



INVESTMENT COMPACT



**ENTERPRISE POLICY  
PERFORMANCE  
ASSESSMENT**

**BULGARIA**

**MARCH 2005**



# Enterprise Policy Performance Assessment

Bulgaria

March 2005



**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](http://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](http://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 Bulgarian EPPA report (2<sup>nd</sup> edition) was provided by the Sofia based Centre for Economic Development. Petar Stankov provided the first draft. The report has benefited significantly from inputs and comments from Declan Murphy (OECD), Inga Stefanowitz (OECD Consultant) and the assistance of Susan Hodgson (OECD) and Georgiana Pop (OECD).

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

## *FOREWORD*

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

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

As part of the 2004 EPPA programme the Investment Compact presents the 2004 edition of the Enterprise Policy Performance Assessment for Bulgaria. 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 Bulgaria, with the

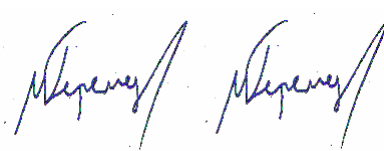
principal aim of facilitating the reform implementation. The OECD, EBRD and European Commission will monitor progress and seek to provide active support on implementation in partnership with the SEE countries in 2005.



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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](http://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 for 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

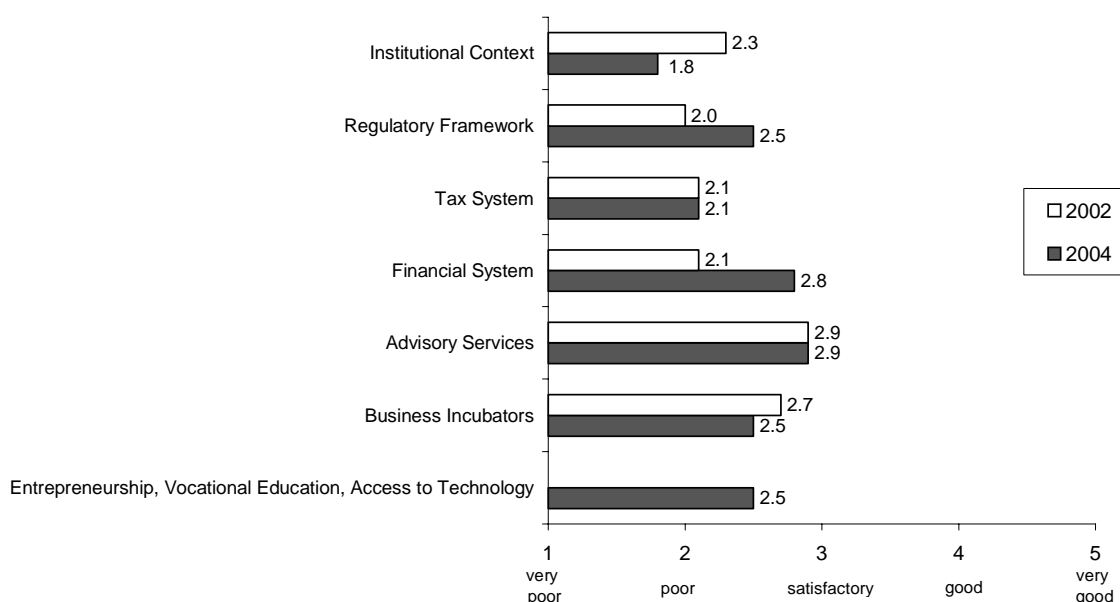
Since the first Enterprise Policy Performance Assessment, released in December 2002, the Government has continued to develop and enhance its SME support policies, which had generally a positive impact on the business environment for small enterprises. Progress across different enterprise policy areas has however been uneven. The opinion surveys carried out for the purposes of this report showed that the majority of entrepreneurs' concerns are related to the institutional framework and in a number of other areas no change was perceived since the previous assessment. Evaluations in the areas of Financial Instruments and Regulatory Framework clearly stand out with entrepreneurs having perceived substantial progress.

Important developments include the entering into force, in December 2003, of the new *Law for Restricting the Administrative Regulation and Control over the Economic Activity*, which provided a general framework for the improvement of the regulatory environment for enterprises. A detailed review of all administrative regimes at the local and central level was carried out by the Ministry of Economy in order to identify and eliminate those most burdensome for businesses; and the adoption by the Government of the Anticorruption Strategy and Implementation Programme. The financial environment improved, with a significant growth in bank loans extended to the private sector, including to SMEs. The tax policy became more favourable in 2004, given the 4.5 point reduction of the corporate tax rate to 19.5% in 2004, with a further reduction to 15% from January 2005 and significant incentives for investment with faster and simpler depreciation provisions for 2005. The new *Law on Investment Promotion* regulating the use by the government of the investment incentives should further enhance the development of the private sector.

A major reorganisation of the institutional framework for the support of SMEs was carried out after the interviews for this report were conducted, and so was not a factor in entrepreneurs' evaluations. In October 2004, following the merger of the Bulgarian Trade Promotion Agency with the Agency for Small and Medium-sized Enterprises, the new *Bulgarian Small and Medium Enterprises Promotion Agency* (BSMEPA) was created. According to the amendments to the *Law on SMEs* (effective as of July 2004) the new Agency has been subordinated to the Ministry of Economy to enhance co-ordination of policy development and implementation. On the Ministry side, an internal restructuring resulted in the creation of the Enterprise Policy Directorate. The Directorate has also foreseen to develop and strengthen the Agency's regional representation.

The effects of this re-organisation remain to be seen, however if thoroughly implemented, the organisational changes are very much in line with recommendations outline in the 2002 EPPA report and have the potential to respond to a number of concerns expressed by the private sector representatives. These include the need for a more scrupulous implementation and monitoring of the Strategy for Small and Medium-Sized Enterprise Development for 2002-2006; for better dissemination of information on legislative changes in the SME area, national and international measures and programmes in support of SME and on the EU requirements ensuing from the accession negotiations; involving the private sector in the policy and law-making processes through more consultations and finally enhancing and redistributing the efforts and resources of the SME institutions to address the needs at the regional and local level.

**Figure I.1. Average Ratings by SME Owners and Managers of the Seven Dimensions of Good Practice, 2002-2004**



### *The institutional framework*

The institutional framework for SME development has been assessed as rather “poor” in this year’s EPPA. Still, a number of structural and functional improvements demonstrate the evolution towards an integrated approach to formulation, implementation and monitoring of enterprise policy. Public-private partnerships (PPP) are gaining importance, yet PPP mechanisms are still not clearly defined. This hinders effective provision of public services to the SME sector affecting perception of the effectiveness of government institutions.

### *Rule of law and regulatory environment*

At the same time, a number of regulatory developments, such as in the areas of company registration, licensing and certification contributed to an improvement of the overall regulatory environment for SMEs, confirmed by entrepreneurs’ positive perceptions. Further improvement may be expected in 2005, should the proposed developments in the registration procedure be implemented. The negative opinions of entrepreneurs in this area stem mostly from insufficient and ineffective consultations in the law-making process.

### *Tax regime for SMEs*

Tax rates in Bulgaria have been steadily decreasing in the last few years. Although this could be regarded as one of the most significant achievements of the fiscal discipline, entrepreneurs still perceive the tax system as too rigid. A number of supplementary measures, both concerning the further decrease of tax rates, as well as tax administration and consultations on tax policy with the business community, may contribute to further improvement.

### ***Financial Instruments for New and Small Business***

Increased competition within the banking sector, resulting in the reduction of interest rates, has been one of the main factors facilitating SMEs' access to finance. Other improvements of the financial environment for SMEs included the setting up of additional guarantee funds, enhanced venture investment in SMEs as well as the support of access to finance for SMEs through tax measures e.g. tax exemptions on profit reinvestment.

### ***Advisory services and business incubators***

Less than a third of Bulgarian entrepreneurs use advisory services, even though they are available in virtually all regions through local business associations, consulting companies and branches of the SME Agency. Moreover, even fewer are satisfied with the range of advisory services available to them. This demonstrates the need for more information on the services available and their potential benefits. Similarly, more information is needed on the availability and benefits of Business Incubators. This area of the government enterprise policy remains under-developed. Most of the existing Business Incubators are primarily serving social functions (under the JOBS - Job Opportunities through Business Support project) or are very recent, which makes an evaluation difficult at this stage.

### ***Entrepreneurship, vocational education and access to technology***

There remains significant scope for progress in the area of education. The education system in Bulgaria has been undergoing a transformation throughout the transition period but is still perceived as inappropriate to the current needs of the market. Its contribution to fostering the entrepreneurial spirit is also insufficient. Against this background, entrepreneurs resort more to apprenticeship as a good complementary mechanism to develop human resources with appropriate skills.

#### **Box 1. Bulgaria and the European Charter for Small Enterprises**

The Charter, a Pan European initiative endorsed by all the EU member states, the EU candidate countries, the countries of the West Balkans, outlines ten policy areas which are instrumental in improving the business environment for small companies. These include regulatory reform, access to finance, business advocacy, entrepreneurship, education, competitiveness, etc. and broadly cover the same policy spectrum as the EPPAs.

Progress on target implementation is reviewed annually in a report prepared by the Bulgarian government and published by the European Commission. The next annual European Charter Report for Bulgaria and the other EU Accession Countries is scheduled to be published in early 2005. The EPPA report contributes to the European Charter process with an independent and business oriented policy implementation assessment.

Over the last two years Bulgaria has made good progress in implementing the principles contained in the European Charter for Small Enterprises. The country has activated a number of programmes supporting entrepreneurship development, vocational training and directed at improving access to credit and technology for SMEs. On line access to public administration bodies has improved and tax form submission and payment via internet has been available since mid-2004. However, on-line access is still constrained by the relative low level of internet penetration among the general population and micro and small enterprises.

### Box 2. Priority Reform Issues For Action

1. Develop and implement a clear policy for information gathering and dissemination. This policy should also take into account information on legislative changes related to the EU accession and on other national and international measures and business support programmes.
2. Accelerate introduction of the 'one-stop shop' principle at the local level and assure its implementation at the central level.
3. Develop a source for practical guidance on tax and social security contribution issues, easy to access and to consult, for SMEs, disseminating it through internet, but also NGOs, private consultants, BSMEPA offices, RDAs and local authorities.
4. Ensure that the possibility for the debtor to prevent, slow down or otherwise obstruct the enforcement proceedings to the detriment of the charge-holder is reduced and ultimately eliminated and that the legitimate exercise of right of defence or appeal is included.
5. Establish regional BSMEPA branches in every large administrative centre on the basis of public-private partnerships (i.e. delegating responsibilities for privately supplied public services to local business associations) to increase the efficiency of provision of the advisory services and to improve dissemination of information about them.
6. Allocate responsibility for the implementation and co-ordination of national and international funding for the creation of business incubators.
7. Expand the secondary, vocational and higher level education curricula to include introductory courses in Entrepreneurship and Small Business Development. Ensure participation and coordination with the private sector.

## 2004 Policy Recommendations and Priorities for Action

### *Institutional Framework for SME Policy*

#### ***Priority for Action***

1. Develop and implement a clear policy for information gathering and dissemination. This policy should also take into account information on legislative changes related to the EU accession and on other national and international measures and business support programmes.

#### *Institutional Changes*

2. Ensure appropriate resources for the new Agency for Bulgarian Small and Medium Enterprises Promotion (BSMEPA) and for implementation of the Strategy for SME Development 2002-2006.
3. Regularly monitor the activities of BSMEPA.

#### *Local and Regional Authorities*

4. Ensure sufficient power and resources to the local and regional authorities, so as to enable them to provide effective support for the SME sector development at both local and regional levels.



5. Improve coordination and cooperation between the Government bodies, local and regional authorities and business.

#### *Information Delivery and Consultancy*

6. Intensify cooperation and dialogue with the civic society and entrepreneurs in particular, in formulation and implementation of the Bulgarian enterprise policy.
7. Make more effective use of the BSMEPA regional network to reach a wider range of enterprises, especially in the remote regions of the country through the creation of a Regional Advisory Council for SMEs.

#### *Rule of Law and Regulatory Environment*

##### **Priority for Action**

8. Accelerate introduction of the ‘one-stop shop’ principle at the local level and assure its implementation at the central level.

#### *Registration, De-registration, Re-registration*

9. Transfer the responsibility for company registration to a non-judicial administrative body i.e. introduce administrative procedures for company registration and create a uniform national register of commercial companies in order to harmonise the procedures, which at present differentiate among the 29 commercial courts. Develop the procedures, reduce cost and improve transparency.
10. Introduce a single code number for each enterprise, in order to save time and costs to entrepreneurs submitting the same information to different bodies.
11. Develop the use of Internet services – E-government (at present 8 business services are available on Internet).

#### *Regulations*

12. Maintain in a consistent manner the existing database of regulatory regimes as part of the Register of administrative structures, as well as the acts issued by executive bodies.
13. Review the municipal level regulatory regimes and formulate proposals for their optimisation; decentralise certain regimes (from central government to municipalities) where possible, including assessment of the administrative capacity of municipalities; transfer the administration of certain regimes to the industrial organisations. (A review and analysis of the municipal level regulatory regimes was prepared in June 2004).

#### *Tax Policy for Small Businesses*

##### **Priority for Action**

14. Develop a source for practical guidance on tax and social security contribution issues, easy to access and to consult, for SMEs, disseminating it through internet, but also NGOs, private consultants, BSMEPA offices, RDAs and local authorities.

*Patent tax*

15. The major taxation regulations for patent tax which cause dissatisfaction among taxpayers should be reconsidered. This refers mostly to the requirement to pay patent tax in a full annual amount, regardless of the real period of activities.

*VAT*

16. Decrease the high threshold for voluntary VAT registration to BGN 10 000 (EUR 5 000) thus allowing a greater number of SME companies to benefit from the VAT regime. It will be in compliance with the EU regulations even before 2007.

*Tax administration*

17. Establish closer cooperation between administration, taxpayers and NGOs while formulating the guidelines and introduction of measures in tax policy.
18. Decrease the incidence of social insurance contributions paid by the employers.
19. Analyse the time necessary to serve taxpayers, possible difficulties, conflict issues – decentralize part of the tax services and make them a prerogative of local authorities.
20. Introduce more effective mechanisms for the settlement of tax disputes.
21. Strict following of the tax appeals deadlines and information request deadlines.

*Financial Instruments for New and Small Business****Priority for Action***

22. Ensure that the possibility for the debtor to prevent, slow down or otherwise obstruct the enforcement proceedings to the detriment of the charge-holder is reduced and ultimately eliminated and that the legitimate exercise of right of defence or appeal is included
23. Ensure that the issue of corruption within the court system as regards the enforcement of secured transaction is efficiently addressed.
24. Improve supervision and regulation of leasing activity, including the extension of the Financial Supervision Commission's powers over leasing companies.

*Advisory Services****Priority for Action***

25. Establish regional BSMEPA branches in every large administrative centre on the basis of public-private partnerships (i.e. delegate the responsibility for privately supplied public services to local business associations) to increase the efficiency of the provision of advisory services and to improve dissemination of information about them.

*Quality and accreditation*

26. Introduce a system of certification and accreditation for advisory bodies, to set quality standards and improve confidence in the benefits of services.
27. Expand the provision of business services, in particular to the least developed regions, improve accessibility, also in terms of prices, and better tailor them to the needs of businesses at all stages of their development.

*BSMEPA and BSMEPA Regional Network*

28. Increase the regional presence of BSMEPA and the supply of information on the availability and range of entrepreneurship support services to businesses.
29. Develop in BSMEPA or deploy external analytical capacity for the market analysis and monitoring to target the resources for support of entrepreneurship in market niches.
30. Integrate all business-support programmes – provided by both the government and private institutions – into a single information source and make it available at the regional level.

*Business Incubators***Priority for Action**

31. Allocate responsibility for the implementation and co-ordination of national and international funding for the creation of business incubators.
32. Define national policy for the development of business incubators.
33. Promote business incubators and disseminate information to Bulgarian entrepreneurs.
34. Evaluate the possibility of using business incubators to support the emerging technological sector.
35. Develop and maintain close relationships with the universities. Graduate students represent an important share of the potential users of BI services.

*Entrepreneurship, Training and Access to Technology***Priority for Action**

36. Expand the secondary, vocational and higher level education curricula to include introductory courses in Entrepreneurship and Small Business Development. Ensure participation and coordination with the private sector.
37. Organise information campaigns in order to promote training for entrepreneurs. Information available on the web sites of business agencies and ministries is insufficient and many entrepreneurs are still not Internet users so their capacity to search for specialised information is limited.
38. Explain and promote the standards ensuing from the EU pre-accession process through the branches of BSMEPA, as well as the remaining regional offices of the Regional Development Agencies and NGOs.
39. Establish offices for technological transfer within each regional office of BSMEPA. Their key task will be to follow the latest technological trends in specific branches and make them known to small and medium-sized enterprises.

*PART II*

*Chapter I*

**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 was collected from the SME focus groups and experts in March and April 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, Vocational Education and Access to Technology*, as well as the opinions on targets relating to the implementation of the European Charter for Small Enterprises. These were not included in the December 2002 EPPA report for Bulgaria. In addition, based on the previous EPPA research experience, some of the questions have been amended and are not directly comparable with the questions posed in the previous study. In the cases where information was not collected for the 2002 EPPA or where modifications have been introduced to questions, this year's results could not be compared with earlier findings. For all other cases, this study tracks progress compared with the previous report.

