

**ENTERPRISE POLICY
PERFORMANCE
ASSESSMENT**

BOSNIA AND HERZEGOVINA

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European Bank
for Reconstruction and Development



Enterprise Policy Performance Assessment

Bosnia and Herzegovina

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STABILITY PACT
FOR SOUTH EASTERN EUROPE



INVESTMENT COMPACT
FOR SOUTH EAST EUROPE



European Bank
for Reconstruction and Development



The Stability Pact for South Eastern Europe is a political declaration and framework agreement adopted in June 1999 to encourage and strengthen co-operation among the countries of South East Europe (SEE) and to facilitate, co-ordinate and streamline efforts to ensure stability and economic growth in the region. (see www.stabilitypact.org)

The South East Europe Compact for Reform, Investment, Integrity and Growth (“The Investment Compact”) is a key component of the Stability Pact under Working Table II on Economic Reconstruction, Development and Co-operation. Private investment is essential to facilitate the transition to market economy structures and to underpin social and economic development. The Investment Compact promotes and supports policy reforms that aim to improve the investment climate in South East Europe and thereby encourage investment and the development of a strong private sector. The main objectives of the Investment Compact are to:

- Improve the climate for business and investment.
- Attract and encourage private investment.
- Ensure private sector involvement in the reform process.
- Instigate and monitor the implementation of reform.

The participating SEE countries in the Investment Compact are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia, Moldova, Romania, Serbia and Montenegro. Building on the core principle of the Investment Compact that “ownership” of reform rests within the region itself, the Investment Compact seeks to share the long experience of OECD countries. It provides region-wide peer review and capacity building through dialogue on successful policy development and ensures monitoring of progress as well as identification of practical steps to implement reform and transition.

The work of the Investment Compact has been actively supported and financed by seventeen OECD member countries: Austria, Flanders (Belgium), Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Norway, Sweden, Switzerland, Turkey, United Kingdom and United States (see www.investmentcompact.org). The European Commission (EC) has, through DG Enterprise and Industry, contributed to the funding for this report.

The Enterprise Policy Performance Assessments (EPPAs) are an output of the SEE Enterprise Forum, a regional policy initiative sponsored by the Investment Compact for South East Europe. The EPPA reports have been jointly produced by the OECD and European Bank for Reconstruction and Development (EBRD), in consultation with the European Commission (DG Enterprise and Industry). The EPPA reports have been initiated by Declan Murphy, Programme Director of the Investment Compact, and their preparation has been co-ordinated by Antonio Fanelli (Principal Administrator, OECD), Francesca Pissarides (Senior Economist, EBRD) and Edward Tersmette (Desk Officer Eastern Europe, EC- DG Enterprise and Industry).

Background research and support for the 2004 Bosnia and Herzegovina EPPA report (2nd edition) was provided by the Business Development Centre Zenica, directed by Senada Keserovic, who provided the first draft.

The assessments and views expressed in this report are those of the Investment Compact Team of the OECD secretariat and of the EBRD Office of the Chief Economist and do not necessarily reflect the views of the OECD and EBRD member countries.

FOREWORD

In all countries the government and its agencies have a fundamental lead role to play in providing an environment favourable to business operations and conducive to private investment. This is especially true for small business. Small and medium-sized enterprises are the backbone of most economies today. In order to flourish and grow they need an environment that facilitates and enables business start-up, does not hamper them with excessive and costly regulations and facilitates access to finance and business services. In this respect there is an urgent need in South East Europe (SEE) to design and implement an effective enterprise policy, as the level of private investment still lags behind that of advanced countries.

For these reasons, in 2002 the OECD and the EBRD launched the Enterprise Policy Performance Assessments (EPPAs) in the framework of the Investment Compact for SEE Programme. The EPPAs consist of a series of reports covering all the countries of South East Europe, assessing the quality of the government policy for the SME sector and regularly monitoring its implementation. In 2003 the Investment Compact published nine country reports (separate reports were produced for Serbia and Montenegro, respectively) as well as a Regional EPPA report measuring progress on SME policy implementation in the SEE against a set of good practices and benchmarks.

As part of the 2004 EPPA programme the Investment Compact presents the 2004 edition of the Enterprise Policy Performance Assessment for Bosnia and Herzegovina. The format of the report is the same as last year, allowing for a direct comparison of the progress achieved since the 2003 EPPA.

The 2004 report has been prepared by the OECD and the EBRD in close consultation with the European Commission, which also provided financial support to the programme. Excellent synergies have been developed between the EPPA and the European Charter for Small Enterprises, with the EPPA providing a set of policy recommendations and priority actions to the government and small business community in those policy dimensions covered by the European Charter. In order to improve the link between the EPPA and the European Charter, the scope of the 2004 EPPA has been expanded. The EPPA reports now cover seven policy areas, adding entrepreneurship, vocational training and access to technology to the previous set of six policy dimensions (institutional framework, regulatory environment, tax policy, access to finance, advisory services, business incubators), bringing their scope closer to that of the EU Charter.

This Enterprise Policy Performance Assessment report is presented as an independent and constructive contribution to the debate on enterprise policy in Bosnia and

Herzegovina, with the principal aim of facilitating the reform implementation. The OECD, EBRD and European Commission will monitor progress and seek to provide active support on implementation in partnership with the SEE countries in 2005.



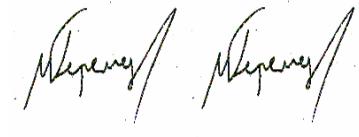
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INTRODUCTION

Scope and Structure of the Enterprise Policy Performance Assessments (EPPAs)

This report provides an assessment of the performance in implementing an effective policy and support framework to promote new enterprise and small and medium business development in Bosnia and Herzegovina in 2003-2004.

The 2004 EPPA Country Reports, including this report on Bosnia and Herzegovina, have been prepared jointly by the OECD and the EBRD, in consultation with the EC and with the assistance of a network of SEE and international expert consultants. The report places strong emphasis on the views of private small and medium-sized enterprises (SMEs) and on their practical experience and perception of the progress made in implementing the policy and support framework for promoting business development over the past year. The EPPAs complement and underpin the aims of the European Charter for Small Enterprises and the monitoring of progress with the best practices, as set out in the Charter, which has been signed by all SEE countries.

The country assessment for Bosnia and Herzegovina is based on a number of contributions:

- insights from entrepreneurs and SME owners, collected through focus group discussions and individual interviews;
- contributions from SME experts, policy makers, representatives of the associations of private enterprises and international and bilateral organisations dealing with SME issues;
- desk research and analysis of existing reports and reviews; and
- the combined experience and judgment of OECD and EBRD experts in this policy area.

The scope of the assessment was designed to address all main policy dimensions at the core of enterprise policy.

In 2002-2003 the OECD and the EBRD launched the first edition of the Enterprise Policy Performance Assessments (EPPAs) with the aim of producing regular assessments and analysis of the enterprise policy reform carried out by the government institutions in each of the countries of South East Europe (SEE). Nine EPPA reports, one for each SEE country (separate reports were undertaken for Serbia and Montenegro respectively), and a Regional SEE Assessment Report were published by the Investment Compact in 2003 and disseminated throughout the SEE Region. All the reports are available from the Investment Compact website: www.investmentcompact.org.

The 2004 EPPA Country Reports represent both a continuation and an expansion of the work started in 2002. The scope of the reports has been expanded in 2004 to include a

seventh policy dimension covering entrepreneurship, vocational education and access to technologies, reflecting the harmonisation of the EPPAS with the scope of European Charter on Small Enterprises. The 2004 framework of research and analysis of enterprise policy now consists of the following seven dimensions of good practice:

- Institutional framework for SMEs policy.
- Rule of law and regulatory framework.
- Tax policy for small business.
- Financial instruments for new and small companies.
- Business consulting services for new and small enterprises.
- Business Incubators.
- Entrepreneurship, vocational education and access to technologies.

The 2004 EPPA Country Report for Bosnia and Herzegovina is structured in two parts. Part I includes an overall assessment of enterprise policy, looking at progress made since the publication of the 2003 EPPA report. It also contains an updated list of policy recommendations and a set of priorities for short term action.

Part II consists of two chapters. The first chapter contains the insight of entrepreneurs and SME owners and managers, while the second is dedicated to analysis and assessment, including a report on the implementation of the policy recommendations listed in the 2003 EPPA Country Report.

The EPPA Methodology

The EPPA methodology has been designed to provide insights and assessments of the performance of the implementation of policies designed to improve the investment environment for business. The EPPAs have been conducted on a standard basis in all countries of the region and provide a benchmark for (a) highlighting key reform issues (b) measuring private sector insights and assessments of the business environment (c) assessing progress on a country-by-country- basis and (d) comparing cross-country reviews for the SEE region.

The policy assessments have been formulated according to the following points:

Focus group research:

Focus group discussions were held with SME representatives. The focus group discussions were guided by a question template, applied to all the SEE countries, derived from extensive case study work on good practice in transition economies and OECD country experience (OECD-UNIDO, 1999).

Individual SME interviews and expert interviews:

A number of individual SME interviews were used to validate the private sector view from the focus group research and to provide insights on key issues in each of the SEE countries. Expert interviews were conducted to cross reference information from the focus groups and contribute to view from the private sector.

Desk research:

Examination of existing reports, databases, documents, *etc.* was conducted by country-based experts and consultants, selected for their enterprise policy knowledge and experience, under the supervision of the OECD Investment Compact Team.

Expertise from the OECD, the EBRD and the EC:

A team of experts from the OECD, EBRD and from OECD countries has reviewed input from focus groups, interviews and desk research and elaborated the country assessments.

A detailed description of the methodology used in the research is presented in Annex III.

PART I

Overall Assessment and Policy Recommendations

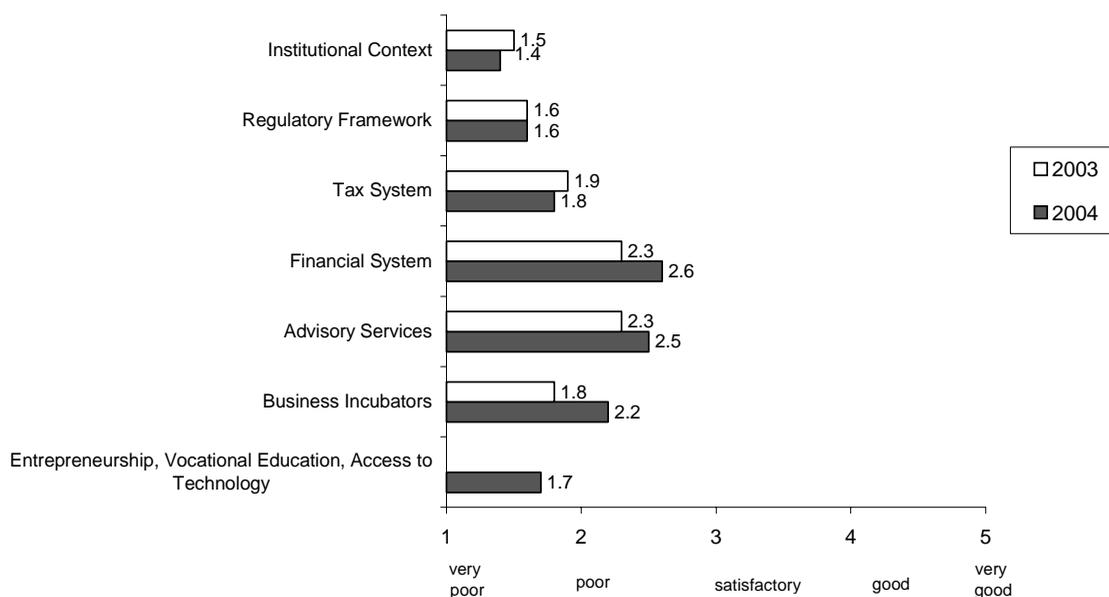
Overall Assessment

Enterprise policy elaboration and implementation in Bosnia and Herzegovina (BiH) is extremely decentralised. Most of the policy functions are performed by the two entities set up under the framework of the Dayton Agreement (the Federation of BiH – F BiH – and the Republika Srpska –RS) and the autonomous District of Brcko, with virtually no coordination among them. The State of BiH retains minimal powers of policy elaboration and implementation, although there have been recently limited steps, encouraged by the international community, towards assigning wider powers of policy initiative and policy coordination to the state government.

It is therefore problematic to present an overall assessment of the enterprise policy performance for BiH, since there is not a single policy, but at least three different locally based policies for the enterprise sector. Even in the case of the two entities and the District of Brcko, policy elaboration is still at an initial stage, as both the institutions and the policy tools have only been very recently set up.

The result of this situation is a major policy vacuum. Micro, small and medium sized enterprises constitute the backbone of the BiH economy, contributing to over 60% to GDP and much of the job creation. However, there is not a specific strategy or institution for the SME sector at state level. This contrasts sharply with the situation in other policy areas, such as privatisation, financial sector development, establishment a common economic space, and with that of other countries of South East Europe and explains the generally poor rating given by private entrepreneurs to policy performance at various dimensions.

Figure I.1. **Average Ratings by SME Owners and Managers of the Seven Dimension of Good Practice, 2003 and 2004**



Since the publication of the 2003 EPPA report for BiH, there have been a number of positive developments that may create the conditions for the introduction of a more structured and consistent enterprise policy. In 2004 a combination of factors has created an environment for promoting economic reforms. These factors range from the need to

satisfy the pre-conditions set by the EC for starting negotiations over the EU Association Agreement to the endorsement of the new Poverty Reduction Strategy paper and the implementation of the Bulldozer Initiative which is supported by the Office of the High Representative.

Concerning the enterprise sector, the most relevant recent developments have been:

- The establishment of SME-oriented institutions in BiH, Federation BiH, Republika Srpska and District Brcko level.
- The launching of five economic regions, defined according to economic integration criteria and spanning across the entity boundaries, and the establishment of five Regional Development Agencies, active in several enterprise policy areas.
- The already mentioned “Adoption of the Middle-term Development Strategy of BiH 2004-2007” (Poverty Reduction Strategy Paper), and preparation and endorsement of five regional development strategies, all having an important private sector development focus- including SMEs development.
- Recent significant legislative and regulatory changes to create single economic space in BiH and to simplify and improve the business environment.
- Reform of Tax system in BiH, which started introducing of VAT.

However, most of the new initiatives are either driven by the international community or donor supported, arising questions over their medium term sustainability and highlighting once again the need to elaborate a comprehensive strategy, elaborated at state level, for the enterprise sector.

There are, in particular, two areas where the lack of common policy approach translates into heavy additional financial and operational burdens for the BiH entrepreneurs: tax policy and administration and regulatory framework. Reform in those areas should be at the core of any future enterprise policy.

Institutional Framework for SME Policy

The institutional framework for enterprise development and SME support in BiH remains weak and underdeveloped, when compared both with international best practices and with the institutional frameworks developed by other countries in South East Europe. Its main weaknesses are:

- the complexity of the institutional arrangements, due to the existence of 14 governments on their territorial entities, each with its own policy prerogatives,
- the lack of co-ordination and cooperation among the institutions dealing with SMEs policy at state and entity level,
- the limited capacity of those institutions and
- the high dependency from donor sponsored initiatives and programmes.

The system is based on a very high level of decentralisation, at both at level of policy elaboration and implementation, per se not a negative feature. But its ability to deliver effective policies is hampered by the lack the institutions needed to create and manage a common business environment, to develop common building components of SME policy

and to conduct an effective policy co-ordination among the various entities and the donor community. However, since the previous EPPA report, there are been some noticeable development that may over the time produce some improvement in relation to the weaknesses mentioned above.

The creation of the Department for the Promotion of Entrepreneurship within MoFTER has provided a reference point for initiating a process of communication and debate among the institutions, at entity and district level, in charge of SME policy. The process is in a very early stage of development and the Department still lacks both the mandate and the human and financial resources to conduct an effective policy co-ordination, but it has started to fill a major void in the BiH institutional framework.

A second positive step, resulting from establishment of the Department and the endorsement of the PRSP, has been the establishment of the Working Group on Enterprise Development, bringing together the institutions working on SME policy, the private sector associations and representatives of the donor community and the IFIs.

The third positive element has been the establishment of five Regional Development Agencies (RDA), with a territorial configuration designed according to the level of economic integration criteria and not the entity boundaries.

Over the next two years we will have a first indication if the newly established RDAs have managed to become the main engine for local economic development, absorbing and integrating the activity of the local entity based institutions, or if the policy initiative should have remained with the existing institutions. Another critical factor will be the capacity of the RDAs to co-ordinate their activity and contribute to the building of a common economic space. The international community, and in particular, the EC and the OHR, play a key role in the development of the RDAs and their decisions on how to channel final resources and technical assistance for local development will have a major influence in determining the pace of economic integration.

A crucial issue in the elaboration of an SME development strategy will be related to the structure of the institutional framework. BiH should seriously consider the establishment of an SME Agency, at state level, following the model adopted by the majority of the other SEE countries. In terms of policy efficiency, a central SME agency, operating locally through the RDAs and integrating the SME agencies operating at entity level will make good sense, overcoming the current fragmentation in a number of uncoordinated initiatives. However, this development needs to pass through the integration of the existing institutions operating at entity and canton level into a new co-ordinated institutional framework, a move that requires wide-spread consensus and political will. The danger is to move towards the establishment of a state and donor supported SME Agency operating without any co-ordination with the SME agencies set up at entity level, the establishing therefore an additional institutional layer and increasing the risks of policy incoherence and inconsistency.

The results of the focus groups clearly indicate that the business community, across the country, is very much in favour of greater integration, administrative simplification and the establishment of a levelled field for all enterprises. The costs of the complex administrative system and the open and hidden barrier to economic integration are by and large not compensated by the preferential treatment and subsidies provided for certain types of enterprises at entity or district level. Those additional costs reduce the competitiveness of the BiH enterprises, just when the country is in the process of

dismantling its trade barrier as a result of the process of European integration and the application of the Free Trade Agreements with the other SEE countries.

Rule of Law and Regulatory Environment

Entrepreneurs participating to the focus groups have expressed a high level of dissatisfaction towards the regulatory framework currently existing in BiH and the level of rule of law enforcement and they have been particularly vocal in their expressing their complaints during the focus group discussions. The overall rating (1.6 over 5) has not changed since the 2003 EPPA. However, some progress has been achieved in these areas since the last EPPA report, but it is mostly confined to the introduction of new legislation (such as the company registration and the bankruptcy laws), passed at state level after a long gestation period, which has still to be implemented. The impact on the business environment has therefore been so far minimal, therefore the entrepreneurs' frustration. The approval of the new company registration law at state level and of the related legislation at entity level has sent a positive signal to the business community, although the law falls short of introducing uniform conditions for company registration across BiH, as the setting of court fees is left to the entities. The law offers the opportunity to bring BiH, a laggard in this area, closer to international best practices and in line with the standards of other SEE countries. Its implementation will be an important test of the willingness of the entities to share information, to value and support a common information tool and of reducing their claim over exclusive regulatory powers over local enterprises. Its implementation will also require the extensive training of registry personnel, lawyers, public notaries and creation of a communication campaign aimed at the business community which explains the new procedures and the rights of entrepreneurs to demand a simple and speedy registration. It will also require monitoring to ensure adoption and implementation and sort out inevitable teething problems. Progress has been made also in reducing the administrative burden linked to the issue of licences and permits. In this area the Bulldozer Initiative, promoted by OHR, has significantly contributed to create the critical pressure to break resistance to reform and mobilise the necessary technical and financial resources, but much more remains to be done. Given the complexity of the institutional framework of BiH, the reform of the regulatory framework has to be conducted in parallel at state, entity and cantonal level. Inevitably progress is going to be patchy and legislative and procedural inconsistencies are going to arise. Already there are some positive cases of successful regulatory reforms introduced in Gradacac, the Sarajevo-Centar municipalities, in the Brcko District and Tuzla Canton and competition among local authorities to attract private investment through better regulations should be encouraged. Unfortunately approximately only half of the municipalities are currently benefiting from donor support and technical assistance programmes. Besides major legislative reform, there is also a need to examine the administrative procedures, particularly concerning contract and law enforcement. Improved procedures and performance, including enhanced appraisal skills of appraisers and enforcement officers, are urgently needed as enforcement officers are not properly empowered to seize, warehouse and conduct auctions of seized assets, whether movable or immovable.

Tax Policy for Small Business

Over the last two years BiH have received a significant amount of technical assistance, particularly from the EU's Customs and Fiscal Assistance Office (CAFAO), USAID's Tax Administration Modernization Project (TAMP), the World Bank and the

IMF, directed at improving the tax regime, restructuring the tax administration and move toward a more co-ordinated and integrated tax policy. However, progress with reform in the tax policy area has been very uneven. Over the last two years we have seen from one side a move towards the harmonisation of excise taxes and the introduction of unified customs duties, as part of the process towards the establishment of a common internal market. On the other side there, there has been no move towards harmonisation on corporate, wage taxes, social security contribution and personal income tax rates and regimes among the two entities and the District of Brcko. The existence of three different tax administrations continues to be a major obstacle towards the introduction of a unified tax regime.

Among the countries of South East Europe, BiH has at the same time the highest and the lowest corporate income tax rate (30% in F BiH and 10% in RS), opening the opportunity for major distortions. The planned introduction of the VAT on 1st January 2006 has the potential to produce a major qualitative change in the tax administration system in BiH. Not only the introduction of VAT will remove the distorting effects of the sale tax and remaining cases of double taxation for companies operating in an entity different of its legal and tax domicile, but, for the first time it will be operated by a central tax administration set at state level and its application will be uniform across BiH.

It is extremely important that the small business sector is well informed and prepared for the VAT introduction and that the new regime does not result in an increase in the tax burden for the compliant enterprises. The experience of other transition countries shows that if properly administrative, the introduction of VAT may contribute significantly to the reduction of the informal economy, but in order to do so it is necessarily that the area of potential VAT evasion is reduced to a minimum and the value added chain is not broken by exemptions or discriminatory treatments applied by the tax administration, limiting the impact of unfair competition based on VAT evasion.

Financial Instruments for New and Small Business

The significant progress in financial sector reform including the amendments to the banking law in FBH and the new banking law in RS, as well as the entry of new foreign banks, have been reflected in increased confidence in the banking sector in the last two years. The banking system overall is quite developed relative to the rest of the region. With many foreign banks present in the country, competition is strong and banks are starting to offer an extended product range (credit cards, consumer loans, mortgages). However, the level of bank intermediation remains low, due to the slow privatisation and restructuring process in the rest of the economy. Small and medium-sized enterprises are still experiencing difficulties in accessing long term credit. The Enforcement Law which was adopted recently and the Law on Secured Transactions should improve the issue of collateral foreclosure, provided that these laws are implemented effectively. Furthermore, despite the recent reorganisation of court system, there is a significant backlog of cases which might adversely effect enforcement for some time to come.

The number of banks in the country is still too large and further consolidation is ongoing and likely to continue. Apart from a very small number of banks with a meaningful market share, relatively good operations and as yet without a strategic partner, the remaining banks are very small or have limited strategic value (and would hence be unlikely acquisition targets even in a more developed market). Stricter rules for inclusion in the deposit insurance scheme and higher minimum capital threshold, combined with enforcement of prudential rules should be used to speed up consolidation

where there is not enough interest by strategic investors. Banks under administration without a clear future should be liquidated as soon as possible.

There are a number of banks which remain to be privatised (or, for those under administration, liquidated), although it is unclear if there is sufficient investor appetite to do so, based upon previous experience. The successful sale of Central Profit Banka, the third largest in the country, to a strategic investor is particularly important for the sector. Non-bank financial institutions are in their infancy. The leasing and insurance sector in particular require development and improved regulatory frameworks. The EU supported the preparation of modern insurance legislation which was submitted to State and Entity Parliaments but is not yet enacted. The IFC-SEED programme co-ordinates the efforts of the international community to work on updating the leasing legal framework. The pension system is largely unreformed and a multi-pillar system with private pensions is not yet in place.

Advisory Services

BiH continues to benefit from a very significant volume of assistance for the provision of business advisory services. Since the publication of the 2003 EPPA report there has been a further expansion of the number of business centres and service agencies in operations and a move towards quality improvement. Entrepreneurs participant to the focus groups have taken notice of this trend. The average rating for advisory service has recorded a marginal improvement compared with the 2003 score. Most business entrepreneurs have indicated that they broadly satisfied with the private consultants, although they would appreciate the introduction of a system of certification, while they are still critical with the performance of the publicly/donor supported business centres. In fact, there is a need to further improve the capacity and the skill level of the staff of those centres, with investments in human resources, IT equipment and external advisory support.

