment Regulations
- Enforcing a Contract: Court Efficiency
- Closing a Business. Bankruptcy

Table 15

The World Bank Summary of Regulatory Indicators - January 2004

Regulatory item	Indicator		
	Croatia	Best	EU-15
Entry regulations			
Number of procedures	12		
Time (days)	49	2 Australia	31
Cost (% of income per capita)	14.4	0.0 Denmark	9.4
Minimum capital (% of income per capita)	24.4		
Employment regulations*	61		
Difficulty of hiring index	60		
Rigidity of hours index	50		
Difficulty of firing index	57	0 Hong Kong	44
Rigidity of employment index	55	0 New Zealand	50
Firing costs (weeks)			
Contract enforcement	22		
Number of procedures	415		276
Time (days)	10.0	27 Tunisia	12.4
Cost (% of debt)		4.2 Norway	
Bankruptcy	3.1		1.5
Time of insolvency (years)	18.0	0.4 Ireland	
Cost of insolvency (% of estate)	26.1		70.2
Recovery rate (cents on 1 USD)**		87.9 Norway	

*Indices are scored between 0 and 100, with 100 representing the highest level of regulation. The rigidity of employment index is the average of the difficulty of hiring, rigidity of hours and difficulty of firing indices. The cost of firing measures the cost of advance notice requirements, severance payments and penalties in weekly salaries.

**Recovery rate measures the proportion of the insolvency estate recovered by stakeholders, taking into account the time, cost, depreciation of assets and the outcome achieved.

Source: Doing Business in 2005, Croatia - Country Profile, The International Bank for Reconstruction and Development /The World Bank, 2004

Regulatory environment is also determined by taxation policies. In 2004, the following taxation scheme is present in Croatia:

Table 16

Taxes in Croatia, 2004

Type of taxes	Taxpayer	Tax basis	Tax rate	Regulations
VALUE ADDED TAX	Private and legal entity (entrepreneur) who delivers goods or performs services	Compensation for goods delivered or services performed	22% and 0%	Value Added Tax Act (NG 47/95, 106/96, 164/98, 105/99, 54/00 and 73/00), Regulation (NG 60/96, 113/97, 7/99, 112/99, 119/99-corrrection, 44/00, 63/00, 80/00, 109/00, 54/0158/03 and 198/03).
INCOME TAX	Private entity who generates taxable income	Total income generated by local taxpayer both in Croatia and abroad, and by foreign taxpayer in Croatia	15%, 25%, 35% ,45%	Income Tax Act (NG 127/00, 150/02 and 163/03) Regulations (NG 90/03, 140/03, 188/03 and 198/03)
PROFIT TAX	Company and other legal and private entity which performs activities with the aim of acquiring of profit	Profit (difference between income and expenditures)	20%	Profit Tax Act (NG 127/00 and 163/03) Regulation (NG 54/01 and 198/03)
SURTAX	Income tax taxpayers	Income tax	<ul style="list-style-type: none"> • Municipality: up to 10%, • City with pop. less than 30,000: up to 12% • City with pop. over 30,000: up to 15% • City of Zagreb: up to 30% 	Act on Financing Local and Regional Self-Government Units (NG 117/93, 69/97,33/00,127/00,59/01,107/01,117/01, 150/02 and 147/03)

When business owners discuss taxation issues, their claims are usually focused only on the level of taxes which they have to pay, having only foggy ideas on the time and costs needed to deal with taxation issues. Therefore, tax compliance costs are a good additional indicator of regulatory burden to businesses, since they are defined as "the costs incurred by taxpayers in meeting the requirements imposed on them by the law and the revenue authorities, over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax"¹⁴. Compliance costs include the following items: labour costs (owner, unpaid help, internal bookkeeper/accountant or other employee who deals with taxes), external costs (bookkeeping/accounting services) as well as other internal non-labour costs (software and hardware (additional), forms and stationary, postage and telephone, instructional literature and seminars, travelling costs, court costs), tax planning.¹⁵ Research undertaken in March-June 2002 on a sample of 257 small businesses (with average number of employees of one) that are personal income tax payers, proved the following conclusions:¹⁶:

- Small business tax compliance costs are regressive, proportionally heavier on the smallest of the small firms. The costs of firms with one and two employees are three times higher than those of firms with six and more employees.
- Taxpayers are not aware what is meant by compliance costs.

- The time cost (predominantly the owner's time) is dominant in the cost structure.
- Concerning the type of tax, personal income tax and VAT are of almost the same importance.
- The percentage of personal income tax compliance costs in the relevant tax revenues is extremely high, which calls for substitution of self-assessment by lump sum tax (estimated tax).
- The high percentage of VAT compliance costs calls for a higher exemption threshold or a higher three-month reporting threshold at least.

This survey on tax compliance costs is a very rare attempt to evaluate the impact of regulatory framework on SME's. In 2003, the Ministry of European Integration prepared a proposal for introducing regulatory impact assessment (RIA) in the Croatian legislative procedure, but there is still no visible implementation of this procedure. There are no procedures assessing the impact of new legislation on business. Therefore, it would be good if the Government started with regular evaluation of the effects of legislation on the SME business environment, using cost benefit analysis, especially before introducing a new legislative.

14. Sanford, C. (ed.): *Tax Compliance Costs Measurement and Policy*, Bath: Fiscal Publications, 1995, p. 1, cited in Blazic, H.: *Tax Compliance Costs of Small Business in Croatia*, Institute of Public Finance, Occasional Paper No. 22, November 24

15. Blazic, H.: *Tax Compliance Costs of Small Business in Croatia*, Institute of Public Finance, Occasional Paper No. 22, November 24, p. 4

16. *ibidem*, pp.9-15

3. Access to finance

Four basic sources of financial support to development of SME's are available in Croatia:

- Banking sector
- Credit and savings cooperatives
- Venture capital funds
- Government-subsidized loan programs

Banking sector

All banks in Croatia are offering loans to SME's with conditions which in 2004 have the following ranges:

Long-term loans

Interest rate: 8-12%

Repayment period: 5-10 years (depending on the purpose)

Grace period: depending on the purpose

Security: collateral 1:1.3 to 1:2, guarantors

Short-term loans for working capital

Interest rate: 9-15%

Repayment period: 1 year

Security: collateral 1:1.3 to 1:2, guarantors

Credit and savings cooperatives

In 2004, there were 110 credit and savings cooperatives in Croatia, but only ten biggest ones provided loans for SME's (representing 75% of the loan portfolio of credit and savings cooperatives). Other credit and savings cooperatives disburse consumption loans.

There are two specialized financial institutions for working with SME's in Croatia: NOA, a credit and savings cooperative in Osijek, and Demos, a credit and savings cooperative in Karlovac. Both institutions are active in war-devastated regions.

NOA, credit and savings cooperative

(www.noa.hr), located in Osijek, was established in 1996, through the USAID grant of 2.5 million USD, with the mission "to revitalize multiethnic life in eastern Croatia and increase of human dignity through the improvement of the life standard". In 1998, NOA enlarged its loan capacity with the donation of Open Society Institute-New York of 500,000 USD through centres for entrepreneurship in Osijek and Dubrovnik.

The present NOA mission is defined as follows: "to supply loans to small entrepreneurs, and in this way, either through self-employment or development of existing businesses, we are providing equal chances for start-ups, youth, women, unemployed, displaced and the poor to secure material existence through their own work, regardless of their sex, race, national and religious affiliation."

NOA developed its expertise in micro-financing with the support of the Opportunity International, Washington D.C. and Soros Economic Development Fund from New York.

