

STABILITY PACT

SOUTH EAST EUROPE COMPACT FOR REFORM, INVESTMENT, INTEGRITY AND GROWTH



MONTENEGRO

ENTERPRISE POLICY

PERFORMANCE ASSESSMENT

(SERBIA AND MONTENEGRO)

Prepared by

**ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT
AND EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT**

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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

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

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

The participating SEE countries in the Investment Compact are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Moldova, Romania and 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 identification of practical steps to implement reform and transition.

The work of the Investment Compact is actively supported and financed by seventeen OECD member countries: **Austria, Belgium, Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Norway, Sweden, Switzerland, Turkey, United Kingdom and United States.** (see www.investmentcompact.org)

This report has been jointly produced by the OECD Investment Compact Team and the EBRD Office of the Chief Economist in co-operation with expert regional consultants. It draws on the extensive experience and work of both organisations in transition economies including the countries of South East Europe. The Enterprise Policy Performance Assessment process, highlighting feedback from SMEs as a key element of the analysis and assessment, was instigated by Declan Murphy, Programme Director of the Investment Compact (OECD) with support from Antonio Fanelli (Principal Administrator, OECD) and Ricardo Pinto (Administrator, OECD).

Background research and information was provided by Petar Ivanovic (Centre for Entrepreneurship and Economic Development, Podgorica), who prepared the first draft of the report. The analysis, assessment and preparation of the final report were undertaken by Ricardo Pinto (OECD), Francesca Pissarides (EBRD) and Peter Sanfey (EBRD) with advice from other colleagues in the OECD and EBRD. The final editing was undertaken by Declan Murphy (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 the EBRD Office of the Chief Economist and do not necessarily reflect the views of the institutions participating in preparing this report or of OECD and EBRD member countries.

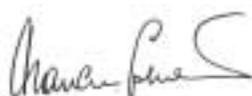
FOREWORD

Starting a business in today's environment brings opportunities and challenges. Changing lifestyles demand greater choice of products and services. New technologies and better access to global markets have provided increased business opportunities. At the same time increased competition, insistence on quality and unremitting pressure for lower costs, just to mention some issues, represent major challenges for business. For Small and Medium-sized Enterprises (SMEs) the challenge is greater. They lack scale, resources and the capacity to handle complex business management. Typically, less than half survive more than five years and only a small proportion go on to become large companies. Entrepreneurship and enterprise development are important elements in creating dynamic market economies. SMEs are a vital source of new jobs, exports and economic contribution to the countries. How to ensure the growth of the SME sector - a fundamental feature of all developed and growing economies - is a major policy challenge for all countries.

This Enterprise Policy Performance Assessment (EPPA) on Montenegro (Serbia and Montenegro) seeks to help address that challenge. The South East Europe (SEE) Compact for Reform, Investment, Integrity and Growth (Investment Compact), a key component of the Stability Pact, has consistently affirmed that the economic revitalisation of South East Europe is primarily dependent on private sector investment. Through the Investment Compact process, Stability Pact partners support and promote the structural policy reforms that will improve the climate for private enterprise and increase investment. Measurable progress has been made in various areas. The creation of a well-resourced Agency for Small and Medium-sized Enterprise Development, together with a government-approved SME strategy, are an important development. Furthermore, the Enterprise Law (2001) has resulted in a significantly improved business environment. Nevertheless, the report shows that the environment for creating and sustaining businesses remains underdeveloped in Montenegro. For example, although the business entry process has been streamlined, major barriers to investment remain, not least in relation to licensing and permits procedures; and consultation and co-ordination with the SME stakeholders leave scope for improvement. Reforming and improving the environment for entrepreneurship remain a priority.

The EPPA draws on the practical experience and views of Montenegrin SME representatives, expert advisors and the complementary experience and skills of the Organisation for Economic Co-operation and Development (OECD) and the European Bank for Reconstruction and Development (EBRD), two Stability Pact partner organisations that have been closely involved in the reform process in transition countries.

The analysis and assessments made, with significant input from research with SME owners and managers provide valuable insights into the key issues confronting the government in Montenegro. The Stability Pact, through the Investment Compact for South East Europe, will continue to contribute to establishing the enterprise framework in Montenegro and in the region as a whole through regular up-dates of the information contained in this report.



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Chapter 1.

SUMMARY CONCLUSIONS AND RECOMMENDATIONS

1.1. Summary Conclusions

The Montenegrin authorities are increasing the support given to the SME sector, in recognition of the growing importance of SMEs to the national economy. This political support is manifested in developments such as:

- The establishment of the Agency for Small and Medium-sized Enterprise Development (ASMED).
- The adoption of the Strategy for SME Development in 2002.
- Major developments to simplify the regulatory environment for business start-ups.

This Enterprise Policy Performance Assessment (EPPA) highlights a number of issues, grounded on insights from SME owners and managers and builds on the recently published OECD and EBRD reports (EBRD, 2002; OECD, 2003; OECD-EBRD, 2003). It identifies a number of actions needed in order to build further on the progress already made in improving the policy environment for SMEs.

In overall terms, the study finds that good progress has been made by the Government of the Republic of Montenegro and ASMED in setting out and beginning implementation of new policies to support the growth and development of SMEs. A stronger outreach and partnership with SMEs is needed if the opportunities for growth of the sector are to be maximised.

In line with experience in other countries at a similar stage of transition to a market-based economy, there are some issues emerging relating to policy implementation. It will take a persistent and determined effort to ensure that implementation is kept on track and momentum maintained. The best way to do this is with regular progress reviews to obtain feedback to identify areas requiring renewed focus.

The main issues identified in this assessment can be summarised as relating to the practicalities of:

- Communicating and consulting effectively with SMEs spread throughout the Republic.
- Co-ordinating the activities of the various bodies working to support SME development.
- Reducing complexity and ensuring coherency and consistency in policy, laws, regulations, procedures and support programmes, particularly between fiscal and developmental policies.
- Avoiding unnecessary changes in laws, regulations and programmes to facilitate planning of investments.

1.2. Summary Recommendations

This project was undertaken during a period when quite a few new laws have been passed and new institutions created in Montenegro. Although a great deal remains to be done, the stage is set for an environment that is friendlier to business, particularly to SMEs. Judging from the responses of the SME owners and managers participating in the research, awareness and approval of the changes are quite strong but there remains a good deal of scepticism about the actual implementation of the reforms. Typical of many countries in the SEE region, there appears to be a lack of faith in the government's ability

to execute the transition process efficiently and without distortions caused by bribery and corruption. The SME experts who also participated in the research tend to be closer to the reforms than the average entrepreneur and displayed more optimism. While they are involved in the reform process and may not be as willing to be critical, this more positive perspective could equally be because they believe that the right steps are being taken. As the effects of these decisions reach the business community, they may also become more optimistic. However, this will only happen if SMEs are enabled to conduct business within an effective framework. At a more general level, the macro-economic sustainability of Montenegro will be difficult to achieve in light of the Republic's reliance to date on grants and remittances from abroad to finance large public and trade deficits.

Institutional Framework

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. This would assist to rebalance perceptions that Government is not sufficiently focused on improving the business environment for small enterprises.
- Create an Advisory Council for SMEs and enable it to become a regular forum for communication and consultation with a wider range of SME stakeholders than is the case at present. Adequate resources need to be devoted to this mechanism in order for it to be recognised as a representative and effective SME stakeholder forum which presents a coherent view on issues relating to SME policy and strategy development.
- Make more effective use of the Agency for Small and Medium-sized Enterprise Development's (ASMED) regional network to reach a wider range of enterprises than at present, especially in the more remote regions of the Republic, possibly through the creation of Regional Advisory Councils for SMEs.
- Facilitate ASMED's mandate to work closely with the organisations active in the SME field and to co-ordinate national efforts to develop SMEs by building effective co-operation between the key SME stakeholders and disseminate information through websites and forums to ensure that SMEs are aware of the useful information as well as the latest developments, and can provide feedback.

Regional and Local Government

- Strengthen the capacity of regional and local administrations to support SMEs through provision of technical assistance and resources to enhance the capacity of staff.

Regulatory Environment

Business Simplification Task Force

- Establish a government-backed "Business Simplification Task Force", with appropriate representation such as ASMED and private sector bodies. It should be led by a senior minister in order to be effective.
- Develop and disseminate a check list of improvements that can be made to further eliminate, reduce or standardise the complexity of procedures for SMEs obtaining licenses, permits and certificates and setting predetermined timescales for each procedure. The proposed reforms pioneered by the Centre for Entrepreneurship and Economic Development (CEED) Interdepartmental Working Group on licensing procedures, permission and registration regimes should be considered in this process.
- Progress the proposed reforms pioneered by the Business Simplification Task Force in close co-operation with ASMED. SME stakeholders should be consulted before proposals are converted into law. The Task Force should recommend reforms, monitor implementation and, if required, intervene to facilitate implementation.
- Adequately staff and fund the activities of the Business Simplification Task Force on a continuing basis with targeted support from Government, IFIs and donors. Business simplification must be regarded an ongoing process, rather than a one-off event.
- The Task Force should present to the Prime Minister/Cabinet a six monthly report charting progress in implementing reforms to simplify the business environment. This report should be subsequently

published (and key progress reported in, for example, the Investment Compact Monitoring Instrument).

Silence is Consent

- Take steps to ensure a greater focus on a “proactive” and “enabling” approach by introducing the principle of “silence is consent” as soon as practical (“silence is consent” is where if the relevant public body fails to answer within a prescribed period, it will be deemed that consent has been given). This principle has already been established through the company registration process, where courts have four working days to issue queries, otherwise firms are automatically deemed to be registered.

“One-Stop-Shops”

- Evaluate pilot “one-stop-shop” initiatives with a view to establishing such a system throughout the Republic, as in the case of other parts of SEE such as Romania (see OECD-EBRD, 2002).
- Introduce a single code number for each enterprise in order to save time and costs to entrepreneurs submitting the same basic information to different bodies.

Corruption

- Include entrepreneurs and business representatives in the Working Group to Fight the Grey Economy in order to raise credibility of the initiative and strengthen the measures. Corruption remains one of the key problems of concern to all legal businesses.
- The Working Group should present to the Prime Minister/Cabinet a six monthly report charting progress in implementing reforms to eliminate corruption and reporting on successes in tackling corruption. This report should be subsequently published.

Tax Policy for Small Businesses

Policy Principles

- The Ministries of Finance and Economy, in co-operation with ASMED, should work together to ensure that:
 - Simplicity, stability and clarity are achieved in tax policy.
 - Fiscal administration is made much more sensitive to the needs of the SME sector.
 - Tax laws and regulations are consistently and fairly enforced, regardless of firm size.
 - Consultation with SMEs, or their nominated representatives, on tax issues is carried out regularly.
 - SMEs are able to obtain regular, simple and up-to-date information explaining the tax system.

VAT

- Evaluate the impact on SMEs of the introduction of VAT as soon as practicable.
- Reduce the VAT refund period to facilitate cash flow, using the international standard of one month.

Grey Economy

- Strengthen efforts to collect arrears, regardless of firm size.
- Improving administration and collection rates to widen the tax base.

Capacity Building

- Use regional forums and seminars to ensure that the SME sector is informed and trained well in advance and fully consulted on the implementation details of forthcoming taxation developments.

