



**ENTERPRISE POLICY
PERFORMANCE
ASSESSMENT**

CROATIA

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Enterprise Policy Performance Assessment

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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 for the West Balkans, EC- DG Enterprise and Industry).

Background research and support for the 2004 Croatia EPPA report (2nd edition) was provided by the Zagreb based Institute for International Relations and the first draft was provided by Dr Nevenka Cuckovic, Dr Will Bartlett, Dr. Predrag Bejakovic and Dr Kresimir Jurlin.

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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 2002 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 Croatia. 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 European Charter.

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

The 2004 EPPA Country Reports have been prepared jointly by the OECD and the EBRD, in consultation with the EC and with the assistance of a network of South East European and international consultants.

In 2002 the OECD Investment Compact and the EBRD launched the Enterprise Policy Performance Assessments (EPPAs) with the aim of producing independent and comprehensive assessments on an annual basis of the enterprise policy carried out by the government institutions in the each of the countries of South East Europe.

The country assessment is the result of the elaboration of a number of inputs: insights from entrepreneurs and SME owners, collected through focus group discussions and interviews, contributions from SME experts, policy makers, representatives of the association of private enterprises, international and bilateral organisations dealing with SME issues, desk research and analysis, combined with the experience and judgement of OECD and EBRD experts. The assessment was originally designed to address six policy dimensions, at the core of enterprise policy.

Nine EPPA reports, one for each of the SEE country, with Serbia and Montenegro being assessed separately, 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 web-site: www.investmentcompact.org.

The EC General Directorate for Enterprise and Industry joined the OECD-EBRD team in October 2003 with the aim of developing synergies between the EPPAs and monitoring of the implementation of the best practices contained in the European Charter for Small Enterprises, signed by all the SEE countries.

The 2004 EPPA Country Reports represent both a continuation and an expansion of the work started in 2002. The scope of the reports have been expanded in 2004 to include a seventh policy dimension covering entrepreneurship, vocational education and access to technologies, thereby better integrating the scope of the EPPAs with that of the European Charter on Small Enterprises.

The 2004 framework of research for analysis of the performance of enterprises policy thus consists of the following dimensions of small enterprise policy:

- 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 Reports are structured in two parts. Part I includes an overall assessment of enterprise policy, looking at progress made since the publication of the 2002 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 contains the insights of entrepreneurs and SME owners and managers, while the second chapter is dedicated to analysis and assessment, including a report on the implementation of the policy recommendations listed in the 2002 EPPA Country Report.

The EPPA Methodology

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 small 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.

The policy assessments have been formulated on the basis of the following inputs:

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, including South East Europe, and OECD country experience (OECD-UNIDO, 1999).

Individual SME interviews and expert interviews:

Individual SME interviews were used to cross check the focus group research and to provide further insights on key issues in each of the SEE countries.

Expert interviews were conducted to cross reference information from the focus groups and individual SME interviews and to contribute to overall views.

Desk research:

Examination of existing reports, databases, documents, etc. was conducted by country-based experts/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 inputs from focus groups, interviews and desk research and elaborated the country assessments.

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

PART I

Overall Assessment and Policy Recommendations

Overall Assessment

The 2003 EPPA reported that, in overall terms, good progress had been made by the Government of Croatia in setting out and beginning implementation of new policies to support the growth and development of SMEs. Croatia had developed a well articulated and far reaching enterprise policy framework and launched a series of initiatives directed at providing financial and operational support to SMEs, at national and regional level.

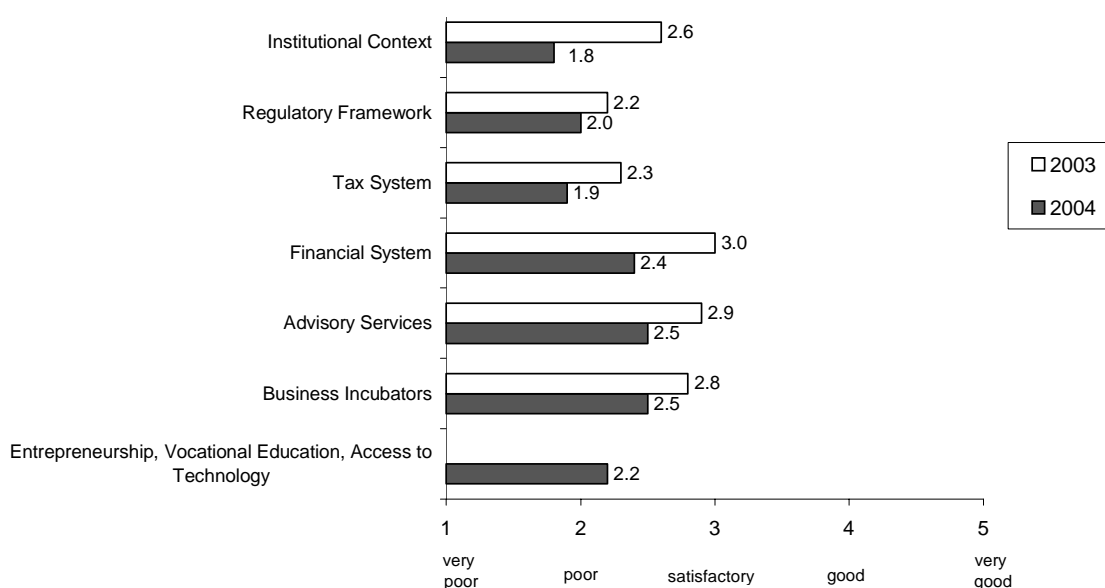
However, during the first half of 2004, there was a temporary loss of momentum in terms of policy elaboration implementation. This slowing down was largely linked to the disbanding in January 2004 of the Ministry for Crafts and Small and Medium Sized Enterprises; the transfer of SME policy portfolio to the newly established Ministry of Economy, Labour and Entrepreneurship; the restructuring of the Croatian Agency for Small Business (HAMAG) and to the coming into power of a new government team.

Of a total of 43 short and medium term policy recommendations, listed in the 2003 EPPA report, as a contribution to the reform agenda, there has been significant progress in the implementation of 3 of them, linked to the provision of support services for SMEs, such as advisory centres and business incubators; limited progress with 27 of them and no relevant progress on the remaining 13 recommendations. (See Section 8 of Part II).

The loss of momentum in policy implementation had an impact on the views of the Croatian entrepreneurs. The result has been a general reduction in the policy performance rating by Croatian entrepreneurs, particularly significant in some key dimensions, such as the institutional contexts, the regulatory framework and taxation, as shown in Figure 1-1.

Momentum was regained in the second half of 2004, with the launching of new financial facilities for SMEs and the refinancing of the existing ones, the introduction of new e-government schemes and the endorsement of the ‘one stop shop’ concept as a way to speed-up regulatory simplification.

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



In general, the average policy performance ratings in this second EPPA report for Croatia remain low, with several falling below an average assessment of “poor”. All ratings somewhat decreased since the 2003 EPPA report, with Institutional Development down from 2.6 in 2003 to 1.8 i.e. below “poor”, followed by the Tax System down from 2.3 in 2003 to 1.9 and the Regulatory Framework, down from 2.2 in 2003 to 2.0, indicating a general dissatisfaction with a slow pace of reform. Business Advisory Services and Business Incubators obtained the highest average rating of 2.5 i.e. in between “poor” and “satisfactory”, down from 2.9 and 2.8 respectively in 2003. Despite the significant progress achieved over the last two years, the low ratings illustrate the significant amount of work which remains to be done in terms of policy implementation and particularly in policy communication to SMEs.

Institutional Framework

Looking at the individual policy assessments, the EPPA findings indicate that Croatia has a fairly well developed and diversified institutional framework for SME support at state, local and regional level. The research confirmed encouraging progress in the strengthening of support structures at local and regional level through the development of regional development agencies and business support centres and incubators. However, SME owners and managers believe the effectiveness of these agencies has not sufficiently improved.

The functions of the previous Ministry for Crafts and Small and Medium Sized Enterprises have been transferred to a Directorate of the newly formed ministry of Economy, Labour and Entrepreneurship (MELE) and the leading personnel of the former Ministry have largely been replaced. A major contributory factor to the poor perception SME owners and managers have of the effectiveness of policy implementation is the impact of the abolition of the previously successful ministry. They believe that the reorganisation has reduced clear organisational responsibility for SME policy. In addition:

- Communication and consultation with the business community on the policies for SMEs are not believed to have improved significantly.
- The strategy for SME development is broadly assessed as being “poor”, (it should be noted however at the time of the research the strategy had not been officially disseminated).
- The aim of creating 400 business zones is considered to be far too ambitious.

A new “Incentive Programme for the SMEs” was adopted in May 2004 to help promote production and export by SMEs. The Croatian Agency for Small Business (HAMAG) is well funded and has begun its activities to assist the SME sector. It implements and co-ordinates the provision of various incentives, guarantee schemes, loans and loan interest subsidies, consultancy and education for SME development. There are also seven regional development agencies.

Zagreb, Međimurje, Primorsko-Goranska and Istrian county have successfully launched a number of SME development and support programmes and have assigned significant funding to them. The counties and municipalities in the regions affected by the war in the 1990s have fewer SME development centres. But, the government has succeeded in the last year and a half in establishing several new centres in these regions, with substantial local co-funding.

Rule of Law and Regulatory Environment

There have been improvements in the rule of law and regulatory environment, including amendments to the Law on Commercial Companies which were adopted in July 2003 and the procedures laid down for company registration are now broadly in line with EU standard practices. A regulatory framework conducive to the growth of entrepreneurship and a fully functional and competitive market economy has been quite well developed in Croatia. However, the low average rating is due to a strong belief by SME owners and managers that the administrative system remains overly bureaucratic and there are still significant costs and delays in starting-up a business, issues include:

- Inconsistency and inefficiency in the application of the procedures for *company registration* so that, in practice, company registration is still a much more time-consuming process than in the EU and in the most advanced transition countries.
- The problems faced in obtaining licences, permits and certificates remain and are a critical obstacle to establishing new companies.
- The principle of “silence is consent” has not yet been adopted.
- On-line registration of enterprises is not yet available.
- There is still no single reference number for each enterprise.
- There appears to have been only modest progress by the Inter Ministerial Task Force on Removing Administrative Barriers and the implementation of its Action Plan for Reducing Business Barriers.
- Reform of the registries for land, real estate and other property is believed to be happening too slowly.

The activities of the State Office for Preventing Corruption and Organised Crime (USKOK) have been intensified, with several successful investigations into the most serious economic crimes. However, corruption still seriously affects the business environment and is of vital concern to SMEs.

Tax Policy

Tax policy has been developed and the system is stable and predictable with incentives being introduced to encourage research and development and there are incentives targeted on economically depressed regions. However, in general the present tax system does not specifically aim to stimulate SME development and the Government has not yet introduced an on-line tax filing system and this is reflected in the SMEs’ poor perception.

Access to Finance

Croatia has a relatively advanced financial sector. In this area it is the most developed country in the region and compares well with the new EU accession countries. Access to finance for SMEs has continued to develop in terms of the range of sources available. There has been a substantial increase in the amount of state budget funds available to provide financial support to SMEs. The existing government lending schemes to the SME sector has been expanded and new ones introduced such as those targeted at enhancing female and youth entrepreneurship. The lower average rating compared to last year reflects the fact that SME owners and managers still have many problems in obtaining

finance and that bank lending policy to the SME sector is believed to have become more conservative over the past year.

Advisory Services

There has been further improvement in the availability of a range of advisory services for newly formed enterprises and in particular for small businesses. However, the longer term financial sustainability of business advisory services especially in remote locations and economically disadvantaged regions is not secure. Trust in and certification of consultants remains a problem and there is still scope for considerable improvement in the quality of the service and advice provided to SMEs by the range of support institutions.

Business Incubators

Government policy of supporting the development of business incubators has achieved some good results since the 2003 EPPA and a 'Special Funding Programme for Enhancement of Development of Business Incubators' has been put in place. But information on Business Incubators is not readily available and they are being constrained by a lack of adequately trained and experienced staff, limiting services in some to provision of physical infrastructure.

Entrepreneurship, Vocational Education and Access to Technology

The education system needs reform to enhance the development of an entrepreneurship culture, improve attitudes and change the social values system.

Croatia has not capitalised on science and technology in the past decade to create competitive production factors, and is loosing export markets for advanced products; reasons for this include loss of linkages with world-class companies abroad.

In conclusion, the new government has continued to emphasise the importance of further strengthening SME development and entrepreneurship as key developmental priorities for the 2003-2007 period and has said that:

- Its intention is to foster the creation of regional development agencies in other counties, following the model and experience of the successful Istrian Development Agency.
- It is in the process of changing the regulations which will give more power to USKOK.
- It plans to introduce additional tax incentives for new industrial enterprises under the proposed Programme for Development of the Entrepreneurial Zones.
- It is aware of the need to establish a body with authority for certification of advisory services and
- It has accepted the need for change in education curricula to help boost entrepreneurship skills and behaviour

Box 1. Summary of Progress on the European Charter for Small Enterprises

Steady progress is being made in implementing the European Charter for Small Enterprises in Croatia. The implementation of the European Charter for Small Enterprises in Croatia is currently focused on the following three areas: **1) Cheaper and Faster Start-Up; 2) Strengthening the technological capacity of small enterprises and 3) Successful E-business models and Top-Class Small Business Support.** Feedback obtained in carrying out this EPPA confirms the importance that the Croatian government attaches to the European Charter.

Cheaper and Faster Start-Up: The government has made matching funds available to local government to support provision of credit to several start-ups that have failed to obtain bank credit due to insufficient collateral. MELE said in September 2004 that attainment of the scheduled benchmark target for providing matching funds was not possible because the legal foundations were not in place to fund local guarantee funds. However, they believe this problem has now been resolved by a new model of guarantee for start-ups recently developed and issued by HAMAG. MELE data shows an increase of 4,264 in newly registered crafts. This is 1,094 more than planned. The statistical data on how many new employees there are in the SME sector (target c) has not been released yet.

Strengthen the technological capacity of small enterprises: The government has put in place an initiative to increase the number of ISO certified business organisations and MELE has an open call for funding proposals from businesses that would like to achieve ISO quality and technical regulation standards. MELE says that about 430 SMEs are now ISO certified. This means that the benchmark target of 350 for this year has been exceeded.

Successful E-business models and Top-Class Small Business Support: There is now one Euro Info Correspondence Centre (EICC) in Croatia. The Chamber of Commerce is implementing a programme of e-learning for entrepreneurs. There are several similar programmes run by other organisations and MELE also has a programme for education of entrepreneurs which financially supports such activities through an open call for proposals.

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. These are reviewed in Chapter 2, section 8 of Part II.

The 2004 EPPA Report includes a new set of policy recommendations, consisting of a number of recommendations retained from last year (selected from 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 we have identified for each policy dimension a Priority for Action 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.

Box 2. Priority Reform Issues for Action

1. The government should establish an inter-Ministerial Group on SME Policy, ensure clear organisational responsibility for SME policy development and improve the awareness among the business community of the policies and achievements of the new Directorate for SMEs
2. Improve the procedures for issuance of licences, permits and certificates by introducing the “Silence is Consent” rule by law within the operation of One Stop Shops. The emphasis should be on the elimination of the need for licenses and permits to start operating a business, except for those needed on health, safety or building permit grounds.
3. The Government should urgently progress plans to develop an on-line tax filing system.
4. Private commercially based financial institutions should become the main providers of finance to the SME sector. The Government should provide advice, training, consultancy, networking support as an alternative to direct financing.
5. HAMAG working with the SME representative bodies should create a register and network of consultants for SMEs and introduce mechanisms for certifying / accrediting them and monitoring the quality of their services
6. Incorporate Business Incubators into the government’s plan to develop the entrepreneurial zones and secure additional national and international resources to promote business incubators effectively.
7. Establish a specialised task force, which would assist in the revision of the education curricula of secondary and graduate schools to better embed entrepreneurial behaviour, practical skills and provide students with some real business experience.

Institutional Framework for SME Policy**Priority for Action**

1. The government should establish and inter-Ministerial Group on SME Policy, ensure clear organisational responsibility for SME policy development and improve the awareness among the business community of the policies and achievements of the new Directorate for SMEs.

Co-ordination

2. The inter-Ministerial Group on SME policy should include representatives of HAMAG, key Ministries such as Finance, Economy, Tourism, Employment, etc, associations and representatives of the SME sector and experts in SME policy development. It should be charged with the following main tasks:
 - Ensuring that the needs of small enterprises are fully considered in national policy-making.
 - Ensuring the effective coordination and implementation of the government’s priority SME programme.

- Overseeing the implementation of the European Charter for Small Enterprises to which the government has already given its signature and
- Ensuring coordination of foreign technical assistance programmes to avoid overlap.

Consultation

3. MELE and HAMAG, in consultation with the inter-Ministerial Group on SME policy should develop an effective strategy for communicating with SMEs, including further improved web sites and forums, to prioritise the dissemination of information about SME policies, programmes and achievements in an accessible.

SME Development Strategy

4. The SME strategy should be developed in far more detail to include defined projects with assigned funding and timeframes.
5. The strategy should pay greater attention to the needs of established firms with growth potential and not only focus on start-ups.
6. The strategy should be disseminated widely to the small business community.
7. The implementation of the European Charter for Small Enterprises to which Croatia has given its signature should be reflected in the strategy's priorities, and progress against its annual targets evaluated and monitored and published in a timely manner.
8. Rather than creating many new business zones and development, the priority should be to improve the operation of the existing zones and support institutions.
9. The small business community should be actively encouraged to participate in the further development of the strategy.

Local and Regional Government: SME Capacity

10. Improving the support services for SME development should take place in the context of the government's overall drive to improve the decentralisation of services and to reform public sector administration. There is also potential for cooperation and better coordination of foreign technical assistance programmes (e.g. UNDP, CARDS – Community Assistance for Reconstruction, Development and Stabilisation).

Rule of Law and Regulatory Environment

Priority for Action

11. Improve the procedures for issuance of licences, permits and certificates by introducing the "Silence is Consent" rule by law within the operation of 'one stop shops'. The emphasis should be on the elimination of the need for licenses and permits to start operating a business, except for those needed on health, safety or building permit grounds.

Company Registration

12. Introduce the 30-day maximum rule for company registration and ensure that it operates effectively.
13. Introduce on-line registration of enterprises via the e-Government programme.

14. The 'one-stop-shop' approach to registration should be established throughout the country in tandem with the drive to develop the business enterprise zones.
15. Introduce a single reference number for each enterprise.
16. Publish, evaluate, and simplify the regulatory regimes that affect the setting-up phase of businesses, as well as the procedures for re-registering and terminating enterprises.

Business Simplification

17. Reinvalidate the government's Programme for Reducing Legal/Administrative Barriers for business with private sector involvement and improve the awareness of its achievements through information campaigns.
18. Evaluate the effectiveness of the programme at least once a year.
19. Focus particularly on introducing more effective systems of land planning, urban planning and zoning regimes and identify specific areas of land which can be prepared for business use and development. This should be incorporated in the government's plans to create enterprise zones, but it should go far beyond that in increasing the supply of land specifically zoned for future business development.
20. There should be a special emphasis on providing land and infrastructure facilities suitable for the need of SMEs crafts and cooperative enterprises.
21. Improve the quality and regularity of consultations between the government and the private sector on draft business legislation. SME stakeholders should be consulted before proposals are converted into law.

Corruption

22. Task USKOK with preparing a report for the Cabinet every six months, charting progress in implementing its action plan. The reports should be subsequently published and promoted particularly to the small business community to improve confidence in progress being made.
23. Evaluate the effectiveness of the Inter Ministerial Task Force on the Grey Economy in order to improve information on its implications for economic development. The private sector should be involved more in this process in order to improve transparency.

Tax Policy for Small Business

Priority for Action

24. The Government should urgently progress plans to develop an on-line tax filing system.

Policy Principles

25. Tax concessions should be targeted at fast growing firms with export potential and should be easily accessible in the current tax year.
26. The Ministry of Finance, in co-operation with the Ministry of Economy Labour and Entrepreneurship and the SME policy community, must continue to work together to ensure:
 - Further simplicity, stability and clarity in tax policy relating to SMEs.

- Fiscal administration is made more sensitive to the needs of the SME sector, for example, in relation to its cash flow impact.
- Tax laws and regulations are consistently and fairly enforced, regardless of firm size.

Tax Filing

27. Progress plans for the development of the on-line tax filing system.
28. Further develop the system to allow small firms to file a simplified tax return.
29. Improve the availability of training on tax matters for entrepreneurs.

Tax arrears

30. Further strengthen efforts to collect tax arrears, regardless of firm size.

Consultation and communication on tax policy

31. Clearer and more up to date information about the tax system and tax concessions should be made available to SME owners and managers.

Financial Instruments for new and Small Business

Priority for Action

32. Private commercially based financial institutions should become the main providers of finance to the SME sector. The Government should provide advice, training, consultancy, networking support as an alternative to direct financing.

Provision of finance to the enterprise sector, regardless of size, is best left to private commercially based financial institutions, as this would guarantee the most efficient allocation of savings. Direct provision of government finance to SMEs should be gradually replaced by a lighter touch regulation, including programmes of advice, training, consultancy, networking support which would enable SMEs to approach the banks as reliable and low-risk business partners to whom the commercial banks would be interested to offer long-term loan capital.

At present the State is attempting to deal with the lack of long term bank finance through direct provision of SME finance using a number of subsidised schemes designed for different segments of the market. This approach is overly bureaucratic, distorts potential competition and provides incentives for rent-seeking behaviour. It is also an inefficient use of public funds and is not self sustainable.