Concerning the publicly supported business advisory centres three issues remain open. The first one concerns the medium term sustainability of those operations, currently largely supported by donors. Local administration should be progressively taking charge of the operating costs, supplementing the budget, where possible, with direct charges to the enterprises for specialised services. The second concerns the regional coverage. Local initiatives are very positive and should be further encouraged, however, at the same time BiH will benefit from the introduction of a mechanism of co-ordination of donor sponsored projects, in order to provide a good regional spreading, and an independent system of project evaluation and exchange of experience. The elaboration of an SME development strategy at state level and possibly the establishment of national SME agency could contribute to local capacity building and better co-ordination. The third issue concerns the range of services provided. It makes sense that local publicly/donor supported business centre concentrate on the provision of basic business services and the provision of more specialised services targeted to groups of small entrepreneurs be left to private consultants. However, there is a need to improve the availability of basic services available to the whole enterprise sector, particularly concerning technical standards, quality certification and foreign markets information. These services can be better provided by business agencies based at regional level. The newly established Regional Development Agencies could play an important role in this area, working in close co-operation with specialised state agencies. The RDAs could also work, in co-operation with LESP and the professional associations, to establish and implement a common system of certification of local consultants.

Business Incubators

With the spreading of new initiatives, entrepreneurs have started to develop an interest in business incubators. The results of the focus group discussions indicate that entrepreneurs consider the business incubators as a valuable tool to support start up, particularly in the ICT sector. These views conflict with the lack of strategy and policy towards business incubators both at state and entity level. The initiative is left to the donor community and the local administrations. The establishment of business incubators should be considered within the framework of regional and local development plans. There should be a mechanism to promote the exchange of experiences, taking into account the lessons learned from the incubators already in operation in BiH and abroad and the provision of a technical assistance facility to the economic departments of the cantons and the municipalities to prepare new projects, through the re-conversion of vacant industrial buildings and former military camps.

Entrepreneurship, Vocational Education and Access to Technology

The entrepreneurs participating to the focus groups have noted that the general public still retains a largely negative image of private entrepreneurs, but their perception is that the situation is improving. As in other areas of enterprise policy, the lack of a strategy covering the entire territory of BiH and of the fact that institutions are not co-ordinated at state level have created a situation where most initiatives concerning entrepreneurship development and education are locally based, with a lack of consistency, interaction and integration among the various programmes.

Box 1. Bosnia - Herzegovina and the European Charter for Small Enterprises

Bosnia and Herzegovina signed the European Charter for Small Enterprises in June 2003. The Charter, a Pan European initiative endorsed by all the EU members states, the EU candidate countries, the countries of West Balkans, outlines ten policy areas which are instrumental to improving the business environment for small companies. These include regulatory reform, access to finance, business advocacy, entrepreneurship education, competitiveness, etc. and broadly cover the same policy spectrum as the EPPAs. Under the framework of the EU Charter Process, the BiH government in 2003 identified a set of targets related to initiatives designed to help small businesses.

Progress on target implementation is reviewed annually in a report prepared by the BiH government and published by the European Commission, together with the other countries in the Western Balkans. The second annual EU Charter Report for the Western Balkan Region, containing the country reports and a regional overview prepared by the European Commission, is scheduled to be published in January 2005.

The EPPA report intends to contribute to the EU Charter process, with an independent and business oriented policy implementation assessment.

Overall, the targets set by BiH in 2003 appeared to be relevant for the small business sector and broadly in line with the EPPA 2003 policy recommendations. As the 2004 EPPA shows, some progress has been made in the area of company registration, entrepreneurship training and consultancy services for small business, but instead no significant progress has been achieved in eliminating remaining cases of double taxation .

This is particularly evident of entrepreneurship education at tertiary level, where there F BiH is moving behind the RS and the District of Brcko, particularly at the tertiary education level. BiH needs a restructured vocational training system, able to provide courses to young students as well as to provide professional training for returning refugees and workers made redundant by the on-going process of industrial restructuring. The vocational training system must take into account requests from the labour markets, which receive inputs from the private business associations, and must include training courses with private companies. Many of the participants in the focus groups have signalled problems in recruiting staff with requested qualifications. Thanks to the support of the international community, the building blocks for effective management training are largely in place, with the introduction of MBA courses, short course programs and a growing number of trained local management trainers. One of the future challenges will be to establish effective links between the universities, business schools, the business community and the local administration. Those higher education institutions should act as an agent for change and promote industrial restructuring and technical innovation.

Box 2. Priority Reform Issues For Action

1. Complete the drafting of the BiH Strategy for Entrepreneurship and Enterprise Development and the Law on SME, currently prepared by the Working Group coordinated by MoFERT, and present them to the Council of Ministers for approval.
2. Implement the new company registration system, according the Law on Company Registration approve by the state parliament in 2004, across all BiH.
3. Remove all remaining cases of double taxation for companies operating in an entity and or district different from that where they have their legal domicile.
4. Complete reform of the system of secured transaction laws and regulation so that creditors are not deterred from starting enforcement of security rights.
5. Complete the draft of the state Law on Business Advisory Services Certification, building on the work started by the Ministry for Development, Entrepreneurship and Crafts of F BiH and working closely with consultant professional associations, such as LEPS, and with business associations.
6. Develop an action plan for promoting the establishment of business incubators, within the framework of the Strategy for Entrepreneurship and Enterprise Development currently under preparation, learning from the experience of the incubators already in operation and building up on the initiative launched by local administrations.
7. Promote the introduction of entrepreneurship as a subject in the last class of all Secondary and Vocational Schools, Faculties amending, if needed, the laws on Education at state, entity and canton level.

2004 Policy Recommendations and Priorities for Action

The 2003 EPPA report included a set of policy of recommendations for each policy dimension covered by the report, to provide inputs to policy discussion and policy making.

The 2004 EPPA Report includes a new set of policy recommendations, consisting of a number of recommendations retained from last year, selected among those that have not yet been fulfilled and are still relevant and a limited number of new recommendations, related to recent policy developments.

In addition, for each policy dimension a Priority for Action has been identified, that should be implemented over the short term (less than one year).

The implementation of the 2004 set of Policy Recommendations and Priorities for Action will be regularly monitored through the Investment Compact monitoring process and will be reviewed in detail in the EPPA 2005 report.

Institutional Framework for SME Policy

Priority for Action

1. Complete the drafting of the BiH Strategy for Entrepreneurship and Enterprise Development and the Law on SME, currently prepared by the Working Group coordinated by MoFERT, and present them to the Council of Ministers for approval.

Policy Co-ordination

2. Strengthen the Department for the Promotion of Entrepreneurship within the Ministry of Foreign Trade and Economic Relations by providing additional financial resources and human resources in order to increase its policy elaboration and policy co-ordination capacity.
3. Review the role and the function of the existing and planned SME development agencies and institutions operating at entity and canton level, as part of the process of elaboration of the BiH Strategy for Entrepreneurship and Enterprise Development and the Law on SME, in order to increase the level of policy co-ordination and streamline the number of institutions in charge of policy elaboration and implementation.

Consultation

4. Establish regular channels of dialogue and consultation between government, both at state and entity level, and private sector associations, building on the experience gained through the process of preparation of the Poverty Reduction Strategy Paper and the Social-Economic Council in the Federation of BiH. In policy spheres, e.g. tax policy, new legislation and regulations affecting businesses, it is urgent to introduce permanent, regular mechanisms for consultation between Government, international institutions seeking to support SME development and the enterprise sector.

Co-ordination of Enterprise Initiatives

5. Establish a system to co-ordinate SME projects and initiatives at the international institution/donor level. The system should be linked to both the implementation of the PRSP strategy and the European Charter for Small Enterprises, integrating the activity at state and entity level. Various organisations are active in the economic development, regional development and SME development fields. Many projects and initiatives have been and continue to be funded, often with insufficient consideration of what is already in place, of lessons learned from past experiences, of financial sustainability, etc.
6. Integrate the newly established Regional Development Agencies in the process of elaboration of the Strategy for Entrepreneurship and Enterprise Development and the Law on SME, preparing the ground for using the RDAs as SME programme implementation agencies at local level.

Definitions and statistics

7. Establish a common and clear definition of SMEs, consistent with the EC definition, applicable to all levels and for all areas, including taxation and statistics. The available statistics are poor and incoherent, making it difficult to determine appropriate policies and evaluate their effectiveness.
8. Co-operate with the State Statistics and relevant ministries to systematically collect statistical information on the SME sector in order to analyse the underlying trends and determine appropriate policy responses. Both could be important objectives of the recently created Department for Entrepreneurship.

SME Representative Bodies

9. Use the Working Group on Entrepreneurship and SME policy as a regular forum for communication and consultation with a wide range of SME stakeholders. Adequate resources need to be devoted in order for the Working Group to be seen as an effective SME tool. This would have synergistic effects in terms of accelerating the process of creating a single economic space by co-ordinating SMEs interests and providing Government with input and feedback on relevant strategies, policies, laws, regulations, etc.

*Rule of Law and Regulatory Environment***Priority for Action**

10. Implement the new company registration system, according the Law on Company Registration approve by the state parliament in 2004, across all BiH.

Registration, De-registration, Re-registration

11. Implement the electronic firm registration system in courts covering the entire country.
12. Introduce a single code number for each enterprise, in order to save time and costs to entrepreneurs submitting the same basic information to different bodies.
13. Move towards a standardisation and a reduction of current company registration fees across all of BiH.

Regulations

14. Speed up the implementation of the regulatory reforms planned within the framework of the Bulldozer Initiative and the PRSP, in order to further reduce and standardise the procedures for SMEs to obtain licenses, permits and certificates and to set pre-determined short time scales for each procedure.
15. Take steps to ensure a greater focus on a “proactive” and “enabling” approach by introducing the principle of “silence is consent” as soon as practical (“silence is consent” means that if the relevant public body fails to answer within a prescribed period, it will be deemed that consent has been given).

Communication with SME Stakeholders

16. Make it understood that SME stakeholders will be consulted on legislation and regulations affecting small businesses before proposals are converted into law.
17. Build effective co-operation between the key SME stakeholders and disseminate information through web sites and forums to ensure that SMEs are aware of the latest developments and ensure that they can provide feedback.

*Tax Policy for Small Business***Priority for Action**

18. Remove all remaining cases of double taxation for companies operating in an entity and or district different from that where they have their legal domicile.

VAT

19. Introduce VAT at state level as soon as practical (planned for the 1 January 2006).
20. Prepare the SME sector for the introduction of VAT, organising information and training sessions for small companies
21. Set the VAT refund period at the international standard of one month.

Grey Economy

22. Widen the tax base as an important means of fighting tax evasion and supporting the integration with the financial system. The introduction of VAT will be an important step in this process.
23. Strengthen efforts to collect tax arrears, regardless of firm size.

Financial Instruments for new and Small Business

Priority for Action

24. Complete reform of the system of secured transaction laws and regulation so that creditors are not deterred from starting enforcement of security rights.
25. Improve the Bankruptcy framework with respect to the restructuring processes as well as the enforcement process over immovable assets.
26. Strengthen the Single Economic Space for banking services by integrating bank supervision at the state level.
27. Improve the system for land and real estate management. A State Law on Restitution needs to be adopted and land books and the cadastre need to be integrated. The land registration system needs to be harmonised.
28. Develop incentives to stimulate the growth of long-term savings. In order to stimulate long-term deposits growth, incentives could be provided such as: repayment of old frozen currency deposits (consistent with the new domestic debt settlement law), further strengthening of the deposit insurance system, introducing new savings instruments.
29. Approve and implement the draft state Leasing Law and the draft state Law on Obligations. Entity laws on leasing will then also need to be mutually harmonised.

Advisory Services Supplied to New and Small Businesses

Priority for Action

30. Complete the draft of the state Law on Business Advisory Services Certification, building on the work started by the Ministry for Development, Entrepreneurship and Crafts of F BiH and working closely with consultant professional associations, such as LEPS, and with business associations.

Long-Term Development

31. Direct the activity of the public or donor funded business advisory services towards the provision of basic services to SMEs, with a focus on start-ups and micro-enterprises, including the provision of critical services as subsidised rates. Seek to develop a competitive private market providing specialised services to the business sector.
32. Co-ordination of Support.
33. Review the plethora of existing and future enterprise development initiatives by international bodies.
34. Build on recent initiatives, such as the recently established Regional Development Agencies, to ensure co-ordination of initiatives, and ensure greater exchange of experience and information among the relevant bodies in the entities.

Quality Standards

35. Monitor the implementation of business advisory and training programmes in order to assess their quality and impact, evaluate the performance of the business consultants and learn from experience.

Business Incubators

Priority for Action

36. Develop an action plan for promoting the establishment of business incubators, within the framework of the Strategy for Entrepreneurship and Enterprise Development currently under preparation, learning from the experience of the incubators already in operation and building up on the initiative launched by local administrations.
37. Disseminate information and promote the role of business incubators to BiH entrepreneurs, using departments and ministries of economy and leaders of business associations such as Chambers of Commerce and others.
38. Develop training and education programmes for business incubator managers and public administration officials in order to ensure greater compliance with best practice in transition and OECD member countries.
39. Invite local administrations to identify idle industrial or military facilities that could redevelop into business incubators or industrial zones and promote the elaboration of redevelopment projects.
40. Evaluate the possibility establishing a funding facility, administrated by the Regional Development Agencies for example, to support business incubators and industrial zone development projects developed by local administrations and business associations. This would promote a transparent competition among these groups.

Entrepreneurship, Vocational Education and Access to Technology

Priority for Action

41. Promote the introduction of entrepreneurship as a subject in the last class of all Secondary and Vocational Schools, Faculties amending, if needed, the laws on Education at state, entity and canton level.

Entrepreneurship

42. Introduce training programmes in all secondary and vocational schools to ensure that teachers are equipped to develop and teach courses on business and entrepreneurship.
43. Involve business end entrepreneurs associations in the entrepreneurship course design and presentation.
44. Complete the implementation of the EU VET programmes for restructuring the education system for entrepreneurship, business, management, etc.
45. Encourage colleges and universities to provide courses and diplomas in Entrepreneurship Studies and Business Management.
46. Create national competitions (among pupils, students, businesses, etc.) which stimulate business awareness, skills and innovation.
47. Develop measures to stimulate greater willingness among enterprises to recruit and train young people through apprenticeships.

Access to Technology

48. Provide sources of information on business standards and opportunities within Ministries and Municipal economic departments.
49. Improve dissemination of information about EU standards (e.g. quality, exports, environmental, health and safety etc.).
50. Improve dissemination of information about business opportunities in the EU and the wider SEE region.
51. Extend the network of Euro Informative Correspondence Centres covering the main economic centres of BiH.

PART II

Chapter 1

Views of the SME Owners and Managers

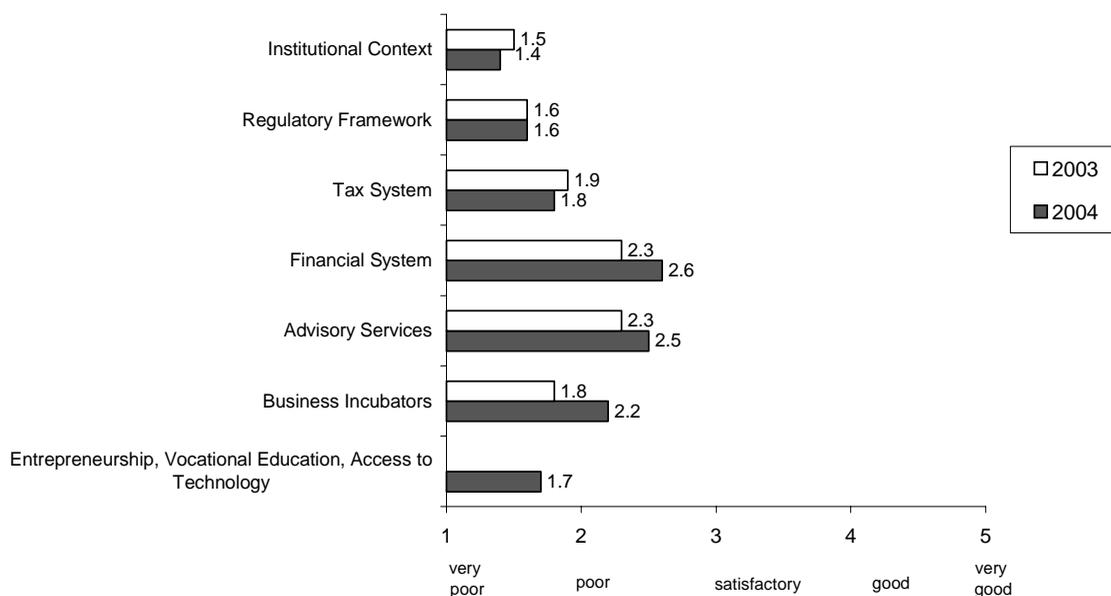
1. Introduction

This section contains the analysis of the results of the focus group research on seven dimensions of good practice for the SME business environment:

1. Institutional framework for SME policy.
2. Rule of law and the regulatory environment.
3. Tax policy for small businesses.
4. Financial instruments for fostering small businesses.
5. Advisory services supplied to new and small businesses.
6. Implementation of business incubators.
7. Entrepreneurship, Vocational Education, Access to Technology.

The analysis highlights the main issues arising from discussion with the private SMEs participating in the EPPA research. The key questions dealt with in the focus group research are summarised at the beginning of each section. The average ratings used to represent the views of the entrepreneurs range from 1 to 5 and can be read as follows: **1 = very poor, 2 = poor, 3 = satisfactory, 4 = good and 5 = very good.**

Figure II.1.1. Average Ratings by SME Owners and Managers of the Seven Dimensions of Good Practice, 2003 and 2004



The average ratings per dimension of good practice are highlighted in figure II.1.1. In general, the EPPA research shows that focus group participants assessed all seven dimensions of the framework and environment supporting SME growth and development as less than “satisfactory”, especially in relation to the Institutional Framework, which was assessed as close to “very poor” (1.4). The Financial Instruments for Fostering Small Businesses was given the highest rating (2.6); almost “satisfactory”.

The main points made by the participants during the focus groups are reported *verbatim* and the quotations most relevant to the analysis are highlighted.

2. Institutional Framework for SME Policy

The issues researched under this heading: are as follows:

1. Clear assignment of organisational responsibility for the development of SME policy.
2. The effectiveness of organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs.
3. The existence, quality and effectiveness of the SME development strategy.
4. The local and regional governments’ mandate and resources (funding, people and skills) to promote SME development.
5. The information provided and awareness by business people of the government’s institutions, policy and programmes to support new entrepreneurs and develop existing SMEs.
6. The existence of consultation between government and the private sector.
7. The quality and regularity of consultation between government and the private sector on SME policy and its performance and assessment.
8. The performance of government institutions supporting small business since March 2003.

Organisational Responsibility

1. Do you know if a clear organisational responsibility for the development of SME policy been assigned by Government?	2004
	No,
	90%

The vast majority of the focus group participants still do not identify a clear organisational responsibility for SME policy, either at state and or entity level. The same result is seen here as in the 2003 EPPA. However, entrepreneurs stated that they heard of some positive changes having been made in the institutional system, but they could not qualify in which manner.

“We understand that the F BiH government is working on an SME development policy, through its Ministries, but we could not name who exactly is in charge of that.”

Participants in some focus groups (e.g. Banja Luka) clearly stated that they are not aware of any institution within the Republika Srpska being responsible for SME development policy.

“If such an organization even exists, it does not provide any kind of visible help to SMEs.”

The entrepreneurs were very clear in their views:

“Our Government, at all levels, has no interest in policy for SME development, because they do not understand the value and potential of this sector of the economy.”

According to the focus group participants, the Chambers of Commerce, among the various existing institutions, should be more pro-active in supporting and promoting SMEs development, but the entrepreneurs had doubts about the way in which the Chambers of Commerce are currently managed:

“We have the Chambers of Commerce to which all SMEs are paying membership fee. They should be responsible for our development, but the money is managed and controlled by very close circle of people.”

Another institution mentioned by entrepreneurs is the Foreign Investment Promotion Agency (FIPA):

“FIPA is responsible for increasing FDI and helping foreign SMEs, but it is not yet at the level needed for the effective promotion of BiH’s interests.”

For the SME managers and owners participating in the focus groups, the solution has to come through a de-politisation of the institutions running the economy:

“A government composed of people with experience in economics and not purely by politicians would recognise the importance of the SME sector and change the face of the economy of BiH. Only in this case could we expect the establishment of institutions really responsible for our needs and our development.”

Effectiveness of the Organisation/s

2. Rating given to the effectiveness of this organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs?	2004	2003
	1.1	1.3

The question was answered by only 24% of participants, as the other 76% replied that they do not know of any institutions in charge of developing an environment supportive of SMEs. Among the respondents the effectiveness of the public organisations was assessed as “very poor”, showing a lower rating than that of EPPA 2003.

The participants concluded that:

“It is too difficult to have an effective policy when even those laws which were adopted through the last two years of reforms, simply cannot be implemented because there are no institutions, not even on a State level, not to mention those at lower levels in charge of implementing those laws.”

In general, focus group participants were also critical regarding the efficiency of those institutions at local level:

“Even those institutions which exist such as the Chambers of Commerce, the Departments of Economy within Municipalities, are serving mainly as vehicles for collecting statistics, without performing the real role for which they have been set up. They simply do not care about our needs.”

Entrepreneurs showed a good degree of awareness regarding the level of efficiency of the various institutions at local level:

“Cantonal authorities are active in Sarajevo. In some cases they fulfill 80% of their duties. But, look at Hercegovina-Neretva Canton which does not fulfill even 20% of their duties regarding SMEs. The majority of Cantons is in the same situation, and it is even worse in RS.”

SME Development Strategy

3. Do you know if a government SME development strategy exists?	2004
	No: 86%

The great majority of the focus group participants were not aware of the existence of any strategy focusing on SME issues at any government level. However, they were aware of the recent elaboration and adoption at state level of a development strategy (the PRSP). The participants stated that:

“It is evident that there is not one consistent SME Strategy, harmonised at all levels.”

“There are not at all such strategies on local level.”

“There are very few municipalities which prepared their development strategies, and, as far as we know, none of them have an SME development strategy.”

“Maybe such Strategies exist, but entrepreneurs are not aware about that, so they are left to themselves.”

3.1. Rating given to the quality and effectiveness of the SME development strategy.	2004	2003
Overall	1.3	1.6
Quality	1.3	
Effectiveness	1.2	
Don't Know	76%	

As a consequence, participants rated the quality and effectiveness of SME development strategy as “very poor”, and again worse than in the last EPPA [1.6]. This assessment was shared by just a quarter of all participants. The vast majority said that they could not assess a strategy that, as far as they knew, did not exist.

This rating is supported by the view that institutions which should develop strategy do not have the skills to fulfil this task:

“The Ministry of Entrepreneurship of the Federation asked our Association of Entrepreneurs to prepare a programme of work for the Ministry. The reality is that the ministries are full of non-professional staff.”

“Even the law on incentive measures for SME development of the RS is very general and lacks a clear policy vision. The Law is weak because it was copied from somewhere, without any consideration for the local situation. What from that Law was implemented in reality so far?”

Local and Regional Governments

4. Rating given to the local and regional governments’ mandate and resources (funding, people and skills) to promote SME development.	2004		
	Yes	No	Don’t Know
Mandate	46%	26%	28%
Resources	24%	41%	35%

In EPPA 2003 the respondents rated the local and regional governments’ mandate to promote SME development as “poor”. This year the assessment could be viewed as similar. Almost half of entrepreneurs participating in the focus groups thought that local and regional governments have a mandate to promote SME development, but only one quarter of the participants thought that they have the human and financial resources for it. A considerable share of participants declared that they are not informed about mandate and resources.

In addition, entrepreneurs think that the funds available to local and regional authorities for SMEs are often not used for proper purposes because of weak human resources and corruption:

“There are some resources, but their use is not transparent because they are not spent in appropriate purposes.”

“There is a high level of corruption in the actual allocation of incentives to SMEs.”

“Our Ministries at entity level do not have enough skilled staff to work with on SMEs development and produce quality results.”

“They obviously have a mandate, but they do not use it! Regarding the resources, they have them, but they have not human resources capable to use the money on optimal manner to support us”

Respondents agreed that local and regional authorities have shown little interest in increasing the financial resources for supporting SME development policies:

“The resources could be raised, there are many ways, but Government is not interested in doing that.”