Financial Instruments for Fostering New and Small Businesses

Continue to Improve Banking Sector Supervision and Regulation

- Strengthen the degree of financial intermediation through measures such as the privatisation or liquidation of problem banks, which in turn would help reduce the problem of directed lending, and a further strengthening of banking supervision and regulation in line with Basle core principles.

Introduce Deposit Insurance and Abolish the Payments Bureaux

- Ensure that deposit insurance is introduced and the payments bureaux are fully eliminated during 2004, as planned. This would, as in other ex-Yugoslav countries, strengthen the role of the banks in providing financial intermediation and would help to raise the level of deposits from the present very low base.

Actively Encourage the Development of Leasing and the Introduction of a Credit Bureau

- The introduction of a credit bureau would provide banks with information about the creditworthiness of companies and would give banks more confidence in their lending activities to the enterprise sector, while the development of leasing would be an extra channel for providing finance to SMEs.

Advisory Services Supplied to New and Small Businesses

Long Term Development

- Continue to prioritise support to SMEs through national policy focusing on subsidised business support services, especially targeting start-ups. In the longer term, competitive private provision of business advisory services may reduce the need for government or donor-funded initiatives to address market failure.
- Work towards achieving financial sustainability as soon as possible. ASMED should formally review its regional network by the end of 2003 with a view to assessing financial sustainability and deciding how the range of services should be developed in the future to provide best value to SMEs.
- Strengthen capacity to support SMEs through provision of resources to train existing staff and hire qualified expertise. ASMED and its regional network (as well as regional and local authorities) are the key organisations responsible for developing and implementing SME policy, however, are relatively inexperienced in the area of enterprise policy and development such as customer relations, research, policy formulation and implementation focusing on the current needs of small businesses, etc.

Quality Standards

- Introduce a system of certification and accreditation of advisory bodies to set internationally agreed quality standards and improve confidence in the benefits of the services on offer. The certification and accreditation must be carried out by a credible representative body.
- Business advisory centres should be encouraged to develop and publish customer charters, setting out the range of services provided, the standards and costs they promise to adhere to. Entrepreneurs need to be informed of the potential gains from receiving professional advice before they become more willing to pay for them.

Local and Regional Support

- Review the plethora of institutions responsible for economic and enterprise development. Following rationalisation of institutional arrangements, central government should consider providing enhanced financial support to enable regional and local authorities to achieve this aspect of their remit.

The Implementation of Business Incubators

National Policy

- Define the national policy for the development of business incubators in Montenegro.
- Allocate responsibility to implementation of business incubators and the co-ordination of national and international funding and assistance for creation of business incubators to ASMED.
- Promote business incubators and disseminate information to entrepreneurs and other interested parties.
- Evaluate the possibility of using business incubators to support economic sectors with potential.

Chapter 2.

INTRODUCTION

Private investment by Small and Medium-sized Enterprises (SMEs)¹ is a key generator of economic growth and social change in OECD member country economies. In most countries world-wide over 90% of all enterprises are SMEs. It is now widely accepted that the contribution of SMEs to new jobs, exports, innovation, competitiveness and regional development is vital to national development. How to benefit from and maximise this contribution is a continuous challenge for all countries. It is a particular challenge for countries undertaking the transition to full market economies.

Economic development generally, and enterprise development specifically, depend first and foremost on the individual ideas, drive and initiative of entrepreneurs. However, the State has a fundamental role to play in providing a favourable framework and environment for private sector development in OECD member countries. In transition economies in South East Europe (SEE), where private investment levels lag behind those of developed countries, the necessity to create this enabling environment for SMEs and private investment is even more urgent. Reform of the business and investment environment for the SME sector leading to the creation of a dynamic entrepreneurial culture is crucial to drive the process of change in industrial structures and transition to market economy structures. Improving competition, innovation and strengthening the service sector will generate employment growth, absorb unemployment due to restructuring and help build-up the tax base.

The OECD and the EBRD have undertaken a series of Enterprise Policy Performance Assessments (EPPAs) in all SEE countries in order to provide insights into the performance in developing the potential of the SME sector. This EPPA seeks to assess progress in creating a supportive business environment for SMEs in the Republic of Montenegro and highlight issues that require attention and priority action. A major emphasis has been to elicit the views of SMEs and in particular obtain their practical experience and perceptions of the key barriers to business and new investment and assessment of progress in implementing policies to encourage the development of SMEs.

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

- Institutional framework for SME 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.

Montenegro has gone through an intense period of democratic, economic and social transition. The Investment Compact, endorsed by the countries of SEE including the Union of Serbia and Montenegro (formerly the Federal Republic of Yugoslavia), explicitly acknowledges that the revitalisation of region must rely primarily on private sector development and investment (Investment Compact Charter, OECD, 2001).

This EPPA for Montenegro provides a qualitative “snap-shot” of the SME perceptions of the business and investment environment measured against the above six dimensions of good practice. It takes into

account other OECD and EBRD studies (OECD, 2003; EBRD Country Strategy for the Federal Republic of Yugoslavia, 2002), and presents views on performance and progress made. It highlights issues and recommends actions to make further progress. This report will be up-dated on a regular basis, thus allowing a fuller picture of progress to be developed over time.

The methodology employed in the assessment is set out in Box 2-1 below.

Box 2-1. 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. Given the very different policies, strategies, institutions, regulatory environment, etc. in Serbia and Montenegro, it was necessary, from a policy perspective, to separate the analysis into discrete elements. Separate reports were prepared for Serbia and Montenegro, allowing the differences between the two systems to be examined.
- II. The main components of the EPPA undertaken in Montenegro 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.
 - Republic-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 Montenegro.
 - Expertise from OECD, EBRD and experts from OECD countries.
- III. Under the guidance of OECD, the focus group research with the private sector in Montenegro was carried out by local consultants, *Centre for Entrepreneurship and Economic Development (CEED)*, using a structured brief and template of questions developed by OECD and EBRD. The focus group research commenced in mid-2002 and other interviews and desk research extended into the second half of 2002/early 2003. It focused on six dimensions of good practice in the following policy areas:
 - The Institutional Framework for SME policy.
 - Rule of Law and the Regulatory Environment.
 - Tax Policy for Small Businesses.
 - Financial Instruments for Fostering New and Small Businesses.
 - Advisory Services Supplied to New and Small Businesses.
 - The Implementation of Business Incubators.

Box 2-1. EPPA Methodology (Cont.)

- IV. Three focus group discussions took place in Podgorica (capital city), Herceg Novi (economically dynamic area) and Bijelo Polje (less dynamic area). In all, 18 entrepreneurs took part in the detailed discussions, covering the following sectors of activity: manufacturing and services, with some trade-oriented companies. The participants included representatives of micro, small and medium-sized companies, ranging from start-ups to well established firms. Standard templates were used for the discussion and the collection of ratings.
- V. Individual interviews with SME owners and managers and local SME experts were carried out, 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 same templates were used for the discussion and the collection of ratings. In addition to the focus group discussions, individual interviews with SMEs and local experts were carried out during 2002. Representatives of 10 SMEs as well as expert institutions, including the Agency for SMEs (the state implementation institution), Montenegro Business Alliance, Faculty of Economics, European Agency for Reconstruction, Centre for International Private Enterprise, Central Bank of Montenegro, Opportunity Bank, Firm Level Assistance Group (FLAG) and USAID took part in the research, allowing for a wider perspective than the focus group discussions. The same template of questions/ratings was employed as for the focus group.
- VI. The findings from the focus groups and interviews obtained were complemented with additional information provided by the EBRD. The EBRD's Office of the Chief Economist has assessed progress in structural and institutional reform across the region since 1994. The EBRD jointly with the World Bank launched the Business Environment and Enterprise Performance Survey (BEEPS) in 1999. The BEEPS asks enterprises to evaluate economic governance and state institutions and assess the extent to which the business environment creates obstacles to the operation and growth of their businesses. In 2002, a second stage of the BEEPS was undertaken, surveying close to 6,000 firms across 26 countries of the region. Because of the small sample of Montenegrin firms, a limited amount of this information is used in this report. Readers are referred to Serbia EPPA (OECD-EBRD, 2003) for a fuller analysis for the Union of Serbia and Montenegro.
- VII. The analysis in this EPPA is based on the methodologies described above (focus group research, expert interviews, secondary data collection and BEEPS). All information has been analysed by the OECD and EBRD, resulting in the assessment presented in this EPPA.

NOTE

1. The notations SME and small enterprise in this report also include micro-enterprises, which according to the EU definition (http://europa.eu.int/comm/enterprise/enterprise_policy/sme_definition/index_en.htm) are independent enterprises with up to 9 employees and whose turnover or balance sheet asset value are \leq €2 million. Small enterprise 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.

INSIGHTS FROM SME OWNERS, MANAGERS AND REPRESENTATIVE BODIES

3.1. Introduction

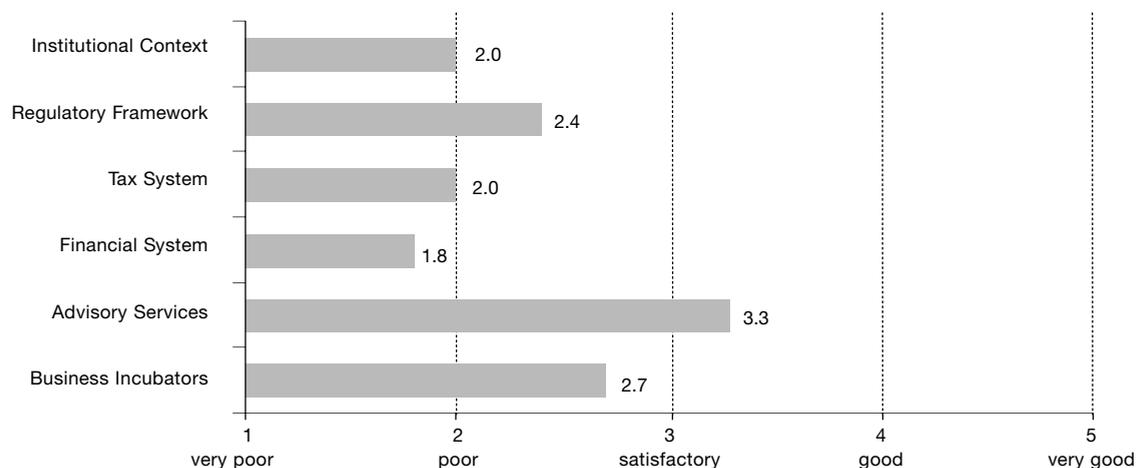
The analysis of the results of the research with the SME focus groups is presented for six framework dimensions of good practice for the business environment:

- Institutional framework for SME 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.

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

The average ratings per dimension of good practice are highlighted in figure 3-1. In general, the ratings are fairly “poor” with access to finance rated the worst of all (1.8 - i.e. between “very poor” and “poor”). Business Advisory Services obtained the highest average (3.1 - i.e. slightly above “satisfactory”).

Figure 3-1. Average Ratings of the Six Dimensions of Good Practice by SME Owners and Managers



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

Other EPPAs draw on the EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS) carried out for 26 countries in 2002. The survey included over 100 firms in Serbia and Montenegro. However, only a small number of these were from Montenegro, ruling out a formal statistical analysis. Nevertheless, given the shared recent history of the two Republics, it is likely that the problems identified for the Union as a whole, as shown in the recently-published Serbia EPPA (OECD-EBRD, 2003), are broadly relevant also for enterprises in Montenegro.

