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# Ex-ante study to assess the potential future use of Financial Instruments to deploy IPA resources in support of Small and Medium -sized Enterprises (SMEs) in Serbia

Final Report

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## Disclaimer



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# 2 Glossary of terms

| | |
|---|---|
| AOFI | Agency for Export Insurance and Financing |
| B2B | Business to business |
| BA | Business Angel Investors |
| BELEX | The Belgrade Stock Exchange |
| CBC | Cross-border cooperation |
| CEO | Chief Executive Officer |
| CFO | Chief Financial Officer |
| CIP | Competitiveness and Innovation Framework Programme |
| COSME | Competitiveness of Enterprises and Small and Medium-sized Enterprises |
| CSF | Common Strategic Framework for Research and Innovation |
| EaSI | Employment and Social Innovation |
| EBRD | European Bank for Reconstruction and Development |
| EC | European Commission |
| EEN | Enterprise Europe Network |
| EIB | European Investment Bank |
| EIF | European Investment Fund |
| EIT | European Institute for Innovation and Technology |
| EMN | European Microfinance Network |
| ENEF | Enterprises Expansion fund |
| ENIF | Enterprise Innovation fund |
| EU | European Union |
| EVCA | European Private Equity and Venture Capital Association |
| FDI | Foreign Direct Investment |
| FEAS | Federation of Euro-Asian Stock Exchange |
| FESE | Federation of European Securities Exchanges |
| FET | Future and Emerging Technologies |
| FI | Financial Instrument |

| | |
|---|---|
| FMCG | Fast Moving Consumer Goods |
| FoF | Fund of Funds |
| GDP | Gross Domestic Product |
| GF | Guarantee Facility |
| GVA | Gross Value Added |
| ICT | Information and communication technologies |
| IFIs | International Financial Institutions |
| IMF | International Monetary Fund |
| IP | Intellectual property |
| IPA | The Instrument for Pre-accession Assistance |
| ISO | International Organization for Standardization |
| KET | Key Enabling Technology |
| KfW | Kreditanstalt Für Wiederaufbau |
| MA | Managing Authority |
| MFI | Microfinance Institution |
| MTP | Multilateral trading facility |
| NARD | National Agency for Regional Development |
| NBS | National Bank of Serbia |
| NES | National Employment Service |
| PE | Private Equity Fund |
| R&D | Research and development |
| RAS | Serbian Development Agency |
| RSD | Serbian Dinar |
| SBA | Small Business Act |
| SBAN | Serbian Business Angels Network |
| SEE | South East Europe |
| SGRS | Société Generale Bank Serbia |
| SIEPA | Serbian Investment and Export Promotion Agency |

| | |
|---|---|
| SMEs | Small and medium enterprises |
| TA | Technical Assistance |
| TT | Technology Transfer |
| VAT | Value Added Tax |
| VC | Venture Capital Fund |
| WB EDIF | Western Balkan Enterprise Development and Innovation Facility |

# 3 Executive summary

## Context and objective of the study

The Delegation of the European Union to the Republic of Serbia (EUD) and the Ministry of Economy of the Republic of Serbia (MoE) commissioned this study to assess the potential future use of Financial Instruments (FIs) in the 2014 – 2020 programming period in support of small and medium enterprises (SMEs) in Serbia. The use of FIs would aim to address the current difficulties Serbian SMEs face when looking for finance. Therefore, the purpose of the study was to assess the market conditions for FI implementation in Serbia in support of SMEs and, if applicable, the formulation of related investment policies and strategies. This study analyses if and to what extent there are weaknesses and financing gaps for SME access to finance in Serbia. It does so through an overview of the availability of different types of finance and an assessment of the effectiveness of existing government schemes for improving SME access to finance. This report identifies market weaknesses and suboptimal investment situations for each type of financial product available for SME financing, and offers an estimate of the financing gaps for the different SME categories (the tables below). Based on these findings, the report offers possible solutions to these problems, including financial instruments described in the proposed investment strategy (PIS).

## Supply, demand and financing gaps

The research carried out for this market study – which included an SME telephone survey (2,000 valid SME responses out of the 96,764 SME sample canvassed), stakeholder interviews (banks, IFIs, government institutions, etc.) and literature/data review – has shown that a reliable quantification of the estimated supply (and, consequently, demand and financing gaps) of financial products for SMEs in Serbia has only been possible for loans and the equity market in Serbia, as summarised in the table below:

Table 1. An estimate of the annual supply of financial products in Serbia in 2017

| Financial product | Total (EUR m) | Micro (EUR m) | Small and medium enterprises (EUR m) |
|---|---|---|---|
| Microfinance | n/a | n/a | n/a |
| Short term loans | 785-868 | 196 – 217 | 589 – 651 |
| Medium/Long term loans | 2,354-2,602 | 589 – 651 | 1,765 – 1,951 |
| Leasing | Exact SME data not available | Exact SME data not available | Exact SME data not available |
| Guarantees | Exact SME data not available | Exact SME data not available | Exact SME data not available |
| Equity market/Technology transfer funds | 35-40 | n/a | n/a |
| **Total** | **3,174-3,510** | | |

(Source: PwC analysis 2016)

The available information, data and/or the responses given by the SMEs in the survey have all shown a fairly shallow financial market in terms of financial instruments choice. Of particular concern is the lack of publicly available data for SME guarantees extended by the banks, which has made it impossible to provide quantitative estimates for this product. Qualitative descriptions of the supply of guarantee products have been offered in the Chapter 7, which gives an overview of financial products supply, with an important finding that bank guarantees (the predominant guarantee type) offered to SME in Serbia are mainly personal guarantees, with no portfolio guarantees developed.

With regard to loans, the analysis has shown the following financing gaps for micro enterprises and for small and medium SMEs, respectively.

**Table 2. Potential financing gaps per financial product for micro enterprises in 2017**

| | Potential demand (EUR m) | Estimated supply (EUR m) | Financing gap (EUR m) |
|---|---|---|---|
| Short-term loans, bank overdrafts and credit lines | 429 - 474 | 196 - 217 | 233 - 257 |
| Medium and long-term loans | 1,293 – 1,430 | 589 - 651 | 705 - 779 |
| **Total** | **1,722 – 1,904** | **785 - 868** | **938 - 1,036** |

(Source: PwC analysis, 2016)

Access to mainstream banking products tends to be limited for micro companies, as banks require from them a good credit history, relatively large turnover and low levels of debt, and sufficient equity. Micro enterprises that cannot fulfil these requirements seek financing from informal sources, e.g. family and friends. In addition, they may also experience problems with defining their financing needs and making a clear business plan for the future, which may be due to the lack of managerial skills amongst the entrepreneurs. It also reinforces the need for improved institutional support when micro enterprises develop after three or four years of operations, as this growth entails new financing problems. In order to cope with these challenges, micro companies will need support to define the most appropriate financing sources and products for their development.

On the other hand, the results of the gap analysis for small and medium enterprises may suggest that financial institutions in Serbia cover the demand for loan products from small and medium enterprises, since the supply of both medium/long-term loans and short-term loans will exceed the estimated demand in 2017. However, an estimated lack of gaps can be misleading. The banking system in Serbia focuses on small and medium enterprises because they have assets and so are deemed to be more bankable than micro enterprises. Additionally, a lack of demand may manifest itself because SMEs generally feel discouraged from seeking financing, as they are aware that they cannot meet bank risk criteria or they have a lack of knowledge about market opportunities. It can, therefore, be concluded that there is *hidden demand* in the market.

The SMEs complete dependency on bank financing makes the financial market in Serbia sensitive to external shocks related to the banking environment, as has been experienced in the EU countries. This dominance of the banking system has to be considered an important market failure in the absence of other, alternative, feasible and competing sources of finance in Serbia.

The equity market is at an early stage of development in Serbia. There is very little publicly available information on the supply of equity. The market is too new (and still too shallow) to establish if a sustainable trend in the supply of equity can be defined. The research done for this study has shown that the estimation of the total value of the equity market supply in Serbia is around EUR 35-40m in 2017, including all the existing venture capital, private equity funds, accelerators and TT, but excluding mezzanine financing (not used in Serbia). Out of the total supply, it is estimated that EUR approximately 7m will be available within the program for cooperation and technology transfer, funded by the Innovation Fund. Additional funds are expected in 2017 by the Innovation Fund, however, exact amounts are not known yet. It is estimated that the overall supply of equity market in 2017 will be similar to that in 2016, and significant growth is not expected in the near future, with the limited number of existing market players. Separate data for micro and SMEs is not available.

The results of the survey show no demand for equity financing and consequently no gap. However, care should be taken when interpreting the results. Lack of demand was probably due to a lack of knowledge and awareness about the equity market on the part of micro enterprises and SMEs. Additionally, the high level of retained earnings may be a sign for equity financing need of both micro and SMEs.

### Conclusions

A total lack of, or relatively limited, supply of some financing products in Serbia, such as microfinance and equity, or the lack of exact data of a specific product for SMEs (e.g. guarantees) makes it extremely difficult, and indeed in most cases impossible, to provide a reliable, quantifiable estimate of supply. The absence of supply also implies a very low awareness of these products on the demand side. Consequently, the demand (or lack thereof) for these specific products expressed by the SMEs in the survey should not necessarily be considered realistic, since the SME respondents have had no relevant experience of these products so far. The analysis has, therefore, identified several market failures with respect to the awareness and availability of financial instruments in Serbia, as indicated earlier on in this study.

To alleviate market failures and suboptimal investment situations – especially with regard to microfinance, portfolio guarantees, and equity financing for SMEs – technical assistance and business support is a needed feature for any successful investment strategy for Serbia.

There are three immediately implementable financing tools that may be set up to expand Serbian SME's access to finance (two financial instruments and a Technical Assistance support facility which would consist in grants):

- **An Accelerator Facility,** which would invest into the share capital of final recipients, combined with technical assistance for mentorship and product development expenses. The facility would provide equity and quasi-equity financing to innovative SMEs at the early stage of their development. This facility could also be used to provide finance in support of SMEs commercialising their products or services.
- **An SME portfolio guarantee instrument** with reduced or no guarantee fee under *de minimis* aid, combined with interest rate subsidies also under *de minimis* aid for the same loan. The fund would

provide the banks in Serbia with guarantee coverage at the SME loan portfolio level, possibly with particular focus on micro-enterprises. This FI would be provided to banks lending to SMEs as financial intermediaries, and not to individual SME borrowers, in order to alleviate the existing credit constraints for SMEs on the Serbian financial market.

- **A Support facility for SMEs,** which would provide technical assistance, grants, disseminate business knowledge, and provide advisory services to SMEs, including micro-enterprises. The key purpose of the facility would be to build on the capacity of existing local networks (e.g. Chamber of Commerce, Regional Development Agencies and similar) in order to provide SMEs with a comprehensive overview of all the existing financing opportunities and to help tailoring their individual financing strategies. This TA facility could also be provided to commercial banks that were not dealing with micro enterprises in the past to raise their awareness on the importance of micro enterprises in Serbia and their needs.

In addition to these two FIs and this TA support facility, two specific FIs were deemed relevant for addressing the SME needs in the field of microfinance:

- **A microfinance capital enhancement (equity) fund** could be developed to support any new non-banking microfinance institutions; and
- **A microfinance First-Loss Portfolio Guarantee (FLPG) fund** would provide micro-loans to already established SMEs and traditional entrepreneurs currently cut off from credit supply (or any financing to support their entrepreneurial activity).

The two microfinance-related FIs require the establishment of the enabling regulatory framework for microfinance provision in Serbia. Given that such legislation is not anticipated for 2017, the launch of the microfinance capital enhancement (equity) fund until is suggested to be postponed until the enabling law comes into force. As for the microfinance First-Loss Portfolio Guarantee (FLPG) fund, the objectives of this FI could be partly fulfilled by the SME portfolio guarantee instrument in the immediate term and the need for a dedicated microfinance FLPG could be reassessed when the enabling regulatory framework is in place.

Regarding the governance options, it is recommended that a modular approach is followed. For the first years of implementation of the FIs, their management could be entrusted to an experienced Fund og Fund manager for example the EIF. It would enable faster setup and implementation of the financial instruments, whilst providing the MoE with top quality expertise and extensive experience of FIs in the SME sector. However, the role of EIF in such a structure would be subject to further discussion with EIF as a next phase in the development of the proposed instruments. Meanwhile, capacities of local institutions for future management should be built over 3-4 year period. Following careful design of the component, the support facility for SMEs could be managed outright by the local entity.

For the implementation of the proposed FIs, the recommended governance structure is a Fund of Funds.

# 4 Introduction

Improving SME access to finance is one of the main priorities of the EU. Support to SMEs through structural funds was provided via Financial Instruments (FIs), in addition to grant finance, throughout the 2007-2013 programming period. The 2014-2020 programming period foresaw a greater use of FIs for all Thematic Objectives (TO) and across all sectors with the objective of reducing the reliance on grant-finance in favour of revolving finance by means of financial instruments. An additional goal is to disburse the funds via financial intermediaries in order to improve delivery and leverage volumes by private-sector participation.

Financial intermediaries (which include banks and other financial institutions) in Serbia are currently limited by solvency constraints and the need to apply strict risk management standards. This exemplifies one of the reasons why SMEs face difficulties in accessing credit. An ex-ante assessment is, therefore, required by the current EU regulations to assess the conditions and existing barriers to finance currently faced by SMEs with a view to identifying if and where the implementation of FIs is likely to produce the biggest positive impact.

This study provides an analysis of the existing demand for and supply of finance to SMEs in the Republic of Serbia. It examines if there are any resultant financing gaps in different market segments, and proposes high-level recommendations to reduce these gaps and alleviate the weaknesses, based on the analysis of identified market failures, suboptimal investment situations, and SMEs' financing needs.

## 4.1 Objectives and the scope of the study

This ex-ante assessment analyses the existing supply of and demand for financing from SMEs in the Republic of Serbia. It aims at identifying and quantifying the market failures and/or suboptimal investment situations, as well as investment needs, for SMEs in the country[1].

This study results from the need expressed by the Delegation of the European Union to the Republic of Serbia (EUD) and the Ministry of Economy of the Republic of Serbia (MoE) to assess the potential future use of Financial Instruments (FIs) for SMEs in the 2014 – 2020 programming period in Serbia. The study will support the MoE in preparing an investment strategy for the design and implementation of FIs that will facilitate SMEs access to finance in Serbia. The purpose of the study is thus to assess the opportunities to implement FIs in Serbia to support its SME sector and, if applicable, help the EU and Serbian authorities in developing and deploying investment policies and strategies to achieve these objectives.

In line with the ex-ante methodological guidelines issued by the European Commission in April 2014, the report seeks to assess:

- On the demand side, the difficulties of SMEs in accessing different types of financing
- On the supply side, the currently available financing in the market, both from public and private sources

[1]In that framework, the present ex-ante report is aligned with the European Court of Auditors (ECA)'s recommendation to base future ERDF operations on a "*sound assessment of the financing gap*", including its quantification.

- Based on the supply and demand analysis, an estimation of any financing gaps and resulting market failures, along with an indication of sub-optimal investment situations in order to assess if there is a case for FIs implementation

### Methodology

This ex-ante assessment employs the European Commission methodological guidelines "Access to Finance Market Assessment" from April 2014, while taking into consideration the country specifics for Serbia.

From the methodological standpoint, the report covers the following main aspects:

- Demand-side analysis through the use of an SME survey which sought to identify the difficulties faced by SMEs in obtaining different types of financing, and a review of strategic documents and statistics
- Supply-side analysis through stakeholder interviews, available supply data analysis and literature review to build an overview of the financial sector and the available financing on the market
- Based on the analysis of supply and demand, an estimation of the gaps and resulting market failures is provided along with an indication of sub-optimal investment situations in order to identify the needs for the use of FIs

Further details on the applied methodology are covered in Chapter 7.

The SME sector incorporates micro, small and medium enterprises. In this assessment, the classification of legal entities was done according to the Serbian Accounting Law (2013). It defines an SME as an enterprise, which fulfils at least two out of three conditions, and offers the following categorisation of micro, small and medium-sized enterprises.

- Micro-sized companies: include entrepreneurs who are self-employed private individuals:
  - Up to 10 employees
  - Up to EUR 700k annual turnover
  - Up to EUR 350k total assets
- Small-sized companies:
  - Up to 50 employees
  - Up to EUR 8.8m annual turnover
  - Up to EUR 4.4m total assets
- Medium-sized companies:
  - Up to 250 employees
  - Up to EUR 35m annual turnover
  - Up to EUR 17.5m total assets

It should be noted that many banks in Serbia classify SMEs differently. Small SMEs are usually up to EUR 2m annual turnover, and medium SMEs are from EUR 2m up to EUR 50m annual turnover[2].

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[2] PwC internal database, bank interviews

## 4.2 Structure of the report

The report is organised in such a way as to bridge the recent trends in SME finance in Serbia with any foreseeable developments in this regard to facilitate conclusions with respect to any identified financing gaps. The report begins with the presentation of the market environment in the Republic of Serbia (Chapter 5), including the description of the macroeconomic context, a detailed overview of the SMEs sector, and a short description of the institutional and legal framework. Then, the existing SME financing instruments available on the Serbian market are described, and an overview of government support schemes and the historical use of Structural Funds given. Serbian policy priorities for SME financing over the coming years are given in Chapter 6.

In Chapter 7, the supply of SME finance is analysed for each category of the financial product. The analysis then focuses on the demand side, according to each SME size. The size of SMEs has been defined according to their number of employees by taking into account the Serbian classification. Adhering to the Serbian categorisation is particularly relevant, given the predominance of micro enterprises in the Serbian economy. The categorisation by company size is useful in distinguishing the specific problems and related needs within the SME population in Serbia. Following the analysis of the supply of and demand for funds from SMEs, potential financing gaps are identified and quantified for different SME categories. Chapter 8 offers recommendations for the potential investment strategy (PIS), whilst Chapter 11 provides further conclusions and recommendations.

# 5 Market environment

## 5.1 Characteristics of the economy and demographics

This chapter of the study contains an overview of the economic context in Serbia. As recommended in each volume of ex-ante assessment methodology for financial instruments, gathering data on macroeconomic indicators, such as Gross Domestic Product (GDP) growth or exports/imports, is an essential step before determining the existence of market failures and suboptimal investment situations.

In 2014, the Serbian economy suffered from low economic growth, high external and public debt, and an unsustainable fiscal position. Low investment levels slowed down the economic development and implementation of structural reforms. Despite a reduction of the foreign trade and current account deficits, there was still a balance-of-payments imbalance.