They identified through discussions, some of the practical bottlenecks which reduce the efficiency of the local and regional institutions which should provide support to SME development:

“Municipalities do not have ICT equipment and the skilled staff for performing administrative procedures. This slows considerably the work of the public administration.”

“In the majority of cases, municipal departments which should closely collaborate with SMEs have very limited office hours – usually two hours per day or one or two determined days per week. That simply is not enough.”

Overall the entrepreneurs’ perception is that enterprises do not obtain assistance from local authorities, with the exception of a few cases such as the District of Brcko, the Canton of Sarajevo and some municipalities such as Gradacac, Gracanica and Laktasi.

Information and Awareness

5. Rating given to the information provided and awareness of the government’s institutions, policies, programmes to support new entrepreneurs and develop existing SMEs.	2004	2003
Overall	1.5	1.5
Information provided	1.5	
Awareness	1.5	

The availability of information and business peoples’ awareness of government institutions, policy and programmes to support new entrepreneurs and develop existing SMEs, has been assessed as “poor”, obtaining the same rating as in the EPPA 2003.

The entrepreneurs participating in focus groups stated very clearly that they did not receive any information from public institutions on programmes and policies supporting the SME sector. They were not only questioning the communication policy of the government institutions at all levels, but they were also wondering if such information was ever compiled and organised. In general, they felt that government institutions were focusing on other issues and felt no obligation to inform entrepreneurs on a regular basis:

“Our government only sends, on a regularly basis, bills and decisions on different fee payments!”

Participants also identified some alternative sources of information:

“If there were not some specialised consultancy agencies we would completely cut off from essential information.”

“Only those entrepreneurs who have friends working in the key Ministries have access to reliable information.”

They also have very critical views of the role of the media in informing the SME sector on governmental and other activities which influence their businesses:

“The media are the only available source of information, although they present it in a general manner, and it is not so rare that they misinterpret.”

“Generally speaking the media are not at all supportive of the promotion of positive cases in the economy, and so neither regarding SMEs. They only devote their attention to stories involving links between business, crime and corruption, very often without much argument, but simply because that attracts more publicity and assures their sales.”

However, in spite of the general negative perception, some of the respondents noted that some of the local entities were behaving more efficiently:

“We have a quite good access to information on local level (Gracanica Municipality), but very often it is not sufficient for decision making.”

“In the case of Sarajevo Canton, the situation is slightly better because they formed Cantonal TV and created an active governmental web-site where you can find economic news and Laws”.

Entrepreneurs in all five focus groups were very critical, even towards the entrepreneurs’ attitude which was judged too passive:

“We accuse the authorities of not being interested in the improvement of current situation concerning the availability of information for the business sector. However, the entrepreneurs are equally not showing much interest. In our municipality we had organised a seminar on the European Community labelling system, but only five entrepreneurs came!”

Entrepreneurs were concerned about the consequences of the systematic lack of information:

“The vast majority of entrepreneurs feel disappointed and disoriented because they are not sure about their future and it is also due to the lack of reliable information on key issues, such as taxes, employment regulations, etc..”

The participants in the discussion maintain that useful business information typically flows through informal sources such as personal networks, contacts and meetings rather than formal channels such as the Chambers of Commerce and other business representations. Since the beginning of 2004 membership of the Chambers of Commerce was no longer compulsory. This leads the entrepreneurs to believe that the Chambers are now too occupied with recruiting new members and augmenting fee collection, that they do not have the time to focus on providing information and business services. At the same time Entrepreneurs’ Associations are still weak and not considered by Government as real partners. Therefore they are often excluded from official information channels. Business associations do not yet have an effective system to disseminate information to their members.

Consultation between Government and the Private Sector

6. Are you aware of regular consultations between government and the private sector?	2004 No: 83%
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The great majority of focus group participants (83%) was not aware that regular consultations between government and the private sector exist.

Some their comments indicate that even when meetings between policy makers and representatives of the business community take place, they are conducted in a very formal way preventing open discussion of the SMEs’ problems and how to solve them:

“The consultations do not exist at all in the RS. The few meetings organised by the Chamber of Commerce and Association of Entrepreneurs were usually attended by government officials lacking the capacity and the authority to discuss the issues on the agenda. They were reduced to taking notes, without saying one single word.”

“Consultations are available in rare ad hoc opportunities such as in the case of PRSP preparation or Bulldozer Initiative, but there is no systematic approach to developing business to government consultations as a permanent mechanism.”

Entrepreneurs were very suspicious of the role played by Chambers of Commerce in consultations with Government:

“There are sometimes consultations between Government and the Chambers of Commerce, but the Chambers of Commerce are much more linked to the government than to the private sector, so they are not fighting for our interests.”

“The same entrepreneurs are always invited to the consultative meetings. It is a bad practice, because new experiences are necessary.”

7. Rating given to the quality and regularity of consultation between government and the private sector on SME policy and its performance and assessment.	2004	2003	
	Overall	1.6	1.4
	Quality	1.7	
	Regularity	1.4	

The quality and regularity of consultation between government and the private sector on SME policy is generally assessed as being slightly better (1.6) than the last EPPA (1.4), but still it is “poor”. The quality of consultations was rated higher (1.7) than their regularity (1.4).

The participants stated some of the reasons for the situation:

“The Socio-Economic Councils are very weak and not sufficiently active; they do not have real results to show so far. They should be involved as real partners in the policy discussion on important issues such as large scale privatisations.”

Entrepreneurs again showed their awareness of their own weaknesses:

“The SMEs are lead by managers who do not have no training and the experience to negotiate with Government representing the broad interest of the business sector. There are many cases where the private sector participants have used these meetings as an opportunities to press for their own interests.”

Generally, participants in focus group discussions were convinced that more regular consultation could be beneficial for the SME sector:

“This is not at all an environment supportive to private investors. Consultations between business and government should be used as a tool to identify real problems and opportunities to overcome the current obstacles.”

The entrepreneurs noted that there are already some cases, at lower governmental level where municipalities conduct regular meetings with entrepreneurs’ associations. In the Brcko District there is a consultation mechanism in place between the local government and the private sector, established through the local Chamber of Commerce.

Change Assessment

8. Rating given to change of the performance of government institutions supporting small business since March 2003.	2004				
	Much worse	Worse	No change	Better	Much better
	12%	19%	52%	17%	

About half of entrepreneurs thought that there has been no visible change in the performance of government institutions’ support for SMEs since March 2003. One third of respondents thought that the situation has deteriorated since last year. The following are some of the reasons expressed by entrepreneurs supporting this negative assessment:

“Over the last year the government liberalised imports from neighbouring countries as a result of the implementation of the Regional Free Trade Agreements.”

But their economies are more competitive than ours. The government did not at all prepare us for the introduction of those trade measures. Nothing was done to strengthen our competitiveness.”

“Our main problem is that policy is involved in each sphere of our business environment, and its influences are mainly negative, creating obstacles for the reform progress.”

“Government should be focused on us, in the same way as we are focusing on our customers! That would result in an enhancement of the business environment.”

“I could so far have employed one hundred people if I only had basic support from our system. Instead I have only ten employees, all as a result of my sole efforts having ten years ago started up a bee-keeping enterprise, from scratch and without any external financing.”

3. Rule of Law and Regulatory Environment

The issues researched under this heading:

1. The formalities (number of steps, time needed, cost, and overall rating) for new company registration (certification of existence).
2. The procedures for obtaining licenses, permits and certificates necessary for business operations.
3. The existence of a government approved programme for reducing the legal / administrative barriers for business and rating of the quality and effectiveness of this programme.
4. The existence of a government approved programme for reducing the impact of corruption.
5. The quality and efficiency of the programme for reducing the impact of corruption.
6. The quality and regularity of consultation between government and the private sector / SME policy community on draft legislation and regulations that affect business. The change in the regulatory environment (registration, licences, permits) since March 2003.

Company Registration

9. Rating given to the formalities (number of steps, time needed, cost, and overall rating) for new company registration (certification of existence).	2004	2003
Overall rating	1.7	1.8
Number of steps	1.9	
Time	1.4	
Cost	1.8	
Overall impression	1.6	

Entrepreneurs did not change their views on company registration procedures, which continue to be rated as “poor”, reflecting the lack of systematic reform of the registration process. Participants gave a negative rating on all the key indicators related to the

registration process. In particular, they had a very negative view of the time required to complete the company registration process. The following are some of the views expressed at the focus group meetings:

“Our change of business activity waited 14 months in the judge’s office, we cannot say why because all of the documents required were submitted.”

“We have had an injection of foreign capital in our company, and the procedure to modify the company registration, reflecting the changes in the ownership structure took two years, so we had to operate without a formally legal situation for long time. Even now four years since the entrance of the foreign partners, we still have not received the documents related to the changes in the ownership of the company’s real estate assets.”

The direct costs of registration are rated also “poor” (1.8). To it one must add the additional cost of complying with the minimum capital requirement rules for legal entities:

“The start up deposit of 5.000 KM (in RS) required for registration of a limited responsibility company is very high for small entrepreneurs.”

The participants in the discussion complained that the entire registration system is not efficient:

“Company registration is very complex and time consuming, but company liquidation and de-registration is even worse.”

Entrepreneurs again expressed their concerns regarding the government’s inability to provide better co-ordination for the key institutions involved in the process of registration, namely the courts, the municipalities, the office of statistics office and the customs administration. Entrepreneurs ask for a “one-stop” office:

“All registration procedures should be finalised inside just one institution, so that entrepreneurs will need to contact only that one office. All the other institutions involved should belinked through internet and other IT tools and should exchange information directly..”

In the view of the participants, the District of Brcko is considered the most efficient provider of registration services for SMEs.

Licenses, Permits and Certificates

10. Rating of procedures for obtaining licenses, permits and certificates necessary for business operations.	2004	2003
	1.7	1.9

The focus group participants also gave the same “poor” rating to the process and procedures for obtaining licenses, permits and certificates necessary for business operations. The rating is lower than that in 2003. They linked the heavy procedures, the long delays, the corruption and the bureaucracy to the complex administration system in place all across BiH, created by layers of local and state institutions.

“We have a very complicated state administration with many overlapping responsibilities within different institutions, so the entrepreneurs are losing much time and money trying to solve very simple issues.”

“They are always changing procedures, and they are longer and more expensive. That makes me crazy! I have to have one employee just to follow all this, and my business can not bear that.”

“In the case of construction projects, obtaining permits and approvals is pure tragedy. Whomever did not go through it can simply not believe how terrible it is.”

Discussants also emphasised the confusion about procedures and competencies present within different governmental levels and bodies.

“The worst is that very often they simply do not know who is responsible for what. That seems incredible, but it is true.”

“We have been waiting for eight months to have an official answer on which authority is in charge of issuing a permit for operating a slaughterhouse.”

Unnecessary delays are especially highlighted by entrepreneurs; here are some of examples:

“These procedures are so complicated and long that many of applicants simply withdraw their application or start operating without all the necessary approval, which is illegal and they risk heavy fines”.

“The State Administration changed the name of the road in which my business is located. As a result I had to change all the legal and registration documents. That cost me quite a lot and took me over year to complete.”

We have been waiting five months to obtain customs identification numbers.”

Participants had very few examples of improvements in the regulatory system:

“Over the last year the situation became slightly better but only in relation to the issue of certificates proving tax payments.”

Discussion participants stressed that the principle of “silence is consent” has not been put into practice. Entrepreneurs continue to be afraid that the inspectors will not be satisfied unless the company can provide a formal authorisation.

Simplification Programme

11. Are you aware of a government approved programme for reducing legal/administrative barriers for business?	No: 82%	
Rating given to the quality and effectiveness of this programme	2004	2003
Overall	1.4	1.3
Quality	1.6	
Effectiveness	1.2	

The overwhelming majority of the participants (82%) was not aware of the existence of any government programme designed to reduce the administrative barriers for business.

They maintained that if such a programme existed, it certainly had not yet achieved any noticeable result.

“The Government in last four years, with donors’ support, conducted a number of studies on the administrative procedures. There has been a well publicised FIAS study and similar initiatives. But in reality nothing has changed and the barriers are still there.”

“The owner is a foreign investor. He employs an expatriate general manager, but his working permit can not be renewed if there are local people with the same educational background who are formally unemployed. It takes on average four months to get an extension of his working permit.”

“It is impossible to submit any kind of application to any of institutions in electronic form, how then can we get thing simplified if nothing is changing?”

Participants also complained about the lack of explanations regarding changes in regulations:

“The worst thing is that we cannot get clear and full information regarding the required steps and documents at the beginning of whole process. The government bodies involved give it to us bit by bit, after much pressure from our side”.

The respondents rate the quality and efficiency of any such programme as “very poor” as in the EPPA 2003 (1.3). It is worth mentioning that the quality of such measures was assessed as “poor” (1.6), while effectiveness was assessed as “very poor” (1.2).

“In many cases we have to submit the full documentation each time we need a renewal of a permit or an authorisation This for instance is the case for the certification of import approval, which in our company has to be renewed every sixty days”.

“The social security administration does will not certify the form M4 (annual report of social contribution payment) unless salaries are paid in cash. I asked them why civil servants could receive their salaries through the bank and private employees could not. The staff simply could not answer my question, but insisted on cash payment for my employees.”

Participants also emphasized that the advanced payment of fees for administrative procedures is an additional cause of very low effectiveness:

“For almost all procedures entrepreneurs first have to pay fees and than to wait so long for the results. It should be changed so that payments are made after the entrepreneur has obtained the documents requested.”

Anti-Corruption Programme

12. Are you aware of government approved programmes for reducing the impact of corruption?	2004 No: 70%
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The majority of participants (70%) was not aware of the existence of government programmes for reducing the impact of corruption.

“If there are such programmes existing, they are hidden from the eyes of the public.”

“Although there has been a slight decrease in the level of corruption in relation to business operations, it is still strong in other areas such as public education and health care.”

13. Rating given to the quality and effectiveness of the Government’s programme for reducing the impact of corruption.	2004	2003
Overall	1.6	1.4
Quality	1.7	
Effectiveness	1.4	

The participants said that in spite of the fact that there are anti-corruption laws and programmes on different levels already adopted, their efficiency is “poor”. That is a slightly better rating than in EPPA 2003 where the rating was “very poor” [1.4].

“From the side of the government there have been only declarations on the fight against corruption, but there has been no real impact. The government seems to have little interest in translating the programmes and declarations into concrete measures.”

“We may have programmes, but we have not the actual tools or instruments to conduct an effective fight against corruption.”

Consultation between Government and the Private Sector

14. Rating given to the quality and regularity of consultation between government and the private sector/SME policy community on <u>draft legislation and regulations</u> that affect business.	2004	2003
Overall	1.4	1.4
Quality	1.4	
Regularity	1.4	

The SME participants in the focus groups rate the quality and regularity of consultation between government and the private sector on draft legislation and regulations that affect business as being “very poor”, as in the EPPA 2003 assessment. The participants think that:

“There are no consultations. Draft laws are prepared according to top-bottom principles, instead of the reverse order and passed to parliament often without any opportunity for the private sector organisations to influence them.”

“There are sometimes consultations on local level, initiated by entrepreneurs, but they are rare and ad hoc”.

Participants noted that much depends on the initiative of the private sector associations:

“Sometimes professional associations promote public hearing when they find out that some important issues would be regulated by that law and the law is already in parliament for discussion.”

“Associations of entrepreneurs have to keep ministries under pressure, otherwise they would not get anything from them.”

14.1 Rating given to change in the regulatory environment (registration, licences, permits) since March 2003.	2004				
	Much worse	Worse	No change	Better	Much better
	8%	13%	53%	26%	0%

The majority of the entrepreneurs believed that the situation has not changed since the publication of the previous EPPA. However, a quarter of the participants believe that things are moving in a positive direction, thanks probably to a number of measures promoted through the Bulldozer initiative. At the same time one fifth of the participants believe that the situation actually got worse or much worse. The following statements express the conflicting views quite well:

“It even seems worse. Maybe some progress could be expected from Bulldozer Initiative, maybe not, we will see”.

“Reform in last 12 months brought higher quality of legal framework, but the problem is that these laws are not implemented, because we do not have the institutions which should implement them, or even where we do have these institutions, they are newly established and still very passive. The best examples of this situation are the Law on Concessions and the Veterinary Law.”

Many entrepreneurs again point their finger to BiH’s complex administrative structure.

“Our regulatory environment is more complicated than necessary because of many layers of administration. That causes a situation in which our laws are more diluted, complex for implementation and less efficient.”

“We should get over the administrative authorities at entity and canton level in reducing the administrative and tax burden and in parallel we should increase the efficiency of state government.”

4. Tax Policy for Small Businesses

The issues researched under this heading:

1. Whether the present tax policy encourages new enterprises and the rating of the tax system in terms of the encouragement / support and ease of use that it provides to new and existing SMEs.
2. The stability and transparency of the tax system for small enterprises.
3. The percentage of annual net profits which SMEs typically pay in tax, and its direction.
4. The consultation and communication between government and the private sector on tax rates and incentives for enterprises.
5. Co-ordination of tax policy with other government policies aiming at improving the operational environment for small business.
6. The change in the tax environment for small business since March 2003.

Encouragement of Enterprises

15. Does the present tax policy encourage new enterprise? Rating given to the tax policy in terms of the encouragement / support and ease of use that it provides to new and existing SMEs.	No: 76%	
	2004	2003
	Overall Encouragement/support Ease of use	1.7 1.7 1.7

The large majority of the focus group participants believe that the current tax regime is not designed to encourage enterprise development.

The concerns of the entrepreneurs are not directly related to the level of the corporate tax rates applied by the different entities. Those rates are considered reasonable, if related to the economic situation of the country. However, entrepreneurs instead complain that the system of incentives for start-ups is not effective. The incentives are too short-term, the start-up tax holiday is too short.

“New SMEs have declining profit tax exemptions only for first 3 years after registration. That period should be longer, considering the fact that start-up businesses start to recover early losses and start to make profits only towards the end of the first five years.”

Tax policy is very much decentralised. Each entity has its own corporate tax regime and its own set of incentives. Within the Bosnian Federation, tax incentives vary from canton to canton.

The focus group discussions revealed that there is widespread disappointment regarding the impact of changes in tax legislation introduced in 2001 and 2002. But again the complaints were not so much against the level of tax rates, but instead against the system of tax inspections and the tax collection procedures:

“In case of a dispute with the tax administration, a company has to pay all the due taxes plus the penalties according to verdict of the first level court, regardless of the fact that the company has lodged a case with a higher court. That is terrible for the liquidity of the company and discourage any action against the unfair behaviour of the tax administration.”

“Many of tax officers and tax inspectors do not act professionally. They do not answer our written requests for clarification. They prefer informal channels of communication and exercise a lot of discretion regarding the type of supporting document that a company must exhibit in case of inspection.”

“There is no real dialogue between entrepreneurs and tax administration officials. Their only interest is in tax collection. They do not want to know about company operations, analysing our cash flow. They are not making any effort to educate entrepreneurs on how to complete the tax returns.”

Entrepreneurs had clear views about the changes needed in the tax administration:

“Tax offices must have access to basic ICT technology and operate in a network.”

“Tax Offices should develop a relationship based on co-operation and dialogue with the SMEs. They should have educational and information programme and should change their behaviour. Each inspection is organised as a punitive expedition.”

Stability and Transparency

16. Rating given to the stability and transparency of the tax system for small enterprises.	2004	2003
Overall	2.1	2.0
Stability	2.2	
Transparency	1.9	

The entrepreneurs rated stability (2.2) and transparency (1.9) of the tax system as “poor”. The combined assessment is virtually the same as for the 2003 EPPA Participants did not perceive the current tax system, based on fiscal decentralisation, leaving therefore to the entities to establish autonomous tax regimes, as stable and transparent.

“The main pressure towards greater stability of the tax system comes from OHR and international community. They are the ones who push for common elements in tax policy with to our local authorities and the local authorities have to take care of their views. The Bulldozer Initiative is the best example for that.”

“Tax policy is more stable since reforms performed in 2002 (in RS), but some issues such as incentives for SMEs which take on new employees are not yet solved.”

The participants are more critical regarding transparency of tax system:

“Although tax collection has improved in the last year, there is still a high level of tax evasion in excise goods. There is no transparency on who is paying taxes and who is not. Some importers and local producers of excise goods benefit from the protection of customs and tax officers. There is a selective implementation of tax policy.”

17. Rating given to the percentage of annual net profits which SMEs typically pay in tax.	2004					
	Corporate Tax as % of annual profit	<10%	10-15%	15-20 %	20-25%	>25%
	Answer	17%	28%	24%	12%	19%

Over 40% of the entrepreneurs participating in the focus groups said that they pay less than 15% of their annual net profits, a relatively low share. But, there is a significant number of participants (19%) which thinks that SMEs pay over 25% of their net profits in tax. In any case, all the entrepreneurs were of the opinion that it is difficult to properly assess this share, because of the weight of the informal economy. The answer varies significantly according to the officially declared or the actual profits.

A serious issue highlighted by entrepreneurs is that a significant part of the corporate income tax is paid in advance on the basis of the previous year’s profits:

“Advance payment of profit tax is a major burden for SMEs’ liquidity. Without liquidity there is no investment and without investment it is not possible to create new jobs.”

17.1 Rating given to the direction of the percentage of annual net profits which SMEs typically pay in tax.	2004		
	Increasing	Decreasing	Stable
	12%	32%	56%

Over half of respondents thought that the percentage of annual net profits which SMEs pay in tax is stable, one third of the entrepreneurs is of the opinion that the tax burden is actually decreasing. This is a positive sign, probably linked to tax measures introduced in both entities in 2003.

Entrepreneurs note that system to calculate the payroll tax is cumbersome, while the current general tax rate on sales is too high (20% and 18%) and promote the growth of the informal economy. The issue should be, at least, partially solved by the introduction of VAT.

Entrepreneurs are of the opinion that introduction of VAT should be accelerated and the international community should provide more support to speed up the introduction process.

“The government at state level should try to be bold in promoting the change to VAT. Nobody believed in change of payment system three years ago, and it had complete success!”

“The government did not take a very firm position regarding the deadline for the VAT introduction. The start date has already been postponed many times, and at the same time the grey economy is flourishing. Whose interest is it?”

Consultation and Communication on Tax Policy

18. Rating given to the communication between government and the private sector on tax rates and incentives for enterprises.	2004	2003
	1.4	1.6

The assessment of the degree of communication between government and the private sector on tax rates and incentives for enterprises is rated “very poor” (1.4). The rating is even lower than in the 2003 EPPA (1.6).

The general view is that there is still a nearly complete lack of communication between government institutions, at all levels, and the business sector on tax policy formulation and implementation.

“Our state does not treat us as partners in tax policy formulation.”

Entrepreneurs argue that government does not monitor and analyse economic trends in the SME sector, and therefore tends to base policy changes, including tax policy, on incorrect assumptions. The process leading to policy elaboration is not clear to entrepreneurs and the communication between the private sector and government institutions still needs major improvement.

Entrepreneurs also complain about the role of tax officers, unwilling or unable to provide advice on how to apply tax regulations and calculate tax liabilities:

“Tax offices should have consultative and not at all only repressive role regarding tax collection.”

Co-ordination of Tax Policy

19. Rating given to the tax policy consistency with the other government policies aiming at improving the operational environment for small business.	2004	2003
	1.7	1.8

The co-ordination of tax policy with the overall government policy remains “poor” (1.7).

“Tax policy is not and will not be consistent, as long as VAT is not introduced across the country, providing more consistency and transparency.”

Change Assessment

20. Rating given to change in the tax environment for small business since March 2003.	2004				
	Much worse	Worse	No change	Better	Much better
	0%	11%	67%	22%	0%

More than two thirds of the respondents are of opinion that there has been no significant change in the tax environment for small businesses since March 2003:

“A poor fiscal policy has serious consequences for the enterprise sector. The biggest source of late payment accruals in BiH is the state sector, and this is another major cause, together with the freeze put on government debt repayment, and with inefficient work of the courts, increase the already critical liquidity situation of many SMEs.” “The Adoption of Law on settling of internal debts should be done urgently.”

5. Financial Instruments for New and Small Businesses

The issues researched under this heading:

1. The stability, competitiveness and services of the banking system.
2. The commercial banks interest in developing the SME sector and the lending attitude by commercial banks with respect to the SME sector.
3. The SME access to the following main sources of finance:
 - Own/family capital
 - Repatriation capital (from family/friends)
 - Commercial banks
 - Micro finance
 - Leasing
 - Other (e.g. credit unions)
 - Venture capital/equity funds
 - and the Bank personnel’s skills.