Loan activities are focused on small business projects, mostly start-ups, but NOA gives incentives (through reduced interest rate) for good clients who come again with business plans looking for growth, in which case they can get a loan up to 50,000 EUR. Interest rate is between 7 and 11%, with repayment period from 6 - 84 months.

From 1996, when NOA was established, NOA disbursed 12,853,000 EUR in 2,420 loans in the average size of 6,841 EUR. Out of 2,420 disbursed loans, 25% were for women entrepreneurs. With the support of NOA's loans 4,449 sustained jobs and 1,693 new jobs were realized, and more than 300 new enterprises were started. NOA reached its financial sustainability in the third year of its existence.

Demos, credit and savings cooperative, located in Karlovac, was established in 1997. Demos is focused on micro-lending in war-devastated region of central Croatia (Knin, Drniš, Petrinja, Pakrac). A majority of Demos's portfolio is in short-term loans (60%). The average size of loans is 1,500 EUR, mostly in agriculture. The interest rate is 15%, repayment period up to 36 months.

Venture capital funds

Venture funds are not yet recognized as an important source for financing the SME sector in Croatia. There is very limited understanding and awareness of equity products and related regulations. There is a perception among SME owners that equity financing is very complicated, complex, demanding and almost impossible to get, that foreign investors can not be trusted, and that their intention is "just to suck out the money quickly from the company and leave"¹⁷. According to the quoted Overview

of SME in Croatia, the following information on venture capital / private equity funds is available:

- SEAF Croatia, established in 1997, with USD 10.4 million capital, made 16 investments with average investment amounting USD 250,000
- Copernicus Adriatic Venture Fund, established by the EBRD and IFC, made 6 investments with portfolio size of USD 12 million
- Quaestus Fund, established in 2003

All investments are concluded with the exit term of 3 to 5 years.

Since 2002, Croatian Bank for Reconstruction and Development has started to selectively invest in equity of growing SME companies (26-50% of total equity and up to about USD 0.8 million), with exit condition of about 5 years.¹⁸

Government programs

The Government is aware of the underdeveloped financial market in Croatia. Through implementation of numerous measures (indirectly through investment incentives and directly through loan programs), the Government intended to change it.

Investment Promotion Act ("Zakon o poticanju ulaganja" NN 73/2000) had the intention to attract domestic and foreign investments, through tax incentives on investments:

- Taxes on profits range from 0% (for a twenty-year holding period) to 7% (for 10-year holding period), provided employment levels are maintained (30 - 75 employees)
- Direct assistance for job creation - up to 15,000 Kuna (app. 2,000 euro) per employee

17. Overview of SME Sector in Croatia, World Bank, Version Date February 3, 2003

18. ibidem

Loan programs¹⁹ started in the year 2000. Until 2004, there were several loan programs, all with subsidized interest rates (app. 7% p/a) and extended repayment period:

Local loan facilities

- In 2000, the Government launched the program named "Snowball".
- In 2001, the Government launched the program named "Entrepreneur", including 66 regional and local government units.
- In 2002, "Entrepreneur 2" was launched, including 107 regional and local government units.

All programs were executed through the banks. Within the framework of these programs 6,690 loans were granted, using 433 million euro.

In 2004, program "Entrepreneur" has been launched to level entrepreneurial activities throughout Croatia, with following conditions:

- Size of loans: min 5,000 EUR, no max level
- Interest rate: up to EURIBOR + 3.70%, up to 6.00%
- Loan costs: up to 0.8%
- Deposit: no
- Repayment period: up to 10 years, with included grace period of up to 2 years
- Guarantee instruments: collateral, government guarantee scheme (Croatian Agency for SME - HAMAG)
- Interests' subsidy: up to 4% (the highest subsidies for loans for women, young entrepreneurs, war veterans, projects focused on new technologies)

Loan program for financing exports

The program started in 2001, with even more favourable conditions: interest rates were further reduced to 4.5% annually: 258 loans were disbursed, using 86.2 million euro.

Loan program for SME's in tourism

This program, introduced in 2001, mobilized funds from 15 commercial banks, with a subsidized interest rate of 5% p/a (which was achieved by subsidies of 1% point granted by the Ministry of Economy, Labour and Entrepreneurship and 1% point granted by the Ministry of Tourism). By 2004, within this program, 636 loans were disbursed, using 113.3 million euro.

Loan program for the implementation of new technologies in the SME sector

For the purpose of improving SME competitiveness, the Ministry of Economy, Labour and Entrepreneurship launched in 2004 a loan program focused on SME's with projects for buying new technology and equipment: 111 such loans were disbursed, using 15.9 million euro.

Loan funds provided by the Croatian Bank for Reconstruction and Development (HBOR)

Among numerous HBOR's loan programs, 7 programs have been focused on financing the needs of SME's:

- Financial restructuring of companies
- Development of SME (direct financing and through commercial banks)
- Development of islands
- Development of SME's in war-devastated regions
- Development of livestock (cattle) production in Croatia
- Start-up entrepreneurs (direct

19. Leppee, M.: Croatian SME's Encouragement Programme - Implementation of the Small Business Development Programme for 2001-2004, in Entrepreneurship and Small and Medium-Sized Enterprises - The Croatian Experience, United Nations & Ministry of Economy, Labour and Entrepreneurship, Geneva and Zagreb, 2004, pp. 18-22

financing and through commercial banks)

- Family businesses in tourism

Besides direct loan programs, the Government of Croatia operates a guarantee scheme through Croatian Guarantee Agency (established in 1995). In the 1995-2003 period, 3,320 guarantees were approved, in the value of 87 million EUR. The default rate is 1.6%. The Agency also approved (in the same period) 3,120 grants for reducing credit costs, in the value of 2.73 million EUR.²⁰

Three basic problems are connected with the Government involvement in providing access to financing for SME's:

- Lack of coordination among state-financed SME on-lending programs and SME loan programs from different State institutions and Croatian Bank for Reconstruction and Development.
- There is no detailed feedback information on the contribution of those programs to creating new jobs or sustaining existing ones, nor on creating new businesses. Therefore, it is impossible to evaluate the programs' effectiveness.
- Operational involvement of the relevant ministry (Ministry of Crafts and SME in 2000-2003 and after that period the Ministry of Economy, Labour and Entrepreneurship) distracted the Ministry from policy and regulatory aspect of the problem.

According to the Global Entrepreneurship Monitor project in all three years in which Croatia was involved (2002-2004), availability of loans was not considered as a severe problem. An additional important fact has been revealed: small and medium-sized companies in Croatia are relying

mostly on traditional banking sources (loans), much less on non-traditional financial instruments (such as venture capital, business angels etc.). It is interesting that the perception of the availability of such non-traditional financial instruments is even higher than the average for surveyed countries:(table 17)

The reality is not supporting such above-average scores, because there are no sufficient equity funds, no business angels, and almost no IPO supporting the development of the SME sector in Croatia.