3.2. Institutional Framework for SME Policy

The issues researched under this heading:

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

Organisational Responsibility

1. Has the government assigned clear organisational responsibility for the development of SME policy?	Yes
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Considering the small size of the economy, a fairly extensive institutional framework exists in Montenegro. The SME owners and managers participating in the research were aware of the fact that the government has created a national institution, the Agency for Small and Medium-sized Enterprise Development (ASMED), whose main purpose and mission is to support SMEs. Although half of the entrepreneurs were not familiar with the specific work of the organisation, they had heard of ASMED's existence. By contrast, all the experts participating in the research were familiar with ASMED and think that organisational responsibility for development of SME policy had been clearly assigned by the government.

The SMEs in the research themselves were less familiar with the operations of ASMED and overall did not respond very positively to this issue:

“Yes, the responsibility has been allocated, but has it been followed up by necessary policies for SME development?”

“The government has started the SME Agency [ASMED] and the Euro Info Centres, but that is all they have done. The results have not been great so far.”

Still, it should be noted that ASMED is a relatively new organisation and that it has not yet had a chance to fully establish itself and raise awareness of its activities at the time when the research was undertaken.

Issues: Although a comprehensive framework is perceived to exist and institutional responsibility for SME policy development is clear, entrepreneurs are not yet very familiar with ASMED and its function and activities.

Effectiveness of the Organisation/s

2. Rating given to the effectiveness of the organisation/s in developing an environment to encourage entrepreneurship and the development of SMEs	1.8
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The majority of the entrepreneurs believe that Montenegrin SMEs are mainly being supported through the private sector itself. Some are critical (possibly because of poor awareness) of both of the government's policies generally and ASMED's effectiveness:

“SME development doesn't seem to be a government priority.”

“... for the amount of government and donor money that has gone in ..., the results could be more impressive.”

However, it is important to note that participants were aware that there are still relatively new institutions that need more time to fully develop:

“It [ASMED] is one year old, well focused now but [there is] room for improvement.”

The participants argue that private sector firms also have a responsibility for building a functioning institutional framework. Entrepreneurs were aware of the need to be more active in establishing effective connections and communication among institutions involved in SME policy. The SME owners and managers underline the need for more specific, tailor-made SME programmes and training of entrepreneurs. Access to human resources and SME financing are considered to be a serious problem in the SME sector.

Issues: The SMEs participating in the research place primary responsibility for economic development with the private sector itself, but think that government is not yet doing enough to develop an entrepreneurial environment conducive to the development of SMEs. They would like to see more effective activity and more communication about it.

SME Development Strategy

3. Rating given to the quality and effectiveness of the SME development strategy	1.9
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The experts who participated in the research were aware of the government's SME strategy and consider it to be relatively good and an improvement on its predecessor:

“The old strategy was very unfocused. We have a new chance with this document.”

“The document's coverage is wide-ranging and universal, but it is still too early to judge the effectiveness.”

All of the participants in the focus groups expressed concerns about implementation, arguing that it will be hard to achieve the aims of the Strategy without the active involvement of the private SMEs and non-governmental organisations working in the area of SME development. The conclusion of the discussion was that there is a need for closer working relationships between the private sector and ASMED in realising the SME strategy:

“The strategy is good but the organisation's effectiveness is questionable.”

Issues: The perception is that the SME strategy is a good framework document but that its implementation is the key issue. Entrepreneurs think that it will be impossible to implement it without the active contribution of the private sector, as well as the other SME stakeholders.

Local and Regional Governments

4. Rating given to the local and regional governments' mandate and resources (funding, people and skills) to promote SME development	2.0
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Participants think that the local and regional governments' mandate to promote SME development is fairly clear in Montenegro, however, they are assessed as having limited legal power. The resources, personnel and skills available are rated as "poor". The entrepreneurs in the focus group discussions are mainly concerned about the way the funding available for SME development is actually being spent:

"Reading the newspapers one might conclude that tens of millions of euros are allocated ... for SME development. If true, there is obviously no lack of funding, rather a lack of results."

A common perception among the participants in the focus groups is that what currently exists is not working very well in providing practical support to them:

"There is no clear understanding within the institutions at the local or regional level ... of the problems faced by SMEs. Therefore, the personnel and the skills available are not in tune with our expectations."

"Work is carried out in each municipality through the Secretariat for Economy, but they seem to be more focused on collecting taxes from SMEs than on helping them."

In addition, ASMED has introduced a network of regional business centres and a Euro Info Centre, however, given that they are at an early stage of their operation, it was not possible for entrepreneurs to judge their performance.

Issues: While the mandate for developing the SME sector is believed to exist, the existence of adequate resources at regional and local level, both financial and human, leaves something to be desired as far as small enterprises are concerned.

Information and Awareness

5. Rating given to the information provided and awareness of the government's institutions, policies, programmes to support new entrepreneurs and develop existing SMEs	2.4
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Turning to the issue of information provision and awareness of institutional policies and programmes, these also receive a relatively poor rating. Obtaining relevant business information appears to be even more problematic for entrepreneurs based outside Podgorica. The SME owners and managers participating in the research were not greatly aware of information about institutions, policies and programmes focusing on enterprise development. The suggestion is that because distribution networks are inadequate, information may not be disseminated very effectively:

"Information provided is satisfactory, but it seems to be channelled to certain groups rather than the general public."

Some participants maintain that the Montenegrin government has not been traditionally very focused on sharing information. Given this context, recent developments are a major improvement, however, most experts that were interviewed argue that this process could be enhanced and made more transparent, relevant and timely. For the moment, the perception among the wider SME stakeholders is that bodies such as NGOs, are more effective in disseminating information.

Some also question whether the business community itself is receptive to such information:

“There is a lack of interest [in changing] on the part of the business community. Both state owned and private enterprises are pessimistic [in nature] and lack incentives to change attitudes.”

Issues: While the government has improved its communication with the private sector and dissemination of information relevant to businesses in recent years, there remains scope for improvement. There is a feeling that information is distributed to select groups rather than being made open available to general public and that private sector themselves could be more active in obtaining information.

Consultation between Government and the Private Sector

6. Rating given to the quality and regularity of consultation between government and the private sector on SME policy and its performance	1.8
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Consultation between the government and the private sector on SME policy received a “poor” rating. It appears that there are several reasons for this assessment, not least because of the perception that the consultation that exists is focused on a very limited number of bodies:

“The government prefers to work alone, or with the Chamber of Commerce, which is not a representative organisation for SMEs.”

“The government consults with donors rather than the private sector.”s

Based on the discussions, the Chamber of Commerce is perceived to represent large firms, especially the state-owned enterprises, and is not seen as being primarily concerned with SMEs. It is argued that the recently established business associations are starting to develop more of a relationship with the government, particularly with ASMED. Nevertheless, the degree and intensity of consultations are considered to be insufficient in quantity and quality and do not meet the needs of the entrepreneurs on a range of issues such as tax policy and reform, business legislation, incentives for SMEs, etc.

It should be noted that entrepreneurs think that the government is not fully to blame for the lack of adequate consultation. It is acknowledged that entrepreneurs themselves tend to mistrust government and are often unwilling to participate in the process, since they are not always convinced that it will be of any practical value.

Issues: Recently formed business associations have enabled more communication between the SME sector and the government to take place. There is much room for improvement, both on the side of the government and the private sector.

3.3. Rule of Law and Regulatory Environment

The issues researched under this heading:

7. The formalities for new company registration and comment on the process.
8. The procedures for obtaining licenses, permits and certificates necessary for business operations.
9. The existence of a government approved programme for reducing the legal / administrative barriers for business and rating of the quality and effectiveness of this programme.
10. The efficiency of the programme for reducing the impact of corruption.
11. The quality and regularity of consultation between government and the private sector / SME policy community on draft legislation and regulations that affect business.

Company Registration

7. Rating given to the company registration procedure	3.4
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Comments by the SME entrepreneurs on the new Enterprise Law and, in particular, the procedures for new company registration were unanimously positive; and were rated even more positively (4.5, i.e. close to “very good”) by experts. There was common agreement that things have become less complicated, time consuming and costly, compared to the previous law:

“The number of steps necessary to register a firm has been significantly reduced and the process itself is not so burdensome any more.”

“The law is very good, and many companies have re-registered.”

It is estimated that partly as a result of the simplified procedures, the number of registered firms in Montenegro has doubled in 2002 compared with 2001 (Commercial Court of Montenegro, web site). This is not to suggest that the system is perfect and the discussion also covered possible developments to improve the system, such as making greater use of the Internet and further training of the commercial court judges.

Issues: By adopting the new Enterprise Law, entrepreneurs acknowledge that government has improved the registration procedure. Issues to be tackled in future include “on-line” company registration.

Licenses, Permits and Certificates

8. Rating of procedures for obtaining licenses, permits and certificates	2.2
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By contrast, the process for obtaining other permits, certificates and licenses, “... **remains difficult and expensive.**” Some responses stress more dramatically the urgent need for reform:

“You still need to go through hell because it is a bureaucratic nightmare. It must be simplified.”

Different ministries retain responsibility for different aspects and, in some cases, such as construction activities, permits are difficult to obtain and corruption is said to be rampant. According to ASMED, the government is undertaking a study to determine where the key bottlenecks lie. It will be a challenge to make improvements in this area as many of the permits are processed by local authorities and involve a large number of people. The SME owners and managers expressed concern that the civil servants may sometimes purposely slow down the process for personal gain or in order that competitors, such as friends and “associates”, obtain scope to fill market niches, thus rendering the activity risky for the applicant.

Issues: While substantial improvement has occurred in the company registration process, licenses, permits and certificates remain problematic to obtain. The perception is that local government staff may sometimes implement the different laws selectively and may not be willing to simplify the process.

Simplification Programme

9. Rating given to the efficiency of the programme for reducing administrative barriers for business	2.5
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While the participants in the research agree that the Enterprise Law had gone a long way to reduce bureaucracy and “red tape”, only one respondent among the experts thought there was a formal government programme to reduce barriers to doing business. Nevertheless, the participants are quite pleased with the progress made, especially in the case of imports and exports:

“There is no programme [for reducing administrative barriers]. Many barriers have been removed, although there are still constraints on imports that should be removed [quotas, procedures etc.]”

“There are many barriers in export or import activities, which don't make sense in a Republic that has only three products under government price control.”

In the absence of a state programme on business simplification, the perception is that the main initiators of progress in this area are the wider SME stakeholders, especially the NGOs, business associations and the international donor community, rather than government.

Issues: The key step towards cutting business “red tape” in Montenegro was the Enterprise Law, however, government momentum in this area has not been maintained. The perception is that business associations and non-governmental organisations are now more proactive in taking the lead in this process.

Anti-Corruption Programme

10. Rating given to the quality and effectiveness of the Government’s programme for reducing the impact of corruption	2.2
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One of the major problems facing the business community is the issue of corruption. Almost all entrepreneurs are aware of the government's Anti-Corruption Initiative and its associated package of laws aimed at reducing the influence of corruption. However, this initiative is assessed as being ineffective (rating: 2.0) and its quality is viewed as being little better (rating: 2.3). It should be noted that based on the focus group discussions, there is recognition that it is too soon to assess the impact of the legislation adopted in 2002.