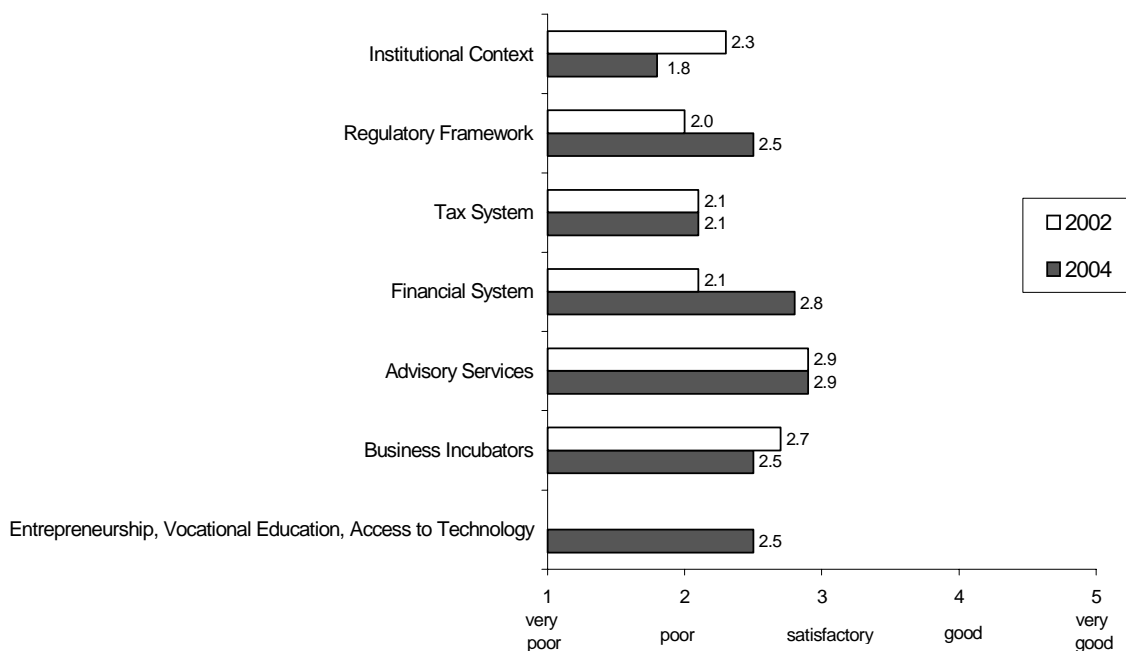
The seven dimensions of good practice assessed for the analysis of the SME business environment include:

1. Institutional framework for SME policy.
2. Rule of law and regulatory environment.
3. Tax policy for small businesses.
4. Financial instruments for new and small businesses.
5. Advisory services for new and small businesses.
6. Business Incubators.
7. Entrepreneurship, vocational education and access to technology.

The questionnaire which served as the basis for discussion by focus group participants and experts, and was subsequently completed individually by them, consisted of two groups of questions. One set comprised categorical questions (yes/no), and the other - qualitative questions rating opinions on a scale of 1 to 5 (with **1 = very poor**, **2 = poor**, **3 = satisfactory**, **4 = good**, **5 = very good**). The average results of the respondents' ratings are presented for each dimension of good practice in the following chapter and are compiled in figure II.1.1 below.

Progress across different enterprise policy areas has been uneven since the first assessment released in December 2002, although the Government continues to develop and further improve its policies in support of the SME sector. Concerns of entrepreneurs mostly regard the institutional framework in place and in a number of other areas no change is perceived compared with the previous assessment. Evaluation in the areas of Financial Instruments (2.8, i.e. close to "satisfactory", compared to 2.1, i.e. close to "poor" in 2003) and Regulatory Framework (2.5, compared to 2.0 in 2003) clearly stands out with important progress perceived by entrepreneurs. In particular, the assessment of Financial Instruments has moved close to the level of the highest rating in the last EPPA – Advisory Services.

**Figure II.1.1 Average Ratings by SME Owners and Managers of the Seven Dimensions of Good Practice, 2002 and 2004**



## 2. Institutional framework for SME policy

The issues analysed in this section of the report include:

1. The presence of a clearly identified organisation in Bulgaria in charge of SME policy development;
2. The efficiency of that organisation/s in the development of environment encouraging entrepreneurship and SME development;
3. The quality and efficiency of the SME Development Strategy;
4. The powers and resources (financial, human and personal skills) of the representatives of the local and regional authorities for the encouragement of SME development;
5. Information available and the familiarity of business with the Government institutions, regarding policies and support programmes for the new entrepreneurs and development of existing SMEs;
6. The quality and frequency of consultations between the Government and the private sector with regard to the SME policy, its performance and evaluation;
7. The work of the Government institutions in support of small business over the last year.

<b>Overall rating of the Institutional framework</b>	<b>2004</b>	<b>2002</b>
	<b>1.8</b>	<b>2.3</b>

### *Organisational Responsibility*

1. Do you know if a <b>clear organisational responsibility</b> for the development of SME policy has been assigned by Government?	<b>2004</b> <b>yes: 52%,</b> <b>no: 34%</b>	<b>2002</b> <b>yes</b>
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The results from the focus groups and the interviews show that 52% of Bulgarian entrepreneurs participating in the focus groups are aware of the existence of a clearly identified organisation, responsible for the SME policy development. They are not familiar however with its goals, functions and tasks, as well as the results of its activities. The following quotation seems representative of the existing communication problems:

*“I know of no organisation which is especially occupied with support, sending bulletins, communications, information, that is useful to the small and medium-sized enterprises to orientate them as to what exactly they want to do and how to do it.”*

According to the experts interviewed, these deficiencies may be attributed to the lack of appropriate resource allocations to the Agency. A number of recent policy developments, such as the amendments proposed by the Government to the Law on SMEs (and adopted in July 2004), are however assessed positively. The amendments aim at a more clear delineation of responsibilities among the public institutions in charge of SME policies, with the Ministry of Economy responsible for the policy development, and the Agency responsible for implementation *“of various programmes which will correspond to what the Ministry sets as priorities or problems to be solved.”* The experts also expect that the effectiveness of the SME policy will further increase with the establishment of 28 AESME regional offices, envisaged by the amended law. At the same time, transferring the SME Advisory Council from AESME to the Ministry of Economy, i.e. closer to the policy-making centre, will allow the Council to analyse the expected impact of the planned policies on business. Once the changes are implemented, it would be advisable to stabilise the institutional framework. Frequent institutional changes do not only hinder institutional capacity, but also confuse the market agents.

### *Effectiveness of the Organisation/s*

2. How do you rate effectiveness of this organisation in developing an environment to <b>encourage entrepreneurship</b> and the development of MSMEs?	<b>2004</b> <b>1.6</b>	<b>2002</b> <b>2.3</b>
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52.3% of the respondents assess effectiveness of the Agency as “very low”, and 40.9% as “low”. What seems to contribute to this negative assessment is the lack of information about the institutions, their goals and activities. The problem is amplified by the changing institutional and regulatory settings:

*“Each year various institutions and organisations change and we are not aware of their requirements, no one tells us about the situation. The laws change and you are expected to know them all, to know the requirements.”*

On the other hand, the experts interviewed, perceive the effectiveness of the organisations as improving. According to them *“there is a relative success and things are developing better. There are more contacts and the responsiveness is better.”*

Differences in the assessments of the Agency’s effectiveness may stem from unbalanced access to information. Experts, having better access to institutions and information, tend to be better informed about the policies in place and their results and assess them positively. At the same time government outreach to the market seems insufficient, in particular in view of the changing institutional and regulatory environment. Inadequate resources allocated to the Agency for policy implementation also contribute to the problem.

### *SME Development Strategy*

3. Do you know if a Government <b>SME development strategy</b> exists?	<b>2004</b> <b>yes: 44%</b> <b>no: 56%</b>	<b>2002</b> <b>N/A</b>
3.1. How do you rate <b>quality and effectiveness</b> of the SME development strategy?	<b>2004</b> <b>2002</b>	<b>2002</b>
Quality	<b>1.9</b>	<b>2.9</b>
Effectiveness	<b>1.6</b>	

Two years since the adoption of the National SME Development Strategy 2002 – 2006, the assessment of its effectiveness and quality has fallen sharply. Entrepreneurs seemed more optimistic about the strategy at the time of its adoption and considered it “very well written”, but are now disappointed with the lack of visible effects:

*“I know it exists, but nothing more. Probably something is being done, but only on paper and in theory.... do something real!”*

Moreover, 56% of respondents had not heard about the strategy at all, which indicates that communication of the strategy implementation and results may have been insufficient.

Similarly, the major criticisms of the interviewed experts were of the strategy implementation and monitoring. According to them the strategy represents a *“mechanical collection of wishes – without resources, without real responsibilities, without human resources assigned.”* For the strategy to bring substantial improvement to the business environment for SMEs adequate resources must be allocated for its implementation and monitoring, and communication with the market intensified.

### *Local and Regional Governments*

4. Do local and regional Government have the <b>mandate, skills and resources</b> (funding, people, skills) to promote SME development?	<b>2004</b> <b>Yes: 27.8%,</b> <b>No: 45.4%</b> <b>*DK: 26.8%</b>	<b>2002</b> <b>N/A</b>
Mandate		
Resources	<b>2004</b> <b>Yes: 23.7%</b> <b>No: 49.5%</b> <b>*DK: 26.8%</b>	<b>2002</b> <b>N/A</b>
*Don’t know		



Almost half of the focus group participants considered that neither local, nor regional authorities possess sufficient power and resources to encourage SME development. Respondents tended to believe that the government policies are only pursued at the central level and negatively assessed the involvement of the local and regional authorities:

*“The State and the Government have good intentions, but when something goes down to the local level, things become different.”*

The predominant opinion of entrepreneurs is also that the local and regional authorities are not unbiased, and their attitude towards SMEs is rather discouraging while it is more favourable towards bigger enterprises. This is often explained by the apparent lack of understanding at the local level of a correlation between the local business development and the overall prosperity of the community/municipality.

Expert opinions in this area differed. Many believed that the local authorities already dispose of important powers to boost the SME growth in their constituencies. Possibilities include the establishment of business incubators or guarantee funds (supplied with funds from local privatisations) that could facilitate access to credit, but very few of them use this capacity in practice. On the other hand, many experts were of the opinion that there is still a way to go in enabling more active and effective SME support at the local level, including provision of appropriate powers and resources.

This creates an important gap between the central level, where the policy is developed and the local level – the closest to SMEs – where it should be implemented. Scope for improvement therefore lies already in a better policy coordination and cooperation among the central, regional and local authorities. Further, possibilities of transferring more powers and resources to the local level can also be explored.

### *Information and Awareness*

5. How do you rate <b>information</b> provided and <b>awareness</b> by business people of the Government's institutions, policies, programmes to support new entrepreneurs and develop existing SMEs?	<b>2004</b>	<b>2002</b>
Information	<b>1.7</b>	<b>2.2</b>
Awareness	<b>1.6</b>	

The SME focus group participants considered the information available and their awareness of the Government SME institutions, policies and programmes insufficient – the rating is lower than their previous assessment. This lack of information seems to be one of the key reasons for their criticism of the existing institutional framework for development of the SME sector. They stressed in particular that SME access to information is much worse than that of large enterprises:

*“In Bulgaria large business is supported. For the small business there is no information - nothing.”*

In this context, the branch organisations are an important source of information about the existing measures and programmes in support of their business. The branch structure is viewed as *“an organisation receiving information and sending it to all of its members. The quality of information is another issue, but at least something is being done.”*

The press, TV, banks and specialised publications are important sources of information. The representatives of small business would however expect more involvement of the local and regional authorities, in particular concerning concrete business opportunities at the local level.

As stressed by the experts, the government has *“no clear and ordered policy on the ways to gather information and the ways to disseminate it to business”*. On the other hand though, they value the fact that *“recently more is discussed about the commitments of Bulgaria in the EU pre-accession process which has consequences for business – what commitments we have undertaken under the different (negotiation) chapters, when these become effective and what this requires of businesses”*.

Still, information about the SME institutions, measures and programmes may be insufficient, in particular at the local level. It is better accessible to bigger enterprises, which can invest more resources in keeping themselves well informed. The SME representatives expect in particular the local and regional authorities to be more active in the delivery of up-to-date, timely and free of charge information on changes in government policies, business opportunities at the local and regional level, as well as the applicable EU requirements. Appropriate channels to transmit this information to the business community need to be established.

### *Consultation between Government and the Private Sector*

6. Are you aware of <b>regular consultations</b> between the Government and the private sector?	<b>2004</b> yes 22.4% no 77.6%	<b>2002</b>  N/A
7. How do you rate the <b>quality and regularity</b> of consultation between Government and the private sector on SME policy and its performance and assessment?		
quality	<b>1.7</b>	<b>2.0</b>
regularity	<b>1.7</b>	

The majority of respondents were not aware of the existing Government-business regular consultation mechanisms. Half of those familiar with the process, considered the quality (50.0%) and regularity (48.9%) of consultations as *“very low”* or *“extremely insufficient”*. The prevailing opinion is that *“they (the government) do their business, and we try to make ours”* and that *“the connection between the Government (...) and the companies is torn.”*

Here, the opinions of the experts and of the business representatives differed again. According to the interviewed experts, consultations between the Government and the private sector have improved and become more frequent. According to them *“there is dialogue, responsiveness, work is going well.”*

As evidenced by the ratings, irregular and insufficient communication between the Government and the private sector creates negative attitudes with respect to the governments’ actions. Business representatives do not believe their concerns and the real market feed-back they can provide are taken into account in developing and implementing government policies. The government seems to have already recognised the importance of making use of external expertise and the expert opinions testify to that. Still, lack of communication with the regulated community can hinder the quality and implementation of policies.

### *Performance of Government Institutions*

8. How do you rate the <b>performance</b> of the Government institutions supporting small business since March 2003.				
<b>Much worse</b>	<b>worse</b>	<b>no change</b>	<b>better</b>	<b>much better</b>
27%	18.8%	39.6%	14.6%	0%

The majority of the focus group participants perceived no improvement (39.6%) in the performance of the Government SME support institutions since the December 2002 assessment. The overall rating of the recent work of the Government institutions supporting small business amounted to 2.4.

### **3. Rule of Law and Regulatory Environment**

The issues discussed in this section include:

1. The registration process for a newly established company – administrative steps, timing, charges or fees;
2. The evaluation of the procedures for obtaining licenses, permits and certificates for carrying out business activities;
3. Programmes for reducing administrative barriers – quality and efficiency;
4. Anticorruption programmes – quality and efficiency;
5. Consultations between the government and the private sector in preparation of business related draft laws and regulations – quality and efficiency.

<b>Overall rating</b> of the Rule of Law and Regulatory Environment	<b>2004</b>	<b>2002</b>
	<b>2.5</b>	<b>2.0</b>

### *Company Registration*

9. Ratings of formalities for <b>new company registration</b> .	<b>2004</b>	<b>2002</b>
number of <b>steps</b> for registration	<b>3.4</b>	<b>N/A</b>
overall rating of the <b>registration process</b>	<b>3.5</b>	<b>2.1</b>
rating of the <b>time</b> needed and cost	<b>3.5</b>	<b>N/A</b>

Business representatives consider the registration process for company start-ups relatively easy, quick and fairly cheap. Compared with December 2002 the evaluation improved (3.5) and is above the average (on the scale 1-5). This is also one of the best rated categories among all issues discussed by the focus groups, even though some concerns were expressed about the costs and the number of bureaucratic formalities involved. Court registration of a new company is relatively quick and takes between 7 and 14 days. The registration with BULSTAT and the Tax Administration takes longer and requires additional formalities.

*“To register a company is a simple task; it is afterwards that the problems begin “*

*“We have the court, tax, NSI and BULSTAT registration, but if we want to register any new site we have to go through the same registration process all over again...”*

Additional problems appear for entrepreneurs in smaller municipalities and to register a business they must travel to district cities, which makes the overall procedure more expensive and time-consuming. Introduction of “one-stop shops” and the provision of services via Internet could considerably enhance the registration process for these entrepreneurs. They also point to the benefits it could have for reducing corruption. On the other hand they note that access to Internet is still a problem for many SMEs and the implementation of “one-stop shops” has slowed down (data from the Foundation of the Local Government Reform (FLGR) shows that at present the “one-stop shop” model has been introduced in 70 municipalities).

Many entrepreneurs resort to the use of legal services for company registration, which as they claim, may save time and costs (as far as registration is concerned the costs are reported relatively as low). The majority however remain cautious with respect to the use of specialised law firms.

***“The whole process is much easier if we use the services of a lawyer – we pay a fee in the range from BGN 40-50 to BGN 100 and the company will be registered within a week – the fee is insignificant.”***

Experts tended to be more critical of the situation and consider business start-ups in Bulgaria still quite problematic, in particular compared with the best practices in the area. Even though company registration received a positive rating from entrepreneurs, there is still scope for improvement. In particular, electronic registers, transferring the registration from courts to administrative bodies, such as the local authorities (as a primary service of one-stop shops) would be beneficial to local businesses.

### ***Licenses, Permits and Certificates***

10. Rating for the procedures for obtaining <b>licenses, permits and certificates</b> necessary for business operations.	<b>2004</b> <b>2.4</b>	<b>2002</b> <b>N/A</b>
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According to many entrepreneurs, conditions and procedures for issuance of certificates, licenses and permits have improved. Clearer rules have been set, which regularise and formalise the processes, thus facilitating the SME operations and reducing the scope for corruption.

***“In general, I can say that by far things have been regularised and we don’t face so many problems as before, at least as far as licensing is concerned. Now the big issue is with the permits, which are subject to increased requirements and for which no-one is willing to give further clarification.”***

Bureaucracy, lack of transparency (in particular concerning permits) and scarce information remain issues of concern. The number of required documents depends on the nature of the business and is in some cases considered excessive. Examples include trading with food products or the construction industry. Procedures are lengthy. Each institution has 14 days to respond; any deficiency in processing the documentation often leads to re-submissions. In the case of the construction industry the procedure may take up to 6 months. Fees are increasing and are considered too numerous.

***“... The whole process takes too long and this is a problem...”***

***“... Fees are paid every time and for everything.”***

These characteristics put SMEs at a disadvantage with their larger competitors, which have more capacity to handle the complicated and costly procedures. Transparency and information about the licensing regimes remain of concern, even though the electronic register of administrative regimes is publicly available. In practice, time and costs of interactions with the administration remain substantial.