In 2014 and 2015, a set of structural reforms and fiscal consolidation measures were brought in to improve the business environment in Serbia and to ensure the stability of public finances. The implementation of these reforms resulted in positive macroeconomic trends in 2015, such as an increase in economic growth, increase in foreign direct investment, and reduction of trade deficit. However, the implementation of the fiscal measures have also resulted in job losses in the public sector, and which – with further substantial layoffs planned in the near future – will have a significant impact on the labour market and the SME segment overall in 2017 and possibly beyond.

### 5.1.1 Key economic indicators

**2016 has seen growth in GDP as a result of improved manufacturing performance and growth in exports.** The financial crisis caused a decline of 3% in Serbia's GDP growth rate in 2009. Since 2009, the economy has been recovering and a further positive trend in the upcoming years is forecast. In 2014, Serbia faced a decline of 1.8% in GDP due to disastrous floods that affected the entire economy. Economic growth in 2015 reached 0.7% (Serbia suffered from a decline in agricultural output in 2014 because of the drought). Positive trends in 2016 have been driven by improved industrial and construction performance and stronger net exports. The National Bank of Serbia has revised its GDP growth forecast for 2016, from 1.8% to 2.5%, and this is due to the monetary policy relaxation, an improved business climate, and an increase in external demand.

**Implementation of structural reforms and improvement of the business and investment environment has led to a greater FDI inflow.** Despite a lack of privatisation receipts in 2015, the share of FDI as a percentage of GDP is greater in 2015 (5.5%), compared to 2014 (3.7%). Net FDI inflow exceeded current account deficit and was widely dispersed across manufacturing. FDIs inflow is continuing in 2016 and it is expected to be at the level reached in 2015 (1.8 bln EUR), with still a high diversification and full coverage of CAD.

**An increase in volume and diversification of exports is helping lower external imbalances.** In 2016, the exports-to-imports ratio stood at 76.4% (12-month moving average), with a tendency to rise further. Higher exports are mainly due to agricultural and manufacturing products. There is still room to boost exports, as only 4.4% of companies are exporting at the moment.

**Significant fiscal adjustments in 2015, which continue this year, have helped stabilise public debt-to-GDP ratio, but have had a negative impact on overall employment.** In order to ensure sustainability of public finances, the government introduced a set of fiscal consolidation measures. Key instruments of fiscal consolidation relate mainly to public expenditure (lowering salaries and pensions in the public sector). Total wages decreased by 2.1% and pensions by 5.2%[3] in 2015. The deficit-to-GDP ratio in 2015 (3.8%) was 2.8 percentage points lower compared to 2014. Further fiscal adjustment is continuing in 2016 and will be driven entirely by a better revenue collection (particularly taxes on consumption) and macroeconomic performance, while current expenditure is kept in check by the IMF programme.

One of the key fiscal measures in 2015 was the rationalisation of the public sector in terms of lowering salaries and pensions, but also cost optimisation through layoffs of excess labour force. The government announced that the year 2016 will be a year of layoffs, based on the agreement with the IMF[4]. Specific austerity measures are still not clearly defined by the government, but it is assumed that layoffs will most affect public companies, such as the railways, telecommunications, a major power supply company, and employees in local municipalities. It is inevitable that the anticipated rationalisation and layoffs will have a negative impact on the general labour market (the current official unemployment rate is 19%[5]), probably also affecting the SME and entrepreneurial segments. Many laid-off people (especially those from the IT or telecommunications sectors) are expected to move into the service industry and provide outsourcing services to large companies. The private sector, however, which includes SMEs, will not be able to generate the jobs needed for the rest of the unemployed from the public sector, and could cause political instability in the country. This is why current state programmes also focus on promoting employment in the private sector, especially SMEs. A detailed overview of these state programmes can be found in Annex 7. Paradoxically, therefore, the SME and entrepreneurship/innovation spheres of the Serbian economy could possibly grow and develop on the back of the public sector restructuring and layoffs, if only well-targeted job creation and entrepreneurship promoting programmes and financial support are in place at the right time to make an impact.

**Low interest rates support the recovery of lending.** Monetary policy relaxation was the main driver of lower interest rates for Serbian Dinar (RSD) lending to households and businesses. Monetary easing by the European Central Bank, as well as a drop in interest rates on savings, contributed to the fall in EUR-indexed lending rates. Further recovery of domestic credit provision is expected in 2016 primarily because of previous NBS monetary policy easing, the resulting fall in lending rates, increasing competition among banks, and growing demand for loans[6]. The RSD has been stable vs the EUR over the last five years. Its low volatility is a result of a favourable risk perception, restrictive fiscal policy, and a better external position.

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[3] National Bank of Serbia (2016), Key macroeconomic indicators. Available at: http://nbs.rs/internet/english/80/index.html

[4] Government of Republic of Serbia (2015), Fiscal Strategy for 2016, available at: http://www.srbija.gov.rs/vesti/dokumenti_sekcija.php?id=45678

[5] Statistical Office of the Republic of Serbia (2016), Latest indicators, http://webrzs.stat.gov.rs/WebSite/Public/PageView.aspx?pKey=2

[6] National Bank of Serbia (September 2016), Macroeconomic developments in Serbia. Available at: http://www.nbs.rs/export/sites/default/internet/english/18/18_3/presentation_invest.pdf

**Structural reforms in 2015 have had a positive impact on business conditions in Serbia.** According to the World Bank's Doing Business report for 2016[7], Serbia has improved its ranking by nine places from 2015 in the ease-of-doing-business category (59 out of 189 in 2016). According to the World Economic Forum Competitiveness report 2015-2016[8], Serbia was more competitive than Albania in 2014 and Bosnia in 2015, and is currently ranked 94th out of 140 in the Global Competitiveness Index. *Access to finance was rated as the most problematic factor in doing business in Serbia*, followed by inefficient government bureaucracy.

### 5.1.2 Credit rating

In 2016, Moody's improved Serbia's outlook from stable to positive B1[9]. Fitch Ratings increased the Serbian credit rating for long-term borrowing in local and foreign currency from B+ to BB-, with a stable outlook for further improvement[10]. This stable outlook is based on improved macroeconomic performance, political stability, banking sector stability and full government commitment to ongoing reforms, defined by IMF.

According to Fitch Ratings, successfully implemented fiscal consolidation was a major contributor to the improved credit rating, thanks to which the fiscal deficit in 2016 will decrease to 3% and the share of public debt in GDP will start to decrease from 2017 onwards.

Bearing in mind favourable developments since the beginning of the year and accelerating growth of GDP, Fitch Ratings revised its general projection of GDP growth in 2016 from 1.7% to 2.4%, major GDP drivers being investments and net export.

Other factors, which contributed to the improvement of its credit rating, are the entry negotiations with the EU, increased efficiency of state administration and quality of regulatory framework.

## 5.2 SME characteristics and environment

### 5.2.1 Overview of the SME market in Serbia

In 2014, there were more than 320,000 small and medium-sized enterprises (SMEs) in Serbia, which indicates the high importance of this segment for the Serbian economy.

The number of SMEs has been increasing over the past few years (Table 3). The increase was particularly pronounced for micro companies between 2012 and 2013 (3.3%), entrepreneurs between 2013 and 2014 (4.3%), as well as total SMEs in general (2.8%). On the other hand, the number of small and medium sized companies decreased over the same period. This can be explained by three trends, all related to the global crisis. First, larger SMEs may have downsized into micro enterprises, which is true

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[7] World Bank Group (2015), Doing Business 2016. Available at: http://www.doingbusiness.org/reports/global-reports/doing-business-2016

[8] World Economic Forum (2015), The Global Competitiveness report 2015-2016. Available at: http://www3.weforum.org/docs/gcr/2015-2016/Global_Competitiveness_Report_2015-2016.pdf

[9] National Bank of Serbia (2016), Macroeconomic developments in Serbia. Available at: http://www.nbs.rs/export/sites/default/internet/english/18/18_3/presentation_invest.pdf

[10] National Bank of Serbia, available at: http://www.nbs.rs/internet/latinica/scripts/showContent.html?id=9803&konverzija=no

for both small and medium sized companies. Second, people made redundant as a result of the crisis may have decided to create their own business instead of finding a job during this difficult period. Third, the use of grants made it easier for the unemployed to start their own company. In 2014, the SME sector recorded a decline of value added by 19.8% and employment by 19%[11].

[11] Ministry of Economy (2015), Report on small and medium-sized enterprises and entrepreneurship in 2014

Table 3. SMEs in Serbia, basic data for 2014

| Market segments | Number of enterprises | Share | Number of people, working | Share | Revenue (EUR thousands) | Share | GVA (EUR thousands) | Share |
|---|---|---|---|---|---|---|---|---|
| Entrepreneurs | 231,616 | 71.3% | 207,748 | 17.7% | 8,171,475 | 10.5% | 2,012,523 | 12.8% |
| Micro (0-9) | 81,327 | 25.0% | 147,641 | 12.6% | 11,623,131 | 14.9% | 1,529,521 | 9,8% |
| Small (10-49) | 9,198 | 2.8% | 185,206 | 15.8% | 14,729,929 | 18.8% | 2,381,148 | 15,2% |
| Medium (50-249) | 2,131 | 0.7% | 220,944 | 18.8% | 16,618,604 | 21.3% | 2,853,537 | 18,2% |
| **SME Total** | **324,272** | **99.8%** | **761,539** | **64.8%** | **51,143,138** | **65.4%** | **8,776,729** | **100%** |
| Large (250+) | 494 | 0.2% | 413,408 | 35.2% | 27,013,546 | 34.6% | 6,888,463 | 44% |
| **Total** | **324,766** | **100%** | **1,174,947** | **100%** | **78,156,684** | **100%** | **15,665,183** | **100%** |

(Source: Ministry of Economy (2015), Report on small and medium-sized enterprises and entrepreneurship in 2014)

Important sectors for Serbian SMEs include the wholesale and retail sales sectors, which contributed 25.7% of the total value added in 2014. The manufacturing sector accounted for 24.8% of the value added, followed by the service sector (23.6%). The wholesale, retail sale and manufacturing sectors include 45.6% of all SMEs, employ 56.3% of the employed, generate 65.9% of the total revenue (43.3% and 22.6%), and generate 50.4% of the total Gross Value Added (GVA) of the SME sector[12]. GVA is defined as the difference between the value of final products in base prices (values of goods and services produced which were created as a result of production process) and intermediate consumption in purchasing prices (the value of all goods and services invested in the production process in a specific calculation period).

The last economic crisis had a negative influence on the development of the SME sector. Although the number of SMEs went up by 20,823 between 2008 and 2014, their employment and value added rates fell by 19% and 15%, respectively.

In 2014, the monthly average of newly established business entities was 3,383 (80% entrepreneurs and 20% enterprises), which is less favourable than the average in 2013, which was 3,621. At the end of 2014, there were 324,766 enterprises in Serbia, which is 2.3% more than in 2013. The greatest dynamics of establishing and closing business entities (entrepreneurs and enterprises) in 2014 was present in the following sectors: wholesale and retail sale (11,422 set up and 9,142 closed), accommodation and food services (5,735 set up and 4,702 closed) and manufacturing (5,343 set up and 4,702 closed)[13].

Unemployment in the non-financial sector continued to grow in 2014, compared to 2013. The Serbian non-financial sector employed 1.2 million workers in 2014, of which 64.8% in the SME sector. In 2014, micro enterprises employed the largest share of SME workers (46.4%), small enterprises 24.6%, and medium size enterprises 29% of all workers.

In 2014, more than 80% of SMEs' foreign trade was generated by only two sectors: manufacturing and wholesale and retail[14].

## 5.3 Existing Financial instruments for SMEs

The analysis of supply and demand highlights the dominant position of the banking sector in the country as the source of SME financing. On the other hand, the Serbian government has named 2016 as the Year of Entrepreneurship and rolled out 33 programmes with the goal of strengthening entrepreneurial skills in Serbia. Microfinance or equity FIs have yet to be implemented. In recent years, financing tools in the form of grants have been widely used, including mainly direct grants and interest rate subsidies. This chapter outlines the existing FIs and grant schemes as well as the historical use of structural funds in Serbia.

### 5.3.1 Institutional structure

The institutional framework which provides support to SMEs and entrepreneurs in Serbia consists of:

- The Development Fund of Serbia

[12] Ministry of Economy (2015), Report on small and medium-sized enterprises and entrepreneurship in 2014

[13] Ibid.

[14] Ibid.

- The Agency for Export Insurance and Financing (AOFI)
- The Development Agency of Serbia
- The Ministry of Economy

A high degree of support is also provided by:

- The National Agency for Employment
- The Innovation Fund

Additionally, many international and European organisations and institutions have an important role in implementing a number of projects aimed at strengthening SMEs in Serbia.

#### *5.3.1.1 Public sector bodies*

The National Bank of Serbia

The National Bank of Serbia (NBS) was established in 1884. In line with other central banks, the NBS role is to achieve and maintain price stability, issue banknotes, establish and enforce monetary policy, and maintain the stability of the financial system in Serbia. The NBS also carries out the supervision of: bank operations, insurance companies, pension fund management companies, financial leasing operations and supervises the provision of payment services and the issuance of electronic money.

All activities of the NBS are carried out under the governing laws. The Law on the National Bank of Serbia further stipulates that, in carrying out its responsibilities, the NBS acts as an autonomous and independent institution.

The existing regulatory framework identifies commercial banks as a major provider of credit in Serbia.

The Development Fund of Serbia

The Development Fund of Serbia is one of the key institutions implementing government programmes for financing SMEs in Serbia. The Fund is a key partner of the Year of Entrepreneurship 2016. More details about the programme can be found in Chapter 5.4.1. The main goal of the fund is to encourage economic and regional development, improve competitiveness of the domestic economy, and encourage the development of the crafts and service sector, employment, and the development of capital markets. The Fund provides various types of loans and guarantees to SMEs and micro companies.[15]

Over the last five years, the Development Fund of Serbia extended around EUR 280m of short-term and long-term loans to SMEs, and an additional EUR 110m loans for the development of municipalities.[16]

The Serbian Export Credit and Insurance Agency (AOFI)

The Serbian Export Credit and Insurance Agency (AOFI), established in 2005 for the purpose of export promotion and development of foreign economic relations, is the official export credit agency of the Republic of Serbia. The AOFI provides export credit insurance and financing to Serbian export-oriented

[15] Information about the Development Fund of Serbia, available at: http://www.fondzarazvoj.gov.rs/

[16] Ministry of Economy (2015), Strategija za podrsku razvoja malih i srednjih preduzeca, preduzetnistva i konkurentnosti za period od 2015. do 2020. Godine

companies. This includes short-term lending at favourable conditions (low interest rates, fast approval process, flexible collateral requirements), factoring, insurance of foreign receivables, and issuance of guarantees for local companies, including SMEs. In general, the AOFI aims at creating a favourable business environment for exporting companies and improving Serbia's exports structure. The AOFI cooperates with various national and international institutions and organisations.[17]

Until 2015, the AOFI had extended EUR 161m short-term loans for exporting companies, EUR 13.09m worth of guarantees, insured contracts with a total value of EUR 106.47m, and purchased EUR 115.5m of receivables through factoring.[18]

The Serbian Development Agency

The Serbian Development Agency (RAS), a state agency, offers a wide range of services in support of foreign direct investments and export promotion, as well as the implementation of projects aimed at improving competitiveness and economic and regional development in Serbia.

The RAS is a newly-established agency, which took over the business of the former Serbian Investment and Export Promotion Agency (SIEPA) and the National Agency for Regional Development (NARD). One of RAS's key activities includes supporting the development of SMEs and entrepreneurs through various programmes[19]:

- **A standardised set of non-financial services for SMEs**: provision of information, trainings, advisory services, mentoring and promotions. Standard services are implemented through regional development agencies.
- **The Year of Entrepreneurship 2016** (For more details please refer to Chapter 5.4.1).
- **The Enterprise Europe Network (EEN)**: a project launched by the European Commission, in 2008, to support the development of SMEs and entrepreneurs. From 2014 to 2020, the EEN will be implemented within the COSME, which supports SMEs in the following areas: facilitating access to finance, supporting internationalisation and access to markets, creating an environment favourable to competitiveness, and encouraging an entrepreneurial culture.
- **Programme supporting development of business incubators**: preparation of a manual for the establishment and development of business incubators, organisation of events, strengthening of human capacity of business incubators, etc.
- **Programme supporting development of innovative clusters**: financing development and execution of joint innovative projects related to the development of new products, processes or services; financing development and testing of prototypes and of new product design and packaging; the implementation and testing of new production processes, financing trade show participation of cluster organisations
- **A non-financial programme supporting exporting companies**: access to a supplier database; information about ISO and other standards; participation in international fairs, and other.

[17] Information about the AOFI, available at: http://www.aofi.rs/o-nama/

[18] Ministry of Economy (2015), Strategija za podrsku razvoja malih i srednjih preduzeca, preduzetnistva i konkurentnosti za period od 2015. do 2020. Godine, available at: http://www.privreda.gov.rs/wp-content/uploads/2015/06/Strategija-mala-i-srednja-preduzeca.pdf

[19] Information about the RAS programmes, available at: http://ras.gov.rs/sr/razvoj-preduzetnistva/projekti#

#### *5.3.1.2 International Financial Institutions*

The European Investment Bank (EIB)

Since 2002, the European Investment Bank (EIB) has approved five Apex loans for the Republic of Serbia for SMEs, midcaps, priority projects, entrepreneurs and local governments, totalling EUR 1,065m (of which EUR 565m has been disbursed). The EIB lending covers the major sectors of the Serbian economy, including infrastructure, energy, transport, services, industrial and education, mainly through local financial institutions. The primary focus is on SMEs, boosting growth and job creation.

The EIB approved for the Republic of Serbia a new, fifth loan for SMEs and other priorities in the amount of EUR 500m, mainly for infrastructure projects as well as investments of local authorities, particularly in environmental protection. The first tranche amounted to EUR 150m. The second tranche of the appex loan, amounting to EUR 150m (out of the total EUR 500m), will be available in March 2017, which could be used to cover some of the gaps identified in Section 7.3 of the report.

The EIB has also signed two loans totalling EUR 80m with Société Generale Bank Serbia (SGRS) to support the SME sector.[20]

The EIB is also involved in the leasing sector, providing loan funding to local leasing companies. Additionally, the EIB also invests into other support facilities through the Western Balkan Enterprise Development and Innovation Facility (WB EDIF) programme (See Chapter 5.4.2).