Improving banks' lending to small clients

33. Commercial banks are increasingly moving into the provision of short-term lending to SMEs. However, banks still favour larger companies, on an even larger scale than prior to the last financial crisis. After the crisis and completion of privatisation and bank restructuring, banks have naturally become more risk averse and thus prefer to deal with larger clients. Two suggestions are made to deal with this issue.
 - The smaller local and regional banks have an important role to play in the provision of loans to SMEs, however they lack SME credit assessment skills. In

this respect the state should take a role in fostering training opportunities in this field.

- In order to deal with the increased risk aversion of the privatised and restructured banking sector, the state could support the private enterprise sector in setting up mutual guarantee schemes of the type used in other OECD countries (i.e. Italy, Germany). These could facilitate SME access to bank loans by overcoming the stringent collateral requirements imposed by banks.

Introduce commercially based micro-finance institutions

34. There are a number of innovative initiatives in the field of micro-credit and credit unions. These are a valuable tool for development of SMEs in high risk, war-affected areas and should continue to receive development support from the state and from international institutions. However, as they stand they are not commercially based, with no hope of reaching sustainability. Initiatives in this area should be further developed along commercial criteria.

Improve the regulatory framework for the non-bank financial sector

35. Regulate and supervise the booming leasing industry, currently one of the main sources of finance for the SME sector in Croatia.

Advisory Services

Priority for Action

36. HAMAG working with the SME representative bodies should create a register and network of consultants for SMEs and introduce mechanisms for certifying / accrediting them and monitoring the quality of their services.

Financial Sustainability

37. HAMAG in consultation with MELE and the donors should review the longer term financial sustainability of business advisory services especially in remote locations and economically disadvantaged regions to establish the issues faced and develop a strategy for ensuring ongoing financial stability. Initiatives could include:
 - Encouraging collaborative relations and networking between advisory and support institutions, as well as the building up of associations of SME advisory institutions in order to generate economies of scale and the transfer of best practice in the provision of advisory services.
 - Organising and operating services on the basis of public-private partnerships.
 - Before extending the coverage of business advisory services, especially to less developed regions of the country, ensure that they are provided with long term state support to ensure continuity and sustainability of services.

Quality and Accreditation

38. Encourage business advisory centres to specify and publish customer charters setting out the range of services provided and the standards they undertake to adhere to.

39. The quality of the advisory and support centres should be continuously assessed to maintain a proper match between the services provided and the demands and needs of the enterprises and to ensure that their effectiveness and standards of service delivery are improved over time.
40. Make the complete information on the advisory services available on-line.
41. The experience from the EU BEST programme should be disseminated throughout the Croatian small business community.
42. As part of the ongoing process of public administration reform, civil servants working in offices dealing with entrepreneurship matters, and managing directors of business support centres and enterprise zones, should be offered intensive courses of further education in the basics of entrepreneurship and its required support services.

Business Incubators

Priority for Action

43. Incorporate Business Incubators into the government's plan to develop the entrepreneurial zones and secure additional national and international resources to promote business incubators effectively.

Policy

44. Publicise the locations, plans and services provided by business incubators.
45. Develop systems to monitor the performance of business incubators.
46. The governance structures of incubators should be improved through greater involvement of the private sector in their governing boards.
47. Further develop the training and education programmes for business incubator managers in order to encourage compliance with best practice applied in transition and OECD member countries.
48. Improve the follow-up facilities and support for the first year after the business moves on from an incubator, in order to maximise the effectiveness of the initial investment.
49. Ensure that incubators provide more than physical infrastructure for micro enterprises and SMEs i.e. special advisory, mentoring, training and business consultancy services, practical assistance on production methods, quality systems, business development, export marketing, access to loan finance etc.

Entrepreneurship, Education and Access to Technology

Priority for Action

50. Establish a specialised task force, which would assist in the revision of the education curricula of secondary and graduate schools to better embed entrepreneurial behaviour, practical skills and provide students with some real business experience.

Education and Training

51. Establish several new Colleges of Entrepreneurship in Croatia to provide diplomas in Entrepreneurship Studies and Small Business Management.

- 52. Develop curricula to provide business studies and entrepreneurship education courses at secondary schools, in line with the provisions of the European Charter for Small Enterprises.
- 53. Develop business studies and entrepreneurship training courses within university science faculties and promote student firms pilot projects.
- 54. Create a national competition among science students for the best business plan for a new enterprise making use of a scientific invention or innovation.

Research and Technology

- 55. Provide training to owners and managers of SMEs in making applications to EU research and development programmes.
- 56. Encourage linkages between small Croatian companies and large foreign companies to facilitate technology transfer.

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. The analysed data were collected from the SME focus groups and experts during May and June 2004 and the questionnaires completed by the participants. The research conducted in 2004 includes the opinions of entrepreneurs and experts on an additional new dimension of Good Practice - Entrepreneurship, Competition, Access to Technology, as well as the opinions on targets relating to the implementation of the European Charter for Small Enterprises. This was not included in the May 2003 EPPA report for Croatia limiting comparison. In addition, some of the questions have been amended and are not directly comparable with the questions in the previous study. In these cases no comparison is given.

The analysis of the SME business environment is made on the basis of assessment of the following seven dimensions of good practice:

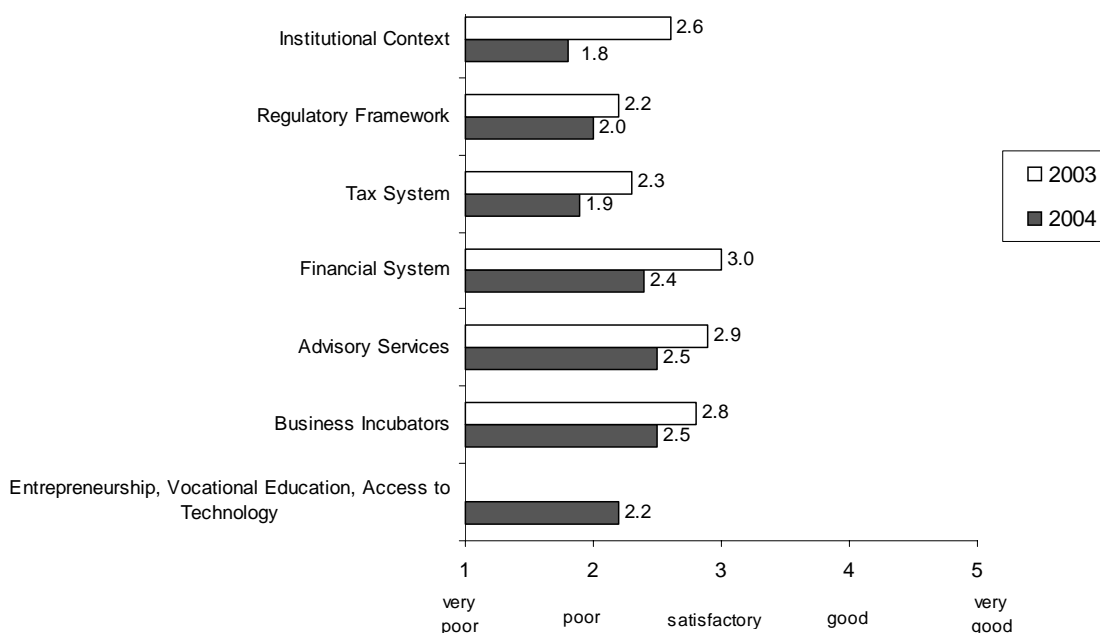
- Institutional framework for SME policy
- Rule of law and regulatory environment
- Tax policy for small businesses
- Financial instruments for new and small businesses
- Advisory services for new and small businesses
- Business Incubators
- Entrepreneurship, fair competition, access to technology and targets related to the implementation of the European Charter for Small Enterprises in the Countries of the Western Balkans

The questionnaire which served as the basis for discussion by focus group participants and experts and which was subsequently completed individually by them, consisted of two groups of questions, one set comprised yes/no questions, and the other comprised questions in which participants rated their opinions on a scale of 1 and 5. (**1 = very poor, 2 = poor, 3 = satisfactory, 4 = good and 5 = very good.**) At the beginning of the analysis of each of the seven dimensions of good practice we present the average results of the participants' ratings on the particular dimension of good practice.

The average ratings per dimension of good practice are highlighted in figure 1-1. In general, the 2004 ratings somewhat decreased on the 2003 EPPA, with the Institutional Development down from 2.6 in 2003 to 1.8 i.e. below "poor", followed by the Tax System down from 2.3 in 2003 to 1.9 and the Regulatory Framework, down from 2.2 in 2003 to 2.0. Business Advisory Services and Business Incubators obtained the highest average rating of 2.5 i.e. in between "poor" and "satisfactory", down from 2.9 and 2.8 respectively in 2003.

The main points made by the participants during the focus groups are reported *verbatim* and the quotations most relevant to the analysis are highlighted. Each section concludes with a summary of the issues emerging from the research.

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



2. Institutional Framework for SME Policy

The issues researched under this heading:

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 awareness of the government's SME development strategy.
4. The quality and effectiveness of the SME development strategy.
5. The local and regional governments' mandate and resources (funding, people and skills) to promote SME development.
6. The information provided and awareness by business people of the government's institutions, policy and programmes to support new entrepreneurs and develop existing SMEs.
7. The awareness of regularity of consultation between government and the private sector on SME policy and its performance and assessment.
8. The quality and regularity of consultation between government and the private sector on SME policy and its performance and assessment.
9. The performance of government institutions supporting small business since March 2003.

Organisational Responsibility

1. Has the government assigned clear organisational responsibility for the development of SME policy?	2004	2003
	Yes: 15.4% No: 84.6%	Yes

This year 84.6 % of SME owners and managers participating in the focus groups and many of the experts that were interviewed, believed that the government has not assigned a clear organisational responsibility for the development of SME sector in Croatia. The explanation for this critical view stems mainly from the recent changes introduced by the new government. As a result of its programme to reduce the number of ministries, the Ministry of Crafts and SMEs was abolished and reverted to become a part of the Ministry of Economy, as it was four years ago. The Ministry of Economy has been merged with the Ministries of Labour and Social Care and the Ministry of Crafts to form the Ministry of Economy, Labour and Entrepreneurship (MELE). A new Directorate for SMEs was formed within MELE with responsibility for SME development.

The participants in the focus group research were concerned that this change, with the Directorate for SME becoming part of a gigantic Ministry, will limit the scope of the government's activities and responsibilities towards the SME sector. It is still too soon to make a final realistic assessment of the impact of the new organisational structure that supports SME at the national level. However, many of the participants in the focus groups mentioned that the changes are already having an adverse effect on the provision of the necessary information and on the level of mutual communication.

Several participants gave a more positive assessment of the efforts of the previous government to assign clear responsibility for SMEs and build better communication with the sector. Others regarded the change as a merely formal difference, and believed that in reality none of the organisational forms (be it Ministry or Directorate) will take any real responsibility for development of the SME sector. They believe what matters is the content and responsibility of the work and not the organisational form.

“To have an independent Ministry and a Minister does not mean much if the programmes are not attractive for us and if they do not have new ideas.”

“For the small business it is not important what the name of the institution is, but whether it recognises our problems and knows how to offer some solutions.”

“We often witness a change of the form, but the content does not actually change much... “

The focus group participants also highlighted that there are many overlapping responsibilities at national, regional and local levels:

“The cooperation and coordination between different government institutions is still poor, and often it reflects a sort of political competition among them, especially if the administration at the local level is controlled by the different parties.”

There is a perception that clarity in the assignment of clear responsibility for SME policy has significantly deteriorated. The government and ministries need to convince the business community that the Directorate for SMEs is seriously in charge and concerned about SME policy, is going to improve the SME policies and programmes and will be better able to coordinate key institutional players at the central, regional and local levels to avoid overlap.

Effectiveness of the Organisation/s

2. Rating given to the effectiveness of the organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs.	2004	2003
	1.9	2.5

The effectiveness of the relevant government organisations in developing an environment that encourages the growth of small business was assessed as being on average below “poor” by SME and expert participants. This is a more critical view than in 2003 when the average rating was 2.5. Most of the focus group participants highlighted the poor level of communication by the new government with the small business sector and the long delay in presenting new measures to tackle the SME sector’s issues. Some of the participants thought that it might have been better to assess the effectiveness of the new government with regard to the SME development at the end of the year, as:

“It is too early to assess the effectiveness of their new programme.”

In explaining their ratings during the group discussion, participants said:

“How can we assess the effectiveness of the new Directorate for SMEs when we have not yet seen their plans and the measures directed towards SMEs, apart from some announcements in the press? We are a bit confused as we do not know if the programmes started within the previous Ministry for SMEs will continue or not....”

“One can observe the problem of discontinuity in the operation of the governmental institution in charge of SME policy and it has an impact on the small business community. Every new government starts with its own concept.”

Some of the SME owners and managers mentioned the lack of information available:

“For example, the Ministry of Economy has not made inherited information from MCSME available and does not present the relevant information such as legislation, strategic documents, current programmes and incentives on-line, which makes it hard for the small entrepreneur to get the relevant information for his business.”

The poor perception of the effectiveness of the SME support organisations could be improved if the amount of information available on current programmes and incentives and dialogue with private sector were to be increased, especially on-line. Decentralisation of the services together with better co-ordination of the central, regional and local initiatives is an option for providing better services and increasing the reach of information.

SME Development Strategy

3. Are you aware of the government’s SME development strategy?	2004	2003
	Yes: 51.9%	Yes: 60%
	No: 48.1%	

Just over a half (51.9%) of the focus group participants were aware of the government’s SME development strategy. This is lower than the 2003 EPPA survey, when it was about 60%. The participants who knew about it referred mostly to the strategy of the previous government, which was available on line at the web-site of the ex-Ministry of Crafts and SMEs, while the new strategy has been only presented in fragments in the press. Therefore most of the participants were not well informed about the new strategy.

The new government programmes and strategy for SME development need to be promoted, communicated much more effectively and the information about them should be made easily accessible to the business community.

Quality and effectiveness of the SME development strategy

3.1. Rating given to the quality and effectiveness of the SME development strategy.	2004	2003
	1.8	2.7

The perception of the quality and effectiveness of the SME development strategy among the focus group participants is much lower than in 2003 when it averaged 2.7. It is now on average 1.8 i.e. less than “poor”. Part of the explanation for the significant deterioration in perception might be the timing of the research i.e. the inability of participants to realistically assess progress, because of the short time the new government has been in office.

Most of the participants were dissatisfied with the fact that the government did not come up with a comprehensive programme or at least state its main objectives within the first 100 days of its rule. It remains unclear which components of the Strategic Programme for Development of Small Businesses 2003-2006, passed by the previous government, will continue and which ones will be substantially redesigned.

Comments on what was announced in the press included:

“I could agree with the general principles of the announced government strategy such as strengthening SME exporters or encouraging the level of SME development in the free business zones. However what remains unknown is how this will be accomplished and through which concrete programmes and funding.”

“From what I have heard it seems that the Government again wants to put the focus on start-ups and crafts, while the real problem lies in creating an environment that would help the growth and technological development of the existing enterprises capable of expanding on the increasingly opening market, not only at home but also abroad.”

Some of them made comparisons with the strategy of the previous government:

“I do not think that there are many changes in the announced strategy as compared to the last one. I could not spot any really innovative solutions to SME development within it.”

The strategy for SME development is broadly assessed as being “poor”. In order to make the strategy more effective, it must pay greater attention to the needs of established firms with growth potential, not only to start-ups. More attention should be given to creating the conditions that could increase the SME competitiveness and export potential.

Local and Regional Governments

4. Do local and regional governments’ have the mandate and resources (funding, people and skills) to promote SME development.	2004	2003
	Yes: 46.2%	n/a
	No: 26.9%	
<i>*Don’t know</i>	*DK: 26.9%	

Most of the focus group participants believed that in principle the local and regional government bodies for supporting SMEs in Croatia have both the mandate and resources (funding, people and skills) necessary to promote SME development (46.2 % of participants). However, quite a large number (26.9%) were unable to comment as they are mostly unaware of their activities and/or rarely use their services. The SME owners and managers participating in the research pointed out that despite the fact that the availability of funding has been increasing, the level of services, apart from some notable exceptions is still rather poor and the staff skills are still inadequate.

“I welcome the general initiative both by the previous and present government to put more resources into the development of regional and local development agencies. They might contribute to encouraging the regionally specific development potentials and entrepreneurship programmes.”

SME owners and managers emphasised the need for further education and training of local and regional government staff. This would enable them to better assess the local SMEs business and entrepreneurship development needs and develop appropriate measures and instruments to address them. The participants considered that a much greater degree of partnership is needed between the enterprise sector and the local and regional authorities to make sound development plans.

The business community is still not fully aware of the institutions, mandate and resources available to support enterprise development at local and regional levels. They specifically suggest further strengthening of the capacity of regional and local development agencies in terms of funding, training and staff.

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
	1.9	2.7

The focus group participants were on average more critical of the availability of information on policies and programmes of support towards the SME sector than in 2003 when the rating was 2.7. A possible explanation is the wider regional coverage of the research this year, with the inclusion of two economically less developed regions around Osijek and Split.

Furthermore, most of the participants thought that the poor assessment of the information available and awareness about it in the small business community stems from the organisational change within the central government, which also has had an impact at the regional and local levels. The change of government has caused an “*information vacuum*” and most of the small entrepreneurs were very dissatisfied about it.

They acknowledged the efforts by the previous ministry to improve the dissemination of the information through information campaigns, introducing free phones at regional level. Most of them considered that the momentum has been lost by the new government. At the time of the research (April 2004), the general awareness among the business community of the existence and whereabouts of specific information was “poor”. This is a considerable deterioration since the 2003 study.

The view could be summed up with a statement of one participant from Osijek:

“Although it was far from being perfect, there were jumbo posters giving the numbers where you could call and get the information about the different programmes and institutions in charge. It was convenient as the number would automatically direct you to the regional offices who know more about your local conditions.”

The statements from other regions were similar:

“It is a paradox: the level of information seems to be less, although the number of institutions in charge is growing.”

The efforts to increase visibility and access to information and improve the dissemination of information lost momentum in the first quarter of 2004 and should be reinvigorated to ensure a wider reach, particularly in the less economically developed regions of the country.

Consultation between Government and the Private Sector

6. Are you aware of the regularity of consultation between government and the private sector on SME policy and its performance?	2004 Yes: 23.5% No: 76.5%	2003 N/A
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Most of the focus group participants were unaware of any consultations going on between the government and the private sector on SME policy. In fact, they thought that it is non-existent and plead that more effort should be made to establish regular contacts and dialogue. There was general view that the business associations such as the Chamber of Commerce; Chamber of Crafts and Croatian Employers' Associations do not well represent the voice of small business sector, because they are dominated by the interests of the larger firms. They believe that the associations need to make a serious effort to establish better representation of the small business community by creating dedicated branches for SMEs, exporters and sectoral groups.

7. Rating given to the quality and regularity of consultation between government and the private sector on SME policy and its performance.	2004 1.6	2003 2.4
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According to the focus group participants, the quality and regularity of consultation remains the least satisfactory aspect of the government's policy performance. These elements of the institutional framework are now generally rated as being even less than "poor" and have enormous scope for improvement.

At present no partnership between government and private sector appears to exist and this needs to be changed. SME owners and managers pleaded for the establishment of regular mechanisms of the communication especially when SME support programmes are launched or when new laws and programmes are being enacted. They also said that the SME business community should be better organised in order to ensure their voice heard.

One of the participants formulated the general focus group participants' view as follows:

“To meet once a year at meetings such as an Entrepreneurs' day could hardly be considered as regular consultation and we need to be heard more often.”

“I do not think that our general small business associations are representing us well when it comes to cooperation with government. We have therefore attempted to better organise ourselves in our branch (metal industry). We cannot blame the other side if we stay passive”.

Consultation with the enterprise sector, including the SME sector, continues to be sporadic and non-existent through regular mechanisms. SMEs argued that there is a need to especially improve the frequency of dialogue and also to actively consult private sector representatives before finalising and implementing new policies and programmes.

Institutional Performance

8. Performance of government institutions since March 2003 in supporting SME development.	No change 72.5%
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The focus group participants overwhelmingly believed that there has been little visible change in the level of institutional support for the SME sector in Croatia since March 2003. The formal organisational structure was subjected to a major change this year, but it is too soon to assess the impact of the changes. It remains to be seen how efficient the new government organisations will be in implementing SME policy. In the opinion of most of the focus group participants, other aspects of the institutional framework have not changed significantly and some recommendations from the 2003 study need to be repeated, especially when it comes to strengthening the support institutions at regional and local levels, in particular in the economically less developed regions.

3. Rule of Law and Regulatory Environment

The issues researched under this heading:

1. The formalities for new company registration and comment on the process.
2. The procedures for obtaining licenses, permits and certificates necessary for business operations.
3. Awareness of 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. Awareness of the programme for reducing the impact of corruption.
5. The quality and effectiveness of the programme for reducing the impact of corruption.
6. The quality and regularity of consultation between government and private sector/SME community on draft legislation and regulation that affects business and assessment of the change in the regulatory environment since March 2003.

Company Registration

9. Rating given to the company registration procedure.	2004	2003
	2.6	2.7

Most of the SME owners and managers believed that the company registration process does not present major problems in Croatia and believe it to be close to “satisfactory”. This is more or less the same as found in the 2003 study.

Some of the focus group participants were from new enterprises which had started their business fairly recently i.e. in the last 1-3 years and they presented their own experiences with registration procedures. One respondent from the Medjimurje region said that judging by his own experience:

“registration procedures are satisfactory and so are the costs”

The owner of a new company from Osijek said he had received good assistance from the local entrepreneurship centre there, while another told of the help he received from the business incubator (BIOS).