Private equity financing in Croatia is characterised by issues typical for a developing economy:

- Third-party ownership is not often accepted or understood (personalized ownership is not easily transferred)
- Elements necessary for vibrant capital markets to support IPOs are going in the wrong direction
 - lack of transparency, regulatory leadership
 - no critical mass of capital market
- no long-term pattern of successful financial ownership
- investment exits
 - divestment process must be agreed at inception of investment
 - assumption of friendly capital markets and deep merger/acquisition candidates is not valid
 - management/entrepreneur must be committed to process

Both the Global Entrepreneurship Monitor project and the Global Competitiveness project identified problems in accessing financial sources due to lack of appropriate guarantee schemes, dif-

20. European Charter for Small Enterprises, Questionnaire 2004, Ministry of Economy, Labour and Entrepreneurship, point 7.2.

difficulties with collaterals because of the outdated property register and non-efficient courts. Those findings were confirmed through the World Bank survey Doing Business in 2005, using the following indicators:

- Getting credit: Legal Rights and Credit Information
- Registering property: Regulations of Property Transfers
- Protecting investors: Corporate Governance

Table 17

Perception of availability of non-traditional financial support - 2003
(2002 indicator for Croatia is in brackets)

Item	Score 5 indicates:	Avg	Croatia
1. Financial support	There are sufficient equity funds, debt funding, government subsidies, private individuals, venture capitalist funds, and IPO are available.	2.61	2.72 (2.17)

GEM Croatia, 2002; GEM Croatia 2003-2004 (in printing); CEPOR

Table 18

The World Bank Summary of Regulatory Indicators Related to Credit Markets - January 2004

Regulatory item	Regulatory item		EU-15
	Croatia	Best	
Credit markets			
Cost to create collateral (% of income per capita)	6.1	2 Australia	31
Legal rights of borrowers and lenders	4	0.0 Denmark	9.4
Credit information index	0		
Public registry coverage (borrowers/1000 adults)	0		
Private bureau coverage (borrowers/1000 adults)	0		
Registering property			
Number of procedures	5		
Time (days)	956	1 Norway	48
Cost (% of property value)	2.5	0.0 Saudi Arabia	6.1
Protecting investors			
Disclosure Index*	4	7 USA	6

*The index span is 0 to 7, with higher values indicating more transparency in corporate governance. The index captures seven aspects of transparency of corporate governance, indicating whether laws and regulations require reporting, and which information is available to all current and potential investors.

Source: Doing Business in 2005, Croatia - Country Profile, International Bank for Reconstruction and Development /World Bank, 2004

4. Access to information and consultancy

Access to information and consultancy is one of the nine basic entrepreneurial framework conditions identified by the Global Entrepreneurship Monitor project, named as "Commercial and Professional

Infrastructure". The GEM surveys revealed slight improvement in perception of professional infrastructure supporting development of the SME sector in 2003, comparing to 2002:

Table 19

Perception of the quality of commercial and professional infrastructure for supporting development of the SME sector - 2003
(2002 indicator for Croatia is in brackets)

Item	Score 5 indicates:	Avg	Croatia
6. Commercial and Professional Infrastructure	Subcontractors, suppliers, consultants, professional legal and accounting services exist; firms can afford them; they are of high quality	3.23	2.75 (2.43)

GEM Croatia, 2002; GEM Croatia 2003-2004 (in printing); CEPOR

This change in perception can be explained by very intense Government efforts in improving access to information and consultancy through establishing numerous institutions, like centres for entrepreneurship, business incubators, business zones etc. In order to better formulate further Government support in improving access to information and consultancy, it would be desirable to make a thorough analysis of effects of implemented programs. Due to criteria of financial support provided by the Government, institutions such as centres for entrepreneurship, business incubators,

regional development agencies, are trying to perform the same programs, which moves their attention from cooperating to competing²¹. Instead, through sharper profiling in their respective missions, and working on improving the quality of their services, those institutions could provide a healthy basis for cooperation, which would increase the capacity, diversity and quality of the supply side of the BDS market.

The major institutions supporting development of the SME's in Croatia active in 2004 are:

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Lauc, B.: "Tržište usluga za poticanje poduzetništva u Hrvatskoj" (Business Development Services Market in Croatia), (master thesis), J.J. Strossmayer University in Osijek, Graduate Program in Entrepreneurship, Osijek, 2004, p.53

Croatian Chamber of Commerce (www.hgk.hr)

Croatian Chamber of Commerce (HGK) is a non-profit, non-governmental association of all legal persons engaged in economic activities. Chamber membership is mandatory and every company registered with the Commercial Court becomes a member. At the end of 2003, there were 87,000 members. HGK consists of headquarters in Zagreb and 20 county chambers within which twelve business sectors are identified, representing areas of economic activity (construction, industry, agriculture, **small business**, financial institutions, information technology, etc.). HGK's main role is representing business sector's interests before creators of economic policy (ministries, Government, Croatian Parliament), promotion of Croatian economy at home and abroad, and undertaking activities for improvement of work and business of companies.

Croatian Chamber of Crafts and Trades (www.hok.hr)

Croatian Chamber of Crafts and Trades (HOK) is a non-governmental, non-profit association of all the crafts in Croatia. Chamber membership is mandatory and every craft registered with county departments for economy becomes a member. At the end of 2003, there were 66,000 members. Since formal professional qualification is required for starting certain types of crafts, HOK carries out professional education required for obtaining qualification in craftsmanship.

To its members, HOK offers information and education on appearance at fairs and organizes connections between craftsmen through cooperatives.

Croatian Employers' Association (www.hup.hr)

Croatian Employers' Association

(HUP) is a non-governmental, non-profit organization of employers, regardless of the legal status (company, craftsmanship) and size of the business entity, organized on a voluntary basis. At end of 2003, HUP had over 5,000 members, which are organized in sectoral associations, such as chemical industry association, steel industry association, transport association, **small and medium-sized entrepreneurs association**. Regional offices in Osijek, Split and Rijeka are constituent parts of the HUP Directorate in Zagreb.

HUP members have access to various services, such as free of charge legal assistance, free protection before courts in labour disputes, protection in case of strike, and mediation in disputes with state institutions and departments, free of charge use of foreign consultant assistance, mediation in international commercial contacts, organization of study trips and presentations, participation in state economic delegations, and free training abroad.

HUP implements educational programs, one of which is "PUMA" -a program for training of managers. The program has been carried out since 1996, with the aim to familiarize managers with ideas, skills, requirements and approaches of modern management theory, and to create a leadership structure which is ready to answer the challenges of present and future economic development.

Centres for entrepreneurship

Centres for entrepreneurship constitute a part of entrepreneurial infrastructure within which the needs of entrepreneurs are being satisfied, with the following goals: promotion of entrepreneurs, providing information on possibilities of becoming an entrepreneur, on incentive measures that entrepreneurs can use, providing advice for running a business, assistance in

business plan creation, consulting services, organization of seminars (training), referring to other specialized types of assistance, cooperation with local and regional self-administration, as well as connecting entrepreneurs. Centres for entrepreneurship, as centres of expert and counselling assistance for entrepreneurs, should be founded in those areas where the number of entrepreneurs justifies establishing of this form of assistance.

Centres for entrepreneurship in Croatia operate under various legal forms (limited liability companies, associations, parts of local administration and self-government bodies), and have been established following initiatives of entrepreneurial individuals, foreign donors, local authorities, and the relevant ministry. At the end of 2003, there were 34 centres for entrepreneurship registered in Croatia, offering services that include training, counselling and providing information to start-ups and owners of small and medium-sized companies. Geographically, centres for entrepreneurship are not well situated, which is best shown by the example of Osječko-Baranjska County (population around 350,000, greatest distance 100 km) with the total of 6 centres for entrepreneurship; this was not the result of demand by small and medium-sized companies, but of uncoordinated actions of foreign donors. Osijek's Centre for Entrepreneurship operates an entrepreneurs' portal (www.poduzetnistvo.org) which proved to be very well received by entrepreneurs because of the quality of information. The portal was developed with the financial support of the SME Policy Centre - CEPOR.

Beside the support of state and local authorities, the centres' activities are also supported by foreign donors (Open Society Institute - OSI-Croatia, United Nation Development Programme - UNDP,

United States Agency for International Development - USAID, Italian Government).