The European Investment Fund (EIF)

The European Investment Fund's (EIF) aim is to support European SMEs by improving their access to finance. Its primary role is designing, promoting and implementing equity and debt financial instruments. Support by the EIF is provided via a wide range of selected financial intermediaries all over Europe, following the EU objectives to support entrepreneurship, growth, innovation, R&D and employment. The EIF is part of the EIB Group and its tripartite shareholding structure includes the EIB (63.7%), the EU represented by the EC (24.3%), and 26 financial institutions from 14 European Union Member States and Turkey (12%).

The main focus of the EIF in Serbia is to grow SME investments and youth employment. In the area of guarantees and securities, the EIF actively supports Serbian SMEs through the WB EDIF. More details on the WB EDIF can be found in Chapter 5.4.2.[21] It provides a guarantee facility for the EUR 30m loan portfolio of UniCredit bank in Serbia. A further call at the Regional level for a similar guarantee for aggregate EUR 17.5m has been launched in March 2016, although the allocation to Serbia is still not quantified. At the end of 2016, EIF signed several new agreements with local commercial banks, to provide financing to SMEs through different programmes. These facilities will eventually have an impact on the total supply of funds on the market on a longer term, as the results are not immediate.

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[20] Information about the EIB credit lines, available at: http://www.eib.org/projects/loans/regions/enlargement/rs.htm?start=2010&end=2016&sector=

[21] Information about the EIF programmes, available at: http://www.eif.org/what_we_do/resources/wbedif/index.htm

**Table 4. Overview of new EIF agreements in Serbia**

| Business line | Deal name | Resources | Signature date | EIF committed amount | Leveraged amount | Availability period | Expected number of SMEs |
|---|---|---|---|---|---|---|---|
| **GUARANTEES** | Banca Intesa ad Beograd - COSME LGF (SMEG 2014) | COSME | 06/12/2016 | 1.8 | 60.0 | 08/12/16-07/12/18 | 3,000 |
| **GUARANTEES** | ProCredit Bank Serbia - WBGF II | WB GF II | 20/12/2016 | 3.5 | 25.0 | 01/02/17-01/02/19 | 138 |
| **GUARANTEES** | ProCredit Umbrella - ProCredit Holding - IFSMEG 2015 | InnovFin SMEG | 21/01/2016 | 5.0 | 10.0 | 01/02/16-01/02/19 | 30 |
| **GUARANTEES** | ProCredit Umbrella - Serbia - IFSMEG 2015 | InnovFin SMEG | 21/01/2016 | 30.0 | 60.0 | 01/02/16-01/02/19 | 181 |
| **GUARANTEES** | Unicredit Umbrella - Serbia - IFSMEG 2016 | InnovFin SMEG | 28/10/2016 | 15.0 | 30.0 | 28/10/16-27/10/18 | 97 |
| **MICROFINANCE** | Erste Bank Novi Sad - EaSI MF - 2016 | EaSI | 18/11/2016 | 0.66 | 4.7 | 18/11/16-17/11/21 | 780 |
| | | | | **55.96** | **189.7** | | 4,226 |

Source: EIF Note: Leveraged amount refers to the portfolio to be built up by the banks

The European Bank for Reconstruction and Development (EBRD)

Serbia started cooperating with the EBRD in 2001. The European Bank for Reconstruction and Development (EBRD) helps Serbia in expanding the role of the private sector and promoting good corporate governance. Support for the development of micro, small and medium-sized enterprises is one of the key objectives of the EBRD. To achieve it, the Bank extends financing to SMEs through a range of intermediaries in its countries of operations. These intermediaries include banks in which the EBRD has an equity stake or with which it has signed a loan or investment. The EBRD has a special focus on the agribusiness value chain, privatisation processes, and energy efficiency.

The EBRD has invested in more than 200 projects in Serbia with a cumulative investment of EUR 4.379bn. 36.9% of its cumulative business volume to date is in infrastructure, 29.0% in the financial sector, 21.4% in industry, commerce and agribusiness, and 12.7% in energy. Some of the current projects for SMEs include: a credit line through Komercijalna Banka to provide continued liquidity to the SME loan market and promote private sector investment (EUR 30m), Intesa Leasing Serbia II to support SMEs by increasing the availability of long-term lease financing (EUR 15m), and a loan through ProCredit Bank for on-lending to small agricultural producers and SMEs (EUR 60m).[22]

The Kreditanstalt für Wiederaufbau (KfW)

The KfW (a German development bank) supports economic and social progress in developing and transition countries. It focuses on poverty reduction and economic development, good governance, education and health care, and climate and environment protection. One of the KfW priorities in Serbia is to support the country in meeting its EU targets. The KfW also promotes sustainable economic development by extending credit lines to micro, small and medium enterprises and municipalities. One of the projects is a Credit Guarantee Fund for the promotion of SMEs. This fund provides guarantees for refinancing loans from international commercial banks to Serbian partner banks that are active in the SME sector. The project's target is to mobilise capital market funds for selected local banks to ensure SMEs' continued access to credit.[23]

## 5.4 Governmental support schemes

### 5.4.1 National support schemes

The Year of Entrepreneurship 2016

The Year of Entrepreneurship 2016[24] is a portfolio of various government programmes which provide financial and non-financial support to the long-term development of entrepreneurs. It aims to help entrepreneurs build their skills and develop start-ups and SMEs at large. The programme will last from March to December 2016, with the total available funds amounting to EUR 131.37m[25]. Its portfolio consists of 33 projects split into six groups: financial support to start business operations (five projects), non-financial support to start business operations (three projects), business improvement (ten

[22] Information about the EBRD programmes, available at: http://www.ebrd.com/serbia.html

[23]Information about the KfW programmes, available at: https://www.kfw-entwicklungsbank.de/International-financing/KfW-Development-Bank/Local-presence/Europe/Serbia/

[24] Information about the Year of Entrepreneurship 2016, available at: http://www.godinapreduzetnistva.rs/Naslovna.aspx/

[25] An official NBS average middle exchange rate between RSD and EUR was used throughout the whole report, when RSD figures were available: For year 2016- 122.9 (period Jan-June 2016); year 2015- 120.7, year 2014- 117.3.

projects), investments (four projects), export (five projects) and innovations (six projects). The programme is implemented through government institutions. An overview of the key programmes of the Year of entrepreneurship is outlined below:

- The programme for start-ups

This programme is funded by the Ministry of Economy, the Development Fund of Serbia, the Development Agency of Serbia, the Ministry of Trade and the Ministry of Labour. The total available resources amount to EUR 4m (RSD 500m) in loans and grants and. The Ministry of Economy gives grants (up to 30% of the total amount) for purchasing equipment and office space renovation. The programmes finance innovative projects, woman entrepreneurship and social entrepreneurship. This programme is intended to support those who need financing to start up in business. Most of the previous, similar programmes had one enormous drawback – the procedures and terms were very complicated. This programme enables the creation of start-ups that cannot meet rigorous conditions by offering them part of the required funding. It consists of the following projects: financial support for start-ups, financial support for innovative projects in IT, and financial support for programmes and projects to support youth employment and provide subsidies for self-employment.

- The programme for exporting companies

This programme is funded by the Serbian Export Credit and Insurance Agency (AOFI) and the Development Agency of Serbia. The total available resources amount to EUR 35m (RSD 4,300m) in short-term loans, warranties, factoring and support to bolster export competitiveness of the Serbian economy. The programme offers more flexible loan conditions through lower collateral requirements. It is designed for companies that need financial support for growth and development of their operations. Particularly, this programme aims at facilitating the establishment of better cooperation and networking, value chains, supply chains, providing easier access to financing and increasing the quality of labour, equipment, knowledge and management skills for exporting companies. Support for internationalisation includes bolstering export competitiveness of the Serbian economy, growing the value of exports, of exporters, and improving the quality of export products.

- The programme for development projects

This programme is funded by the Ministry of Economy and the Development Fund of Serbia. The total amount of available resources is EUR 22.5m, out of which EUR 4.5m (RSD 550m) is provided by the Ministry of Economy and EUR 17.9m (RSD 2,200m) is available through the Development Fund. Support includes the combination of grants (20%) and loan provided by the Development Fund (80%). This programme aims at financing new technologies- technological processes, patents, licences, development of innovative projects, new product launch in production, renewal energy/energy efficiency projects, purchase/building of production premises and for purchase of new or used equipment. Twenty percent of the funds (per project) can also be used by SMEs for financing working capital.

- The programme for purchase of equipment

This programme is funded by the Ministry of Economy, the Development Agency of Serbia, and the Development Fund of Serbia. The total available resources amount to EUR 4.6m (RSD560.7m) in long-term loans and grants (25% of the investment is a grant). The programme is designed to provide SMEs with better access to finance to purchase production equipment. Its main focus is on established companies that need financial support to further growth and development. Programmes are designed to facilitate the establishment of better cooperation and networking, value chains, supply chains, provide easier access to financing, increase the quality of labour, equipment, knowledge and management skills.

Based on the feedback received during the interviews, the main disadvantage of the existing programme is a large a number of administrative and monitoring processes involved in applying for the grant and in post-receipt monitoring. This could be the limiting factor for companies that want to grow their business.

### 5.4.2 Regional support schemes

The Western Balkan Enterprise Development & Innovation Facility (WB EDIF) is an EU-funded initiative which aims to increase the availability of financial resources to SMEs based in the Western Balkans. The WB EDIF also aims at bolstering support services for private sector development, as well as at supporting socio-economic development and EU accession across the WB region. The European Commission, the European Investment Fund (EIF), the European Investment Bank (EIB), and the European Bank for Reconstruction and Development (EBRD) launched the WB EDIF in December 2012.

The total available resources amount to EUR 300m. The WB EDIF does not support entrepreneurs directly but provides funding through local financial intermediaries (debt and equity products, support services).

The WB EDIF consists of four different pillars and financial instruments:

- Guarantee Facility (GF and GF II) - UniCredit Serbia signed an agreement with the EIF in August 2014, to participate in the WB EDIF as the financial intermediary that provides loans to SMEs. Five million EUR was invested for a EUR 30m portfolio. The feedback from UniCredit Serbia is that more than half of SMEs that received this type of funding would not be able to receive funding without the guarantee in place (based on the existing risk criteria)[26]. New agreement was signed with ProCredit Bank in December 2016, with EUR 3.5m being invested for a EUR 25m portfolio (See above). The benefit passed on to the SMEs is that the guarantee replaces part of the collateral, provides lower pricing, and so start-ups can get more funds than would have been available otherwise.
- Support Services Facility - There are a few Support Services projects in Serbia run by the OECD (Small Business Act monitoring), the World Bank (Venture Capital and Investment Readiness, Road to Europe – Program of Accounting Reform and Institutional Strengthening (EU-REPARIS), the EBRD (Small Business Support), and the EIB. Support services facility also focuses on capacity building support for the implementation of financial Instruments. A feasibility study for Centers of Excellence and Evaluation of IP (Intellectual property) potential in the region are in preparation. All these projects provide technical assistance in support of the financial instruments.
- Enterprise Innovation fund (ENIF) – The ENIF was established in 2015, with a total amount of up to EUR 40m, available to the whole region (30% allocated to Serbia). Out of EUR 40m, EUR 1.5m is allocated to seed financing. The ENIF is managed by South Central Ventures, an independent private entity with offices in Belgrade, Skopje, Ljubljana and Zagreb. Until now, there have been five investments in total, three of them in Serbia. South Central Ventures provides equity finance to innovative SMEs, mainly in the IT sector: software solutions, big data processes, B2B, artificial intelligence. The main focus is on start-ups as well as established companies that are in an early

[26] An interview with the representatives of the WB EDIF and UniCredit Serbia

stage of development. The Serbian government is also planning to participate in the ENIF with its own funds contribution, but the timing of that is still unknown.

- Enterprises Expansion fund (ENEF) – The ENEF was established in 2014, with the total amount of funds up to EUR 100m. The EBRD runs the ENEF and provides equity financing to established SMEs with high-growth potential. There was already one investment in Serbia within the ENEF and another two are expected before the end of 2016. Total investments until 2016 year-end will amount to EUR 30m.

### 5.4.3 Other support schemes

Support programme to SMEs through an Italian credit line

There are two credit lines offered by the Italian government in cooperation with the Ministry of Finance of Serbia and nine local banks. Both credit lines are intended for SME funding and amount to EUR 63.25m (one loan of EUR 30m and another of EUR 33.25m).

Up to 30% of the individual loans may be used for working capital and goods necessary for project implementation. At least 70% of the individual loans may be used for spare parts, procurement of equipment, technology and industrial licenses of Italian origin.

The main goal of the two credit lines is to contribute to the economic growth of Serbia by encouraging development of the private sector and supporting Serbia's efforts to integrate with the European Union. The sectors in focus are: agriculture, construction, electrical industry, telecommunication, textile industry, mechanical engineering, chemical products, healthcare, services, energy, production, transport and tourism.

Users of this credit line can be SMEs, micro entities and entrepreneurs registered in Serbia, as well as public utility companies. Loan can be used for purchase of used equipment.

COSME

COSME[27] is an EU programme designed to improve competitiveness of enterprises and SMEs and to promote entrepreneurship. COSME started in 2014 (in Serbia two years later) and will continue until 2020. The available budget is EUR 2.3bn. EIF and Banca Intesa Belgrade signed the first agreement under the COSME programme in Serbia, in December 2016. EIF provides a guarantee, which will enable the bank to support SMEs with EUR 60m in loans, over next two years. Loans will be working capital loans with favourable conditions- longer maturity period and no hard collateral required to the SME.[28]

Key target segments are traditional SMEs, entrepreneurs, business support organizations, and regional and national administrations, and COSME operates through the following measures:

- Access to finance: COSME aims at providing increased access to finance for companies in different stages of their lifecycle: creation, expansion, or business transfer. COSME operates through the Loan Guarantee Facility and the Equity Facility for Growth. The Loan Guarantee Facility provides guarantees and counter-guarantees to financial institutions, so that they can provide more loans to SMEs. The Equity Facility for Growth provides assets in the form of venture capital to equity funds

[27] Information about COSME, available at: https://ec.europa.eu/growth/smes/cosme_en

[28] http://www.eif.org/what_we_do/guarantees/news/2016/cosme_banca_intesa_serbia.htm

investing in SMEs, mainly in the expansion and growth-stage phases. This generates a high leverage effect which could not be easily achieved through national facilities.

- Creating better framework conditions for competitiveness: COSME creates better framework conditions for competitiveness by reducing unnecessary administrative and regulatory burdens. Some of the actions include measuring the impact of relevant Union law on SMEs, developing smart and business friendly regulations for them and reinforcing the use of the "Think Small First" principle, which is in line with the goals of the Small Business Act (SBA). The programme is helping SMEs take-up new business models and integrate them into new value chains.
- Access to markets: Support for enterprises so they can benefit from the EU single market and make the most of opportunities offered by markets outside the EU. COSME funds the growth-oriented business support services through the Enterprise Europe Network (EEN), which helps SMEs find business and technology partners, understand EU legislation and access EU financing.
- This programme also funds web tools specifically designed for enterprises development, such as the Your Europe Business Portal that provides practical online information for entrepreneurs who want to become active in another Member State, and the SME Internationalisation Portal, which puts the emphasis on support measures for companies that want to develop their business outside Europe.
- Promotion of Entrepreneurship: The implementation of the Entrepreneurship 2020 Action Plan is supported by COSME through research, mobility exchanges, best practices diffusion and pilot projects in such areas as entrepreneurship education, mentoring or the development of guidance and support services for new entrepreneurs, including young, women and senior entrepreneurs. A cross-border exchange scheme, Erasmus, aims to assist new aspiring entrepreneurs in acquiring relevant skills to run and grow a business by working with an experienced foreign entrepreneur for up to six months. Another focus of COSME is on digital entrepreneurship to help EU businesses benefit from new opportunities of the digital era, which became crucial for competitiveness and growth.

HORIZON 2020

Horizon 2020[29] is the biggest EU Research and Innovation programme. The Common Strategic Framework for Research and Innovation (CSF) is created in order to streamline three existing initiatives and make them more SME-friendly and open to new participants: the 7$^{th}$ Framework Programme (FP7), the innovation part of the Competitiveness and Innovation Framework Programme (CIP), and the European Institute for Innovation and Technology (EIT).

The CSF with total resources of EUR 80bn will promote activities that are in line with the Europe 2020 priorities such as the development of technologies underpinning innovation across different sectors, access to risk finance and access with simple rules and procedures. One third of the resources are available for financing SMEs.

The priority "Industrial leadership" aims at making the EU more attractive to businesses of all sizes, with the total resources of EUR 17.9bn. Three key elements will support this goal:

- A strong focus on developing European industrial capabilities in Key Enabling Technologies (KETs) with a budget of EUR 5.89bn.

[29] Information about Horizon 2020, available at: https://ec.europa.eu/programmes/horizon2020/

- Access to Risk Finance. Under this programme, total resources of EUR 3.5bn are planned for financial instrument facilities and accompanying measures, specifically for research and innovation. At least one third of this amount is dedicated to SMEs. Two financing facilities are available:
    - A debt facility to provide loans, guarantees and other forms of debt finance to entities of any size or form, including research and innovation-driven SMEs
    - An equity facility to provide finance to early- and growth-stage investments, with a particular focus on early-stage SMEs with the potential to carry out innovation and grow rapidly
- Innovation in SMEs. This new instrument is designed to enable easy access with simple procedures and rules. The new instrument encourages SMEs to put forward their most innovative ideas with an EU dimension. However, it will be also used across all societal challenges and industrial technologies. The specific SME measures of FP7 are integrated with the new instrument in one comprehensive, simple and easily reachable scheme. It should be noted that there are tax incentives on innovative companies i.e. they are exempted from paying VAT. The condition is that the companies have to present their contract with the European Commission and Innovation Fund.

The total of EUR 3.1bn is assigned to Future and Emerging Technologies (FET), which supports cooperative research across scientific and industrial disciplines with a clear final objective within the priority “Excellent Science”.

Regarding the third key objective “Societal challenges”, companies are expected to play a major role. The total budget amounts to EUR 31.7bn.

There are currently no publicly available data on the success rate of Serbian companies in Horizon 2020. Serbian SMEs participate in Horizon 2020 with relatively low hit-rates. However, a number of companies have passed the threshold but not received funding due to high competition. These companies are given a so-called Seal of Excellence to distinguish them. There are some initiatives aimed at supporting these companies, possibly under the WB EDIF platform.

Based on the feedback received during the interviews with key stakeholders, there are a few limiting factors faced by the SMEs when applying for finance to both COSME and Horizon programmes. These are mainly related to having language issues when applying for loans, complex application package requirements, and lack of market awareness of the programmes. Many local agencies, institutions (e.g. RAS, Chamber of Commerce Ministry of Education, Ministry of Science and Technological Development) and funds promote existing programmes and provide advisory to SMEs when applying for support; however, there is still room to boost the promotion of Horizon 2020 and SMEs’ awareness that such programmes exist.