### *Simplification Programme*

11. Awareness of the Government approved <b>programme for reducing administrative barriers for business.</b>	<b>2004</b>	<b>2002</b>
	<b>yes: 30%</b>	<b>N/A</b>
	<b>no: 70%</b>	
	<b>2.1</b>	<b>N/A</b>
quality		
effectiveness	<b>1.9</b>	<b>2.0</b>

The evaluation of the quality and effectiveness of the Government simplification programme remained at the same – relatively “poor”, as in the previous assessment. This reflects the fact that simplification measures remain practically unknown to entrepreneurs and those who have heard about them do not perceive much improvement, in particular concerning the SME sector.

*“I have been in this business for 12 years now but I have hardly seen any change or any business incentives.”*

Many focus group participants perceived the situation as deteriorating – the number of documents for carrying out business activities has been increasing; new administrative barriers are emerging. At the same time, when required to meet the same formal obligations and costs, SMEs feel at disadvantage with large enterprises. Their businesses are more vulnerable to any increases of formal requirements and operational costs and they believe this should be taken into account.

Entrepreneurs remain relatively unfamiliar with “one-stop shops”. Problems in dealing with the administration, especially at the local level, remain important and the majority is convinced that this type of service will speed up the procedures, save time and cost and reduce corrupt practices. Some fear however that the implementation of the one-stop shop will put another link in the administrative chain, thus making the whole procedure even clumsier. Similarly, the *Law for restricting the administrative regulation and control over the economic activity* as well as the rights and possibilities deriving from it remain unknown. Only one focus group participant (operating in marketing and communications) had heard about this law, but his knowledge about concrete provisions, such as the “silence is consent” principle, its meaning and purpose was limited.

### *Anti-Corruption Programme*

12. Are you aware of Government approved programmes for reducing the impact of <b>corruption</b> ?	<b>2004</b>	<b>2002</b>
	<b>yes: 63%</b>	<b>N/A</b>
	<b>no: 37%</b>	
13. Rating given to the <b>quality and effectiveness</b> of the Government’s programme for reducing the impact of corruption.	<b>2004</b>	<b>2002</b>
quality	<b>1.8</b>	<b>N/A</b>
effectiveness	<b>1.7</b>	<b>2.1</b>

Corruption is perceived as a widespread phenomenon, although opinions differ between the larger cities and smaller municipalities. For example, in Sofia corruption is apparently widespread, while in smaller cities e.g. Sevlievo, SME managers do not perceive it as a problem:

*“I have been in this business for 12 years now and have not encountered any corrupt practices – neither have I been asked for a bribe, nor have I offered...”*

This may be explained by the fact that in smaller municipalities people know each other well so corruption is more risky. Entrepreneurs also pointed to a number of corruption-generating factors – these include relatively low salaries in the public sector, little respect for public institutions, and complicated procedures, such as for issuance of licenses, permits and certificates (especially licenses for alcohol production and distribution). Finally, business representatives also recognise their own contributions to the development of corrupt practices.

Anticorruption programmes are not perceived as providing a solution to this problem. 68% of the managers are aware that such programmes exist; however, almost 80% of them find these programmes inadequate and inefficient. They are of the opinion that corruption may be counteracted through optimisation of regulatory regimes, implementation of one-stop shops, and a widespread use of Internet.

### *Consultation between Government and the Private Sector*

14. Rating of the <b>quality and regularity of consultation</b> between Government and Private sector on draft legislation and regulations that affect business.	2004	2002
quality	1.9	2.0
regularity	1.6	1.5

Business representatives would welcome more dialogue with the government in the preparation of business related legislation and the present quality and frequency of consultations do not meet their expectations. Ratings in this category remain “poor”. The current erratic interaction between business and the government undermines their confidence in the institutions and in the quality of the adopted legal measures. Information about the aims and expected results of regulation is insufficient. The *Law for restricting the administrative regulation and control over the economic activity* stipulates that the institutions proposing new laws or amendments to the legislation must prepare prior analysis of the potential impact on the business environment, but the practice is not yet widespread:

*“..Every time I read a new law I keep thinking whether the people who wrote this law have any idea about business ...”*

Expert opinions on the dialogue between the private sector and the government were not very different, despite the fact that they participate in this dialogue more – e.g. through the Council for Economic Growth, which discussed the main lines of development of the economic policy, and in preparation and discussion of various draft laws by different committees of the National Assembly. Experts believed that despite this communication, the formulated proposals have not been taken into consideration.

Rating for the changes in the <b>regulatory environment</b> (registration, licenses, permits, certificates) since March 2003.				
<b>much worse</b>	<b>worse</b>	<b>no change</b>	<b>better</b>	<b>much better</b>
2.1%	23.4%	57.4%	17.1%	%

#### 4. Tax Policy for Small Businesses

The main issues analysed under this heading include:

1. The extent to which the tax policy carried out so far encourages the establishment of new companies and assessment of the tax incentives for new and existing SMEs;
2. Stability and transparency of the taxation system regarding SMEs;
3. Interaction with tax administration;
4. Communication between the Government and the private sector regarding tax rates and incentives for enterprises;
5. Consistence of the tax policy with other Government policies, targeted at improvement of the environment for SME development;
6. Dynamics of the tax obligations as a share of the SME annual net income;
7. Development of the tax system over the last year.

<b>Overall rating</b> of Tax Policy for Small Business	<b>2004</b>	<b>2002</b>
	<b>2.1</b>	<b>2.1</b>

Compared to the 2002 survey, a slight increase in entrepreneurs' overall rating of tax policy for small businesses in Bulgaria was registered. The most positive developments have been acknowledged under two criteria: share of tax obligations of net annual income (a 41-55 % decrease over the two-year period) and consultation and communication between the Government and the private sector on tax rates and incentives (1.8 in 2004 and 1.5 in 2002). On the other hand, however, all other indicators reveal slight general worsening, which reflects the perception that the implemented tax reforms have not been sufficient to meet entrepreneurs' expectations and actual needs. The conclusion is supported by the fact that 2/3 of all persons interviewed claim there has been no change in the tax system since March 2003. Better-targeted efforts are needed in strengthening the tax system's stability and tax policy's consistency with other governmental policies, aiming at encouraging SME development in Bulgaria.

#### *Encouragement for Enterprises*

15. Does the present tax policy <b>encourage new enterprise?</b>	<b>2004</b>	<b>2002</b>
	<b>Yes: 2.1%</b> <b>No: 97.9%</b>	<b>Yes: 11.1%</b> <b>No: 77.8%</b>
Rating given to tax policy in terms of <b>encouragement, support and ease of use</b> that it provides to new and existing MSMEs.	<b>2.0</b>	<b>N/A</b>
Encouragement / support	<b>1.6</b>	<b>N/A</b>
ease of use	<b>2.3</b>	<b>N/A</b>

***“Things are going from bad to worse as a result of the tax policy”.***

The predominant opinion among the entrepreneurs was that the tax policy effective currently does not encourage the establishment of new enterprises (97.9%). Only 2.1 % of the focus group participants pointed out that there exist tax incentives for economic initiative. In comparison, the 2002 research showed 77.8% considered that the tax policy hinders the start of small and medium-sized business, according to 11.1% its impact is stimulating, and the others do not provide synonymous evaluation. The extremely negative position of the entrepreneurs is based on the absence of significant positive changes in the tax treatment of the small and medium-sized business, as well the focus of a considerable part of the tax alleviations mainly on the large companies. The interviewees drew on the increased difficulties when meeting the legally established tax liabilities. Taxes are perceived as a burden against which business does not receive the quality public services it needs to function.

***“There is no policy for business encouragement which is active. There is such only on paper”.***

The majority of the entrepreneurs considered the tax incentives for new and existing SMEs extremely insufficient (60%), and 26% characterises them as rather insufficient. Only 2% of the entrepreneurs provide a moderately positive rating of the measures applied. The alleviations directed towards foreign investors are negatively perceived, as Bulgarian companies have no opportunity to benefit from them. One of the measures, which could, according to the focus group participants, alleviate the financial status and stimulate the SME development, is the exemption from taxation of the profit reinvested in the fixed assets.

***“Tax incentives for the new and existing SMEs are extremely insufficient. The tax policy implemented does not encourage entrepreneurship and often leads to incapacity to pay the liabilities due.”***

***Stability and Transparency***

16. Rating given to the <b>stability and transparency</b> of the tax system.	<b>2004</b>	<b>2002</b>
stability	<b>2.0</b>	<b>2.2</b>
transparency	<b>2.1</b>	<b>2.6</b>

***“It is not stable and it is not transparent”***

Overall, more than half of the focus group participants rated the stability of the tax system regarding small and medium-sized enterprises as “poor” (2.0). This is on average a negative development compared with results of the 2002 assessment (2.2). Only 2.1 % of the focus group participants in 2004 characterised the stability of the tax system as “good”, and 31.9% and 27.7 % respectively as “very poor” and “poor”. A little over one third (38.3%) gave a rating of “satisfactory”. The major criticisms were directed towards the frequent changes in the tax legislation that prevent the long-term planning of activities and often do not correspond with the specific needs of business. Another main hindrance is the delayed preparation and interpretation of the secondary legislation regulating the application of the tax laws.

The entrepreneurs’ overall rating of the transparency of the tax system also marked a negative development with a decrease from 2.6 in 2002 to 2.1 in 2004. 43.5% of focus group participants rated the transparency of the tax system with respect to SMEs as



“satisfactory”. The prevailing opinion is also negative with 32.6% of the interviewees having defined the transparency of the tax system as “very poor”, and 23.9% as “poor”. These rather negative ratings may be a result of the distorted communication between government authorities and entrepreneurs, as well as of the latter’s insufficient understanding of the nature and objectives of the measures taken.

### *Net Profits*

The average share of the tax requirements from the annual net income of companies dropped from 35.8% in 2002 to 16-25% in 2003. The percentage of enterprises, allocating over 25% of their net income to cover tax payments, decreased from 71.2% to 45.7%. However, about one quarter of the entrepreneurs are in the two lowest categories where the ratio of tax to net income are respectively 11-15 % and below 10%. The status of the tax environment has seen a more positive development since the 2002 EPPA research. The decrease of the relative share of the tax obligations to net income is a criterion of key importance for the evaluation of tax environment. If it is not a result of a fall in profit, the decrease of tax obligations has a positive effect on the corporate finances as it releases financial resources for investment in the activity.

#### *“The social contributions are definitely growing.”*

Against the background of the falling average tax requirements, the weight of social contributions is becoming a serious obstacle for SMEs. Some of the proposals made by focus group participants were to:

- Decrease of the amount of social insurance payments by the employer;
- Alleviate the regime for the recruitment and discharge of employees;
- Improve communication with the National Social Security Institute (NSSI) administration;
- A more flexible approach to the minimum social insurance thresholds with consideration of the specificities of the different enterprises and activities.

According to the focus group participants their main financial burden is from insurance, rather than tax payments. The majority of the recommendations expressed refer to the alleviation of the administrative regulation and the necessity for a more differentiated approach, taking in consideration the real capacity of enterprises.

### *Consultation and Communication*

17. How do you rate the <b>consultation and communication</b> between the Government and the private sector on tax rates and incentives.	<b>2004</b>	<b>2002</b>
	<b>1.8</b>	<b>1.5</b>

#### *“Somewhere the connection breaks”.*

Communication between the Government and private sector regarding tax rates and enterprises’ incentives is the only indicator in the sphere of tax policy where a positive change in the entrepreneurs’ rating was observed; from 1.5 in 2002 to 1.8 in 2004. In contrast to the preceding research where opinions on communication were divided equally between “poor” and “very poor”, in 2004 12.8 % gave a “satisfactory” rating and 51.1% almost “satisfactory”.

*“Communication is all one way”.*

One of the major problems according to the entrepreneurs is the lack of communication between Government and private sector with regard to tax rates and the incentives to enterprises. The participants in the research were in agreement that SME representatives' recommendations do not have an influence on the direction and measures of tax policy in the country.

*Manner of work with the tax administration**“There is not any serious problem.”*

The manner of work with the tax administration is outlined as one of the less problematic areas of interaction between the state and business with the highest overall rating in ‘Tax Policy for Small Business’ of 2.3. However, over one third of the entrepreneurs did give a negative estimation of this indicator, and according to 10% the co-operation with tax administration is made easy. From the interviews held it becomes clear that the relations with tax administration are comparatively well arranged thanks to the two parties' numerous years of experience in the process. The main criticisms are therefore directed more towards the activities of the National Insurance Institute whose regulations and procedures are still not well enough known to small and medium-sized business.

*Policy Consistency*

18. How do you rate the <b>consistency</b> of tax policy with other Government policies aiming at improving the operational environment for small businesses?	<b>2004</b>	<b>2002</b>
	<b>2.2</b>	<b>2.5</b>

*“It is not consistent.”*

The average rating of the focus group participants on the consistency of the tax policy with other Government policies targeted at improvement of the environment for SME development dropped to 2.2 in 2004 compared with the 2002 rating of 2.5. According to 32.6 % of participants, tax policy is rather inconsistent with the other Government policies, and according to 28.3% there is no consistency at all. In the 2004 research there were no particularly positive ratings given. During the interviews entrepreneurs emphasised the inconsistency of some specific tax measures with the announced overall target of the economic policy for the creation of incentives for SME.

*Developments in the tax system*

19. How do you rate the <b>change</b> in the tax system since March 2002?				
<b>much worse</b>	<b>worse</b>	<b>no change</b>	<b>better</b>	<b>much better</b>
4.2 %	20.8 %	66.7 %	8.3 %	0%

*“Nothing has changed tangibly.”*

The development of the tax system during the last year received the highest average rating (2.8) of all the indicators. However, according to 66.7% of the focus group participants the tax system has not gone through substantial changes. About one quarter of focus group participants perceived a decline and almost 10% considered that there has been some improvement.

*“They only changed the percentage of profit tax.”*

*“Some taxes dropped, but I have not been affected - not in my business.”*

Entrepreneurs considered that during the period reviewed there were no substantial changes in the tax system towards the encouragement of SME activities in the country. The most often cited new measures are related to the decrease of the corporate income tax rate – a measure targeted towards the large companies and with limited significance for the SME sector. The focus group participants did not comment on the other components of the tax environment outside the amount of the tax rate. This may be an indication of insufficient progress in the optimisation of the tax collection process, targeted at cutting taxpayers' costs.

## 5. Financial Instruments for New and Small Businesses

The evaluation of the policy for SME financing includes the following:

1. Soundness and competitiveness of the banking system and quality of bank services.
2. The attitude of commercial banks towards SME sector development and SME lending.
3. SME access to finance from the following sources:
4. Own/family funds.
5. Funds from abroad.
6. Bank loans.
7. Micro finance.
8. Leasing.
9. Risk capital/debt financing.
10. Qualifications of the bank servants.
11. Access to bank loans for working capital, property and technology investments.
12. Comparative analysis of the SME banking environment relative to the previous year.
13. Comparative analysis of the banking services offered to SMEs relative to the previous year.

<b>Overall rating</b> of Financial Instruments	<b>2004</b>	<b>2002</b>
	<b>2.8</b>	<b>2.1</b>

### *Stability, Competitiveness and Services*

20. Rating given to <b>stability, competitiveness and services</b> provided by the banking system.	<b>2004</b>	<b>2002</b>
stability	<b>3.2</b>	<b>3.5</b>
competitiveness	<b>3.3</b>	<b>2.5</b>
services provided	<b>3.1</b>	<b>2.1</b>

Entrepreneurs appear to have gained confidence in the banking system and the quality of bank services. The overall rating increased to 3.2 compared with 2.7 in 2002. Despite the slight decrease in the stability rating (3.2) relative to the previous survey, it is still “satisfactory”.

*“Taken as a whole, the banking system is stable and offers the most important products and services.”*

There has been substantial growth in banking competition relative to the previous survey. The average assessment of competitiveness is 3.3, compared to 2.5 in 2002. The quality of bank services has substantially improved (3.1):

*“There is high competition and banks are making efforts to maintain good quality of service”*

*“There are progressively more bank services offered on the market.”*

The overall rating may be an indicator that enterprises do not avail of all bank services, as illustrated by the following statement:

*“We hardly use any banking services. The only thing we do is make bank payments and pay our invoices via bank transfers, and that’s more or less all we do.”*

### ***Banks’ Interest / Attitude to SMEs***

	2004	2002
21. Rating given to the commercial bank <b>interest</b> in development of SME sector.	2.7	N/A
<b>Lending attitude</b> by commercial banks with respect to SMEs	3.0	2.1

Entrepreneurs’ rating of the banks’ interest in the SME sector development and SME lending has greatly improved since 2002 research e.g. average rating on banks’ lending attitude has increased from 2.2 to 3 in 2004. The overall rating is still however less than “satisfactory”:

*“There has certainly been a change. Many people I know have borrowed once; then have borrowed again after repaying the first loan, etc. I can say that there is now more of a positive change.”*

Banks are showing growing interest in working with SMEs and the increased lending to SMEs supports this. Nevertheless, entrepreneurs still face a number of problems when borrowing money, among which are the collateral requirements and high interest rates.

### ***Access to Finance***

Entrepreneurs’ opinion of SMEs’ access to the main sources of finance shows the same rating as in the previous study (2.5). However, there has been a change in the rating of the different sources of finance. According to the focus groups, own/family funds still remain a major source of finance.

Relative weight of the major sources of finance (according to entrepreneurs) is presented in Table 1.1.

**Table 1.1: Relative Importance of Main Financial Sources Accessed by SMEs (2004-2002)**

<b>22. Access to main financial sources</b>	<b>Rating 2004</b>	<b>Rank 2004</b>	<b>Rating 2002</b>	<b>Rank 2002</b>
Own/family capital	<b>3.0</b>	<b>2</b>	4.1	1
Repatriation capital	<b>2.5</b>	<b>4</b>	1.8	6
Micro-finance	<b>2.2</b>	<b>5</b>	2.4	3
Other (e.g. credit unions)	<b>N/A</b>	<b>-</b>	1.8	5
Venture capital/equity funds	<b>1.9</b>	<b>6</b>	1.7	8
Commercial bank credit	<b>2.5</b>	<b>3</b>	2.2	4
Leasing	<b>3.0</b>	<b>1</b>	2.7	2
Credit reference sources	<b>N/A</b>	<b>-</b>	1.8	7

The survey confirmed that leasing is among the leading sources of SME financing in the country. The subjective assessment of entrepreneurs rates leasing as almost as important as commercial banks, although in absolute terms banking system loans surpass the loans extended by other sources of financing.