While there was some frustration that corruption is so prevalent in Montenegro, the fact that the government had officially taken on this challenge is appreciated:

“The good thing is that the government has decided to start the fight against corruption.”

Experts think that the legislation itself offers potential:

“The Public Procurement Law is effective. The money laundering and anti-monopoly laws are OK.”

They also support the entrepreneurs’ opinion that: ***“the programme itself is still quite new and has not yet made an impact.”*** Nevertheless, the SME owners and managers stress that what they are looking for is results, rather than good intentions:

“It is good that the government is trying to tackle this, but it is a very pervasive issue. The government needs to be more proactive.”

Issues: While government is making formal efforts to fight corruption, the SME sector is looking for measurable results and achievements. There is a perception that laws have only been adopted recently and need time for effective implementation, nevertheless, the SME sector expects a greater degree of pro-activity on the part of government in tackling this important issue.

Consultation between Government and the Private Sector

11. Rating given to the quality and regularity of consultation between government and the private sector on draft legislation and regulations that affects business	1.6
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The experts and entrepreneurs have different opinions about the current levels of Business-Government consultation. While SME experts tended to think that this is above “satisfactory” (3.2 for quality and regularity) the entrepreneurs had a very different perception, rating it between “very poor” and “poor”. According to the experts, more business associations are now involved in the process and the public debate for laws, which gives everyone an opportunity to contribute. This relatively positive

evaluation came with some qualifications, namely that these developments are due much more to the efforts of NGOs and the international donor community to generated dialogue and communication, rather than government instigation:

“The NGO community has led the discussion [on the need for consultation]. It is not due to the government.”

One has to interpret the above quotation with caution since there is still an absence of regular consultative meetings with SME stakeholders in Montenegro. At the same time, it should be noted that some experts blamed the problems in this area on the SME community itself:

“Business associations are always asked to give opinions and recommendations on draft laws, but they are not always capable of making educated comments.”

Opinions on this issue are sharply divided. Nevertheless, according to the entrepreneurs themselves, the government has been more focused on other issues than on SME development in the recent past, therefore:

“All attempts from the business side are a waste of time, money and energy since no-one wants to listen to the real problems facing the private sector.”

“We are ready to work together with the government to support changes in Montenegro. At the end of the day, we are the ones that provide new jobs, social benefits, pensions, taxes... to the system”.

Issues: While there are now better opportunities for business associations to be more involved in consultation with government, those associations themselves need to develop their activities and understanding of their role in a market economy and democratic society. There is a willingness on the part of the private sector to take more responsibility for future SME development, if allowed to engage in an effective mechanism for consultation.

3.4. Tax Policy for Small Businesses

The issues researched under this heading:

12. Whether the present tax policy encourages new enterprise and rating of the tax system in terms of the encouragement, support and ease of use that it provides to new and existing SMEs.
13. The stability and transparency of the tax system for small enterprises.
14. The consultation and communication between government and the private sector on tax rates and incentives for enterprises.
15. Co-ordination of tax policy with other government policies.

Encouragement of Enterprises

12. Rating given to tax policy in terms of the encouragement, support and ease of use that it provides to new and existing SMEs	1.6
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According to the overwhelming majority of SME managers and owners participating in the focus groups, the current tax policy does not encourage the development of either new or existing enterprises. In general terms, tax policy is viewed as being relatively “poor”, as both experts and entrepreneurs believe that the laws could be more focused on the needs of the SME sector:

“There are some provisions for SMEs, but not many.”

“The new taxes are an improvement, but there is nothing specific for small businesses.”

Whilst recognising that the package of new tax laws comes into full effect in 2003, the participants maintained that lower taxes would help SMEs to do more business as well as impacting on the scale of the informal economy:

“Business people want to reduce wage costs. At present they keep everyone on the minimum wage and pay the remainder ‘under the table’, increasing the grey economy.”

Entrepreneurs argue that additional incentives for SMEs, for example tax breaks for new investments and generation of new jobs would assist in stimulating more start-ups and enabling existing firms to remain operational. They think that the focus of tax incentives should be on ***“underdeveloped sectors and new enterprises”***, thus incentivising firms willing to invest, create jobs and increase profitability.

It was also noted during discussion that more effective tax collection is critical in Montenegro: ***“Selective enforcement needs to end - everyone must pay.”*** Although custom duty collection has improved since the adoption of the new custom regime, the participants argue that evasion seems to be shifting to other taxes:

“Some firms are not reporting all their import and other activities. For them it is no big deal to pay customs tax, but to ... report all employees and pay taxes on their salaries ... and 20% corporate tax, are seen by some as good reasons to underreport.”

An additional issue raised in the discussion is that since Montenegrins are fairly adept at tax avoidance, the government will have to be more innovative and less bureaucratic in order to achieve greater tax compliance:

“It [government] discourages business [from paying taxes]. It asks for too much information that people are reluctant to give.”

Issues: While certain taxes such as custom duties have been reduced, the overall tax burden is considered by the business community to be a barrier to reducing the informal economy. Incentives, for example for new investments and job creation, are argued to be very important for the expansion of the SME sector.

Stability and Transparency

13. Rating given to the stability and transparency of the tax system for small enterprises	2.5
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The SME owners and managers participating in the research do not assess the overall tax system as being particularly stable or transparent (2.3 for stability and 2.6 for transparency). For example, it has been announced that VAT would apply in Montenegro to IT equipment from 1 April 2003. As a consequence, this equipment is frequently bought in Serbia, where it remains zero-rated, and imported into Montenegro without paying taxes. The result is that Montenegrin firms are losing their market share. Participants argue that there is typically no discussion of proposed reforms and changes are implemented without warning or sufficient time for preparation:

“The private sector should be more involved in the procedure for changing tax legislation.”

Entrepreneurs argue that the tax laws are now much clearer and easier to understand than the previous ones and note that the Department of Public Revenues has recently opened a Tax Hotline to make information more easily available. As not all the new tax laws apply as yet, it is difficult for respondents to respond to this issue, but in general they think that this is a positive development. They also note that other overarching political aspirations affect the stability of the legislation:

“The laws may change because of the agreement with Serbia, and once again when Montenegro [seeks Candidate Country status and eventually] joins the EU.”

Issues: The government has adopted a package of new tax laws, not all of which have been implemented at the time of the research. The private sector is currently not greatly involved in the process of tax changes and argues that these are often introduced rapidly and without sufficient consideration of the adjustments that enterprises must make.

Consultation and Communication on Tax Policy

14. Rating given to the communication between government and the private sector on tax rates and incentives for enterprises	1.3
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Consultation on tax policy is seen as inadequate by the entrepreneurs. The perception of the degree of dialogue and communication in relation to changes to the tax system is that:

“We have not been involved whatsoever in discussion about the new tax laws, either through the business associations or as individuals.”

“There was no public debate about the package of tax laws.”

This issue was rated much more positively by experts (2.6), but they acknowledged that consultation was “poor” and that “opportunities” may have been missed in the rush to pass the package of tax legislation. However, they maintained that the situation has improved compared to 2001. In support of this claim, the entrepreneurs in the focus groups pointed to recent TV adverts and seminars that have provided further scope for information and discussion, whilst maintaining this did not constitute consultation *per se*.

Participants in the focus groups do acknowledge the inevitability of changes and reforms during a period of economic transition, nevertheless:

“With all respect, we feel abandoned. There were no public debates about the new tax laws. Everything was happening ‘behind the scenes’.”

“If we had been involved, we feel that the tax laws would have been better.”

Issues: While entrepreneurs do not contest the necessity for change during the transition process, the small enterprise sector would like a greater degree of consultation on changes to the tax system, since this directly affects their activities. Building trust between government and private sector and creating a general framework for tax partnership remain as a challenge.

Co-ordination of Tax Policy

15. Rating given to the tax policy co-ordination with the overall government policy	2.4
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The government is judged to have done a reasonable job at co-ordinating tax policy with other legislation, “... ***especially with customs, [and the] monetary areas.***” Whilst acknowledging that not all the new legislation has been passed, for example the pension and labour laws, the entrepreneurs feel that improvements can be detected, such as the fact that the new VAT law will be implemented at the same time as the Customs law. However, the perception remains that co-ordination with budgetary policies at the local and national level could be improved:

“It is hard to tell whether the tax and custom policies are connected with municipal and state budgets, and the degree to which these activities are co-ordinated.”

Issues: The SMEs participating in the research think that there are some weaknesses in the co-ordination of tax with other policies but that broadly, this has proceeded well.

3.5. Financial Instruments for New and Small Businesses

The issues researched under this heading:

16. The stability, competitiveness and services of the banking system.
17. The commercial banks' interest in extending credits to the SME sector and lending attitude with respect to the SME sector.
18. The SME access to the following main sources of finance:
 - Own/family capital.
 - Micro finance.
 - Venture capital/Equity.
 - Repatriation capital (from family / friends abroad).
 - Commercial banks.
 - Leasing.
 - Credit reference sources.
 - Bank personnel skills.
 - Others (e.g. credit unions).
19. The availability of finance for SMEs at local and regional level.
20. The availability of funding for all sectors including technology companies.

Stability, Competitiveness and Services

16. Rating given to the stability, competitiveness and services provided by the banking system	2.2
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Although problems remain, it appears that confidence is returning to the banking system. Entrepreneurs participating in the focus groups assessed the stability of the banking system as close to "satisfactory" (2.5), whereas the degree of competitiveness and the services provided are rated at or close to "poor" (2.2 and 2.0). The experts were more positive (stability: 2.7, competitiveness: 2.5 and services: 2.5). The following quotation is illustrative of opinions about the banking system:

"Compared to when the Dinar was our currency [until October 1999], the banking system is stable. The current state of the national economy is not great, privatisation is under way, citizens still do not deposit money in banks but nevertheless, there has been an improvement. More money is available for loans, inflation is lower and business people can make plans."

However, the participants in the research stressed that the banking environment still has some way to go:

"The system [legislative framework] is not conducive to improving the banking sector."

Issues: The banking sector is on the road to recovery, although obstacles remain. As the economic environment improves, the banks are expected to begin offering a wider palate of services and on a more competitive basis.

Banks' Interest / Attitude to SMEs

17. Rating given to the commercial banks interest in developing SMEs and their lending attitude to the SME sector	1.9
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Commercial banks are perceived by entrepreneurs as having a limited interest in SMEs, though the experts rate this marginally higher (2.3). Entrepreneurs believe that the Montenegrin commercial banks basically seek to make profit without incurring risk:

“Due to the overall economic situation, banks are not willing to fund SMEs. It is just too expensive for them.”

The SME experts stress that commercial banks are not yet sufficiently flexible to take risks on financing newly established enterprises without previous credit history, and that more generally:

“Banks require collateral worth three times the value of the loan. When we add annual interest rates of 18% and the slow procedures for processing credit applications, how can they claim that they are supporting SMEs?”

SMEs participating in the focus group discussions think that the interest rates charged by banks are expensive but there is a perception that things are changing for the better. For example, the fact that the new private banks are willing to credit SMEs up to a threshold of €50,000 is seen as a positive development. This trend does not appear to apply to the state banks, leading to the perception that:

“Private banks are more interested in the SME sector; state banks are not.”