<u>InnovFin</u>

InnovFin is a joint initiative launched by the EIF and the EIB under the Horizon 2020 programme. It is a financing and advisory facility aiming at innovative SMEs. It finances research and innovation activities of early stage and established SMEs. There are also funds for large projects, targeting large companies. The financing facility includes a wide range of loans, guarantees and equity funds, which can be provided directly or through financial intermediaries (usually banks). InnovFin builds on the success of the former Risk-Sharing Finance Facility developed under the seventh EU framework programme for research and technological development (FP7).[30]

**Table 5. Criteria to apply for InnovFin guarantee facility**

| | |
|---|---|
| • Financing innovative projects | • Reduced collateral requirements |
| • The minimum loan amount is EUR 25,000, and the maximum individual amount per client is EUR 7.5 million | • Better interest rates in relation to standard loans |
| • The loans may be investment loans, revolving or working capital | • The minimum maturity is 12 months, and the maximum maturity is 10 years |

Source: https://www.procreditbank.rs/en/strana/7641/the-innovfin-programme-

In Serbia, there are three guarantee facilities provided to two local commercial banks (ProCredit and Unicredit bank), with the aim to improve access to loan finance for innovative SMEs. Under these facilities, total amount of financing that will be available to SMEs in the market amounts to EUR 100m (See Section 5.3.1.2).

EaSI

The Employment and Social Innovation (EaSI)[31] programme is an EU-financing instrument aimed at fighting social exclusion and poverty, promoting a high level of quality and sustainable employment, ensuring adequate and decent social protection and improving working conditions. The EaSI budget for 2014 to 2020 amounts to EUR 919.2m.

The EaSI is directly managed by the European Commission. It brings together three EU programmes managed separately between 2007 and 2013: PROGRESS, EURES and Progress Microfinance. These three programmes have become the three axes of the EaSI.

The PROGRESS axis is related to the modernisation of employment and social policies. This covers 61% of the total budget. The EURES axis is supporting job mobility (18% share of the total budget) and the third axis provides access to microfinance and social entrepreneurship, with a 21% share of the budget.

Some of the objectives of this programme are the following: development of adequate social protection systems and labour market policies, modernisation of EU legislation and effectiveness of its application, promotion of geographical mobility and employment boost. Achieving these objectives will be done by focusing on vulnerable groups, such as young people, on promotion of gender equality, and on combating long-term unemployment, poverty and social exclusion.

In 2016, Erste bank Serbia and EIF signed an agreement under EaSI, whereby EIF provides a guarantee that will enable a bank to support around 850 local micro companies with EUR 4.7m of loans[32].

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[30] http://www.eib.org/infocentre/publications/all/innovfin-eu-finance-for-innovators.htm

[31] Information on the EaSI is available at: http://ec.europa.eu/social/main.jsp?catId=1081

[32] https://www.erstebank.rs/sr/o-nama/press/saopstenja/2016/11/22/korak-po-korak

## 5.5 Historical use of IPA resources

The Instrument for Pre-accession Assistance (IPA) is the financial instrument to provide EU support to the beneficiaries in implementing reforms with a view of EU membership. The IPA beneficiary countries are divided into two groups: EU candidate countries and potential candidate countries in the Western Balkans.

IPA I, which ran from 2007-2013, included five different components: the assistance for transition and institutional building, cross-border cooperation, regional development, human resources, and rural development.

Significant funds from IPA resources were allocated to private sector development. During these seven years, EUR 105m was dedicated to the national IPA programme for capacity building and investment support. The funds for the latter were allocated to SMEs, science (R&D) and trade, innovation and infrastructure. The objectives for private sector development were investment in research and innovation, improvement of regulatory and administrative environment for doing business in Serbia, and increase in the competitiveness of Serbian enterprises in the EU market.

Table 6. IPA funds allocated to private sector competitiveness over 2007-2013

| Year | Funds allocated |
|---|---|
| 2007 | **EUR** 3.5m |
| 2008 | EUR 3m |
| 2009 | None |
| 2010 | EUR 5.5m |
| 2011 | EUR 11.2m |
| 2012 | EUR 6m |
| 2013 | EUR 12.9m |

(Source: The Delegation of the European Union to the Republic of Serbia)

The IPA II will run over 2014-2020 and it will have a new framework for providing pre-accession assistance. Priority sectors for funding during this period are democracy and governance, rule of law and fundamental rights, environment and climate action, transport, energy, competitiveness and innovation, education, employment and social policies, and agriculture and rural development. It can be observed that there is a relatively low proportion of funding under the Competitiveness and Innovation sector.

Table 7. Transition assistance and institutional building - IPA I resources allocation by objectives: 2007-2010

| Year | Overall | Political requirements | Social-economic criteria | European Approxima-tion of | Ability to assume obligations of | Other |
|---|---|---|---|---|---|---|

| | | | | sectoral policies[33] | membership | |
|---|---|---|---|---|---|---|
| **2007** | EUR 164.8m | EUR 56.5m | EUR 71m | EUR 34.5 m | | GTAF- EUR 2.83m |
| **2008** | EUR 168.6m | EUR 92m | EUR 29.5m | | EUR 44.05m | Support measure facility - EUR 3.09m |
| **2009** | EUR 70.5m | EUR 17.15m | EUR 40.35m | | EUR 11.5m | Project preparation facility - EUR 1.5m |
| **2010** | EUR 174.2m | EUR 54.12m | EUR 75.3m | | EUR 42.78m | Project preparation facility - EUR 2m |

(Source: Serbia-financial assistance under IPA II, available at: http://ec.europa.eu/enlargement/instruments/funding-by-country/serbia/index_en.htm)

**Table 8. Country action programme – IPA II resources allocation by sectors: 2014-2015**

| Sectors | 2014 | 2015 |
|---|---|---|
| Democracy and governance | EUR 55.8m | EUR 111.1m |
| Rule of Law and fundamental rights | EUR 27.5m | EUR 20.6m |
| Energy | EUR 12.6m | |
| Transport | | EUR 64.8 |
| Competitiveness and innovation | EUR 6m | |
| Education, employment and social policies | EUR 19m | |

(Source: Serbia-financial assistance under IPA II, available at: http://ec.europa.eu/enlargement/instruments/funding-by-country/serbia/index_en.htm)

[33] The selected fiche under this priority builds upon results to date under CARDS (Community Assistance for Reconstruction, Development and Stabilisation) and will reinforce the enabling regulatory environment for the fiche objectives under Priorities 1 and 2. For example Support to Customs Procedures, Border Control Standards and Aviation standards will facilitate better exploitation of Serbia's transport/logistical advantages (EuroCorridors VII/X).

# 6 Serbia's priorities and policies for SME finance

In March 2015, the Serbian government approved the "Strategy in support of the development of entrepreneurs and SMEs for the period 2015-2020"[34], accompanied by an action plan[35] which determined the framework, goals, priorities and measures for improvement of SMEs in Serbia. The main goal for the government before 2020 is to: improve business environment, access to finance, support development of human resources, strengthen competitiveness and maintain sustainability of SMEs, open access to new foreign markets, and support the development of an entrepreneurial mind-set, woman entrepreneurship, youth and social entrepreneurship.

Successful implementation of the strategy should result in a 10% increase of the total number of SMEs and entrepreneurs by 2020 (compared to 2013), and a 24% increase in the number of employees in the SME sector.

The new strategy replaces and builds on the strategy for development of innovative and competitive SMEs for the period 2008 to 2013, which was prepared back in 2008. The current strategy is also reflecting the existing policy of the European Union (the act on small companies), and of the European Strategy for 2020.

The key strategic goals for supporting SME finance are:

- Improvement of the quality of the banking sector offer for SMEs

The provision of finance by the banking sector is mainly characterised by unfavourable loan conditions for SMEs manifested by high interest rates, high collateral requirements (e.g. hard collateral of a good quality), and lack of long-term loan financing opportunities. Start-ups and entrepreneurs are rarely financed by the banks and they are in the least favourable position when it comes to meeting loan conditions.

In order to increase the accessibility of loans to the most vulnerable SME populations, the government introduced favourable credit lines in cooperation with foreign institutions, such as the EIB. The Development Fund of Serbia plays an important role in providing favourable credit lines for financing SMEs, and the AOFI provides loans, factoring and guarantees, subsidised loans. The Development Fund is probably the only institution, which directly offers loans to start-ups and entrepreneurs. *Consequently, there is still a lot of room for improvement in this respect*.

- Development of new financial instruments

Guarantee schemes and other alternative sources of finance are still in development in Serbia. In order to create a favourable business and regulatory environment for the development of new FIs, the government defined a few priority measures within the aforementioned strategy document:

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[34] Ministry of Economy (2015), Strategija za podrsku razvoja malih i srednjih preduzeca, preduzetnistva i konkurentnosti za period od 2015. do 2020. Godine, available at: http://www.privreda.gov.rs/wp-content/uploads/2015/06/Strategija-mala-i-srednja-preduzeca.pdf

[35] Ministry of Economy (2015), Akcioni plan za sprovodjenje Strategije za podrsku razvoja malih i srednjih preduzeca, preduzetnistva i konkurentnosti za 2015. sa projekcijom za 2016. Godinu, available at: http://www.privreda.gov.rs/wp-content/uploads/2015/06/Akcioni-plan-mala-i-srednja-preduzeca1.pdf

- Development of new models of financing SMEs through participation in the available EU programmes (e.g. COSME, Horizon, WB EDIF).
- Establishment of national, local and mutual guarantee schemes, which would serve as loan collateral and potentially lower the risk taken by banks. This would give smaller and more risky companies an opportunity to obtain loans, which they might have never had before due to insufficient collateral.
- Creation of favourable conditions to promote development of private equity finance, venture capital, business angels and mezzanine financing. This includes the development of a regulatory framework, setting up a database of all entrepreneurial projects with an investment potential, and setting up a mutual fund with private funds to support innovative companies.
- Removal of administrative burden and improvement of the regulatory environment for microfinance. It is necessary to define a regulatory framework for setting up microfinance and other non-banking credit institutions that will regulate licensing and supervision of all credit institutions.
- Removal of regulatory limitations and establishment of more favourable conditions for leasing and factoring for SMEs.
- Improvement of the eligibility of SMEs in accessing different financing sources.

All these measures aim at raising awareness and preparing entrepreneurs, business leaders and financial advisors to use alternative sources of finance. This will be achieved by organising meetings and training sessions to inform SMEs and micro companies about all the available sources of finance related to non-banking FIs, give overview of all the existing programmes to improve business skills, competences and financial knowledge of SMEs.

All implementation measures listed in the strategy document will be financed by the budget of the Republic of Serbia and donations: primarily IPA resources, donations from bilateral agreements between countries and international financial institutions.

There are also non-financial measures that the government is planning to take in order to support the development of SMEs. This includes the improvement of the regulatory environment for companies that went bankrupt, the improvement of public administration through introduction of electronic systems, the introduction of education programmes for SMEs, and many other initiatives.[36]

[36] Ministry of Economy (2015), Strategija za podrsku razvoja malih i srednjih preduzeca, preduzetnistva i konkurentnosti za period od 2015. do 2020. Godine, available at: http://www.privreda.gov.rs/wp-content/uploads/2015/06/Strategija-mala-i-srednja-preduzeca.pdf

# 7 Market analysis and findings (Building block 1)

This chapter contains an analysis of the existing supply of and potential demand for selected financial products available in Serbia for micro, small and medium-sized enterprises.

Chapter 7.1 presents the methodology used to calculate the supply of the main financial products available in Serbia as well as the overview of the current supply of the main financial products. This overview focuses on the supply trends observed in recent years. Moreover, wherever possible, this chapter offers a quantification of the estimated potential annual supply of these financial products in 2017.

Chapter 7.2 presents the methodology used to calculate the demand for the main financial products available in Serbia as well as the results of the SME survey. Where possible, this chapters offers a quantification of the estimated potential annual demand of financial products in 2017.

Chapter 7.3 presents the calculation of the estimated financing gaps.

Chapter 7.4 outlines the insights gathered from the past and current market experience as part of a continuous improvement process. The goal of this chapter is to encourage the recurrence of positive outcomes while deterring undesirable ones.

Chapter 7.5 identifies the value added of the potential future financial instruments. Using the information gathered during the identification of potential market failures, the assessment of value added of FIs compared to other possible forms of intervention (e.g. grants) is given.

Chapter 7.6 includes the estimation of additional public and private resources. This chapter identifies the origin of the resources and when they would be potentially available.

## 7.1 Supply

### 7.1.1 The methodology used to compute supply

The anticipated annual supply of the main financial products available to SMEs in 2017 has been calculated on the basis of numerous sources of information, market trends and projections, allowing for a comprehensive and complementary approach. Whilst particular characteristics of each product have been highlighted, the general approach to the calculation of supply is described in the following steps:

- First, the analysis considers all the amounts provided to SMEs in Serbia for the relevant products where data is available for recent years. The supply information used concerns SMEs only, excluding large companies.
- Within the supply of financial products to SMEs, the amounts provided to size category (1) micro and together to (2) small and medium enterprises are estimated. This is done by using information provided by both stakeholder interviews and found in the literature.
- The amounts to be provided between 2016 and 2018 are then estimated by taking into account:
    - The trends observed over 2011-2015 for each financial product.

- The real GDP forecast for Serbia in 2016 (+2%) and in 2017 (+2.5%) made by the European Commission in May 2016[37].
- The market dynamic anticipated in each market in future by the market stakeholders to define the upside and downside scenarios.

This trend analysis is a necessary component of the methodology, since the development of the future supply of financial products depends to some extent on the supply characteristics in the past, unless there are known or assumed reasons to believe there will be a break in the historical trends (e.g. an exceptional growth in financial intermediaries, a new strong industry development, or other shocks) that can be identified or predicted. Economic growth is also taken into account as an important indicator of the economic performance of Serbia.

Finally, the perception of the market developments provided by the interviewed stakeholders is a more subjective element. Insights from relevant financial institutions have been used to estimate the growth of their offer of finance.

### 7.1.2 Overview of financial products supply

The analysis of the supply side is divided into two parts. The first part presents an overview of the current supply of various financial products. The second part presents the quantification of the anticipated supply of key financial products in 2017 in Serbia.

The paragraphs below give an overview of the supply of the following financial products in Serbia:

- Microfinance
- Short-term loans, bank overdrafts and credit lines
- Medium and long-term loans
- Export credit
- Leasing
- Factoring
- Equity financing
- Technology Transfer Funds [with possible additional attention to Innovation Performance]
- Business Angel Financing
- Growth Capital
- Replacement, rescue/turnaround and buyout capital
- Mezzanine financing

<u>Microfinance</u>

The EU definition describes microfinance as loans up to EUR 25,000, offered specifically to micro enterprises, entrepreneurs and other individuals who may encounter difficulties when applying for a conventional loan. Microfinance is, therefore, an important incentive to encourage the development of

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[37] European Commission (2016), European Economic Forecast, available at: http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip025_en.pdf

micro enterprises and job creation. Moreover, the efficient provision of microfinance tends to play a crucial role in mitigating the effects of financial and economic crises.

The microfinance market is underdeveloped in Serbia. Only banks are allowed to offer microfinance to SMEs, whilst non-banking credit institutions are not. This is mainly due to a lack of a regulatory framework for the microfinance market and non-banking credit institutions. Regarding the institutional framework, possibilities for enhancement of regulatory framework in the area of financial services, which might enable introduction of non-deposit financial institutions, is under careful and thorough consideration within NBS.

A distinction has to be made between micro credits provided by a commercial bank and microfinance provided by a specialised institution. Microfinance offers much broader set of FIs targeted at low-income population. Users of microfinance are usually long-term unemployed (people who lost their jobs), who cannot meet traditional bank criteria (insufficient collateral availability, no credit history and lack of full financial statements). Microfinance aims at providing finance and technical assistance to traditional start-ups.

Currently, there are three microfinance providers, which are registered as limited liability companies. These are:

- Agroinvest
- Fond za mikro razvoj
- MicroFinS

These institutions provide funds through banks as financial intermediaries, particularly through guarantee schemes, i.e. providing guarantee deposits to banks as collateral for funds offered to micro companies by the banks. This model, however, makes microfinance very complex and expensive for micro companies and entrepreneurs alike.

Loans (short, medium and long-term loans[38])

Information on the total outstanding and new loans issued to SMEs was provided by the National Bank of Serbia for the period from 2011 to 2015. This information was not publicly available, as it presents only estimations based on the NBS survey of SMEs, which the Bank runs on an annual basis. Exact data are not available as banks are not legally obliged to submit data separately for the SME sector, but only for corporates in total. More detailed information on loans to micro, small and medium-sized legal entities is not available, and so the estimate of loan disbursements to SMEs is presented in Table 9 below.

**Table 9. Estimate of loan disbursements to SMEs (EUR million) over 2011-2015**

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| **Short-term loans (<1 year)** | 1,308.3 | 1,057.9 | 1,208.4 | 1,232.9 | 1,153.3 |
| **Long-term loans (>1 year)** | 3,012.2 | 2,829.5 | 2,417.5 | 2,937.4 | 3,544.4 |
| **Total loans outstanding** | **4,320.5** | **3,887.4** | **3,625.9** | **4,170.3** | **4,697.7** |

[38] In the present report, it is considered that short-term loans also include bank overdrafts and credit lines. Short-term loans comprise tenors of up to one year, while medium and long-term loans comprise tenors of over one year.

| | | | | | |
|---|---|---|---|---|---|
| **Newly approved loans** | **3,322.6** | **2,846.8** | **2,339.5** | **2,796.2** | **3,156.7** |
| *Short-term newly approved* | *830.7* | *711.7* | *584.9* | *699.1* | *789.2* |
| *Long-term newly approved* | *2,491.9* | *2,135.1* | *1,754.6* | *2,097.1* | *2,367.5* |

(Source: National Bank of Serbia (2015), Bank survey on SMEs)

Furthermore, the breakdown of new loans by repayment period and size of business is not available from any public sources. Hence, the information received from the NBS (i.e. based on their SME survey) was used as a proxy in this study. This analysis gave a ratio of 25 / 75 of short-term loans (maturity < 1 year) to medium/long term loans (maturity > 1 year) from 2011 to 2015.