The weight of the funds received from friends and relatives abroad has increased since the previous survey. This source of financing plays a key role in meeting investment and working capital needs, as well as in improving the consumption of enterprises and households in Bulgaria.

*“We want to borrow a BGN 2,000 loan. Well, for this amount of money I won’t go to the bank... Any friend will give me this money...”*

Entrepreneurs often use consumer loans for business purposes. This practice creates problems for statistical reporting concerning bank loans to SMEs.

*“I got a loan., but instead of an investment loan I got a consumer loan.”*

One of the most frequent problems faced by SMEs is the lack of state guarantee funds. According to one of the interviewed experts *“there are no guarantee funds in Bulgaria except for the Micro Credit Guarantee Fund, which has more of a social than business function. This fund aims to support social employment and enforces too many requirements when it comes to extending a loan.”*

Entrepreneurs rated risk capital/debt financing funds as least important sources of finance.

### ***Working Capital, Investment and Technology***

<b>23. Rating of the bank funding for:</b>	<b>2004</b>	<b>2002</b>
<b>working capital</b>	<b>2.5</b>	<b>N/A</b>
<b>bank funding for capital investment</b>	<b>2.3</b>	<b>N/A</b>
<b>bank funding for technology investment</b>	<b>2.2</b>	<b>N/A</b>

Focus group participants gave relatively low ratings to access to bank loans for working capital (2.5), capital investments (2.3) and technology investments (2.2). This overall rating of 2.3 stands out against the higher rating of quality of service and improved access to bank loans. The indicators also show that SME lending in Bulgaria has increased over the past few years.

Difficulties in identifying loan types and tracking of the loans by purpose could be factors in the low rating given in this area.

***“The purpose of the loan is beside the point. I took a working capital loan, which I used for buying equipment.”***

The classification of bank loans by purpose shows the lack of a long-term strategy. Entrepreneurs are of the opinion that banks are unable to differentiate between or market the different types of SME loans. Therefore, entrepreneurs often apply for simple consumer loans.

One of the interviewed experts (an entrepreneur) said: ***“That’s what we want: investment loans. Efforts must be united in this direction, because everyone wants to lend mortgage loans, while investment loans are between 5 and 7 years – it’s hard”.***

### ***Summary of Financial Instruments***

<b>Changes for SMEs since March 2002</b>	<b>2004</b>
bank environment	<b>3.4</b>
provision of services	<b>3.3</b>
lending	<b>3.6</b>

When asked to compare the current situation with the situation in 2002, entrepreneurs gave positive assessments of the general bank environment with respect to SMEs. There is no doubt that this also reflects the improved ratings on the soundness and competitiveness of the banking system and quality of bank services. Despite the relatively low rating on the access to bank lending described above, the bank statistics show a boom in lending over the last two years. There the latter should have influenced SME lending as well.

***“There is high competition and banks are putting efforts into maintaining good quality of service, to extend loans.”***

***“No, I haven’t faced any problems obtaining a loan. On the contrary I have been offered loans.”***

***“This is the only sector where I see an improvement in Bulgaria –the banking sector.”***

The fundamental service provided by banks is lending, however, entrepreneurs also noted a positive development in advisory, payment and other services.

***“Banks are the institutions, which can furnish you with information on any new events – king’s loans, SAPARD, etc.”***

***“Banks don’t earn from lending, etc., they earn from the quality of the service they offer.”***

***“Banks are more open towards companies. Years ago they did not extend any loans, now they extend all types of loans. Banks already know the companies and they can make a good team.”***

Nevertheless, we should note that the evaluation of the positive developments over the last year surpasses the rating of the services that are presently offered by banks. There is a criticism of the poor quality of bank services and there are cases where banks are launching misleading advertising campaigns.

*“Banks have expanded the scope of services offered. Those services, however, are expensive for small and medium enterprises and this creates the fundamental problem, because no matter what kind of services are offered, they always require collateral – land and immovable property.”*

### ***Qualifications of the bank personnel***

Entrepreneurs rated the skills of the bank employees between “satisfactory” (3) and “good” (4). The overall rating has improved slightly (3.5) compared to the previous survey (3.3). This rating is among the highest in the financial instruments SME sector. This increased rating can be explained by the growing interest of banks in lending and customer acquisition resulting from rising competition. The completion of the bank privatisation and the favourable macro-economic environment are contributing factors. Prevailing foreign ownership in the Bulgarian banking system also results in improved quality of service.

*“Bank staff are kind and attentive... They are among the few professionals in Bulgaria.”*

## **6. Advisory Services for New and Small Businesses**

The issues discussed in the following section include:

1. Use and satisfaction with the range and quality of advisory services available to new entrepreneurs and SMEs from private consultants and the Government;
2. Entrepreneurs’ assessments of the diversity of services, the quality, efficiency and benefit to their business;
3. Matching consultant services with the need and demand for them;
4. The skills, experience and quality of the personnel that consult the small and medium-size business;
5. The consistency of the consultant services provided;
6. Rating of the change in provision of consultant services in comparison to year 2003.

<b>Overall rating of Business Advisory Services</b>	<b>2004</b>	<b>2002</b>
	<b>2.9</b>	<b>2.9</b>

### ***Business Advisory Services (BAS)***

	<b>2004</b>	<b>2002</b>
24.1 Do you <b>use</b> advisory services?	<b>Yes: 17%</b> <b>No: 83%</b>	<b>N/A</b>
Private consultants	<b>Yes: 26.7%</b> <b>No: 73.3%</b>	<b>N/A</b>
Government – donor supported consultants	<b>Yes: 8.7%</b> <b>No: 91.3%</b>	<b>N/A</b>

The use of consultant services is not widespread, even though the majority of entrepreneurs are familiar with them. Only about 9% of the focus group participants use the services of governmental and donor-sponsored consultant centres and roughly a quarter use the advice of professional private business consultants. Entrepreneurs tended to believe that the services are either too expensive for them or are not well adapted to their needs.

***“I have never used this kind of service because I cannot afford it.”***

Another problem is availability of these services throughout the country:

***“There are consultant offices and consultant services but only in Sofia. What they can surely do is to provide a consultant who comes to Sevlievo once a week or once a month. I guarantee that people are going to line up for him.”***

There is clearly a potential for a wider use of consultant services by entrepreneurs. A greater availability of the services throughout the country, in particular in the regions, and lower prices would attract and benefit a larger group of entrepreneurs.

	2004	2002
24.2 Are you satisfied with the <b>range</b> of business advisory services available to new entrepreneurs and SMEs?	<b>Yes: 9.4%</b> <b>No: 90.6%</b>	N/A
by private consultants	<b>Yes: 35.3%</b> <b>No: 64.7%</b>	N/A
by Government – donor supported consultants	<b>Yes: 11.8%</b> <b>No: 88.2%</b>	N/A
Rating	<b>1.9</b>	<b>2.7</b>

The 2004 assessment of the consultant services provided to SMEs is lower than in the previous report, with only around 10% of polled business representatives satisfied with their diversity. This result may be due to the fact that the 2004 survey included representatives from distant provincial areas, with different business and institutional environment characteristics. In general, entrepreneurs tended to believe that consultant services are not well tailored to their needs and often too expensive, in particular when it comes to specialised consulting. In view of their limited capacity, they would rather resort to more general forms of consulting, such as seminars, which they find sufficient sources of information on potential markets and customers.

***“In my opinion, seminars should be organised for everyone that is interested in using consultation. This should continue until the small-size firms become stabilised, because only a small number of firms can afford specialised consulting.”***

Entrepreneurs also make a distinction between the services provided by private and public consultants and consider the former better suited to their needs. They also seem to trust the private consultants more, especially when of a foreign origin, as they believe that foreign companies employ better qualified staff:

***“Generally speaking, the professionals work for international firms.”***

Entrepreneurs are familiar with consultant services in areas such as the European assistance programmes for small and medium-sized enterprises, tax consulting, staff recruitment, gathering of marketing information. Other forms of consulting, such as the government programmes for start-up, assistance remain relatively unknown.



***“I have not even heard of something like this. These programmes for the promotion of small and medium-sized businesses do not reach us.”***

The use of consultant services remains limited. More active involvement of regional BSMEPA units and more information on the entrepreneurship support programmes could encourage entrepreneurs to make greater use of them.

### ***Efficiency of Business Advisory Services***

25. Do business service providers operate <b>efficiently</b> ?	<b>2004</b>	<b>2002</b>
	<b>Yes: 17.2%</b>	<b>N/A</b>
	<b>No: 82.8%</b>	
rating of private consultants	<b>3.0</b>	<b>2.7</b>
rating of Government / donor supported advisory services	<b>2.4</b>	

The rating of the efficiency of the consultant services has not changed since last year (overall rating 2.7) and remains “satisfactory”. Entrepreneurs tended to be more satisfied however with the services provided by private consultants. 25% of the business representatives in focus groups evaluated their efficiency as “good”, while only 4% gave the same evaluation to the publicly provided services.

***“When you are faced with a conscientious consultant company, this is fine – not all of them are like that. It is hard to tell whether the information they provide is reliable. This cannot be verified.”***

This irregularity of information requires that the government take a more active stand with respect to provision of advice to SMEs. So far, entrepreneurs value the efficiency of the services provided by the private consulting companies more than the publicly provided services. Increasing the regional presence of BSMEPA could help to increase the efficiency of the consulting services. Possibilities for public-private partnerships could be explored for this purpose.

### ***Responsiveness to Demand***

26. <b>Responsiveness</b> to demands and needs of enterprises.	<b>2004</b>	<b>2002</b>
rating of private consultants	<b>2.7</b>	<b>2.7</b>
rating of Government / donor supported advisory services	<b>2.4</b>	

Similarly to the December 2002 evaluation, entrepreneurs assessed the match between supply and demand for consultant services as “satisfactory”. At the same time they rely more on their own market assessment and seldom make use of the advisory services available:

***“The mistake made by the Bulgarian small and middle-sized business is that nobody ever makes the effort to explore the business he is engaged in. Everything depends on one’s own judgment.”***

Their rating of the responsiveness of private consultants, as for the other categories, remains slightly higher than that of the government services. Entrepreneurs tend to trust the private consultants’ assessments more and believe that they are more efficient and responsive to the needs of the market.

### *Human Capital*

27. Rating of <b>skills, quality and experience</b> of the staff providing Business Advisory Services.	<b>2004</b>	<b>2002</b>
skills	<b>3.1</b>	<b>3.5</b>
experience	<b>2.9</b>	<b>2.9</b>
quality	<b>3.2</b>	<b>3.6</b>

Entrepreneurs are satisfied with the skills, experience and quality of the personnel providing advisory services and, although their assessment in this category is slightly lower than that of the previous survey, it is one of the highest in this study. Professionalism of the private, and especially, international consultants is most valued, but in general entrepreneurs remain cautious in using external advice:

*“There are no professionals in the consultant companies”.*

It seems that even though entrepreneurs highly appreciate the skills and experience of the consultants, these assets are alone not sufficient to increase the use of their services.

### *Continuity of Provision*

28. How do you rate the <b>continuity</b> of Business Advisory Services available?	<b>2004</b>	<b>2002</b>
	<b>2.8</b>	<b>2.6</b>

Advisory services should continue to correspond with the needs of SMEs at different stages of their development. In Bulgaria, entrepreneurs remain relatively satisfied with the continuity of Business Advisory Services provided throughout the stages of their development, although they are at the same time unfamiliar with the full range of services available. They could benefit from more information on the programmes for business start-ups and support in development. In particular, relevant information could be made available at the regional level.

### *Changes Since 2003*

29. Rating of the <b>changes</b> in provision of Business Advisory Services for SMEs since March 2003				
<b>much worse</b>	<b>worse</b>	<b>no change</b>	<b>better</b>	<b>Much better</b>
0%	0%	68.0%	32.0%	0%

Despite the ongoing diversification of the range and opportunities presented by the governmental programmes for promotion of entrepreneurship and the programmes of the business organisations, entrepreneurs did not perceive significant changes with respect to the provision of Business Advisory Services. Most of them are familiar with the consulting opportunities, but they are uncertain whether they correspond to their needs, or else consider them too expensive. This seems to be due primarily to insufficient information and communication with businesses, in particular at the local level. A greater use of these services could however help their long term development.

*“Evidently, something has changed. Since more and more people work in these agencies, something must have changed.”*

## 7. Business Incubators

The issues discussed with the business representatives under this topic included:

1. Awareness of and experience with business incubators, and their value for new entrepreneurs and existing SMEs;
2. Efficiency of the government policy and programme for encouraging the establishment of business incubators;
3. The extent to which the activities of business incubators respond to the needs of entrepreneurs;
4. Evaluation of the changes over the last year.

Overall rating of Business incubators	2004	2002
	2.5	2.7

### *Experience with Business Incubators*

30. Are you <b>aware</b> of what business incubators are?	2004 Yes: 32.6% No: 67.4%	2002 N/A
Use of business incubators	No: 100%	Yes 11.8% No 88.2%
Rating given to the <b>importance</b> of business incubators	2.9	3.4

The concept of a business incubator remains relatively unknown to the majority of entrepreneurs and managers of SMEs. Only about one third of the businessmen interviewed in the focus groups were familiar with them, and none of them had any experience or relations with Business Incubators.

Indeed, the number of operational Business Incubators in Bulgaria is limited. Many new entrepreneurs are considerably under-informed about the different market and public institutions in place. The focus group participants in Sofia, for example, knew about Business Incubator organisations, but seemed to have little understanding of their goals and the advantages they offered.

*“Transparency is totally missing...”*

Entrepreneurs in the regions were not familiar with the concept of Business Incubators at all, and did not know that they exist in Bulgaria. More information on the availability of the Business Incubator services could help raise the awareness of the business development possibilities they offer and thus increase the use.

### *Government Policy*

31. Is the Government <b>policy and programme</b> for encouraging business incubators efficient	2004 Yes: 4.2% No: 95.8%	2002 No: 93.4%
Rating	2.2	2.5

The majority of the focus group participants found that the government policy for encouraging the establishment of Business Incubators is inefficient, obviously as most of

the businessmen interviewed were not familiar with the concept of Business Incubators. At the same time, it seems that the government has not actively engaged in the development of the initiatives in this regard. More efforts may be needed in order to encourage the introduction of business incubation organisations.

### *Focus on Needs*

32. To what extent do the activities of business incubators <b>respond to the needs</b> of local entrepreneurs?	<b>2004</b>	<b>2002</b>
	<b>2.8</b>	<b>2.1</b>

Given the fact that 100% of the focus group participants has not used Business Incubators, it was impossible to collect testimonials on the quality of service provided by Business Incubators in Bulgaria.

Lack of understanding (or misunderstanding) of Business Incubators may be a reflection on the effectiveness or efficiency. Entrepreneurs may need to be better familiarised with Business Incubator structures, in particular in view of the similar findings concerning the government/donor supported schemes for start-ups.

### *Schemes for Start-ups*

33. Are you <b>aware</b> of other Government – donor supported schemes for start-ups (newly established small companies)?	<b>2004</b>	<b>2002</b>
	<b>Yes: 17.2%</b> <b>No: 82.8%</b>	<b>N/A</b>

Few interviewed entrepreneurs were aware of government or donor supported schemes for start-ups, and so even fewer had made use of them. These results correlate with the entrepreneurs' assessments of the performance of government SME support institutions– 85% of entrepreneurs perceived no improvement in their performance. This negative attitude concerns all government institutions in general. Entrepreneurs tended to perceive the state more as a tax collector than a business supporter.

*“...there certainly are such schemes, but what do they do? – do they train entrepreneurs or something? – I don't know...”*

The fact that the vast majority of Bulgarian entrepreneurs neither use Business Incubators, nor use or know of other government or donor-sponsored schemes for start-ups, calls for more efforts in the dissemination of information. This could be done in particular, through the new regional branches of the SME Agency and various local business organisations.

### *Evaluation of Changes*

34. The <b>change</b> of Government policy towards business incubators since December 2002				
<b>much worse</b>	<b>worse</b>	<b>no change</b>	<b>better</b>	<b>much better</b>
4.8%	4.8%	81.0%	9.4%	0%

Entrepreneurs remain unfamiliar with Business Incubators or government supported start-up projects and perceived no change in this respect since the last assessment. Indeed, there are very few business incubators and information about them is insufficient. A more active entrepreneurship policy may be necessary for Bulgaria to support its entrepreneurship growth objectives.

## 8. Entrepreneurship, Training and Access to Technology

The issues reviewed under this heading include:

1. Contribution of the education system to the cultivation of the entrepreneurial spirit in the country;
2. Awareness of the existing training schemes and programmes, designed for entrepreneurs;
3. Entrepreneurs' assessment of the quality of vocational training, related to their business;
4. Efficiency of apprenticeship in the country;
5. The process of recruiting qualified staff;
6. Government programmes, aimed at increasing the technological capacity of companies;
7. Change in the image of entrepreneurs over the last year.

<b>Overall rating</b> of Entrepreneurship, Education and Access to Technology	<b>2004</b> 2.5	<b>2002</b> N/A
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### *Entrepreneurial Spirit*

35. How much is the <b>education system</b> contributing to the creation of an <b>entrepreneurial spirit</b> in your country?	<b>2004</b> 2.4
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The focus group discussants and experts interviewed did not believe that the Bulgarian education system nurtures the entrepreneurial spirit. They considered it too conservative for the current market environment, even though it has undergone several reforms. The experts point out in particular that the curricula in both secondary and higher education are outdated.