Entrepreneurial incubators

Entrepreneurial incubators are communities of small entrepreneurs who are just starting their business, set in a specific locality. Beside business premises, entrepreneurial incubators also provide organized technical and administrative support, which contains organizational and advisory assistance, and use of administrative and related services under favourable conditions (use of conference rooms, administrators, use of information equipment, accounting service for users in the incubator).

At the end of 2003, there were 13 entrepreneurial incubators registered in Croatia, most often owned by units of local administration and self-government, and are supported by the Ministry of Economy, Labour and entrepreneurship.

Technology centres and parks

Technology centres have first appeared in Croatia at the end of 1990's as an initiative started by universities and local administrations. This is how technology centres in Zagreb, Rijeka and Osijek were created. The Centre for Technology Transfer in Zagreb (CTT- www.ctt.hr) was founded by the Faculty of Mechanical Engineering and Naval Architecture, with the support of the Ministry of Science and Technology of the Republic of Croatia. It was founded with the aim of providing support to development of business processes through continuous research and development activities. Within its activities, it systematically implements strategies of connecting scientific research resources and scientific research institutes with the economy. The connecting purports the transfer of technology and knowledge from the scientific community to companies whose business

requires the application and implementation of new technological solutions, modern production processes, and adaptation of business organization to market economy requirements. In Rijeka, Technology - Innovation Centre of Rijeka Ltd. (TIC www.ticri.hr), which assists entrepreneurs with founding of companies for development of products or services based on advanced technology and facilitates their growth and development, was founded by the University of Rijeka. Technology Development Centre Osijek Ltd. (www.tera.hr) was registered in 2002 as the result of cooperation between Josip Juraj Strossmayer University of Osijek, the City of Osijek and Osječko-Baranjska County, with the mission of development of knowledge-based economy using significantly improved existing technologies (products, services, processes and procedures with newly added value), and commercialisation of publicly funded research of Josip Juraj Strossmayer University of Osijek for the support of regional development and keeping of entrepreneurial and qualified workforce in the region. Technology Development Centre in Osijek offers accommodation and business support in its incubator to beginner entrepreneurs.

The only technology park in Croatia is Technology Park Zagreb Ltd. (TPZ - www.tehnopark.hr), an entrepreneurial incubator for advanced technologies founded in 1994, within the Končar Concern. In 1998, it came under the ownership of the City of Zagreb, with the aim of promoting entrepreneurship and private initiatives in the field of development and advanced technologies in the City of Zagreb.

Regional development agencies

At local administration level, there are several development agencies aiming to

co-ordinate development projects in the framework of a county. Under the LEDA program, the UNDP supported the establishment of local economic development agencies in war-devastated regions:

- Development Agency of Osječko-Baranjska County, Osijek, www.osječko-baranjska-županija.hr
- Istrian Development Agency, Pula, www.ida.hr
- Regional Development Agency (REDEA), Cakovec, www.mpc-cakovec.hr
- Regional Development Agency PORIN, Rijeka, www.rijeka.hr
- LEDA - Entrepreneurship Centre of Vukovarsko-Srijemska County, Vinkovci, www.pc-vs-z.hr
- LEDA - Local Economic Development Agency, Okučani, www.hinet.hr/leda
- LEDA- Local Economic Development Agency, Sisak, e-mail: leda@sk.htnet.hr
- LERA - Local Economic Development Agency "Krka", Drnis, e-mail: krka@si.htnet.hr

Municipal or county "borders", and the politization of development issues which happens in some situations impose problems in developing visionary and efficient strategic goals. It would be advisable to establish regional agencies covering broader regions, not to be enclosed within county or municipality borders. Therefore, establishing the Development Agency North - DAN, as a joint enterprise of four counties (Krapinsko-Zagorska, Varaždinska, Koprivničko-Križevačka and Međimurska) in late December 2004 is promising to look at regional development issues from the point of view of broader interests of regional cooperation.

Private consultants

The initiatives of the relevant ministry for organizing a network of consultants which appeared at the start of 1999 proved fruitless. At the end of 2002, through United States Agency for International Development (USAID) initiative, Association of Management Consultants (UPS) was founded as a voluntary and independent professional association of private and legal entities with the aim of protection and improvement of quality of all forms of business counselling. The Association defines standards for Croatian business consultants and organizes

educational programs for its members.

Ending with December 31, 2004, 12 candidates have been educated according to the Program for Education and Development of Consultant Network for Small Business, which is being implemented by Croatian Agency for Small Business (HAMAG). They have thus obtained the right to Consultant for Small Business Certificate and participation in the Project for Co-financing of Consultant Services. The start of realization of this project is foreseen for the first quarter of 2005.

5. Education for entrepreneurship

In 2002, the Global Entrepreneurship Monitor project determined, and then confirmed in each of the next surveys (in 2003 and 2004), the non-existence of focused education for entrepreneurship as the major obstacle in developing entrepre-

neurial society in Croatia. Using the scale 1 to 5, where 5 indicates the highest contribution to the development of entrepreneurship, primary, secondary and tertiary education got the lowest scores among the nine elements of entrepreneurial framework:

Table 20

Perception of the quality of education supporting development of the SME sector - 2003 (2002 indicator for Croatia is in brackets)

Item	Score 5 indicates:	Avg	Croatia
4.a Education and Training	Primary and secondary level of teaching stress creativity, self-sufficiency, initiative; provide instruction in market principles; and pay adequate attention to entrepreneurship	2.06	1.59 (1.63)
4.b Education and Training	Enough university courses on entrepreneurship exist, business education in world class; vocational, professional and continuing education provide good preparation for self-employment	2.79	1.97 (2.01)

GEM Croatia, 2002; GEM Croatia 2003-2004 (in printing); CEPOR

In primary education, entrepreneurship is not recognized as a skill in any way; it is only randomly and casually mentioned depending on the school principal and/or teachers.

In secondary education, entrepreneurship is recognized as a skill in some vocational schools (economic) as a compulsory course in the curriculum. In cooperation with Junior Achievement²², 600 secondary school students participate in the

project of introducing entrepreneurship and student enterprises. A similar project, in which 5 schools participate, is launched in co-operation with Kulturkontakt from Austria. Since 2000, 5 schools have been involved in the students' business plan competition program, introduced by the Business Innovation Program, a Norwegian NGO, in cooperation with the Centre for Entrepreneurship in Osijek. The program is financially supported by NORAD (Norwegian Development Agency).

In Croatia there is only one university program (masters) focused exclusively on entrepreneurship (J.J. Strossmayer University in Osijek - www.psp.efos.hr), and one polytechnic level program (VERN, Zagreb - www.vern.hr).

The masters degree Program in Entrepreneurship at the J.J. Strossmayer University in Osijek has been established in 2000 with the financial help of the Open Society Institute - New York. The program proved to be very unique not only in its content (entrepreneurship and SME's), but also in methodology (case studies, team and individual projects based on real life problems). Despite the fact that the program is fully focused on entrepreneurship, students cannot get an academic title in entrepreneurship, but in economics. There are plans to start undergraduate as well as doctoral level programs in entrepreneurship in the year 2005, and, in three years' period, to establish a specialized school in entrepreneurship, offering undergraduate, master's and doctoral programs in entrepreneurship, as well as executive programs, jointly with the Centre for Entrepreneurship in Osijek.

VERN is a private, polytechnic level school in Zagreb, and it offers a three-year program focused on economics of entrepreneurship. The school was established in 2000.

Due to evident interest in entrepreneurship education, all Croatian universities are planning to introduce some courses or concentrations on entrepreneurship starting with the school year 2005/2006.