Short-term loans are defined as loans to be repaid within one year or less and most commonly used to finance working capital needs. In the present report, it is considered that short-term loans include credit lines and bank overdrafts. Credit lines are defined as maximum loan amounts approved by a bank to a company where interest is charged only on the used part of the loan. Overdrafts are an extension of credit from a bank when an account reaches zero, thus allowing a company to continue withdrawing money even if the account has no funds any more. These financial products are usually characterised by smaller collateralisation than longer-term products. Nonetheless, collateral remains a key concern both for banks (in terms of the value of collateral required) and for SMEs (due to lack of assets that could be collateralised). Based on the information received from the NBS, around 50% of the companies stated that they needed additional collateral (promissory notes are obligatory for each loan) when applying for loans. Medium and long-term loans have maturities longer than a year and usually finance investments.

Banks are a dominant source of financing for SMEs in Serbia with working capital loans as the most commonly used loans. According to a separate analysis, which was conducted by the NBS, loans to finance working capital represent 46% of total newly-approved corporate loans in 2016, followed by investment loans (33.2%)[39]. Investment loans are mainly taken out to finance the purchase of new equipment. Generally, based on the information received from the interviewed banks, obsolete equipment is the main problem faced by Serbian producers.

Based on interviews, the highest share of SME loans is taken by small and medium enterprises. Loans supplied to micro enterprises and entrepreneurs are low compared to their share in the total population of SMEs. One of the reasons is that the Serbian banking sector rarely serves start-up entrepreneurs and micro companies if they do not have a good credit rating and can offer significant collateral. The main reasons are high transaction costs for small-size loans and high risk related to financing clients with low rating and no credit history. Additional obstacles that prevent companies from obtaining financing are non-transparent financial statements (artificially limiting profits for tax purposes) and high indebtedness. Farmers often face problems in obtaining bank loans, as they have simple accounting bookkeeping (full financial information is not available and their assets are usually related to land and livestock), and banks require specific scoring models for proper risk assessment. According to bank interviews, only 7% of entrepreneurs disclose financial statements. On the other hand, banks do not seem to be proactive enough in trying to bolster financial knowledge and awareness of the micro market, and even in adapting their products to the micro market specifics. Very few banks organise regular seminars or educational workshops to raise knowledge and become more familiar with SMEs.

[39] National Bank of Serbia (2016), Trends in lending, first quarter report 2016, available at: http://www.nbs.rs/internet/english/90/trendovi_kab/index.html

Programmes that are subsidised and provided by the government are usually promoted through local chambers of commerce and agencies but, generally, there is still some room for improvement in this regard.

As the distribution of the total amount of new loans supplied to micro and small and medium enterprises is not publicly available, estimations were made on the basis of previous experience in other countries. The assumption was that 25% of the newly approved loans for SMEs are provided to micro enterprises and 75% to small and medium enterprises. As a whole, SME loans represent around 30% of total corporate loans in Serbia.

In terms of currency structure, the largest share of loans is foreign currency-indexed. The structure of corporate loans in 2016 is dominated by foreign currency, with EUR loans making up 76.2% of the total net loans[40]. The share of the dinar loans in 2016 is lower than in 2014 (30%), as a large share of loans approved in 2014 were dinar loans subsidised by the government, and most of them are maturing in 2016. Subsidised loans were based on an interest rate subsidy offered by the government at favourable borrowing conditions, and the primary users have been larger SMEs. Seventeen banks participated in the programme back in 2014. *There are no new subsidised loans offered to the market in 2016 due to the government monetary restrictions.*

The relatively high proportion of official corporate sector non-performing loans (NPLs) contribute to banks' reluctance to finance smaller-size corporates (the official corporate NPL was 22% at the end of 2015[41]), leading to high interest rates (due to high risk mark-up). According to an OECD report, the rate of NPLs attributed to SMEs was 29% in 2014. This is the main reason why banks are very selective in providing loans to companies and reluctant to finance risky SMEs.

The introduction of a monetary policy in 2013, together with tough competition, resulted in a decline in corporate interest rates. The lower cost of corporate financing produced a more favourable business environment for companies, encouraging new investments. According to the NBS survey in 2015, the average weighted interest rate for SMEs was around 12% (foreign currency interest rates ca. 8%), compared to 2014 when it was much higher.

Export credit

According to the AOFI yearly report, total loans given to exporting SMEs amounts to EUR 27.7m. Currently, only 4% of all SMEs are exporting companies. SMEs generate 76% of total exports in Serbia, and their share of exports makes up 14% of the GDP[42]. The main issues faced by export companies are the high quality standards required by the EU market and lack of competitiveness and foreign market knowledge.

There are currently five programs in place that provide financial and educational support to exporters, all implemented by the Serbian export credit and insurance agency (AOFI) and by the Development Agency of Serbia (RAS). The AOFI provides financial support via short-term loans, warranties and

[40] National Bank of Serbia (2016), Trends in lending, first quarter report 2016, available at: http://www.nbs.rs/internet/english/90/trendovi_kab/index.html

[41] National Bank of Serbia (2016), Banking sector Fourth Quarter Report 2015. Available at: http://www.nbs.rs/internet/english/55/55_4/

[42] Ministry of Economy (2015), Report on small and medium-sized enterprises and entrepreneurship in 2014

factoring for a total amount of approx. EUR 33.5m (RSD 4.12bn). The RAS provides support for internationalisation in terms of research of foreign markets and competition, support for enterprises at an early stage of development, improvement and development of new products, and other activities that help export companies succeed in foreign markets.

Table 10. Loans extended to exporting SMEs in 2015

| | Number of loans | Amount of loan (in EUR ) | % share out of all exporting companies |
|---|---|---|---|
| Micro companies | 1 | 100,000 | 0% |
| Small-size companies | 94 | 15,467,000 | 30% |
| Medium-size companies | 38 | 12,086,000 | 24% |
| **Total SME** | **133** | **27,653,000** | **54%** |

(Source: AOFI (2016), Annual report 2015, available at: http://www.aofi.rs/wp-content/uploads/2014/01/Izvestaj-o-poslovanju-2015.pdf)

Leasing

Leasing is used to acquire goods by making instalment payments over time. Under this type of contract, the buyer is leasing the goods and does not assume ownership until the full contract amount is paid.

The financial leasing market in Serbia consists of 16 leasing providers, 14 of which are subsidiaries of international bank groups.

The total value of financial leasing amounted to EUR 433.2m[43] at the end of 2015. The largest sector applying for financial leasing are non-financial corporates which account for more than 82.8% of all approved transactions (EUR 358.8m). Agricultural companies represent 4.5%, and entrepreneurs 3.7% of all transactions. Financial leasing is mainly used for financing lorries and buses (34.9%), and motor vehicles (28.0%).

When looking at the sectoral distribution, main users of financial leasing are companies from the transport sector, warehousing and information and communication (35.6%), followed by trading (15.7%).[44]

There are no publicly available data specifically for SMEs. According to the assessment conducted by the EIB in May 2016[45], the estimated proportion of leases allocated to SMEs is 70%, as reported by the leasing companies interviewed. Based on this information, the estimated value of financial leasing to SMEs amounted to EUR 251.2m in 2015.

Factoring

Factoring is the use of company receivables to finance current working capital needs. This instrument is used mostly in a supply chain environment by SMEs that suffer from delayed payments from clients.

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[43] Using year-end exchange rate between Serbian Dinar (RSD) and EUR: year 2015- 121.6261

[44] National Bank of Serbia (2016), Financial leasing Sector in Serbia, Fourth quarter report 2015, available at: http://www.nbs.rs/internet/english/57/index.html

[45] EIB (2016), Assessment of financing needs of SMEs in the Western Balkans countries, Serbia, available at: http://www.eib.org/infocentre/publications/all/econ-synthesis-report-assessment-of-financing-needs-of-smes-in-the-western-balkans.htm

Due to its small market size, business in Serbia is conducted in a traditional style, where the relationship between buyer and seller is personal and more focused on sales and the relationship with the customer, rather than on collections or risk assessment. Effective payment terms are long and often with significant delays after the due date. Standard credit terms in Serbia (prescribed by the law) tend to be around 45 for public companies to 60 days for private companies, but average collection period is extremely high reaching 141 days in 2015[46]. As a result, companies are forced to acquire further debt financing in the form of overdrafts and other short terms loans to finance their necessary day-to-day expenditure.

There are more than 20 suppliers of factoring in Serbia. Factoring Law adopted in 2013 was the basis for further development of factoring. Factoring providers include ten commercial banks that offer factoring and quasi-factoring i.e. when banks do not take over full insolvency risk. Factoring is also provided by the Agency for Export Insurance and Financing (AOFI) for exporting companies, and eleven specialised factoring companies. The level of factoring in Serbia is low (compared to EU countries), therefore there is room for the potential development both in the domestic and the export market of the supply chain finance/reverse factoring offer, following on the trend established in other European countries where factoring generally represents more than 10% of GDP.

Data about the total value of factoring activities for SMEs in Serbia are not publicly available. The estimate of the total value of the factoring market (including large companies) in 2014 was EUR 412m[47]. This estimation is based on the information provided by 12 factoring companies.

Until 2015, the AOFI has purchased EUR 47.3m of receivables for SMEs through its factoring activities in Serbia. SMEs represent 70.85% of all factoring activities of the AOFI. The AOFI carries out for its clients the international – export factoring and internal factoring business i.e. factoring business on the domestic market with subsidy rights for the exporters.

**Table 11. Factoring activity of SME exporting companies in 2015, financed by the AOFI**

| | Number of companies | Turnover (in EUR ) | % share out of all exporting companies |
|---|---|---|---|
| **Micro and small companies** | 47 | 20,607,181 | 30.89% |
| **Medium-size companies** | 19 | 26,660,850 | 39.96% |
| **Total SME** | **66** | **47,268,031** | **70.85%** |

(Source: AOFI (2016), Yearly report 2015, available at: http://www.aofi.rs/wp-content/uploads/2014/01/Izvestaj-o-poslovanju-2015.pdf)

Guarantees

The most widespread types of guarantees in Serbia are bank guarantees. The banks approve payment and performance guarantees in dinars and in foreign currencies to their clients. Alongside, there are also guarantees for securing deposits on participation in the privatisation tenders of companies and guarantees issued in favour of some government institutions, such as the Fund for the Development of

[46] BCR Publishing (2015), World Factoring Yearbook 2015, available at: https://view.publitas.com/bcr-publishing/wfy15/page/282-283

[47] BCR Publishing (2015), World Factoring Yearbook 2015, available at: https://view.publitas.com/bcr-publishing/wfy15/page/282-283

the Republic of Serbia, for loan repayments. Guarantees are mainly personal guarantees and portfolio guarantees are not developed. There are few strong clusters (e.g. IT cluster, agricultural), however they are not regulated and their activities are mostly limited to cross-border cooperation (e.g. trade shows). The RAS provides grants to clusters for development of common products and financing of trade shows, however there is no evidence of portfolio guarantees.

Additionally, guarantees of some state agencies (e.g. the AOFI) are not recognised as state guarantees by the banks (first class collateral); therefore, they do not have a significant effect on risk margins and collateral requirements.

*The total value of bank guarantees extended to SMEs in Serbia is not publicly available. The total amount of all guarantees in Serbia amounted to EUR 2.3 bn at the end of 2015.Export guarantees*

The AOFI is one of the few institutions, which insures exporting companies. It insures 1% of total SME exports. It issues guarantees, counter guarantees and other forms of sureties for export business and investments abroad.

Types of guarantees issued by the AOFI:

- Bid guarantees
- Performance guarantees
- Advance payment guarantees
- Retention money guarantees
- Maintenance guarantee

In 2015, the AOFI issued EUR 2.6m worth of guarantees for SMEs[48].

Equity market

Three types of the most common equity investments are Private Equity Funds (PEs), Venture Capital Funds (VCs) and Business Angels (BAs). These categories of investors have specific, different goals, preferences and investment strategies; however, together they provide financing in order to nurture expansion, new-product development, or restructuring of corporate operations, management, or ownership.

PE funds often target established and mature companies to invest in and at times they acquire majority stakes in these companies. PE funds are usually generalist, so they invest in various industry sectors, and/or various geographic locations.

On the other hand, VC funds and BAs typically invest in young, growing or emerging companies, and rarely obtain majority control. In terms of sectorial orientation VC funds are usually specialist investors (specialising in a few industry sectors where a VC fund manager has expertise in, or investing in, only a limited geographic area). Venture Capital funds generally:

- Finance new and rapidly growing companies with scalable potential
- Purchase equity shares, i.e. become shareholders in the underlying company

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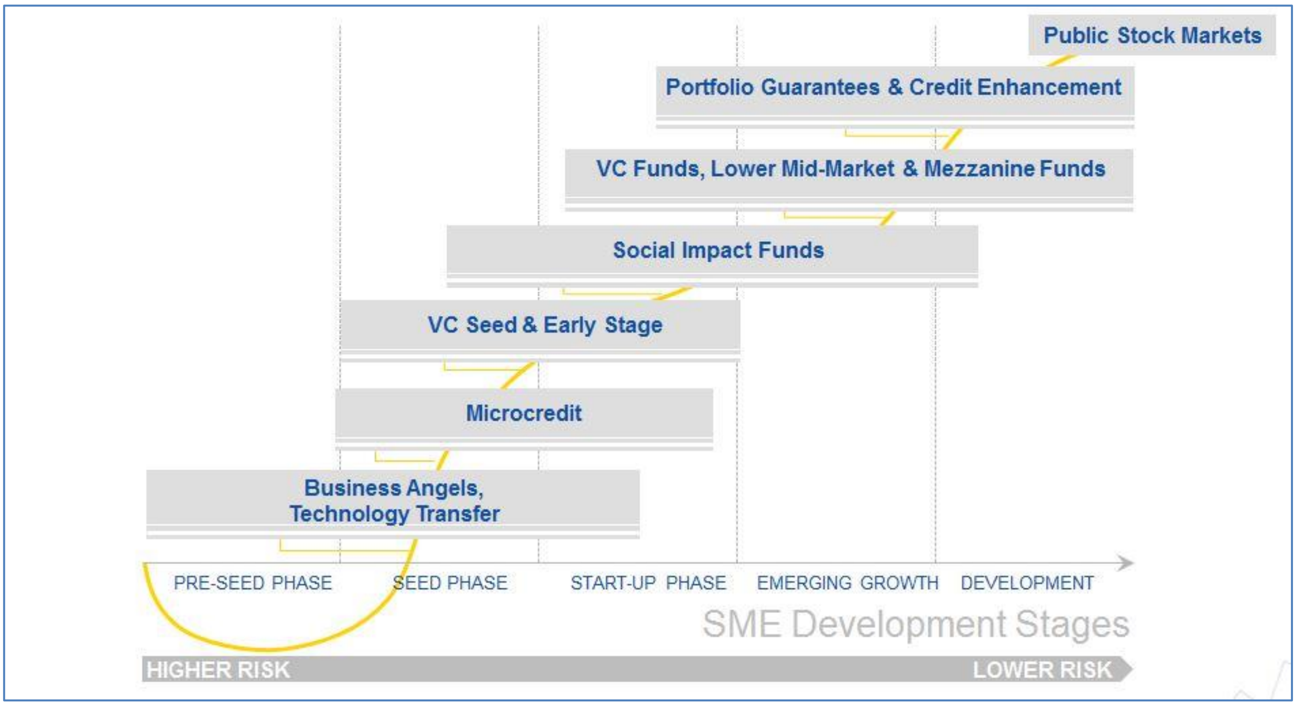
[48] AOFI (2015), Yearly report 2015, available at: http://www.aofi.rs/o-nama/planovi-poslovanja/

- Invest in companies with innovative products or services and developing intellectual property (IP)
- Assist in the development of new products or services though their expertise, contacts and knowledge
- Add value to the company through active participation alongside senior management
- Take higher risks with the expectation of higher rewards and thus are able to finance companies which banks would never consider
- Have a pre-defined period within which they want to liquidate their investment (an exit strategy)

The different types of equity financing, namely BA, VC, and PE, can be categorised according to five phases of SME development, although these definitions and typical sources of funding of each/several phase will vary from sector to sector, as illustrated in Figure 1.

- **Pre-seed and seed phases**, i.e. the very first stages of the life of a company, from concept development to a working prototype/beta testing to the development of patents, licences, the creation of spin-offs, start-ups, and commercialisation of products; they are typically financed by Technology Transfer (TT), Business Angels, microcredit and/or family and friends
- **Start-up phase** refers to the start of revenue generation, often financed by TT, Business Angels, Microcredit and VC seed
- **First success phase** corresponds to the set-off of the company, usually financed by VC seed and early stage
- **Emerging growth phase** when the company expands, targets new products and/or markets, provided most often by later-stage VC funds and PE funds
- **Development phase: buy-outs** and or **public stock markets (IPO)** when an SME is sold for the new development or its shares are sold on the stock exchange

Figure 1. SME development stages their typical sources of funding




(Source: EIF, 2016)

The positioning of each type of capital depends on the company lifecycle and needs.

The equity market is at an early stage of development in Serbia. There is very little publicly available information on the supply of equity. The market is too new (and still too shallow) to establish if a sustainable trend in the supply of equity can be defined. Over the last few years, and currently, only a few funds provide equity investments in Serbia, with the following indicative amounts derived from stakeholder interviews and literature research for this study. The estimation of the total value of the equity market supply in Serbia is around EUR 35-40m in 2016, including all the existing venture capital and private equity funds, accelerators and TT, but excluding mezzanine financing (see below). It is estimated that the supply will be similar in 2017 and significant growth is not expected in the near future, with the existing market players. Due to the limited number of market players, separate data per each player are not given in the report for business confidentiality reasons.

*Venture Capital funds*

Several investments were provided under the WB EDIF programme, which is financing innovative companies and start-ups. Until 2016, there were three investments in Serbia under the ENIF programme, managed by South Central Ventures, a venture capital fund. There are EUR 40m resources available for financing within the ENIF, EUR 10-15m available to Serbia each year, for a period of the next three years. Out of EUR 40m, EUR 1.5m are allocated to seed financing and the rest to financing companies at an early development stage. Until now, there have been three investments in Serbia, mainly supporting IT sector start-ups. One of the investments was co-financed with the local Startlabs VC fund.

Startlabs is one of the leading venture capital funds in Serbia, if not the only one. It offers pre-seed and seed investments up to EUR 50,000 for a 10-15% equity stake. It is located in Serbia and financed by investors from the United States. Startlabs provides technical assistance, office space and mentoring (in Serbia and in San Francisco) for at least six months for each start-up. The fund provides financing at a very early stage, and it is open to co-financing in the later stages, if there are other investors interested and willing to invest further in the company. The approach is specific for each start-up, which is one of the main differences between venture capital funds and accelerators. Until now, the fund has had 14 investment in Serbia. Startlabs focuses on highly innovative companies, mainly in IT software segment. One of the investments was co-financed with South Central Ventures (Workpulse), and the fund also cooperates with other regional funds, such as Launch Hub in Bulgaria, Silicon Gardens, Eleven in Bulgaria, Innovation fund and many others. Therefore, there is also a cross-border cooperation between different funds.