4. The bank funding availability for working capital, for capital investment and for technology investment. The change in the banking environment for SMEs since March 2003 regarding Provision of services and Lending.

Stability, Competitiveness and Services

21. Rating given to the stability, competitiveness and services of the banking system.	2004	2003
Overall	3.4	3.0
Stability	3.5	
Competitiveness	3.2	
Services	3.4	

In general, the participants in focus group discussions agreed that the banking system recorded further progress in last two years, in terms of stability, competitiveness and services. They rated those three dimensions as “satisfactory” and slightly better (3.4) than in the 2003 EPPA (3.0).

The entrepreneurs also stated that their confidence in the banking system is stronger than two years ago, as a result of a higher penetration of foreign banks, the progress made on bank privatisation, as well as the introduction of the deposit assurance. For those reasons they assessed stability to be almost as good (3.5).

“Efficiency of commercial banks has much improved. There is greater financial stability but also greater competition among banks and this is good.”

But, there are many of participants who believed that competition could be further improved:

“Their services in general are still very expensive including daily money transactions for SMEs.”

“When we were establishing our loan guarantee scheme, only one bank was ready to discuss with us. The others did not show any interest.”

Banks’ Interest / Attitude to SMEs

22. Rating given to the commercial banks interest in developing the SME sector and their lending attitude with respect to the SMEs.	2004	2003
Overall	2.6	2.2
Interest	2.4	
Lending Attitude	2.7	

The entrepreneurs believe that commercial banks’ attitude towards SME financing could be further improved. The banks’ interest is rated “poor” (2.4):

“Banking sector, in spite of the progress made in last two years remains still pretty conservative on lending to SMEs.”

“The majority of commercial banks are still not ready to take a risk with lending to SMEs. We can not yet talk of a partnership with the small enterprise sector.”

Entrepreneurs complain about a sometimes inflexible attitude towards SMEs:

“It is true that interest rates are decreasing and loan maturity is increasing, but the procedures for obtaining a loan are still too long and time consuming.”

“Banks are not ready to allow any flexibility in the loan repayment schedules, even when companies have solid reasons to ask for a short delay.”

The focus group participants again connect the banks’ unwillingness to finance SMEs with their perception of the risk related to the weak legislative framework, in relation to right of banks over collaterals and the poor state of the court system. They also emphasised that smaller banks are more careful regarding SMEs needs.

“It is better to deal with a smaller bank, because it better know needs of client. Larger banks are more distant towards SMEs needs and especially towards small firms.”

“The lending procedures are often very complicated. Smaller banks are ready to guide companies through the process, but bigger banks are not ready to invest the time.”

Access to Finance

23. Rating given to the access to main sources of finance and the quality of bank personnel skills , to small businesses.	2004	2003
	2.5	2.2

The overall rating of access to main sources of finance and the quality of personnel skills is still “poor” (2.5), a result slightly better than that of the 2003 EPPA (2.2), but according to the respondents’ comments a satisfactory performance is still far.

The entrepreneurs rated use of own/family capital and micro-finance as the main two sources of financing for SMEs, but the importance of own/family capital in 2004 decreased compared with 2003. Respondents argue that this is due to the lack of liquidity in recent years and because of reduced repatriated capital and almost all reserves of individual capital have already been spent.

On the other hand commercial bank lending is again rated as the third most important source of SMEs’ financing and assessed as close to “satisfactory” (2.7), with a marked improvement over the 2003 EPPA, confirming the trend emerged for the answers commented above.

Micro-financing was also rated by entrepreneurs almost as “satisfactory” (2.8), again an improvement compared with the 2003 EPPA.

“Micro financing institutions are more efficient than commercial banks because they provide consultancy services to their clients in addition to funding. That contributes also to very high loan repayment rate.”

Focus group participants have highlighted a number of problems related to bank lending such as relatively short maturities (it is difficult to get loans longer than three years) and a perception of bias in lending practices in favour of larger firms.

Table 3-1. **Relative Importance of Main Financial Sources Accessed by SMEs**

Financial Sources	Rating	Ranking
Family or individual capital	2.8 [3.6]	1 [1]
Micro-finance	2.8 [2.4]	2 [4]
Commercial bank loans	2.7 [2.2]	3 [3]
Leasing	2.5 [1.7]	4 [5]
Repatriated capital	2.4 [2.5]	5 [2]
Venture capital	1.9 [1.7]	6 [6]
Credit Unions	1.5 [1.3]	7 [7]

5= most important source of financing; 1= least important source of financing

As a source of finance for SMEs, leasing also made progress in assessment by respondents from “poor” (1.7) in 2003 to close to “satisfactory” (2.5) in 2004.

Focus group participants noted that there are still numerous obstacles to the expansion of leasing in BiH:

“Leasing is available, but it is very expensive. The problem with leasing is that banks are keen to expand consumer leasing for cars and other durable goods because it is more profitable, not industrial leasing. That is why SMEs face huge problems regarding procedures.”

Access to venture capital is rated again “poor” (1.9) as in EPPA 2003 (1.7), as this type of financing remains largely unknown for small business. There is also still little knowledge and access to Credit Unions which were assessed (1.5) as a source of finance for SMEs.

The following quotation captures what entrepreneurs would like to work towards:

“Promissory notes and bank cheques should be finally introduced in BiH financial dealing as secure instruments of payment. We have the possibilities to use them, but there are not effective sanctions against uncovered cheques and notes. That is why so far everybody avoids using them, but promissory notes could help to smooth SMEs’ liquidity problems.”

23.1 Rating given to the quality of bank personnel skills .	2004	2003
	3.2	2.8

Turning to more general issues, entrepreneurs consider the quality of bank personnel skills in BiH to be fairly satisfactory (3.2). The entry of foreign banks is thought to have positively influenced the level of staff skills in commercial banks, but further improvement in this area is needed:

“Banks have skilled personnel, but the problem is that they are very selective regarding quality of the services provided to different SMEs.”

“Lending officials are not very willing to go into detailed analysis of the company business. They are mainly applying standard credit assessment procedures. For instance I got a grace period of 6 months on a loan covering cattle breeding when the natural cycle is twelve months!”

Access by purpose of investment

24. Rating given to the bank funding for working capital .	2004 2.5
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The participants consider access to finance of working capital to be close to “satisfactory” (2.5). According to the participants:

“In the majority of banks, working capital can be financed up to 30% of total loan amount. That is insufficient and that is why SMEs borrow from micro-finance institutions even if they are more expensive.”

24.1 Rating given to the bank funding for capital investment .	2004 2.4
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Entrepreneurs rated bank funding for capital investment as “poor” (2.4) and is still mainly caused by troubles with collateral registering of real estate (inefficient courts, slow and costly procedures). They stated that fears are present on both sides: the banks and themselves.

“SMEs are not dissuaded from borrowing for capital investment by the over complicated collateral registration obligations.”

24.2 Rating given to the bank funding for technology investment .	2004 2.3
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Access to bank funding for technology investment is also rated “poor” (2.3).

“Leasing could be good model of SMEs needs for new technologies financing, but banks imposed such rigorous conditions that very a small number of enterprises succeed to get it.”

Regarding the availability of bank loans for various sectors of activity, the entrepreneurs noted that companies operating primarily in agricultural production and tourism registered some improvement in their access to bank financing. This is a result of various loan programmes launched by international organisations such as the World Bank and donors such as USAID and through credit lines administered by commercial banks. But still banks target the most profitable sectors of activity, such as construction, trade, oil-import, production and wood processing.

Change Assessment

24.3 Rating given to the change in the banking environment for SMEs since March 2003.	2004 2.7
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Entrepreneurs rated the change in the banking environment for SMEs since 2003 close to “satisfactory” (2.7) but they also emphasised their concerns and suggestions for its improvement:

“In our difficult business environment the only real positive story is the development of the banking sectors.”

“Competition among banks is still limited. There is a good potential for expansion. Only stronger competition can deliver a significant reduction on lending spreads and improve service quality.”

24.4 Rating given to the change in the banking environment for SMEs since March 2003 regarding provision of services .	2004 2.9
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Provision of bank services for SMEs changed to nearly “satisfactory” (2.9) over the last year, which is a result of the entrance of new FDI in the sector, as well as merging of domestic banks.

“The only one real Micro-credit bank operating in BiH, the Pro-Credit Bank (ex-Micro Enterprise Bank), has continued to improve the range and the quality of their services.”

“Services of banks are improved including introduction of e-banking.”

24.5 Rating given to the change in the banking environment for SMEs since March 2003 regarding lending .	2004 2.6
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6. Advisory Services for New and Small Businesses

The issues researched under this heading:

1. Use of professional business advisory services from private consultants and from government/donor supported advisory centres and satisfaction with their range available to new entrepreneurs and SMEs?
2. Efficiency of private and public advisory services operations.
3. Responsiveness of private and public advisory services provided to the demands and needs of enterprises.
4. The skills, experience and quality of the staff providing business advisory services.
5. The continuity of business advisory services available.
6. The change in the provision of business advisory services for SMEs since March 2003

Range of Advisory Services

25. Does your company make use of professional business advisory services?	2004
Overall	Yes, 60%
From private consultants?	Yes, 55%
From government/donor supported advisory centres?	Yes, 40%

More than half (60%) of participants in focus group discussions use external professional business advisory services. Private consultants are more frequently used than government or donor supported advisory services.

25.1 Are you satisfied with the range of advisory services available to new entrepreneurs and existing SMEs?	2004
Overall	No, 78%
<i>By private consultants?</i>	Yes, 66%
<i>By government/donor supported advisory services?</i>	Yes, 35%

The majority of entrepreneurs (78%) are of opinion that the range of advisory services is satisfactory in BiH. Participants rated the range of advisory services provided by private consultants much better than that of government/donor provided services.

“We are more satisfied with private consultants services because they are more client oriented and invest in the range and quality of services provided. On the other side is their interest to do so.”

However some of the entrepreneurs expressed concerns about the lack of quality standards set for service providers and would like to see a more pro-active role of the government, extending the certification system.

“There are many service providers which are not certified. Concentration of certified providers is in big urban Centres. In such circumstances, entrepreneurs take all the risk, as uncertified advisory service providers are more likely to suggest inefficient solutions to their business problems.”

25.2 Rating given to the range of advisory services available .	2004	2003
	2.5	2.2

“Advisors which are really able to provide wide range of consultancy services are very rare. Most of the external consultants specialize in on a specific field, such as accounting and auditing.”

Among the focus groups participants there is significant level of un-satisfaction regarding the performance of foreign consultants working in the SMEs area. Over one fifth of respondents is of opinion that:

“Money given to the foreign experts engaged in BiH does not stay in BiH and it is not reinvested in the advisory sector. Instead, foreign experts take it back to the countries which donated it. In addition, foreign experts staying on short term assignment often do not show the same level of commitment as they do not take responsibility for the long term success of the project!”

Efficiency of Advisory Services

26. Do advisory services operate efficiently ?	2004	2003
Rating given to the efficiency of advisory services available to SMEs.	No: 51%	
Overall	2.5	2.4
Private	3.2	
Public	1.7	

The respondents were equally divided about the efficiency of the advisory services. However, private service providers were rated much more efficient than the public ones

“Private consulting companies are mainly specialised, while public consultants offer more general services. That is one of the reasons why private providers are more efficient.”

“...There is a lack of team work within business advisory services providers, and that has a negative influence on the range of services, as well as on its efficiency...”

“After all, the best source of information and business solutions are those which are collected through exchange of information among SMEs in the same business line.”

Overall rating of efficiency of advisory services is between “poor” and “satisfactory” (2.5), a rating slightly better than in the 2003 EPPA.

Responsiveness to Demand

27. Are services provided responding to demand and the needs of enterprises? Rating given to the responsiveness of advisory services to demand and needs.	2004	2003
	Yes: 60%	
		2.4
Overall	2.4	
Private	3.1	
Public	1.5	

Although the majority (60%) of participants thought that advisory services provided are responding to the demands and the needs of enterprises, overall, the extent of that responsiveness is assessed as “poor” (2.3).

“Entrepreneurs ask for advice only in a case of urgency, when a problem is already so big that any kind of quality of advice can hardly help.”

“Some Advisory services are extremely expensive, as for example lawyers’ fees established by Chamber of Lawyers, so companies are reluctant to use those services unless it is absolutely necessary.”

Participants rated private advisory services responding to the needs of enterprises as fairly “satisfactory” (3.1) while public advisory services were assessed closed to “very poor” (1.5).

In the participants’ view, the responsiveness of advisory services to demand of SMEs could be improved by government and business representative institutions, through various stimulating measures.

“SMEs need consultancy services, but they are too weak to pay the fees charged for individual advisory services. There is still a need for more and better quality public service centres, linked for instance to the Chambers of Commerce.”

Human Capital

28. Rating given to the skills, experience and quality of the staff providing advisory services.	2004	2003
Overall	3.2	2.5
Skills	3.2	
Experience	3.1	
Quality	3.3	

The SMEs participating in the focus group research rated skills, experience and quality of the staff providing advisory services as “satisfactory” (3.2), a good improvement compared with the rating of the 2003 EPPA. All three main characteristics of business advisory services (skills, experience and quality of the staff) they rate almost equally (3.2), (3.1) and (3.3) respectively.

“Quality depends mainly on experience, maybe even more than on their knowledge, so the longer the advisors are in business the better they are.”

Continuity of Provision

29. Rating given to the continuity of advisory services available.	2004	2003
	2.3	2.2

The participants of focus groups rate continuity of advisory services being offered in BiH as “poor” (2.3), as they did in EPPA 2003.

There entrepreneurs are of the opinion that government should provide financial support in order to improve the access of start-ups to business advisory services, but again there should be more quality controls on the services provided.

“There is not a single institution which certifies the quality of advisory services. Some of the service companies are not even registered.”

Some of the entrepreneurs try to solve the quality problem by themselves:

“I try to guarantee continuity in the relationship with my main external advisors, in exchange for reasonable fees and good quality service. at the end of the day is to the advantage of my company to develop a long-term partnership with them.”

Change Assessment

30. Rating given to the change in the provision of business advisory services for SMEs since March 2003.	2004				
	Much worse	Worse	No change	Better	Much better
	2%	4%	55%	39%	0%

7. Business Incubators

The issues examined under this heading were:

1. The awareness of what business incubators are, experience with business incubators and their importance of new entrepreneurs and existing SMEs.

2. The efficiency of the government policy and programme encouraging the establishment of business incubators.
3. The extent to which the business incubators' activities are focussed on the needs of the local entrepreneurs.
4. The awareness of other government/donor supported schemes for start-ups (new established small companies).
5. The change in the government policy towards business incubators since March 2003.

Experience of Business Incubators

31. Are you aware of what business incubators are?	2004
	Yes: 73%

There has been a very significant improvement in the basic level of information on business incubators since the 2003 EPPA, although over a quarter of the respondents did not know much about business incubators. This is not surprising given that there are only three business incubators in operation in BiH. According to entrepreneurs, the lack of information is even higher in the public administration.

“The problem is that most of our local government leaders still do not know what Business Incubators are. How we can expect to see any significant development in this area?”

31.1 Have you used or do you have experience with Business Incubators in your country?	2004
	No: 83%

The great majority (83%) of focus group participants made no contact at all with business incubators. Participants mainly got their information from the media or from training courses.

One of the participants of the Zenica Focus group stated he is trying to set up a centre specialised in bee-keeping and honey production, working on the same principles of a business incubator, including a bee-keeping training school. However, he is facing problems in putting together the funds necessary to develop the centre, as no public institution or private bank is interested in financing it.

31.2 Rating given to the business incubators' value to new entrepreneurs and SMEs.	2004	2003
	3.6	3.5

Entrepreneurs highly rate the value of business incubators to new entrepreneurs and existing SMEs, although they do not have enough information to evaluate them properly. The general view is that business incubators are good for enterprise development.

“It would be very useful to have here (Banja Luka) one business incubator which would support young entrepreneurs in the information technology sectors.”

The majority of participants in almost all focus groups stated that government can easily speed up the establishment of business incubators in BiH by re-developing empty

military buildings and factories (excluding them from the privatisation process) together with business associations or other similar institutions.

Government Policy

32. Is the government policy and programme of encouraging the establishment of Business Incubators efficient?	2004
	No: 87%

The majority of participants answered that, for their knowledge there are no policies and/or programmes for encouraging the establishment of Business Incubators in BiH.

“For instance the government of the Republika Srpska has shown no interest in developing business incubators. There is no co-ordination with the municipal authorities for the allocation of empty industrial buildings for this purpose.”

32.1 Rating given to the efficiency of the government policy encouraging business incubators.	2004	2003
	1.4	1.3

The efficiency of government policy for encouraging business incubators is assessed as being close to “very poor” (1.4) as it was rated in EPPA 2003 (1.3). Again the large majority of the participants are of the opinion that such a policy does not even exist at all.

Entrepreneurs welcomed the establishment of two new business incubators in the last two years, as part of employment generation programmes and emphasised the need to provide more information and/or training to Government officials and the entrepreneurs on how to establish and operate business incubators.

Governance Structures / Locations, the Infrastructure and Facilities

Many participants stated that they are not aware of the existence of three business incubators in BiH.

Entrepreneurs participating to the Mostar focus group stated there were still many problems with the operation of the Mostar Business Incubator.

“Our Business Incubator in Mostar is suffering of one major limitation: it can not host production businesses because of lack of space.”

“A second issue is that the range of activities represented in the incubator is too scattered. It is therefore difficult to provide efficient business advisory services.”

Focus on Needs

33. Rating given to the extent to which the business incubators’ activities respond to the local entrepreneurs’ needs.	2004	2003
	1.7	1.1

Based on the very limited experience of the three incubators in operation, entrepreneurs are of the opinion that business incubators’ activities do not respond at the moment to the local entrepreneurs’ needs. The few entrepreneurs who visited all three incubators active in BiH are of the opinion that public administration does not provide any concrete support to improve the efficiency of business incubators.

“Those Incubators which are under public control are not as efficient as those managed by NGOs.”

34. Are you aware of other government/donor supported schemes for start-ups (new established small companies)?	2004 No: 67%
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Two thirds of entrepreneurs participating in focus group discussions were not aware of other government/donor supported schemes for start-ups (new established small companies). In the case of the Sarajevo focus group a majority of participants were aware of existence programmes supported by the World Bank and USAID.

Change Assessment

35. Rating given to change in the government policy towards business incubators since March 2003?	2004				
	Much worse	Worse	No change	Better	Much better
	5%	12%	57%	26%	0%

8. Entrepreneurship, Vocational Education and Access to Technology

The issues examined under this heading were:

1. The contribution of the education system to the creation of an entrepreneurial spirit in country.
2. The awareness of any training schemes for small entrepreneurs.
3. The quality of vocational training, the effectiveness of the apprenticeship and difficulties of staff recruitment.
4. The government’s provision of information about business standards and business opportunities.
5. The government’s programmes to improve the technological capacity of small enterprises.
6. The change in the image of entrepreneurs in country since March 2003.

Note: This dimension was not included in the 2003 EPPA, therefore there are no 2003 ratings.

Entrepreneurial Spirit Creation

36. Rating given to the contribution of the education system to the creation of an entrepreneurial spirit in country.	2004 1.7
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Entrepreneurs participating in focus groups were critical of the contribution made by the education system to the creation of an entrepreneurial spirit. The average rate was “poor” (1.7).

“The whole educational system, including the seven universities existing in BiH, is separated from the real economy and is operating without taking into consideration the demand for qualified personnel, but we still do not have the right political climate for a qualitative reform of our education system.”

Entrepreneurs complain that little weight is given to teaching entrepreneurship:

“In the Faculty of Economics as well as in some Technological faculties there are courses that touch entrepreneurship. They exist also in lower level courses in the Secondary schools (e.g. Economics), but overall the teaching of entrepreneurship related subjects is insufficient.”

Their general statement regarding unsatisfactory efficiency of education system is that:

“Our educational system does not manage to produce even skilled workers, can you imagine entrepreneurs?”

Training schemes

37. Are you aware of any training schemes for small entrepreneurs?	2004 No: 77%
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The majority of respondents (77%) was not aware of the existence of any training scheme for small entrepreneurs. They stated that whatever is organised in this sense, could not be named a training scheme as of yet, as the schemes are occasional and poorly organised.

“Such programmes are performed ad hoc thanks to the activities of NGOs’ projects, but there is a lack of systematic approach.”

Again, participants from Sarajevo were more positive.

“There is for instance an ETF supported programme, established together with a consortium including the Sarajevo Business School, which is part of the Faculty of Economics, and SEED.”

“The Chamber of Commerce of the Sarajevo Canton is also active in organizing training courses for entrepreneurs, but the fees should be lower, at least for its members.”

Vocational training

38. Rating given to the quality of vocational training like in relation to the activities of respective business of SME.	2004 1.9
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Participants were hardly aware of the existence of such training. They stated that vocational training is mostly done informally, within the company.

Apprenticeship

38.1 Rating given to the effectiveness of the apprenticeship in country.	2004 1.9
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There is total lack of efficient apprenticeship in BiH in the post-war period. Participants rated the effectiveness of the apprenticeship as “poor” (1.9).

“They assign us secondary-schools students for training stages, but we can use them only for menial jobs.”

“Before the war it was compulsory to pass an apprenticeship exam in front of a professional commission. This does not exist at all nowadays.”

Staff recruitment

38.2 Rating given to the extent to which difficult is it for respective company to recruit staff with the right skills.	2004
	2.2

The ability to recruit the staff with the right skills is assessed by respondents as “poor” (2.2).

“There is complete inconsistency between demand and supply of skilled staff. The educational system is not responding to the business needs. E.g. we do not have in Gracanica a vocational school for plastics manufacturing, although we are leaders in BiH in this sectors.”

“For some professions it is almost impossible to find workers with the appropriate educational background. There is a big gap between the offer of labour and the needs of SMEs.”

The quality of vocational training, the effectiveness of the apprenticeship and difficulties of skilled staff recruitment for SMEs were all assessed as “poor”. Regarding the importance of all these issues for a higher quality of employment, entrepreneurs emphasised the need for systematic governmental support in solving these issues.

Business standards and opportunities information

39. Rating given to the government’s provision of information about business standards and business opportunities in country.	2004
Overall	1.5
Standards	1.4
Opportunities	1.6

Entrepreneurs rated the government’s provision of information about business standards and business opportunities in BiH as close to “poor” (1.5). The rating is even lower for information regarding technical standards:

“It is bizarre how a huge administrative apparatus for a relatively small country is not capable of providing basic information regarding technical standards in different professional areas?”

“Entrepreneurs are trying to obtain such information from Governmental bodies. But, information is scattered among several bodies. It seems that our public administration, at all levels, is in a permanent phase of re-organisation.”

Some of the participants had more positive views:

“Government does not usually provide such kind of information, but Chambers of Commerce sometimes do.”

Technological capacity improvement

40. Rating given to the government's programmes to improve the technological capacity of small enterprises.	2004 1.3
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The entrepreneurs rate government's programmes to improve the technological capacity of small enterprises, as "very poor" (1.3).

"The state is simply not interested in providing information on business opportunities, standards or new technologies. It is totally up to the entrepreneurs to organise themselves."

"However there are some positive examples occasionally, as in the case of Tuzla Canton where the Cantonal Bureau for Employment has engaged experts in different sectors. They offer their services on a regular basis, though the Municipalities, to SMEs, supporting their technology improvement programmes."

Assessment of change in entrepreneurs' image

41. Rating given to change in the image of entrepreneurs in the country since March 2003?	2004				
	Much worse	Worse	No change	Better	Much better
	2%	11%	59%	28%	0%

There has been no change in the image of entrepreneurs in BiH since March 2003, according to the majority opinion (59%) of focus group participants. However, 28% of the participants believed that the situation has somewhat improved in comparison with last year.

"It was improved slightly, but that depends also on individual perception and the company location."

"The Chambers of Commerce should work on improving the image of entrepreneurs, but generally they are not doing much. There is a lack also of professional business associations which would defend and promote the image of their members."

PART II

Chapter 2

Analysis and Assessment

This chapter presents the OECD-EBRD analysis and assessment of the seven dimensions of good practice for the business environment. It reviews the current situation in each of these areas, takes into account other OECD and EBRD studies and analyses of good practice and the private sector views, based on the preceding qualitative research with the owners and managers of SMEs. The assessment of the current situation leads to a series of recommendations by the OECD and EBRD presented in Part I of the report.