Outside of formal education, there are many institutions providing training for start-ups or already established businesses, like centres for entrepreneurship, Chamber of Commerce, Croatian Bank for Reconstruction and Development, Croatian Employers' Association. In 2003 and 2004, SME Policy Centre CEPOR, in cooperation with the J.J. Strossmayer University in Osijek, developed a national training program for SME's with growth potential "Growth and Development". The project was co-financed by the European Training Foundation, Ministry of Crafts and SME's and the Soros Foundation, New York.²³ The program will be implemented in 2005 by three centres for entrepreneurship (Osijek, Čakovec, Pula).

6. Inter-firm co-operation and clustering

There is no systematized information on inter-firm co-operation. In 2003, the Ministry of Crafts and SME's announced a program promoting clustering, which was continued in 2004 by the newly established Ministry of Economy, Labour and Entrepreneurship.

There are only a few projects focused on clustering, like in furniture industry (Zagreb and Vinkovci), in metal industry (Osijek).

Croatian wood cluster (Hrvatski drvni cluster) was established in 2002 within the framework of the USAID program "Improving Croatia's International Competitiveness" implemented by the J.E. Austin Associates. More than 20 furniture producers as well as other institutions joined the

cluster. The goal of the cluster is to improve the competitiveness of Croatian wood industry, through exporting products with a higher degree of finalization, i.e. products with higher values.

Wood cluster Slavonski hrast (Slavonian Oak) was established in 2004, as a cooperative of 13 wood producers, and is located in Vinkovci. The cluster was established as a part of the USAID CEP project, implemented by Deloitte.

Metal industry cluster in Osijek is in the process of establishment, through cooperation between one mid-sized growing company (MIO d.d.) and 15 smaller businesses. Osijek's Centre for Entrepreneurship and the J.J. Strossmayer University in Osijek are involved in the project since 2003.

7. Stabilization and Association process

7.1. EU assistance (human, technical and financial)

Croatian progress towards the EU is determined by the internal capacity in implementing reforms, based on the criteria set by the Copenhagen European Council of 1993 and the Stabilisation and Association Process conditionality, as defined by the Madrid European Council on 29 April 1997. In May 2000, the Commission adopted a "Feasibility Report"²⁴ proposing the opening of negotiations for a "Stabilisation and Association Agreement (SAA)", which was signed in October 2001, and an Interim Agreement (IA) is in force since March 2002. The application for EU membership was submitted by the Government of Croatia in February 2003. The first "National Programme for the Integration of the Republic of Croatia into the EU" was adopted in December 2002. A second National Programme was adopted in January 2004, comprising all chapters of the *acquis communautaire*.

Economic criteria, even political ones, spelled out by Copenhagen and Madrid documents, are very relevant for the SME sector (from ensuring access to information and finance to empowering for participating in taking business opportunities, as well as to eliminating administrative obstacles in starting and running businesses).

The "Opinion on Croatia's Application for Membership of the European Union", dated 20 April 2004, in chapter 16, related to the SME's, specifically identified the following issues²⁵ :

- **no regulatory impact assessment** to evaluate the effect of legislation on the business environment, but mentioning that such procedure is in preparation
- **time necessary for registration** of a company has decreased over the last years, but work on simplifying procedures should continue. An e-signature law was passed in January 2002, but virtually no e-business currently takes place and on-line company registration is not possible.
- there is **no tax exemption for small companies** in national taxation. Certain tax reliefs serve the purpose of rehabilitation of specific geographical areas or specific categories of people.
- **access to finance** for SME's has improved with banks offering relatively low interest rates but the requirement for collaterals can still be a hindrance to bank lending.

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COM (2000) 311 of 24 May 2000
"Opinion on Croatia's Application for Membership of the European Union", Commission of the European Communities, COM (2004) 257 final, Brussels, 20 April 2004, p. 93

- **education and training for entrepreneurship** is not recognised as a separate and distinct topic in the secondary education curriculum but some donor-supported extracurricular activity exists. The choice of such courses at university level is limited.

In concluding remarks, the

Commission of the EU stated:

"Croatia should further adjust its legislation and rules affecting business, improve the administrative and judicial environment and continue implementation of the European Charter for Small Enterprises. Alignment with the new Commission recommendation on the SME definition should be carried out. Overall, Croatia should be able to participate fully in EU SME Policy."

Between 1991 and 2003, Croatia received EURO 550 million of EU assistance, but the majority (490 million EURO) was focused on emergency support through the

European Commission's Humanitarian Aid Office (ECHO) and the Obnova program. The EU consolidated its assistance in 2000 under the Community Programme for Assistance, Reconstruction, Development and Stabilisation (CARDS), simultaneously with launching the Stabilisation and Association process. In the framework of the CARDS National Programmes, the total financial allocation for the 2001-2004 period amounts to EURO 257 million for the following five main priorities: democratic stabilisation, economic and social development, justice and home affairs, administrative capacity building, and environment and natural resources. Croatia was actively involved in defining those priorities through relevant ministries, potential beneficiaries, international financial institutions and the non-governmental sector. Implementation of CARDS assistance has been slow but there are signs of improvement due to increased absorption capacity in the Croatian administration²⁶.

7.2. Other donor assistance

Besides cooperation with the EU, three major donors are actively involved in supporting processes of developing market economy and democratic society in Croatia: World Bank (WB), European Bank for Reconstruction and Development (EBRD) and European Investment Bank (EIB).

World Bank/IFC/IBRD²⁷:

Since 1993, World Bank has supported 21 project totalling USD 1.064 million (infrastructure, health, agriculture and forestry, enterprise and financial sector reform, capital market development, judicial and pension system reform) and provided a number of grants in the total amount

of USD 20 million.

IFC (International Finance Corporation) projects, specifically focused on strengthening the SME's access to financial sources:

- Trščanska Štedionica Banka, d.d. , 1995-1999
In December 1995, IFC Board approved an equity investment of USD 1.5 million equivalent for 14% of Trščanska Štedionica Banka (TSB). TSB is a joint venture between Cassa di Risparmio di Trieste (CRT), from Italy, IFC, and some 12 local partners. The close involvement and technical support

²⁶ ibidem, p. 9

²⁷ The World Bank Office, Zagreb

from CRT was expected to result in a strengthening of the financial sector, and in support for small and medium-sized businesses in Croatia.

- Alpe Jadran Bank, 1997 - credit line for SME
In December 1997, IFC Board approved a USD 4 million equivalent loan to Alpe Jadran Banka (AJB), a small regional bank based in Split. The proceeds of the loan has been on-lent to AJB to small and medium enterprises (SME's). The loans were primarily used for trade finance as well as for acquisition and modernization purposes. The project's purpose was to ease medium-term funding constraints on private sector SME's and support the institutional development of AJB.
- Adriatic CP (Croatia Capital Partnership), 1999
In January 1999, IFC approved investment of USD 5 million (up to 20%) in the private equity fund (venture capital), which will make equity and equity-related investments in small and medium-sized enterprises (SME's). The Fund has USD 30-35 million capital commitments from Zagrebacka Banka, EBRD, Die Erste Bank, CCP Capital Ltd. and Advent International Corporation. Advent IC will invest in the Fund and will take an active role in the governance of the Fund.
- Bjelovarska Bank, 1999, credit line for SME
In March 1999, IFC Board approved a EUR 16.0 million equivalent loan to Bjelovarska Bank (BB), a medium-sized Croatian bank based in Bjelovar. The proceeds of the loan will be on-lending to pri-

vate Croatian small and medium sized enterprises (SME's). The loan is for the purposes of term financing for modernization and/or expansion projects, permanent working capital in accordance with the applicable laws and regulations of the Country and the provisions of the loan.

- Privredna Bank, 2005, credit line for SME
The loan of 75 mil EUR should strengthen the position of Privredna Bank as the leading Croatian bank focused on SME's.