*Accelerators*

Eleven is currently the biggest player in the region, being an accelerator and venture capital fund for early-stage investments. Eleven has huge support from the Bulgarian government and it received EUR 12m funding provided by the European Investment Fund through the JEREMIE initiative, with a focus on the CEE region. Eleven currently represents one of the biggest early stage investors in CEE, also attracting start-ups from Serbia. Since 2012 until now, Eleven had EUR 12m investments in the region. Eleven has two acceleration programmes where they offer EUR 25k for up to 8% of the company, or EUR 100k for more advanced companies. Start-ups can receive up to EUR 200k investment from this fund. Support from the Bulgarian government is substantial and Eleven currently has more than 150 mentors and partners that bring practical, global experience and connections to over 50 companies that go through the accelerator each year[49].

Based on the latest available data, so far Eleven has invested in 17 start-ups in Serbia, in total amount of EUR 2m[50]. Several of them have gone through Start-up Academy by SEE ICT the local entrepreneurship education programme, which shows that this kind of support is important for countries such as Serbia. The first Serbian start-up in which Eleven invested was VetCloud, a tool for veterinarians to interact with pet owners. They became the first and only Serbian start-up in Techstars and have raised a total of approximately EUR400k in their seed rounds.

Eleven mainly supports innovative technology start-ups. In terms of industries, it mainly focuses on entertainment (16% of the investments in the region), productivity (15%), e-commerce (10%), digital media, food and sports (9% each). [51]

ICT Hub, who was a major incubator and a centre for technology entrepreneurship development in Serbia, started to provide financial support to entrepreneurs in Serbia in 2017. ICT hub will invest EUR 1m in the next two years (with a potential for additional funding), for supporting start-ups.

*Private Equity funds*

Blue Sea Capital is the leading private equity (PE) fund in Serbia. Its main focus are stable or growing businesses in the region that need capital to accelerate their growth and value. Blue Sea Capital looks to make investments in companies with an enterprise value ranging from EUR 5m to EUR 30m, seeking to invest from EUR 5m to EUR 15m in order to acquire majority stakes (individually or alongside potential co-investment partners). Targeted industries in Serbia include FMCG, non-cyclical industries, and healthcare. Some of the largest investments of Blue Sea Capital in Serbia were Imlek, Bambi and Knjaz Milos (part of Moji Brendovi group) and a network of Medigroup, the biggest private medical or healthcare group in Serbia.[52]

*Incubators and science parks*

There are few major incubators and a centres for technology entrepreneurship development in Serbia. They help technology-based entrepreneurs successfully develop their products and enables them to transition into the financing stage and enter the market. They offer a modern workspace and full mentoring, technical and infrastructural support. Biggest science park is the Science and Technology park Zvezdara, located in Belgrade. It hosts around 50 start-up and high-growth companies.[53]

*Business Angels*

Business angels operations in Serbia are limited to the non-financial domain. The Serbian Business Angels Network (SBAN) is the only organisation of this type in Serbia with a goal to connect business angels (individuals ready to invest in new business ideas and projects) with entrepreneurs who have a

[49] Information about Eleven, available at: http://11.me/

[50] http://infographic.11.me/

[51] http://en.startit.rs/11-serbian-startups-in-bulgarian-accelerator-eleven-raised-760-000e-so-far/

[52] Information about Blue Sea Capital, available at: http://www.blueseacap.com/investments/

[53] http://www.ntpark.rs/

developed business plan and the idea to develop a business project. There is no evidence of any BA finance operations in Serbia, and their involvement has been limited to the organisation of seminars, networking events and provision of advisory services to entrepreneurs. According to interviews with the representatives of the two VC funds, which have activities in Serbia, market knowledge and awareness of equity financing is generally low. The culture of equity funding from third party investors is not a common local practice, and it may be most relevant only for young, high-growth innovative companies (software development). They show most of the demand for equity financing and they are the most attractive to funds due to their high-growth potential. There are also a few emerging accelerators which focus mainly on technology start-ups. Non-technology, small business owners, generally tend to be risk-averse and prefer using the funding sources with which they are familiar (working capital loans mainly). However, non-technology start-ups or micro companies are essentially left without any source of funding, as banks are reluctant to finance them.

Additionally, the interviewees pointed out that there are many financing opportunities for start-ups in Serbia, yet, based on their own experience, grants, loans and accelerators tend to limit growth of a company. Tight monitoring and administration requirements tend to be a big burden for start-ups, which tend to lose focus on their actual business. Additionally, there is a lack of technical assistance accompanying grants and loans, which is a great disadvantage compared to VC funds that provide such service to the companies they finance.

In general, the entrepreneurial ecosystem in Serbia is slowly taking shape, but a sizeable private sector catalyst is needed to make the sector viable and attract further capital. In terms of a regulatory environment, it was clearly stated that without the assistance of public institutions and government intervention (e.g. introduction of tax incentives for equity finance), the equity market will not change dramatically. There is a lack of regulatory framework which would promote development of local equity funds, protect them and reward them for taking on risks (e.g. via tax incentives). The emergence of new equity funds will also depend on the economic development of the country. Serbia, however, seems to be on the investment radars of foreign funds, and the emergence of new players is expected in the future.

Technology transfer/Innovation funds

*EU support to innovation sector in Serbia – „Innovation Fund of the Republic of Serbia"*

In 2011, the Serbian Innovation Fund received EUR 8.4m support from IPA funds to manage the Innovation Serbia Project. This project has been a first ever-concerted effort of the Serbian Government, the European Union and the World Bank to develop instruments and programs devoted to promoting innovation development in Serbia and facilitating the creation of institutional infrastructure essential to the country's innovation ecosystem. From 2011-2016, there were two programs running:

- Mini grants up to EUR 80k for start-ups, which are not older than two years in the time of application. Funding was used only for early growth innovative companies (not entrepreneurs). Mini Grants Program aimed to support early-stage development of projects with technical innovation. Innovations are not necessarily limited to IT innovations, but can include introduction of new products, services and technologies. 85% of the project was financed with the grant and 15% was co-financing by the company. Monitoring is done on a quarterly basis throughout the whole project.

Grants can be used for purchasing equipment, R&D, staff expense, support functions and patents and trademarks. Until 2016, EUR 3m mini grants were allocated for 41 projects.

- While the Mini Grants Program aimed to support early-stage development of projects with technical innovation, the Matching Grants Program focused on generating collaboration opportunities for Serbian innovative SMEs with strategic partners by lowering the risk associated with the initial phase of project development, by providing co-financing of up to 70% for two year Matching Grants Projects (up to EUR 300,000 per project). This is a conditional grant, where the Fund also receives 5% of the annual company revenues for an additional five years if the project is successful. A grant can be used for purchasing equipment, R&D, staff expense, support functions, patents and trademarks, and marketing & sales activities (up to EUR 8k). Until 2016, EUR 3m matching grants were allocated for 11 projects.

The Innovation Fund has committed EUR 6 million for financing total of 52 projects with great global export potential in various areas and industries. Serbian entrepreneurs have shown dedication to their ideas and trust in their teams, and are now ready to effectively contribute to the development of Serbia's new innovative economy and compete on the international economic scene.

Interviewees from the Innovation Fund pointed out that the main disadvantage of the programs is high administration requirements related to monitoring, which imposes a lot of burden on the start-ups. Additionally, it was pointed out that the companies would generally need more technical assistance and coaching in the future. There will be additional funds for Mini and Matching grants at the beginning of 2017.

Currently, there are two ongoing programs from IPA 2013 in place, which are related to Technology Transfer support:

- Technology Transfer Facility. This component (part of the EU funded project in the amount of EUR 2.5m) supports the establishment of a centralized Technology Transfer Facility (TTF) within the Innovation Fund, employing international and local experts in order to stimulate and coordinate technology transfer of public R&D organizations. It also provides support services to local Technology Transfer Offices (TTOs), research and development (R&D) and innovation support organizations to enhance their capacity and effectiveness to consummate deals. According to the interview feedback, the universities are not very interested in participating in this program.
- The Collaborative Grant Scheme provides financial assistance in the form of grants of up to EUR 300,000 to consortia consisting of at least one Serbian private-sector company and at least one registered Serbian R&D organization, with the aim of bringing together the best potential from the private and public research sectors in implementing activities which will explore research and technological potentials and provide clear prospects for commercial use and exploitation. A program for cooperation between science and economy was introduced in June 2016. The total available funds for this program is EUR 4.4m, out of which EUR 2.4m is provided by the IPA, EUR 1m by the state budget, and EUR 1m by private sources. There are workshops organized every week for the interested companies.

According to the information received from the interviews, SMEs that get initial funding from the Innovation Fund usually obtain further funding from local and regional accelerators in their next development phase: e.g. financing from the aforementioned fund "Eleven" is common.

Grants from the Innovation Fund are so far EU funded from IPA. The Serbian Innovation Fund has already applied for additional IPA funds, which they expect to get in 2017.

Mezzanine

Mezzanine financing represents a hybrid form of debt and equity. It refers to financial instruments situated between senior debt and equity in a company's capital structure (hence the name "mezzanine", i.e. between the two). Mezzanine usually takes the form of convertible debt (the lender can exchange the debt for the company stock), debt with attached warrants (which allow the lender to acquire company stock) or preferred stock (which earns a dividend).

Mezzanine instruments for SMEs have not been developed in Serbia yet, and so no quantification of mezzanine supply for SMEs has been possible at the time of writing of this report.

### 7.1.3 Quantification of financial products supply

As described in Chapter 7.1, the quantification of the expected supply of financial products takes into account:

- The current supply trend of each product under consideration
- The GDP growth forecasts for Serbia provided by the European Commission as of May 2016: (+2%) for 2016 and (+2.5%) for 2017

Table 12. Estimate of the annual supply of financial products in Serbia in 2017

| Financial product | Total (EUR m) | Micro (EUR m) | Small and medium enterprises (EUR m) |
|---|---|---|---|
| Microfinance | n/a | n/a | n/a |
| Short term loans | 785-868 | 196 – 217 | 589 – 651 |
| Medium/Long term loans | 2,354-2,602 | 589 – 651 | 1,765 – 1,951 |
| Leasing | n/a | n/a | n/a |
| Guarantees | SME data not available | SME data not available | SME data not available |
| Equity market/Technology transfer funds | 35-40 | n/a | n/a |
| **Total** | 3,174-3,510 | | |

(Source: PwC analysis 2016)

Microfinance

To date, microfinance supply is very low in Serbia and is currently undeveloped. As explained above, this is mainly due to a lack of a regulatory framework that is expected to be in place in the medium term. Until then, the three existing microfinance institutions provide loans through banks. The virtual absence of a microfinance sector has left the supply of microloans low. Nevertheless, banks displayed a high level of awareness of the lack of microfinance supply, and some have begun to develop products in order to target this market[54].

Short-term loans, overdrafts and credit lines

According to the interviews with bank stakeholders, banks in Serbia are not currently facing liquidity issues, but may experience problems finding bankable projects. This is consistent with the messages received from the banking sector in the region and across the European Union.

This report considers only loans to non-financial corporations.

Based on the adopted computation methodology, the supply of short-term loans for 2017 will range from EUR 785m to EUR 868m. The computation has taken into account the trends in short-term loan supply between 2011 and 2015 (+0.1% on average per year between 2011 and 2015), GDP growth forecast at 2% for 2016 and 2.5% for 2017 and the banks' commonly shared perception that there are no specific constraints foreseen in the future that could limit loan supply. This perception has been translated into the calculation with a variation of the supply between - 5% and + 5%.

This supply of short-term loans for SMEs has been broken down into supply for micro enterprises on the one hand and for small and medium enterprises on the other, using information provided by commercial banks. Since the National Bank of Serbia does not provide a split between the three sizes of companies, it was determined based on the feedback received from key players in the market and on previous experiences. As a result, 25% of short-term loans were assigned to micro companies and 75% to short and medium companies. Table 13 below provides an overview of the resulting supply of short-term loans in Serbia.

Table 13. Estimated annual supply of short-term loans to SMEs in 2017 in Serbia

| Supply of short-term loans to SMEs | (e) 2017 (EUR m) |
|---|---|
| Total supply to micro enterprises | 196 - 217 |
| Total supply to small and medium enterprises | 589 - 651 |
| **Total** | **785 - 868** |

(Source: PwC analysis, 2016)

Medium and long-term loans

The estimate of the supply of medium and long-term loans for 2017 was calculated using the same approach as for short-term loans. The computation is based on the trend in supply of medium and long-term loans from previous years (+0.1% on average per year between 2011 and 2015) and GDP growth forecast at 2% in 2016 and 2.5% for 2017. Additionally, lack of specific constraints in the supply of medium and long-term loans perceived by bank stakeholders is translated into the variation of the supply, between -5% and +5%.

The supply of medium and long-term loans to SMEs in Serbia in 2017 is estimated to range from EUR 2,354m to EUR 2,602m. Table 14 below provides an overview of the supply.

[54] EIB (2016), Assessment of financing needs of SMEs in the Western Balkans countries, Serbia, available at: http://www.eib.org/infocentre/publications/all/econ-synthesis-report-assessment-of-financing-needs-of-smes-in-the-western-balkans.htm

Table 14. Estimated annual supply of medium and long-term loans to SMEs in 2017 in Serbia

| **Supply of long-term loans to SMEs** | **(e) 2017 (EUR m)** |
|---|---|
| Total supply to micro enterprises | 589 - 651 |
| Total supply to small and medium enterprises | 1.765 - 1.951 |
| **Total** | **2,354 – 2,602** |

(Source: PwC analysis, 2016)

Leasing

The estimate of the supply of leasing in 2017 could not be evaluated due to the lack of publicly available information. The leasing market is very well developed in Serbia, however there is no reliable data to calculate the amounts in case of SMEs.

Equity market/Technology transfer funds

The supply of equity in 2017 was estimated based on the interviews with several equity suppliers in the market. There is no publicly available information over the equity market.

Based on the interviews, EUR 35-40m are currently available through different PE and VC funds in 2016, technology transfer funds as well as the accelerators, and it is estimated that this number will not change in 2017. Out of the total supply, it is estimated that approximately EUR 7m will be available within the program for cooperation and technology transfer, funded by the Innovation Fund. Due to business confidentiality reasons, the amounts per different types of equity financing could not be stated (e.g. private equity funds, venture capital funds, accelerators).

Table 15. Estimated annual supply of equity to SMEs in 2017 in Serbia

| **Supply of equity to SMEs** | **(e) 2017 (EUR m)** |
|---|---|
| Private Equity/Venture Capital/Accelerator | 28-33 |
| Technology Transfer funds | 7 |
| **Total** | **35 – 40** |

(Source: PwC analysis, 2016)

## 7.2 Demand

### 7.2.1 The methodology used to compute demand

The methodology developed to assess the demand for financing from Serbian SMEs, relies on the sampling strategy used to conduct SME market research via telephone interviews. A sample size of 96,764 SME contacts that was used during the research was provided by the Statistical Office of Serbia. The questionnaire included 22 open questions (cf. Annex 4), and the SME survey was conducted according to the SME industry and the SME size breakdown into micro, small and medium enterprises. The surveyed SMEs reported their financing experience (in EUR) in the recent past and their financing needs in the near future. Target contact persons in each company were the owners and CEOs (in micro companies) or CFOs (in small/medium companies).

Given the random arrangement of the SME sample (i.e. 96,764 SMEs) and the number of responses obtained (i.e. 2000 responses), the demand figures provide a reasonable estimate for each of the categories of SMEs sizes in Serbia.

The quantification of the demand for funding has been performed separately for micro enterprises and for small and medium enterprises to increase reliability through a larger sample size. Moreover, interviews with representatives of SMEs and commercial banks (cf. Annex 2) have highlighted that financing demand from small and medium enterprises is often similar in Serbia. Various financial products have been considered in the analysis. The computation of the amounts that the companies expect to require in 2017 was performed by using the following approach:

- The "outliers" from the sample are left aside, i.e. where some firms indicated EUR amounts or extremely high financing figures for a particular type of financing. In order to avoid a situation where a few responses severely skew the global estimate of the demand, these responses are taken out.
- The average of the remaining amounts is calculated. This step is conducted for each financial product and for each analysed SME category, i.e. the micro companies on the one hand and the small/medium-sized companies on the other.
- The final calculation of the demand for the entire population of each category of companies is conducted as follows:
    - The total number of companies of the specific size category is computed (the number is adapted to show the realistic number of bankable companies)
    - This computed number is multiplied by the average amount to be sought in 2017

The results obtained for each financial product thus correspond to the estimated potential total demand for this specific product.

To ensure that the sample of SMEs was as representative as possible, the survey conducted for the study canvassed SMEs from different sectors (i.e. industries). It is important to remember that their answers are largely based on their perception of their own business needs, their expectations for the economy (GDP growth), and of the overall business climate. These subjective perceptions and expectations of the SMEs are formed in the current climate where the market operates within a relatively low-growth environment.

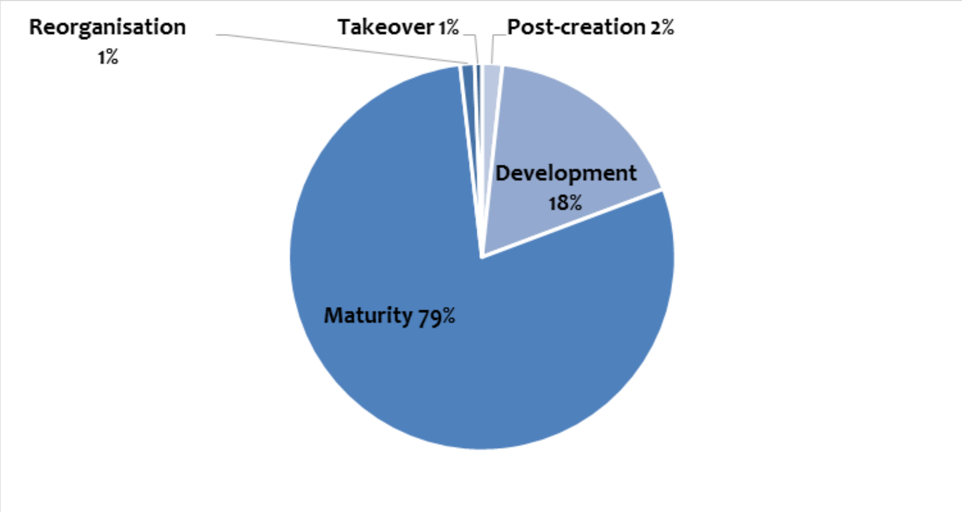
### 7.2.2 Demand for financing from micro enterprises

#### *7.2.2.1 Financing micro enterprises in Serbia*

Micro enterprises represent more than 95% of the SME population in Serbia. Assessing and improving micro enterprises' access to finance would consequently affect the largest part of the SME population, including its economic performance and social impact, particularly on job creation.