Some of the participants, however, said that the time needed for registration should be shorter as it sometimes takes 2-3 months, depending on the type of company you register and on administrative capacities and skills at the local level. Most of the participants agreed that it is rather easy and quick to establish a micro enterprise or a craft, but it takes longer to establish a limited liability company.

In the discussions they spoke in favour of the new government’s recent ideas to introduce ‘one stop shops’ for registration procedures and to introduce the ‘silence is consent’ principle, to boost start-ups.

“I think that the registration procedure depends on your relationships with the local bureaucracies, and these should speed up the registration procedure to avoid us hiring experienced lawyers who know how to ‘oil’ it.”

“Registration is not an obstacle. However, it could be organised more efficiently, for instance electronically to ease up the whole process; we know that in some countries the registration procedure takes only couple of days.”

“To establish a company engaged in trading or retail activities is relatively easy, but to establish one in production is difficult. Especially problematic is expanding activities into a field for which your registration does not specifically apply, so sometimes this takes further registration.”

The participants argued that registration procedures should be further simplified by allowing on-line registration especially for micro firms. The government should also pursue the idea of the introduction of a time limit for administration and establishment of the one-stop shops i.e. the ‘silence is consent’ principle.

Licences, Permits and Certificates

10. Rating of procedures for obtaining licenses, permits and certificates.	2004	2003
	1.9	2.4

The problem of obtaining licences, permits and certificates is still perceived by most of the focus group participants as a major obstacle to establishing new companies in

Croatia. The assessment of that issue considerably worsened compared to the 2003 study. Appropriate policy actions should be taken to tackle it efficiently (deregulation, monitoring of issuance etc). Both SMEs and experts mentioned that the procedures must be made much less complicated and the time required considerably reduced.

“To register a company is not a huge problem, but to get all the licences and permits needed to satisfy the standards of business is a huge problem, particularly in some areas that are more heavily regulated than others.”

It was also noted that the requirements are not applied consistently and that there is scope for a better inspection system. In this respect there are significant regional disparities, resulting from the differing qualities of local and regional administration.

“The problem is also in the weak monitoring and inspection systems which actually allow unfair competition among entrepreneurs as the standards are not applied on an equal basis: to some they apply to others they do not...”

Some participants particularly highlighted difficulties in getting location and building permits. This sometimes causes huge problems for investing in new company sites, and slows down the whole procedure. They considered it a systemic administrative problem, as the land and cadastre registers are not in order, especially in some regions. Several participants emphasised that this provides good opportunities for corruption. They said that the cost of getting the building permits is too high.

“It all builds up the costs of starting the business”.

One respondent from Rijeka region said:

“In our region, the case of one marina is well known. It took six and a half years to get its operation permit from the local administration. It almost seems like the bureaucracy is inventing the requirements in order to justify its existence - it is hard to convince me that these procedures could not be significantly simplified ...”

Another from Zagreb also said:

“The problem with the issuance of licences and permits is that the existing regulations often contradict one another, are not consistent with one another and sometimes they block the issuance of the operation permit. If there are no appropriate bylaws and sub-acts adopted, you are blocked, and administration has a good cover for doing nothing on your case.”

The problem of obtaining licences, permits and certificates remains and is a critical obstacle to establishing new companies in Croatia. The appropriate policy actions should be urgently taken to tackle it efficiently.

Simplification Programme

11.1. Are you aware of the Government programme for reducing legal and administrative barriers to business?	2004 Yes: 54.9% No: 45.1%	2003 N/A
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Over a half of the focus group participants in the 5 Croatian regions were unaware that the Government has been implementing a programme for reducing the legal/administrative barriers for businesses since 2002.

About 45% of participants did not know about the initiatives undertaken under this programme. Awareness varies considerably across the regions and the programme is better known in the north of the country (the capital city, Rijeka, Cakovec). The participants thought that reform of the cadastre and land registers is on-going, with the assistance of the World Bank and EC, but they were not aware of the results of the reform and they did not see the effects at local level. There is considerable scope for better information campaigns in this area.

11.2. Rating given to the efficiency of the programme for reducing administrative barriers for business.	2004	2003
	1.8	1.9

The overall assessment of the efficiency of the programme has remained at approximately the same level as in the 2003 study. Those participants who knew about the programme considered it poorly effective and thought that the Government should pay more attention to improving its results, particularly, as mentioned earlier, in the area of company registration procedures and regulation of the issuance of licences and permits (especially building and location permits). The participants suggested that an Inter-Ministerial Task Force should initiate the establishment of a ‘one stop shop’ where all the documents could be gathered and dealt with together. One respondent’s comment illustrates the general opinion of the focus group participants in the different regions:

“There have been little improvements in this area. The results of the Action Plan are unknown to me. If there has been the progress, it should be publicly presented.”

The communication of the results of Action Plan for Reduction of Barriers remains a problem. The Task Force should improve the exchange of information with business community.

Anti-Corruption Programme

12. Are you aware of the Government’s Anti-Corruption Programme?	2004	2003
	Yes: 50%	N/A
	No: 50%	

There were mixed views when discussing the awareness of the anti-corruption programme being implemented by the Government. Half of the participants had heard about it, while the other half had not. However, most of the experts interviewed knew about the programme and knew something about the USKOK’s (The Office for Prevention of Corruption and Organised Crime) activities.

13. Rating given to the quality and effectiveness of the Government’s programme for reducing the impact of corruption.	2004	2003
	1.9	1.8

Most of those who had heard about the Government’s programme to fight corruption assessed its efficiency as “poor”, in line with the EPPA in 2003.

Generally the participants considered that the efficiency of the implementation of the government’s anti-corruption programme has not changed significantly compared to the previous study a year ago. They believed that it does not yield the type of tangible results that would be felt in everyday business and be favourably perceived by the public.

One respondent in Zagreb said:

“The fight against organised crime in the country is still weak. In the last 5 years the state has initiated only 3 actions that are known to me - far too little.”

The Government should increase the visibility of the results of the Anti-Corruption Programme by improving the information campaign and also find effective mechanisms to include the business community and make them important allies in fighting corruption.

Consultation between Government and the Private Sector

14. Rating given to the quality and regularity of consultation between government and the private sector on draft legislation and regulations that affects business.	2004 1.7	2003 2.2
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The quality and regularity of consultation between the Government and the private sector is perceived to have fallen below “poor”. Most of the SME managers and owners that participated in the focus group discussions are dissatisfied with the dialogue they have with the Government, especially prior to the adoption of new legislation that affects small business. They emphasised that the large enterprises through different lobbying groups dominate the debate and that the voice of small business associations is weak in dialogue with the Government. One of the focus group participants in Osijek stated:

“Sometimes, but not often, we are invited to give our opinion but little change happens after that, I think that meetings with the people at the ministries are more of a courtesy than substantive”.

93.8 % of the SME owners and managers believed that there have been no major changes in regulatory framework that affects small business in the last year.

Regular communication and consultation with the business community remains a significant problem. The Government should devote much more effort to building effective mechanisms to facilitate timely communication of all relevant information and regular consultation with private sector on regulatory and other issues that affect them.

4. Tax Policy for Small Businesses

The issues researched under this heading:

1. Whether the present tax policy encourages new enterprise and 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 typically paid by SMEs.
4. The consultation and communication between government and the private sector on tax rates and incentives for enterprises.
5. Consistency of tax policy with other government policies.
6. Change in the regulatory environment for taxation since 2003.

Encouragement of new Enterprises

15. Rating given to tax policy in terms of the encouragement, support and ease of use that it provides to new and existing SMEs.	2004	2003
	1.8	2.2

92% of the SME owners and managers participating in the focus group research believed that the present tax policy does not encourage the establishment of new enterprises in Croatia.

The present tax system is considered “poor” in terms of encouraging the formation of new firms in Croatia. The view is somewhat weaker than the view expressed in the 2003 EPPA. The participants believed that the growth of newly formed enterprises is weak and the total number of companies is actually stagnant or decreasing, as most of them are struggling to survive.

“The total tax burden is especially heavy in the first years of business. There are no special concessions or grace periods if you are small. This should change.”

When discussing the ease of use of tax regulations for the small business, the participants emphasised that crafts firms find it easier, especially those that stay outside the VAT system. However, simplified tax reporting and book keeping should also be available to SMEs. Focus group participants also pleaded for the introduction of the facility for filing tax reports for small companies electronically.

Stability and Transparency

16. Rating given to the stability and transparency of the tax system for small enterprises.	2004	2003
	2.2	2.6

The perception of the stability and transparency of the tax system was regarded as being far from satisfactory. It is now rated slightly above “poor”. SME owners and managers were much more critical than the experts interviewed. The latter considered the transparency and stability as “satisfactory”, measured by the number of changes introduced in the last year.

A typical view of the participants could be summed up with the following quote from one SME manager from Split:

“Yes, the tax system seems to be stable and predictable, but that does not mean that it is good. It is not good when the Government is not changing what we consider a discouraging tax system.”

Another respondent commented about announced changes in the VAT rate:

“The announced changes of VAT rates starting from January 2005 are merely cosmetic. The real problem lies in Income tax and social contribution taxes which are generally high and discouraging for business.”

The focus group participants also frequently complained about difficulties in fully benefiting from some of the tax incentives, such as those for new employees. They found the procedures complicated, so they preferred not to engage with the process.

“The tax incentives offered, for instance for the newly employed categories of population such as new graduates, war veterans, invalids, self-employed etc, are not very beneficial, as you only get the benefits after 2 years, not immediately.”

“VAT has to be paid at the time of the issuance of an invoice and not at the time when it is paid. The problem of liquidity is substantial if you are a small enterprise, particularly if there is a protracted delay in payment of already delivered goods and services. Those who do business with state firms know about the problem, as their liquidity is poor. It could bring your business down. This should change.”

During the focus group discussions, the participants argued strongly that the tax system should be simplified and the same treatment should apply to all enterprises, both big and small companies, in the interest of transparency and fairness.

“Nobody offers me an instalment payment option for social contributions and tax debts, as are frequently offered to the large companies. I think that fiscal authorities are only tough when it comes to small companies, the big companies always escape...”

Some participants pleaded for special rules and incentives targeted only at the SME sector.

Simplification of the tax procedures for micro and small enterprises is urgently required. The Government needs to introduce an on-line tax filing system especially for micro and small and medium enterprises. Tax incentives should be offered for new investments in technology developments

The Annual Tax Paid on Net Profit

Most of the focus group participants (41.3%) said that small and medium sized companies in Croatia typically pay between 20-25% of their annual net profits in tax. However, there were mixed views on whether the amount paid in taxes is growing or is stable. 46.3% considered it to have been stable over the last year. 43.9% of the participants thought that the proportion of their net profits paid in tax was growing, while 9.8% of them thought that the proportion paid is decreasing.

Consultation and Communication on Tax Policy

17. Rating given to the communication between government and the private sector on tax rates and incentives for enterprises.	2004	2003
	1.7	2.0

The rating of the perception of the Government’s communication with SMEs and the private sector more generally on tax rates and on incentives for enterprises slightly worsened when compared to the 2003 study. It is now well below “poor”. Echoing the results under questions 7 and 14 above, the participants in the focus group discussions believed that:

- the government has not yet found efficient mechanisms for regular interactive communication with the SME community,
- the government still responds inadequately to proposals coming from SMEs and that
- the incentive programmes and drafts of new laws are not thoroughly discussed with SME representatives before being adopted.

It was acknowledged that part of the blame for this rests with the weak organisation of SME business associations and the other organisations that are meant to represent them in the dialogue with the Government. In the opinion of the focus group participants, these bodies are not effective. There is also a strong perception that issues relating to

stimulating start-ups and the problems of new firms' dominate the policy-making process, to the exclusion of other issues such as supporting technological growth and innovation.

“On different occasions we have tried to communicate that we need a tax system which would assist us in technological growth and offer incentives for investment in new products. But what we are lacking is a practical way to influence the tax policy”.

Finally, there is a perception among SME representatives that other pressing economic development issues dominate the tax policy debate, taking precedence over the needs of small business.

SME owners and managers felt that they are not consulted when the new tax legislation and regulatory measures are in preparation. A priority policy action for the next six months should be to develop the mechanisms for regular and timely consultation with SME representatives, including working with the private sector representative bodies to help them improve their own procedures to ensure that they effectively represent the needs of the SME sector in discussions.

Consistency of Tax Policy

18. Rating given to the consistency of the tax policy with overall government policy.	2004	2003
	1.9	2.2

The focus group participants believed that tax policy is not very consistent with other government policies and believed its co-ordination is “poor”. The prevailing view of the SME participants was that the current tax policy is not developmental in its nature and does not stimulate the expansion of the SME sector. However, the participants were aware of the problems with the fiscal deficit and did not expect that the policy will alter towards being one with drastically lower the tax rates in the short term. Some of the announcements by the new Government about lowering tax rates such as VAT rates were not commented on enthusiastically and were considered likely to have little impact on small business.

“The tax policy is not well coordinated with other government policies that aim towards better support to the SME sector (financial, employment, education, etc). A lot of contradiction exists. This proposal on VAT reduction illustrates it well.”

The problem of high social contributions and income taxes is hurting the competitiveness of small business exporters :

“Finding ways of scaling back these rights would be much more important than lowering the VAT rate”.

Tax policy should be better coordinated with the other policies that promote SME development and job creation, especially in the context of EU integration requirements.

19. The assessment of change in the tax system since March 2003.	2004
	No change: 88.5%

The dominant perception among the SME owners and managers is that no significant changes have taken place in the Croatian tax system since March 2003.

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 extending credits to the SME sector and their lending attitude to the SME sector.
3. Ratings of SME access to the following main sources of finance:
4. Own/family capital.
5. Micro finance.
6. Venture capital/Equity.
7. Others (e.g. credit unions).
8. Repatriation capital (from family / friends abroad).
9. Commercial banks.
10. Leasing.
11. Bank personnel skills.
12. Ratings of bank funding for working capital, capital and technology investments.
The change in the banking environment and provision of services and lending since March 2003.

Stability, Competitiveness and Services

20. Rating given to the stability, competitiveness and services provided by the banking system.	2004 2.7	2003 3.3
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The perception of the stability, competitiveness and services provided by the banking sector is now below "satisfactory". The focus group participants were generally more critical of the banking sector performance than the participants were in 2003. There was a general perception that, although the foreign banks have brought significantly positive developments, in the availability of funding, reduction of the interest rates and the quality and variety of services, they remain reluctant to fund small businesses on a significant scale.

The focus group participants believed that the banks are still overly conservative and that it is still rather hard to find a bank, which would fully support the developmental ambitions of an expanding SME enterprise if it could not provide enough collateral to guarantee repayment of the loan.

SME owners and managers criticise foreign banks for being more interested in lending to individual citizens instead of to companies. They said that they understand that the bank's policy is led by the objective of making higher profits. But, most of the participants expressed great dissatisfaction with such a short term banking policy and thought that the Croatian National Bank should intervene as regulator in this area to ensure more balanced lending policies.

Some of the participants commented favourably on the Government's recent announcement that it intends to form one large state owned bank through a merger of the

state's stakes in the Croatian and Postanska banks to ensure more influence in implementing the government's financial policy for the SME sector. However, there was some disagreement that this was a good thing. One of the participants said:

“I do not think that government subsidised interest rates is a real a solution over a longer period of time. If your business project cannot work on the markets terms after 2-3 years and on the basis of market interest rates, you should consider closing down your business. Your market chances are marginal if you continue to rely on the government lending.”

Others said:

“I think that the bank interest rates are not dramatically higher than those from subsidised loan schemes. These days one can get a loan, which can be realistically repaid. Previously this was not the case.”

“I think that exporters and fast growing enterprises now experience banks knocking on their doors, as is a case with my company. It was almost unimaginable only couple of years ago.”

The participants were concerned with the higher interest rates in Croatia than in the neighbouring EU countries and the need for an increase in the range of banking services available to the SME sector.

Banks' Interest / Attitude to SMEs

21. Rating given to the commercial banks interest in developing SMEs and their lending attitude to the SME sector.	2004	2003
	2.4	2.6

Most of the SME managers and owners were more critical of the commercial banks' attitude towards developing the SME sector than they were in 2003. This might be because of the recent changes in banking policy. For example, lending activities were discouraged by the Croatian Central Bank's introduction of higher mandatory reserves to stop the rapid expansion of lending that occurred in 2003. These measures led to a reduced level of lending to the enterprise sector, in particular to smaller businesses.

Although there has been an impressive improvement in the delivery of SME finance by the banking system in recent years, the interest and attitude of the banks is still inadequate to satisfy the needs of the growing SME sector. Participants particularly referred to the need to improve the availability and affordability of bank loans and for a reduction in the level of the interest rates. It would appear that the SMEs still experience a degree of discrimination in the financial services provided through the banking system. The participants' perception of the reason for this was that banking services rely heavily on the experience with their established clients, and tend to discriminate against new clients where there is more limited information about their ability to repay a commercial loan.

The participants' concerns about the availability of bank loans concentrated particularly on the process of assessing credit applications:

“It is a shame that you can more easily get a loan for buying a Mercedes or a yacht, than get a loan for starting or expanding your business. The documentation is not demanding for personal loans, while the guarantees for repayment of a loan for business investment include all of your property and several other guarantees.”

“I think it is not fair that I should have to guarantee with all my property, repayment of such loans if I have a limited liability company. The state should improve the guarantee mechanisms for exporting and expanding companies, the burden should not be only on my shoulders.”

An increase in the conservativeness of the bank's lending policy to the SME sector was particularly noticed since the 2003 EPPA report. The government needs to encourage banks to lend more to the enterprise sector by introducing better registries for land, real estate and other property to ease the collateral assessment process and also by simplifying the procedures for guarantees given through HAMAG.

Access to Finance

22. Rating given to the access to key sources of finance and guidance on financial matters to small businesses.	2004 2.4	2003 2.5
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Table 1.1. Relative Importance of Main Financial Sources Accessed by SMEs

Financial Sources	2004 Rating	2003 Rating	2004 Ranking	2003 Ranking
Family or own capital	3.3	(3.5)	1	1
Leasing	3.1	(2.9)	2	2
Commercial Banks	2.5	(2.7)	3	3
Repatriation capital	2.3	(2.2)	4	6
Micro-finance Funds	2.1	(2.4)	5	4
Venture/Equity Funds	1.9	(1.7)	6	7
Others (e.g. credit unions)	1.8	(2.2)	7	5

Index: 1= low, 5 = high.

The focus group participants, in line with the 2003 EPPA, ranked the capital from family and friends as being the most accessible form of finance. This source of finance, in particular family savings, is still considered to be much more attractive and reliable when seeking to expand business operations and is much simpler to put in place compared with the conditions required by the commercial banks.

The second major source of finance for most of the SMEs participating in the focus groups is leasing. It is perceived to have easier terms and for most of the smaller companies to be the most convenient way of funding equipment, computers, company cars, production lines, office space etc. The explanation for the slightly improved rating of leasing this year is the availability of a wider variety of leasing services from most of the foreign banks, who have exploited the fact that this is a market with huge potential in Croatia. Statistics for 2003 show that the leasing industry grew at a rate close to 40 %.

Repatriation capital as a source of finance for SMEs moved up from 6th to 4th place in the rankings. A possible explanation might be the inclusion of the two economically less developed regions in this year's survey. These traditionally have had high labour migration. Most of migrant workers work in Western countries, especially in Germany, while their families remain in Croatia. Some of the migrant workers or members of their

families have set up their own businesses in Croatia upon returning to Croatia with the encouragement of the governments of migrant recipient countries, particularly Germany.

The ranking of venture capital or equity funds also improved from 7th to 6th place. However in reality the availability of this type of funding is still rather limited in Croatia. The improvement might be because some of the focus group participants had received financial assistance for the development of their businesses from the Small Enterprise Assistance Fund (SEAF) capital fund Croatia.

The focus group participants assessed the skills of bank personnel as being on average between “poor” and “satisfactory” (2.6). One participant from Rijeka reflected the opinion of many:

“Bank personnel in most of the major banks dealing with loans for the SME sector have satisfactory skills. This has improved in the last 2-3 years. The major problem is however the rigid rules small business must comply with to get a loan.”

The research confirms that non-banking sources of finances are still vitally important for SMEs. The government should continue to develop new sources such as business angels and equity funds, as well as institutions for micro-finance.

22.1 Ratings given to the bank funding for working capital, capital investments and technology investments.	2004
	2.2

Table 1.2. Relative Importance of Different Purposes of Bank Funding Accessed by SMEs

Bank Funding	Rating	Ranking
Working capital	2.2	2
Capital Investments	2.3	1
Technology Investments	2.0	3

Source: Index: 1 = low, 5 = high.

The SME owners and managers ranked the availability of bank lending for working capital and capital investments as still “poor”, although they acknowledged that the situation has improved over the last two to three years.

“One can interest a bank in approving a loan for capital and technology investments only if you can provide credible collateral for loan repayment, which often includes all the property of the entrepreneurs”.

“At present I can get a loan for a new production line or production site only if I guarantee its repayment with my own property worth several times more. This should change: I am convinced that such rigorous requirements do not exist abroad”.

The guarantee schemes provided by the Croatian Agency for Small Entrepreneurship for capital investments seem to be too complicated and inadequate to satisfy the needs of the SME sector.

22.2 Rating given to the change in the banking environment since March 2003.	2004
	2.5

The SME owners and managers believe that on average the situation for the banking sector's provision of services and lending for SMEs has deteriorated and lies between "worse" and "no change".

6. Advisory Services for New and Small Businesses

The issues researched under this heading:

1. Use and satisfaction with the range and quality of advisory services available to new entrepreneurs and SMEs from private consultants and government / donor supported advisory centres, rating of the present services and comment on the changes needed.
2. Efficiency of advisory services operations.
3. Responsiveness of advisory services provided to the demands and the 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. Rating of change in the provision of advisory services for SMEs since March 2003.