Besides this financial support, IFC provided also technical assistance, such as:

- Leasing Technical Assistance
During the year 1999, IFC provided Leasing TA to the Croatian Government. Croatian Government recognized the importance of leasing as a financing source to SME's - a key engine of economic growth - and has therefore requested IFC technical assistance. The goal of the TA is changes to regulatory framework, encompassing tax, legal, and accounting issues. After detailed and profound research, IFC provided a report with in-depth analysis and proposed modifications and changes needed for the development of leasing industry in Croatia.
- Insurance Study
During the year 1999, IFC contracted Ireland's consultant company to research the insurance market in Croatia, with a goal to assess information about IFC's potential involvement in insurance industry in Croatia.

International Bank for Reconstruction and Development (IBRD) projects:

- Farmer Support Services Project, 1996-2002, 30 mil USD, resulted in direct financing of 40 family farms
- Technical Assistance for Institutional Regulatory Reform for Private Sector Development, 1999-2005
- Croatia Social and Economic Recovery Program (in preparation, expected approval in 2005), with the component of direct financing of SME's in regions of special state concern (war-devastated regions)

European Bank for Reconstruction and Development (EBRD)

Since 1994, EBRD has made investments totalling 1.325 million euro (corporate sector: pharmaceutical, food, cement and communications; financial sector and

municipal infrastructure). In 2002, the EIB has provided loans to the amount of 130 million euro for regional development (transport and communications infrastructure), economic and social cohesion, and environmental protection.

There are several donors' programs specifically focused on technical assistance to the SME sector, like governmental programs of the USA, the Netherlands, Germany and Italy.

USA²⁸

USAID's objective in the Croatia's economic sector is growth of a dynamic and competitive private sector, to be accomplished by improving the macroeconomic environment for private sector growth and delivering direct assistance to private organizations and enterprises.

Programs and projects focused directly or indirectly to SME's:

Privatisation Program

Implementer: J.E. Austin Associates

Partners: National Competitiveness Council, FIAS Secretariat, secondary cities, business and local government partners, members of the clusters, selected media

Projects	Progress to end of 2003	End Result
Assist Croatian Privatisation Fund privatise state-owned enterprises	USAID assisted CPF to prepare 60 companies for tender of which 50 were tendered and approximately 12 sold. USAID also assisted management of CPF-owned enterprises with the preparation of 40 assets or subsidiaries of which 28 were tendered and at least 6 sold.	By late 2005, it is expected that the CPF will fully divested its holdings with this assistance.
Public education material (disseminated through TV, radio, print media, on buses and special publications)	Educational messages addressed common public concerns such as "Will I lose my job?", "Are we selling our sovereignty?", and "Why is 1 Kuna sometimes the right sales price?" Several internal company privatisation newsletters were produced, as well as CD's with interviews with key government officials for all 130+Croatian radio stations, trainings for journalists, development of communication strategies for enterprises managers, and town meetings for affected communities.	Improved public awareness and understanding of the need for privatisation as an economic reform and a balanced, issue-focused, discussion in the media of the process.

28 Source: <http://www.usembassy.hr/usaideconomic.htm> (25.12.2004.)

Agribusiness Competitiveness Enhancement

Implementer: Development Alternatives Inc.

Partners: Croatian Agribusiness SME's, Croatian agricultural Producers, Croatian agricultural associations and cooperatives, Ministry of Agriculture, Croatian agro-tourism sector, agricultural finance institutions.

Projects	Progress to end of 2003	End Result
Building relationships among small and medium producers, privatised agricultural combinats, newly emerging SME's, processors, supermarkets, and the tourist sector	Twelve producer organizations representing nearly 2000 farmers improved links with key processors, distributors and supermarkets. Surveys of the food service and supermarket sectors were completed and direct linkage with major food retailers established.	Increased utilization of Croatian inputs in domestic processing, large supermarket chains and in the tourist sector, accompanied by a decrease in the agricultural trade deficit.
Improved on-farm productivity and efficiency	Demonstration plots using improved technologies doubled production of selected horticulture products; improved product grade; and significantly increased farmer profits. The processors involved plan to assist their growers to apply the new technologies in 2004. Technical assistance provided to livestock producers through eight farmer organizations improved business management, husbandry and production practices, resulting in improved quality and volume of production. A pilot dairy activity resulted in a 13% increase in production and a leading dairy processor is working with the project to adopt the model for their producers in 2004.	Improved on-farm efficiency and productivity achieving marginal returns that attract investment to the farms where assistance is provided and results in the expansion of farm production
Improving access to agricultural finance	Five producer organizations were assisted in the development of business plans and formal requests for funding for capital expansion. Three organizations received funding..	Sustainable, commercially viable mechanisms in place providing expanded access to credit for agricultural producers, SME's and processors.

Raising Income in Economically Distressed Areas

Implementer: Development Alternatives Inc.

Partners: Emerging commercial and non-commercial farmers, cooperatives, farmer associations, traders, processors; Ministries of Agriculture and Small and Medium Enterprise, The Association of Cooperatives, Municipality and Regional authorities, agricultural and micro-finance institutions.

Projects	Progress to end of 2003	End Result
Technical and informational support to emerging commercial agricultural producers in expanding quantities and meeting market quality requirements.	Project just under way.	Improved on-farm efficiency and productivity providing additional jobs and income.
Development and strengthening of agricultural associations and cooperatives.	Project just under way.	Improved efficiency and development of marketing channels, quality control, and product standards.
Improving access to agricultural finance	Project just under way.	Provide access to credit to individual farmers for financing increased production and newer production technologies.

Energy Sector Restructuring

Implementer: Pierce - Atwood, Hunton - Williams, Nexant, U.S. Energy Association (USEA)
Partners: Ministry of Economy, Croatian Energy Regulatory Council, Hrvatska Elektroprivreda, Energy Institute "Hrvoje Pozar", Ministry of Health, the City of Rijeka

Projects	Progress to end of 2003	End Result
Assistance in the drafting of Energy laws	4 energy laws passed by Parliament in July 2001. Statutory framework for an energy market was identified as one of the prerequisites to EU accession.	Open and unbiased access to the local power market for energy providers. Non household customers to purchase power from provider of choice.
CERC - Institutional Capacity Building	CERC attained autonomy and capability to issue and revoke energy licenses, give opinions on proposed tariff models and monitor their implementation, set transmission fees and stranded costs, settle disputes.	Improved customer protection and continues monitoring a transparent power market.
Assistance to HEP, relationship with CERC	HEP group and affiliated daughter companies will have defined generation, transmission and distribution tariff methodologies to provide a transparent end user tariff.	Clear separation of accounts between HEP and daughter companies resulting in transparent end user tariffs.
Energy Planning & Energy Efficiency	In line with the new energy laws, the city of Rijeka is the first city in Croatia to institute a comprehensive long-term energy plan methodology.	Secure and affordable long-term power supply. Pilot program will be implemented in other Croatian cities.