BiH presents a special case among the countries of South East Europe. The EPPA reports focus mainly on the enterprise policy set by the central government bodies. However, as a result of the current constitutional arrangements introduced after the Dayton Peace Agreement, the two entities (the Federation of Bosnia and Herzegovina and the Republika Srpska) and the District of Brcko have considerable autonomy over the policy elaboration and implementation for most of the dimensions covered by the EPPA report. The role of the State of Bosnia Herzegovina in the enterprise policy area, as well in area economic area is not yet fully defined, being linked to the debate over the constitutional structure of the country, while the International Community, through OHR and other multilateral and has much larger weight in determining the policy directions than in other countries of South East Europe.

The analysis therefore covers both the policy conducted at the level of entity and district as well as a state level. Efforts have been made to highlight the connections as well as the contradictions current in place between the various policy levels.

1. Implementation of the Institutional Framework for SME Policy

Situation on the Institutional Framework

The institutional framework to support of SMEs in BiH is complex, with a number of institutional institutions operating at state, entity and local level. The framework is still going through a process of transformation as new relations are being developed between state and entity institutions, with the support of the international community

SME and Enterprise Development Institutions

BiH State

The institutional framework for enterprise policy at state level is still at an embryonic stage.

Economic development, including enterprise development falls at state level under the portfolio of the Ministry of Foreign Trade and Economic Relations (MoFTER,) of BiH. Within the ministry a Division for Development and Entrepreneurship¹ was set in 2003, including a Department for Promotion and Development of Entrepreneurship. This department has today only two employees: the Head of Unit and an Expert Associate. The resources available to this Department are limited, covering just the salaries and office costs, leaving no margin for programme funding.

There is no SME strategy, elaborated at state level, at present. However, the Medium-term Development Strategy of BiH (Poverty Reduction Strategy Programme- PRSP) has a section on private sector development. The PRSP, elaborated with the support of the World Bank and the IMF and adopted by the state parliament in March 2004, is the most comprehensive medium term economic policy document elaborated and endorsed at state level and form the basis for the support programme of the international community.

The PRSP covers a wide range of issues, focusing on the main development goals for BiH and preparation of the ground for increasing economic and social integration with the European Union. The Strategy Programme places a good deal of emphasis on creating an enabling environment for investment and SME development.

Its main priorities in this area are: the adoption of an SME Strategy for BiH, the establishment of coherent and consistent legal and institutional framework for supporting the development of entrepreneurship across all BiH, the establishment of a Guarantee Fund to support SMEs and the encouragement of training and education of entrepreneurs and SME managers.

Using the PRSP as a framework, the MoFTER, through the Department for Promotion and Development of Entrepreneurship, has launched in September 2004 a process for the elaboration of an SME Development Strategy at state level, aimed at covering the whole territory of BiH and the role and the links between the state and entity/district institutions dealing with SME issues.

The process should lead to the drafting of an Enterprise Development Law at state level. The law should include a common definition of micro, small and medium sized enterprise, using as reference the EU adopted definition and provide the legal basis for the establishment of an SME agency at the state level, if a political consensus could be reached.

A working group, consisting of senior officials of state and entity/district institutions, representatives of the private sector and SME experts, has been recently set up, with the technical assistance of IFC SEED.

Federation of BiH

The Ministry of Development, Entrepreneurship and Craft of the FBiH, created in 2003, is responsible for developing the SME sector within the entity, in recognition of the importance of the small business sector for the development of the FBiH. There are about 90,000 SMEs (including sole traders) in FBiH.

The Ministry has three departments: entrepreneurship promotion, sector development and craft. It has a total staff of twenty two. The Department for Entrepreneurship Promotion, which deals more directly with SME policy, has a staff of four.

The resources at the disposal of the Ministry for SME policy are limited, given its wide-ranging objectives, but are still much larger than those available at state level. In 2003 the Ministry was assigned a provisional budget of €15 million for the establishment of an fund providing cash incentives to start-ups. However, the budget allocation was later blocked, due to budget constraints. In 2004 the budget allocation amounts to a modest €775,000, to be increased in 2005 to a €1,850,000, with the bulk assigned to the provision of cash incentives for start-ups.

The Ministry is also working on the drafting of an Enterprise Development or SME Law, to be approved by the FBiH parliament and an SME Strategy, including the establishment of an SME agency at entity level. The Law will have broadly the same scope of the Enterprise development Law planned at state level.

At the moment it appears there is no evident co-ordination between the actions planned at state and entity level, the only point of contact being the working group.

Republika Srpska

The Ministry of Economy, Energy and Development of the RS is responsible for developing the SME sector through its Department for SMEs and Handicrafts.

The RS has adopted an SME strategy (The SME Development Programme 2002-2005) in December 2001. The Law on Incentives for SMEs was approved in September 2002, providing the legal framework for the establishment of the RS SME Agency and the RS Fund for SME Development. RS adopted the EC SME definition.

The RS SME Agency is not yet fully operational, due to a lack of funding and human resources, although a Steering Committee has been recently established. The same situation applies to the SME development Fund which was expected to have a budget of €1.5 million, to be used mainly for start-up support.

The SME Agency is expected to become operational in the second half of 2004, under the management of the Foundation for Development and Employment.

In addition, the Department for SMEs and Handicrafts has also established a Revolving Credit Fund for SMEs in 2003, with €7.5m start-up capital from the RS budget, managed by the Foundation for Development and Employment.

District of Brcko

The Department of Development and Land Planning of the Government of DB deals with SME development and over the last three years the DB administration has worked intensively on the development of an autonomous legislative framework for economic activity. Since 2001, the key focus has been on establishing the Development Agency of Brcko District (BDDA). A Regional Development Strategy for the Brcko District (2002-2006) has been elaborated. BDDA is acting as an executive agency in charge of the strategy implementation. In the area of enterprise development, the key initiatives implemented so far are the establishment of a “business service centre” to support SMEs and the introduction of a “one-stop-shop” for business registration.

Other Institutions Supporting SMEs and Enterprise Development

An important recent development has been the establishment of five Regional Development Agencies (RDAs), under the framework of a Regional Development Project supported by the EC. The five agencies - North-East BiH (NERDA), Herzegovina (HERDA), Sarajevo (SERDA), Central BiH (REZ-RDA) and North-West BiH (ARDA) - cover the whole territory of BiH, but the innovative point is that they include cantons and municipalities belonging to both entities. The criteria for determining the territorial cover of each RDA has been based mainly on economic criteria, fostering local economic integration. The process of establishing the RDAs started in late 2003, promoted by municipalities, cantons and business associations. The five RDAs are in the process of elaborating their Regional Development Strategy, according to EURED guidelines. The RDAs aim at creating a regional partnership among all key local players, including the business community and have a specific mandate to support SMEs. However, at this stage no specific tool or policy measure for SME support has been identified

In parallel to process of establishing the five RDAs, other local development institutions have been launched and other planned up, within the borders of the two entities. Already a number of local development agencies are in activity (Brcko District DA, Tuzla Canton DA, Birac Region DA, Semberija DA, Posavina DA, Banja Luka

Economic Region DA , Enterprise DA Banja Luka, Enterprise DA Bihac, SINERGIJA, North-West RDA, Middle Bosnia Canton DA, Upper Drina Valley DA.

In February 2004 the BiH Forum on Regional Economic Development was launched and a working group made of the various local and regional development agencies has been set up. The purpose of the Forum is to advise and lobby, on regional development policies, and promote regional economic integration.

The *Foreign Investment Promotion Agency (FIPA)*, established in July 1999 is one of the few institutions operating at state level providing services to the business sector. FIPA has developed relations with both with the state administration as well as with the entities and the cantons as well with the business community. FIPA has a network of 5 regional offices in 5 economic regions of BiH.

SME Representation

The Chambers of Commerce (CoC)

There are 19 CoC in BiH comprising: 1 BiH Foreign Trade Chamber, 2 entity CoC, 1 CoC of Brcko District, 10 Cantonal CoC in F BiH and 5 regional CoC in RS.

The only institution operating across the entities is the Foreign Trade Chamber. Its main activities are directed towards assisting its members, directly and through diplomatic and consular networks in foreign trade and investment operations; co-operating with other Chambers in the country and abroad; promoting and implementing training programmes; collecting and elaborating economic data and market analyses; promoting the BiH economy and presenting the products of BiH companies at international fairs. A similar set of activities is performed by the entities and cantonal/regional CoC. The activities of the Chambers of Crafts are mainly focused on helping with registration procedures and lobbying at entity / cantonal levels.

Members of the Foreign Trade Chamber of BiH are legal and natural persons operating in various businesses, banking and finance, public utilities and other activities. Membership is mandatory for all enterprises in BiH which perform export and import activities (there are about 40,000 at present).

Membership of the CoC in the Federation of BiH and Republic Srpska is no longer obligatory, as of 1st January 2004. Membership in the Brcko District has been on a voluntary base since its establishment on 2000. The principle of voluntary membership also applies to the three newly formed Chambers of Crafts, created in 2002.

As from January 2004, membership fees vary according to the decision of each cantonal/regional CoC assembly and it is based on the total sum of gross salaries. For example, the membership fee of the Sarajevo Canton CoC (1,700 members) and Zenica-Doboj Canton CoC (400 members), both of which had about 10 times more members while membership was mandatory, is about 4% of the gross salary bill, depending on the size of the SME. Membership of the Foreign Trade Chamber of BiH is mandatory only for SMEs which are registered for import/export activities and amounts to 2% of their gross salaries. In addition, SMEs pay 1% on the value of imported goods and services and 0,5% on the value of exported goods and services. The membership fee cannot exceed 20.452 € per year.

The key source of funding for most CoCs is the membership fee. Few chambers, such as CoC of Sarajevo Canton in the FBiH, manage also to raise significant funds from other

sources of income, such as training fees, etc. The CoCs have been until recently fulfilled the double role of being both a semi-government institution delivering services to the business sector and the representatives of the business community *vis à vis* the government. The end of mandatory membership and the establishment of independent business associations is radically changing the role of the CoCs and without a extensive re-organisation of their activity their role may be greatly reduced.

Business Associations

SMEs representation as well as advocacy and public-private partnership is still very weak. Although many business associations have been created over the last few years in BiH, mainly based on sector/trade affiliation at municipal canton and entity level, their role is still marginal. The only business association operating at state level is the BiH Association of Employers, set up in July 2004, as an umbrella organisation of the employers associations of the two entities. There are rare branch-affiliated Associations that succeeded to establish themselves on State level, as Association of wood-processing producers “Drvo BiH”.

A number of international and bi-lateral organisations operating in BiH are supporting the establishment of independent business associations as SEED, CIPE, GTZ, trying both to improve the advocacy capacity of the association *vis à avis* the government, as well as their ability to provide services to their members, such as dissemination of trade information’, participation to trade fairs, information on technical standards, etc.

The influence of business associations is felt stronger at local level, For instance, local entrepreneurs associations are involved in the elaboration and implementation of local economic development plans and are working with the newly established RDAs. Local business associations have contributed to develop programmes for vocational education in partnership with the EC VET programme and in the establishment of pilot local employment offices.

Business – Government Consultations

Business-government consultation in BiH is still mainly conducted at entity or district level. So far no regular consultation mechanism has been established at state level, although preliminary discussions have been conducted at parliamentary level.

The main channel of consultation, at entity level, is provided by the *Social-Economic Council*, a tripartite body responsible for ensuring effective communication between government, the business community and the trade union. The FBiH has been the first one to establish a council in October 2002, followed by RS in 2003, while at state level, there plans to establish a Social-Economic Council in the first half of 2005.

In FBiH the Council consists of 15 members (5 representatives of each of the three partners - the Government of FBiH, the Trade Union of BiH and the Association of the Employers of FBiH) and its work has been quite effective, according to the Association of Employers of FBiH (composed of over 3,000 members). The councils, in both entities, have an active role during the process of discussion of drafts of laws on socio-economic issues and provide a table for social and economic policy co-ordination and for negotiating collective agreements with the Trade Unions. The councils have regular monthly meetings meet monthly meetings. Their role its to elaborate non binding proposals and policy recommendations for the government consideration.

In the Brcko District, the consultation process has developed according to a different model, partly because of the absence of an Employers' Association structured in the same way as in the two entities. The consultation channel passes through the local Chamber of Commerce, which has been granted permanent attendance (without voting rights) to the Parliament of BD. It uses this right to express the views of SMEs and protect their interests during the procedures for preparation, discussion and adoption of laws and regulations.

Donor Co-ordination

The *international community* plays a particularly important role with respect to enterprise development in BiH. The Economic Department of the Office of the High Representative (OHR); the EC Delegation; the World Bank; the EBRD, UNDP, the IFC South East Europe Enterprise Development (SEED) Programme; and bilateral donors such as USAID, GTZ, SIDA, CHF, CIDA and DFID are particularly active in BiH.. Given the resources involved and the complexity of the policy environment in BiH, the necessity for greater donor co-ordination is increasingly recognised in order to ensure effective use of resources and address the increasing degree of “donor fatigue”.

At the moment there is no specific institution within the state administration charged with overall donor co-ordination for the enterprise and private sector development. Such function is currently partly performed by the Ministry of European Integration, the Ministry of Foreign Trade and Foreign Economic relations and the by the Working Group on the implementation of the PRSP.

Assessment

The institutional framework for enterprise development and SME support in BiH remains weak and underdeveloped, when compared both with international best practices and with the institutional frameworks developed by other countries in South East Europe. Its main weaknesses are:

- the complexity of the institutional arrangements, due to the existence of 14 governments on their territorial entities, each with its own policy prerogatives,
- the lack of co-ordination and cooperation among the institutions dealing with SMEs policy at state and entity level,
- the limited capacity of those institutions and
- the high dependency from donor sponsored initiatives and programmes.

The system is still based on a very high level of decentralisation, both a level of policy elaboration and implementation, *per se* not a negative feature, but it lacks the institutions needed to create a common business environment, to develop common building components of SME policy and to conduct an effective policy co-ordination among the various entities and with the donor community.

The situation of the institutional framework for enterprise development reflects, in a way, the reality of the political environment in BiH and its development is largely dependent on the direction taken by the constitutional arrangements between the various components of BiH.

However, since the previous EPPA report, there are been some noticeable development that may over the time produce some improvement in relation to the weaknesses mentioned above.

The creation of the Department for the Promotion of Entrepreneurship within MoFTER has provided a reference point for initiating a process of communication and debate among the institutions, at entity and district level, in charge of SME policy.

The process is so far at a very early stage. The opportunity for dialogue is often provided by external factors, such as the commitments taken by BiH following the endorsement of the European Charter for Small Enterprises or the elaboration of the PRSP. The Department still lacks both the mandate and the human and financial resources to conduct an effective policy co-ordination, but it has started to fill a major void in the BiH institutional framework.

A second positive step, resulting from establishment of the Department and the endorsement of the PRSP, has been the establishment of the Working Group on Enterprise Development, bringing together the institutions working on SME policy the private sector associations and representatives of the donor community and the IFIs.

The Working Group provides the opportunity for a more deep and regular dialogue on SME policy. It supported by technical assistance provided by SEED and it has started to work on the identification of the elements for a common basic background policy on SMEs. BiH still does not have an official definition of what micro-small and medium sized enterprises, does not collect systematically statistics on the sector and it has widely different tax and regulatory regimes at entity and district level.

One of the targets set by BiH in 2004 for the European Charter for Small Enterprises, agreed by MoFTER, the two entities and the DB, is the elaboration of strategy for SME Development at BiH level and the preparation of draft law on SMEs at state level. The ground work is expected to be conducted by the Working Group and completed by September 2005.

The third positive element has been the establishment of the five Regional Development Agencies, with a territorial configuration mainly determined criteria of economic integration, not by the entity boundaries.

A crucial issue, to be dealt by the SME development strategy under elaboration, is related to the structure of the institutional framework. BiH should seriously consider the establishment of an SME Agency, at state level, following the model adopted by the majority of the other SEE countries. In terms of policy efficiency, a central SME agency, operating locally through the RDAs and integrating the SME agencies operating at entity level will make good sense, overcoming the current fragmentation in a number of uncoordinated initiatives. However, this development needs to pass through the integration of the existing institutions operating at entity and canton level into a new co-ordinated institutional framework, a move that requires wide-spread consensus and political will. The danger is to move towards the establishment of a state and donor supported SME Agency operating without any co-ordination with the SME agencies set up at entity level, the establishing therefore an additional institutional layer and increasing the risks of policy incoherence and inconsistency.

Over the next two years we will have a first indication if the RDAs if the newly established RDAs would have managed to become the main engine for local economic development absorbing and integrating the activity of the local entity based institutions,

or if the policy initiative would have remained with the existing institutions. Another critical factor will be the capacity of the RDAs to co-ordinate their activity and to contribute to the building of a common economic space. The international community, and in particular the EC and the OHR are bound to play a key role in the development of the RDAs. Their decisions on how to channel final resources and technical assistance for local development will have a major influence in determining the pace of economic integration.

The results of the focus groups clearly indicates that the business community, across the country, is very much in favour of greater integration, administrative simplification and the establishment of a levelled field for all enterprises. The costs of the complex administrative system and the open and hidden barrier to economic integration are by large not compensated by the preferential treatment and subsidies provided for certain types of enterprises at entity or district level. Those additional costs reduce the competitiveness of the BiH enterprises, just when the country is in the process of dismantling its trade barrier as a result of the process of European integration and the application of the Free Trade Agreements with the other SEE countries.

The business associations need to increase their policy advocacy role, particularly at this stage when the SME institutional and policy framework is under discussion. The BiH Association of Employers could play an important role on representing the independent voice of entrepreneurs.

As the progress is made on building a common economic space, a private-public table of consultation is much needed. The structure could reflect either that of the Social-Economic Councils set at entity level, but BiH should look also at the experience of the other SEE countries and the new EU member countries.

The elaboration of a Strategy for SME Development, within the framework of the PRSP, could provide a good base for launching a government led co-ordination process with the IFIs and the donor community. Again the decision over the institutional structure of the policy implementation network will be critical for securing donor support.

2. Implementation of the Rule of Law and the Regulatory Environment

The Situation in the Rule of Law and the Regulatory Environment

As noted in the previous EPPA report, the general legal and regulatory framework affecting the SME sector in BiH is complex and highly variable. This is the result of the uncoordinated interaction of at least four key levels (state BiH; the two entities and the district; and cantons in F BiH), all of which have their own powers and responsibilities. Furthermore, as many regulatory functions are the responsibility of *local government*, laws are often inconsistently and arbitrarily enforced. However some progress has been since the completion of the 2003 EPPA report.

Company Registration

There is no common registration procedure across the BiH, neither a state company register. Company registration is conducted for the moment according to procedures set at entity/district level. According to the report prepared by the government of BiH set for the European Charter for Small Enterprises in 2004, the time and costs needed to register a company in the Court Register/Chamber of Commerce vary according to the entity. On average it takes 20 days to complete company registration in the F BiH at the costs of €

500; 30 days on average in RS at the cost of € 800 and 15 days in the DB at the costs of € 700. The only common element is the requirement of a minimum capital of € 1.000. BiH had a target, set in 2003 under the EU Charter for Small Enterprises process, to reduce company registration time and process across the country to an average time of 20 days and a maximum cost of € 500 by September 2004.

The target has not been fully met. However, the BiH parliament approved in July 2004 a significant reform of the company registration system. The reform is the result of a technical assistance project supported by the UK government through DFID. The new state Law on Company Registration introduces a streamlined procedure aiming at reducing registration time at around 7-5 days. However the law does not regulate registration fees, which are still set by the courts and vary in the two entities and the DB.

The new process applies nationwide, and introduces standardized forms for use in FBiH, RS and BD.

The registers of enterprises will still be located in the courts, but with administrative officers handling the procedures instead of the judges, eliminating therefore the cause of possible delays and reducing the administrative burdens put on the judiciary system. The register will remain under the entity/district jurisdiction, however all the registers will share the same software and will be linked to each other on line with mutual access.

Courts registration will only be required for companies seeking to incorporate with legal person status. The application will be process through dedicated software, limiting the discretion powers of the court. Individual enterprises and unlimited partnership companies will continue to register through municipal offices, and their data will be integrated in the national data base of registered companies.

In order to became effective the two entities and the district of Brcko have to approve legislation in line with the state law on company registration. Entities have an obligation to procedure within 60 days from the publication of the Company Registration law on the Official gazette of the state of BiH. This procedure was not yet completed at the time of writing this report. The approval of the Company Registration Law was part of the measures to be approved in order to meet the conditions for the opening of the negotiations on the Association Agreement with the EU. The World Bank will monitor and support the implementation of the law through its Business Environment Adjustment Credit operation.

Licences, Permits and Certificates

The system for obtaining licences and permits remains overall complicated, due to the number of institutions and jurisdictions involved, with overlapping authority and not well defined competencies.

BiH exporters, for instance, face serious problems in obtaining quality certificates for their products and services. Quality standards have often not been updated and there is a lack of laboratory and certifying bodies. The EC is supporting the establishment of a BiH Standardisation Institute, operating according to EU practices. GTZ, USAID and SEED are supporting the introduction of quality certification in a number of industries. Customs procedures are complicated and opaque, often resulting in delays at border crossings and additional costs to businesses. CAFAO is engaged in improving customs services as well, to reduce costs and delays in obtaining licences and certificates required for the import and export process.

Inspections

SMEs still regularly complain about that inspections are conducted in an arbitrary way, they are too frequent and long lasting.

Several technical assistance programmes, supported by EC CARDS, the World Bank and SIDA are under way, with the purpose of streamlining the number of inspection bodies and making more transparent their operations. In particular the World Bank has recently completed an inventory of the inspection requirements and procedures at entity level, with the purpose of introducing a more transparent and efficient system by the end of 2004, including better training for inspectors and the introduction of a Code of Conduct.

Business Simplification

Several initiatives on business simplification have been launched in BiH over the last four years, but only recently companies have started to register some improvement.

The process started in 2002 with the preparation of a report by the Foreign Investment Advisory Services (FIAS, 2001) on administrative barriers to investment in BiH. The FIAS report led the BiH Council of Ministers and the Entity Governments to approve an *Action Plan on the Removal of Administrative Barriers for Investments* in 2002, but the follow up has been very limited.

The issue of administrative barriers was picked up in 2002 by OHR, that in consultation with local stakeholders, the IFIs and the donor community, launched the so “*Bulldozer Initiative*”, targeting a number of administrative barriers (including various licences, construction permits), identified with the contribution of stakeholders and donors. The approach of the OHR is to identify high priority, short-term actions that can have an immediate impact on the business environment. This initiative is stimulating interest in public/private partnerships in problem solving while providing a model for promoting priority reforms. It successfully completed the first two phases of regulatory framework improvement, each one involving the introduction of 50 simplification measures within 150 days, and it has started Phase III on July 2004, presenting 50 new measures that were forwarded to the Council of Ministers and Governments of Entities on 10 January 2005. The OHR has transferred the competencies for managing the Bulldozer Initiative to the BiH Employers Association in the beginning of November (officially on 14 December 2004).

A major obstacle is constituted by the obsolete land registration / cadastre system currently in place across BiH, being non-transparent, inaccurate, incomplete, and difficult to access. The result is that there is no certainty on property titles and a large number of property title disputes ends up in court. This situation often applies to real estate properties obtained by companies via the privatisation process or bought from privatised companies. Therefore banks are reluctant to accept real estate property as collateral, fearing property title disputes. GTZ and SIDA are actively supporting the reform of land the registration / cadastre system in BiH, but this is by nature a long term process. The project has developed a sound technical approach for the modernisation of the present Austrian system, which has barely evolved since the 19th century. Due to the declared policy of the previous regime to undermine private property and the impact of the Bosnian war, the cadastre has been poorly maintained and there is huge backlog of unregistered real estate transactions.

Disputes Resolution

BiH still has no efficient mechanism either inside or outside of court for dispute resolution and enforcement of contract obligations, which is a very important issue for SME sector. A number of organisations, such as, the World Bank, SEED, USAID, are providing technical assistance in this field, introducing mediation as an alternative to litigation to solve business disputes, improving court administration and strengthening enforcement procedures, through legal training of execution officers and appraisers. USAID, the Council of Europe are providing training and resource materials on civil procedure through the judicial training centres set up at entity level.

These are medium term programmes, but their impact on the business environment could be significant, particularly for improving access to credit for SMEs and reducing the level of arrears in the economy. One of the main obstacles is to their implementation is the traditional bias against creditors (including poor understanding of the time value of money) still present in the legislation and in court procedures (USAID, 2004,c).