Aside from the usual critique of excessive interest rates and collateral requirements, the major concern in Montenegro relates not so much to the banks’ rejection of firms’ applications for credit, but to the time required in order to process credit applications and obtain decisions by commercial banks.

Issues: The perception is that commercial banks, particularly the state owned ones, have credit requirements which are viewed as being difficult for SMEs to afford. While it is understood that it is more risky lending to SMEs and that banks need to protect themselves, there is a perception that they also need to be more realistic in their lending requirements if they wish to diversify their portfolios. The credit application procedures are also considered to take excessively long at present.

Access to Finance

18. Rating given to the access to key sources of finance and guidance on financial matters to small businesses	1.9
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Table 3-1. Relative Importance of Main Financial Sources Accessed by SMEs

Financial Sources	Rating	Ranking
Remittance capital	2.9	1
Micro-finance	2.7	2
Commercial banks	1.8	3
Own/family capital	1.8	3
Venture Capital	N/A	-
Leasing	N/A	-
Others (e.g. credit unions)	N/A	-

Note: The ratings used to represent the views of the entrepreneurs range from 1 to 5 and can be read as follows: 1 = very poor, 2 = poor, 3 = satisfactory, 4 = good and 5 = very good.

Remittance capital and micro-finance were identified as by far the most common sources of financing for SMEs, with commercial banks and own/family capital being less important. The somewhat low rating given to own/family capital may reflect a degree of confusion about the difference between “remittance” and “own/family” capital, since remittances usually come from family members:

“Most SMEs use own/family capital. Access to micro finance is improving, however, other forms of finance are rare and accessing finance from commercial banks is tough.”

Micro-finance organisations are limited in number, but are perceived to have done very good work in Montenegro. The problem appears to be that:

“[There are] Only two micro-credit organisations left. This is not enough.”

Nevertheless, access to micro-finance is rated much better (2.7) than access to credit from commercial banks (1.8). This is perceived to be in part because of the new Banking Law regulations supervised by the Central Bank and the lack of awareness by existing banks of the new products and services demanded by private firms. Generally, entrepreneurs believe that the private banks offer better services than the state-owned ones. On the other hand, SME experts believe that all bank employees need (re)training after years of stagnation:

“The personnel in the sector are good, have been around for a long time, understand different instruments, but it is hard to function in this financial environment.”

“Once they [the bank staff] know you, they treat you well and provide a better service.”

According to the participants in the focus groups, there are no leasing companies in Montenegro at the moment. Access to venture capital and other sources of finance, for example credit unions, is also non-existent.

The general conclusion is that entrepreneurs find it very difficult to obtain finance. The procedures are perceived to be time-consuming and both interest rate and loan security requirements are viewed to be overly demanding for Montenegrin business conditions. This leads the SME owners and managers participating in the research to conclude that:

“Alternative financing schemes should be actively pursued.”

Issues: The most popular methods of financing remain remittances and micro-finance, as opposed to loans from commercial banks. Other sources of finance which are increasingly developing in the SEE region do not yet exist in Montenegro. There is a need for micro-finance institutions to be further developed in the Republic and for the sources of enterprise finance to be diversified.

Access at Local and Regional Levels

19. Rating given to the access to finance at local and regional levels	1.4
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Access to finance at both the local and regional levels is assessed to lie between “very poor” and “poor”. Although there is limited local government finance, commercial banks such as Ekos banka and Komercijalna banka are thought to be making some inroads beyond the capital city by opening branch offices in a number of municipalities. Entrepreneurs stress that: **“Theoretically financing is available all over [the Republic]”**, but that in practice, this is not the case. Northern Montenegro, the poorest part of the Republic, is identified as being a case in point. A further issue worth noting is that information on the financial sources available is considered by the participants to be limited and poor in quality at present.

Issues: While more banks are opening branches around the Republic, accessing finance at the local level remains difficult. Regional and municipal finances to assist enterprise development are limited.

Access by Sector

20. Rating given to the access to financial sources for all sectors including technology companies	1.4
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The availability of finance to all sectors of economic activity was also assessed as being “poor”. While funding is technically available for all sectors, some such as production, are perceived to be favoured by financial institutions over others and interest rates vary accordingly. Entrepreneurs maintain that commercial banks are only interested in investing in what they already know and feel comfortable with:

“They don’t yet know how to analyse business plans for all sectors.”

Issues: Finance is theoretically available to all sectors, including the technology sector. In practice, commercial banks are thought to stick closely to the sectors of business activity that they know well.

3.6. Advisory Services for New and Small Businesses

The issues researched under this heading:

21. Satisfaction with the range and quality of advisory services available to new entrepreneurs and SMEs and rating of the present services and comment on the changes needed.
22. Efficiency of advisory services operations.
23. Responsiveness of advisory services provided to demand and the needs of enterprises.
24. The skills, experience and quality of the staff providing business advisory services.
25. The continuity of business advisory services available.

Range of Advisory Services

21. Rating given to the satisfaction with the range of advisory services available to new entrepreneurs and SMEs	3.1
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This is a relatively new area of activity in Montenegro. The participants in the research stress that it has only been in the last few years that advisory services have been offered:

“Consulting services are new - they are trying to meet clients’ needs.”

Nevertheless, most of the SME owners and managers participating in the focus groups express their satisfaction with the range and quality of the business service on offer. However, the entrepreneurs believe them to be quite limited in nature: ***“Services are good but narrow [in scope].”***

Participants feel that government could play a greater role in helping this sector to develop and diversify further.

Issues: The range of services on offer to entrepreneurs is considered to be broadly “satisfactory”, but quite limited at present.

Efficiency of Advisory Services

22. Rating given to the efficiency of advisory services available to SMEs	3.1
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Entrepreneurs perceive a gradual improvement with respect to the efficiency of the advisory services on offer. The main organisations currently working in this field are thought to be donor-sponsored: ***“Only NGOs work in this area.”*** The participants argued that this represents a potentially large market for private provision and that competition should be encouraged:

“There is a need to develop [business advisory] networks throughout Montenegro with advisors from different professions and backgrounds.”

Respondents emphasise that they still perceive a gap between accessing business consultancy and advice and actually obtaining finance, especially for new businesses:

“Even if we have a good idea, business plan and consultant, the banks or other financial institutions take either too long to respond to our applications or simply refuse to finance new programmes without justifying their decisions. One might ask: what is the point of business services, especially for start-ups?”

Clearly, the use of business advisors to facilitate access to finance is only one part of the package of services which start-ups and existing firms can avail of. Based on the discussions, entrepreneurs in Montenegro appear to trust foreign advisors more than local companies. This is partly due to concerns over possible misuse of commercially sensitive information if this is made available to local advisers. However, there is also a perception that owners and managers are: “... **smart enough and don't need consulting services**” and that business advisory services are: “... **very expensive and few companies can afford to use them.**” Such concerns and views are not atypical of perceptions in other SEE countries.

Issues: Advisory services are perceived to be fairly efficient and improving but entrepreneurs need to be persuaded of the value of such services. They remain unwilling to give external consultants access to business information, consider them to be expensive and view themselves as being capable of dealing with their business' development needs.

Responsiveness to Demand

23. Rating given to the responsiveness of advisory services to demand and needs	3.2
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The participants in the focus groups argue that the services on offer tend to be responsive to and satisfy their needs, although this varies from provider to provider. At the same time, participants in the focus groups are divided over the issue of the cost of advisory services. Some considered the price to be too high, making them unaffordable to many smaller companies, while others consider it to be reasonable. All respondents support the charging of fees for business advisory services, believing this to be appropriate in a market economy based on a strong and competitive private sector. At the same time, there is perception that some international donors prefer to continue supporting the delivery of free business advisory services, leading to a discussion about the perceived lack of co-ordination in the implementation of donor SME programmes. Allied to this was a perception that not all firms have equal access to business services on offer.

Some of the entrepreneurs acknowledge that they themselves have to learn to use business advisory service providers effectively. They maintain that at the moment, there is: “**no market for real advisory services.**” but that it is only a matter of time before the economy recovers and enterprises have more resources and a greater inclination to use such services.

Following the adoption of the new package of tax laws, the participants in the focus groups believe that the main demand for business advisory services lies in the field of tax planning and protection. Demand is also strong for advice relating to EU standards and the generation of export to EU countries.

Issues: Participants agree that the responsiveness of business advisory services varies from organisation to organisation. As the provision of business advisory services is a relatively new concept, the firms themselves cannot always identify precisely what their needs are but are particularly interested in obtaining assistance with applying the new tax regime, quality standards and exports.

Human Capital

24. Rating given to the skills, experience and quality of the staff providing advisory services	3.2
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The skills, experience and quality of the business advisors and consultants working with enterprises are perceived to be “satisfactory” (skills: 3.6, experience: 3.0 and quality: 3.1):

“The skills and quality are good. Experience is more limited because these organisations are still new.”

People working in this field are thought to be “smart kids” well on the way towards becoming capable business advisers. They are aided by international technical assistance programmes, which are accelerating the learning process through the provision of training and other support.

Issues: While the business community perceives business advisory capabilities to be quite good, organisations that provide such a service are still relatively inexperienced. Further investment in business advisors and experts is required, together with better marketing for the services on offer.

Continuity of Provision

25. Rating given to the continuity of advisory services available	3.9
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Some of the participants think that the consulting firms were developing “long-term relationships” with their clients, others that this is not the case, since firms’ needs tend to be specific and time-limited. The issue was raised as to whether small enterprises really understand how to work with business advisors effectively:

“The advisors are very good but enterprises need to use them properly.”

“Consultants try to determine the need but firms often cannot specify what they actually need.”

The overall conclusion was that the business advisory providers are working fairly well in a growing market, and are in a position to make the most of opportunities, as demand increases: ***“[It is a] Good start.”***

Issues: Demand for consulting services is still quite limited but expected to grow. A culture of using and benefiting from good consultancy/advisory services has yet to evolve.

3.7. Business Incubators

The issues examined under this heading were:

26. Experience with business incubators and importance to new entrepreneurs and existing SMEs.
27. The efficiency of the government policy and programme encouraging business incubators.
28. The state of the business incubators’ governance structures.
29. The locations, the infrastructure and facilities of business incubators.
30. The extent to which the business incubators’ activities are focussed on the needs of the local entrepreneurs.
31. The extent to which the operating conditions, services and charges are transparent and clear.

Experience of Business Incubators

26. Rating given to the business incubators’ importance to new entrepreneurs and existing SMEs	3.7
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The participants in the focus groups were not able to answer all the questions in this section since business incubators do not yet exist in Montenegro. The responses in this section should be treated with due caution.

Many entrepreneurs in the focus groups did not have clear idea about the nature and function of business incubators: ***“How do they function?”*** was a frequently asked question during the focus groups.

Despite the lack of detailed knowledge, the participants recognise that business incubators could be of value to both start-ups and recently established companies. Entrepreneurs react very positively to the question: “**Would you join a business incubator?**”, suggesting potential for the future. The participants highlighted the following reasons for joining business incubators: contacts, business opportunities, better understanding of obstacles to doing business (especially export/import activities and taxes) and lower costs of doing business.

Issues: Business incubators do not exist in Montenegro but the businessmen participating in the research are optimistic about the potential of the concept.