Use and Range of Advisory Services

23.1 Do you use advisory services ?	2004	
Overall	Yes: 44.2%	No: 55.7%
Private consultants	Yes: 41.2%	No: 58.8%
Government/donor supported consultants	Yes: 39.2%	No: 60.8%

Interestingly, more than half of the SME owners and managers that participated in the focus group research do not use any advisory service when dealing with the business problems they face. This points towards several problems such as the quality of advisory services available and their cost.

23.2 Rating given to the satisfaction with the range of advisory services available to new entrepreneurs and existing SMEs.	2004	2003
	2.4	2.9

The SME participants were critical of the range of advisory services available to the SME sector. This was especially the case in the two less developed regions included in the survey (Osijek and Split). In general, the views expressed are more negative than in the 2003 study.

The focus group participants were particularly dissatisfied with the provision of advisory services by the state advisory organisations and said that much more effort should be put into improving the standard of delivery of such services. The participants were especially critical of the regional offices of the Chamber of Commerce and the Chamber of Crafts, as they are financed by taxpayer's money.

Most of the participants also point to the problem of uncertified consultants and pleaded for the reintroduction of the certification of consultants to international standards in order to ensure higher quality service and fairer prices.

Here are some of the most frequent opinions:

“It seems that the private advisory organisations are better organised than the public ones, particularly those with a good reputation. However, they tend to be rather expensive.”

“Publicly provided advisory services are mostly too general to be useful when you have a sophisticated business problem to be solved. However, one can notice improvements, particularly when it comes to the consultancy available to advise on starting a business”.

“I have had an excellent experience with one foreign consultancy company and it had such a positive development for the business of my firm. The first step is to seek help in searching for solutions”.

“I used to think that I could not learn anything new after being 15 years as an entrepreneur. However, the willingness to learn continuously from the expertise available can really make such a difference, as it did for my firm.”

The Government should urgently revitalise or create a new efficient network of consultants available to advise SMEs and aim to stabilise the market by ensuring certification of advisory services and qualified consultants.

Efficiency of Advisory Services

Close to 70% of focus group participant SME owners and managers were generally dissatisfied with the efficiency of advisory networks available to the SME sector in Croatia.

24. Rating given to the efficiency of advisory services networks available to SMEs.	2004	2003
	2.3	3.0

The average rating has deteriorated significantly when compared to the 2003 study and demonstrates the need for urgent policy action. The focus group participants were less satisfied with the efficiency of the advisory networks available to the SME sector in 2004, but they did rate slightly better the range of services available from the private

consultants (2.5). The services available from public consultants were regarded as “poor” (2.0).

Several participants pointed towards the problem for them of a non-existing advisory network, and for a map of available institutions to be made publicly available:

“Presently at national level there is no effective advisory network, let alone at regional or local level. I consider it a problem if the information on available advisory service is lacking. I think that at least at the level of Ministry there should be a list of certified organisations available in the country. This is a basic infrastructure offered to entrepreneurs in every European country. I cannot understand why nobody is dealing with it”.

“I think that state and donor organisations should work together on that front.”

The focus group participants asked for the reintroduction of certification of advisory services and monitoring of the standards in the delivery of the services.

Responsiveness to Demand

Generally, the focus group participants believe that the available advisory services do not respond to the demands and needs of the small business. That view was expressed by 72.3% of participants.

25. Rating given to the responsiveness of advisory services to demand and needs.	2004	2003
	2.2	2.5

The SME owners and managers believe the responsiveness of the available advisory services for the SME sector is “poor”. Their views were slightly more critical in this respect than in the 2003 study. The private advisory service providers were assessed by the 2004 focus group participants as slightly better (2.3) than the public ones (2.1). The explanation for this might be that most of the enterprises are actually unaware of the advisory services available and that an additional effort needs to be put into disseminating public information on the range of the services available.

The information on the range of the services available should be gathered in one place and be made available on-line.

Human Capital

26. Rating given to the skills, experience and quality of the staff providing advisory services.	2004	2003
	3.0	3.0

The skills, experience and quality of the staff providing the services to the SMEs was considered by the participants as being on average “satisfactory”, and it has not changed since the previous survey. The quality of the staff was assessed at 3.1, followed by the skills at 3.0 and experience at 2.9. SME owners and managers in the discussions referred to the experiences of their own firms in dealing with the services of the consultants as illustrated by:

“We seek top quality consultants experienced with the problems we want to solve. The better we can formulate the problem, the better the consultants can lead us to the correct solution. However, the final decision and risk is exclusively ours and not the consultant’s”.

Many participants raised the issue of ensuring continuous training and education of consultants to meet the more specific needs of SMEs. They also mentioned that foreign consultants often lack local knowledge on a situation, but have better knowledge of problem solutions methodologies.

The continuous education of consultants should be a must, especially for public advisory organisations which are lagging behind, particularly in the economically less developed regions,

Continuity of Provision

27. Rating given to the <i>continuity</i> of advisory services available.	2004	2003
	2.5	3.1

Continuity in the provision of advisory services was believed to be on average between “poor” and “satisfactory”, weaker than was found in the previous study. An explanation can be found in the very critical views expressed by the participants in the economically less developed regions where the advisory services available cannot be sustained, as they depend heavily on outside financial support, especially from the various donor organisations. Once this funding ceases, the provision of services will cease too.

Securing the longer term financial sustainability of business advisory services especially in remote locations and economically disadvantaged regions is a critical issue. Public-private partnerships should be developed especially in the entrepreneurial zones.

28. Change in the provision of business advisory services for SMEs since March 2003.	2004
	No change 78.4%

Over three quarters of the SME owners and managers participating in the focus group discussions (78.4%) said that no substantial change has occurred in the provision of advisory services to the SME sector since March 2003, and that there is scope for considerable improvement on this front.

7. Business Incubators

The issues examined under this heading were:

1. Awareness of and experience with business incubators and their value for new entrepreneurs and existing SMEs.
2. The efficiency of the government policy and programme for encouraging business incubators.
3. The extent to which the business incubators’ activities meet the needs of the local entrepreneurs.
4. The awareness of the other government/donor supported schemes for start-ups.
5. The change of the government policy towards the business incubators since May 2003.

Experience with Business Incubators

Most of the SME owners and managers participating in the research (84.6 %) knew what Business Incubators are. This might be a result of an information campaign and funding incentives provided for the creation of business incubators by the ex-Ministry of Crafts and SME since 2002.

However, most of the participants (72.5%) did not have any personal experience with Business Incubators.

The Importance of Business Incubators

29. Rating given to the business incubators' importance to new entrepreneurs and existing SMEs.	2004	2003
	2.7	3.3

The importance of Business Incubators for entrepreneurship development in Croatia is generally recognised and the focus group participants believed it to be close to "satisfactory", but less so than in the 2003 EPPA.

One of the micro-enterprise owners from Osijek who started up his business in a Business Incubator said:

"The Business Incubators are the positive way of promoting new start-ups, especially in the counties with a low level of new business, such as for instance in the region of Eastern Slavonia. We had a good experience with BIOS here, especially in the last year or two".

The government needs to circulate more information about well functioning Business Incubators in order to make the knowledge about them available to potential users, particularly in the economically less developed regions.

The Efficiency of the Government Policy for Business Incubators

30. Rating given to the efficiency of the government policy and programme of the establishment of Business Incubators.	2004	2003
	2.1	2.5

The focus group participants criticised the general government policy and programmes for the establishment of Business Incubators in Croatia and consider these to be on average "poor".

Most of them had heard of the programmes launched by the ex-Ministry (MCSME) but could not realistically assess their reach and outcome. The participants said that the information on existing Business Incubators and their operational experience is not readily available at the national level, and that the new Directorate for SMEs at the Ministry of Economy, Labour and Entrepreneurship should put much more effort in to making this information available on-line for all those interested from the small business community. The participants also said that the efficiency of the implementation of government policy towards the Business Incubators is very dependent on the support of local administration, especially in respect of funding. Those who had experience with Business Incubators commented along these lines:

"The problem with business incubators is that one really does not know what their main function is, mainly because the range of services they offer is rather broad. It

might be better to create specialised ones, for example for electronic software or computer design, etc.”

The information on Business Incubators is not readily available and the services they offer not specialised enough. The production Business Incubators could be part of the entrepreneurial zones as the supportive infrastructure there might be better.

Focus on needs of SMEs

31. Rating of the extent to which the business incubators' activities meet the needs of the local entrepreneurs.	2004	2003
	2.7	3.0

The operation of Business Incubators in meeting the needs of the local participants was assessed by focus group participants as being close to “satisfactory”. However, the focus group participants argued that this could be also improved and better adjusted to the local needs.

“Business incubators often serve as a powerful public relations card for local administration. More dialogue with entrepreneurs might bring better understanding of what the local community actually needs.”

Business Incubators should adjust better to local needs and be non-political in deciding what is best for the region. Better dialogue with the SME community is needed on their detailed needs.

Other programmes that support start-ups

32. Are you aware of other government/donor programmes that support start-ups?	2004	2003
	Yes: 32% No: 68%	N/A

More than two thirds of SME owners and managers (68%) were unaware of any other government or donor programme focusing on encouraging start-ups. This means that there is considerable scope for improvement in the dissemination of information, as in fact there are several specific government programmes focusing on start-ups and financed through the Croatian Bank for Reconstruction and Development HBOR, and also some donor programmes such as those of UNDP and EC focusing on start-ups on local and regional level.

Change since March 2003 in Business Incubator policy

33. Change in the in the government policy towards Business Incubators since March 2003.	2004
	No change: 68%

68% of the participants believed that there has been no change in the government policy towards Business Incubators since March 2003.

8. Entrepreneurship, Education, Access to Technology

The issues examined under this heading were:

1. The contribution of the education system to the creation of an entrepreneurial spirit.
2. Awareness of the training schemes for small entrepreneurs.
3. The quality of vocational training in relation to business activities.
4. Rating of the government's provision of information about the business standards and business opportunities.
5. Rating of the government's programmes aimed at improving the technological capacity of small enterprises.
6. Rating of the change in the image of entrepreneurs since March 2003.

Contribution of the education system

34. Rating on the contribution of the education system to the creation of the entrepreneurial spirit.	2004
	2.1

The focus group participants were very critical of the education system in Croatia and its contribution to the creation of a positive entrepreneurial spirit and on average considered it "poor". They also consider the educational system to be a major obstacle to the development of a competitive SME sector in Croatia.

Participants believed that secondary schools and graduate studies are lacking programmes that would teach students some useful and practical skills and a basic knowledge of entrepreneurial activities. In their opinion, most of the knowledge acquired through formal education is rather abstract. They believed that the education system is not teaching students the practical principles and mechanisms of competitive markets and the needed entrepreneurial confidence and knowledge. They thought that very few students start their own companies or crafts after leaving school. Most of them prefer to go into the state administrative professions or politics, as they consider these more lucrative than starting their own business.

"Our graduate economic schools are not useful for the SME sector. More focus should be provided by developing business schools, which pay more attention to practical business knowledge, not economic theory. We are lacking good business schools."

One of the focus group participants from Rijeka summed up the views of the most of the SME participants:

"Only better education can change the social values system and attitude which is not very supportive of entrepreneurship in Croatia. We should embed entrepreneurial behaviour through the education system, starting as early as teaching it in primary schools."

The formal education system needs reform to enhance the development of an entrepreneurship culture, attitudes and change in the social values system.

Awareness of the training schemes for small entrepreneurs

35. Are you aware of training schemes and programmes for small entrepreneurs?	2004 Yes: 69.2% No: 30.8%	2003 N/A
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Close to 70% of the participants were acquainted with the existence of the different training schemes and programmes for small entrepreneurs. They get this information from the local or regional centres for entrepreneurship development, the local administration or from business associations. The focus group participants emphasised the need for improving managerial skills training programmes as they thought that there is still a considerable need for such education.

The quality of the vocational training

36. Rating of the quality of the vocational training in relation to the business activities	2004 2.5
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The quality of the vocational training in Croatia was considered by the focus group participants to be on average between “poor” and “satisfactory”, mainly because it is considered to be inadequate in encouraging entrepreneurship.

“Often you get students that come out of a school with very poor knowledge of the skills needed to work in some branches such as the metal industry, civil engineering or the ceramic industry, let alone for some craftworks where really specific knowledge is required. This is a product of the education system where not enough attention is paid to the practical aspects as a method of teaching. Fortunately, this seems to be changing, so our pressure might bear fruit.”

The system of apprenticeship is considered to be ineffective and costly and is also rated as “poor” (1.9). The SME community felt that more organised efforts should be invested in preserving some of the crafts and handwork skills through the organisation of better apprenticeships. The participants considered that the Chamber of Crafts should be more active in this respect.

“Students avoid the professions in crafts. These are mostly underpaid and associated with hard labour. This should change with the advancement of the small business sector and such professions could regain respect”.

Most of the SME owners and managers meet with difficulties in employing skilled labour for their businesses, and they regard the situation in vocational training and apprenticeship as being between “poor” and “satisfactory”. One focus group participant said:

“I can only get someone highly trained and skilful in my branch of activity (metal industry) if I give them much higher salaries than anywhere else. So that’s what we do to be competitive.”

They believe that vocational training should be improved not only through the formal education system but also by putting in place continuous training and retraining programmes which could lead towards continuous improvement in the skills of the workforce.

“Knowledge is progressing at such a pace that one cannot rely only on the knowledge acquired through formal education. We have to understand that we are out in a market”.

Improve the quality of vocational training to better satisfy the needs of small business and crafts in the productive parts of the economy.

37. Rating of the government’s provision of information about the business standards and business opportunities for SMEs.	2004
	2.1

The government’s provision of information about business standards as well as business opportunities for SMEs was assessed as being “poor” on average. The participants expressed critical views of the dissemination of information on product or services standards.

They believe quality standards are very important especially in the context of further opening up of markets as a result of the EU integration process. In their view the business associations such as the Chamber of Commerce should be more active, in particular, in analysing and highlighting market potential and business opportunities for the different sectors and branches of industry. They should make the information more widely available to the business community.

There is a need to improve dissemination of information on requirements for ISO and other quality standards to the SME community. SMEs expect better access to on-line information, and better networking possibilities in particular with companies in the EU and also in the SEE region where the market potential for their products and services remains unexplored.

38. Rating of the government’s programmes to improve the technological capacity of small enterprises.	2004
	1.9

The present Government’s activities and programmes aimed at improving the technological capacities of the SME sector is assessed as being on average just under “poor”. Most of the SME participants thought that Government is unaware of the importance of this issue to competitiveness. Apart from some of the programmes that they have heard of, such as those supporting innovation, the participants believed that the Government has not created an environment that would stimulate enterprises to invest in new technologies.

SME owners and managers believed that the Government should be much more supportive of small business, especially through tax policies, as innovation and technological advancement is an engine of competitiveness in the enlarged EU. They believe that not acting now would hold back the development of the Croatian SME sector. Participants strongly believed that the institutional framework for supporting the development of innovative products needs to be improved, particularly in the area of intellectual property protection.

The institutional framework needs to be improved, for example through technology and innovation centres that could assist in the development of innovative products based on recognised patents and to improve intellectual property protection.

The Change in the Image of Entrepreneurs

39. The rating of the change in the image of entrepreneurs since March 2003.	2004		
	Better 17.6%	No change 72.5%	Worse 7.8%

Only 17.6% of focus group participants were of opinion that the image of entrepreneurs in Croatia has improved in the last year, while 7.8% consider that the image even worsened. Over 72% of them considered that there has been no significant improvement in the public perception of entrepreneurs. Most of them considered that the public image of entrepreneurs is not good and that this is a product of distorted social attitudes, which is still suspicious of a successful entrepreneur. Many participants in the focus group research said that entrepreneurial behaviour is still not sufficiently socially promoted or rewarded in Croatia. They believe this to be a result of the badly handled privatisation process in the 1990s.

PART II

Chapter 2

Analysis and Assessment

This chapter presents the 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 what changed in comparison to the 2003 EPPA Study; other OECD, EC, EBRD, Croatian studies and analyses of good practice; local research studies 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, EC and EBRD, as presented in Chapter 1.

1. Institutional Framework for SME Policy

The Situation on the Institutional Framework

This report mainly focuses on the changes in the institutional framework for the development of the SME sector in Croatia that have taken place since the previous report which was published in May 2003.

The biggest change occurred in the central government organisation that is in charge of articulating and implementing SME development policy, as well as proposing new legislative and regulatory rules affecting the sector.

Since January 2004, the key institution in charge of development policy for SMEs at the state level has been the Ministry of Economy, Labour and Entrepreneurship (MELE) and within it the Directorate for SME and Crafts. The new Government that took office at the end of December 2003, decided to abolish the independent Ministry for Crafts, Small and Medium Enterprises (MCSME), as part of a wider programme to reduce the number of ministries within the new government. A new Ministry of Economy, Labour and Entrepreneurship (MELE) has been created from the merger of three separate ministries: the Ministry of Economy, Ministry of Labour and Social Care and the Ministry of Crafts and Small and Medium Entrepreneurship.

This organisational change is a reversion to the organisational structure in place up to the year 2000. However, the Directorate for SMEs is now a part of a huge Ministry, which has a lot of other economic and labour priorities apart from entrepreneurship.

The new government has continued to emphasise the importance of further strengthening SME development and entrepreneurship as one of its developmental priorities for the 2003-2007 period (Programme of the Government of the Republic of Croatia, Developmental Priorities, December 2003, www.vlada.hr).

At the beginning of May 2004 the Government adopted a new ‘Incentives Programme for Small and Medium Entrepreneurship’. The programme has set the following several new strategic goals for encouraging SME development in the medium-term:

- More equal development of all the Croatian regions.
- Increasing the number of the small and medium sized companies (TEA index¹).
- Creating new entrepreneurial zones.

¹ TEA (Total Entrepreneurial Activity) Index measures the number of newly established companies in relation to the adult population of a country (age: 18-64) over the past 42 months. The index is calculated within the Global Entrepreneurship Monitoring Project (GEM) of The London Business School and Babson College Boston. The 2002 results for Croatia show that in the year 2002 there were 3.6 companies per 100 adults, while TEA Index for Poland was 4.4; for Slovenia 4.6, for Hungary 6.6 and 9.1 for Ireland.

- Removing administrative obstacles.
- Increasing the competitiveness of the various sub-sectors (through investment in enterprise development, education and new technologies).
- Changing the structure of activities in favour of production activities.
- Strengthening the export orientation of the sector.
- Creating a positive entrepreneurial spirit (development of the entrepreneurial culture).
- Networking and better linking within the small business sector as well as between SMEs and large companies (networks, cooperatives, clusters, cooperation).
- Increasing the number of people employed in crafts from an average 1.4 to 2 employees.
- Reducing the tax burden.
- Including the target population group (youth, women, war veterans) in entrepreneurship activities.
- Developing additional education and training programmes for entrepreneurship.

The other key SME support institutions at national, regional and local levels are continuing their operations. Among them at national level is the very important Croatian Agency for Small Business (HAMAG) which implements and co-ordinates the various incentives for SME development, as defined in the Law on Stimulating the Development of Small Entrepreneurship (March 2002). HAMAG was established in June 2002 as a legal successor to the Croatian Guarantee Agency (CGA), the key government SME support institution since 1996. HAMAG is funded by the state budget, international loan schemes and other sources. It plays a crucial role since it is in charge of implementing the short and medium term plans for the development of small business and co-ordinating all financial incentives to SMEs. Its prime goals include:

- Encouraging the establishment and development of small business entities.
- Promoting investments in small businesses.
- Extending loans to small business entities.
- Issuing loan guarantees.
- Providing financial support for the reduction of borrowing costs.
- Subsidising loan interest rates.
- Inviting bids for leasing or selling of real-estate.
- Providing support for fostering employment.
- Providing incentives for the development of modern technologies.
- Providing support for participation in international fairs and exhibitions.
- Promoting female and youth entrepreneurship.
- Performing other specialised tasks.

The Agency started functioning in January 2003. And after some initial problems it has now begun its activities to assist the SME sector. In 2004 the Agency plans to focus on achieving progress in two particular areas: a) simplification of procedures for provision of guarantees b) development of an efficient consultancy network and certification.

The financial support to SMEs in 2003 through the ex-MCSME (such as SME incentives, subsidised loans and other capital assistance) amounted to roughly €10.2 m (State Budget Plan, Ministry of Finance, 2003). However, there is also a significant amount of additional financial support available for the SME sector from the state budget via other ministries (Ministry of Tourism, Ministry of Public Works, Reconstruction and Development) as well as through the Croatian Bank for Reconstruction and Development (HBOR). This amounts to a total of €68 m, according to the 2003 Budget Plan of Ministry of Finance. The Budget Plan for 2004 envisages a further increase in the finance available for SME development through the Ministry of Economy Labour and Entrepreneurship (Directorate for SME) of about 16%.

The responsibility for coordination of the system of institutions (including HBOR, the SME business development centres, regional development agencies, business incubators, free business zones, business associations, regional and local administration, etc), were taken over from MCSME by the Ministry of Economy, Labour and Entrepreneurship and its Directorate for SMEs. This new ministry now mediates between banks and entrepreneurs, provides consultancy services and assists in searching for investment funds. Its work is backed-up by initiatives of other ministries and state agencies that have SME support programmes, self-employment initiatives and sectoral activities. The other ministries and organisations involved include the Ministry of Tourism, Ministry of Agriculture, Ministry of Science, Croatian Employment Bureau, Regional Development Fund and the Fund for Development and Employment.

Other important support institutions for SMEs at the national level are:

- Croatian Bank for Reconstruction and Development (HBOR).
- Croatian Chamber of Economy.
- Croatian Chamber of Crafts.
- Small Business Association at the Croatian Employers Association (HUP).
- Croatian Association of Cooperatives.
- Association of Croatian Institutions for Encouraging Entrepreneurship (UHIPP).