Results of the online survey indicate that very few respondents identified their company to be in the initial stages of the development lifecycle (initiation and creation). The results also indicate that only 2% of micro enterprises considered that their company is in a post-creation phase, as illustrated in Figure 2. Both of these could have a considerable potential to grow and create further job opportunities. On the other hand, 18% of all micro enterprises believed that their business was still developing and a majority of them (79%) believed that they have reached a maturity stage, which could still produce growth, but likely at a lower level.

Figure 2. Development stage of micro enterprises in Serbia[55]




(Source: PwC, SME survey among Serbian SMEs, 2016)

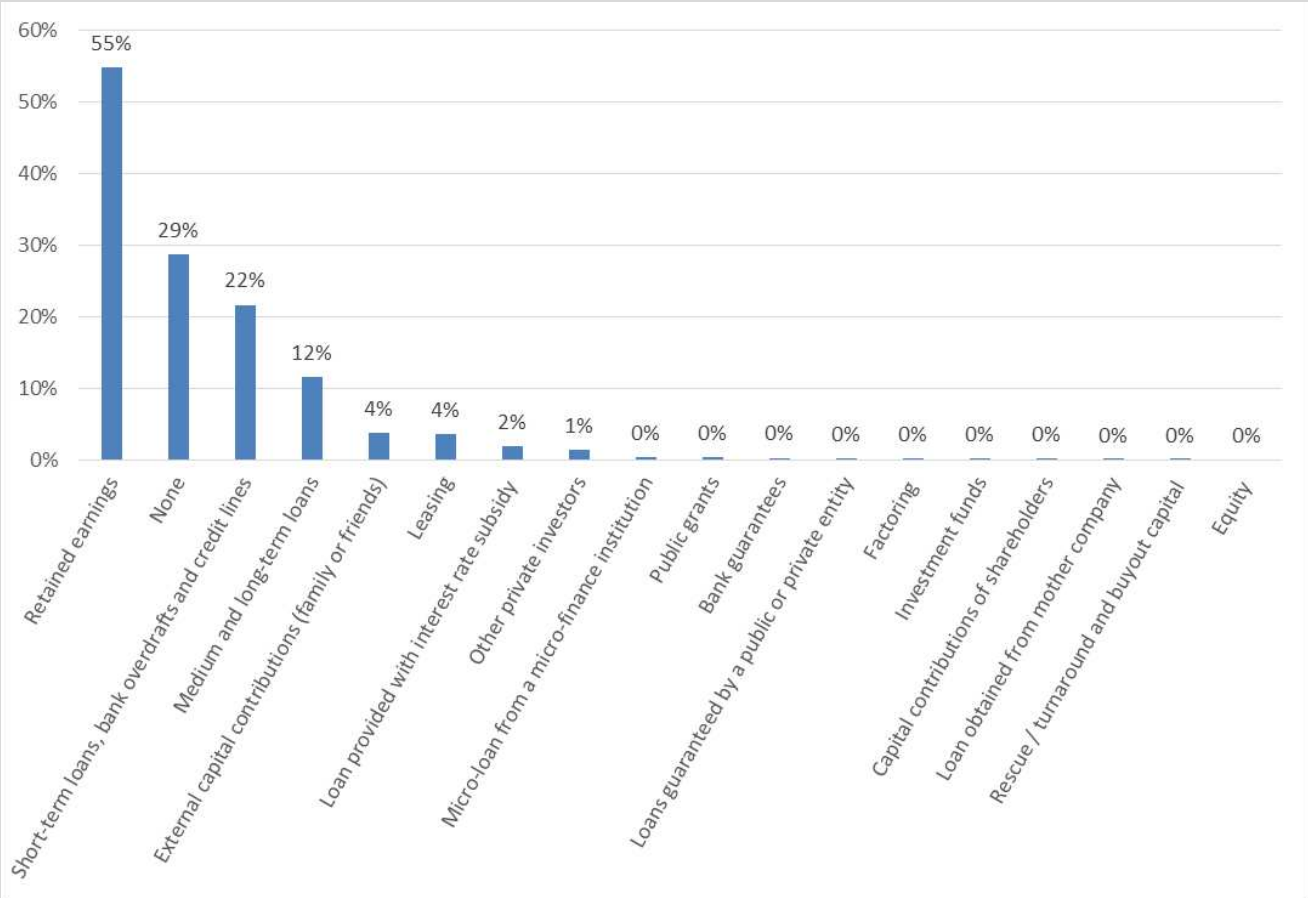
Figure 3 below illustrates that most of the micro enterprises that were interviewed used retained earnings (55%) to fund their business over the last three years (2014-2016). The rest of the enterprises used mainly short-term loans, bank overdrafts and credit lines (22%), and medium to long-term loans (12%).

Around 4% of all the micro enterprises indicated that they used capital contributions from family and friends, and 4% of them used leasing as a funding source. A small share of respondents used subsidised loans (2%), and only 1% had funding from private investors. 29% of all respondents did not use any source of financing. There were no respondents who used such other sources of financing as microfinance, public grants, bank guarantees or any type of equity financing.

In the survey, SMEs were asked to state how successful they were in obtaining different forms of financing. Out of those who used any financing at all, almost all were successful in obtaining it (only 1% was unsuccessful).

[55] The number of micro enterprises which have provided an answer: 1,660

Figure 3. Sources of funding used by micro enterprises between 2014 and 2016[56]




(Source: PwC, SME survey among Serbian SMEs, 2016)

According to a large proportion of micro enterprises, support from public and private institutions is perceived as limited. According to the SME survey, even those companies that were looking for finance did not seek such support. Moreover, when companies did seek assistance, they frequently had a feeling that it was not forthcoming. In particular, micro enterprises stated that they were not supported by the state (17% lacking support as opposed to 6% not lacking support) and by the city (13% lacking support as opposed to 9% not lacking support). 55% did not request any support from commercial banks, but a majority of those that did request it, did not have a feeling that they were lacking support from banks. Informal support by friends and family proved to be among the most effective, since 22% of the respondents felt supported by them upon asking for it. Other professional networks, such as accountants, tax or financial consultants, play an even more important role, with 42% of the respondents being satisfied with their assistance as illustrated in Figure 4 below.

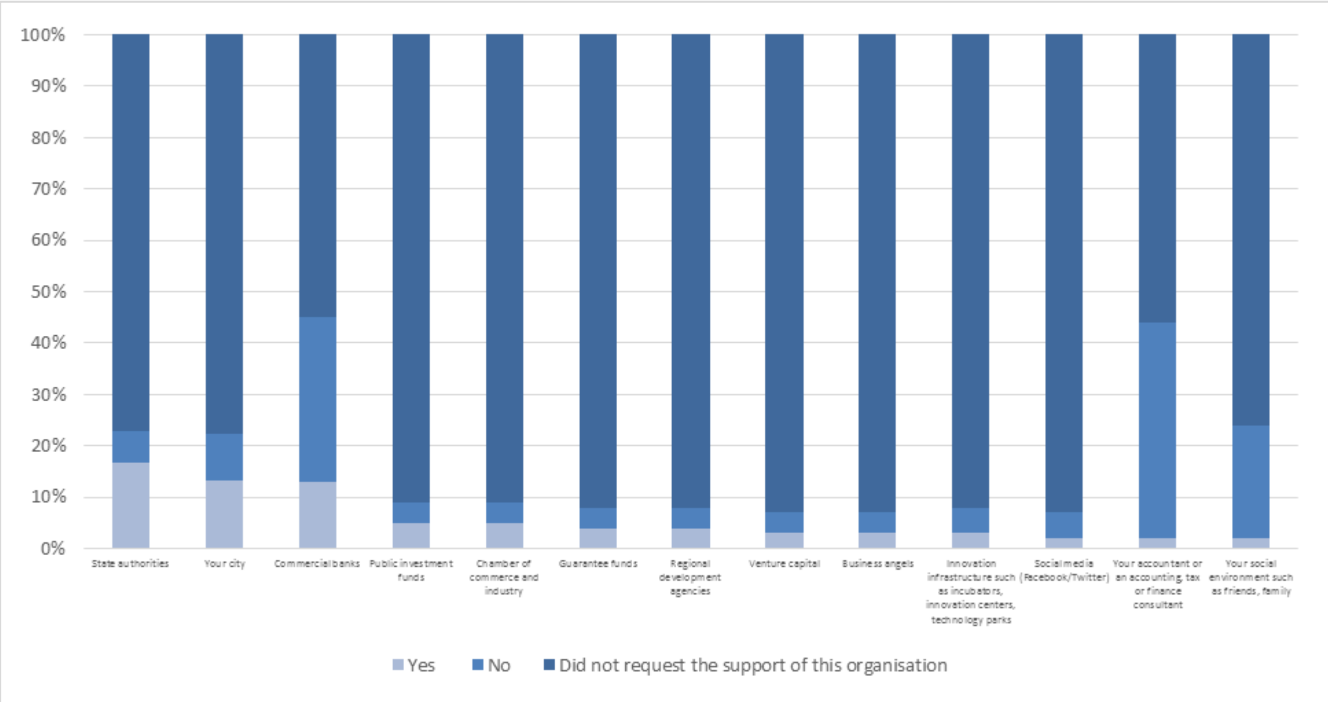
The survey further queried on the perception of sufficient access to finance for different products. Approximately 55% of micro enterprises seeking finance have stated they have sufficient access to short-term loans, bank overdrafts and credit lines, while 43% have indicated they have sufficient access to medium and long-term loans[57]. These two financial products are also the most relevant forms of financing to SMEs, with 67% and 59% of respondents indicating their relevance. What is interesting is

[56] The number of micro enterprises that provided an answer: 1,660

[57] The number of micro enterprises that provided an answer: 1,660

that 60% of micro enterprises have stated that microfinance is not relevant to them, and 23% have indicated that there is sufficient access to microfinance on the market. These results can be explained by their lack of knowledge about microfinance and a lack of formal institutions, so that some respondents might have confused it with micro loans provided by the banks. On the other hand, micro enterprises have felt that there is a lack of access to investment funds, equity financing, and grants, and so they considered them as the least relevant financing sources for SMEs (85% on average).

Figure 4. Feeling of lack of support among micro enterprises when seeking finance[58]




(Source: PwC, SME survey among Serbian SMEs, 2016)

Simultaneously, however, the majority of micro enterprises in Serbia did not feel discouraged when looking for finance. According to the survey conducted for this study, only 26% of micro enterprises in Serbia have felt always (4%), often (7%) or sometimes (15%) discouraged in seeking finance over the last three years[59]. This may be attributed to the fact that the majority of micro enterprises did not even look for external financing over the last three years. Another assumption could be made that the micro companies are generally not aware of the market opportunities and availability of different sources of financing. Micro companies (including entrepreneurs) may lack the requisite knowledge to seek finance.

86% of respondents faced no difficulties in accessing finance over the last three years. As for the respondents who faced difficulties, 5% of them attributed them to the financial situation of their businesses, 4% to the banks willingness to provide finance, and 4% faced difficulties related to loan applications.

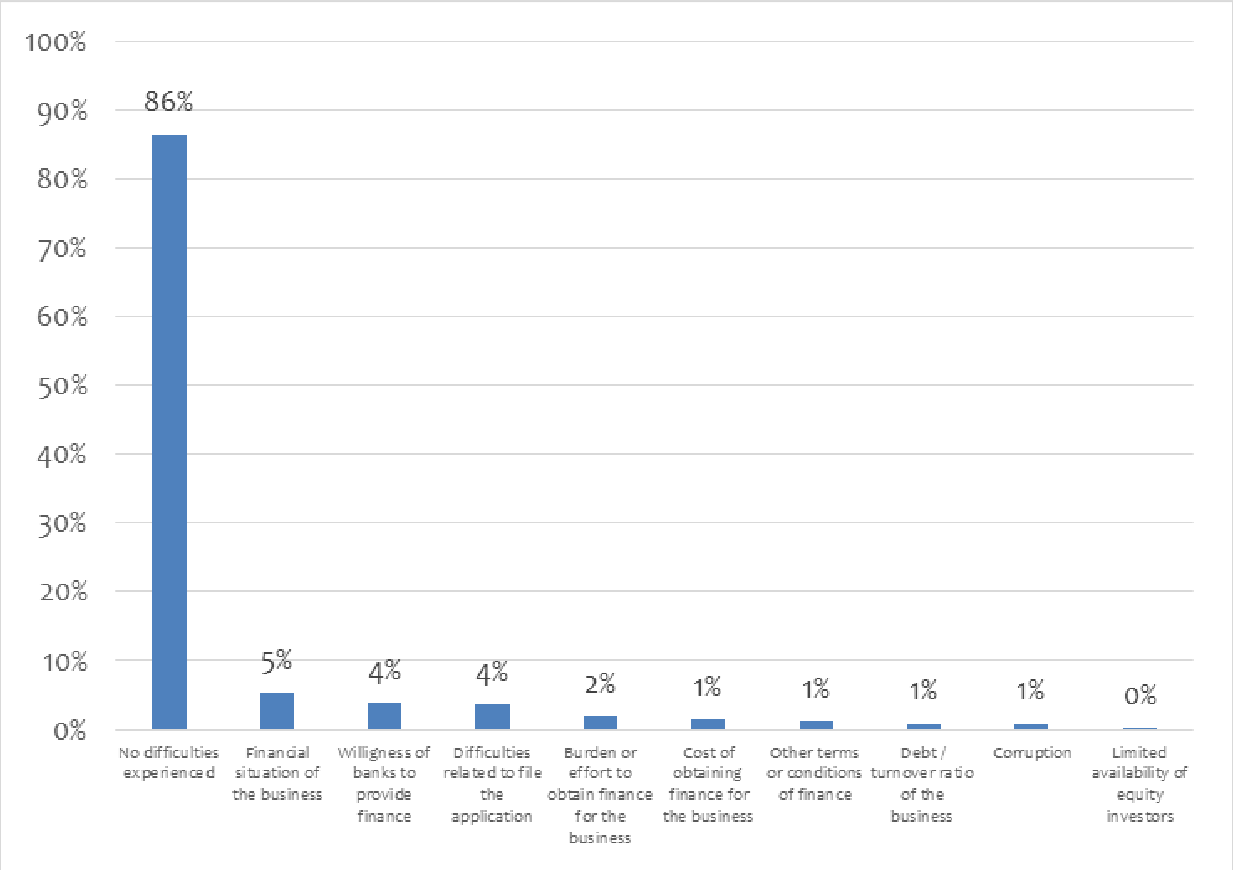
The main difficulties identified as barriers to SME financing can be linked to three factors: (1) the deteriorating financial situation of an enterprise, (2) a higher debt/turnover ratio, and (3) a higher cost

[58] The number of micro enterprises that provided an answer: 1,660

[59] The number of micro enterprises that provided an answer: 1,660

of obtaining finance for the business. When it comes to banks, 63% of respondents said that the banking behaviour did not change and there was still a willingness of banks to provide them with financing.

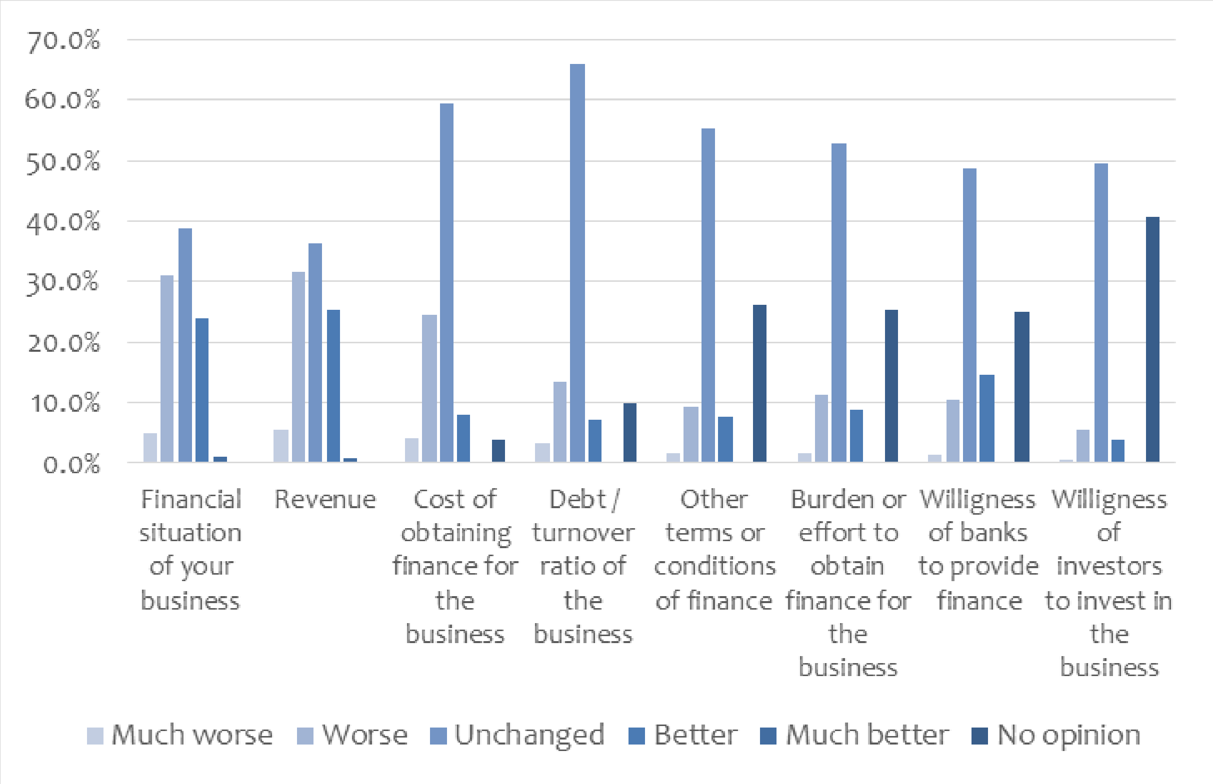
**Figure 5. Reasons for the difficulties for micro enterprises in accessing finance over 2014-2016**[60]




(Source: PwC, SME survey among Serbian SMEs, 2016)