*“The education system has been undergoing too many experiments.”*

### *Training Schemes*

36. Are you aware of <b>training schemes</b> for entrepreneurs?	<b>2004</b> <b>Yes: 36.4%</b> <b>No: 63.6%</b>
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Only around one third of the focus group participants had heard about training programmes, even though most of them were more designed to upgrade the qualifications of the unemployed. These mainly included computer and foreign language courses. However, entrepreneurs considered them necessary and useful:

*“When you work for a small firm, you have to improve your competences.”*

The expert respondents though considered the existing training schemes insufficient. The issue of their effectiveness was also raised.

### *Vocational Education Training*

37. What is the <b>quality of Vocational Education Training</b> in relation to your business?	<b>2004</b>
How effective is <b>apprenticeship</b> in your country?	<b>2.6</b>
How difficult is for you to <b>recruit staff</b> with the right skills?	<b>3.7</b>
	<b>2.4</b>

Despite the relatively low awareness of training programmes for entrepreneurs, respondents assessed their quality as “satisfactory”. Experts interviewed confirmed the positive participation of SME managers in vocational training. Entrepreneurs also valued the effects of these trainings on the quality of their staff.

The effectiveness of apprenticeship is assessed as “good”, which is the highest rating given within this year’s survey. Entrepreneurs estimate that apprenticeship complements regular and vocational training.

*“I got involved in a project, which enhances the professional qualities of my employees. I appreciate highly loyalty to the company. The person may not be a distinguished professional, but he will work for us for a long time – for that reason we need to make a good team together. Qualities can be gradually developed.”*

Apprenticeship gives an opportunity to train the company’s own employees, in particular in view of the difficulties some entrepreneurs experience in recruiting staff with the required skills. Recruiting new employees is considered rather difficult.

*“It is very difficult. We resort to the help of agencies, otherwise it is impossible.”*

On the other hand though, many note that a high level of unemployment makes it easier to recruit staff. Well trained and qualified employees often remain too expensive for the small enterprises. This is why many smaller firms prefer to hire less-qualified staff and offer them training. Training is also often continued for the qualified staff to develop their specialised skills.

*“People come with the right qualifications, but they need training. We use seven types of machines and they are specialised. No matter where a seamstress has worked before, I will have different requirements.”*

Apart from the recruitment problems, entrepreneurs find it difficult to retain qualified staff. In some sectors, qualified workers seek better job opportunities abroad.

*“Unlike other sectors, in the construction field we have highly-qualified staff and that is exactly where the problem lies – they are too highly qualified. You have just employed him, he has just started working and on Thursday he tells you: On Saturday I leave for Germany.”*

Experts confirm these opinions. They find the education system mal-adjusted to the present market needs and consider it an important reason behind recruitment problems. They also note that staff fluctuations are an issue. In the absence of qualified staff, entrepreneurs prefer to recruit less-qualified employees and train them. This is why they rate apprenticeship highly.

### *Business Standards and Opportunities*

38. Government provision of information about <b>business standards and business opportunities</b> in your country.	<b>2004</b>
	<b>2.1</b>

Government provision of information about business standards and opportunities was perceived by the majority of respondents as either “very poor”, or “poor”, which makes it one of the lowest ratings in this survey.

*“Everything is subject to constant changes. There are no standards.”*

What amplifies the problem is that the provision of information seems insufficient and entrepreneurs consider themselves badly informed. An important example concerned the deficiencies of the government’s Communication Strategy for Bulgaria’s accession to the EU.

On the other hand, more and more entrepreneurs use Internet in order to obtain the information necessary for their business, both in the country and abroad. Internet ranks third as a source of information for business opportunities and new technologies in Bulgaria.<sup>1</sup> Opinions of the focus group participants seemed to confirm that:

*“One can find information on Internet. I receive most of my orders via Internet. I definitely use Internet.”*

State institutions also post information on Internet on their own web-sites, which are, in most cases, regularly updated. However, entrepreneurs do not seem to consider this information sufficient.

### *Technological Capacity*

39. Rating of the Government <b>programmes</b> to improve the <b>technological capacity</b> of small enterprises	<b>2004</b> <b>1.8</b>
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Over 80% of focus group participants assessed the government programmes to improve the technological capacity of small entrepreneurs as “poor” or “very poor”. This low rating stems from the fact that the respondents were mostly unfamiliar with the relevant programmes.

### *Image of Entrepreneurs*

40. How do you rate the <b>change in the image</b> of entrepreneurs since December 2002?				
<b>much worse</b>	<b>worse</b>	<b>no change</b>	<b>better</b>	<b>much better</b>
10.0%	22.5%	62.5%	5.0%	0%

The negative image that became associated with entrepreneurs in the mid 1990s, is still prevalent according to the 2004 EPPA research, i.e. that of a person operating on the edge of or outside the law.

*“A lot of people confuse entrepreneurs with the individuals who have acquired wealth illegally. If we are able to differentiate between the two images, I am sure most Bulgarians will have respect for the successful person.”*

On the other hand, the interviewed government officials viewed the image of entrepreneurs as steadily improving. Some entrepreneurs and expert respondents also perceived a positive trend. Overall, the change of the image of entrepreneurs was assessed as “satisfactory” by the entrepreneurs themselves and “better” by experts:

<sup>1</sup> ASME. SME Report 2002-2003.

*“Our image has started changing, but it has still not completely changed. It will change after ten years or so.”*





## *PART II*

### *Chapter II*

## **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 has changed since the December 2002 EPPA; other OECD, EC, EBRD, Bulgarian 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 led to the series of recommendations presented in Part I of this report.

## **1. Implementation of the Institutional Framework for SME Policy**

### ***Situation on the Institutional Framework***

Since December 2002 the government has continued a consistent and active SME development policy. New steps included significant amendments to the Law on SME and adoption of the Law on SME Investment Support, as well as an important functional reorganisation of the Ministry of Economy.

According to the new ‘Structural Regulations of the Ministry of Economy’, adopted in October 2003, the Ministry has been reorganised with the aim of assigning responsibility for various policy areas (the general economic policy, enterprise policy, corporate governance and restructuring and the investment policy) to different Directorates. At the same time, a clear delineation between the policy making and implementation responsibilities has been introduced with the amendments to the SME Law. The Law provides for the Ministry of Economy to formulate, coordinate and monitor the Government SME support policy, while the SME Agency is charged with implementation of the national strategies and working programmes adopted by the Council of Ministers. It was further decided to merge the SME Agency with the Trade Promotion Agency in order to combine some of the interrelated functions and improve accessibility and responsiveness to the business. The new Bulgarian Small and Medium Enterprises Promotion Agency (BSMEPA) was launched in October 2004. The reorganisation should help improve the performance and efficiency of the institutions, as well as ensure a better functioning of the overall institutional environment.

Important amendments to the Law concerned the SME Advisory Council. Its role has been extended to serve as an advisory body to the Minister of Economy on the issues related to policy-making and regulatory changes in the area of entrepreneurship support, as well as to perform “public oversight” of implementation of the national entrepreneurship strategies and programmes. The Law also explicitly requires now that the policy development and implementation be carried out in consultation with NGOs, branch chambers and unions, business associations and academia.

Vertical co-ordination has been assured through the establishment of the BSMEPA local branch offices, which should reduce the gap between the policy implementation at the central and local level. It should also bring the information, advisory, start-up and operations services closer to the business.

Finally, the Law sets in compliance with the EC recommendations the SME definition, which was one of Bulgaria’s EU accession requirements. According to the new definition a micro enterprise is a company with less than 10 employees; a small enterprise employs less than 50 people, its annual turnover is up to BGN 5m and balance sheet value of the assets of up to BGN 1m; a medium-sized enterprise employs less than

250 people, its annual turnover is up to BGN 15m and balance sheet value of the assets up to BGN 8m. The independency criterion is also set in the law, making the new definition in compliance with the relevant EU non-financial provisions. The new higher financial thresholds applied to SMEs will not extend considerably the number of enterprises eligible for financing under national and international programmes. At the same time, the new definition will help standardise the data on SMEs, allow comparisons of the status and policy efficiency with other countries, and finally provision of better-tailored recommendations.

The new law on SMEs constitutes an important step forward in improving the institutional framework for the SME policy development and implementation. A transparent organisational environment with clear allocation of responsibilities, better policy co-ordination and co-operation with stake-holders should improve the understanding, compliance and “ownership” of reforms. Business should receive timely and up-to-date information on the legislative changes in the area, available financial support measures, expert assistance for business start-ups and development, new requirements deriving from the future EU membership, and other business support and partnership measures. To this end, appropriate institutional capacity of the SME administration has to be built for the reforms to be fully implemented.

Steps have also been taken since the last assessment to improve SME financing opportunities. The *Law on SME Investment Support* provides for a possibility of financing by special shareholding companies, investing through share capital, long-term loans or convertible bonds, called “venture capital companies”.

### ***Assessment***

This year the institutional framework for SME policy received the lowest rating (1.8) of all seven elements of the SME policy surveyed and was less favourably assessed by entrepreneurs than in the December 2002 EPPA (2.3).

The major criticism of entrepreneurs and experts concerns the efficiency of SME institutions. Here the opinions shifted from “satisfactory” in 2002 to “very poor” in 2004 by more than half of respondents. The key reason behind this shift in assessments seems to be the meagre knowledge of entrepreneurs about the targets, functions, tasks and results of the activities of the SME institutions and organisations as they feel considerably under-informed. According to experts, the absence of sufficient financial and staff resources has hindered the Agency’s capability to produce more visible results. In this respect, the recent organisational changes to the SME institutional environment are assessed positively and are expected to allow better tailored SME policy making and implementation.

Similarly, entrepreneurs seem to feel disappointed with the quality of the National Strategy for Encouragement of SME Development (2002-2006) adopted in 2002, as illustrated by the change in the majority ratings from “satisfactory” in 2002 to “poor” in 2004. In particular the effectiveness of the strategy is currently estimated as “very poor” (by 41.3%) or “poor” (by 54.3%). The 2002 survey was carried out soon after the adoption of the strategy and reflected the positive assessments with respect to the quality of the document and the government’s intentions. Two years down the implementation path and entrepreneurs point however to the absence of sufficient resources behind the strategy, which hinders its practical application. Their practice-based opinions in this area are shared by the experts, who apart from the financing problems also point to the absence of “ex ante” analysis and monitoring of the strategy implementation.

There is a widespread opinion among entrepreneurs that the local and regional authorities dispose neither of the powers nor of resources to implement effective local and regional policy in support of the SME sector. The predominant opinion is that, even though efforts are made at the Government level, at the local and regional level the measures and programmes are not implemented. Expert opinions in this respect are less radical. Being more familiar with the principles set by the existing legislation, many of them take the position that sufficient powers and resources to assist the establishment and development of SMEs at the local and regional level are already in place, but are not used in practice. They stress in particular that in some areas, such as privatisation, once the overall legal preferences for SMEs have been removed, more depends on a local or regional initiative. At the local level though, small businesses feel at a disadvantage with their bigger competitors, in particular regarding access to information on existing projects and programmes in support of entrepreneurship.

Insufficient information about the government policy and measures for establishment and development of SMEs seems the main factor behind this year's low assessment of the institutional framework. The majority of entrepreneurs consider that the information provided and consequently their knowledge about the Government SME institutions, policies and programmes is "very poor", as compared with "satisfactory" at the time of the previous assessment. At the same time, Bulgarian entrepreneurs remain quite passive in accessing information; little use is made of the existing channels, such as NGOs, branch unions and business organisations or of the Internet. Still, according to the interviewed experts, there is scope for improvement of the government SME information policies, providing business with up-to-date and reliable information, establishment of multiple and stable information channels, going beyond the traditional methods used so far, such as brochures and using more "plain language" in the government documents and publications. Finally, appropriate resources have to back the new more expansive approach. The experts view positively the initiative of the Government to inform business of its commitments and opportunities in the process of Bulgaria's accession to the EU. This is seen as an important step in the preparation of the Bulgarian business to face the competitive pressure of the EU Common Market.

Communication between the government and market agents should be two-way. Many of the focus group participants assessed the quality of the SME policy consultations between the Government and the business as "very poor" (50.0%) and the regularity also as "very poor" (48.9%). The average ratings in this category are slightly lower than those in 2002 (1.7 & 1.7 in 2004 compared to 2.0 & 1.7 in 2002). Entrepreneurs mainly complain about the lack of visible substantial effects of these consultations. Experts seem to hold more positive opinions. They stress in particular the efficient functioning of the Economic Growth Council and a number of round tables in the recent years held to discuss the major problems facing business and jointly search for the solutions.

In spite of the moderate evaluations of the overall institutional framework for the support of SMEs this year and in comparison to 2002, entrepreneurs seem fairly satisfied with the performance of the government SME institutions (2.4) and experts consider it quite good (3.4). This makes this category the highest rated aspect among all institutional framework dimensions. A more active role of the Government in the legislative sphere brings about optimistic expectations about the conditions for establishment and development of entrepreneurship. Experts recommend that the proposed legislative measures be publicised so that there is more trust in government actions and support for its initiatives, as collection and dissemination of information remain highly criticised by entrepreneurs. Even more could be achieved through further intensification of the

dialogue with the business community. Capacity of the government SME institutions is improving as they accumulate knowledge and experience and is reflected in the changing attitude towards these institutions. Representatives of branch associations point to a number of remaining problems that mostly relate to the overall SME environment and bureaucratic difficulties, but also stress the problems associated with the inefficient judiciary.

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

### *Situation in the Area of the Rule of Law and the Regulatory Environment*

The overall assessment of the regulatory environment for development of entrepreneurship has improved since the last survey and reflects a number of regulatory enhancements introduced by the government over the last two years. The government decision No. 392/7 of June 2002 abolished 73 regulatory regimes and simplified another 119. The work to bring the regulatory framework in line with the decision continues. According to the Government report<sup>1</sup>, in September 2004 the decision had been implemented in 82%, with 158 regimes abolished or simplified (or in the process of being abolished), and 34 pending. A regulatory database has been created as part of the Register for administrative structures and the acts of executive bodies, and has been accessible via Internet as from February 2003<sup>2</sup>. The database contains detailed information on the regimes administered by the central and municipal authorities and provides entrepreneurs with quick access to the legislative requirements, administrative procedures, documents, as well as the information on the fees for issuing licenses, permits or registration.

Entry into force in December 2003 of the *Law for Restricting the Administrative Regulation and Control Over the Economic Activity* constituted an important step towards optimisation of the business environment. The Law aims at simplifying the licensing regimes and diminishing the state interventions into the business operations. To this end, it sets the rules to govern the relations among entrepreneurs, the central administration and the local government authorities with respect to starting, developing and terminating business activities. It introduces common principles, more transparent and simplified procedures and thus also reduces the scope for corruption.

In the area of licensing, the law enumerates the activities subject to the license requirement. These include banking and insurance, pension assurance, certain manufacturing, transportation and trade activities, as well as exportation of weapons, ammunitions and goods with potential double usage, CD production, etc. The law envisages licensing of hospitals, distribution of pharmaceutical products, radio-TV and telecommunication activities. It prohibits introduction of new licensing regimes by means of lower level regulations and establishes that only central administrative authorities can issue licenses.

In order to enhance business start-ups and facilitate business activity, as well as to reduce the scope for corruption, the Law introduces the “silence is consent” and “one-stop shop” principles. The “silence is consent” principle relates to the issuance of licenses for one-off deals or transactions and applies only if the relevant law does not stipulate otherwise. In the absence of an administrative decision within the term provided by the law the applicant must inform the administration that it will undertake the steps to start the relevant business activity. From this moment onwards the administrative authority has 14 days to issue a decision. Should the administration continue to be silent, the deal may be carried out. With respect to “one-stop shops” the Law requires that the

authorities optimise, where possible, their interactions with the business with the view to avoid multiple applications and procedures. The *Concept paper for improving administrative services through one-stop shops* and the *E-government Strategy* were further developed by the Government in implementation of these provisions. The documents seek to simplify the administrative procedures for citizens, businesses and the state administration, reduce the possibilities for corruption and reduce time and costs spent on administrative activities. They foresee to optimise the use of the Internet, with a minimum set of services to be launched on Internet by 2005 – 12 services for citizens and 8 for businesses. To this end, a number of legislative measures are foreseen to ensure an effective implementation of the E-government Strategy.

An important innovation concerns the introduction of a regulatory *impact assessment* of draft legislation. The Law requires that the authority proposing a new regulatory measure, which anticipates introduction of a new licensing or registration regime, must justify the need for such a regulation. The justification must include a detailed economic analysis and an assessment of the impact, which the regime might have on the economic activity. The new requirement is particularly valued by experts and entrepreneurs, as it provides for a more transparent and predictable regulatory process and helps ensure better quality of new regulation.

The Law also required that all administrative and local government authorities bring the existing regulations in line with the new law within 6 months after its promulgation, but the process has been delayed. Similarly, the simplification of licensing regimes (including at the municipal level) has not been completed, although consultations with business are ongoing to advance the process.

The level of corruption is an important indicator of the transparency and clarity of the regulatory environment and the functioning of the rule of law. The *Report of the International Transparency Organisation* released in October 2003 ranks Bulgaria 54 among the 134 surveyed countries. This result is comparable with that obtained by the new EU members from CEE (with Latvia, Poland, Slovakia rated lower and Estonia, Hungary and Lithuania higher on the list) and above the average for the SEE region (with Romania, Croatia, Macedonia, Serbia and Montenegro rated lower).

In September 2003 the Government Anticorruption Agency released its Report on coordination of the measures to combat corruption. These mostly include educational and information programmes for businesses and the administration, introduction of the code of ethics for the civil servants, etc. According to the Report, during the period September 2002 – 2003 over 2000 civil servants had been dismissed for corruption and further 1800 investigated by the Ministry of Interior and the inspectorates under signals of corruption. 200 investigation cases had been submitted to the prosecution and some of those are subject to indictments. The Report also includes an Implementation Programme for the National Anticorruption Strategy for 2004-2005.