These organisations provide support to small enterprises but also co-operate with the Ministry of Economy, Labour and Entrepreneurship in order to disseminated information on their programmes to SMEs.

In April 2004 a new Association of Exporters and Entrepreneurs was established with the aim of establishing an umbrella association: the Confederation of Croatian Entrepreneurs. This new association will represent both small and large companies. Their aim is to introduce some competition for the established business associations in Croatia. It remains to be seen if it will successfully fulfil the need for better representation of small business in Croatia.

At the regional and local level, support for the SME sector is organised through the regional and local administrative bodies. There are 21 counties in Croatia, and most of

them have established a regional business support centre organised and financed by the regional body in charge of economic development. There are 123 towns and cities and 420 municipalities, some of which host close to 40 existing local business support centres.

These local and regional institutions also have a role in the implementation of the new Incentive Programme for Small Business Development in terms of decentralisation of government funding and supporting and tailoring programmes to the needs of local entrepreneurs. Their quality varies in accordance with the level of economic development in the area, the funds assigned for SME development, as well as the skills and expertise of personnel of these centres.

In order to increase the amount of non-commercial finance available to the sector, local SME support funds have been established with financial support from the government, and from the county budgets and placed in local banks for SME loans. In parallel with this the government is attempting to provide advisory services to entrepreneurs to assist in the development of business plans and in their approaches to the local funds for credits.

Zagreb, Međimurje, Primorsko-Goranska and Istrian county have successfully launched a number of SME development and support programmes and have assigned significant funding to them. There are also seven regional development agencies. The most recently established one (end of March 2004) is the Regional Development Agency of Međimurje, which followed six years of the successful operation of the Centre for Entrepreneurship Međimurje.

The new government has stated its intention to foster the creation of Regional Development Agencies in other counties, following the model and experience of the successful Istrian Development Agency.

The counties and municipalities, especially in the regions affected by the war in 1990s, have fewer SME development centres. The government has succeeded in the last year and a half in establishing several new centres in these regions, with substantial local co-funding. The foreign technical assistance programmes (such as UNDP, CARDS, World Bank, USAID, EBRD) also support development at the local level, so funding is not a major problem and there are various programmes to assist these regions into the future. Croatia gained EU candidacy status in June 2004. It is expected that the counties, cities and municipalities will become more active in developing favourable conditions for SME development in future, especially within the context of the EU integration process requirements as.

Assessment

The bodies involved in the new organisational structure have started implementing the new government's policy for SME development. The state has also dedicated a substantial budget for implementation of its policy through the Ministry and HAMAG (Croatian Agency for Small Business). Apart from this funding, as previously indicated, there is a substantial amount of state budget funds available for SMEs through other ministries and a number of other institutions provide financial support to SMEs. These include the Croatian Bank for Reconstruction and Development, and the Croatian Chamber of Commerce and the Craft Chamber.

It is too soon to assess the success of these new structures, but SME owners and managers believe that the reorganisation of the central ministry in charge has diminished

its clear organisational responsibility for SME policy, as the Directorate for SMEs now operates as a part of a very large Ministry. The research participants were of the opinion that the changes had reduced the availability of information in the first quarter of 2004.

The newly adopted Incentives Programme for SMEs (May 2004) is considered by the research participants to offer little that is new, apart from focusing on strengthening the institutional support structure by increasing the number of entrepreneurial zones (from the current 114 to a total number of 400). They expressed their concern about the plan being unrealistic, and suggest that instead of building new zones, the operational capacity of old ones should first be strengthened.

They believe that HAMAG needs to be further strengthened within the context of the recent abolishment of MCSME, both in terms of funding and the capacity of its staff.

There is scope for considerable improvement in the quality of the service and advice provided to SMEs by the range of other support institutions, in particular in relation to further education and training of the staff and funding for the programmes; as well as for promoting SMEs development.

The number of towns and local authorities which also have their own local business support centres has increased, and although most are fairly insignificant there have been important initiatives in some localities to establish business support centres, technology parks and business incubators.

The focus group research and the interviews with experts revealed that although Croatia has a fairly well developed and diversified institutional framework for SME support at state, local and regional level, among entrepreneurs its effectiveness is generally perceived as “poor” and has deteriorated since the previous EPPA study. The deterioration in the perception among the SME owners and managers could be because three to four months is too short a period to estimate how efficiently the new organisational structure at the state level will be in delivering the various types of support to SMEs. Another explanation for the poorer perception about the existing institutional support infrastructure could be the presence of focus group of representatives from the two economically distressed regions who had particularly critical views.

The experts consulted confirmed encouraging progress in the development of support structures at local and regional level through the development of regional development agencies and business support centres and incubators. They said that Zagreb, Međimurje, Primorsko-Goranska and Istrian counties can be considered SME developed regions with well-functioning regional and local bodies supporting the SME sector. The experts expect their further strengthening in the future especially in relation to their mandate and funding.

However, the focus group participants were critical in their assessment of the mandate and resources (the funding and capacity of the staff) of regional and local support structures and believe them to be poor. They believe that the counties and municipalities, particularly in the poorer regions lack the absorption capacity, expertise and skills to develop support centres with an ongoing entrepreneurial dynamic and on a sustainable basis.

One of the key weaknesses in the institutional framework lies in the area of the quality and regularity of consultation between the government and the enterprise sector. Although numerous institutions exist, they are characterised by a “top-down” approach to policy making, even though such policy is largely delivered at a local and regional level.

The system remains bureaucratic and lacks an adequate involvement of the private sector, other stakeholders and social partners in the formulation and evaluation of policy.

Several studies, including this one indicate that the small business community is not satisfied with the present levels of service and support provided to them by the mandatory business organisations such as chambers and that there is much scope for improvement in this area, particularly at regional and local levels.

The research indicates that effective policy implementation will be impaired unless the relevant institutions co-ordinate their activities in order to ensure that they are informed of each other's activities and that these do not undertake overlapping work.

Overall, the focus group research suggests that weakness remains and the participants rated most of the areas of the institutional framework covered by the study as less than "satisfactory" and being generally close to "poor". This critical view is of some concern as there is a plethora of support institutions for SMEs in Croatia.

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

The Situation on the Rule of Law and the Regulatory Environment

Most of the regulatory framework refers to all enterprises, particularly when it comes to the registration and operation of businesses. The following specific legislation that presently regulates the operation of small businesses:

- The Law on Stimulating Small Business Development (Official Gazette, 29/02).
- Law on Crafts (Official Gazette no. 77/93, 90/96, 64/01, 71/01; compiled text 49/03).
- Law on Commercial Companies (Official Gazette no. 111/93, 34/99, 121/99, 52/00, 118/03).
- Law on Co-operatives (Official Gazette no. 36/95 and 12/02).
- Law on Enhancing Small Business Development (Official Gazette no. 29/02).

The other key regulation that affect the operation of small business such as tax regulations and financial regulations do not have different provisions for different sizes of enterprise.

There were very few major changes in the regulatory framework that directly affected the enterprise sector over the last year. The most important was related to the adoption of the amendments to the Law on Commercial Companies in July 2003. In 2004 the government also adopted a complete text of Law on Crafts with a compilation of all previous changes by amendments to the original text in order to make it more transparent.

The total time taken for all procedures for registering a company can be up to 45-50 days while obtaining a building and location permit (for building new business premises) takes a minimum of three months. In the Action Plan for Reducing Business Barriers (see below), the previous government had recommended a time limit of 30 days for company registration, after which the registration would become automatic. It was also trying to reduce the costs of various procedures for company registration and licence and permit issuance, especially for small business and crafts start-ups.

The costs of registering new firms have not changed since the March 2003 and depend on the legal form of the company. To establish a limited liability company, the minimum capital requirement is HRK 20,000 (about €2,600). Apart from this, potential entrepreneurs are required to pay registration costs amounting to at least 6,500 HRK (€860), covering fees for several registry requirements (including a registration announcement in the Official Gazette and national daily papers, court registry fees, certificates for minimum capital, opening bank accounts, company seal etc.). The requirements for registering a craft firm or co-operative are significantly lower. The certificate fee for crafts is about 500 HRK (about €66), but there are discounts for persons starting crafts in the areas of special state concern (namely the war affected zones), on islands or for unemployed persons, for whom the costs are reduced to 200 HRK (about €26). Unemployed people over the age of 45, those with at least 20 years of working experience, and former war veterans are fully exempted and the court registry fee amounts to 270 HRK (about € 36).

The Inter-Ministerial Task Force on Removing Administrative Barriers to investment is implementing the Action Plan for Reducing Business Barriers and continues to simplify procedures, eliminate barriers and reduce costs to start-ups, especially for “green field” foreign investments. It is headed by the Vice-Prime Minister, while the Ministry of Economy co-ordinates the work of the Task Group. The Task Force consists mostly of civil servants from ministries and other government bodies. Apart from the reform project of land property cadastre, it also initiated an inventory of assets owned by the state with the aim of increasing transparency and facilitating foreign investment. In 2003 the task force initiated the legislative changes that could ease up the issuance of permits for foreign workers, which were very rigid and were an obstacle in developing some businesses (such as shipbuilding, road building and other civil engineering works and the tourist industry).

The principle of “silence is consent” has not yet been adopted although the present Government intends to pursue its introduction, and has recommended an even more ambitious time limit of 7 days.

The Government has given corruption serious consideration and is in the process of changing the regulations which will give more power to the State Office for Preventing Corruption and Organised Crime (USKOK). Its activities have been intensified in the last year with several successful investigations into the most serious economic crimes, such as money laundering, financial frauds, abuse of official positions, privatising firm’s profits, fictitious capital investments and illegal capital drains that are eroding public trust in the market economy and its institutions. At the time of EPPA research, the new Government was drafting changes to the regulations to provide greater authority to USKOK in preventing organised crime and corruption.

The grey economy is estimated to have accounted for 10% of Gross Domestic Product (GDP) over the period 1996-2000 (Institute of Public Finance, 2002). That is an important reduction compared to about 25% in the mid 1990s. The Government has continued the work of the Inter-Ministerial Task Force on the Grey Economy in order to co-ordinate measures aimed at creating a better regulatory framework, as well as creating incentives to formalise the grey economy. The work of the Task Force focuses on providing public information on the causes and effects of the grey economy and its impact on economic development.

Assessment

According to the various domestic and foreign assessments, including the recent EC study evaluating Croatian suitability for candidacy status, a regulatory framework conducive to the growth of entrepreneurship and a fully functional and competitive market economy has been quite well developed in Croatia. Most of the experts consulted during this research and other analysts in Croatia consider the present regulatory framework for operation of the enterprise sector to be quite well developed and conducive to a functioning market economy and entrepreneurship. However, despite significant progress in 2004 in adopting a number of laws as well as various codes and practices guiding market behaviour, problems remain, particularly relating to enforcement, inconsistency and sometimes over-regulation. There is a scope for further improvements especially in the context of harmonisation with EU legislation. The strong external pressure for the continuous improvement of the business regulatory framework in Croatia will continue now that Croatia has received candidate status in the EU integration process.

The procedures for *company registration* are now broadly in line with EU standard practices and are not considered by most studies to present crucial legal or administrative barriers to business start-up (World Bank, 2003; EC 2003; FIAS, 2002) including this one. However, due to inconsistency and inefficiency in the application of these procedures by the different segments of the administration and at regional level, company registration is still a much more time-consuming process than in the EU and in the most advanced transition countries. The government is aware of this fact. A skilful lawyer can register a company within one to two weeks, illustrating that the problems are mainly related to transparency and unnecessary bureaucracy.

The achievements of the Inter-Ministerial Task Force on Removing Administrative Barriers and the implementation of its Action Plan for Reducing Business Barriers seem to be rather modest. The improvements that have been made in relation to getting faster permits for employing foreign workers, as a result of pressures coming from some industries, such as civil engineering, shipbuilding, and tourism are appreciated, but the time and costs for establishing a new business remain too high.

The SME focus group participants believed the overall regulatory and legal framework to be still “poor”, in line with last years survey. Participants said that the registration procedures are inefficiently applied in some areas, but that is not the major obstacle. They believe that the procedures for obtaining licenses, permits and certificates etc. required for business operations is totally unsatisfactory, costly and time consuming, especially when compared to EU benchmarks. They suggest that simplification of procedures, precise regulation of requirements and monitoring of compliance should be urgently introduced. Activities to remove administrative barriers to business should be stepped up with the help of international organisations such as FIAS and the World Bank.

The recent Report of National Competitiveness Council (*55 Recommendations for Increasing the Competitiveness of Croatia, 2003*) suggests that the time required for registration should be substantially reduced (the suggested time limit is one week) if the Government wishes to achieve the goal of increasing the number of new enterprises and job creation.

According to most of the recent surveys, *land acquisition, registration and site development* are still the most complicated parts of starting a new business in Croatia, and still constitute impediments to a higher inflow of foreign investment. The procedures are

bureaucratic and time-consuming, but the key issue is the chaos in land and cadastre registry, which is now being tackled with World Bank and EC assistance and is expected to come to fruition by 2007.

The quality and regularity of consultations between the government sector and the private sector on draft regulations and legislation that affect business is similarly seen to still be “poor”.

Corruption is a phenomenon that still seriously affects the business environment and is of vital concern to SMEs. This is confirmed by the SME owners and managers who still see it as a very critical issue. The efforts to tackle corruption are welcome, though there is evidence that the situation may still be deteriorating. The Transparency International Corruption Perception Index (Transparency International, 2003) placed Croatia in 59th place compared to 53rd place in 2002. Considerable scope still remains for improvement in the work of USKOK, especially involving the private sector in the process and adopting a more precise and concrete action plan to reduce corruption.

The main causes of the significant reduction in the levels of the grey economy to 10% compared to 25% in the mid 1990s were:

- Faster economic growth and increases in GDP levels during the period.
- Changes in the structure of consumption.
- Improvements in the recording and statistical system.
- The introduction of VAT.
- The stabilisation of the large retail systems and
- The entry of the foreign firms and banks into the Croatian market (Ott, 2002).

There is a need for more frequent surveys of the grey economy, as it is still very significant in labour market, retail trade and tourism. As recommended in the 2003 EPPA: the effectiveness of the Inter-Ministerial Task Force on the Grey Economy could be improved by more active private sector involvement, and is again a recommendation of this EPPA report.

By introducing a time limit (the recent Government suggestion is 7 days) for company registration by law, after which the registration would be automatic, Croatia would effectively start working towards the implementation of the principle of “silent consent” as a mode of fighting bureaucratic labyrinths. Under such a rule if the relevant public body fails to answer within a prescribed period, it will be deemed that consent has been given. The extension of this principle would work towards streamlining and reducing compliance costs for various company registration and licensing procedures. Allied to the above, in the new Incentives Programme for SMEs (May, 2004), the Government has agreed the need for creating a “One-Stop-Shop” system, as in the case of other SEE countries such as Romania.

Despite recent improvements in the regulatory environment facing entrepreneurs in Croatia, it remains overly bureaucratic and there remain significant costs and delays in starting-up a business.

3. Implementation of Tax Policy for Small Businesses

The Situation on Taxation Policy for Smaller Businesses

There has been little significant change in taxation policy in Croatia since the 2003 EPPA. The system in its main features remains more or less the same as a year ago, apart from the introduction of some additional income tax incentives for research and development costs that came into force in December 2003. The present taxation system remains stable and predictable.

Taxation policy and collection systems in Croatia are designed to be neutral, treating all enterprises equally, regardless of size. However, more recently, some incentives to stimulate private sector development have been adopted, such as relieves for operating in tax-free zones, war-affected regions, highlands and islands etc. as discussed below.

All joint stock companies and other legal persons reporting profits pay Corporate Income Tax (CIT) at the rate of 20%.

In 2002 the government adopted the changes to the Law to Stimulate Investment (2000) affecting the tax and customs treatment of potential investors, both domestic and foreign. New incentives now apply to new domestic or foreign “green-field” investment as well as established companies operating in the tourism sector, with investment of over HRK 4m (€530,000). The incentives cover: leases, construction permits, sale or concessions of real estate or infrastructure on a commercial or special basis as well as subsidies for new employees and their training. A Fund for Real Estate and a Fund for Stimulating New Employment have been created. The profit tax incentives applied to the types of investment are set out in table 2.1 below.

Table 2.1. Investment Incentives

Investment (HRK/€ mil.)	Profit Tax Rate	Duration of Tax Incentive	Min. No. of employees
HRK 10-20 / €1.3-2.6	7%	10 years	30
HRK 20-60 / €2.6-8	3%	10 years	50
HRK 60 / €8 and more	0%	10 years	75

Investment Promotion Law, Official Gazette 73/00.

The total amount of the tax relief may not exceed the amount of the investment. A taxpayer that has had tax relief and lost the right to make use of it cannot be granted the right to make use of it again. The investors who are entitled to tax relief are also granted customs exemption for the equipment needed in the operation of the established enterprises. Tax relief can be used only by those carrying out the incentive measures as defined by the Investment Incentives Act. An exception is if the investment is made in the tourist industry. At the request of the investor and on the recommendation of the Ministry of Tourism, the government of the Republic of Croatia can decide that an existing company may be granted tax relief.

The Government plans to introduce additional tax incentives for new industrial enterprises under the proposed Programme for the Development of the Entrepreneurial Zones (May 2004). This will include the abolishment of the property tax and reducing profit tax, as well as further reductions in the income tax rates especially in the areas of special state care. It has charged the Ministry of Finance to prepare the draft regulations.

There are some other exemptions, deductions and tax incentives:

- Regions affected by the war (the areas of special national concern), where enterprises pay 25%-75% of the rate (depending on the region or area) if they employ more than five employees, provided that more than 50% of the employees have their homes in these regions.
- Hill and mountain areas: for an enterprises that operate in hill and mountain areas, employing more than 5 employees (for non-defined periods of time) and where more than 50% of the employees have registered domiciles and live in the hill and mountain area, CIT is 75% of the prescribed rate.
- Businesses operating in tax-free zones pay only 50% of the rate, while those investing more than HRK 1m (about €133,000) are exempt from profit tax for 5 years; and the profit tax rate is reduced to 7% or even to 0% if the investments is in the HRK 10-60m (about €1.3-8m) range. An exemption from CIT is granted in the free zones of Vukovar and Srijem counties. The exemption applies for a period of 5 years from the start of the business activities in the zone. After the end of this period, the CIT is payable at 25% of the general rate.
- The taxable base is reduced by the salaries and social security contributions for new employees in the first year of their employment and for up to three years for the disabled.
- A taxpayer established under the provisions governing occupational rehabilitation and employment of disabled persons is subject to a reduced CIT rate, which is 25% of the general rate.

Tax incentives for research and development costs were introduced recently (Book of rule on personal income tax (Official Gazette no. 40/03, 188/03, 198/03.) and are in effect from 27th of December 2003. They include:

- 100% reduction of the taxable income by the costs of the research and development
- Depreciation charges for the acquired intangible assets.
- Allowance of education and professional improvement costs.

The taxable base can be further reduced by the amount of all costs incurred by the taxpayer for research and development during the tax year (costs of salaries, material, amortisation for intangible assets obtained exclusively for research and development, training of employees, etc). The effect is that these costs are deductible twice, first as deductible expenditures when taxable profits are calculated, and second as a reduction of the already calculated taxable base for CIT purpose.

Research is defined as an original and planned investigation undertaken for the purpose of acquiring new scientific and technical knowledge and understanding, and includes fundamental and applied research. Fundamental research is deemed to be a theoretical or experimental work undertaken for the acquisition of new knowledge without any concrete application, while applied research is deemed to be theoretical or experimental work undertaken for the acquisition of new knowledge and aimed at the attainment of a practical objective.

Development is defined as systematic work that is founded on the results of scientific research and practical experience aimed at the creation of new materials, products and

systems and the introduction of new or a considerable improvement of existing processes, systems and services. Intangible assets are defined as patents and licenses that are used for the performance of the research and development activity as well as capitalised expenses for development.

The Personal Income Tax (PIT) rates are divided into four categories: 15% for those earning less than two monthly personal income tax deductions (2 x HRK 1,500 or about €400); 25% for those who earn less than HRK 6,750 (about €900); 35% for those earning less than HRK 21,000 (about €2,800); and 45% for those earning more than HRK 21,000. The annual personal tax deduction amounts to HRK 18,000 (about €400). As of 1st January 2003, a new income tax allowance was introduced for health care costs and for satisfying certain housing needs (up to HRK12,000), along with a reduction in the tax base for the wages paid to pupils during their practical work and apprenticeship. At the end of 2003, the non-taxable amount of special bonuses was increased from HRK 1,000 to 1,600 (€215). In addition, there is a local income tax (surtax) in urban areas exceeding 40,000 inhabitants, ranging from 10-30%, calculated on the basis of the income tax. Small businesses fall into the income tax system if their earnings do not exceed HRK 85,000 yearly (about €11,300).

Employers and employees are obliged to make social insurance contributions such as pension, health and unemployment insurance. Employees pay 20% of gross wages and/or salaries for pension insurance (15% for 1st pillar mandatory public pay-as-you-go system and 5% for the 2nd pillar mandatory funded private pension fund). Employees do not pay a contribution for health insurance. It is paid by the employer. Employers are obliged to pay social security contributions (*doprinosi socijalnog osiguranja*) on gross wages and salaries (excluding fringe benefits) of the employees at the following rates: 15% for health insurance; 0.5% for special health insurance aimed for on-the-job accident and occupational disease; and 1.7% for unemployment insurance. The total paid by the employee is 20% on gross wages; while the total paid by the employer is 17.2%

The Value Added Tax (VAT) was introduced in 1998 and stands at 22%; certain products are zero-rated, such as bread, milk; books, pharmaceuticals etc. The threshold for VAT registration is HRK 85,000 or about €11,300, with a standard accounting period of one calendar month. However, businesses with a turnover of less than HRK 300,000 yearly (about €40,000) are subject to a standard accounting period of three months. Most micro and small enterprises remain outside of the VAT regime (i.e. if they earn less than HRK 85,000). However, they may choose to register for VAT and are entitled to VAT refunds from the Tax Administration. Foreign companies not registered in Croatia are not entitled to VAT refunds. The VAT refunds period has been reduced from 30 to 15 days.