Croatian Enterprise Promotion Activity (CEPA), started in 2001, ended in 2004

Implementer: Deloitte Touché Tohmatsu

Partners: Croatian SME's, Croatian BDS providers (consultants), Ministry of SME's, Bankers Association, Croatian Employers Association, Association of Management Consultants

Projects	Progress to end of 2003	End Result
Training (increase competitiveness of manufacturing and service enterprises)	Nine training courses in quality management, finance, marketing, human resources and consulting skills, featuring software-based tools, were prepared and tested based on widely accepted management and analytical techniques to assist consultants and clients to improve enterprise performance and competitiveness. More than 200 consultants have been trained. Ten instructors have been trained through a train-the-trainer program. By the end of 2003, eleven practicum assignments, designed to provide enhanced training and positive operational performance impact to enterprises, were completed or are under way.	Trained, skilled and certified consultants committed to continuing education and high standards of conduct and ethics providing quality services to the Croatian enterprises they serve. This enhances the operational performance and profitability of the enterprises, improving their competitive position in domestic and external markets.
Standards and Certification	Provisional certification of eight consultants as ISO Lead Auditors and 13 consultants in Basic Competency in Hazard Analysis and Critical Control Point (HACCP) Food Safety. High quality standardized training materials were developed for HACCP, necessary for any food processor placing processed foods and meat through large distribution channels.	More than 150 consultants certified by international certifying bodies, providing their skills domestically for the enterprises that are seeking accession to international certification.
Establishment of a self-regulating organization	A self-regulating organization, Association of Management Consultants (AMC) was established, and currently has a membership of 106 individuals and consulting firms.	A fully sustainable AMC for the consulting industry in Croatia providing cutting edge best practices and internationally certified training to consultants, setting the standard for quality delivery of enterprise management support tools.

New program: Enhancing SME performance (ESP), from 2004

Implementer: DAI - Nathan Group llc

The Netherlands - Program for Cooperation with Countries in Eastern Europe (PSO)²⁹

Dutch donors' programs are present in Croatia since 1996:

Table 21

The Netherlands Program for Cooperation in Croatia (PSO)

Year	Number of projects	Budget (EUR)
1996	3	933,308
1997	5	892,405
1998	4	1,137,150
1999	3	1,338,651
2000	5	2,251,295
2001	5	2,254,688
2002	5	3,191,360
2003	7	3,565,893
2004	2	1,770,000
Total	39	17,334,750

Projects related to the SME sector:

Projects in 1996

- PSO96/CR/1/1 "Dairy Demonstration", budget 504,204 EUR

Projects in 1997

- PSO97/CR/1/1 "Introduction of small-scale milk processing in Croatia", budget 371,575 EUR

Projects in 1998

- PSO98/CR/1/6 "Potato Demonstration Project", budget 410,397 EUR
- PSO98/CR/2/1 "Support to the Development of Small Business Sector in Croatia", budget 428,131 EUR

Projects in 1999

- PSO99/CR/1/8 "Strengthening of the Mushroom Sector", budget 340,335 EUR
- PSO99/CR/1/9 "Improvement of the Fruit Sector in Croatia", budget 340,335 EUR

Projects in 2000

- PSO0/CR/1/10 "Biological Vegetable Project", budget 453,780 EUR
- PSO0/CR/1/13 "Rebirth of the Oblacinska Cherry", budget 453,720 EUR
- PSO0/CR/2/14 "Croatian Development Framework: A Catalyst for SME Growth",

²⁹

Source: www.pso.nl

budget 436,476 EUR

Projects in 2001

- PSO01/CR/1/10 "Strengthening of fish-farming in Croatia", budget 449,242 EUR
- PSO01/CR/1/22 "Production & marketing fish consumer packs", budget 448,644 EUR
- PSO01/CR/1/25 "Improvements in the pork production chain in Croatia", budget 449,242 EUR

Germany³⁰

German support was delivered through GTZ (Deutsche Gesellschaft fuer Technische Zusammenarbeit, GmbH) since the year 2000:

Projects in 2000:

- Support in promoting business activities, in cooperation with the Croatian Ministry of Crafts and SME's, budget 1.3 mil euro

Projects in 2002:

- Strengthening the SME's, budget 0.4 mil euro
- Planning the regional development, budget up to 0.6 mil euro
- Fund for educational and training activities, budget up to 0.3 mil euro

Projects in 2003:

- Promoting economic development and employment in food industry, budget up to 1.5 mil euro
- Fund for educational and training activities, budget up to 0.5 mil euro

Italy³¹

The Government of Italy pledged 3.5 mil euro for supporting projects in the war-devastated region of eastern Croatia. The agreement between two governments was signed in November 2000, with the idea to connect two Croatian counties (Osjecko-Baranjska County and Vukovarsko-Srijemska County) with the Italian region Friuli-Venezia-Giulia, for working on projects in agriculture, SME's, institutional building and social issues. Ongoing SME projects are (January 2004 - March 2005):

- Wine roads of Eastern Slavonia, 270,000 EUR
- Support in Development of Small and Medium Enterprise in Osjecko- Baranjska and Vukovarsko-Srijemska Counties, 600,000 EUR
- Building tourist potential of "Kopacki Rit" through multimedia marketing activities, 15,000 EUR
- Support in realization of Technological Park in Osijek, 85,000 EUR
- Vukovarsko-Srijemska County wood cluster, 225,000 EUR

30 Source: [www.mei.hr/default.asp?mode=1&gl=200412030000003&jezik=1&sid \(10.01.2005\)](http://www.mei.hr/default.asp?mode=1&gl=200412030000003&jezik=1&sid (10.01.2005))
 31 Source: www.informest.it

7.3. Donor co-ordination

Since 2000, there is a Directorate for the Co-ordination of Assistance Programmes and Co-operation with EU, located at the Ministry for European Integration. The main tasks of this Directorate are to programme foreign assistance in co-operation with other state administration bodies, and provide expert assistance and information on

EU programmes in which Croatia participates. But, despite this, even on information level, it is difficult to get insight in all donors' programs. There were several attempts to co-ordinate donors in order to avoid overlapping of projects proposed by the international community, but they did not yet prove very successful.

8. Recommendations

Recommendations are based on the following conclusions and expectations:

- Croatia is falling behind the growth paths of new EU member countries, such as the Czech Republic, Hungary, Poland, Slovakia and Slovenia
- With 10,030 USD GDP pc at ppp in 2002, Croatia reached only 92.3% of 1990 value of actual GDP³².
- Strategic goals for the ten-year period 2004-2014, as spelled out by the National Competitiveness Council³³, are
 - To achieve sustainable level of GDP growth, by doubling 2002 value of GDP pc at ppp, which will allow Croatia to reach 55-60% of average GDP pc in the EU around the year 2014. In order to reach this goal, GDP has to grow at 5% or higher rate.
 - To half the unemployment rate, from 14% (according to ILO methodology) in 2003 to under 8%.
 - To increase the contribution of exports in GDP, from 50% in 2002, to more than 65% in 2014.

The role of SME is obvious: small businesses already proved to be the only job-generating part of Croatian economy, but the SME sector does not contribute to generating new values or to export as much as it could. The whole SME sector must become a stronger employment generator, but must also become a strong contributor to the GDP and export capacity of Croatia. Therefore, the National Competitiveness Council specifically identified the following goals for the SME sector:³⁴

- To intensify entrepreneurial activity by increasing the number of start-ups on 100 adults from 3.6 (TEA index in 2002) to 10 (expected TEA index in 2014)
- To increase the productivity of SME's
- To increase the export capacity of SME's

The Government of Croatia identified four groups of 29 chapters from *acquis communautaire* according to expected difficulties to deal with in the process of EU accession. The SME field (chapter #16) is considered to be easier to prepare for accession process, because it could be adjusted to EU policies and standards without considerable difficulties in a 5-year period.³⁵

32 Gligorov, Vladimir: Recent Economic Developments and the Competitiveness of the Croatian Manufacturing Industry, Wiener Institut fuer Internationale Wirtschaftsvergleiche (wiiv), 2004

33 55 Recommendations for Improving Competitiveness of Croatia, National Competitiveness Council, Zagreb, January 2004, pp. 13-15