Court System and Business Legislation

There has been some significant progress since the last EPPA report concerning the court system across BiH.

The court system has restructured, concentrating the activity on a smaller number of courts. Specialised commercial divisions are being established at 15 first instance courts in F BiH and RS.

Concerning business legislation, both entities enacted new Bankruptcy Laws and Laws on Enforcement Procedures. New Civil Procedure Codes are being introduced, bringing tighter timeframes for court decisions. These reforms are supported by the International Community, with USAID playing a leading role, through training programmes for judges, lawyers, trustees, focusing in particular on bankruptcy, liquidation and enforcement of commercial laws.

Bribery and corruption

Transparency International has covered BiH for the first time in its Corruption Perception Index 2003² Survey. Within 133 assessed countries BiH took 70th position with score 3.3.³ According to the BEEP Survey (2002), 22.4% of BiH small enterprises offer bribes frequently and the average bribe tax as a percentage of annual firm revenue amounts to 0.9%. A survey conducted by the Southeast European Legal Development Initiative (SELDI) in 2001 measured public attitudes toward corruption in each of the SPAI member states. In BiH, corruption was seen as the second most important problem after unemployment.

The Action Plan for the fight against corruption was prepared and adopted in 2004, and its completed implementation is planned for July 2005.

The Law on Money Laundering has recently been adopted, and according to the Action plan of the Council of Ministers of BiH for the prevention of money laundering, Money Laundering Prevention Unit was established in 2003.

Statistics

Although BiH Agency for Statistics was established in 2003 the system of harmonised statistics nationwide is not yet fully operating in practice. BiH Law on

Statistics was adopted in May 2004, and Entities Laws on Statistics were harmonized according to that state Law in meantime. Despite the existence of Statistical Agencies at BiH and entities/cantons level, there is a significant degree of inconsistency in the systems of business data collection and processing. The RS uses the former Yugoslavia methodology of data collection and processing, but in F BiH a modified model of EU statistical methodology is in use (only some part of collection and processing data, as e.g. public revenues and expenditures are complying with EU standards in F BiH). Both systems operate using outdated hardware and software, making the situation more complicated.

Data on SMEs are extremely poor. Firstly there is still a lack of a common definition of SMEs applied across BiH. In fact only the RS has introduced an SME definition for SMEs.

The RS considers micro-sized enterprises those with average annual number of employees less than 10, annual total turnover less than €200,000 and assets value less than €100,000. The criteria for Small-sized Enterprise are: 10-49 employees, €200,000-€10 million, €100,000-€5 million and Medium-sized Enterprise satisfy the following criteria: 50 – 250 employees, minimum €10 million, minimum €5 million, respectively. Preparations for harmonisation of these definitions with the latest EC definition of SMEs are in flux.

Currently no one can provide even approximate number of active SMEs in BiH, and not at all by their respective categories. All sources of data on SMEs (including Statistics offices, Tax administrations, AFIPs, Chambers of Commerce, Registration courts, Entities and Cantonal relevant ministries, Entities offices for development planning,) are inaccurate, not updated and give within themselves contradictory information. Even worse situation is regarding another basic data such as number and structure of employees, annual revenues, structure by sectors, amount of exported/imported goods and services, contribution to GDP, vital for SME policy elaboration.

However, the Department for Promotion and Development of Entrepreneurship under MOFET is promoting the introduction of Law on SME Statistics at state level (expected to be adopted in 2005), linked to the proposed Law on SMEs (also expected to be adopted in 2005), introducing a legal framework for the harmonisation of SME statistics collected at entity level.

According to the EU Charter for Small Enterprises 2003 BiH Report, there were about 30.000 registered SMEs (99.3% of all enterprises) in 2003, contributing to 36% to GDP and generating 63% of total employment.

Assessment

Entrepreneurs participating to the focus groups have expressed a high level of dissatisfaction towards the regulatory framework currently existing in BiH and the level of rule of law enforcement and they have been particularly vocal in their expressing their complaints during the focus group discussions. The overall rating (1.6 over 5) has not changed since the 2003 EPPA.

However, some progress has been achieved in these areas since the last EPPA report, but it is mostly confined to the introduction of new legislation (such as the company registration and the bankruptcy laws), passed at state level after a long gestation period, but still not implemented. The impact on the business environment has therefore been so far minimal, therefore the entrepreneurs' frustration. The action of the International

community has been instrumental in achieving the modest progress. Its support and lobby will be again essential for securing the full implementation of those reforms.

The approval of the new company registration at state level and of the related legislation at entity level has sent a positive signal to the business community, although the law falls short of introducing uniform conditions for company registration across BiH, as the setting of court fees is left to the entities. It should finally bring BiH, a laggard in this area, closer to international best practices and in line with the standards of other SEE countries.

Its implementation will be an important test of the willingness of the entities to share information, to value and support a common information tool and of reducing their claim over exclusive regulatory powers over local enterprises. Its implementation will also require the extensive training of registry personnel, lawyers, public notaries and a communication campaign to the business community, explaining the new procedures and the rights of entrepreneurs to demand a simple and speedy registration. It will also require a monitoring to ensure adoption and implementation and sort out inevitable teething problems.

Progress has been made also in reducing the administrative burden linked to the issue of licences and permits. In this area the Bulldozer Initiative, promoted by OHR, has significantly contributed to create the critical pressure to break resistance to reform and mobilise the necessary technical and financial resources.

Much remains to be done and it is important not to lose the momentum for reform generated over 2004 by a combination of factors, such as the fulfilment of the conditions for the opening of the negotiations with the EU over the Stability and association Agreement, the approval of the new PRSP and the implementation of the OHR Bulldozer Initiative.

Given the complexity of the institutional framework of BiH, the reform of the regulatory framework has to be conducted in parallel at state, entity and cantonal level. Inevitably progress is going to be patchy and legislative and procedural inconsistencies are going to arise. Already there are some positive cases of successful regulatory reforms introduced in Gradacac, Sarajevo-Centar municipalities, in the Brcko District and Tuzla Canton and a competition among local authorities to attract private investment through better regulations should be encouraged. Unfortunately approximately only half of the municipalities are currently benefiting of donor support and technical assistance programmes.

Beside major legislative reform, there is also a need to look at the administrative procedures, particularly for what concerns contract and law enforcement. Improved procedures and performance, including enhanced appraisal skills of appraisers and enforcement officers, are urgently needed, as enforcement officers are not properly empowered to seize and auction movable and immovable assets.

Currently most of the efforts are directed at improving the skills of judges, trustees and attorneys. But other professionals involved in the bankruptcy and enforcement actions are not required to have mandatory training. SMEs are very badly affected by the inability to enforce contract obligations, particularly towards the public administration and state companies, the largest source of arrears.

3. Implementation of Tax Policy for Small Businesses

The Situation on Taxation Policy for Smaller Businesses

Since the establishment of the state of BiH, tax policy and tax administration has been the largely conducted independently by the two entities (FBiH, RS) and the District of Brcko, without a mechanism for tax policy co-ordination and a high level of decentralisation. The results have been the establishment of a set of three parallel tax regimes, with discriminatory tax treatment according to the company location, a significant amount of double taxation affecting companies operating across the entity boundaries, the multiplication of taxes and tax compliance requirements and a high level of instability and uncertainty over the effective corporate tax regime.

However, since the previous 2003 EPPA report some noticeable progress has been registered. There has been a major reform in the area of indirect taxation, with the planned introduction of VAT on 1st January 2006, and the establishment of an Indirect Tax Administration (ITA), operating at state level and based in Banja Luka, supported by four regional centres in Banja Luka, Sarajevo, Tuzla and Mostar in charge of the administration of VAT, customs duties and excise taxes. There has been also a modest move towards tax administration simplification and tax policy harmonisation, although the double taxation issue has yet to be sorted out and corporate tax rates applied in the two entities and the DB vary considerably.

Direct Taxation:

- **Corporate Profit Tax:** 30% FBiH, 10% RS, 20% DB, paid monthly in advance (upon to tax office judiciary made on bases of net-profit made in previous year), various exemptions allowed.
- **Wage Tax:** 5%, 30% FBiH, on net salary (depending on category of income), 10% RS, 10% DB.
- **Payroll Tax:** 43,5% FBiH, on gross salary (pension fund, health fund, health solidarity, unemployment funds: FBiH, Canton), 42% RS on net wages (pensions and invalid insurance, health insurance, unemployment, child protection), 40-46% DB on net wages (depending on whether the employee is included in the RS or the FBiH funds).
- **Citizen Tax:** various types in Cantons of FBiH (e.g. Canton Sarajevo has 8)⁴, 23 various types in RS.
- **Personal income Tax:** 5% (applied to physical persons who have income above triple the canton's average annual salary).
- **Property tax:** Tax on the sale or transfer of property. Tax on income from property and property rights.

The International Community, in particular the IFIs (IMF and World Bank), the EC, with CAFAO, the US with the TAMP and GTZ, played a major role in promoting tax reform, working through the International Advisory Group for Taxation (IAG-T), led by representatives of the Office of the High Representative. A key priority of the International Community has been the introduction of uniform VAT tax rate and VAT

regime across all BiH, under the management of single administration, in order to strengthen the process of establishing a single economic space.

In the area of direct taxation, where there has been limited progress on reforms, the entities are currently evaluating the impact of a new corporate and income tax scheme, introduced already in Brcko District.

While there has been progress in reforming tax legislation, relatively little has been done to reform tax administration. In fact BiH has three separate tax administrations operating at entity/district level and its developing fourth one, operating at state level. Each administration has its own procedures, tax collection schedules and inspection systems. The system is even more complex for what concerns social security payments.

A company employing workers residents in different entities, districts and cantons has to make separate payments to the various local social security funds, which result in significant administrative burden. A similar regime of fractioned tax payments applied to sale tax. There is a general need to consolidate tax charges and rationalise tax payments.

Second obstacle for small companies is related to the issue of Taxpayer Certification. In both the RS and the FBiH, taxpayers are required to obtain separate “certification” from the tax authorities for each type of tax paid. This certificates are a requirement to complete a number of business transactions (e.g. to purchase of a vehicle a private enterprise must present a certificate of compliance with the tax authority). The information technology (IT) systems required to process this tax compliance certificates has been developed, with the support of the TAMP Programme, supported by the US, but the large backlog of applications and a poor tax payer data base are preventing its smooth application.

High social security contributions and a complex and inefficient tax administration are promoting tax evasion and the growth of the informal economy and the related effect of unfair competition.

Assessment

From a small business perspective, the main issues with the tax regime(s) currently in place in BiH are not so much related to the nominal tax rates, with the complexity of the tax system, the administrative burden and the inconsistencies between the different tax regimes applied across the countries, generating cases of double taxation.

Over the last two years BiH have received a significant amount of technical assistance, particularly from the EU’s Customs and Fiscal Assistance Office (CAFAO), USAID’s Tax Administration Modernization Project (TAMP), the World Bank and the IMF, directed at improving the tax regime, restructuring the tax administration and move toward a more co-ordinated and integrated tax policy.

However, progress with reform in the tax policy area has been very uneven. Over the last two years we have seen from one side a move towards the harmonisation of excise taxes and the introduction of unified customs duties, as part of the process towards the establishment of a common internal market. On the other side there, there has been no move towards harmonisation on corporate, wage taxes, social security contribution and personal income tax rates and regimes among the two entities and the District of Brcko. The existence of three different tax administrations continues to be a major obstacle towards the introduction of a unified tax regime.

Among the countries of South East Europe, BiH has at the same time the highest and the lowest corporate income tax rate (30% in F BiH and 10% in RS), opening the opportunity for major distortions.

The planned introduction of the VAT on 1st January 2006 has the potential to produce a major qualitative change in the tax administration system in BiH. Not only the introduction of VAT will remove the distorting effects of the sale tax and remaining cases of double taxation for companies operating in an entity different of its legal and tax domicile, but, for the first time it will be operated by a central tax administration set at state level and its application will be uniform across BiH.

It is extremely important that the small business sector is well informed and prepared for the VAT introduction and that the new regime does not result in an increase in the tax burden for the compliant enterprises. The experience of other transition countries shows that if properly administrative, the introduction of VAT may contribute significantly to the reduction of the informal economy, but in order to do so it is necessarily that the area of potential VAT evasion is reduced to a minimum and the value added chain is not broken by exemptions or discriminatory treatments applied by the tax administration, limiting the impact of unfair competition based on VAT evasion.

It is essential therefore that the large majority of the business sector fully understand the wider implications of the VAT introduction and develop a non confrontational relationship with the new indirect tax administration. This can be achieved by intensify the channels of consultation and communications with the business sector.

4. Implementation of Financial Instruments for Fostering Small Businesses

The Situation on Financial Instruments

The significant progress in financial sector reform including the amendments to the banking law in FBH, the new banking law in RS, as well as the entry of new foreign banks, have been reflected in increased confidence in the banking sector in the last two years. The banking system overall is quite developed relative to the rest of the region. With many foreign banks present in the country, competition is strong and banks are starting to offer an extended product range (credit cards, consumer loans, mortgages). However, the level of bank intermediation remains low, due to the slow privatisation and restructuring process in the rest of the economy. Small and medium-sized enterprises are still experiencing difficulties in accessing long term credit. The Enforcement Law which was adopted recently and the Law on Secured Transactions should improve the issue of collateral foreclosure provided that these laws are implemented effectively. Furthermore, despite the recent reorganisation of court system, there is a significant backlog of cases which might adversely effect enforcement for some time to come.

The number of banks in the country is still too large and further consolidation is ongoing and is likely to continue. Apart from a very small number of banks with a meaningful market share, relatively good operations and as yet without a strategic partner, the remaining banks are very small or have limited strategic value (and would hence be unlikely acquisition targets even in a more developed market). Stricter rules for inclusion in the deposit insurance scheme and higher minimum capital threshold, combined with enforcement of prudential rules should be used to speed up consolidation where there is not enough interest by strategic investors. Banks under administration without a clear future should be liquidated as soon as possible.

There are a number of banks which remain to be privatised (or, for those under administration, liquidated), although it is unclear if there is sufficient investor appetite to do so, based upon previous experience. The successful sale of Central Profit Banka, the third largest in the country, to a strategic investor is particularly important for the sector. Non-bank financial institutions are in their infancy. The leasing and insurance sectors in particular require development and improved regulatory frameworks. The EU supported the preparation of modern insurance legislation which was submitted to State and Entity Parliaments but is not yet enacted. The IFC-SEED programme co-ordinates the efforts of the international community to work on updating the leasing legal framework. The pension system is largely unreformed and a multi-pillar system with private pensions is not yet in place.

Development Bank

There is no development bank working in the whole of BiH. There are however two banks in the Federation of BiH: the Bank for Development and Reconstruction, Sarajevo and the Investment Bank of FBiH, Sarajevo, both of them active in SME lending.

Commercial Banks

As of the 31 December 2003, 37 banks have operated in BiH out of which 30 are private and 7 state-owned and 19 banks benefited from deposit insurance licence obtained by the Deposit Insurance Agency. Further consolidation of the sector occurred during 2004, and the number of banks covered by deposit insurance has risen to 21. In 2003, bank lending increased by 30% as compared to 2002. Loans to households increased by 37%, loans to private companies increased by 38%, while loans to public enterprises were reduced by 22%. Although the overall volume of lending to the private sector has increased, SMEs in Bosnia still face serious difficulties in accessing bank finance. Domestic credit to the private sector is in fact still low (36 per cent of GDP in 2002), although on a rising trend. Commercial banks lending to SMEs is mostly funded by targeted donors' and IFIs' credit lines.

The single most important factor that hindered the growth of bank credit to the enterprise sector was the inadequate secured transaction legal and regulatory system, among the worst in the region, compounded by an inefficient court system, making collateral foreclosure difficult. The legal framework for secured transactions has nevertheless substantially improved recently. A new regime for secured transactions (pledge) over movable property was adopted in 2004. The new regime is more flexible and market-oriented than before. In addition a serious effort of harmonisation between the two Entities and the District of Brčko has been made: the new Framework Pledge Law adopted in May 2004 applies to all parts of Bosnia and Herzegovina.

The law adopts a so-called "functional" approach to security, covering possessory (when the debtor must transfer the collateral to the creditor or a third party) and non-possessory pledges, liens, leases and other security rights. The law leaves great freedom to the parties to define the object of the security (specifically, generally, including pool of fluctuating assets) and also the secured debt (revolving loan, credit line, etc). The security interest is subject to registration in a centrally held register in order to be opposable to third parties and to determine the creditor's priority order. The register which is operated by the Ministry of Justice has started operated and is available electronically.

Increasing competition among banks stimulated by the entry of several foreign banks has led to a reduction of interest margins on SME loans. Nominal interest rates on commercial loans have decreased from an average annual rate of 20% (in 2002) to around 9.5%.⁵

MicroFinance

ProCredit Bank is the only microfinance bank present in BiH. It specialises in providing MSMEs and rural and urban households with suitable facilities for deposits, micro and housing loans, as well as payments services. As of December 2004, it had issued 34,246 loans of \$ 4,969 average since 1997 and only 0.53% of its portfolio was in arrears.

There are also a number of microfinance institutions (MFIs) providing micro-credit schemes to the micro sector and sole traders. The principal MFIs are: PARTNER – Tuzla, MI BOSPO – Tuzla, SUNRISE – Sarajevo, SINERGIJA PLUS - Banja Luka, LOK Micro – Sarajevo, REZ-FUND – Zenica, BENEFIT – Lukavica, EKI Mikro – Sarajevo, BOSVITA – Tuzla, MIKRA – Sarajevo, Micro ALDI – Gorazde, MICROFIN- Banja Luka, Micro WOMEN for WOMEN International – Sarajevo, MELAHA – Sarajevo, WORLD-VISION – Zenica, PRIZMA Mikro – Mostar, LINK Mostar. They are supported by the Association of Micro-Finance Institutions, which was established in 1999. The Association strives to improve the conditions and business environment faced by micro finance institutions through lobbying and networking. MFIs are regulated by a law which imposes limits on the amount of the first loan issued to a client (KM 5,000), total loan amounts to a single client (KM 30,000) and the maximum maturity of the loan (36 months).

The World Bank micro-credit project, which started in 1996, utilises local NGOs (established as non-profit micro-credit institutions) to provide finance to borrowers in rural areas and those living in poverty. In 8 years of existence it issued 150,000 loans with arrears under 1%. It is estimated that these loans supported over 200,000 jobs (USAID, 2004c). The average loan amount in this programme increased gradually with time. As the programme is to end in June 2005, only some of the NGOs participating will be able to survive, having reached a degree of commercialisation and financial sustainability which will allow them to borrow on commercial terms. In addition, consolidation of the sector has already started with merger of two institutions and the announced merger of 4 others. It is expected that within a timeframe of 5 years, up to 5 institutions only will exist as sustainable enterprises.

Amendments to the Law on MFIs were prepared but are currently on hold at the Ministry of Finance until amendments to the Law on banks are approved by relevant government bodies. It is likely that the approval will take place by the end 2005. Once the law is approved, these institutions will be established as legal entities, serving as financial companies that are able to take deposits and raise capital through debt (and equity offerings).

Credit Guarantee Schemes

USAID initiated a Loan Guarantee Program in 2003 through local lending institutions (UPI Bank Sarajevo, Volksbank BiH, and Zagrebacka BH Mostar) to make resources available for investments in SMEs that support development objectives. USAID provides the partner banks with a 50% guarantee on the loan principal extended under the terms of the agreements. The banks use their own funds and credit review process to fund and approve these loans to private enterprises in agricultural production and processing, wood processing, and tourism. The loan amounts qualifying for this guarantee range between US\$ 15,000 and US\$ 2,000,000. The banks have a 4-year period to use the guarantee, and the guarantee coverage will last for 7 years.

Kreditanstalt für Wiederaufbau (KfW), has issued guarantees to two banks (ProCredit Bank and Raiffeisen Bank) for a total of € 7.5 million to support loan extension to

enterprises in housing, reconstruction, and infrastructure and to start-ups. The total volume of extended loans under this guarantee programme is € 50.3 million but only € 10 million of which are loans to SMEs. The loan amounts qualifying for this guarantee range between KM 10,000 and KM 100,000.

The Investment Guarantee Agency (IGA) funded by the World Bank Group, is issuing 15-50% guarantees solely to export oriented businesses in BiH. Guarantees are issued with IGA's charge of 2.5% cost on annual basis, with an average € 250,000 guaranteed amount.

Two donor-funded Credit Guarantee Schemes have recently been introduced as a tool for support to SMEs development in:

- Mostar (funded by the Italian government, managed by "LINK"), supporting start-up enterprises;
- Brcko District (funded by UNDP), supporting start-up mainly agriculture producers.

A third Loan Guarantee Fund is currently being set up in Central BiH by the Cantonal governments, local municipalities and Business Associations.

No Mutual Credit Guarantee Schemes have been developed in BiH so far.

Other Non Bank Financial Instruments

Leasing is not yet an important form of financing for SMEs in BiH. Only few of the 40 commercial banks operating in BiH (e.g. Raiffeisen Bank, Pro-Credit Bank, etc.) provide leasing. Hypo Leasing holds approximately 60% of the market share, while VB Leasing, Raiffeisen Leasing, and Euroherc Leasing hold the remaining share. A small volume of leasing business was covered by HVB Leasing through cross-border transactions. The announced entry to the market of Unicredito Group Locat Leasing will bolster competition. Approximately 70% of all leasing transactions involve financing of vehicles, including private cars, commercial vehicles, and rolling machinery. Equipment and other machinery leases make up the remaining 30%. Approximately 70% of lessees are companies, and the remainder is private citizens.

As the BiH law on financial leasing is still being under consideration of the Council of Ministers, the sector is unregulated and unsupervised. The Bulldozer Committee Phase II is supporting the approval of the draft law prepared by SEED. GTZ and USAID have complemented this law with work to set up a Moveables and an Immoveables Pledge Registries, respectively.

The insurance industry, like leasing and other non-traditional financing alternatives, is in its infancy in BiH. Total premiums in the insurance market in 2002 amounted to KM 265 million. The 10 largest insurance companies in Bosnia hold 70% market share and most policies are written for auto and third party liability (USAID, 2004c). The insurance market in BiH is poorly regulated.

At the State-level, the Ministry of Finance and Treasury is in charge of the insurance sector. In the FBiH and RS, each Ministry of Finance oversees insurance, but with differences between them. In the Federation, the function of supervision is devolved by law to the Insurance Supervision Authority. In the RS, the Ministry of Finance is in charge of supervision.

The Law on Insurance Companies was adopted in May 2004, drafted by the European Commission. The law provides for insurance supervision in a single economic space and in line with the EU legal structure. It provides for the set up of a State-level insurance agency, responsible for ensuring congruency between entity supervisors, EU convergence, and conciliation of inter-entity supervision disputes.

The pension reform supported by the World Bank is progressing slowly. The primary mortgage market is growing while the relevant legal and institutional infrastructure is very underdeveloped. For this reason, when issuing mortgage loans banks demand loan guarantees in addition to security against the property. Stock exchanges opened in both Entities in 2002. The Sarajevo Stock Exchange has 485 listed companies and 11 privatisation investment funds with a market capitalisation of approximately USD 1.2 billion. The Banja Luka Stock Exchange has only three listed companies and 13 privatisation investment funds plus 642 on the free market list, with a market capitalisation of approximately USD 760 million⁶. Trading is primarily related to privatisation vouchers.

Assessment

Existence of secured financing environment to reduce the risks involved in advancing credit is seen as the single most important obstacle for SMEs to obtain access to external sources of finance. This has been achieved partially by the enactment of laws which define property rights (the Pledge Law) and registration of such property rights. The Law on Obligations, however, is still to be adopted. The judiciary process to resolve disputes and enforce rights remains the main weakness of the system. There is also a gap in planned training and resources for judges and execution officers.

Priority in bankruptcy reform is more practical than legislative. Sufficient laws are in place for a reasonable level of legal certainty, although additional legislative changes are needed.

Banks have been operating in both Entities through their branches opened with no need for additional registration in the opposite entity. However, banking supervision is still at the Entity level and a genuine Single Economic Space for the provision of bank services is not yet in place. A law to consolidate bank supervision at the state level is before parliament at present, and approval is expected before the end of 2005.

The system for land and real estate management must be improved. A State Law on Restitution needs to be adopted and land books and the cadastre need to be integrated. The land registration system needs to be harmonised. Without these developments it will be very difficult for SMEs to use real estate as collateral in their loan applications, or for start-ups to obtain mortgage loans in order to secure initial capital for their business.