The efforts to improve the capacity of the central and local administration authorities are continued. In July 2003 the Civil Service and the State Administration Law was amended to introduce competition procedures for employment of civil servants, as well as the procedures for the annual performance assessment. These should help improve the quality of the civil service corps and offer civil servants better career development opportunities. The Law also contains anti-corruption provisions to eliminate possible conflicts of interest. Civil servants are obliged to declare by 31<sup>st</sup> March each year all commercial, financial or other business interest, which they or their relatives may have

with respect to the functioning of the public institutions they represent. The law stipulates that these should primarily be avoided or resolved if a conflict of interests emerges.

### **Assessment**

The overall assessment of the rule of law and the regulatory environment for development of entrepreneurship has improved since the December 2002 survey (2004 – 2.5, 2002 – 2.0). Still, 57% of the respondents perceive no considerable change. The main business development obstacles voiced by entrepreneurs include the length and proliferation of administrative procedures, their costs, and the lack of good coordination – different institutions often require presentation of the same documents and forms, which causes duplication of efforts, waste of time and resources.

At the same time the registration process of a new company is assessed more positively. The overall evaluation, including the administrative steps, timing and charges, has been given one of the highest scores (above 3) under this study. The process should be enhanced further with the implementation of the *Strategy for setting up a central register of the legal entities and an e-register centre in Bulgaria* (introduced with Decision #322 of the Council of Ministers). The assessment of the procedures for issuance of certificates, licenses and permits is less favourable. Also, the government programmes for reducing administrative barriers remain relatively unknown to entrepreneurs and these who are more familiar with them do not seem to perceive their effects. The evaluation of the programme quality is 2.0 and of the programme effectiveness – 1.9, almost the same as in 2002 – 2.0.

Corruption is perceived as a widespread phenomenon, although opinions about it differ between the larger cities and the smaller municipalities (more corruption is perceived in Sofia than in smaller cities such as Sevlievo). Entrepreneurs also remain critical of the existing anticorruption programmes. 63.3% of the interviewed SME managers are aware of the programmes, but find them inadequate in terms of quality (76.2% of interviewees) and inefficient (81% of interviewees). SME managers share the opinion that optimisation of the regulatory regimes, implementation of the ‘one-stop shop’ principle and more use of the Internet have a significant potential for reducing corruption.

Business representatives are also convinced that more dialogue between the private sector and the government in preparation of business related draft laws could enhance the overall regulatory environment. Ratings in this category fell well below 2. The efficiency and frequency of the dialogue do not meet the expectations. The erratic interaction between the business and the government affects confidence in the regulatory institutions and measures and undermines the business compliance with the regulatory requirements.

## **3. Implementation of Tax Policy for Small Businesses**

### ***Situation in the Area of Tax Policy for Small Businesses***

Tax laws in Bulgaria do not envisage specific alleviations and incentives related to investments and development of the SMEs. The reasons for this are two-fold: on the one hand, the state tax policy is based on the principle of neutrality and equal standing of the tax subjects, and on the other hand – the opportunities for provision of preferences are limited by the necessity to realise sufficient budget contributions. In 2003 and 2004 the downward trend of decreasing tax rates continued and transfer of the weight to the indirect taxes was also noticeable.



Since the beginning of 2003 the municipal tax was revoked and a single rate was introduced for profit taxation by corporate tax amounting to 23.5%, which was later dropped to 19.5% (effective as of 1 January 2004 and to 15.0% as of 1 January 2005). During next year further decrease of the rate is planned. The annual depreciation rates are also increased for some groups of assets to 50% as of January 2004 (computers and software) and the depreciation methods are simplified. The measure is of particular importance to the high-tech SMEs and manufacturing enterprises. As of January 2005 some groups of assets have been added to this accelerated depreciation pool of assets – machines, manufacturing equipment and apparatuses, but only under certain limiting conditions. With the amendments to the Law on Corporate Income Tax a new Art. 61e was created, regulating exemptions amounting to 100% of the corporate tax for the persons, performing manufacturing activities in regions with unemployment rate by 50% higher than the average for the country. The goal of the measures is to encourage the development of business and investments in production. As a great part of the companies are subject to patent tax under the Law on Taxation of the Income of Natural Persons (LTINP), the incentives pointed out have a limited effect on the SME sector.

An essential peculiarity of the patent tax is that it is fixed as an absolute amount in LTINP and is not influenced by the financial result. The amount of the liability is determined by the functional type of the enterprise and the specificity of the activity. With regard to patent tax the most important change, effective from the beginning of 2004, is in the scope of the persons subject to patent tax – the annual turnover as a condition of this taxation regime decreased from BGN 75 000 (EUR 39 000) to BGN 50 000 (EUR 26 000), which makes it the same as the registration threshold under the Law on VAT. The change aims at differentiation of the scope of small business, which is also related to alleviation of the reporting of the tax liable companies. Thus, the paradox was removed that companies paying patent tax should be also registered under the Law on VAT in the case of turnover between BGN 50 000 and BGN 75 000.

In the area of indirect taxes, the excise increase on fuels and tobacco goods should be highlighted. This increase is a result of the commitments undertaken by the Republic of Bulgaria in order to reach the minimum amount of excise for the EU.

To recapitulate, it should be pointed out that it is necessary for efforts to be focused in the direction of establishment of a stable tax environment with a system of clear regulations and sanctions. Decrease of tax rates is only one aspect of development of tax policy. The other important measures include consulting the representatives of business, improved access to information, lowering the costs for payment of tax obligations by the introduction of up-to-date technologies in the work of the administration, etc. To reach maximum effect, tax incentives should be combined with other forms of encouragement of SME (advisory services, help in preparation of projects, etc.)

### **Assessment**

According to the average rating on the dimension of tax policy, no considerable change has occurred since 2002. The criticisms regarding tax policy are pragmatic - ***“Taxes have to be paid, because the State lives on that”, “I want to work and to have the capacity to pay my dues” (Sofia)***. The dissatisfaction of business is due to the incapacity to implement specific strategic plans and intentions for growth because of external factors. The accusation by 98% of the entrepreneurs that the tax system does not encourage the development of SMEs is grounded on a several very essential problems:

- Absence of incentives for investment – “...*you have to fully pay all taxes and only then re-invest*”(Plovdiv)
- High VAT rate;
- Imposition of additional social contributions – “*Why should the person working at two places pay for 16 hours? Those who want to work more are not stimulated*” (Yambol);
- Advance instalments for profit tax which do not take into consideration the changes in demand.

Such a policy is strongly restrictive and does not favour the growth of SMEs - “*There is no support or incentive, because after I have created one company and have fulfilled all the requirements and paid all the fees, I do not see any sense in founding a new company and creating jobs*” (Yambol).

Concerning the remaining aspects of tax policy for SMEs, the communication between the institutions, business and NGOs has considerable potential for further development. According to the focus group participants, the interests of the large company owners are protected and the consultations on problems affecting all enterprises are performed at high level, which does not result in solutions on the spot in the country and as a whole. The representatives of the SME sector do not have access to analytical information “*We heard that they would give us analyses of what was done... but so far I have not heard anything*” (Sofia). It would be useful if behind every political decision there is an economic reasoning accessible to business which explained in detail the possible consequences in the short-, mid- and long-run. In this context the role of the NGO sector as a mediator between tax authorities and small businesses is rising, because it possesses enough potential to supply information services which are not supplied by the tax administration.

The third problem of the current tax policy is that it is not consistent with the other dimensions of the state policy, targeted at the encouragement of business development in the country. The decisions are not taken with a view to the overall strategy, but fragmentarily and as an end unto themselves.

The ratings given by focus group participants show that regardless of the sharp criticisms addressed to the state in the course of discussions, the business environment is improving, although slowly. Proof of this is the decreasing share of those who paid over 25% of their annual income for taxes from 71% (2002) to 45.7%. However, the opinion of this 73.3% (33% in 2002) of participants, sharing the opinion that tax weight is increasing should not be ignored.

Interaction with the tax administration received quite a positive rating – 38.3% stated that it is “*neither difficult, nor easy*” and 8.5% find it “*rather easy*”. Entrepreneurs’ dealings with personnel did not reflect a negative perception of the service: “*The tax authorities have already become better, they have more experience*” (Sofia).

The results of the expert interviews support the conclusions of the focus groups. According to the experts as a whole the tax policy does not encourage business development, as it is not consistent with the other activities of government in this direction. Partial solutions such as the decrease of tax rates do not have a strong effect, if they are not combined with other measures: “*alleviations, support, guarantee funds, assistance in preparation of projects, consulting, subsidies and others*”. There is no

interaction between the institutions in this respect; work is done for its own sake, without a unified strategy.

In addition, tax procedures are complicated. Optimisation is required not for its own sake, but rather after a preliminary analysis of each stage separately and elimination of the expendable steps in the process – *“to clarify the entire procedure, to make a review of which stages from this procedure are superfluous or duplicate”*.

The latest developments in the tax policy show a certain degree of centralisation of the State Tax Administration, which could lead to closing down a number of local tax offices across the country. This move could leave SMEs with less information and fewer contact points with the tax administration, and should be counter-balanced by a more intensive information campaign.

#### 4. Implementation of Financial Instruments for New and Small Businesses

##### *Situation in the Area of Financial Instruments*

The Bulgarian banking sector is dominated by western banks which control over 82% of the market. 2004 saw a continuation of the sharp growth in lending activities in Bulgarian banks (see table below), primarily in corporate lending (including medium sized lending) and consumer finance. Increased liquidity and competition in the sector have been among the determinants of the credit boom.

Domestic credit to private sector, official data (end-year, percentage change)	2000	2001	2002	2003	2004
<b>BULGARIA</b>	27.97	32.85	42.55	49.19	58.67
<b>Stability Pact Countries average</b>	<b>26.49</b>	<b>25.39</b>	<b>24.83</b>	<b>29.17</b>	<b>28.89</b>

The biggest monthly growth was recorded in July 2004 when bank lending activities increased by 17.2 per cent over the previous month. Given their concern that the rapid pace of credit expansion might increase Bulgaria's external vulnerability, the central bank and the IMF have, since 2003, been gradually enforcing credit reducing measures. Initially the strategy to control credit growth focussed on the intensification of supervisory activity (increase of frequency of on-site inspections, tightening of provisioning requirement on classified loans, increase of information available to lenders through the expansion of a credit register, introduction of stricter treatment of profits for the calculation of own capital in line with EU banking directives). In 2004, given the ineffectiveness of these measures in reducing the fast credit expansion, the authorities introduced liquidity draining measures. Government deposits at commercial banks were transferred to the central bank. In July 2004 the coverage of reserve requirement was increased to include most liabilities previously excluded from the deposit base. From October 2004 the proportion of cash in vaults that can be used to comply with the reserve requirement has been halved. Yet, as Bulgaria gained investment grade rating in 2004, access to foreign capital for local banks became easier and allowed banks to overcome the reduced domestic liquidity constraint. Consequently, in February 2005 the central bank adopted further amendments to the Regulation on the Minimum Required Reserves (MRR) held by commercial banks with the Bulgarian National Bank. The new measures comprise the following elements:

1. The banks with the most aggressive lending policy shall hold additional MRR with the BNB, which will represent another ‘cushion’ against a potential realisation of the accumulated credit risk.
2. Commercial banks shall fall under the scope of the Regulation only if they meet the two criteria at once:
  - they exceed the quarterly credit growth rate set by the central bank – 6% for the first quarter; 12% for the first two quarters; 18% for the first three quarters;
  - and 24% for the entire year; and- the sum of the loans granted by them and the risk-weighted off-balance sheet items converted into assets, reduced by the amount of their own funds, exceeds 60% of the funds they have attracted from persons other than banks and non-bank financial institutions.
3. Any bank which reports values higher than the above criteria shall allocate additional MRR with the BNB, paying the double absolute amount of excess over the quarterly growth rate provided in the Regulation. Any bank that meets these criteria will remain outside the scope of the Regulation. Under the Regulation the banks which are willing to exceed the quarterly values set may do so, but they will have to ‘pay’ for the extra risk by keeping additional MRR with the BNB.
4. Furthermore, the amendments to Regulation N 21 decrease the number of the currencies in which commercial banks may hold their MRR. From 1 April 2005 the MRR may be held in the national currency (the BGN) or in the reserve currency (the Euro). (Source: National Bank of Bulgaria:  
<http://www.bnb.bg/bnb/home.nsf/fsWebIndex?OpenFrameset>)

An on-line credit register which reports all banks’ loans began operating in July 2004. The country is preparing three new laws on money transfer, consumer protection and consumer loans in order to protect the rights of the bank clients when faced with bad service from commercial banks.

Over the last two years commercial banks have shown an increasing interest in SME lending, in line with the overall credit expansions of the banking sector and the reduction of bank margins on less risky segments of the banks’ loan portfolio. The availability of donors’ and IFIs credit lines often accompanied by technical assistance targeted at improving the lending methodology and credit skills in the field of SMEs has stimulated further SME lending activity among Bulgarian commercial banks. Under the joint EU/EBRD Facility for SME financing, several Bulgarian banks have committed to increased SME lending (HebrosBank, RaiffeisenBank, Unionbank and United Bulgarian Bank).

One bank, ProCredit Bank, has a clear “micro profile” in its lending activities with micro loans (loans less than € 10,000) accounting for 88% of all business loans outstanding. At the end of September 2004, after almost three years of operation, ProCredit Bank had total assets of € 151 million, and built up a net loan portfolio of € 119 million consisting of 18,000 business loans (average loan amount remains around € 6,500). To date, the bank has disbursed € 220 million in 34,000 business loans and is disbursing up to 1,800 business loans per month. Its fastest growing product is the Express Micro Loan, of less than € 2,000 and disbursed often within one day. The remainder of Procredit Bank’s loan portfolio includes loans of up to € 500,000 to its few largest clients. In addition to standard business loans, the bank offers guarantees and letters of credit, housing loans, and consumer loans as well as credit lines and overdraft facilities. A leasing subsidiary, ProLease (Bulgaria) AD,

was established in 2003 to expand ProCredit's business in the leasing area. As of August 2004, ProLease had concluded 199 leases for a total amount of € 2.1 million with an average lease amount € 8,700. The majority of leasing transactions finance the purchase of equipment (38%), followed by machinery and cars (around 23% each), trucks and buses (10%) and dental equipment (7%).

Non-bank micro credit providers are active in providing credit to micro entrepreneurs. The Co-operative Union of Popular Savings Societies, a union of 22 co-operatives has since 1994 extended 16,400 loans. Microfund EAD started work in 1999 and has, through 10 branches and 7 offices, extended over 2,075 micro-credits totalling over BGN 22 million in worth. Nachala, registered as a cooperative in August 1997, through 11 regional offices has provided 10,574 loans, worth in total over BGN 36 million. Ustoi is a programme supported by USAID that has been for more than five years extending loans in support of small entrepreneurs in Bulgaria. Currently, Ustoi has over 4,600 clients (over 70% of them women, as specifically targeted by the programme). The Swiss Agency for Development and Cooperation (SDC) is an international cooperation structure of the Ministry of Foreign Affairs of the Swiss Confederation. In its programme for private sector support SDC gives priority to assisting the development of SMEs, organic farming and local tourism. A special Guarantee Fund provides access to funding for enterprises that are not creditworthy enough for the banks but at the same time show economic viability. In Bulgaria the agency partners among others with UBB Bank, HebrosBank, ProCredit Bank, the Bioselena Foundation, the FAEL Foundation, the National Business Development Network of the JOBS project of UNDP.

### **Assessment**

According to the EBRD, banking reform in Bulgaria has advanced in 2004. This is reflected in a specific transition score for the sector of 3.7, up from 3.3 in 2003, and comparable to the average for the Stability Pact group of countries of 3.0. Transition scores range from 1 to 4+, where 1 indicates little or no progress from a command economy and 4+ indicates standards close to those of a well functioning market economy.

<b>Banking reform &amp; interest rate liberalisation</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
<b>BULGARIA</b>	3.0	3.0	3.3	3.3	3.7
<b>Stability Pact Countries</b>	<b>2.5</b>	<b>2.5</b>	<b>2.7</b>	<b>2.7</b>	<b>3.0</b>

According to the World Bank "Doing Business" report<sup>3</sup> both the legal index<sup>4</sup> which is a measure of how well collateral and bankruptcy laws facilitate lending, and the credit information index<sup>5</sup>, which measures the scope, access and quality of credit information available through public registries or private bureaus, score close to the OECD average, and generally above the regional average. The cost to create collateral appears to be low, however, rather than being good news, this reflects the absence of a collateral registry. This means that despite the fact that banks require traditionally high level of collateral to extend loans, the secured creditor (the bank) is disadvantaged because it is unable to notify other creditors of their right to the collateral through a registry.

Indicator	Bulgaria	Regional Average	OECD Average
Cost to create collateral (% of income per capita)	1.0	7.7	5.2
Legal Rights Index	6	5.4	6.3
Credit Information Index	4	2.0	5.0
Public credit registry coverage (borrowers per 1000 adults)	13	6.3	76.2
Private bureau coverage (borrowers per 1000 adults)	0	46.7	577.2

In 2004, the EBRD<sup>6</sup> carried out an analysis of the enforcement of secured transactions in central and eastern Europe. Through a survey of legal companies operating in the region EBRD built a set of indicators relating to the amount a creditor could be expected to recover, the time needed to realise recovery and the simplicity of the legal process. Each of these criteria is assessed on the basis of 0 (worst) to 10 (best). In Bulgaria, a quick procedure (8.3 on a scale of 10) coupled with a significant complexity rating of the legal system results in a mediocre return (5.3) for the creditor in terms of recovery. The analysis identifies the areas in most need of reform as those of debtor obstruction (i.e. the possibility for the debtor to prevent, slow down or otherwise obstruct the enforcement proceedings to the detriment of the charge-holder; the legitimate exercise of right of defence or appeal is not included) and of corruption (specifically the impact of corruption within the court system on the enforcement process).

## 5. Implementation of Advisory Services for New and Small Businesses

### *Situation in the Area of Advisory Services*

The advisory services for the small and medium-size enterprises in Bulgaria continue to develop with an increase in the number and range of specialised advice provided. SME organisations, programmes and projects are numerous, but few entrepreneurs are inclined to make use of them.