Government Policy

27. Rating given to the efficiency of the government policy encouraging business incubators	1.6
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The SME participants in the research are aware of the fact that there are not yet any business incubators. The SME experts pointed out that:

“There have been several attempts [to create them in Montenegro] but none have succeeded... further attempts will be made.”

The majority of participants believe that business incubators should be established to help the development of the private sector, generate employment and help increase competitiveness. They assess the efficiency of government policy to promote business incubators as “poor” at present, since so little is known about them, and nothing exists on-the-ground. Plans exist to start business incubators in the near future:

“Incubators are in our [ASMED] plan and implementation will start in 2003. This project will be funded by the EU and training has already started.”

Key policy challenges include raising knowledge and awareness, as well as accelerating the process of implementing the first business incubator.

Locations, Infrastructure and Facilities / Focus on Needs / Governance Structures / Transparency

Business incubators do not yet exist in Montenegro.

Chapter 4.

ANALYSIS AND ASSESSMENT

This chapter presents the OECD-EBRD analysis and assessment of the six dimensions of good practice for the business environment to complement the analysis of the discussions with the owners and managers of SMEs were presented in the preceding Chapter of this report. It reviews the current situation in each of these areas, takes into account other OECD and EBRD studies and analyses of good practice, and the private sector views, based on the preceding qualitative research with the owners and managers of SMEs. The assessment of the current situation leads to a series of recommendations by the OECD and EBRD, presented in Chapter 1.

4.1. Implementation of the Institutional Framework for SME Policy

The Situation on the Institutional Framework

SME policy in Montenegro is largely the responsibility of the *Agency for Small and Medium-sized Enterprises Development (ASMED)*, established in 2000. Unlike other SME Agencies in the region, ASMED is not under a ministry, but operates as an independent organisation reporting directly to the Prime Minister. ASMED is financed from the state budget (€3 million per annum) and through international donor support, for example European Agency for Reconstruction (EAR) (€800,000), Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) (€1.5 million), Central European Initiative, etc. The resources are used to run ASMED, its regional network, as well as undertake strategic and development projects, including the provision of financial support to SMEs. As such, ASMED is on a much sounder financial footing than most similar organisations in the region.

ASMED was established by a Government Founding Decision that defines its rationale, statute and functions. ASMED's main function is to *co-ordinate SME policy* at national level with the aim of creating a better business environment, a demanding task in a Republic where, for example, 37 laws with implications for economic policy have been passed in the last two years. It does so principally by seeking to co-operate with other ministries in the preparation of proposals, laws, regulations, etc. through working groups that include representatives from other relevant ministries.

ASMED has *four regional offices* (in Bar, Bijelo Polje, Rozaje and Podgorica) and plans to open additional offices in future. The role of the local offices is to provide information and consulting activities to local businesses. It has 25 staff (of which seven are based in the Euro Info Centre in Podgorica), as well as four international consultants providing advice to the Agency.

The “*Policy Strategy to Support the Development of Small and Medium Sized Enterprises*” is the first SME strategy in Montenegro and received government approval in 2002. It seeks to create a favourable environment for the development of a competitive SME sector and its priorities include:

- Promoting entrepreneurship.
- Promoting business skills.
- Ensuring fair competition.
- Reducing regulatory and administrative barriers to business development.
- Simplifying the business taxation system.
- Encouraging the formation of private business associations.

- Increasing access to business information.
- Increasing supply of business services.
- Facilitating access to affordable finance.

The Working Programme on SMEs was developed in accordance with the Policy Strategy and contains short-term and medium-term objectives (until 2003) but there are no long-term objectives. Specific measures and actions are defined as well as the responsible institutions, with a view to achieving the objectives of the Policy Strategy.

Several government institutions have influence on SMEs, not least the Fund for Employment, the Ministry of Economy and the Fund for Development. Where other ministries deal with SME-related issues, ASMED is expected to co-operate with these governmental organisations through Working Groups but it is not clear how active these are at present.

Since the adoption of a new package of legislation to regulate the role of the municipalities and process of decentralisation in Montenegro, *local government* has more power and influence on economic development (and thus enterprise development) through new local tax collection powers. Research reveals that major administrative burdens related to licensing procedures remain at the local level and that this is an area in need of simplification in future (Analysis of the Business Registration Process in Montenegro, CEED, 2003). This places a strong emphasis on the need for the private-public partnership and better co-ordination of SME development activity.

A number of institutions are of growing importance to SME development in Montenegro. Some of the notable ones include the new Euro Info Centre, the Montenegro Business Alliance (MBA), Centre for Entrepreneurship and Economic Development (CEED), the Women Business Centre (WBC), the Centre for Applied Research and Analysis (CARA), Women Business Forum, etc. The Chamber of Commerce also has a role to play, but is not considered by small business entrepreneurs to be an important player supporting SME development in Montenegro.

At the present point in time, no formal or regular government-business *consultative body* exists.

Assessment

The Agency for Small and Medium-sized Enterprises Development (ASMED), a relatively new institution, has been tasked with implementing the SME policy and strategy in Montenegro. It works directly with the Prime Minister in improving the SME environment and thus has good access to decision-making power. ASMED has co-ordinated the process of developing an SME strategy which has now been approved by the Government. It is well financed, is seeking to extend its regional network and benefits from technical support from donors. This is a much more stable financial and institutional basis than enjoyed by similar organisations elsewhere in the SEE region. All this suggests that ASMED is well-placed to actively work towards the improvement of the SME sector in Montenegro.

The research demonstrates that awareness of the existence of ASMED and approval of the general SME strategy is relatively high. That said, entrepreneurs do not yet perceive its activities and effectiveness very positively, bearing in mind the fact that it is a relatively new organisation that is yet to prove itself. For the moment, international donors and the NGO stakeholders are perceived as being more influential organisations.

The local perception is that SME-relevant information and/or reform initiative tends to come from the wider business community and donor organisations than through government. There is scope for better integration and improved co-ordination of SME activities being undertaken in Montenegro. At the same time, there is a need for the business community to become better organised, such as through business associations of various sorts. The overall impression is that there are currently various organisations

working on SME development, but that there is little effective co-operation and co-ordination of activity, research, information, etc.

Partly as a consequence of the above, there is currently insufficient communication between government and the SME stakeholders, including the SMEs themselves. Indeed, the perception is of an almost entire absence of dialogue between private sector and government in relation to the development of policy, strategy and legislation, except in an *ad hoc* sense. Further, there is a feeling that even when the private sector and its representatives submit comments and proposals for reform, these typically fail to receive due attention or obtain feedback from government. This applies, for example, in the case of tax policy, labour laws, pension reform, etc., where businesses are not consulted and changes are introduced late, resulting in confusion and unnecessary compliance costs for businesses. Whilst recognising that the government has moved to enhance consultation on an issue-by-issue basis, the analysis in this report suggests the need for more representative, regular and permanent dialogue mechanisms between government and the enterprise sector.

SMEs do not perceive that they are being taken seriously into consideration by the relevant institutions, particularly enterprises located beyond the boundaries of the capital city. Firms located in less dynamic and more remote regions of Montenegro, especially the smaller ones, do not feel that they are in any way included in the policy-making process. Consideration needs to be given to this issue, especially given ASMED's increasing geographical reach through its regional network.

Local government is now perceived as having a relatively good mandate to promote SME development but the resources available remain limited despite the fiscal decentralisation that has taken place. At the same time, ASMED's regional offices are new, and have yet to engage fully with both potential entrepreneurs and existing SME owners and managers looking for effective business advice and support. Funding for the regional offices has been available to date, but most of it has come from international donors and is likely to be reduced or terminated in the medium-term. There is a need to ensure that staff (national agency, regional offices and local authorities) is adequately trained and obtain the experience and know-how that is valued by small businesses.

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

The Situation on the Rule of Law and the Regulatory Environment

At the end of 2001, the government adopted a new *Enterprise Law* designed to streamline and simplify the procedures for creating and registering enterprises. The new procedures were designed to stimulate entrepreneurship and business development in Montenegro by eliminating unnecessary procedures, whilst at the same time promoting corporate governance, consistent with international best practice.

Additional improvements include the reduction of the cost associated with establishing limited liability companies (LLC) and the relaxation of registration requirements to encourage new start-ups. All requirements for establishing an enterprise are covered by the law, although certain aspects are governed by other laws such as securities regulations, competition, labour, foreign trade and investment laws. There are no provisions governing socially owned companies or public (state owned) enterprises, as is the case in Serbia.

As a result, the number of steps for *business registration* as well as number of the documents needed was reduced. For example, an LLC can now be set up with just €1 of founding capital plus a further €10 for the Commercial Court fee. The procedure for registering all forms of businesses has been redefined. The result is that Courts have four working days to issue the registration, otherwise firms are automatically registered. The fact that the procedure is quick and cheap has reportedly resulted in a significant increase in the number of businesses registered in Montenegro, with numbers doubling in 2002 (Commercial Court of Montenegro, 2002). All firms need to renew their registration on an annual basis in order to continue operating legally and a *Business Registry* was also established in 2002 for the first time.

The concept of *national treatment* of foreigners applies in Montenegro, which means that international investors can set-up businesses and own property on the same basis as local citizens. Montenegro does not require citizens from most countries to purchase visas.

Permissions and licenses aim to protect the public interest. In practice, these often represent unnecessary barriers to new and existing business and increase the costs of doing business. Conforming to complex and often inconsistent rules and legislation can be difficult, time-consuming and expensive, especially for smaller firms. In the absence of a national forum for business simplification, the Centre for Entrepreneurship and Economic Development (CEED) established an *Inter Departmental Working Group* in 2002 with the aim of simplifying licensing procedures, permission and registration regimes. The activity is under way and is expected to assist the government to identify methods of simplifying the process of licensing as a logical next step to the simplification of the business registration procedure.

The *regulatory regime* has changed significantly in the last two years following the introduction of the Enterprise Law (see above). In addition, a package of six Tax Laws, the Bankruptcy Law, Cross Border Insolvency Law, Accounting Law, etc. were adopted by the Montenegrin parliament in December 2001. Despite this package of reforms, the bureaucracy remains somewhat unclear and adds significantly to the costs of starting a business. Nevertheless, the overall business regulation climate has improved markedly, though the challenge remains of ensuring effective implementation of the laws and regulations.

The *Secured Transactions Law* is designed to enhance economic development through the accommodation of credit transactions secured and supported by pledged assets. It provides the exclusive means by which pledges are created, enforced and terminated. Mortgages or pledges related to property are the subject of a separate law. It defines the respective rights, duties and responsibilities, and allows the pledging of a wide variety of assets, including inventory and receivables. The law seeks to encourage commercial lending as a tool for business growth and the necessary legal framework to provide a greater degree of confidence for lenders.

The *Enterprise Insolvency Law* seeks to create a set of rules for the resolution of business failure in a predictable manner. It provides a legal mechanism for viable businesses to reorganise where possible and an orderly means of exit when they cannot. It is designed to be consistent with international insolvency expectations. The Cross-border Insolvency Law provides a framework for dealing with bankruptcy matters beyond the borders of a particular country.

The new *Accounting Law* introduced 18 of the 40 International Accounting Standards (IAS) and all Montenegrin businesses were obliged to adopt these standards by the end of 2002. Further IAS standards are expected to be gradually introduced.