Incentives to stimulate the growth of long-term savings need to be developed. Commercial banks in BiH are hindered in their lending activity by a clear mismatch between the maturity of their loans and deposits. In clear violation of liquidity regulations of the entity banking agencies (banks are under the obligation to cover credits with maturities of up to 90 days in full) some banks finance their loan activity frequently with increased foreign borrowing. Deposits are in fact not growing at the pace necessary for banks to meet the current level of demand for loans. In order to stimulate long-term deposits growth incentives could be provided such as: repayment of old frozen currency deposits (consistent with the recent domestic debt settlement laws), strengthening the deposit insurance system, introducing new savings instruments.

The draft state Leasing Law and the draft state Law on Obligations will be - when approved and implemented - a big advancement towards use of lease finance as an alternative source of external finance for SMEs. Until now the few banks that have initiated some form of leasing activity have done so on the basis of the interpretation of entity laws on obligation. However because of the absence of a proper legal framework leasing has not developed to its full potential. Entity laws on leasing will then also need to be mutually harmonised. Regarding insurance market it can be assessed that BiH has a significant space to develop property & casualty and life insurance.⁷ Life insurance, in particular, will be a prerequisite for pension reform which needs to be addressed at all levels of BiH.

5. The Situation on Advisory Services

The 2003 EPPA reported that there were about 40 business centres and service agencies, primarily providing support and services to the SME sector, in operation in BiH, the majority of them donor supported. The number of advisory units has continued to expand, notably with the establishment of a new Business Service Centre by the Government of Zenica-Doboj Canton, the creation of Business Centres within the 14 municipal business associations formed by CHF in Central BiH and the setting up of Business Development Department or Units within the newly established Regional Development Agencies.

Much of donor effort is directed to support projects developed in co-operation with local authorities, aiming at creating a partnership between the public sector, the enterprises and the local community around a set of agreed local development priorities.

Most of these local advisory centres provide services and sometimes financial support for start ups, for re-starting of agricultural production, for the integration of returnees and job creation. Many of the donor sponsored centres aim at operating as a sort of one-stop shops, delivering all locally administered licenses and permits, on top of basic business information.

In addition there are several specific small scale projects, mainly micro business development, focusing on targeted groups: youth, women, small scale agriculture farms.

There is instead limited public assistance for SME outside that provided by local business centres. At state level, given the absence of a state SME Agency and of a state SME strategy, there is no specific institution in charge of promoting and co-ordinating the provision of basic advisory services, particularly to enterprises operating beyond the entity and district boundaries. The Foreign Investment Promotion Agency (FIPA) is the only state supported service agency operating through the country, but its main mandate is to assist foreign investors and does not specifically focus on SMEs. In spite of the significant efforts of the donor community and the local administration, there is still a significant gap in the provision of basic business information and advisory services, a gap that the newly established Regional development agencies may contribute to fill.

On the side of the provision of private consultative services, there has been recently some noticeable progress, with the establishment of LESP.net, a coordinating association of local consultants. LESP may become a vehicle for introducing minimum standards on consultative services and to provide on-going training to private consultants, while at present its efforts are limited to the development of an ethical code for consultants.

Donors have set a wide range of interventions to develop the supply of professional advisory services for SMEs. Many donor programs focus on promoting demand side for consultancy services. DFID, EU, USAID, GTZ, SIDA and SEED have launched projects providing consultancy support to individual businesses, recently privatized enterprises and selected industrial sectors.

These projects use consultants to upgrade management, marketing and quality control of local companies, in addition to the elaboration of business and investments plans. However, the sustainability of those projects, once donor funding ends, remains an open question. SEED has devised a scheme where the local consultancy component is paid at full local cost by the local enterprise, while the international consultancy costs meet by the SEED. Other donor organisations have started with the provision of free consulting services, moving progressively towards charging enterprises for the local costs of these interventions.

Assessment

BiH continues to benefit from a very significant volume of assistance for the provision of business advisory services. Since the publication of the 2003 EPPA report there has been a further expansion of the number of business centres and service agencies in operations and a move towards quality improvement.

Entrepreneurs participant to the focus groups have taken notice of this trend. The average rating for advisory service has recorded a marginal improvement compared with the 2003 score, but a significant number of focus group participants (39%) have indicated that the situation has improved compared with 2003, while a very small minority has reported a worsening of the situation.

Most business entrepreneurs have indicated that they broadly satisfied with the private consultants, although they would appreciate the introduction of a system of certification, while they are still critical with the performance of the publicly/donor supported business centres. In fact, there is a need to further improve the capacity and the skill level of the staff of those centres, with investments in human resources, IT equipment and external advisory support.

For what concerns the publicly support business advisory centres three issues remain open:

- The first one concerns the medium term sustainability of those operations, currently largely supported by donors. Local administration should progressively taking charge of the operating costs, supplementing the budget, where it is possible, with direct charges to the enterprises for specialised services.
- The second one concerns the regional coverage. Local initiatives are very positive and should be further encouraged, however, at the same time BiH will benefit from the introduction of a mechanism of co-ordination of donor sponsored projects, in order to provide a good regional spreading, and an independent system of project evaluation and exchange of experience. Currently co-ordination is donor based and project monitoring is conducted directly by the sponsoring donor organisation. The elaboration of an SME development strategy at state level and possibly the establishment of national SME agency could contribute to local capacity building and better co-ordination.
- The third issue concerns the range of services provided. It makes sense that local publicly/donor supported business centre concentrate on the provision of basic

business services and the assistance of targeted groups of small entrepreneurs, leaving to private consultants the provision of more specialised services. However, there is a need to improve the availability of basic services to the whole enterprise sector, particularly for what concerns technical standards, quality certification, foreign markets information. These services can better provided by business agencies based at regional level. The newly established Regional Development Agencies could play an important role in this area, working in close co-operation with specialised state agencies. The RDAs could also work, in co-operation with LESP and the professional associations to establish and implement a common system of certification of local consultants.

6. Implementation of Business Incubators

The Situation on Business Incubators

Currently there are seven active Business Incubators in BiH. The first three formed are based in: Gradacac (established in 1998), Modrica-Tarevci (formed in 2002 and in operation since 2003) and Mostar (formed in 2003 and dedicated to SMEs operating in the service sector), while in the last EPPA report just one incubator was in operation.

Two additional projects have been approved by the EC Quick Impact Facilities 2, and were established in Zenica and Zepce, re-converting existing industrial buildings. A further business incubators were established until the end of 2004: in Lipnica near Tuzla and agriculture business incubator in Topola in RS. As a total, there are now seven operating BI in BiH.

Projects have been made for the establishments of business incubators in Sarajevo, Bugojno, Prijedor (the Sarajevo BI will be dedicated to the Information Communication Technology sector).

The performance of existing incubators was assessed as satisfactory, particularly by the participants of the focus group held in Mostar. Anyhow, it is still early to make considerable assessments regarding general BI performance in BiH due to a fact that 5 of total 7 were formed in last 2 years.

All these initiative are locally or/and donor supported. At state level, there is still a lack of policy with respect to Business Incubators.

The responsibility for project implementation is unclear. The mobilisation of resources is done ad hoc and the there no there is effective co-ordination concerning the standards applied to the various incubators the quality of the service offered and their sustainability over the medium term

Assessment

With the spreading of new initiatives, entrepreneurs have started to develop an interest towards business incubators. The results of the focus group discussions indicate that entrepreneurs consider the business incubators as a valuable tool to support start up, particularly in the ICT sector.

This views conflict will the lack of strategy and policy towards business incubators both at state and entity level. The initiative is left to the donor community and the local administrations. The establishment of business incubator should be considered within the framework of regional and local development plans. There should be a mechanism to

promote the exchange of experiences, taking into account the lesson learned from the incubators already in operations in BiH and abroad and the provision of a technical assistance facility to the economic departments of the cantons and the municipalities to prepare new projects, through the re-conversion of vacant industrial buildings and former military camps.

7. Implementation of Entrepreneurship, Vocational Education, Access to Technology

The Situation on Implementation of Entrepreneurship, Vocational Education, Access to Technology

Entrepreneurship

The current education system in BiH is not significantly contributing to the creation of an entrepreneurial spirit.

There are no common educational curricula in BiH, as they are set at entity and canton level. A state Law on High Education is currently in Parliament, but its approval process is progressing very slowly.

Entrepreneurship courses are currently conducted in secondary schools in the FBiH (Croatian Curriculum), as well as in RS (starting from the 2004/5 school year, while in the District of Brcko entrepreneurship is included only secondary economics school curriculum. Entrepreneurship courses are also conducted in vocational schools in the F BiH and RS.

At tertiary level, entrepreneurship and business subjects are taught in the RS at the Economics Faculties, at BA and MBA level and at a number of technical faculties (mechanical engineering, metallurgy, technology, geology and mining, agriculture, veterinary, forestry, bio-technology). However, there are no programmes for conducting practical stages with private companies, business incubators and technological parks. In the District of Brcko Entrepreneurship is included in curriculum of the Business and Management courses conducted by the Economics Faculty. There no similar courses in the F BiH.

Vocational Education

There is not common curriculum of Vocational Education at state and entity level. There are actually 4 curriculum at entity level (RS, DB and 2 in FBiH: Croat and Bosnian) with, in addition, slight differences within cantonal curriculum in FBiH.

As in the other dimensions of SME policy, the donor community is supporting several programmes related to vocational education. The EC, through the EU VET Programme, is supporting vocational school reform, promoting the merger and restructuring of a number of vocational courses and the updating of the curricula. The EC is also planning to increase its support to adult training, using the vocational schools to provide part-time courses for adults outside school hours.

Active in this area are also Norway (which is sponsoring entrepreneurship training in a number of vocational education schools), the Open Society Foundation (sponsoring a pilot Entrepreneurship training program in secondary schools), Switzerland (sponsoring

the development and equipment of three training workshops with Employment Bureau covering IT, metal working and building construction).

A number of donors⁸ launched programs to improve operation of local employment offices, assisting them to develop active labour market policies in addition to their social assistance role. These focused on linking SME job vacancies with suitable unemployed people and developing training programs to help the unemployed acquire marketable skills. Anyhow, entrepreneurs EPPA 2004 participants complained Employment Bureau services quality.

In addition, a number of donor projects on the IT training, mainly targeted to company managers and university students, i.e. USAID sponsored a curriculum development for university accounting departments, training of the first 1000 students and 800 practicing accountants & bookkeepers, the Soros Foundation helped the Economics Faculty at the University of Sarajevo to create the Center for Management and Information Technologies (MIT) Centre.

SEED is working on both the supply and demand sides of SME training and education. Work with business associations, municipalities, large company supply chains, and others has helped SEED to identify SMEs training needs and introduces tailor-made courses, in partnership with local educational and consulting companies. GTZ is conducting training courses for entrepreneurs as part of its programme to encourage the development of SMEs in Northern BiH.

At higher level there are programs that have been developed to create graduate and post graduate development of management skills for the next generation of managers. The most significant is the establishment of new business school in Sarajevo for the entire SEE Region. The School, supported by USAID, will offer MBA courses in co-operation with the University of Delaware.

Access to technology

At the moment, there are not active government policies to encourage access to technology for SMEs, either at state or entity level, while the basic legislative framework to support the introduction and the development of new technologies is not yet in place. At state level, the Law on the establishment of BiH Measurement Institute, the Law on establishment of BiH Standardization Institute and Law on establishment of Intellectual Property Institute have been approved by BiH Parliament. The BiH Standardization Institute and BiH Intellectual Property Institute were established on the end of 2004.

Technology Parks

There is only one technology park, in operations in BiH, recently established in Banja Luka. However, there are plans and negotiations to establish a second BiH technology park in Zenica, making use of the infrastructure and the technical skills of the “Kemal Kapetanovic” (metallurgy institute) and the Faculties of Metallurgy and Machinery in Zenica. This institute was a distinguished scientific research institute, linked to the steel factory in Zenica (the biggest in the former Yugoslav Republic).

Access to On-Line Services

The use of internet for Business to Business transactions and for the dissemination of information the enterprise sector by the public administration is still very limited, hampered by the high costs of internet connection, the limited number of service providers and the

existence of three separate telecommunications networks. The two entities and the District of Brcko have set up web sites containing information on legislations, regulations and government tenders. However, the provision of services on line (such as the submission of tax forms, permit and licence application, etc) is not yet possible.

Assessment

Entrepreneurs participating noted that the general public still retains a largely negative image of private entrepreneurs, but the situation is improving. Entrepreneurs gave also poor ratings to government policies conducted both at entity and state to promote entrepreneurship, training of entrepreneurs, vocational education and access to technology.

As in other areas of enterprise policy, the lack of a strategy covering the whole territory of BiH and of coordinating institutions at state level, have created a situation where most initiatives are locally based, with a lack of consistency, interaction and integration among the various programmes.

This is particularly evident of entrepreneurship education at tertiary level, where there F BiH is moving behind the RS and the District of Brcko, particularly at the tertiary education level.

BiH needs a restructured vocational training system, able to provide courses both young students as well as to provide professional training for workers, made redundant by the on going process of industrial restructuring, and for returning refugees. The vocational training system must take into accounts the requests coming from the labour markets, receiving inputs from the private business associations, and must include training stage with private companies. Many of the participants to the focus groups have signalling problems in recruiting staff with the requested qualifications.

The building blocks for effective management training are largely in existence, with the introduction of MBA courses, short course programs and a growing number of trained local management trainers, thanks to the support of the international community. One of the future challenges will be to establish effective links between the universities, business schools, the business community and the local administration. Those higher education institutions may act as an agent for change and promote industrial restructuring and the technical innovation.

8. Report on the implementation of the 2003 EPPA Policy Recommendations

In this section we assess progress in implementing the 2003 EPPA recommendations:

EPPA 2003 Recommendations on the Institutional Framework	Progress since EPPA 2003⁹
<p><i>Policy Co-ordination</i></p> <ul style="list-style-type: none"> • Co-ordinate SME policy and strategy at state level. 	Limited Progress
<p><i>Consultation</i></p> <ul style="list-style-type: none"> • Initiate regular and effective two-way dialogue between the Government and the business community. 	Limited Progress
<p><i>Single Economic Space</i></p> <ul style="list-style-type: none"> • Create a single economic space as soon as practical. 	Significant Progress
<p><i>Co-ordination of Enterprise Initiatives</i></p> <ul style="list-style-type: none"> • Co-ordinate SME projects and initiatives at the international institution/donor level. 	Limited Progress
<p><i>Definitions and statistics</i></p> <ul style="list-style-type: none"> • Create a consistent definition of SMEs, consistent with the EC definition, applicable to all levels and for all areas, including taxation and statistics. • Co-operate with the State Statistics and relevant Ministries in order to systematically collect statistical information on the SME sector, with the aim of analysing the underlying trends and determining appropriate policy responses. 	No Progress
<p><i>SME Representative Bodies</i></p> <ul style="list-style-type: none"> • Create an Advisory Council for SMEs (ACSME) at state level to enable it to become a regular forum for communication and consultation with a wide range of SME stakeholders. 	No Progress
<ul style="list-style-type: none"> • Evaluate the need for the extensive network of Chambers of Commerce. The evaluation should cover their role and services offered, as well as the introduction of voluntary membership, as in other SEE countries such as Romania. 	Limited Progress

<p>EPPA 2003 Recommendations on the rule of Law and the Regulatory Environment</p> <p><i>Registration, De-registration, Re-registration</i></p> <ul style="list-style-type: none"> • Implement an electronic company registration system in Courts covering the whole country. • Introduce a single code number for each enterprise, in order to save time and costs to entrepreneurs submitting the same basic information to different bodies. • Evaluate, simplify and publish the regulatory regimes that affect the setting-up phase of businesses. The same applies to procedures for re-registering and terminating enterprises. Work towards reducing the time and cost associated with entry and exit. • Move towards the creation of a “One-Stop-Shop” system throughout the country, as in the case of other SEE countries such as Romania (see OECD-EBRD, 2002). <p><i>Regulations</i></p> <ul style="list-style-type: none"> • Prepare a list of improvements to further reduce and standardise the procedures for SMEs in obtaining licenses, permits and certificates and to set predetermined short time scales for each procedure. • Take steps to ensure a greater focus on a “proactive” and “enabling” approach by introducing the principle of “silence is consent” as soon as practical (“silence is consent” meaning where the relevant public body fails to answer within a prescribed period, it will be deemed that consent has been given). <p><i>Communication with SME Stakeholders</i></p> <ul style="list-style-type: none"> • Give an undertaking that SME stakeholders will be consulted on legislation and regulations affecting small businesses before proposals are converted into law. • Build effective co-operation between the key SME stakeholders and disseminate information through web sites and forums to ensure that SMEs are aware of the latest developments and can provide feedback. <p><i>Other Areas for Consideration</i></p> <ul style="list-style-type: none"> • Allow for quick resolution of commercial disputes through ‘out of court settlements’. 	<p>Progress since EPPA 2003</p> <p>Limited Progress</p> <p>Significant Progress</p> <p>Significant Progress</p> <p>Limited Progress</p> <p>Limited Progress</p> <p>Limited Progress</p> <p>Limited Progress</p> <p>Limited Progress</p>
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<p style="text-align: center;">EPPA 2003 Recommendations on Tax Policy for Small Businesses</p> <p><i>Policy Principles</i> The Ministries of Finance in the entities, in co-operation with OHR and the international donor community, to work together to ensure that:</p> <ul style="list-style-type: none"> • Simplicity, stability and clarity are achieved in tax policy. • Fiscal administration is made more sensitive to the needs of the SME sector. • Tax laws and regulations are consistently and fairly enforced. • SMEs are able to obtain regular, simple and up-to-date information explaining the tax system to increase the levels of transparency. <p><i>VAT</i></p> <ul style="list-style-type: none"> • Introduce VAT at state level as soon as practical (planned for 1st January 2006). • Set the VAT refund period at the international standard of one-month. <p><i>Grey Economy</i></p> <ul style="list-style-type: none"> • Widen the tax base as an important means of fighting tax evasion and supporting the integration with the financial system. • Strengthen efforts to collect tax arrears, regardless of firm size. 	<p style="text-align: center;"><i>Progress since EPPA 2003</i></p> <p style="text-align: center;">Limited Progress</p> <p style="text-align: center;">Limited Progress</p> <p style="text-align: center;">N/A</p> <p style="text-align: center;">Limited Progress</p> <p style="text-align: center;">Limited Progress</p>
<p style="text-align: center;">EPPA 2003 Recommendations on Financial Instruments for Fostering New and Small Businesses</p> <p><i>Promote a healthy banking system</i></p> <ul style="list-style-type: none"> • Encourage restructuring/recapitalisation of banks and stimulate consolidation. <p><i>Deepen bank intermediation</i></p> <ul style="list-style-type: none"> • Push ahead with legal and judicial reforms. Despite the large number of banks in BiH, banking intermediation remains low. • Use start-up microfinance banks and EBRD-related banks as role models for the rest of the system. Promote the broadening of products offered by the banks to increase intermediation. Encourage banks to be more prudent regarding mis-matches of start-up companies and to seek additional long-term financing sources such as long term loans for SMEs. 	<p style="text-align: center;"><i>Progress since EPPA 2003</i></p> <p style="text-align: center;">Limited progress</p> <p style="text-align: center;">Limited progress</p> <p style="text-align: center;">Limited progress</p>

<p>EPPA 2003 Recommendations on Advisory Services Supplied to New and Small Businesses</p> <p><i>Long-Term Development</i></p> <ul style="list-style-type: none"> • Prioritise the support to SMEs through national policy by focusing on subsidised business support services, especially targeting start-ups. <p><i>Co-ordination of International Support</i></p> <ul style="list-style-type: none"> • Review the numerous existing and future enterprise development initiatives. Building on recent initiatives, ensure co-ordination of initiatives to increase the scope for financial sustainability. <p><i>Quality Standards</i></p> <ul style="list-style-type: none"> • Evaluate the possibility of creating a representative body for business advisories and consultants as a way of strengthening support and services, as well as ensuring co-ordination of activity for the benefit of the enterprises. • Introduce of a system of certification and accreditation of advisory bodies to set quality standards and improve confidence in the benefits of services. A credible representative body should carry out the certification and accreditation. 	<p>Progress since EPPA 2003</p> <p>No Progress</p> <p>Limited Progress</p> <p>Limited Progress</p> <p>No Progress</p>
<p>EPPA 2003 Recommendations on the Implementation of Business Incubators</p> <p><i>National Policy</i></p> <ul style="list-style-type: none"> • Develop a policy with respect to business incubators in BiH, including responsibility for implementation and securing commensurate national and international resources in order to promote business incubators effectively. • Disseminate information and promote the role of business incubators to BiH entrepreneurs with departments and ministries of economy, as well as leaders of business associations, such as Chambers of Commerce and others. • Develop training and education programmes for business incubator managers in order to ensure greater compliance with best practice in transition and OECD member countries. • Evaluate the possibility of using business incubators to support the agribusiness and high-tech sectors. • Evaluate effectiveness and financial sustainability of small business incubators of less than 2.000 m². 	<p>Progress since EPPA 2003</p> <p>No Progress</p> <p>No Progress</p> <p>No Progress</p> <p>Limited Progress</p> <p>No Progress</p>

Notes

- 1 The division has four departments: Dept. for Economic Development, Dept. for Project Preparation and Coordination, Dept. for Cooperation with international institutions, Dept. for Development and Entrepreneurship Promotion.
- 2 CPI 2003 Score relates to perceptions of the degree of corruption as seen by business people, academics and risk analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).
- 3 Source: <http://www.transparency.org/cpi/index.html#cpi>.
- 4 Property tax. Tax on income from property and property rights. Tax on income from copyrights, patents, and technical innovations. Profit tax for individuals. Tax on gifts and inheritances. Tax on gambling winnings. Tax on income from agricultural activities. Income tax of physical persons (individuals). Tax on consumption of alcohol and soft drinks for catering/restaurants.
- 5 Source: Central Bank of BiH, Monthly Bulletin, Year 7, Issue No 4, April 2004, page 1.
- 6 Data from the World Bank Report on Observance of Standards and Codes (ROSC) – Bosnia and Herzegovina – Accounting and Auditing – October 19, 2004
- 7 Most of the products offered today are in auto liability.
- 8 World Bank (Social adjustment & Technical adjustment credits) GTZ, SIDA, DFID, EU VET, EU QIF, Open Society Foundation
- 9 Recommendation implemented *i.e.* law / policy approved and implemented, effective strategy approved and being implemented efficiently or agency fully operational and achieving results on the ground; Significant progress *i.e.* law / policy approved, preparatory work for implementation completed and progress made on the ground; Limited progress *i.e.* some preparatory work done, legislation drafted or agency beginning implementation; No progress *i.e.* no progress since last EPPA

Annex I

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Annex II

Web Sites

Agency for Intermediary, Informatics and Financial Services of RS - <http://www.apif.net/>
Agency for Privatisation of Federation BiH - <http://www.apf.com.ba/>
Agency for Statistics of BiH - <http://www.bhas.ba>
Audit of the Institutions of BiH - <http://www.revizija.gov.ba/>
Brcko District Development Agency - <http://www.rabd.org/>
Country Watch - <http://www.countrywatch.com/>
Business Rating 500 the Republika Srpska - <http://www.rejting.com/>
Canton Herceg-Bosnia - <http://www.hbzup.com/>
CARE - Quick Impact Facility - <http://www.qif.ba/>
Central Bank of Bosnia and Herzegovina - <http://www.cbbh.ba/>
Chamber of Commerce of Canton Sarajevo - <http://www.pksa.com.ba/>
Chamber of Commerce of the Federation of BiH - <http://www.kfbih.com/>
Chamber of Commerce of Canton Una-Sana - <http://www.pkusk.com.ba/>
Chamber of Commerce of Canton Zenica-Doboj - <http://www.pkzedo.com.ba/>
CIA World Factbook on Bosnia - <http://www.cia.gov/>
CIPE - Center for International Private Enterprise - <http://www.cipe.org/>
EC - European Commission - <http://www.europa.eu.int/comm/>
EBRD - European Bank for Reconstruction and Development - <http://www.ebrd.com/>
EURED - European Union Regional Development Program for BiH – <http://www.eured-bih.org/>
Federation BiH Institute for Statistics - <http://www.fzs.ba/>
FIPA – Foreign Investment Promotion Agency of BiH - <http://www.fipa.gov.ba/>
Foundation for sustainable Development of the Federation of BiH - <http://www.odraz.ba/>
Forum on Corporate Governance - www.korporativno-upravljanje.ba/
Fund for Development and employment of RS - <http://www.rsdef.org/>
Government of Canton Sarajevo - <http://www.ks.gov.ba/>
Government of Canton Tuzla - <http://www.vladatk.kim.ba/>