The Croatian Parliament decided on March 24, 2004 that for the year 2005 the standard VAT rate will be lowered to 20%. However, it has had to be postponed because of the current high fiscal deficit. Most of the analysts pointed out this problem at the time when the Decision was adopted by the Parliament.

Excise tax is applied to domestically produced or imported oil and oil derivatives, tobacco products, alcohol, non-alcoholic drinks, beer, coffee, passenger cars, motorbikes, boats and air planes, jewellery, watches, furs, clothes and weapons. In addition, the Law on Real Estate Transfer Tax regulates taxation in the transfer of real estate. All real estate transfers are taxed at a rate of 5%.

Assessment

Most of the experts and analysts believed that the present tax system encourages business development and entrepreneurship in Croatia. This because of the fairly low profit tax rate, and the various income and profit tax exemptions and incentives set out above. The focus group representatives of the small business community also believed that the system is fairly stable and transparent (though there were some counter opinions arguing that it is not so good). The new R&D tax incentives are a very attractive regime and should encourage a considerable increase in research and development if the regime is administered in a non bureaucratic manner. The reduction in the VAT refunds period is a very important improvement for small business finance.

Simplified procedures exist for tax reporting and refund for small and micro enterprises, though there is room for further improving the information and training for entrepreneurs, on-line submission of tax returns etc.

The 2004 focus group research confirms that the present tax system is not designed to specifically stimulate SME development. Most SME owners and managers believed the tax system should be more tuned to their specific needs. There is still a perception among the SME business community that the tax system still reflects the interests of the large enterprise sector, which dominates the economy. Although in principle the system is neutral and treats all enterprises equally, regardless of size, large enterprises in practice are still able to exercise considerable influence over changes and reforms to the tax system in a way that small enterprises cannot.

The tax burden is still considered far too high by small firms, especially when it comes to social contributions levels which they argue increase labour costs and makes them uncompetitive.

SME owners and managers also argued that special tax incentives should be provided to particularly encourage fast growing, export oriented and technologically advancing SMEs, in order to build a dynamic and regionally competitive enterprise sector capable of coping with the competition from EU companies. They believed that too much attention is given to pampering the micro start-ups while at the same time adequate attention is not paid to recognising companies with growth potential, especially in technologically innovative and knowledge based sectors.

The focus group participants also believed that the tax collection system is particularly tough on the SME sector. They say that the large enterprises are often given concessions when they do not pay due taxes, for example, by offering them special instalment schemes when they are behind with their payments, but smaller firms are never given such concessions. This may be the reason why part of the small enterprise sector (especially in tourism, retail trade and construction sectors) continues to operate in the grey economy. They believe such discrimination should be eliminated and that all the firms should be treated equally by the tax authorities.

4. Implementation of Financial Instruments for Fostering Small Businesses

Current Situation on Financial Instruments

As of April 2004, the banking system included 41 commercial banks (of which 6 are local subsidiaries of foreign banks), 5 housing savings banks and the Croatian Bank for Reconstruction and Development (HBOR). The total number of commercial banks continued to decrease as a result of several mergers and acquisitions during the course of 2003. Riječka banka merged with Erste and Steyermerksische Bank, Zagorska banka merged with Samoborska banka, The HVB bank merged with Splitska banka; and Cassa di Risparmio di Trieste merged with Zagrebačka banka. The concentration of banking assets will most likely continue into the future as the level of the competition in the sector increases.

In the course of 2003 and into the beginning of 2004, the level of banking sector intermediation remained high, compared to both the other countries in the Stability Pact region and the advanced transition economies that are now members of the EU. Total banking assets in 2003 amounted to HRK million 204,504 (€27,835 million), according to the preliminary reports of the CNB, close to 106% of GDP and a higher level than in most new EU countries. Domestic credit increased in 2003 to over 64% of GDP and domestic credit to private sector to 55.4% of GDP.

Table 2.2 Domestic Credit (in % of GDP)

	2001	2002	2003
Domestic Credit	52.1	61.4	64.1
Domestic Credit to Private Sector	43.0	51.9	55.4

Source: Croatian National Bank, 2004

Despite this, the measures introduced by the Croatian National Bank (CNB) in early 2003 to limit credit expansion, severely affected enterprise access to bank finance. The credit controls were introduced to curb the exceptionally rapid domestic credit and the mounting external imbalance experienced in 2002. The measures included the compulsory purchase of CNB bills if bank loans expanded at a rate higher than 16% and a reduction to 35% of the minimum required ratio of foreign exchange assets to foreign exchange liabilities. The banks adjusted to these measures by extending proportionally more loans to households, thus lowering their portfolio risk. Loans granted to the enterprise sector increased only by 5.1%, (as opposed to 22.6% in 2002), while the growth rate of loans to citizens increased at 27.5% in 2003, compared to 43.0% in 2002 (CNB Newsletter, no 91, March 2004). Larger enterprises were typically directed by local banks to their corporate banks abroad. This resulted in the 2003 external borrowing being 2.5 times higher than in 2002. Smaller enterprises, unable to borrow abroad, were the worst affected by the credit controls. The central bank abolished the credit controls in early 2004, but data for the first half of the year shows that domestic credit growth has not yet bounced back.

Following a series of sales to foreign strategic investors and subsequent mergers and acquisitions during the period between 1998 and 2003, the market in 2003 is led by

Unicredito/Allianz group holding 24.2% of the market through Zagrebacka Banka, followed by Intesa-BCI controlling around 18.5% through Privredna Banka Zagreb.

Since 2003, the government has tried to stimulate bank credit to the SME sector by providing loan guarantees and, in some cases, loan subsidies for special programmes (e.g. export oriented SMEs as well as SMEs in the tourism sector) or regions in special state care (war affected, economically depressed and highland), mainly through the ex-Ministry of Crafts and Small and Medium Enterprises (MCSME), but also through several other ministries.

The MCSME in cooperation with the banks, counties, cities and municipalities developed a comprehensive programme for providing significant funds through subsidised long-term credits to SMEs through several well developed programmes such as “Entrepreneur/Poduzetnik”, “Snowball” “Export”, “Tourism”. The loans are given for a period of 2 to 12 years, with grace period of 6-24 months, at an interest rate in the range 4.5% to 7%. The total funding available under these programmes from MCSME is close to HRK 4 billion (about 500m Euro).

Loan guarantees to the SME sector for loans of under HRK 400,000 (about €57,000) are provided through the HAMAG (from mid 2002 a legal successor of the Croatian Guarantee Agency (HGA). HAMAG provides the guarantees and helps in obtaining credit by offering non-returnable financial support (grants) to fund the credit costs of entrepreneurs through several programmes for enhancement of entrepreneurship: “START” programme for start-ups; the “Razvitak” (Development) programme for already established SMEs, the Programme for the Regions of Special State Care (war affected areas; islands, highlands) and the Programme for Funding Long Term Operational Assets.

The Programme of Support to already established SMEs includes the facility for provision of guarantees for credit of up to HRK 400,000 and provision of grant support for financing the administrative costs of extending a bank loan up to a maximum of HRK 16,000 (about €2,100). The main condition is that the SME must be 100% privately owned and registered in Croatia. The programme designed for start-up businesses START offers additional support for 50% of loan-related costs such as consulting fees (these however have to be arranged through a special Consulting Network and agreed in advance). The Programme for Regions of Special State Concern aims to enhance entrepreneurship among war veterans and their families as well as returnees to these regions.

Under the Programme for Long Term Operational Assets, HAMAG provides guarantees to successful entrepreneurs in industry that employ up to 100 people and for credit of up to HRK 300,000.

As the financial sector in Croatia develops, commercial banks are becoming important sources of finance to the SME sector and they play an increasingly active part in the provision of loans for SMEs, both through the administration of dedicated credit lines provided by various national and international organisations and agencies, e.g. government, HBOR, and EBRD and through their own resources. The credit lines played a significant role in the past, when banks suffered from liquidity constraints. As liquidity is no longer such a problem for commercial banks, these credit lines are not as sought after by the banks as in the past. Commercial banks now mostly use their own funds to lend to SMEs, however most loans have short maturity and are denominated in domestic currency with a form of indexation to hard currency (devizna klauzula). As the

competition in the banking sector continues to increase, lending rates have been steadily decreasing over time.

The Croatian Bank for Reconstruction and Development (HBOR) is a state-owned financial institution set up to stimulate economic development. Supporting SMEs is one of its main areas of activity. HBOR provides SME loans indirectly, via commercial banks, as an industrial policy tool. For example loans provided by HBOR include: loans to family businesses in the tourism sector, to farmers in east Slavonia, to start-ups on islands, former war zones and distressed areas, alongside loans to existing SMEs. Eligible borrowers are private domestic enterprises with a maximum of 250 employees. The maximum loan size is HRK 8 million (over 1 million Euro) financing up to 75% of investment costs. Repayment terms are between 4 and 10 years and interest rates charged range between 5.5%-7.5%. Loans for start-ups range between € 10,000-250,000, financing up to 70% of the set-up costs. Repayment terms are up to 12 years with a 2 year grace period, while interest rates charged range from 5% to 7%.

HBOR currently also operates two direct-lending SME loan programmes:

- **Development of Private SMEs:** this programme supports SMEs by providing long-term loans for the modernisation and expansion of existing enterprises, handicrafts and other types of entrepreneurial activities. Loans can be used for investment in fixed assets (business premises, equipment, etc.) and working capital (up to 30% of the loan amount) and refinancing of existing financial obligations. The funds are administered through commercial banks. Eligible sectors include manufacturing industry, crafts, tourism, agriculture, transport and other services. Up to 70% of eligible investments are financed from the HBOR loan. The loan amount ranges between €10,000 and €1,000,000; maturity is up to 8 years, with a grace period of up to 2 years. Interest rates are 5.5%-7%.
- **Incentives to Start-ups:** this programme is designed to assist the start-up of businesses and handicrafts, thus creating new employment opportunities. It prioritises export and production projects, investments in new technology and joint investments with foreign partners. Business start-ups require 30% of the investment amount in assets. The categories of investments covered by the programme include machinery and equipment, and business premises. The loan amount ranges between €10,000 and €500,000; and the repayment term is up to 12 years, with a grace period of up to 2-3 years. Interest rates vary from 5% (in special state concern areas and islands) to 7%. Up to 70% of eligible investments are financed from the HBOR loan.

In 2002 HBOR launched the “Loan Programme to Support the Tourism Sector”, under which companies, institutions or individuals engaged in the tourism industry can make use of favourable conditions. Interest rates are set at 5.5% for borrowers that generate at least 30% of their sales income from exports. They are set at 7.5% for other borrowers.

Another important source of SME finance in Croatia is leasing and it is mainly provided by the commercial banks. During 2003, because the credit controls limited severely the lending activity of banks, the leasing industry experienced remarkable growth in its volume of activities. Leasing companies are unsupervised and unregulated in Croatia.

A number of programmes for SME development also exist with the support of international organisations. Since the year 2000, several international organisations and institutions have intensified their technical assistance programmes in the field of development of crafts and small and medium entrepreneurship. These programmes have

become even more important since Croatia obtained the status of EU Candidate Country. The International Financial Institutions (IFIs) provide SME credit lines as well as funding for training, education, institution and capacity building.

The USAID programme aimed at assisting economic development in Croatia was developed in 2000 as a 5-year plan (2001-2005) with a special emphasis on SME development through training and education and SME investment projects. The total USAID budget for Croatia in 2003 was approximately US\$ 45 million. USAID was very active in the promotion of a dynamic and competitive private sector through the Croatian Enterprise Promotion Activity (CEPA) – a 3-year programme (2001-2003) worth approximately US\$ 7 million implemented by Deloitte Touche Thomatsu in cooperation with local partners (Ministry of SMEs, Croatian Employers Association, Croatian Banking Association, Association of Management Consultants, SME representatives). This programme provides business development services to enterprises of all sizes, with emphasis on SMEs through an independent network of trained and certified consultants. The project also addresses inefficiencies in the SME financial markets and other constraints to enterprise growth. Future USAID priorities in the SME sector include provision of direct assistance to create 20,000 registered jobs over the next 4 years by establishing 1,000 new enterprises per year in the manufacturing, tourism and agriculture sectors.

The UNDP and the UNOPS implemented and co-financed with the EC a programme for the creation of Local Economic Development Agencies (LEDAs), important institutional support structures for economic development of war affected areas. With their help four LEDAs and two Business Development Support Programmes were created and are operational in these areas. Phase I of the programme involves small loans via local banks (max. \$US 7,000) to families. The loans are based on a membership system and the UNDP guarantees up to 50% of the loans. Additional EU funds (€ 3.2 million) assisted to expand and consolidate this programme. Under Phase II small credits were provided to SMEs, with an initial ceiling of € 25,000.

In 2003 UNDP continued to support the development of regional counties in the war affected areas and economically depressed regions, with a special focus on small municipality project financing, funding for which has been provided under the regional EC CARDS programme. In 2003 the UNDP supported the formation of an association of 12 farmers-organic food producers called Eko-Dalmacija in Sibensko-kninska County, as an effort to support employment through small farming in this very economically depressed region with extremely high unemployment. UNDP also actively supported training course “Start Your Business” for unemployed business starters and also “Improve Your Business Methodology” through LEDAs.

The European Bank for Reconstruction and Development (EBRD) has been active in SME credit matters mostly via commercial banks on-lending, especially for growing and regionally expanding local and international SMEs. The EBRD is also providing other SME support via its participation in the “Turn Around Management” (TAM) and “Business Advisory Services” (BAS) programme in Croatia under which 132 individual advisory services have been performed so far with total value of €1 million. The current EBRD strategy for 2003-2004 focuses on the following two priority areas in the enterprise sector:

- a) Reaching small enterprises through on-lending with local banks and
- b) Promoting new green-field investment opportunities and FDI inflows.

The strategy focuses on restructuring of tourism enterprises and agribusiness. The EBRD also supports the regional expansion of the Croatian companies by funding acquisitions and mergers and making equity investments in expanding companies. The Bank continues to provide longer term funding for institutional building to banks for both SMEs and the retail/mortgage sector, and also supporting the development of non-bank institutions such as leasing and insurance companies. The EBRD has so far arranged 15 SME credit lines to local banks for on-lending for the total amount of 180 million Euros, which have enabled the financing of 421 individual SME investment projects. Within its strategy for enterprise sector development in Croatia, the EBRD is targeting, in particular strategic foreign investors, especially medium sized companies able to help Croatia to create a vibrant Mittelstand.

Micro credit programmes are mainly administered through the NGOs and were at their peak of activities in the post-war period. Presently there are two active: CRS/Mikro-plus Fund and Micro credit Savings and Loans Co-operative (NOA). The loans are to finance working capital, equipment and raw material. EBRD is providing technical assistance funds to MikroPlus to allow it to shift from group lending to individual MSME lending and up to September 2004 this has resulted in 39 loans to micro-entrepreneurs averaging about US\$ 4,200.

At present there is only one specialised SME targeted equity fund in operation in Croatia, the Small Enterprise Assistance Fund (SEAF), a private fund established with assistance from USAID. The SEAF equity fund has been active in SME equity participation in Croatia over the last five years. Up to April 2004 there were in total 17 investments worth US\$4,395,550 and the average investment size is US\$258,560, with an average participation share of 30%. SEAF seeks minority equity participation (20-49%) in medium-sized enterprises with a good track record and prospects of growth. Investments range between €100,000 and €1,000,000, for a maximum duration of 5 years, after which the shares can be re-purchased by the firm's owner or sold in the local capital market. SEAF can also provide technical assistance on a cost-sharing basis.

Assessment

Croatia has a relatively advanced financial sector, as shown by the scores in Table 2.3 below. In this respect Croatia is the most developed country in the region and compares favourably even to those transition countries which became EU members in 2004. Using EBRD's standard scoring system (ranging from 1= little or no progress from the command economy starting point to 4+= equivalent to those of a well functioning market economy) the Croatian banking system has been rated as 4 in 2004, an upgrade from the rating in 2002, in light of the significant increase in bank lending to the private sector, against a solid background of banking consolidation, foreign participation and improvements in supervision and regulation. In particular, bank privatisation is mostly completed and the recent adoption of a new banking law consistent with EU legislation has further strengthened the regulatory environment. Moreover, the regulatory framework for bank supervision has been strengthened by the adoption of several by-laws in 2003 and 2004. The Croatian National Bank also reorganised its Banking Supervisory Department in early 2004 so that it can conduct on-site supervision. On the other hand the non-banking financial sector is still lagging behind at 2.7 in 2003. The government is committed to reforms in this sector, as proved by the recent decision to appoint a working group to draft new laws on insurance and on investment funds, which are expected to be adopted by the end of 2005.

Table 2.3 EBRD Score for Financial Sector Reform

		1997	1998	1999	2000	2001	2002	2003
Financial Institutions	Banking reform & interest rate liberalisation	2.7	2.7	3.3	3.3	3.3	3.7	3.7
	Securities markets & non-bank financial institutions	2.3	2.3	2.3	2.3	2.3	2.7	2.7

Source: EBRD

Access to finance for SMEs has continued to develop in terms of the range of sources available. There is a vast array of programmes and facilities available as set out above. But SME owners and managers still have many problems in accessing finance. Communication and coordination of the many programmes needs to be further improved. Policy actions by one branch of Government can still be in conflict with the actions of other branches. The decision to introduce credit controls to curb the booming credit expansion and the ballooning external imbalances is an example of lack of co-ordination among government institutions. While bank lending to SMEs suddenly came to a halt, the government was trying to stimulate SME credit with loan guarantees and subsidies. Another example of poor co-ordination in policy making is demonstrated by the reduced effectiveness of government's SME programmes (guarantees and subsidised lending) which were offset by exacting collateral requirements and slow banking and guarantee procedures. The result is that in the SMEs opinion the banking sector's effectiveness for SMEs has deteriorated significantly since the previous EPPA study (see Chapter 3). This reinforces the need for much greater consultation with SMEs before radical changes are introduced.

Another dominant feature of 2003 was the significant expansion of leasing as a source of finance to the enterprise sector. Its rapid growth can be partly explained by the restrictive measures introduced by CNB in early 2003 leading to reduction in the growth of credits from the banking sector. Leasing is considered by SME owners and managers to be very important for the SME sector and its potential for growth is still enormous.

Since the first quarter of 2004 there has been some slowdown in the implementation of programmes providing subsidised long-term credits to SMEs mainly attributable to the change of the government and reorganisation in the ministries in charge of SME sector. A number of problems also remains in policy design and implementation that affected the performance of the support programmes and contributed to the critical views expressed by the focus group participants. Particularly highlighted was the lack of transparency and insufficient co-ordination of the various institutions in charge of implementation of the programmes and measures and the burden of bureaucratic procedures to obtain the subsidised funding. Cautious lending practices adopted by the domestic banks since their restructuring and privatisation and a higher degree of risk aversion as compared to the period before the banking crisis have also contributed to the relatively slow implementation of the government programmes.

Supply of short-term bank finance for SMEs is now increasing. Yet, provision of long-term bank finance for the sector remains insufficient to meet the SME sector's development potential. Demand for finance from the SME sector still considerably exceeds supply.

Despite all the development in the banking sector, the main sources of finance for the Croatian SMEs are still own funds and loans from family/friends.

Although the financial market in Croatia is fairly advanced compared to other countries in the CARDS (Community Assistance for Reconstruction, Development and Stabilisation) region, the operation of venture capital funds is not widespread. Access to venture and equity capital remains poor.

Because of competition from the numerous subsidised government programmes, commercially based micro-finance institutions have not developed in Croatia. The number of non-commercially based micro credit programmes active in Croatia seems to have decreased in 2003. The financial sector is not yet sufficiently responsive to the needs of micro enterprises and SMEs. Loan application processing times are still rather long ranging between 2 weeks and two months.

A healthy, profitable financial sector is needed for providing access to finance for SMEs on a sustainable basis. Profitable private financial intermediaries are the necessary link between domestic savings and investment by private sector enterprises. Despite the positive trend of deepening bank intermediation, increasing liquidity and decreasing real interest rates, the private sector still regards the risk-averse approach of banks and the cost of obtaining bank finance as major obstacles to doing business. Suggestions were made by focus group participants that mutual guarantee schemes could be adopted to deal with the current phase of high risk aversion of the restructured and privatised local banking system. These have been successful in developed OECD countries.

5. Implementation of Advisory Services to New and Small Businesses

The Situation on Advisory Services

The availability of a range of advisory services for newly formed enterprises and in particular for small businesses continued to improve in the last year and a half, mostly as a result of increased state funding available at the central and local levels, but also as result of some public-private partnership initiatives.

The number of business support centres has increased considerably and there are currently about 40 different types of business support centres and centres for entrepreneurship development at the level of regional counties, cities and municipalities in Croatia. Each regional county in Croatia has at least one business support centre of some sort, while many of the cities and municipalities, aiming to promote a dynamic SME sector, have established their own entrepreneurship centres to support specific local initiatives.

We can distinguish at least two types of advisory support institutions:

- Classic business centres dealing with a very broad range of activities and
- Those which were founded as centres for entrepreneurship, especially oriented to technology development and technology transfer.