The share of the *grey economy* is estimated to account for 30-40% of GDP (Institute for Strategic Studies and Prognoses, 2002). Studies (CEED, 2000 and 2002; Business Statistics 1999, 2000 and 2001, CEED and Centre for Applied Research and Analysis, 2002) reveal that it is principally the high tax and social security burden, rather than the registration and licensing regimes that give rise to the grey economy in Montenegro. In the SME sector, this is manifest in such factors as illegal workforce hiring, failure to use cash tills, etc. Changes arising from the new tax system are expected to have an effect in reducing rent-seeking incentives and the share of the grey sector in the economy. The government has created a *Working Group to Fight the Grey Economy*, currently made up exclusively of civil servants.

Over and above the informal economy, corruption is considered to be a serious problem in Montenegro. A *National Anti-Corruption Strategy* was adopted in mid-2001 to create a legal and institutional framework to promote co-operation in fighting corruption and to implement specific measures, however, its impact has not yet been assessed.

Assessment

Following the introduction of the Enterprise Law, company registration has become relatively cheap, quick and effective. Montenegro's new law received unanimous approval from participants, with most of the credit for this law given to the SME stakeholders for initiating and contributing to this process.

By contrast, licenses and permits remain very difficult. The procedures for obtaining other licenses and permits remain lengthy, complicated and corruption is rampant. The fact that different ministries are involved, as well as numerous agencies at various administrative levels, compounds the difficulties. Tackling anything at the municipal level is perceived by entrepreneurs to be a daunting challenge. There have been recent initiatives to simplify licences and permits. Initiatives are underway to set-up "one-stop-shops" at the municipal level and predefining the maximum number of days within which municipalities must issue licences as the next logical step to improvement of the business regulatory regime. This pressure arises partly as a result of non-transparent and rent-seeking behaviour that persists in the licensing environment. An Interdepartmental Working Group set-up by CEED is seeking to simplify licensing procedures, permission and registration regimes but this has yet to deliver concrete improvements which are of benefit to SMEs. This initiative is very welcome in Montenegro, though it is common for such initiatives elsewhere to be government-sponsored and co-ordinated, often backed with international donor support and close involvement of the business community.

The government has received commendations for the Anti-Corruption Law and the associated strategy. Many respondents equated corruption with the informal economy and believe that this is a critical business issue for Montenegro to tackle. The Working Group to Fight the Grey Economy has been assigned an important task, but has yet to convince SMEs that it is capable of making progress. Entrepreneurs think that the results have been negligible so far, partly due to a lack of private sector involvement in this organisation.

There is increasing recognition that business simplification is a long-term process, rather than a one-off event. This suggests the continuing need to test possible solutions, co-ordination and implementation of the recommendations. These activities should be adequately funded and have a direct link to the private sector and its representatives in order to develop a revolving set of priorities. In this context, the fact that the government has begun working more closely with recently formed private business association is an improvement on the past, when the major and sometimes only official link was with the Chambers of Commerce and Industry. Business associations, such as the Montenegro Business Alliance, are invited more frequently by government to take part in consultation about possible policy reforms, but there is scope for further improvement in the process.

4.3. Implementation of Tax Policy for Small Businesses

The Situation on Taxation Policy for Smaller Businesses

The Montenegrin government is committed to undertake an overall reform of the fiscal system, a major part of which involved the adoption of six new tax laws in December 2001. The focus of *tax policy* based on the adopted laws is collecting taxes efficiently, broadening the tax base, reducing tax rates and simplifying tax administration procedures. The reforms have concentrated on the implementation of tax laws but in future are expected to target the elimination of exemptions introduced in the laws on direct and indirect taxes and modernisation of tax administration.

With regard to the latter, the *Ministry of Finance* is responsible for determining tax policy in Montenegro. It is in charge of the overall taxes, while municipalities are in charge of local taxes. Following a process of fiscal decentralisation, municipalities are responsible for administering numerous communal taxes and fees.

The new *Corporate Profit Tax Law* established a rate of 15% for taxable profits up to €100,000 and a rate of 20% for profits over €100,000. It provides incentives for firms wishing to reinvest up to 35% of the

declared profit. The tax rate is 20% on the remaining 65% of declared profit. There are no special incentives for SMEs.

Montenegro used the sales tax until 1 April 2003, at which point the *VAT Law* went into effect. Under the old legislation, total tax rates were 24% for goods, with a reduced tax rate of 15% for certain goods and 12% for services. The flat-rate VAT is 17%. Any business with an annual taxable turnover of over €18,000 must be VAT registered. Voluntary registration is possible for firms with a lower turnover.

The *Personal Income Tax Law* became effective in July 2002 and the first tax return was due in April 2003. Previously, 19% was automatically deducted from salaries, regardless of income levels but the new personal income tax is progressive, as set out below:

- €0 - €600 taxable income: Untaxed.
- €600 - €2,000 taxable income: 17% of the taxable income in excess of €600.
- €2,000 - €3,500 taxable income: €238 + 21% of the taxable income in excess of €2,000.
- €3,500+ taxable income: €553 + 25% of the taxable income in excess of €3,500.

It is anticipated that the key advantages of the new law will be a greater degree of fiscal fairness and a simplified tax filing system.

A more comprehensive *Excise Tax Law* went into effect in April 2002. It treats excisable goods in a more consistent manner and increases the amount of excise tax collected on specific goods such as certain imported tobacco products, while decreasing tax on cheaper cigarettes. It excludes products that generate little revenue or are difficult to control. It also limits taxable products to three categories: alcohol and alcoholic beverages; tobacco products and mineral oils; mineral oil derivatives and substitutes.

The new *Property Tax Law* came into effect in January 2003. It reduces tax liabilities for primary residences to a maximum of 50%, depending on the number of family members in the household, a provision that will be eliminated by 2005. Both legally and illegally constructed buildings are subject to the Property Tax Law. The tax is based on the market value of the property (instead of an estimated capital value, as was previously the case) and applies both to land and improvements (instead of just the latter).

The *Law on Tax Administration* presents a basis for transforming, modernising and simplifying the tax administration and associated procedures. It became effective in January 2002 and defines the rights and obligations of tax payers as well as the tax administration, the process of tax registration, assessment, payment, collection, control and deadlines. Penalties are payable if tax obligations are not fulfilled.

The six new laws discussed above are broadly in line with EU legislation and are designed to help create an environment that is attractive to both domestic and foreign investors. It remains to be seen how the Montenegrin tax institutions will cope with the challenging implementation task ahead of them.

Assessment

Montenegro passed a package of new tax laws in 2001. Respondents were aware of the new laws, but opinions ranged widely. They recognise that the tax system is much simpler to understand than the old laws, but regret the fact that there are no specific incentives for small businesses and that the payroll taxes remain significant, encouraging businesses to continue paying their staff “under the table”. A neutral tax system which is more transparent and stable should still be of benefit to small enterprises. There has been a large degree of tax avoidance in the past and a demanding challenge for the government remains the enlargement the tax base by ensuring that all companies comply with the tax laws. In this context, the introduction of VAT should help, however, it remains to be seen whether the VAT rate will be the same in both Serbia and Montenegro. If this does not happen, distortions may result, such as an incentive for smuggling activity.

The findings of the focus group research need to be treated with caution, as part of the package had not been implemented at the time of the research. The reactions to the new tax package varied, but in general, there was a perception that there is not a sufficient focus on the SME sector. Whilst they do welcome the efforts to reduce the overall tax burden, the main concern is that tax policy does not do enough to encourage the development of either new or existing enterprises to survive and prosper.

Businesses are looking for stability, simplicity and transparency in the fiscal system (OECD-UNIDO, 1999). A simple, clear and stable tax system, with a fiscal burden that corresponds with the current level of economic development, should be the guiding principle for the fiscal agenda of Montenegro.

In addition, it will be particularly important for greater efforts to be made to improve consultation with the private sector, as a way of designing sound policies, forewarning firms and avoiding unnecessary compliance costs.

4.4. Implementation of Financial Instruments for Fostering Small Businesses

The Situation on Financial Instruments

During the 1990s, the Montenegrin economy shrank in size by about 30% and the banking sector was largely stagnant. However, significant changes have taken place since then. On the macroeconomic front, a notable change occurred in October 1999 when Montenegro adopted the German Mark as a parallel currency and subsequently as the only means of payment. At the beginning of 2002 the German Mark was replaced with the Euro. This development was based on the argument that a *stable currency* is one of the preconditions for economic development, including SME development. Inflation remained stubbornly high for a period, partly due to large increases in administered prices such as electricity, but is now at single-digit levels on an annual basis.

The Montenegrin *banking system* has undergone significant change as a result of monetary and banking reform such as the introduction of the German Mark and then the adoption of the Euro and the establishment of the Montenegro Central Bank, and is starting to show signs of recovering. The Central Bank of Montenegro was established in 2001 and has been engaged in active supervision of the banking system. As of end-2002, there were 10 commercial banks operating in Montenegro, with two new licences granted in 2002 to Atlasmont Bank a.d. Podgorica and Opportunity Bank a.d. Podgorica. A major development in July 2003 was the privatisation of the largest bank, Montenegro Banka a.d. Podgorica, to Nova Ljubjanska Banka of Slovenia. The obligatory reserve requirement has been reduced progressively from 100% in 1999 (effectively no bank lending permitted) to 23% in March 2003, which has increased confidence in the system. This in turn has enabled the banking sector to increase its lending activities.

The *quality* of the services is improving. Nine banks until today have received licences to operate. International payments were improved and now require less time. A SWIFT code was given to the Montenegro Central bank. Competition in the banking sector is increasing, mainly thanks to the recent establishment of several private banks such as Opportunity Bank, Eurmarket Bank and Montenegro Commercial Bank. Commercial banks have started to introduce service packages to SMEs which means that the range of services being provided is increasing. For example, credit cards such as Visa and Master are being reintroduced by four banks, a service which was not offered during the period of UN sanctions and high inflation.

There remains a lack of trust in the banking system following the collapse of certain banks and pyramid schemes. Overall savings are growing slowly and at the moment are still at a very low level. Total savings in June 2002 increased by 4% in comparison to the previous month, and by 36% compared to the end of 2001. The 4% increase from May to June was a result of increased term deposits over one year by 18.5% and sight deposits by almost 8%. At the same time, term deposits up to one year decreased by 1%. The

structure of savings shows that term deposits up to one year, at €3.8 million, make up 50.3% of the total savings of €7.6 million (Institute for Strategic Studies and Prognosis, Montenegro Economic Trends 11, 2002).

At end-2002, total assets in the banking sector amounted to €340 million, or 28% of GDP. All commercial banks are extremely conservative when providing small loans to SMEs, with a maximum loan limit of €50,000 in most cases. ASMED also operates an SME credit line provided through private banks (terms up to three year and conditions such as 6 to 12 months grace period and interest rates from 15-18%). The state-owned *Fund for Development* capitalised with privatisation revenues, also provides SME loans with an annual interest rate between 6-9%. The *Fund for Employment*, channels donor funds to SME start-ups.

The banking system in Montenegro is very much dominated by the *commercial banks*. As of December 2002, there were no SME credit guarantee schemes, equity funds, leasing arrangements or specially designed long-term credit lines for SME development available in Montenegro. Encouraging the diversification of the SME financing pattern in the medium and long-term should contribute to the development of the SME sector and is a priority.