The organisations providing specialised advice to support SMEs include government institutions, business associations, business centres, and research and academic centres. The government organisations include in particular:

- *Bulgarian Small and Medium Enterprise Promotion Agency (BSMEPA)* – provides information and consultation. BSMEPA has 6 regional offices but following the amendments to the SME Law, 28 regional units are expected to start functioning, one for each district of the country.
- *Bulgarian Trade Promotion Agency* (merged with BSMEPA as of October 2004). It provided free consultant assistance to Bulgarian entrepreneurs. Its main services included facilitating contacts between Bulgarian and international firms, providing help and information when Bulgarian companies participated in international projects, programmes, fairs and forums, and providing information about donor programmes.
- *Bulgarian Agency for Export Insurance* – supports the Bulgarian exporters by giving their international clients the opportunity to use deferred payments.

- *Foreign Investment Agency (Bulgarian Investment Agency)* - supports Bulgarian entrepreneurs by keeping a database of investment projects, in which investment capital from international partners is sought.
- *Employment Agency* – Its regional units provide assistance in searching for qualified human resources.

The government organisations offer a wide range of projects and programmes for promoting entrepreneurship and management know-how, but only less than 10% of the SMEs in Bulgaria have participated in these projects. The major government programmes and projects are:

- *JOBS (Employment through supporting business)* – under this project of the Ministry of Labour and Social Policy and the United Nations Development Programme, 24 business centres, 11 business incubators and 3 information business centres have been established. Its main goal is to create conditions for sustainable job creation by supporting micro and small enterprises and farms within the regions with high unemployment. Since the advisory services are characterised by high regional disproportions, JOBS concentrates on market niches mostly in the non-dynamic regions of the country.
- Consultant services for small and medium-sized enterprises and technological grant schemes;
- Aid for development and research;
- Assistance in improving professional qualifications;
- Professional education and training.

Business associations and business centres provide an increasing number of services to SMEs. The following business associations are most active:

- *Bulgarian Industrial Association* – organises various trainings for SMEs, seminars, conferences, participates in the discussion of bills, provides information about new business requirements related to Bulgaria's EU accession, assists the industrial development, facilitates access to financing, participation of SMEs in international programmes, the search for business partners and the protection of intellectual property.
- *Bulgarian Chamber of Commerce and Industry* – provides information about markets, foreign trade regimes, participation in international fairs, organises management trainings.
- *Bulgarian Association of Regional Development Agencies (BARDA)* – its 18 regular and 15 associated agencies and business centres cover all regions of the country.
- *Bulgarian Association of Management Consulting Organisations (BAMCO)* – provides various services in the area of SME management.
- *Bulgarian Association of Craftsmen* – assists in enhancing the qualifications of craftsmen.
- *National Association of Small and Medium-sized Business* – provides information services and conducts marketing surveys, prepares business plans, and organises tax and legal consultations.

An important and successful initiative is the Business Advisory Service ("BAS") Programme, a multi-donor programme assisting the development of small and medium sized enterprises, managed by the TAM Management Unit (TAMU) at the European Bank for Reconstruction and Development (EBRD). The BAS Programme assists small and medium sized enterprises to enhance their competitiveness, marketing and financial management, to implement quality management systems, business and strategic planning. The programme works directly with individual SMEs, assisting them through partially financing of business consulting services. At the same time, BAS builds local/national consultancy capacity to serve enterprise needs. Typical BAS projects are short-term projects with a rapid payback period, such as upgrading management/financial IT systems, market research, introduction of quality management systems enterprise (re)organisation, etc. The consulting assignment is carried out by qualified and approved local business and management consultants rather than BAS staff. The BAS model is market oriented. Enterprises pay at least 50% of the cost of each project, which ensures that the provision of business advice is driven by the real needs of the enterprise.

The BAS Programme commenced operations in Bulgaria in November, 2001 aiming to meet the rising demand for consulting services in the country. As at the end of December 2004 BAS Programme Bulgaria has undertaken 147 projects utilizing € 1,572,874. Of those, 124 have been disbursed for € 769,904. A consultants database has been set up listing some 125 consulting companies, of which 101 have been retained under a BAS funded project. One year after grant disbursement companies show the following results: total sales on an annual basis have increased by 25%, total number of employees by 7%, and productivity with 17%.

A variety of non-government research centres conduct SME support projects concentrating on the provision of specialised advice and maintain close co-operation with the business community. These include the Centre for Economic Development, the Centre for Study of Democracy, the Institute of Market Economics, the Institute of Economic Policy, the Centre for Entrepreneurship Development and the Foundation for Entrepreneurship Development. In addition, nearly 2000 private sector companies complement the provision of advisory services.

### ***Assessment***

Despite what seems an important supply of advisory services for SMEs, in a range of fields, their use remains limited and entrepreneurs do not perceive evident changes in this area compared with the previous assessment. Entrepreneurs tend to be under-informed about the availability of professional advice and its benefits, and trust more their own business intuition and market assessments. "Intuitive" entrepreneurship prevails over intellectual entrepreneurship. Entrepreneurs remain passive recipients of information and do not actively look for it, even though they recognise at the same time the benefits of professional assistance.

Quality of the specialised services is being associated with their price, although, at the same time entrepreneurs are not inclined to invest much in professional advice. Quality of international and private consulting is as a rule rated higher. The range of services used, in particular at different stages of a business development, remains limited. Consultant services in the areas such as the European integration, human resources and taxation are more popular, but entrepreneurs also tend to believe that government assistance under the European integration programmes is mostly directed to bigger businesses. Assessments such as these highlight the need for more information about the availability and scope of



professional advice provided by the government. The regional units of BSMEPA may be best suited to channel this information, in particular to the less dynamic, distant regions.

An important number of advisory services and assistance could also be provided at an affordable price by business centres established on the basis of public-private partnerships, which should attract more entrepreneurs. Strategic business development could benefit from advice with respect to international markets, subcontracting, and participation in industrial clusters – the areas in which the advisory services are not widespread.

## 6. Implementation of Business Incubators

### *Situation in the Area of Business Incubators*

The concept of Business Incubators has been known in Bulgaria for more than 10 years, but has not translated thus far into concrete, co-ordinated actions with a policy and resources behind it. Only one third of the focus group participants were familiar with the concept itself, but none of them have had any experience using the Business Incubator services. Entrepreneurs remain as a rule unfamiliar with business incubators, or with their goals or benefits. This in turn generates more mistrust with respect to the concept and its practical application. Indeed, there are very few operational business incubators in Bulgaria and the government policy in this area seems to lag behind the needs of entrepreneurs. On one hand, the government support for establishment of Business Incubators seems insufficient, and on the other information about the operating Business Incubators too scarce. The few operational Business Incubators were created as a result of the financial support from foreign donors and programmes. The most important of them are presented below.

### *JOBS project of the Ministry of Labour and Social Policy, supported by UNDP*

Under the JOBS project at the beginning of 2004 a network of 35 business centres was organised in 42 municipalities, including 13 Business Incubators and 3 information business centres (see table 2.1). At this stage 4 of the Business Incubators are virtual. Their basic functions include office renting at preferential prices, accounting and consulting services for entrepreneurs. All Business Incubators and Business Centres under the JOBS project provide leasing schemes for equipment and machinery.

Table 2.1. **Regions under the JOBS Project**

<b>Business Centres (BC) - 35</b>	<b>Business Incubators (BI) - 13</b>
Aitos, Berkovitsa, Blagoevgrad, Byala Slatina, Velingrad, Vidin, Gotse Delchev, General Toshevo, Devin, Dobrich, Dulovo, Elhovo, Isparih, Karnobat, Karlovo, Kotel, Kubrat, Malko Tarnovo, Montana, Novi Pazar, Nova Zagora, Pernik, Peshtera, Polski Trambezh, Parvomaj, Razlog, Ruen, Straldzha, Sungurlare, Samokov, Silistra, Sliven, Teteven, Turgovishte, Shoumen.	Aitos, Vidin, Gotse Delchev, Isparih, Karlovo, Malko Tarnovo, Nova Zagora, Pernik, Samokov, Silistra, Sliven, Turgovishte, Shoumen.
	<b>Information BC (IBC) – 3</b>
	Kotel, Straldzha, Sungurlare.

The total area of all Business Incubators is 6439 sq.m. As of 31 March 2004 the business incubators have been hosting 76 new businesses with almost 300 people employed. About half of the companies (43) provide services, and the others are production oriented. They mostly operate in the areas of tailoring, furniture production, frozen vegetables, cosmetics, software, etc.

The incubation period under the JOBS programme is up to three years. 25 companies have left the business incubators since March 2004. Their cumulative employment under incubation was 230 people, and they have provided jobs for 204 additional employees since leaving the incubators.

A comprehensive assessment of the business incubator activities to date may be difficult due to the fact that they have only been operational for less than 5 years. Nevertheless, the JOBS initiative proves useful in promoting entrepreneurship, providing training and boosting the regional economy.

The overall results of the activities of the JOBS project as of August 2003 are provided in table 2.2.

Table 2.2. **JOBS Project Development**

Activities	2001	June 2002	September 2002	December 2002	March 2003	June 2003	August 2003
Permanent employment (people)	1 500	2 616	4 682	5 613	6 425	7 617	8 000
Temporary employment created (days)	9 357	11 804	12 825	13 428	-	-	-
Leasing (mln. BGN)	0,557	1,15	1,45	1,89	2,21	3	3,8
IBC (clients)	-	6 965	18 125	33 124	49 752	-	-
Clients Trained	1 100	2 882	3 685	4 565	7 665	8 746	9 300
Consulting services (number of companies)	2 100	4 529	6 227	7 755	9 546	11 107	12 000

### ***Business Incubator - Ruse***

Business Incubator - Ruse was created in 1997 with the financial support of the PHARE programme and was managed by the Business Centre for SME Support (BCSMES). The incubator operated for 5 years (until 2002) and for this period it hosted 14 companies providing work for 90 employees. 4 firms successfully graduated the business incubator. The business incubator was closed because of technical reasons (necessity to clear the occupied buildings), as well as the launching of the Business Incubator II.

Officially Business Incubator II became operational in 2000. It was launched with the support of the Austrian government. The Ruse municipality provided the building for the incubator (2690 sq.m.), free of charge for a period of ten years. An innovative approach was introduced in Business Incubator-II to offer the companies the unlimited period of residence.

Business Incubator-II started with 28 companies and as of 31 March 2004 there was only one firm that had successfully left the incubator. Fifteen companies are still

occupying the Business Incubator, and the rest have discontinued their activities. The operational companies provided work for 92 people.

Other projects have reached a different level of implementation. Most of them are either non-operational, or provide only a limited number of services to a small range of companies.

### ***Assessment***

Financial support from international donors or programmes has so far been crucial for business incubator initiatives in Bulgaria. Most of the government and local authorities' programmes foresee the establishment of business incubators, but the results so far have been limited. The government (or local authorities) involvement so far mostly concentrated on the provision of premises for a business incubator free of charge for a certain period of time. That alone may be insufficient, bearing in mind that most of the buildings need serious investment for restoration and reconstruction. A more active government policy may be needed, also with respect to the dissemination of information about business incubation initiatives.

The so far limited experience of business incubation - most of the business incubators in Bulgaria, including these under the JOBS and Ruse projects, have existed for less than five years - makes it difficult to evaluate their accomplishments in terms of actual incubation results, even though the projects themselves have been implemented. Also the decision to remove the time limit for companies occupying the premises (Ruse BI-II) goes beyond the business incubator assumed business start-up support and may distort the results. This solution may also suggest that in this case entrepreneurs needed additional incentives to enter the incubator.

Some opportunities for the establishment of business incubators in Bulgaria with the support of international funds and know-how have been missed. The two PHARE sponsored projects related to business incubation – “Investment in Business Incubators in Regions in Industrial Decline” and “Establishment of High-Tech Business Incubators” were started in 2000 and 2001, but subsequently held up for several months, then restarted in mid-2003 and finally suspended at the end of 2003. Entrepreneurs and experts are concerned about these delays or suspension of projects. Views are expressed that the administration may be lacking capacity to process and implement them. Up-to-date Information about the projects being implemented is difficult to obtain, including on the official Internet sites of the responsible ministries, coordination among different departments is insufficient and responsibility unclear.

Results of the expert interviews and focus group discussions confirm a limited progress in this area. Participants of the focus groups rated the value of Business Incubators for new entrepreneurs and SMEs lower than in the previous assessment (rated 3.47 in 2002 and 2.85 in 2004), which on the other hand may be related to the fact that in 2004 none of the focus group participants had any experience with Business Incubators. Similarly, the rating of the efficiency of the government programmes aimed at encouraging the establishment of business incubators decreased from 2.5 in 2002 to 2.2 in 2004.

Better results were obtained regarding the correlation between business incubator activities and entrepreneurs' needs. The assessment in this category improved from 2.1 to 2.8. None of the indicators was however rated above the “satisfactory” level (3), which is

indicative of the poor progress, but also of the lack of knowledge of entrepreneurs in this area.

Results of the interviews with the Bulgarian experts seem to confirm that availability of information about business incubators is a problem. Most of the interviewees assessed the value of business incubators for entrepreneurs and SMEs quite positively (rated 4, compared to 2.9 by the focus group participants). Most of them were also familiar with other government/donor supported schemes for start-ups, while 82.8% of the focus group participants were not aware of them. These differences in assessments can be explained by the fact that experts have much better access to information, while entrepreneurs spoke only of their own experience. More information about different possibilities for supporting business start-ups (or development) could also help entrepreneurs take more initiative and actively engage in co-operation with the authorities. Development and maintenance of close relationships with the leading universities could help reach the graduate students who represent an important group of potential users of the business incubator services.

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

### ***Situation in the Area of Entrepreneurship, Training and Access to Technologies***

The Bulgarian education system has undergone a number of reforms since 1989, including measures aimed at developing entrepreneurial skills. Entrepreneurship has not been introduced as a subject in elementary schools. Out-of-classroom training methods are applied in secondary and secondary vocational education, which are not obligatory for students. Subjects taught in certain vocational schools and secondary schools of economics include the Fundamentals of Entrepreneurship, Small Business Management, Marketing and Business Communication. A number of initiatives for increasing the quality of vocational training have been launched under Leonardo da Vinci Programme and by some innovation centres and NGOs, such as the Bulgarian Association for Management Development and Entrepreneurship and the European Software Institute Centre in Bulgaria. A textbook “Entrepreneurship and Small Business” has been published. Majoring in Entrepreneurship and Business has not been introduced in higher education institutions, although the subject is included in the training curricula of certain majors.

In addition, certain training modules for entrepreneurs are available, but they reach a rather limited number of entrepreneurs. Resource Centre Foundation and JOBS (Job Opportunities through Business Support) Project have also launched some training schemes, designed for developing entrepreneurial skills, including on “Business Planning”, “How to succeed in job hunting”, “Small business management and marketing”, “My home – my business”, etc.

Measures focused on introducing the Bulgarian business to the new standards stemming from the European integration are included in the 2003 government Communication Strategy for Bulgaria’s accession to the EU. The main objective of the Strategy is to acquaint individuals and businesses with the commitments undertaken in the negotiation process and with the opportunities, offered by the EU and the single market.

The government has also undertaken to improve the technical capacity of the Bulgarian SMEs. Among other measures, 5 national scientific programmes for research

and technological development have been enhanced and adjusted for this purpose. The programmes are managed and financed by the ministries responsible for their implementation. The government policy in this area concentrates mostly on facilitating the transfer of technologies from research institutes to SMEs. BSMEPA has joined the framework of the Bilateral Technical Co-operation with Germany and started a project to create an information system for supporting SMEs through technology transfer from Bulgarian universities. Other public authorities also engage in promotion of the development and dissemination of ICT in Bulgaria. A number of private consulting companies participated in a USAID project for technology transfer from the Bulgarian Academy of Science and Universities.

### **Assessment**

Progress in the education system reforms to foster entrepreneurial skills has been uneven. Entrepreneurship classes are taught both in secondary schools and universities, but are insufficient to significantly change the approach to entrepreneurship and entrepreneurs. Results of the focus group discussions and the expert interviews seem to confirm that. Similarly, the impact of the training schemes for entrepreneurs remains insignificant – the opinion shared by most entrepreneurs, even though the training supply has increased in number and scope. The initiatives include the government programmes, as well as a number of the NGO- and academia-led projects.

Vocational training opportunities are available, but they are rarely used by entrepreneurs and potential employees. Nevertheless, the entrepreneurs who have attended such training, or whose employees have done so, appreciate its efficiency. Effectiveness of apprenticeship is also valued. Entrepreneurs willingly resort to it, as it allows developing the employees' skills according to the requirements for a specific job.

Recruiting qualified employees remains difficult for most entrepreneurs. The educational offer, which is not always responsive to the needs of the market, is partly responsible for the problem. The other problems include a weak labour discipline and staff fluctuations, as well as emigration, typical for the higher qualified employees. In regions with high unemployment recruitment is naturally easier, in particular in the lower-skilled categories of staff. This is where employment is also less expensive due to the unbalanced negotiating positions between employers and employees.

Information on business standards and opportunities is scarce and entrepreneurs gave it a "poor" rating. Despite the availability of the Communication Strategy for Bulgaria's accession to the EU, the standards and opportunities related to the European integration remain relatively unknown. The Ministry of Economy (MoE) has undertaken to acquaint business with the requirements in a number of areas, ensuing from Bulgaria's future membership of the EU, but the information campaign does not seem to have reached many entrepreneurs. In response, in September 2004 MoE established a specialised call centre to better disseminate information on the *acquis* implementation in Bulgaria. The remaining institutions, involved in the negotiation process, have been less active.