Most of the former are trying to develop based on the “one-stop shop” advisory model, offering services such as: information (e.g. new credit and investments lines); consultancy services; access to finance (financial and credit consulting); development, investment, marketing and business planning; services for co-operation (in the country and abroad) and education and training services, etc. The latter mostly focus on issues such as technology transfer, R&D, publishing activities, business plans and investments studies, as well as business, technical, financial, legal and educational services.

Most of the business support and entrepreneurship centres were established with state funding and with generous co-financing from regional and local administration. However, once the funding from state, donor or other support comes to an end, most of these organisations will struggle to survive. This is the main reason some are attempting to broaden their agendas by becoming regional development agencies, with EU accession in mind. It is also central government's and the donor's policy (UNDP and CARDS) to support the establishment of such agencies.

As mentioned in 2.4 above, there are four fully operational Local Economic Development Agencies (LEDAs), all established between 1999 and 2001. They were established as a part of UNDP/UNOPS programme, oriented towards economic recovery in the former war-affected areas (i.e. Southern Dalmatia, Banovina, Western Slavonija and Eastern Slavonija). All were established as non-profit institutions to exploit all possible opportunities, including co-operation with other institutions. Additionally, the Business Development Service Providers linked with the same initiative have been extended with the help of the CARDS Programme and contracted to the Centre for Enterprises Osijek, Technology Research in Slavonski Brod, Technological Centre Split and Centre for SME Sibenik.

The Incentives Programme for SME Development (May 2004) has put a special emphasis on establishing entrepreneurial industry zones as a special engine for promoting development of entrepreneurship in Croatia, especially in the counties, cities and municipalities. This initiative could also help reduce the huge economic disparities that exist between the different regions in Croatia and create new employment, especially in manufacturing. The Programme plans to increase the number of business zones to 400 in the next four years (2004-2008), compared to the 114 that presently exist. The government considers that entrepreneurial industry zones should become a core "seed" for SMEs' development and has set the following main goals to be achieved within a four year period:

- Increase the number of entrepreneurial zones to about 20 per county instead of the present 5 to 6.
- Increase the proportion of production enterprises to 80% instead of the present 20%.
- Set up an operational programme for development of the existing and the building of new zones in cooperation with the local and regional administration.
- Standardise the content of the activity of entrepreneurial zones across the regions to avoid disparities.
- Establish "one-stop shops" for processing all the documents required for new enterprises.
- Set transparent conditions of usage for the enterprises in the zones.
- Determine precise ways of financing the zones.
- Increase the rate of the new firms formation from the present 2.2% to 5% annually.
- Increase the additional numbers employed in small businesses from the present 3,000 to 10,000 persons annually.

Fifteen free zones have been established based under the Croatian Free Zones Act, which stipulates that:

- Domestic and foreign persons benefit from equal treatment in the free zones.
- All forms of international trade and exchange may be carried out within a zone.
- Goods may be freely imported and exported.
- Goods may remain within a Zone for an unlimited period of time.
- No customs duties or taxes are levied on goods stored in a Zone.
- Users of a zone pay profit tax amounting to 50% of the prescribed rate (i.e. 10%).
- Users who build infrastructure facilities within a zone exceeding HRK1m (about €133,000) are exempt from profit tax for the first five years of doing business.

A Free Zone may be established on the basis of a concession granted by the Croatian Government through a competitive tendering process. Domestic and foreign firms may carry out any economic activity in a Zone (except for retail trade) on the basis of an agreement made with the founder of the Zone.

The technological parks initiatives have also been growing. There are number of innovation centres and technology transfer centres. Applying a more rigid classification, 5 institutions could currently be considered as genuine technology parks: the Innovation Centre of Rijeka (TIC); the Techno Park Zagreb (TPZ); Technological Centre Split; Technological Park Varazdin and Centre for Technological Slavonski Brod.

TPZ was founded in 1994 and is a combination of technological park and business incubator. Its main aims are to support business start-ups, advise entrepreneurs, provide business education and training, deliver project management and introduce quality certifications such as ISO 9000. It is supported by funds from the SME Development Programme of the Ministry of Crafts, Small and Medium Entrepreneurship. It has 1,000 m² of business premises and about 300 - 500 clients. 50% of its operating budget comes from the municipality and the remainder from its commercial services such as renting space and facilities to other entrepreneurs. TPZ deals with similar issues as TIC.

Presently there are several different types of business networks functioning. Apart from the mandatory organisations, such as chambers of commerce and crafts, most of them were established by initiatives of the private sector around some formal business-related organisations and associations. For example, the Croatian Employers' Association (HUP, Zagreb) in co-operation with USAID started a programme for networking enterprises within the Global Technology Network (GTN, www.hup.hr/hrvatski/gtn/gtn.asp). The Association of Croatian Institutions Promoting Entrepreneurship (UHIPP) was established at the end of 2000 and its membership in 2003 included 39 organisations ranging from entrepreneurship centres, business incubators, technology parks and development agencies.

In 1997, the Croatian Network of SME Consultants (HMK) created a network of approved consultants and trainers focusing on enterprise development. The members of the HMK Board were appointed by Ministries of Economy and Finance, as well as the Croatian Guarantee Agency, however, the network has been affected by lack of funds, as well as strong state influence on the consultants in the network. HMK is no longer operating but retains a small certified pool of consultants. The Croatian Association of Business Women (KRUG, www.businesswomen.hr) was established in 2002, consisting

of successful women managers, entrepreneurs and others that are involved in economic development. It continues to promote female entrepreneurship as an important avenue for SME development. The 2004 Incentive Programme for SMEs especially emphasises the promotion of female entrepreneurship in 2004 and in cooperation with local administration has secured funding for a subsidised loan interest scheme with rates of only 2%, for development of business plans, for informatics equipment, education and for counselling.

Finally, a Network of Business Innovation Centres (BICRO) was founded in 1997 and is closely linked with R&D at universities and financial institutions, offering seed capital and various innovation schemes. The activities of members of this network will also be stimulated by the funding through 2004 Project for Innovators by the Ministry for Economy Labour and Entrepreneurship (MELE).

Assessment

Intensive development of business advisory support services started in mid-1990s, but the number of various business support centres has particularly increased in the last 2 to 3 years as a result of various funding programmes available at the central, regional and local levels. Most of these were founded by local/county authorities and some interested private enterprises, as well as with the help of donor support. The ex-Ministry for Craft, Small and Medium Enterprises tried to expand their work by providing additional funds, for example, via the Programme of Support for SME Development, which included creation of entrepreneurial zones, business incubators and financial support for the development of new SME business support centres.

The policy of the newly elected Government also puts significant emphasis on encouraging the development of support institutions, in particular, through the entrepreneurial zones, regional development agencies and business incubators. However, most of the focus group participants and experts consulted consider the aim of creating 400 business zones to be a far too ambitious programme, and doubt that Croatia really needs that many zones, bearing in mind that the present 114 zones only operate at between 30 and 50% of their capacity. They believe that a more useful policy might be to improve the operation of existing zones as they are lacking good infrastructure facilities and also to provide better advisory support on them in order to fully exploit their operational capacities.

Most of business support centres are facing significant challenges relating to their financial sustainability, the appropriateness of their geographical locations and retention of experienced human capital. There are however several successful examples of continuous improvement in the range and quality of service provided, as well as meeting the needs of SME sector in terms of leading strategic economic development issues. For instance, some of the business support centres have grown into regional development agencies. The most recent one is the Medimurje Entrepreneurship Centre, which since the end of March 2004 is in the process of transformation into Medimurje Regional Development Agency following the role model and best practices of the Istrian Development Agency.

The sustainability of the LEDA and CARDS partnerships is an important issue, although further foreign technical assistance funding is expected especially now that Croatia has become an official EU candidate. However, even within that context, LEDAs and other Business Development Services initiatives need to find ways to ensure their

sustainability on a more commercial basis through more efficient public-private partnerships.

Croatia still lacks a well-articulated and coordinated institutional structure for regional development. This results in intense competition between the various bodies (business centres, LEDAs, chambers of commerce, private consultancies etc.) for a market niche within local economic development. Another problem is a lack of monitoring and evaluation of the scheduled activities during the different phases of implementation.

The long-term LEDA strategy is to become key actors, linking up with local authorities and other government and non-government institutions. In the short-term they are developing a very broad range of activities and some sort of specialisation should be promoted to avoid overlapping with other bodies.

The lack of an efficiently functioning advisory services network still remains a problem particularly related to the problem of low general knowledge and appreciation of the range of services available. Apart from some successful but dispersed initiatives to put such information on comprehensive entrepreneurship portals such as the www.poduzetnistvo.org, presently there is no central inventory of all advisory support institutions in Croatia. A HMK type initiative should be reinvigorated. The central state SME support organisations under the guidance of MELE should make an effort to map all the resources available and put the list for use on-line.

Certification of consultants remains an on going problem and a central umbrella organization should be established in order to restrict the unfair competition mushrooming on the market and the risk to SMEs from inexperienced or unqualified consultants. The best consultants tend to have higher education, as well as a domestic and/or some form of foreign professional certification, in combination with extensive professional experience. There is a need to improve the overall standards in this relatively new market. The introduction of minimum standards and certification for providers of advisory services (such as qualifications, membership of relevant bodies, confidentiality principles, charging policies and other general quality standards) would go a long way towards creating greater confidence and willingness to use and pay for advisory services.

In general our research shows that the services on offer only partially meet the needs of SMEs. In particular, the services offered remain fairly basic. Croatian SMEs are increasingly looking to obtain more sophisticated services that have the potential to add real value to their operations. There is a need for more diversified and specialised advisory services focusing on issues such as financial management, organisation, governance and technological development.

There also appears to be a geographical concentration of services in the capital city and the more economically developed regions. The lack of support for start-ups and established businesses is particularly obvious in the smaller towns and less developed counties, such as Slavonija, Dubrovnik and Banovina. The government needs to reassess its policies in this respect, to make them more consistent with the EC pre-accession instruments, for which it will be eligible in due course, which puts strong emphasis on regional development, including SME development.

6. Implementation of Business Incubators

Business incubators are generally defined as special facilities for new and young developing businesses. Business Incubators provide such businesses with premises, infrastructure, a comprehensive range of services and support, so that they can improve their ability to initiate and run their operations during the early developmental period. The combined features of physical facilities, a focus on start-ups and SMEs and “soft” advisory and support services provided are what distinguish business incubators from other industrial centres or industrial estates (OECD-UNIDO, 1999, pp.51-53).

The Current Situation on Business Incubators

Several new Business incubators were established in 2003 as a result of a *Special Funding Program for Enhancement of Development of Business Incubators* initiated by the ex- Ministry of Crafts, Small and Medium Entrepreneurship (MCSME). The Ministry has approved more than 7 million kunas in incentives for the operation of Business Incubators in 2003. The activities and functions of business incubators are often also part of the activities of other SME support institutions, such as entrepreneurship centres and technology parks. This can make the precise categorisation of these institutions rather difficult. In April 2004 we could identify about 15 fully operational Business Incubators out of 20 registered as such at the time of their establishment. However, there are also several incubators operating under the remit of some of the Centres for Entrepreneurship or Technology Centres (for instance in Pakrac, Samobor or Split). Most of the Business Incubators are located in less developed regions such as Slavonija, Banovina and Lika. They also exist in the more economically developed regions such as Istria, Primorsko Goranska Županija and along the Adriatic coast. The most recently established ones are in Bjelovarsko-bilogorska County and Podravina.

In most of the business incubators, the premises and services are partially and sometimes to a large extent subsidised by the municipalities. The duration of tenancy tends to be five years.

The target markets for the Osijek Business Incubator (BIOS) are start-up entrepreneurs and small and new businesses up to one year old involved in production or production based services. The use of the premises is limited to 3 to 5 years, depending on the type of industry. The office space and production facilities are free in the first year of tenancy, while later payment of limited fees is expected. BIOS has considerably expanded its activities and capacity utilisation over the last year or two. It now hosts more than 15 tenants. The services offered by BIOS to tenant firms include the following:

- Office and workshop space at preferential rates.
- Use of office, computer and communication equipment.
- Use of meeting facilities and park space.
- Other support services, such as consulting services and conference hall usage

Tenants also have the possibility of obtaining an additional service package arrangement at preferential prices covering:

- secretarial services.
- audiovisual equipment and conference room lease (up to 10 hrs a month)

- corporate identity development
- fax and copier usage
- presentation of the tenants businesses on the bios.osijek.hr web portal
- computer usage assistance (up to 10 hrs a month)
- lectures, seminars and workshops on entrepreneurial topics
- expert seminars – related to the clients’ business activities
- joint marketing efforts at trade fairs and exhibitions.

BIOS is also active in promoting new SME networking initiatives, such as clusters in the graphical industry and is also active in improving the informatics tools for the Association of Institutions that Promote Entrepreneurship (UHIPP).

The Technology Centre Split on the other hand operates as an incubator that promotes new technologies, innovations, and entrepreneurship. Its objective is to provide support for SMEs in order to develop innovation, know-how, technology, prototypes and to market preliminary products in as short a time span as possible.

Its tenants are small, hi-tech companies operating in the area of business software, process software, information and communication technologies, process automation, advanced internet services, system and design optimisation, etc. It was established as a project of the Ministry of Science and Technology of the Republic of Croatia jointly with the German Ministry of Science and Technology. It acts both as a business incubator and a technology transfer centre.

Assessment

The government policy of supporting business incubators has achieved some results over the last year and a half. Several new Business Incubators have been established with the support of the funding programme of the ex-Ministry (MCSME) available to regions, cities and municipalities for financing establishment of Business Incubator offices, related infrastructure works and advisory services.

In line with one of the main recommendation of EPPA 2003 the Government has concentrated attention on encouraging business incubators in economically depressed regions with several Business Incubators established there as a means of stimulating entrepreneurial activity. Participants in the focus groups suggested that unused state property could continue to be assessed to determine whether it can be converted into effective business incubators.

The intensity of activities of the Business Incubators vary considerably. Some are very successful while others are far from exploiting the full potential of their premises and sometimes operate with a rather low profile. The best known and with good business records are the Business Incubators in Labin, Porin (Rijeka), the Technological Centre in Split (TCS) and most recently BIOS in Osijek.

Most of the experts consulted, as well as the focus group participants believed that the business incubators in Croatia have had a positive impact on encouraging new entrepreneurs through providing accessible office / production space for the first few years after the registration of firms. The experience of business incubators is rated positively by those start-up entrepreneurs participating in the research who originated

from the Business Incubators. Some of the SME focus group participants stressed the positive experience and support in starting and developing their businesses that they had from BIOS.

The other participants regarded Business Incubators as useful instruments in assisting start-ups. However, they were of opinion that scope for improvement must exist as they were not previously acquainted with government policy in this area. They suggested that accurate and up to date information about the operation of Business Incubators should be available on-line.

It is also encouraging that Business Incubators are also being established as a student initiative (for instance at the Faculty of Electrotechnics Zagreb). Such initiatives would need to be more widely promoted at undergraduate and vocational education training level. The new Government has adopted a 'Programme for Encouragement of the Establishment of Student's Firms' and has provided funding for promoting such initiatives in the secondary schools.

The development of Business Incubators may be constrained by a lack of adequately trained and experienced staff. Management staff need to be more specialised in entrepreneurship. Appropriately qualified incubator managers, combined with adequate financial support, are considered to be important factors for the success of future programmes for encouraging business incubators. Managers may benefit from exposure to the knowledge and experience of business incubators in EU and OECD member countries and those in the new EU accession countries.

Efforts should be made to raise the general awareness of the potential offered by Business Incubators. The SMEs participating in the research were broadly aware of what they involve and their potential usefulness, however, there is a view that more and better diffused information is required for the Business Incubators to take-off more effectively. The impact of business incubators may be affected by the lack of suitable follow-up: sound plans need to be developed for tenants vacating at the end of the contract period. Research is required into the performance and effectiveness of the eleven existing incubators. This should focus on the appropriateness of existing entry and exit policies. Furthermore, the governance structure should be analysed and recommendations made for improvement, in order to ensure compliance with best practice in EU transition and other OECD countries.

7. The Competitive Conditions for Entrepreneurship: Education, Access to Knowledge and Technology

Assessment of the Situation in Education, Access to Knowledge and Advanced Technology

Education and Access to Knowledge

The present education system does not support rapid development of an entrepreneurial culture and spirit in Croatia, according to recent analysis by the National Competitiveness Council (March 2004) and the Institute of Public Finance (June 2004). Entrepreneurial behaviour needs to be embedded throughout the education system. Basic entrepreneurial knowledge needs to be incorporated into the curricula as early as primary and secondary schools. The activities of graduate business schools also need to be improved in this respect.

Most of the existing economic schools and a few of the good business schools are of little relevance to the SME sector. Training programmes for SMEs have considerably increased in number in recent years, however, they are still inadequate to meet the needs of entrepreneurs especially when it comes to acquiring more specialised knowledge, such as the development of business plans, new product development, technology requirements, management skills, marketing, financial management etc.

The focus group participants were very critical of the education system in Croatia and its contribution to the creation of a positive entrepreneurial spirit, giving a rating of “poor”. They also considered the educational system to be a major obstacle to the development of a competitive SME sector in Croatia. The participants considered that secondary schools and graduate studies lack programmes that would teach students some useful and practical skills and a basic knowledge of entrepreneurial activities. In their opinion, most of the knowledge they acquire through formal education is rather abstract.

The SME owners and managers also believed that the education system is not teaching graduate students the principles and mechanisms of competitive markets and the needed entrepreneurial confidence and knowledge. They said that very few students start their own companies or crafts after leaving school. Most of them go into the state administrative professions or politics, as they believe these to be more lucrative than starting your own business.

The immediate policy actions should emphasise adjusting the education system to embed entrepreneurial behaviour and incorporating crucial entrepreneurial knowledge and skills into the curricula as early as primary and secondary schools. They also believe that the development of qualified business schools at graduate levels should be further enhanced, possibly with international technical assistance.

Technology and Research and Development

Investment in research and development, especially by the business sector is a requirement for adopting new production processes and creation of competitive products. Therefore, it is necessary to stimulate companies to use science and technology to build innovative capacity. According to UNCTAD (1999), successful countries do not apply import substitution policies or passive market liberalisation. Generally, these countries build a strategic approach along an active technology-specific learning curve to stimulate the transfer and use of the advanced production technologies. Government has an important role in terms of developing the education system, generating modern managerial and technological skills and stimulating research and development (R&D) by the business sector, linked to research conducted by public universities and institutes.

In the past decade, Croatia has not capitalised on science and technology in creating competitive production factors, and is losing export markets for advanced products by breaking linkages with world-class companies. Management has been more focused on privatisation and defensive restructuring than on advancing in technology and access to industrial knowledge. Although R&D expenditure in the business sector doubled in real terms over the 1997-2001 period, its share in total R&D expenditures (42% in 2001) was still significantly below the average for EU countries, where some two thirds of R&D expenditures are accounted for by the business sector. The same trend is seen in the share of researchers in the business sector (16% of the total), whereas the same indicators for the EU countries stood at 49%. Activity in patent registration in Croatia is similar to other countries in transition and considerably lower than in the EU.

The low use of knowledge and advanced technology in the economy is confirmed by the findings of the GCR Report (*Global Competitiveness Report 2002-2003*, WEF, 2003), published by the World Economic Forum (WEF), in which Croatia has been included since 2002. Among 102 countries Croatia was in 53rd place on the Growth Competitiveness Index (GCI) and 62nd on the Business Competitiveness Index (BCI), indicating rather low overall competitiveness. However, on the Technology Index (which is a component of the Growth Competitiveness Index), Croatia is more advanced, being ranked 41st.

The GCR report shows that compared to 2002 there has been a noticeable improvement in Croatia's performance on the Technology Index. The most important element in the improved ranking is the achievement of 39th position in information and communication technologies (ICT). The ranking by innovation sub index puts Croatia in 48th position. Croatia is ranked 43rd among 77 countries that are not listed as "core innovators" i.e. that accept new technologies mostly created in the advanced countries.

A possible explanation is that the advanced communication technology infrastructure and a significant innovation potential are not yet reflected in an innovative and technologically modern business sector. A more detailed insight into the indicators and survey results used in technology ranking provides some evidence for that. (Table 2.4).

Table 2.4 Science and technology related items used in the GCR ranking 2003/2004

	Item	Rank
Positive	Prevalence of foreign technology licensing	21
	Telephone lines per capita	31
	Personal computers per capita	33
	Quality of math and science education	34
	Internet users per capita	34
	Firm-level innovation	35
	Mobile telephones per capita	36
Average	Quality of public schools	41
	Quality of scientific research institutions	42
	Availability of scientists and engineers	43
	Internet access in schools	43
	Internet hosts per capita	43
	Capacity for innovation	45
	University/industry research collaboration	46
Negative	Company spending on R&D	57
	Nature of competitive advantage (production factors used)	66
	Government procurement of advanced technology products	74
	Quality of management schools	79
	Technological sophistication of the country	80
	FDI and technology transfer	88

Source: Global Competitiveness Report 2003/2004

Some of the statistical indicators i.e. telephones, personal computers and internet users rank Croatia rather high in the world competitiveness ladder. It is interesting to note that, according to the executive survey, licensing is used by Croatian companies. And innovation capacity at the firm level is perceived as being rather good. However, the low overall ranking indicates that foreign investment is not being used significantly as a means for technology transfer.

An important issue identified in the survey is that the overall technological sophistication of the country is rather low, ranking Croatia as low, at 80th position among the 102 countries listed in the GCR, again probably due to low new investment in advanced technology. This is also evident in the low ranking for the nature of competitive advantage which indicates that production in Croatia is still based largely on labour and natural resources and not on science and technology. Further evidence for this is the inadequate level of company R&D expenditure.