The results of a recent survey on Barriers to Doing Business in Montenegro (CEED, 2002, pp.74-77) showed that 30.5% respondents used a bank loan as a source of financing and 69.5% respondents never obtained any credit. Among all respondents that have never received a loan, 15.4% did apply for one. Compared to figures in the year 2000, the number of firms that have applied for a bank loan has declined, and 10.5% fewer firms have obtained credit from a bank in 2002.

While 58.3% of large companies borrowed from banks, only 25.3% of micro companies succeeded in doing the same. Regarding the SME sector, 45.2% of small and 46.2% of medium sized companies used a bank loan as a source of capital. Successful borrowers are in 4.7% of cases large companies, 4.0% medium sized, 28.2% small and 63.1% micro-enterprises. Compared to figures from the 2000 survey, smaller firms can more easily borrow money in the year 2002.

Assessment

The banking sector is perceived as having improved in recent years, but to still be in a rather fragile condition. Competitiveness among state owned banks remains almost non-existent, but the recent establishment of several new private banks and the privatisation of Montenegro Banka have brought about some positive changes that are expected to continue.

SMEs have not benefited enormously from the transition. It has become somewhat easier to get credit, but interest rates remain high and amounts available as loans are small. It is especially difficult for start-ups, as they usually have no collateral. Again, the private banks are starting to do more in this area, and this will possibly push the other banks into doing the same.

Own/family capital is perceived as the major source of available credit to SMEs, and micro-credit outside of loans from friends or family. There are not enough micro-credit organisations to support the market. Commercial banks of course give credit, but were given a low rating because it is still difficult to get a loan without connections. Other forms of financing have a very small presence in Montenegro.

Montenegrin banks suffered severely in the 1990s, but are starting to recover thanks not only to increased stability, but also to the opening of new private banks, which has heightened competition in the sector. In terms of SMEs, however, the environment remains poor. It is still very difficult for small businesses to access credit, and the type of financing available is limited. The primary source of credit is friends and family (CEED, 2002 and 2003).

4.5. Implementation of Advisory Services to New and Small Businesses

The Situation on Advisory Services

Adequate *business advisory and information* services are critical to the rapid development of the SME sector. Since SMEs play an important role during the process of economic transition, services that have the potential of accelerating their development and assist them to contribute to growth are important for economic development. Where they exist, entrepreneurs, potential entrepreneurs and business managers can take advantage of a variety of business services that are designed to promote start-ups and growing SMEs.

In Montenegro business advisory services are offered by a number of *organisations*:

- Agency for SME development (ASMED), with its four regional offices.
- Centre for Entrepreneurship and Economic Development (CEED), with its six regional offices.
- Firm Level Assistance Group (FLAG).
- Agency for Restructuring and Foreign Investment.

Two of the main advisory services, FLAG and CEED, are donor-funded but international support is not expected to last indefinitely. They have in the past offered services for free, but are starting to charge as they make the critical move towards achieving financial sustainability. In addition, there are a few governmental institutions that provide general advisory support, such as the Fund for Development and the Fund for Employment. Several *business support centre networks* are worth highlighting, such as the Montenegro Business Alliance (MBA) with its four regional offices; and a network of agribusiness associations.

Over and above these, there are growing numbers of business consultancies, training organisations, legal/accounting firms and other types of *private sector firm* providing business services to SMEs on a commercial basis. The most typical *business advisory services* include: distribution of business information, business-to-business meetings, consulting, business planning, marketing, etc. Comparing 2001 with 2000, research on SME needs (CEED, 2002, pp.122-127) shows an increase in *demand for services* related to accounting, legal services and business planning but reduced interest in business advice, marketing and training. At the same time, there is parallel growth in demand for information and advice for services such as leasing, use of new technologies and establishing business contacts with local / foreign partners.

There is a trend among the micro and small firms to use the services provided by business associations and external consulting services (CEED, 2002, pp.123-125). It appears that the level of use of external consultants is related to the educational attainment of the owners of the businesses: entrepreneurs with primary/secondary education use external consultants twice as much as owners with higher education. Finally, studies and business practices in Montenegro (CEED, forthcoming) suggest that SMEs do not yet make adequate use of the information and services available through business centres and business support institutions.

Institutions supporting *export promotion*, such as the Trade Promotion Executive Agency, are not yet well established in Montenegro. There are attempts by ASMED and CEED to provide institutional support to exporters through information distribution and web sites, however, these activities are not well known and there is currently insufficient contact with SMEs.

Assessment

The provision of business advisory services is a relatively new field in Montenegro, and while the range of services currently on offer remain narrow compared to just a few years ago, the improvement is significant.

Businesses that have used these services are generally satisfied with them and would use them in future. Nevertheless, there are only a few organisations offering advisory services and many of the consultants are young and relatively inexperienced. Entrepreneurs seem to trust foreign advisors more than local companies and are divided in their attitude about paying for such services: some would prefer to obtain business advice for free; others do not mind paying for the service as long as they receive quality advice that adds value to their business activities.

Good practice suggests that introducing standards with respect to advisory services (qualifications, membership of relevant international bodies, confidentiality principles, charging policies and other general quality standards) could help generate greater confidence and willingness by the private sector to use and pay for such advisory services.

There is some concern that the business advice services that are delivered through international donor programmes do not always match with what entrepreneurs consider to be their actual needs. This suggests a need for donors to evaluate and co-ordinate their activities, not least because donor funding is not expected to continue for much longer. It is essential for ASMED to focus attention on how best the existing business advisory services can achieve financial sustainability.

4.6. Implementation of Business Incubators

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

The Current Situation on Business Incubators

One of the most potentially successful forms of support to SMEs, especially start-ups, is the development of so-called business incubators. However, the *concept of business incubators* does not have a solid foundation in Montenegro at present. The main reason for this appears to be a lack of awareness of the ideas and principles of this type of business support institution, together with insufficient support of the concept.

CEED, in partnership with the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ), has attempted to build momentum for such a concept. A document focusing on SME development was presented to the Montenegrin Government in 2001 (CEED - GTZ *Operational Strategy for the Economic Development of Montenegro*, 2001) which includes recommendations that business incubators be established in Montenegro, including other proposals such as ways of assisting start-ups. The idea of developing business incubators has *made little progress* so far.

Assessment

There are no business incubators in Montenegro at present. There have been attempts to introduce this concept in the past, but due to the instability in the SEE region the timing did not turn out to be propitious. It is anticipated that within the next year there will be further attempts in Montenegro and those who were familiar with business incubators argue that this will prove to be advantageous to the SME sector. Despite the lack of detailed knowledge, the private sector readily recognises the potential offered by business incubators in terms of business development. They would be interested in joining such incubators and encourage the government to promote its establishment. Although they are enthusiastic, it is not clear at this stage that they really understand what business incubators are and there is a need for information dissemination and policy development in this area.

Chapter 5.

INFORMATION SOURCES

Balance Sheets of Commercial Banks and Companies (various)

Centre for Entrepreneurship and Economic Development (CEED), *Business Statistics 1999*.

Centre for Entrepreneurship and Economic Development (CEED), *Business Statistics 2000*.

Centre for Entrepreneurship and Economic Development (CEED) and Centre for Applied Research and Analysis (CARA), *Business Statistics 2001*.

Centre for Entrepreneurship and Economic Development (CEED) *Barriers for Doing Business in Montenegro - 2000*, CEED, Podgorica.

Centre for Entrepreneurship and Economic Development (CEED) *Barriers for Doing Business in Montenegro- 2002*, CEED, Podgorica.

Centre for Entrepreneurship and Economic Development (CEED) – *GTZ Operational Strategy for the Economic Development of Montenegro*, CEED, 2001

Centre for Entrepreneurship and Economic Development (CEED) – *Business Rating 300 Most successful Companies in Montenegro*, CEED, 2000, 2001, and 2002

Centre for Entrepreneurship and Economic Development (CEED) *Analysis of the Business Registration Procedure in Montenegro – 2003*, CEED, Podgorica.

Centre for Economic Development, *Code of Best SME Finance Practices in South Eastern Europe, 2001*, CED, Sofia.

EBRD (2002) *Country Strategy for the Federal Republic of Yugoslavia*, EBRD, London.

Institute for Strategic Studies and Prognoses (ISSP) (2002) *Household Survey Reports 5, 6 and 7*.

OECD (2001) *The Stability Pact: The Investment Compact for South East Europe*, OECD, Paris.

OECD (2003) *OECD Economic Surveys Federal Republic of Yugoslavia – Economic Assessment – Volume 2002*, Supplement No. 3 – January 2003, OECD, Paris.

OECD-EBRD (2001) *Entrepreneurship and Enterprise Development in the FYR Macedonia: Country Assessment and Recommendations*, joint OECD-EBRD report, Paris, OECD

OECD-EBRD (2002) *Entrepreneurship and Enterprise Development in Romania*, OECD, Paris.

OECD-EBRD (2003) *Serbia Enterprise Policy Performance Assessment (Serbia and Montenegro)*, OECD, Paris.

OECD-UNIDO (1999) *Entrepreneurship and Enterprise Development in Transition Economies: Policy Guidelines and Recommendations*, OECD, Paris.

Chapter 6.

WEB SITES

Employment Office – <http://www.zzzcg.org>

Agency for SMEs – <http://www.nasme.cg.yu>

Fund for Development – <http://www.fzrcg.cg.org>

Centre for Entrepreneurship and Economic Development (CEED) – <http://www.visit-ceed.org>

Institute for Strategic Studies and Prognoses (ISSP) – <http://www.isspm.org>

Euro Info Centres – <http://www.euroinfo.cg.yu>

Montenegro Business Alliance (MBA) – <http://www.visit-mba.org>

Chambers of Commerce – <http://www.pkcg.org>

Workers' Union – <http://www.sssc.cg.yu>

Union of the Economist of Montenegro – <http://www.secg.cg.yu>

Central Register of the Commercial Court – <http://www.crps.cg.yu>

Ministry of Finance – <http://www.ministarstvo-finansija.cg.yu>

Government of Montenegro – <http://www.vlada.cg.yu>

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The Organisation for Economic Co-operation and Development (OECD) groups 30 member countries sharing a commitment to democratic government and the market economy. With active relationships with other countries, Non-Governmental Organisations and civil society, it has a global reach. Best known for its publications and statistics, its work covers economic and social issues from macroeconomics, to trade, education, development and science and innovation. Over time the OECD's focus has broadened to include extensive contacts with non-member economies and it now maintains co-operative relations with some 70 of them. These contacts aim to further economic integration by making the OECD's experience available to other countries and enabling the OECD to profit from the insights and perspectives of non-members. (see www.oecd.org)

The European Bank of Reconstruction and Development (EBRD) was set up in 1991 to support the development of market economies in central and eastern Europe and the Commonwealth of Independent States following the collapse of communism. The EBRD supports the economies of its 27 countries of operations by promoting competition, privatisation and entrepreneurship. Taking into account the particular needs of countries at different stages of transition, the Bank focuses on strengthening the financial sector, developing infrastructure and supporting industry and commerce. The EBRD is the largest investor in South Eastern Europe and is also an active contributor to the Stability Pact. (see www.ebrd.com)