Government of the Federation of Bosnia and Herzegovina - <http://www.fbihvlada.gov.ba/>

Government of RS - <http://www.vladars.net/>

IFC - International Finance Corporation - <http://www.ifc.org/>

IMF - International Monetary Fund - <http://www.imf.org/>

IMG - International Management Group - <http://www.img.ba/>

International Crisis Group - <http://www.intl-crisis-group.org/> - <http://www.crisisweb.org/>

KfW - Kreditanstalt für Wiederaufbau - <http://www.kfw.com/>

MIGA - Multilateral Investment Guarantee Agency <http://www.worldbank.org/>

Ministry of Agriculture, Water Management and Forestry of F BiH - <http://www.fmpvs.gov.ba/>

Ministry of Agriculture of Canton Una-Sana - <http://www.poljoprivredausk.co.ba/>

Ministry of Economy of Canton Zenica-Doboj - <http://www.minpzdk.gov.ba/>

Directorate of European Integration - <http://www.mei.gov.ba/>

Ministry of Finance of F BiH - <http://www.fmf.gov.ba/>

Ministry of Foreign Affairs of BiH - <http://www.mvp.gov.ba/>

Ministry of Justice of F BiH - <http://www.pris.gov.ba/>

Ministry of the Liberation War Veterans and Disabled Veterans Issues of F BiH - <http://www.fmbi.gov.ba/>

Ministry of Social Affairs, Displaced Persons and Refugees of F BiH - <http://www.fmsa.gov.ba/>

Ministry of Transport and Communications of F BiH - <http://www.fmpik.gov.ba/>

OECD - Organisation for Economic Co-operation and Development - <http://www.oecd.org/>

Office for Budget Audit Bank of the Federation of BiH - <http://www.saif.ba/>

OHR - Office of the High Representative - <http://www.ohr.int/>

Parliament of the Federation of BiH - <http://www.parlamentfbih.gov.ba/>

Privatisation Agency of RS - <http://www.rsprivatizacija.com/>

Republika Srpska Institute for Statistics - <http://www.rzs.rs.ba/>

Securities Commission of the F BiH - <http://www.komvp.gov.ba/>

SEED - Southeast Europe Enterprise Development - <http://www.ifc.org/seed/>

SEED - Southeast Europe Business Network - <http://www.seebiz.net/>

The Chamber of Foreign Trade of Bosnia and Herzegovina - <http://www.komorabih.com/>

The Council of Ministries of BiH “Poverty Reduction Strategy in BiH” - <http://www.prsp.info/>

The Registry of securities of the Federation of Bosnia and Herzegovina - <http://www.rvp.ba/>

The Chamber of Commerce and Industry of RS - <http://www.pkrs.inecco.net/>

The Chamber of Commerce and Industry of Banja Luka Region - <http://www.komorabl.inecco.net/>

Transparency International BiH- <http://www.ti-bih.org/>

United Nations Mission in BiH - <http://www.unmbih.org/>

UNIDO - United Nations Industrial Development Organisation - <http://www.unido.org/>

UNDP - United Nations Development programme, Resident Mission BiH - <http://www.undp.ba/>

USAID - United States Agency for International Development - <http://www.usaid.ba/>,

USAID BF- USAID Business Finance - <http://www.usaidbf.ba/>

World Bank - <http://www.worldbank.org/>; Resident Mission BiH - <http://www.worldbank.ba/>

World Bank data - <http://dev.data.worldbank.org/>

World Bank Governance and Anti-Corruption - <http://www.worldbank.org/wbi/governance/>

Annex III

EPPA Methodology

I. The EPPA methodology has been designed to provide insights and assessments of the performance in the *implementation* of policies to improve the investment environment for business. The EPPAs have been conducted on a standard basis in all countries of the region and provide a benchmark for (a) highlighting key reform issues (b) measuring private sector insights and assessments of the business environment (c) assessing progress on a country by country basis and (d) comparative cross-country review for the SEE region.

II. The main components of the EPPA undertaken in BiH are as follows:

- A question template was derived from extensive case study work on good practice in transition economies and OECD country experience (OECD-UNIDO, 1999), and used in the research across all the SEE countries. The questionnaire introduced for the previous EPPA edition has been partly modified in 2004, in order to clarify some of the questions and to assure greater integration with the dimensions covered by the EU Charter for Small Enterprises. However, care has been taken to retain a high degree of comparability in the focus group ratings emerging from the 2003 and 2004 questionnaire.
- Country-based experts/consultants were selected for their enterprise policy knowledge and experience.
- Focus group discussions were held with SME representatives.
- Individual SME interviews were undertaken to validate the focus group research and to provide insights on key issues.
- Expert interviews were conducted to cross reference information from the focus groups and contribute to views.
- Desk research involving examination of existing reports, databases, documents, etc. was carried out.
- Expertise was provided from OECD, EBRD and experts from OECD countries.

III. Under the guidance of OECD, the focus group research with the private sector in BiH was carried out by local consultants, *Business Development Centres in Zenica and Banja Luka*, based on a structured brief and the template of questions developed by OECD and EBRD. The desk research commenced in March 2004 and other focus group research and interviews extended in April and May 2004. It focused on seven dimensions of good practice in the following policy areas:

- The Institutional Framework for SME policy.
- Rule of Law and the Regulatory Environment.
- Tax Policy for Small Businesses.
- Financial Instruments for Fostering New and Small Businesses.
- Advisory Services Supplied to New and Small Businesses.
- The Implementation of Business Incubators.
- Entrepreneurship, Vocational Education, Access to Technology.

IV. Five focus group discussions took place to reflect the structure of BiH. The first was in Zenica, involving participants from the economically less dynamic area of Central BiH region. The second was in Tuzla attended by participants from North-east region of BiH. The third took place in the capital city of the State and Federation of BiH, Sarajevo attended by participants from Sarajevo Macroeconomic Region. The fourth was held in Mostar, attended by participants from the less economically dynamic area of Herzegovina region. The last focus group took place in capital city of RS Banja Luka, involving participants from the economically dynamic area of North-west BiH region. In all, 49 entrepreneurs took part in the discussions covering the following sectors of activity: agriculture, manufacturing, services, trade, tourism, building and transport. The participants included representatives of micro, small and medium-sized companies, ranging from start-ups to established firms. Standard templates were used for the discussion and the collection of ratings.

V. In addition, 10 individual interviews were carried out with panel of SME experts and practitioners, as well as with the main policy making / implementation organisation, which helped to collect and update the background information for the performance assessment and supplement, to validate the results of the focus groups allowing for a wider perspective than the focus group discussions and to cross-reference the information that was obtained in the focus group discussions. Representatives of six SMEs supporting Institutions including the RS Employers' Confederation (a entity level business organisation), BiH Association of Cooperatives (a state level agriculture producers organisation), Business Incubator Mostar, University of Sarajevo and Business School of Sarajevo, Chamber of Commerce of F BiH, CIPE- Centre for International Private Enterprise (USAID founded initiative, working with business associations and chambers of commerce representing the wood processing, tourism and agricultural sectors to build sustainability and develop communications, advocacy, and membership services). Also two Experts from private Agencies providing advisory services on Technology and on Law took part in the research. Two interviews were held with policy making organisations including The Ministry of Foreign Trade and Economic Relations of BiH- Unit for Development and Entrepreneurship Promotion, and Ministry for Development and Entrepreneurship of FBiH.

VI. The findings from the focus groups and interviews obtained were complemented with additional information provided by the EBRD, particularly for the dimension related to financial instruments for fostering small business.

VII. The analysis in this EPPA is based on the methodologies described above (focus group research, expert interviews, secondary data collection) and is complemented by the EBRD assessment. All information has been analysed by the OECD and EBRD, resulting in the assessment presented in this EPPA.

Annex IV

Attainment of the EU Charter for Small Enterprise 2003 Targets¹

EPPA	EC Charter for Small Enterprise
Institutional framework for SMEs policy.	10. Develop stronger more effective representation of small enterprises' interests at Union and national level
Rule of law and regulatory framework	2. Cheaper and Faster Start-Up
	3. Better legislation and regulation
	5. Improving on-line access
Tax policy for small business	7. Taxation and financial matters
Financial instruments for new and small companies.	
Business consulting services for new and small enterprises.	9. Successful E-business models and Top-Class Small Business Support
Business Incubators.	
Entrepreneurship, vocational education and access to technologies.	1. Education and training for entrepreneurship
	4. Availability of skills
	8. Strengthen the technological capacity of small enterprises
	6. Getting more out of the Single Market

¹ European Charter for Small Enterprises - Report on Small Enterprises in the Bosnia and Herzegovina, according to European Commission Questionnaire for 2004, MoFTER of BiH.

BiH selected Objectives only in 3 Chapters (2.,3.,7.) of EU Charter to be achieved during 2004, so for mentioned 3 Chapters focus of EPPA Comments is on achievement of their respective Objectives, while Actions recommended by Charter were considered regarding other seven Chapters.

Field of the Charter: 1 – Education and training for entrepreneurship

Actions recommended:

1. Nurture entrepreneurial spirit and new skills from an earlier age and throughout the education system.
2. Develop specific business related modules in education schemes in secondary level, in colleges and universities.
3. Promote the entrepreneurial efforts of young to-be entrepreneurs.
4. Develop appropriate training schemes for managers in small enterprises.

EPPA Comments:

The current education system in BiH is not significantly contributing to the creation of an entrepreneurial spirit. There are no common educational curricula in BiH, as they are set at entity and canton level. A state Law on High Education is not yet in implementation. Entrepreneurship courses are currently conducted in secondary and in vocational schools in the FBiH (Croatian Curriculum), as well as in RS (starting from the 2004/5 school year), while in the District of Brcko entrepreneurship is included only secondary economics school curriculum. Entrepreneurship and business subjects are taught at the Economics Faculties, at BA and MBA level and at a number of technical faculties.

The donor community is supporting several programmes related to vocational education: The EC through the EU VET Programme (supporting vocational school reform); Norway (sponsoring entrepreneurship training in a number of vocational education schools), the Open Society Foundation (sponsoring a pilot Entrepreneurship training programme in secondary schools), Switzerland (sponsoring the development and equipment of three training workshops with Employment Bureau covering IT, metal working and building construction); SEED (working on both the supply and demand sides of SME training and education); GTZ (conducting training courses for entrepreneurs as part of its programme to encourage the development of SMEs in Northern BiH). At higher level there are programmes that have been developed to create graduate and post graduate development of management skills for the next generation of managers. The most significant is the establishment of a new business school in Sarajevo for the entire SEE Region. The School, supported by USAID, will offer MBA courses in co-operation with the University of Delaware.

Entrepreneurs participating EPPA noted that the general public still retains a largely negative image of private entrepreneurs, but the situation is improving. Entrepreneurs gave also poor ratings to government policies conducted both at entity and state level to promote entrepreneurship, training of entrepreneurs and vocational education.

The lack of a strategy covering the whole territory of BiH and of coordinating institutions at state level, has created a situation where most initiatives are locally based, with a lack of consistency, interaction and integration among the various programmes. This is particularly evident of entrepreneurship education at tertiary level, where the F BiH is falling behind the RS and the District of Brcko. BiH needs a restructured vocational training system, able to provide courses to both young students; professional training for workers, made redundant by the on-going process of industrial restructuring; and for returning refugees.

Field of the Charter: 2 - Cheaper and Faster Start-Up

Objective:

Reduce the costs of a start up to € 500 maximum and the time needed to 20 days.

Deadline: September 2004. Benchmark: n/a.

Measures: To make amendments and supplements of the laws defining the procedures of registering economic activities on a way to prescribe both reduction of time and reduction of registration costs.

EPPA Comments:

EPPA 2003 and 2004 research showed enormous dis-satisfaction of private sector regarding conditions of business start up in BiH. Recently (July 2004) the first phase of the reform of business registration procedures was finalised, after 3 years, with the adoption of the Law on Registration of Enterprises at state level.

Entrepreneurs participating in focus groups, as well as experts interviewed through EPPA 2004 a few months before that, expressed their great disappointment in the prolongation of the finalisation of the reform. Law determines that procedures of registration will not exceed 5 days, and fees will be determined by entity level laws for which the adoption deadline was the end of November 2004. It is expected that fees will not exceed 500 Euros, and that they should be harmonised within Entities. A single Register of Enterprises will provide better and faster registration process, as well as implementation of BiH-wide unique registration code that will prevent misuse and reduce the grey economy activities.

Taking into account that implementation of new procedures for registrations of enterprises must wait for the adoption of entity level laws, installation of hardware & software, and trainings of court officers, the private sector is sceptical about having a functional new system in the near future. An open issue is also whether Entities and DB will have harmonised fees schemes for registration costs, or not. Harmonisation of fees and other registration requirements is recommended option.

Field of the Charter: 3 – Better legislation and regulation**Objective:**

1. Harmonisation of state/entity laws regulating the sector of small and medium-sized enterprises. This includes definitions, policy orientation and role of institutions.
2. Deadline: September 2004. Benchmarks: n/a.
3. Measures: Competent ministries in the Entities and BD shall pass new and harmonize the existing laws regulating constitution, growth and business activities of SMEs.

EPPA Comments:

Some efforts towards the improvement of regulatory framework for SMEs have been made: drafting of the Law on Stimulation of Development of Small Entrepreneurship in FBiH; adaptation of the Law on encouraging the SMEs development in RS (regarding SMEs definitions according to EU standards); and proposal by BD Government to Assembly a Law on SMEs (whose realisation was postponed due to prioritising other Laws by BD Government). However in general, the harmonization of legislation and regulation of SMEs businesses environment was not completed. Bulldozer initiatives Phases II and III (ongoing) had achieved partial results regarding harmonization of regulations. Along with various programmes and projects focused on business regulatory framework reform, mainly donated by IOs, BiH authorities have prepared a set of new Laws as an answer to at least 16 requirements of EC as a pre-condition for start of process of SAP negotiations. Although half of these Laws were adopted during the period July-September 2004, they are not yet implemented. Very slow and weak implementation of the Laws adopted within the last 2 years is the main cause of entrepreneurs' and experts' dis-satisfaction.

Field of the Charter: 4 – Availability of skills

Actions recommended:

Ensure that training institutions, complemented by in-house training schemes, deliver an adequate supply of skills adapted to the needs of small business, and provide lifetime training and consultancy.

EPPA Comments:

Work with business associations, municipalities, large company supply chains, and others has helped donors (SEED,...) to identify SMEs training needs and introduces tailor-made courses, in partnership with local educational and consulting companies. A number of donors (World Bank - Social adjustment & Technical adjustment credits, GTZ, SIDA, DFID, EU VET, EU QIF, Open Society Foundation) launched programmes to improve operation of local employment offices, assisting them to develop active labour market policies in addition to their social assistance role. These focused on linking SME job vacancies with suitable unemployed people and developing training programmes to help the unemployed acquire marketable skills. Anyhow, entrepreneurs EPPA 2004 participants complained Employment Bureau services quality. In addition, a number of donor projects on the IT training, mainly targeted to company managers and university students, i.e. USAID sponsored a curriculum development for university accounting departments, training of the first 1000 students and 800 practicing accountants & book-keepers; the Soros Foundation helped the Economics Faculty at the University of Sarajevo to create the Center for Management and Information Technologies (MIT) Centre. There are no programmes for conducting practical stages with private companies, business incubators and technological parks.

The vocational training system must take into account the requests coming from the labour markets, receiving inputs from the private business associations, and must include training stages with private companies. Many of the focus group participants have signalled problems in recruiting staff with the requested qualifications. The building blocks for effective management training are largely in existence, with the introduction of MBA courses, short course programmes and a growing number of trained local management trainers, thanks to the support of the international community. One of the future challenges will be to establish effective links between the universities, business schools, the business community and the local administration. Those higher education institutions may act as an agent for change and promote industrial restructuring and the technical innovation.

Field of the Charter: 5 – Improving on-line access

Actions recommended:

Encourage public authorities to increase their electronic communication with the small business sector, permitting companies to receive advice, make applications, file tax returns or obtain simple information on-line

EPPA Comments:

The use of internet for the dissemination of information to the enterprise sector by the public administration is still very limited, hampered by the high costs of internet connection, the limited number of service providers and the existence of three separate telecommunications networks. The State Parliament, Council of Ministers and some Ministries (including MoFTER), two Entities and the District of Brcko have set up web sites containing information on legislations, regulations and government tenders. However, the provision of services on line (such as the submission of tax forms, permit and licence application, etc) is not yet possible. In addition, the reform of business registration process does not plan on-line registration in the first phase of its implementation.

Field of the Charter: 6 – Getting more out of the Single Market

Actions recommended:

1. Pursue reforms aimed at the completion in the EU of a true internal market, which is user-friendly for small business in critical areas for development of small businesses, including electronic commerce, telecommunications, utilities, public procurement and cross-border payment systems.
2. Apply European and national competition rules to make sure that small businesses have every chance to enter new markets and compete on fair terms

EPPA Comments:

The UNDP lead activities on establishing e-business pre-conditions in BiH. The use of internet for Business to Business transactions is still however very limited, because of reasons explained in field 5 of Charter.

The Competition Council officially became operational at the end of 2004.

The application of agreement on free trade and liberalisation of trade in general is conducted with difficulty, arising from BiH's insufficient readiness in all activities i.e. measurement, stimulation of domestic production, custom charges etc. The EU market access by the SMEs has been worsened, with the export enterprises unable to reach the set standards, due to a lack of coordination between the quality standard regulations and the CE approval. The Chambers of Commerce provide work permits for the enterprises working abroad for a definite period of time, thus giving them considerable assistance.

Field of the Charter: 7 – Taxation and financial matters**Objective:**

1. Cancellation of obligatory Chamber membership (as of 1st January.2004)
 2. Cancellation of double taxation throughout BiH territory,
 3. Cancellation of obligatory annual name protection fees of companies
- Deadline: 1st January 2004 for 1., September 2004 for 2. and 3. Benchmark: n/a.

Type of measures to be undertaken to achieve this: pass corresponding decision at the level of entities and BD governments for regulating the matter of membership in chambers, fee payment and to avoid possibility of double taxation in the Entities and BD.

EPPA Comments:

Although the cancellation of obligatory Chamber membership was successfully achieved since 1st January 2004, it is applicable only for Cantonal/Regional level of CoC.

Compulsory membership to the Foreign Trade Chamber BiH and to CoC of FBiH (for SMEs which are members of Cantonal CoCs) still exists and is an issue on which SMEs in EPPA 2004 expressed their dis-satisfaction, as well as on the obligatory annual fee for raising companies. Both issues need to be resolved as priorities, and they are addressed within 3rd Phase of Bulldozer Initiative. Double taxation, as well as fees on liquidation of SMEs, still exist and support EPPA participants' concerns regarding the long-term impact of these barriers on their growth. Although it was not within EU Charter 2003 objectives, the issue of establishing start-up financing has to be highlighted.

Field of the Charter: 8 – Strengthen the technological capacity of small enterprises

Actions recommended:

1. Strengthen programmes aimed at promoting technology dissemination towards small enterprises as well as the capacity of small business to identify, select and adapt technologies.

2. Foster technology co-operation and sharing among different company sizes and particularly between European small enterprises, develop more effective research programmes focussed on the commercial application of knowledge and technology, and develop and adapt quality and certification systems to small enterprises.

3. Support actions at national and regional levels aimed at developing inter-firm clusters and networks, enhance pan-European co-operation between small enterprises using information technologies, spread best practice via co-operative agreements, and support co-operation between small enterprises in order to improve their capabilities to enter pan-European markets and to extend their activities in third country markets.

EPPA Comments:

At the moment, there are no active government policies to encourage access to technology for SMEs, either at state or entity level while the basic legislative framework to support the introduction and the development of new technologies is not yet in place. At state level, the Law on the establishment of BiH Measurement Institute, the Law on establishment of BiH Standardisation Institute and Law on establishment of Intellectual Property Institute are approved by BiH Parliament. BiH Standardisation Institute and BiH Intellectual Property Institute were established at the end of 2004.

Excepting the recently established technology park in Banja Luka, there is not another technology park in operations in BiH. However, there are plans and negotiations to establish a BiH technology park in Zenica, making use of the infrastructure and the technical skills of the “Kemal Kapetanovic” (metallurgy institute) and the Faculties of Metallurgy and Machinery, linked to the steel factory in Zenica.

Cluster development is just beginning in BiH, but the establishment of interconnected groups of companies operating in the same industry, may considerably promote the introduction and the spread of technical innovations. It is therefore important that efforts are made to reconnect existing research and development centres, either in the universities or in the remaining technical institutes, to the emerging clusters as well as to the business incubators and the planned technological parks.

Entrepreneurs gave also poor ratings to government policies conducted both at entity and state level for the promotion of access to technology.

Field of the Charter: 9 – Successful E-business models and Top-Class Small Business Support

Actions recommended:

1. Encourage small enterprises to apply best practice and adopt successful business models that enable them to flourish in the new economy.
2. Develop information and business support systems, networks and services which are easy to access and understand and relevant to the needs of business.

EPPA Comments:

At state level, given the absence of a state SME Agency and of a state SME strategy, there is no specific institution in charge of promoting and co-ordinating the provision of basic advisory services, particularly to enterprises operating beyond the entity and district boundaries. The Foreign Investment Promotion Agency (FIPA) is the only state supported service agency operating throughout the country, but its main mandate is to assist foreign investors and does not specifically focus on SMEs. Donors (DFID, EU, USAID, GTZ, SIDA and SEED) have set up a wide range of interventions to develop the supply of professional advisory services for SMEs, providing consultancy support to individual businesses, recently privatized enterprises and selected industrial sectors. Much of donor effort is directed to support projects developed in co-operation with local authorities, aiming at creating a partnership between the public sector, the enterprises and the local community around a set of agreed local development priorities. There is still a significant gap in the provision of basic business information and advisory services. On the side of the provision of private consultative services, there has recently been some noticeable progress, with the establishment of LESP.net, a coordinating association of local consultants. LESP may become a vehicle for introducing minimum standards on consultative services and for the provision of on-going training to private consultants. However, the sustainability of those projects, once donor funding ends, remains in question. The EPPA focus group participants have noted the expansion of the number of business centres and service agencies in operations, and a move towards quality improvement. The average rating for advisory service has recorded a marginal improvement compared with the 2003 score, but a significant number of focus group participants (39%) have indicated that the situation has improved compared with 2003, while a very small minority has reported a worsening of the situation.

Currently there are seven active Business Incubators in BiH, while in the last EPPA report just one incubator was in operation. The first 3 formed Business Incubators are based in: Gradacac (established in 1998), Modrica-Tarevci (formed in 2002 and in operation since 2003) and Mostar (formed in 2003 and dedicated to SMEs operating in the service sector). Two additional projects have been approved by the EC Quick Impact Facilities 2, and established in Zenica and Zepce, re-converting existing industrial buildings. Additional business incubators were established towards the end of 2004: in Lipnica near Tuzla and agriculture business incubator in Topola in RS.

All these initiative are locally or/and donor supported. At state level, there is still a lack of policy with respect to Business Incubators. With the spread of new initiatives, entrepreneurs have started to develop an interest in business incubators. The results of the focus group discussions indicate that entrepreneurs consider the business incubators a valuable tool to support start-up, particularly in the ICT sector. The establishment of business incubators should be considered within the framework of regional and local development plans in BIH, providing a technical assistance facility to the economic departments of the cantons and the municipalities in preparing new projects, through the re-conversion of vacant industrial buildings and former military camps.

Field of the Charter: 10 – Develop stronger more effective representation of small enterprises' interests at Union and national level

Actions recommended:

Review how the interests of small businesses are represented at national level, including through the social dialogue

EPPA Comments:

SMEs representation as well as advocacy and public-private partnership is still very weak despite the existence of a wide network of Chambers of Commerce and Business Associations. The business associations need to increase their policy advocacy role, particularly at this stage when the SME institutional and policy framework is under discussion. The BiH Association of Employers could play an important role in representing the independent voice of entrepreneurs. As progress is made on building a common economic space, a private-public table of consultation is much needed. The structure could reflect either that of the Social-Economic Councils set at entity level, but BiH should look also at the experience of the other SEE countries and the new EU member countries. The establishment of State level Council is planned for the first half of 2005. The results of the focus groups clearly indicate that the business community, across the country, is very much in favour of greater integration, administrative simplification and the establishment of a level playing field for all enterprises.

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