Until recently investment in education, R&D and advanced technology was not adequately recognised by the government authorities as a key contributor to economic growth, but this is changing. Support programmes for crafts and small and medium enterprises, often have no clear incentives for investment in advanced technology and knowledge based production and services. An important step was made in 2003, with the introduction of special tax benefits for R&D expenditures in the business sector (see Section 3 above). The new R&D tax incentives are a very attractive regime and should encourage a considerable increase in research and development if the regime is administered in a non bureaucratic manner.

EU candidate-country status should also significantly contribute to the process of expanding the technological base of the country, not only by introducing mechanisms for stimulating R&D activities but by creating a framework for cooperation of Croatian companies with the EU ones that will result in significant transfer of new technologies.

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

In this section we assess progress in implementing the 2003 EPPA recommendations, highlight priority policy actions and make additional recommendations based on the findings of the 2004 research.

EPPA 2003 Recommendations on Institutional Framework	Progress since EPPA 2003
<p><i>Co-ordination</i></p> <ul style="list-style-type: none"> • The Ministry for Crafts and SMEs should work with the organisation active in the SME field, co-ordinate national efforts to develop SMEs by building effective co-operation between the key SME stakeholders and disseminate information through web-sites and fora to ensure that SMEs are aware of the latest developments and can provide feedback • Activate the Agency for SMEs (HAMAG) as soon as possible. In order to accelerate the process of small enterprise policy implementation, ensure that it co-ordinates its activities closely with the Ministry for SMEs as well as other SME stakeholders. • Implement an Inter-Ministerial Group on SME policy. This should be chaired by the Ministry for Crafts and SMEs, and include key ministries such as Finance, Tourism, Employment etc. to ensure that the needs of small enterprises are fully considered in national policy-making. • Improve co-ordination of the different activities of key national and local institutions as well as international organisations that support development of the SME sector in Croatia, in order to increase synergies and avoid overlap. 	<p>Limited Progress</p> <p>Limited progress</p> <p>Limited Progress</p> <p>Limited progress</p>
<p><i>Consultation</i></p> <ul style="list-style-type: none"> • Initiate regular and effective dialogue between Government and the business community. 	No progress
<p><i>SME Development Strategy</i></p> <ul style="list-style-type: none"> • Apart from focusing on easing new SME start-ups, it is important to create an institutional environment that will also increase the survival rate of small businesses. 	Limited Progress
<p><i>Local and Regional Government: SME Capacity</i></p> <ul style="list-style-type: none"> • Strengthen the capacity of regional and local administrations (as well as the Chamber of Commerce) to support SMEs through provision of technical assistance and resources to enhance the capacity of staff in areas such as customer relations, policy formulation and implementation focusing on the current needs. 	Significant progress

EPPA 2003 Recommendations on the Regulatory Environment	Progress since EPPA 2003
<p><i>Company Registration</i></p> <ul style="list-style-type: none"> • Introduce the 30-day maximum rule for company registration and ensure that it operates effectively. • Ensure a greater focus on a “proactive” and “enabling” approach by introducing the principle of “silence is consent” as soon as practical • Evaluate the possibility of introducing “one-stop shop” initiatives with a view to establishing such a system throughout the country • Introduce on-line registration of enterprises via the e-Government programme • Introduce a single reference number for each enterprise, in order to save time and costs to entrepreneurs submitting the same basic information to different bodies. • Publish, evaluate, and simplify the regulatory regimes that affect the setting-up phase of businesses, as well as the procedures for re-registering and terminating enterprises. This could significantly ease formation of new enterprises in Croatia 	<p>No progress</p> <p>No progress</p> <p>Limited progress</p> <p>No progress</p> <p>No progress</p> <p>Limited progress</p>
<p><i>Business Simplification</i></p> <ul style="list-style-type: none"> • Evaluate the effectiveness of the Ministerial Task Force on Removing Administrative Barriers and its Action Plan for Reducing Barriers to Business, with the active involvement of the Ministry for Crafts and SMEs and HAMAG, once it is established. • Consider introducing private sector representation in the Task Force. • Improve the quality and regularity of consultations between the Government and the private sector on draft business legislation. SME stakeholders should be consulted before proposals are converted into law. 	<p>Limited progress</p> <p>No progress</p> <p>Limited progress</p>
<p><i>Corruption</i></p> <ul style="list-style-type: none"> • Evaluate the effectiveness of The Office for Preventing Corruption and Organised Crime (USKOK), and its associated action plan. • Task USKOK with preparing a report for the Cabinet every six months, charting progress in implementing its action plan. The reports should be subsequently published. • Evaluate the effectiveness of the Inter-Ministerial Task Force on the Grey Economy in order to improve information on its implications for economic development. The private sector should be involved more in this process in order to improve transparency. 	<p>Limited progress</p> <p>No progress</p> <p>Limited progress</p>

EPPA 2003 Recommendations on Tax Policy for Small Businesses	Progress since EPPA 2003
<p><i>Policy Principles</i></p> <p>The Ministry of Finance, in co-operation with the Ministry for SMEs and the SME policy community, should work together to ensure that:</p> <ul style="list-style-type: none"> • Simplicity, stability and clarity are achieved in tax policy with respect to SMEs. • Fiscal administration is made more sensitive to the needs of the SME sector, for example, how the tax system can negatively affect cash flow. • Tax laws and regulations are consistently and fairly enforced, regardless of firm size. This applies especially to the collection of social security contributions. • Consultation with SMEs or their nominated representatives on tax issues is carried out regularly. • SMEs are able to obtain regular, simple and up-to-date information explaining the tax system. 	<p>Limited progress</p> <p>Limited progress</p> <p>Limited progress</p> <p>No progress</p> <p>Limited progress</p>
<p><i>Tax Filing</i></p> <ul style="list-style-type: none"> • Allow small firms to file a simplified tax return without the need to comply with complex accounting standards, thus reducing the compliance burden. • Enable enterprises to submit tax returns electronically via the Internet. 	<p>No progress</p> <p>No progress</p>
<p><i>Tax arrears</i></p> <ul style="list-style-type: none"> • Strengthen efforts to collect tax arrears, regardless of firm size. 	<p>Limited progress</p>
<p><i>Consultation and communication on tax policy</i></p> <ul style="list-style-type: none"> • Improve the Government's communication strategy on tax policy issues in order to increase awareness and knowledge about tax rates and incentives 	<p>Limited progress</p>

EPPA 2003 Recommendations on Financial Instruments for Fostering New and Small Businesses	Progress since EPPA 2003
<p><i>Type of Government Intervention</i></p> <ul style="list-style-type: none"> • Direct provision of government finance to SMEs should be gradually replaced by a lighter touch regulation, including programmes of advice, training, and consultancy and networking support, which would enable SMEs to approach the banks as reliable and low-risk business partners. 	Limited progress
<p><i>Improving banks' lending to small clients</i></p> <ul style="list-style-type: none"> • Commercial banks are increasingly moving into the provision of short-term lending to SMEs. However, banks still favour larger companies on an even larger scale than prior to the last financial crisis. After the crisis and completion of privatisation and bank restructuring, banks have naturally become more risk averse and thus prefer to deal with larger clients. Two suggestions may be made to deal with this issue: <ul style="list-style-type: none"> – The smaller local and regional banks have an important role to play in the provision of loans to SMEs, however, they lack SME credit assessment skills. In this respect, the state should take an active role in fostering training opportunities in this field. – Second, in order to deal with the increased risk aversion of the privatised and restructured banking sector, the state could support the private enterprise sector in setting up mutual guarantee schemes of the type used in OECD countries such as Italy and Germany. These could facilitate SME access to bank loans by overcoming the stringent collateral requirements imposed by banks. 	<p>Limited progress</p> <p>No progress</p>
<p><i>Type of government Intervention</i></p> <ul style="list-style-type: none"> • Financial support to knowledge-based and innovative technology companies should also be made easier to access. 	Limited progress
<p><i>Introduce commercially based micro-finance institutions</i></p> <ul style="list-style-type: none"> • Micro-credit and credit unions are a valuable tool for development of SMEs in high risk, war-affected areas and should continue to receive development support from the state and from international institutions. Initiatives in this area should be further developed using commercial criteria. 	No progress

EPPA 2003 Recommendations on Advisory Services Supplied to New and Small Businesses	Progress since EPPA 2003
<p><i>Financial Sustainability</i></p> <ul style="list-style-type: none"> Continue to prioritise the support to SMEs through national policy focusing on subsidised business support services, especially targeting start-ups. In the longer term, competitive private provision of business advisory services may reduce the need for government or donor-funded initiatives to address market failure. Extend the network of business support services to areas of the country that are currently not covered. 	<p>Limited progress</p> <p>Significant progress</p>
<p><i>Quality and Accreditation</i></p> <ul style="list-style-type: none"> Introduce 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 could perform this role. Encourage business advisory centres to specify and publish customer charters and to provide specialised services, setting out the range of services provided and the standards they undertake to adhere to. Entrepreneurs need to understand the potential benefits of receiving professional advice before they become more willing to pay for them. 	<p>No progress</p> <p>Limited progress</p>

EPPA 2003 Recommendations on the Implementation of Business Incubators	Progress since EPPA 2003
<p><i>Policy</i></p> <ul style="list-style-type: none"> Secure national and international resources in order to promote business incubators effectively. Promote business incubators by disseminating good practice information to entrepreneurs. Assess the possibility of using business incubators to support enterprise activity in economically depressed regions. Evaluate the criteria for entry and exit from business incubators, as well as governance structures, in order to secure greater transparency in their operation Develop training and education programmes for business incubator managers in order to ensure greater compliance with best practice in transition and OECD member countries. Ensure that incubators provide more than physical infrastructure for micro enterprises and SMEs i.e. special advisory, mentoring, training and business consultancy services, practical assistance on production methods, quality systems, business development, export marketing, access to loan finance etc. 	<p>Significant progress</p> <p>Limited progress</p> <p>Limited progress</p> <p>Limited progress</p> <p>Limited progress</p> <p>Limited progress</p>

Annex I

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Annex II

Web Sites

Association of Croatian Institutions for Enhancing Entrepreneurship (UHIPP):
<http://www.mpc-cakovec.hr/uhip.htm>

Association of Management Consultants: <http://www.ups-amc.org/>

Business Incubator Osijek (BIOS): <http://www.bios.hr/>

Business Incubator Kutina: <http://www.pin.kutina.hr/>

Centre for Entrepreneurship Medjimurje: <http://www.mpc-cakovec.hr/>

Centre for Entrepreneurship Impuls – Bjelovar: <http://www.impulscentar.com/>

Centre of Entrepreneurship, Osijek: www.cfe.tel.hr

Centre for Entrepreneurship Promotion (CEPOR): <http://www.cepor.hr/>

Centre for Entrepreneurship and Crafts Promotion (CEPOS): <http://www.cepos.hr/>

Centre for Technological Development Slavonski Brod (CTR): <http://www.ctr.hr>

Croatian Agency for Small Business (HAMAG): <http://www.hamag.hr/>

Croatian Bank for Reconstruction and Development (HBOR): <http://www.hbor.hr/>

Croatian Chamber of Economy: www.hgk.hr

Croatian Chamber of Crafts: <http://www.hok.hr/>

Croatian Employers' Association: <http://www.hup.hr/>

Croatian National Bank: www.hnb.hr

Croatian Post Bank: www.hpb.hr

Entrepreneurship Centre Dubrovnik: <http://www.dcp.hr/>

Entrepreneurship Centre Pakrac: <http://www.grad-pakrac.hinet.hr/>

Entrepreneurship Centre of City of Rijeka: <http://www.grad-rijeka.hr/>

Entrepreneurship Portal: <http://www.poduzetnistvo.hr/>

Erste & Steiermaerkische Bank, Zagreb: www.esb.hr

Financial Agency FINA: www.fina.hr/

Hypo-Alpe-Adria Bank, Zagreb www.hypo-alpe-adria.hr

International Finance Corporation, Croatia: www.ifc.hr

Institute of Economics, Zagreb: <http://www.eizg.hr/>

Institute for International Relations (IMO) Zagreb: <http://www.imo.hr/>

Istrian Development Agency (IDA): <http://www.ida.hr/>

LEDA- Krka: www.hinet.hr/lera-krka

LEDA- Western Slavonija: www.hinet.hr/leda

Medjimurje County Centre for Entrepreneurship (MPC): <http://www.mpc-cakovec.hr/>

Ministry of Economy, Labour and Entrepreneurship: www.mingor.hr

National Competitiveness Council of Republic of Croatia:
<http://www.konkurentnost.hr/>

Privredna Banka, Zagreb: www.pbz.hr

Regional Development Agency Medjimurje (REDEA): <http://www.mpc-cakovec.hr/>

Reiffeisen Bank, Zagreb: www.rba.hr

Rijecka banka Rijeka: www.rbri.hr/

Seaf Fund: www.seaf.hr

Technological Centre Split (TCS): <http://www.tcs.hr/>

Technological Park Zagreb (TPZ): <http://www.tehnopark.hr/>

Technological Innovation Centre (TIC) Rijeka: <http://www.ticri.hr/>

Women Entrepreneurs Association- Krug: www.businesswomen.hr

World Bank Office, Croatia: <http://www.worldbank.hr/>

Zagrebacka banka: www.zaba.hr

Annex III

EPPA Methodology

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 Croatia in 2004 are as follows:
 - A question template derived from extensive case study work on good practice in transition economies and OECD country experience (OECD-UNIDO, 1999) and used in the research.
 - Identification and consultation with Croatian based experts/consultants to provide their enterprise policy knowledge and experience.
 - Focus group research: focus group discussions to facilitate structured discussions were held with SME representatives.
 - Individual SME interviews were held to validate the focus group research and to provide insights on key issues.
 - Expert interviews: to cross reference information from the focus groups and to contribute views.
 - Desk research: involving examination of existing reports, databases, documents, etc. for Croatia.
 - Consultation with experts from OECD, EC, EBRD and experts from OECD countries.
- III. Under the guidance of OECD, the focus group research with the private sector in Croatia was carried out by local consultants, The *Institute for International Relations (IMO)*, using the structured brief and template of questions developed by OECD, EC and EBRD. The focus group research commenced in April 2004 and other interviews and desk research extended to May and June 2004. It focused on the 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, Education and Access to Technology.
- IV. Five focus group discussions took place: Zagreb (capital city region), Primorsko-Goranska County (Rijeka region), Medjimurje County (Čakovec region); Osječko-Baranjska County (Osijek region) and Splitsko-Dalmatinska County (Split region). In all, 54 participants took part in the detailed discussions, covering the following sectors of activity: services, trade, tourism, processing industry civil engineering and IT. The participants included representatives of micro, small and medium-sized companies, ranging from start-ups to well established firms. Standard templates were used for the discussion and the collection of ratings: Each focus group participant also completed a detailed questionnaire.
- V. In addition to the focus group discussions, individual interviews with SMEs and local experts were carried out. 19 experts took part in the research, to provide for a wider perspective than and complement the focus group

discussions. These were drawn from small business associations, advisory agencies, universities, as well as central, regional and local administrations in charge of small business development (Ministry of Economy, Labour and Entrepreneurship; Croatian Agency for Small Entrepreneurship (HAMAG); Croatian Chamber of Commerce (HGK); Centre for SME Policy Development (CEPOR); Faculty of Economics, Rijeka; Centre for SME Development, Rijeka Municipality; Office for Economic Development, Primorsko-Goranska County, Rijeka; Centre of Entrepreneurship Medjimurje (MPC), Cakovec; The Chamber of Commerce, Cakovec, Ministry of Finance-Tax Directorate, Cakovec; The Sector for Economic Development, Medjimurje County Administration, Cakovec; Business Incubator BIOS, Osijek; Centre for Entrepreneurship Osijek; Regional Agency for Development, Osijek; Technological Centre Split (TCS); Regional Chamber of Commerce Split; Faculty of Economic, Split; Association of Crafts Split; Chamber of Crafts Split; Office for Economy, City of Split; Croatian Employment Bureau Split. The same template of questions/ratings was employed as for the focus group research. Each expert also completed the questionnaire.

- VI.** The 2003 ratings are reported together with each of the questions for each dimension of good practice. The findings from the focus groups and interviews obtained through the procedure detailed above were compared with the EPPA 2003 results and complemented with updates and additional information provided by the IMO team. The juxtaposition of the ratings for 2003 and 2004 in the text of chapter 3 indicates the direction of change in perceptions of SME owners and managers.
- VII.** The analysis and Assessment in Chapter 4 of this EPPA is based on the methodologies described above (focus group research, expert interviews, and secondary data collection). The information has been analysed by the OECD, EC and EBRD, resulting in the assessment presented in this EPPA.
- VIII. NOTE :** The notation SMEs and small enterprises in this report also includes micro-enterprises, which according to the EU definition (http://europa.eu.int/comm/enterprise/enterprise_policy/sme_definition/index_en.htm) are independent enterprises with up to 9 employees and whose turnover or balance sheet asset value are \leq € 2 million. Small enterprises are likewise defined as having between 10 and 49 employees and turnover or balance sheet asset value of \leq € 10 million and medium sized companies as having between 50 and 250 employees and turnover of \leq € 50 million or balance sheet asset value of \leq € 43 million.

Annex IV

Attainment of the European Charter for Small Enterprise 2003 Targets

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

Objective/benchmark: Ease the small business start-ups in Croatia through the following actions:

- (a) provide matching funds to local government to ensure the provision of credit to 100 start ups which fail to obtain bank credits due to insufficient collateral (September 2004);
- (b) increase the number of registered companies from 161.270 to 164.430 (September 2004);
- (c) increase the number of employees from 704.980 to 741.600, mainly through a recruitment drive in the crafts sector (September 2004);
- (d) introduce on-line registration for crafts (February 2004)

EPPA Comments: According to both the 2003 and 2004 EPPA research reports cheaper and faster start up remains an important area of SME development in Croatia. Especially important is the simplification of the registration and licensing procedures by introduction of a maximum administrative time limit and application of the “silence is consent” rule after its expiration. The target in discussion is 30 days, but there are also ambitious proposals to adopt 7 days. However, no time period has been adopted as a legal rule yet. Before making a final decision it will be important to determine a realistic time limit in relation to the present administrative capacity, especially in relation to the cadastre and land registers.

The Ministry of Economy, Labour and Entrepreneurship- MELE said in September 2004 that attainment of the scheduled benchmark target a) was not possible because the legal foundations were not in place to fund local guarantee funds. However, they believe this problem has now been resolved by a new model of guarantee for start-ups recently developed and issued by HAMAG.

In relation to target b), MELE data shows an increase of 4,264 in newly registered crafts. This is 1,094 more than planned. The statistical data on how many new employees there are in the SME sector (target c) has not been released yet.

On-line registration for crafts has not been implemented yet, but commencement of some pilot projects in advanced municipalities could be a realistic target for the next year and activities in implementing this idea should be strengthened.

Field of the Charter: 8 – Strengthen the Technological Capacity of Small Enterprises Regulation

Objective/benchmark: Increase the number of ISO certified business organisations from 250 to 350.

Deadline/period of realisation: September 2004

EPPA Comments: The EPPA 2004 research report stressed the importance of this initiative. The government has put in place an initiative to increase the number of ISO certified business organisations, as presently there are insufficient number of such business organisations within the SME sector. It is a very costly and demanding process and therefore government policy and funding support is necessary to get closer to EU standards. The Ministry of Economy, Labour and Entrepreneurship (MELE) has an open call for funding proposals from businesses that would like to enter achieve ISO quality and technical regulation standards (<http://www.mingorp.hr/>). This area remains an important activity within the scheduled European Charter targets for 2004. According to data made available by MELE at the end of September 2004, about 430 SMEs are now ISO certified, which means that the benchmark target for this year has been exceeded. Management systems, education and information campaigns should continue to be strengthened in the different organisations involved (MELE, Croatian Chamber of Commerce, Chamber of Crafts, the Croatian Institute for Standardisation and Measurement etc.). Continuous impact assessment of the introduction of new standards and regulations on SME sector performance in Croatia is required.

Field of the Charter: 9 - Successful E-Business Models and Top-Class Small Business Support

Objective/Benchmark: To raise the availability of information about market opportunities and quality standards implementation.

Action: execution of an e-learning pilot project introducing e-learning in up to 30 small companies (December 2004).

EPPA Comments: The EPPA 2004 research highlights the value of such a target/ initiative. The small business community should be made better acquainted with the best e-business models and practices through different training programmes. They should also be informed about the market opportunities and quality standards through the available information on-line and in information centres open to the public. The National Competitiveness Council has also highlighted this area as being very important.

Presently there is one Euro Info Correspondence Centres (EICC) in Croatia; the latest was established within the Croatian Chamber of Commerce in 2003. The EICC Zagreb plans to develop its network in Croatia by strengthening relay office in Rijeka and establishing new EICC relay offices in Split, Pula and Osijek in the future, to provide for more support for Croatian entrepreneurs at a regional level. The Chamber of Commerce also implements a Programme of e-learning for entrepreneurs, and there are several similar programmes run by other organisations such as the Croatian Employers Association, the Chamber of Crafts, UHIPP, counties and municipalities. MELE also has a programme for education of entrepreneurs which financially supports such activities through an open call for proposals. This report would recommend that in the future SMEs should be able to access on-line the most relevant statistical data on the market performance of the SMEs in different sectors (such as sales and exports, productivity, efficiency, value added, employment etc.) in order to be able to assess and monitor their competitive strength in the market.

The implementation of activities in the field of development of information and business support networks should be further strengthened and new actions and initiatives identified in agreement with the Government, especially within the implementation of EU pre-accession economic programme and European Charter in order to strengthen the competitiveness and development potential of the Croatian SME sector.

Annex V

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