The lowest rating in this category is given to the existing government programmes for improving the technological capacity of SMEs. The assessment seems to be associated with the lack of information on the programmes or difficulties with their implementation (for example PHARE-sponsored projects on Investment in SME Business Incubators in Areas of Industrial Decline and Quality Management Systems). Capacity problems to absorb assistance are perceived on both the government and the business side. SMEs find it difficult to follow and understand the benefits of the programmes, including the EU

pre-accession programmes, experience problems with funding and other applications. More information and training, possibly by the extended regional BSMEPA structures, could help them benefit better from the existing offer. Scarce information on alternative financing sources, such as a micro-credit guarantee fund, and the unclear organisational framework for technology transfer to SMEs present additional obstacles to improving technological capacity of the Bulgarian SMEs.

The image of the Bulgarian entrepreneur suffers from much prejudice, mostly related to Bulgaria's communist past. The business origins and development in mid 90s additionally impaired the image of businessmen, associating the business activity with illegal actions. Nevertheless the public prestige of entrepreneurs is gradually growing, which was reflected in entrepreneurs' satisfaction with the change in the entrepreneur's image since 2002.

## 8. Report on the Implementation of the 2002 EPPA Policy Recommendations

In this section progress in implementing the 2002 EPPA recommendations is assessed.

<i><b>EPPA 2002 Recommendations on the Institutional Framework</b></i>	<i><b>Progress since EPPA 2002<sup>7</sup></b></i>
<i><b>Institutional changes</b></i>	
<ul style="list-style-type: none"> <li>• Define clearly the relationship between SME policy-making and implementation.</li> </ul>	<b>Recommendation implemented</b>
<ul style="list-style-type: none"> <li>• Clarify and strengthen the model that has been pursued so far, including with respect to the Ministry of Economy.</li> </ul>	<b>Recommendation implemented</b>
<ul style="list-style-type: none"> <li>• Both ASME's funds and the associated reporting should be with the same organisation – the Ministry of Economy, in order to secure effective transparency, accountability and synergy.</li> </ul>	<b>Recommendation implemented</b>
<ul style="list-style-type: none"> <li>• Regular (monthly) meetings between the Ministry of Economy and ASME to ensure implementation of SME policy generally and the national SME strategy specifically.</li> </ul>	<b>Significant progress</b>

<i><b>Financial Support for ASME and the National SME Strategy</b></i>	
<ul style="list-style-type: none"> <li>• Secure and stabilise the medium-term future of ASME and its regional branches through a mixture of national and international resources. The Ministry of Economy to ensure financial stability of the institutions.</li> </ul>	<b>Significant progress</b>
<ul style="list-style-type: none"> <li>• Ensure the provision of adequate financial support for the effective implementation of the second National Strategy for the Encouragement of SME Development and the associated Working Programme (2002-2006).</li> </ul>	<b>Limited progress</b>

***Regional and Local Government***

- Review the multiplicity of institutions with an SME-related remit – over 300 organisations in 19 hierarchical levels. Strengthen the capacity of regional and local SME support institutions. **Limited progress**

***Communication with SME Stakeholders***

- Communicate and consult with SMEs on Government policies and strategies by developing more representative, regular and permanent mechanisms for dialogue between Government and the sector. **No progress**
- Strengthen the Advisory Council for SMEs (ACSME) to enable it to become a regular forum for communication and consultation with a wider range of SME stakeholders. **Significant progress**
- Make more effectively use of ASME's regional network to reach a wider range of enterprises, especially in the more remote regions of the country through the creation of Regional Advisory Council for SMEs. **Limited progress**

***EPPA 2002 Recommendations on the Regulatory Environment******Progress since EPPA 2002******Registration, De-registration, Re-registration***

- Introduce a single code number for each enterprise, in order to save time and costs to entrepreneurs submitting the same information to different bodies. **Limited progress**
- Evaluate the pilot “one-stop-shop” initiatives with a view to establishing such a system throughout the country. **Limited progress**
- Publish, evaluate, and simplify the regulatory regimes that affect business start-ups, re-registration and de-registration. **Limited progress**
- Adjust the SME definition in line with the standards of the European Union. **Recommendation implemented<sup>8</sup>**

***Regulations***

- Implement the proposed reforms identified by the Inter Ministerial Working Group on Administrative and Regulatory Environment in close co-operation with ASME. Strengthen the Group's resources and capacity to recommend further reforms and monitor implementation. **Significant progress**
- Take steps to ensure the implementation of a proactive approach to regulations by introducing the principle of “silent consent” as soon as possible. **Significant progress**
- Ensure that the adoption of new legislation or regulation of businesses is preceded by an assessment of their likely impact on SMEs in the form of a report to Ministers. **Significant progress**
- Present a public report to the cabinet every six months, charting progress in implementing reforms to eliminate corruption and reporting notable successes in tackling corruption. **Significant progress**

<i><b>EPPA 2002 Recommendations on the Tax Policy for Small Businesses</b></i>	<i><b>Progress since EPPA 2002</b></i>
<i><b>Policy Principles</b></i>	
• Greater simplicity, stability and clarity are achieved in tax policy.	<b>No progress</b>
• The fiscal administration is made much more sensitive to the needs of the SME sector.	<b>Limited progress</b>
• Tax laws and regulations are consistently and fairly enforced.	<b>No progress</b>
• The integration of the tax system is continued.	<b>Limited progress</b>
• Consultation with SMEs or their nominated representatives on tax issues is carried out regularly.	<b>No progress</b>
• SMEs are able to obtain regular, simple and up-to-date information explaining the tax system.	<b>Limited progress</b>
<i><b>VAT</b></i>	
• Design the VAT refund period to facilitate cash flow, using the international standard of one month.	<b>Limited progress</b>
• Permit SMEs with turnover of less than BGN 50.000 (EU 26,000) to register for VAT at their own discretion.	<b>Recommendation implemented</b>
<i><b>Grey Economy</b></i>	
• Strengthen efforts to collect arrears, regardless of firm size.	<b>Significant progress</b>
• Improve administration and collection rates to widen the tax base.	<b>Limited progress</b>
<i><b>Consultation</b></i>	
• Use regional forums and seminars to ensure that the SME sector is consulted on the implementation details of forthcoming taxation developments, and is informed/trained in advance.	<b>Limited progress</b>



<i><b>EPPA 2002 Recommendations on the Financial Instruments for SMEs</b></i>	<i><b>Progress since EPPA 2002</b></i>
<p><i><b>Debt Collection</b></i></p> <ul style="list-style-type: none"> <li>Improve the legal framework regulating collection from bad debtors – speed-up foreclosure procedures for available security (mortgages and registered pledges), accelerate the execution by non-secured creditors, and rationalise and tighten bankruptcy procedures.</li> </ul>	<b>Significant progress</b>
<p><i><b>Collateral</b></i></p> <ul style="list-style-type: none"> <li>Amend the central bank’s regulations on the definition of collateral as “liquid collateral” for the purpose of determining the net exposures of banks. In addition to the collateral types that currently qualify as liquid, some other traditional security types could be also defined as such – guarantees by prime banks, mortgages on industrial and commercial real estate, pledges of some types of machinery and equipment.</li> <li>Appropriate discounts, such as the traditional 50% on real estate could be applicable to the additional types of collateral defined as liquid.</li> </ul>	<p><b>No progress</b></p> <p><b>No progress</b></p>
<p><i><b>Diversification of Finance</b></i></p> <ul style="list-style-type: none"> <li>Facilitate the repossession of leased equipment and rationalise the VAT regime for leasing activities.</li> <li>Facilitate the setting-up and operation of venture capital and direct equity investments.</li> <li>Extend financial supervision to the lending activities of credit unions.</li> <li>Introduce the legislative framework allowing securitisation of pools of receivables.</li> </ul>	<p><b>No progress</b></p> <p><b>Significant progress</b></p> <p><b>No progress</b></p> <p><b>Significant progress</b></p>
<i><b>EPPA 2002 Recommendations on the Advisory services for New and Small Businesses</b></i>	<i><b>Progress since EPPA 2002</b></i>
<p><i><b>Long Term Development</b></i></p> <ul style="list-style-type: none"> <li>Continue to prioritise the support to SMEs through national policy focusing on subsidised business support services, especially targeting start-ups.</li> </ul>	<b>Significant progress</b>
<p><i><b>Service Provision</b></i></p> <ul style="list-style-type: none"> <li>Review the range of services provided with a view to provide best value to fee-paying SMEs and comply with donors’ targets.</li> </ul>	<b>Limited progress</b>
<p><i><b>Quality Standards</b></i></p> <ul style="list-style-type: none"> <li>Introduce a system of certification and accreditation of advisory bodies to set quality standards and improve confidence in the benefits of services.</li> </ul>	<b>No progress</b>

<i><b>EPPA 2002 Recommendations on the Business Incubators</b></i>	<i><b>Progress since EPPA 2002</b></i>
<i><b>National Policy</b></i>	
<ul style="list-style-type: none"> <li>• Define national policy for the development of business incubators.</li> </ul>	<b>No progress</b>
<ul style="list-style-type: none"> <li>• Allocate responsibility for the implementation and co-ordination of national and international funding for the creation of business incubators.</li> </ul>	<b>Limited progress</b>
<ul style="list-style-type: none"> <li>• Promote business incubators and disseminate information to Bulgarian entrepreneurs.</li> </ul>	<b>No progress</b>
<ul style="list-style-type: none"> <li>• Evaluate the possibility of using business incubators to support the emerging technological sector.</li> </ul>	<b>No progress</b>

## Notes

1. Ministry of Economy, “Registration, licensing and control” Directorate, summary report for the implementation of Decision No.392/2002 of the Council of Ministers
2. [www.government.bg/ras/](http://www.government.bg/ras/)
3. <http://rru.worldbank.org/DoingBusiness/ExploreEconomies/BusinessClimateSnapshot.aspx?economyid=30>
4. It ranges from 0-10, with higher scores indicating that those laws are better designed to expand access to credit
5. The index ranges from 0-6, with higher values indicating that more credit information is available from a public registry or private bureau.
6. <http://www.ebrd.com/pubs/law/lit/sp04/01enforcing.pdf>
7. Recommendation implemented i.e. law / policy approved and implemented, effective strategy approved and being implemented efficiently or agency fully operational and achieving results on the ground; Significant progress i.e law / policy approved, preparatory work for implementation completed and progress made on the ground; Limited progress i.e. some preparatory work done, legislation drafted or agency beginning implementation; No progress i.e. no progress since last EPPA.
8. This recommendation is implemented in the new Law for SMEs (adopted in July 2004 and effective of August 2004) as concerning the non-financial criteria

## *Annex I*

### **Information Sources**

- Agency for Encouragement of Small and Medium Enterprises, annual reports, various publications
- BIBA (2004) White Paper on Business Climate 2003- Tax Policy Chapter, Sofia.
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## *Annex II*

### **Web Sites**

Agency for Encouragement of Small and Medium-Size Enterprises - [www.asme.bg](http://www.asme.bg)

Bulgarian Export Insurance Agency - <http://www.baez-bg.com>

Bulgarian Association of Management Consulting Organisations (BAMCO) <http://www.delin.org/bamco/>

Bulgarian Chamber of Commerce and Industry: <http://www.bcci.bg>

Bulgarian Industrial Association: <http://b2b.bia-bg.com>

Bulgarian International Business Association- <http://www.biba.bg/>

Bulgarian National Bank - [www.bnb.bg](http://www.bnb.bg)

Bulgarian Trade Promotion Agency: <http://www.bepc.government.bg/>

Centre for Economic Development - <http://www.ced.bg/>

Coordination Commission for Reducing Corruption - [www.acc.government.bg](http://www.acc.government.bg)

European Bank for Reconstruction and Development - [www.ebrd.com](http://www.ebrd.com)

Foreign Investment Agency: [www.bfia.org](http://www.bfia.org)

Government of Bulgaria - [www.government.bg/ras/](http://www.government.bg/ras/)

Investment Compact for South East Europe - [www.investmentcompact.org](http://www.investmentcompact.org)

JOBS Project - [www.jobs-bg.org](http://www.jobs-bg.org)

Ministry of Economy: <http://www.mi.government.bg>

Ministry of Finance of the Republic of Bulgaria- <http://www.minfin.bg/>

Ministry of Labour and Social Policy: [www.mlsp.government.bg](http://www.mlsp.government.bg)

Organisation for Economic Cooperation and Development - [www.oecd.org](http://www.oecd.org)

The Bulgarian Association of Regional Development Agencies (BARDA) - <http://www.barda.bg>

Transparency International - Bulgaria - [www.transparency-bg.org](http://www.transparency-bg.org)

### *Annex III*

## **EPPA Methodology**

Private investment by Micro, Small and Medium-sized Enterprises (MSMEs) is a key generator of economic growth and social change in OECD member country economies. In most countries, over 90% of all enterprises are MSMEs. It is now widely accepted that the contribution of MSMEs to new jobs, exports, innovation and regional development is vital to national development. How to benefit from and maximise this contribution is a continuous challenge for all countries. This Enterprise Policy Performance Assessment (EPPA 2004) seeks to help address that question for Bulgaria and highlight issues that require attention and priority action.

The State has a fundamental role to play in providing a favourable framework and environment for private sector development in OECD member countries. In the transition economies of South East Europe (SEE), where private investment levels lag behind those of developed countries, the necessity to create an enabling environment for SMEs and private investment is more urgent. Reform of the business and investment environment leading to the creation of a dynamic entrepreneurial culture is crucial to drive the process of change in industrial structures and the transition to market economy structures.

The OECD and the EBRD have undertaken a series of Enterprise Policy Performance Assessments (EPPAs) in all SEE countries in order to monitor the development of policies and infrastructures to support the MMSME sector. Substantial emphasis has been placed in eliciting the views of private MSMEs on their past experience and perception of the key barriers to business and new investment, and their assessment of progress in implementing policies to encourage the development of MSMEs.

Previous OECD research has identified seven broad dimensions of the framework and environment supporting MSME growth and development, which are particularly important for Governments to get right:

- Institutional framework for MSME policy.
- Rule of law and the regulatory environment.
- Tax policy for small businesses.
- Financial instruments for fostering small businesses.
- Advisory services supplied to new and small businesses.
- Implementation of business incubators.
- Entrepreneurship, education and access to technology.

Bulgaria has gone through an intense period of democratic, economic and social transition. The Investment Compact, endorsed by the countries of SEE, including Bulgaria, explicitly acknowledges that the revitalisation of the SEE region must rely primarily on private sector development and investment (Investment Compact Charter, OECD, 2001). This EPPA captures private sector insights measured against the above seven dimensions of good practice. They present views on performance and progress made on the basis of good practice indicators developed for transition economies. They take into account other OECD and EBRD studies (see EBRD Country Strategy, 2002; OECD-EBRD, 2001). The EPPA research provides a qualitative “snap-shot” of the MSME perceptions of the business and investment environment. It highlights issues in need of policy attention and indicates a number of recommended actions. This report is presented as a contribution to enhance policy dialogue between the key MSME representative associations and the supporting State institutions. The 2003 information is up-dated, allowing a fuller picture of progress over time to be developed.

The methodology employed in the EPPAs is set out in the box below:

### **Box 3. 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 Bulgaria are as follows:

- A question template was derived from extensive case study work on good practice in transition economies and OECD country experience (OECD-UNIDO, 1999) and used in the research.
- Country – based experts / consultants were selected for their enterprise policy knowledge and experience.
- Focus group research: focus group discussions were held with SME representatives.
- Individual SME interviews: to validate the focus group research and to provide insights on key issues.
- Expert interviews: to cross reference information from the focus groups and contribute to views.
- Desk research: examination of existing reports, databases, documents, etc. for Bulgaria.
- Expertise from OECD, EBRD and experts from OECD member countries.

**III.** Under the guidance of OECD, the focus group research with the private sector in Bulgaria was carried out by local consultants, Centre for Economic Development and ESTAT Agency, using a structured brief and template of questions developed by OECD and EBRD. The focus group research commenced in March 2004 and other interviews and desk research extended into May 2004. It focused on seven dimensions of good practice in the following policy areas:

- The Institutional Framework for SME policy
- Rule of Law and the Regulatory Environment.
- Tax Policy for Small Businesses.
- Financial Instruments for Fostering New and Small Businesses.
- Advisory Services Supplied to New and Small Businesses
- Business Incubators
- Entrepreneurship, education and access to technology.

**IV.** Six focus group discussions took place. Two were conducted in Sofia (capital city), and one in each of the following cities: Plovdiv (large city in a dynamic region), Sevlievo (small city in a dynamic region), Jambol (large city in a less dynamic area), and Radomir (small city in a less dynamic area). In all, 50 entrepreneurs took part in the detailed discussions, covering the following sectors of activity: manufacturing, production, services and trade-oriented companies. The participants included representatives of micro, small and medium-sized companies, .../



**Box 3. EPPA Methodology (cont.)**

/... ranging from start-ups to established firms. Standard templates were used for the discussion and the collection of ratings. Comparisons are made with ratings derived from focus group discussions carried out in September – December 2002. The EPPA 2002 involved 18 entrepreneurs participating in three focus group discussions. The 2002 ratings are reported here as background information. Together with the last questions for each dimension of good practice, addressing the direction of change in the preceding year, the ratings provide an indication of the direction of change in perceptions.

**V.** Individual interviews with 11 MSME experts were carried out as part of the research, allowing for a wider perspective than the focus group discussions and to cross reference the information that was obtained in the focus group discussions. The organisations included the following: MSI Bulgaria, Bulgarian Association of Management Consultants Organisations, Foundation for Development of Entrepreneurship, Ministry of Economy, Finera Ltd. Consultants House, Bulgarian Industrial Association, Ministry of Finance, Agency for Small and Medium-size Enterprises, Centre for Entrepreneurship Development, Bulgarian Chamber of Commerce and Industry, National Association of Small and Medium-Size Business.

**VI.** The analysis in this EPPA is based on the information collected by the local consultants using the methodologies described above (focus group research, expert interviews, secondary data collection) and is complemented by the EPPA 2003 results. All information supplied by the local consultants has been analyzed by the OECD and EBRD, resulting in the assessment presented in this EPPA.

**Note:** The notation MSMEs 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](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*

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