34 ibidem, p. 41

35 Speech delivered by the Minister of European Integration, Ms. Kolinda Grabar-Kitarovic, Zagreb, October 4

8.1. Short-term recommendations

The only document in Croatia which suggests short-term recommendations is the European Charter for Small Enterprises, Questionnaire 2004. All recommendations are framed in one-year period. They cover the following fields of the Charter: education and training, cheaper and faster start-up, improving on-line access, taxation and financial matters, and successful e-business models and top-class support³⁶:

- Education and training for entrepreneurship (#1 of the Charter); short-term objectives are:
 - 20 SME consultants certified by the end of the year 2004. In 2005, 20 more certified consultants
 - Croatian Small Business Agency
 - HAMAG
 - to improve 57 programs for crafts education (secondary vocational level) - Ministry of Economy, Labour and Entrepreneurship, Division for Crafts
 - to train 3920 start-ups through "Start-up Programme", Ministry of Economy, Labour and Entrepreneurship
 - to train 4000 participants in the framework of "Growth Programme" - Ministry of Economy, Labour and Entrepreneurship
 - to train 600 start-up entrepreneurs as part of loan requests -
- Croatian Bank for Reconstruction and Development
 - to open two regional information centres of the Croatian Bank for Reconstruction and Development
- Cheaper and faster start-up (#2 of the Charter); short-term objectives are:
 - To improve the effectiveness of local administration offices for crafts registration - Ministry of Economy, Labour and Entrepreneurship
- Improving on-line access (#5 of the Charter); short-term objectives are:
 - Adoption of regulations to implement the methods of exchange data between state administration bodies - Central Government Office for e-Croatia
- Taxation and financial matters (#7 of the Charter); short-term objectives are:
 - To increase the number of issued guarantees for SME's (1500 new ones) - Croatian Small Business Agency HAMAG
- Successful e-business models and top-class small business support (#9 of the Charter); short-term objectives are:
 - To accelerate the presence of new technologies through government's institutions

8.2. Long-term recommendations

The identified obstacles in small and medium-sized enterprises development in Croatia are mostly results of fragmented policy approach and/or lack of institutional

infrastructure. Bringing together conclusions of many international and local surveys on the status and problems of the SME sector in Croatia³⁷, as well as the Program

³⁶
³⁷

European Charter for Small Enterprises, Questionnaire 2004, Ministry of Economy, Labour and Entrepreneurship
The most recent surveys used for this report are:

for Promoting Development of SME's in the 2004-2008 Period, which is primarily based on recommendations developed by the National Competitiveness Council, the following recommendations can be drawn: Promoting Development of SME's in the 2004-2008 Period, which is primarily based on recommendations developed by the National Competitiveness Council³⁸, the following recommendations can be drawn:

1. A holistic view of SME sector development is needed to overcome fragmented and non-consistent policy solutions³⁹
 - a.) Core areas to address:
 - I. Transparency
 - II. Legal and regulatory compatibility (eliminating administrative burdens)
 - III. Training of public administration officials. A good basis for such a training program could be the study developed by the UNIDO and

2. Government support
 - a.) Core areas to address:
 - I. Eliminate administrative burdens in order to achieve the following standards in a 5-year period: 3 days for registration, max 5 documents and 1 permit
 - II. To establish on-line registration as a pilot project in several municipalities in 2005.
- OECD: Effective Policies for Small Business: A Guide for the Policy Review Process and Strategic Plans for Micro, Small and Medium Enterprise Development⁴⁰
- b.) Key players:
 - I. Ministry of Economy, Labour and Entrepreneurship
 - II. Ministry of Finance
 - III. Ministry of Science, Education and Sport
 - IV. CEPOR, SME think tank
 - V. Universities

- Doing Business in 2005: Removing Obstacles to Growth, the World Bank, the International Finance Corporation and Oxford University Press, 2005
 - Global Entrepreneurship Monitor project 2002, 2003,2004
 - Competitiveness Report, 2003, 2004
 - The Quality of the Business Environment: Early Warning System - Europe and Central Asia, 2004
 - Croatia: Barriers to Growth, A Competitiveness Report, prepared by Luis-Alvaro Sanchez for the Croatian Ministry of Economy, February 2004
 - Croatia: Enterprise Policy Performance Assessment, OECD, May 2003
 - Report on the Implementation of the European Charter for Small Enterprises in the Countries of the Western Balkans, SEC(2004) 149, Brussels, 2004
 - European Charter for Small Enterprises - Questionnaire 2004, Republic of Croatia
 - Opinion on Croatia's Application for Membership of the European Union, Commission of the European Communities, COM (2004) 257 final, Brussels, 20 April 2004
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 - Croatia: Economic Vulnerability and Welfare Study, World Bank, Poverty Reduction and Economic Management Unit, June 2000
 - Croatia: A Policy Agenda for Reform and Growth, Overview, World Bank, Volume 1, February 2000
- 38 Program poticaja malog i srednjeg poduzetnistva, approved by the Government of Croatia on May 5, 2004.
- 39 Reports such as Human Development Report 2003 - Millennium Development Goals: A compact among nations to end human poverty, UNDP, Oxford University Press, 2003, could be of help in thinking holistically and at the same time referring to the human being level.
- 40 This guide was prepared by Professor Allan Gibb, policy advisor to the OECD / UNIDO Forum on Entrepreneurship and Enterprise Development. Using the draft version of this guide, the CEPOR - SME Policy Centre, with the help of Professor Gibb, developed a training program for high ranked Croatian government officials in 2003, but the implementation failed because there was no interest on the government side.

- iii. Access to information
 - 1. to establish internationally (EU) compatible statistics on SME's, as well as sub-national statistics on SME's
 - 2. to continue with supporting development of network of centres for entrepreneurship, empowered to act as ONE-STOP-SHOP
 - 3. to provide *benchmark* information on productivity of industries, with the possibility to identify differences due to the size of enterprises
 - 4. to educate media in SME's and entrepreneurship issues
- iv. Access to finance
 - 1. a national, cohesive policy of promoting equity investing in SME sector, with policy focus on reducing the risk or increasing potential return (tax credits, grants and loans to funds, co-investment in funds, partial guarantee against losses, leveraged investments in funds)
 - 2. a national policy of promoting private equity financing for new businesses through business angels (providing outside equity capital and mentoring for growing businesses), using the U.S. and EU best practices
 - 3. limited direct government interventions, but using them for special situations, e.g. through Community Development Venture Capital focusing on SME's
 - in low-income communities, and/or through the scheme of government grants and low-interest loans providing working capital for technical assistance
 - 4. promoting business angels source of financing SME through tax incentives
 - 5. promoting alternative financial sources for SME's through campaign and regulatory framework (leasing, factoring, credit cards)
- v. Decrease tax compliance costs, especially for the smallest businesses
- vi. Empower SME's for exporting:
 - 1. provide subsidies for SME's entering process of quality certification
 - 2. provide loans for export oriented production
- vii. Intensify innovation activities of SME's through providing incentives, education, loan programs
- viii. Access to education focused on entrepreneurship
 - 1. provide more flexible legal framework for introducing new curricula in formal education system,
 - 2. introduce entrepreneurship courses from primary to tertiary level of education
 - 3. support students' business plan competition
- 3. Research and science
 - a.) To intensify research activities in entrepreneurship in order to develop foundations for new paradigm and discipline, since it is neglected in traditional sciences

9. Conclusions

Analysing the conclusions and recommendations of used surveys, from 1997 on, there is only one conclusion appropriate for this survey:

Since there is such a high consensus on problems, causes and recommenda-

tions, the political will and coordinated efforts of all stakeholders in Croatia are needed to eliminate obstacles sooner than it is recommended and create a vibrant sector as a driving force for innovations and job creation, and a major contributor to the national wealth.

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