[60] The number of micro enterprises that provided an answer: 1,660

Figure 6. Perception of change in the conditions of debt financing in 2014-2016 by micro enterprises in Serbia[61]

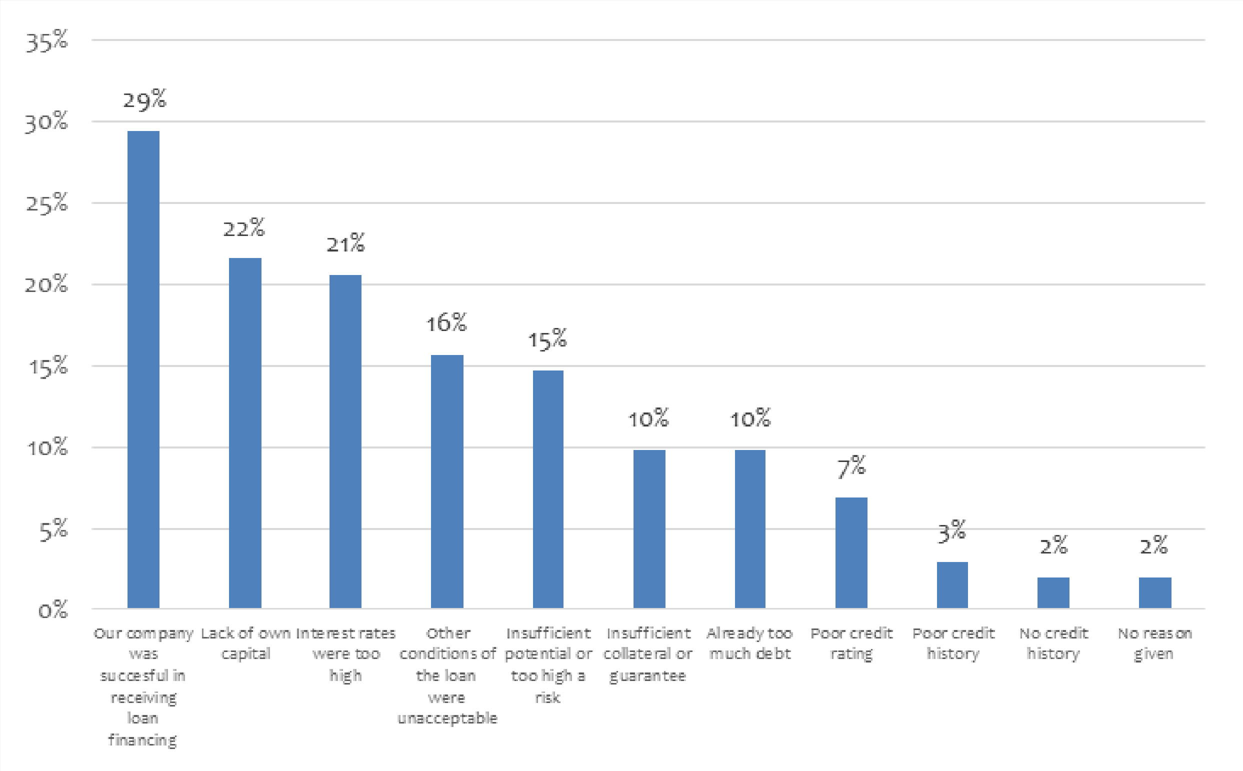



(Source: PwC, SME survey among Serbian SMEs, 2016)

More than 80% of respondents did not ask for any financing. However, of those that did, only 6% were unsuccessful or partially successful in obtaining loans. The main reasons for facing obstacles in accessing debt finance are: lack of own capital (22%), high interest rates imposed by the commercial banks (21%) and other loan conditions which were unacceptable (16%), such as insufficient collateral (10%).

[61] The number of micro enterprises that provided an answer: 1,660

Figure 7. Obstacles to loan financing reported by micro enterprises[62]



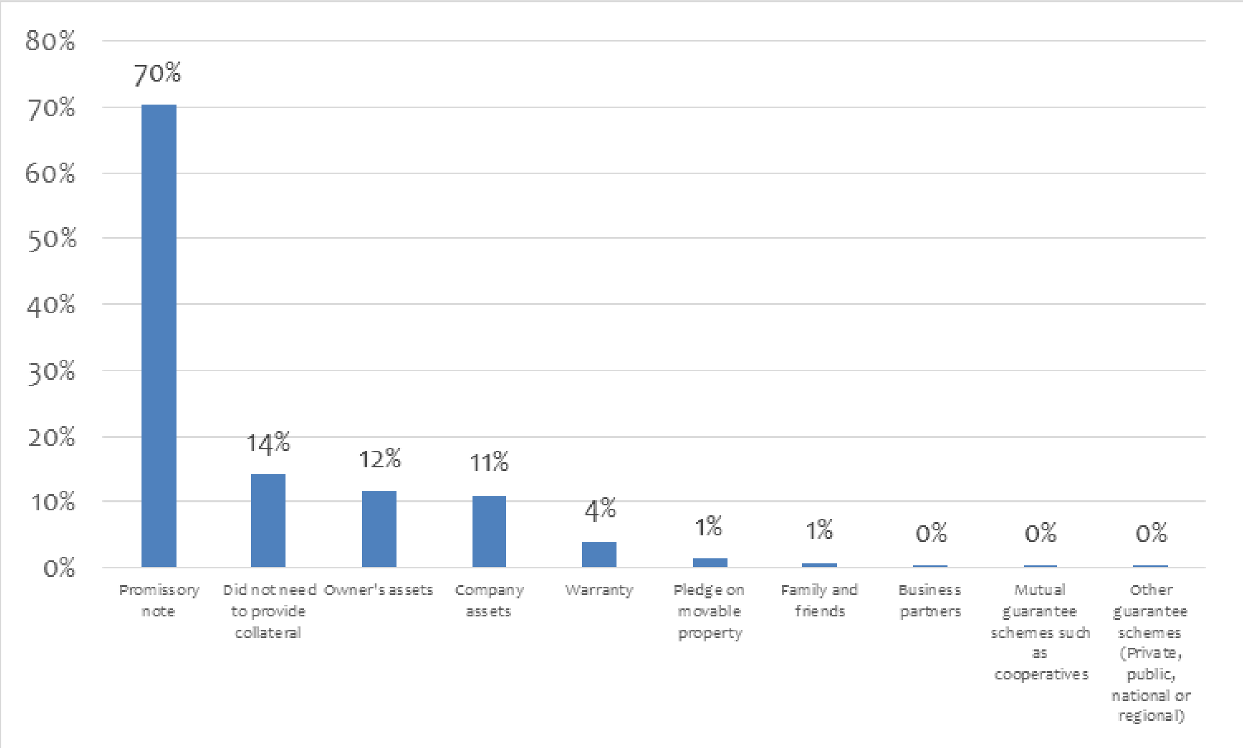

(Source: PwC, SME survey among Serbian SMEs, 2016)

Despite the abovementioned difficulties in getting loans, those of the respondents that did receive them, received on average the same amount they had sought.

However, it is of note that successful loan applications require collateral. As illustrated in Figure 8 below, out of 35% of SMEs which obtained loans as a source of financing over the last three years, 70% had to issue promissory notes as collateral. Promissory notes are a key condition for all banks in Serbia. Besides the promissory notes, 12% relied on own assets and 11% on company assets as loan collateral.

[62] The number of micro enterprises that provided an answer: 102

**Figure 8. Type of collateral provided for debt financing by micro enterprises**[63]

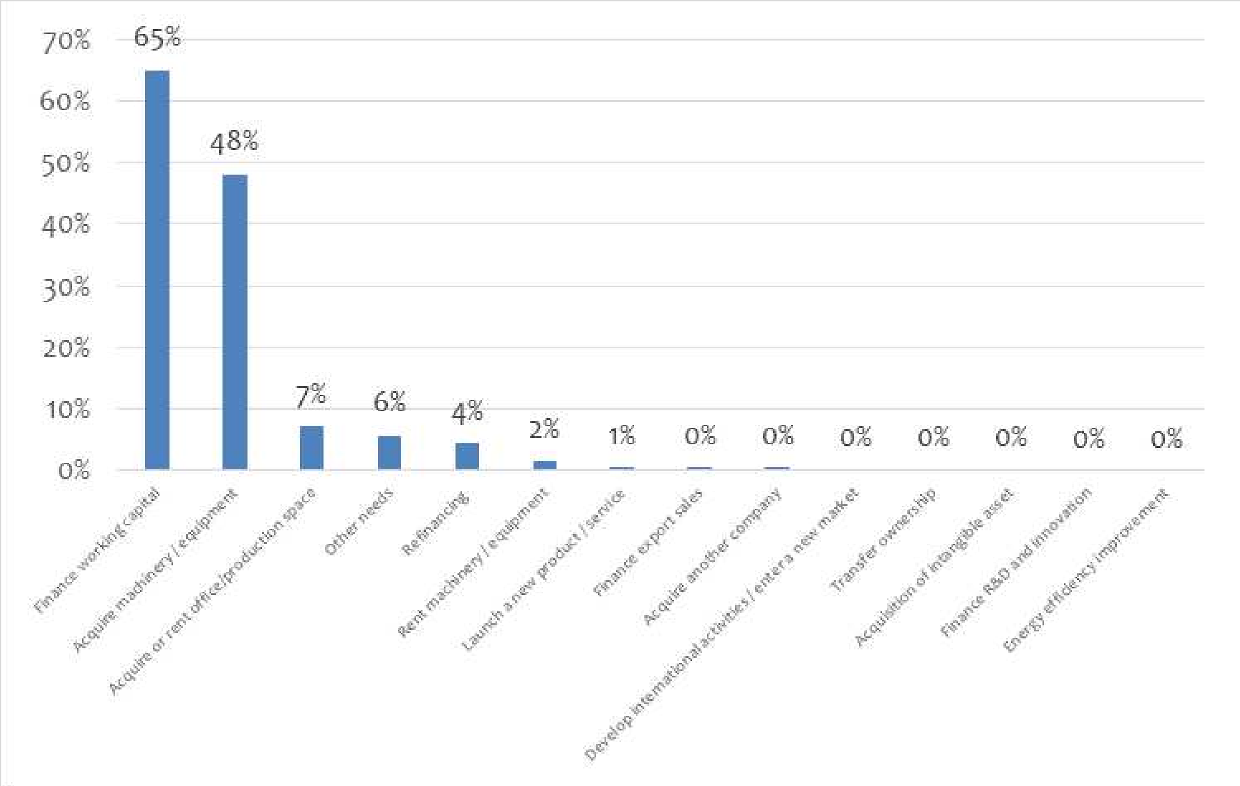



(Source: PwC, SME survey among Serbian SMEs, 2016)

Concerning the purpose of financing, the SME survey highlighted that the financing obtained by micro enterprises was primarily used for working capital (65% of reasons to seek financing). The launch of new products and services accounted for only 1% of reasons given, which was less than the acquisition of machinery, equipment, land or buildings category, with over 56%. Only 4% of the stated purpose for financing was used for refinancing of the existing obligations. No financing was used to enter new markets. It has been indicated that the local market is limited and saturated, with limited opportunities for growth. *Therefore, the unwillingness or inability of micro enterprises to expand their business scope or export their products and services is a crucial indication.* Apart from the existing government programmes that promote exports, there should be further support to motivate micro enterprises to seek new opportunities.

[63] The number of micro enterprises that provided an answer: 526

Figure 9. Use of funding by micro enterprises (2014-2016)[64]




(Source: PwC, SME survey among Serbian SMEs, 2016)

The survey also investigated the needs of micro enterprises for future funding sources in 2017. The results for the products that micro-companies intend to seek are presented in Figure 10. The majority of the respondents (65%) do not plan to seek external financing or will use retained earnings (24%) as a source of funding.  The rest of the respondents plan to use traditional banking products, such as loans (13%) and external contributions from family or friends (3%). This is probably due to the lack of alternative finance providers in Serbia. Equity funding from corporate bonds or rescue / turnaround and buyout, or mezzanine and hybrid finance, were not mentioned as a future financing source by the micro enterprises which responded to the questionnaire.

Those who will use external funding have reported that they will use it mainly to finance working capital (64%) and to purchase equipment or machinery (36%)[65].

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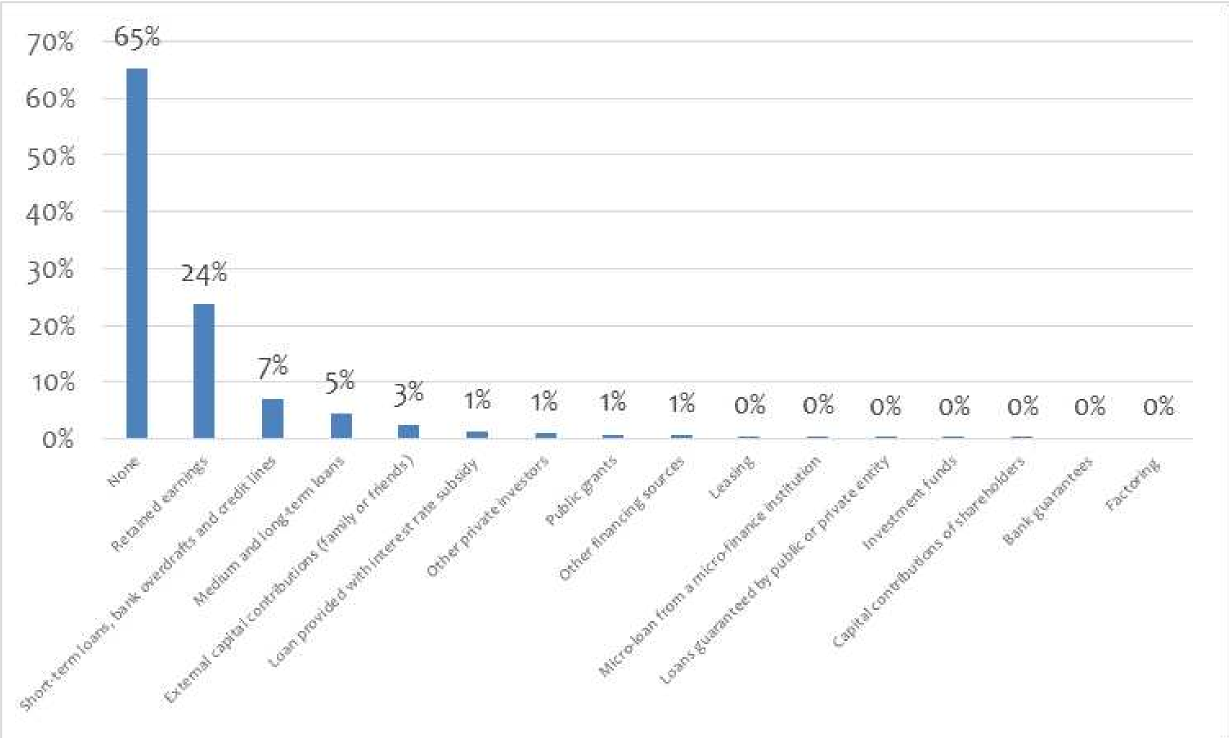
[64] The number of micro enterprises that provided an answer: 1,184

[65] The number of micro enterprises that provided an answer: 576

**Figure 10. Expected sources of financing in 2017 indicated by micro enterprises**[66]




(Source: PwC, SME survey among Serbian SMEs, 2016)

### *7.2.2.2 Quantification of potential demand by micro enterprises in Serbia*

The information provided by micro enterprises in the SME survey was used in estimating demand for the following financial products

- Short-term loans, bank overdrafts and credit lines
- Medium and long-term loans

The average amount of short-term loans to be sought by micro enterprises in 2017 is EUR 14,605. The average amount of medium and long-term loans is EUR 44,057.

To calculate micro enterprises' total demand for each selected financial product, the total population of micro enterprises has been identified on the basis of the following analysis:

- First, the number self-entrepreneurs was removed (231,616), because they have different financing needs
- Second, 38% of the remaining micro-enterprise population is considered, since only this proportion of micro enterprises is considered bankable according to the information received from the market

In order to estimate the total demand from micro enterprises, the average amount is multiplied by the adjusted population (30,904 micro enterprises).

[66] The number of micro enterprises that provided an answer: 1,660

This method is applied to computing a demand estimate in 2017 for the two financial products. A variation of -5% and +5% around this volume is then calculated to take into consideration the potential fluctuation of demand. The results by product are given in the table below.

**Table 16. Annual demand for financial products by micro enterprises in Serbia in 2017**

| | Average finance to be sought by a single micro enterprise (EUR m) | Finance to be sought by all micro enterprises (EUR m) |
|---|---|---|
| Short-term loans, bank overdrafts and credit lines | 0.015 | 429 - 474 |
| Medium and long-term loans | 0.044 | 1,293 - 1,430 |

(Source: PwC analysis, 2016)

Micro enterprises usually consider taking out long-term loans to renew their equipment and machinery. However, they are also willing to use them to support their financing needs over the next few years, especially for working capital purposes. In fact, micro enterprises seem not to be able to clearly distinguish the purpose of loans based on different loan tenors when looking for financing.

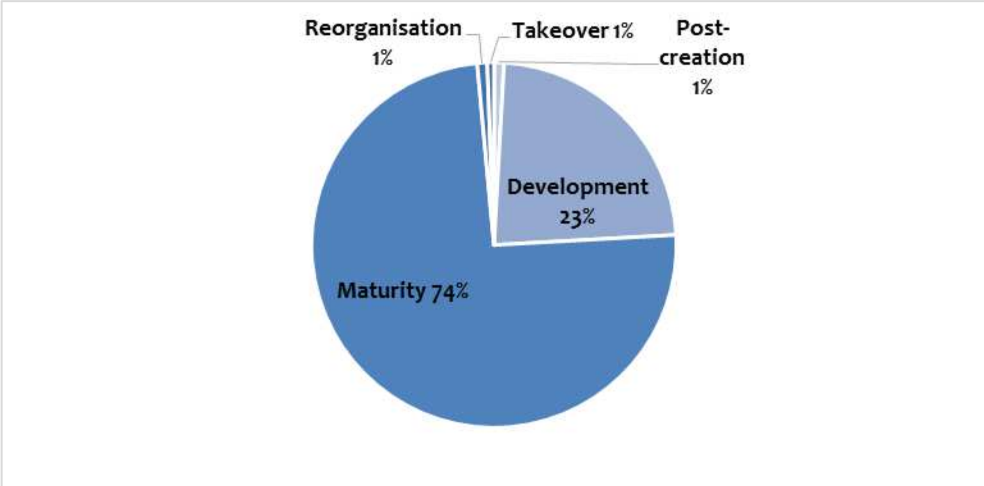
### 7.2.3 Demand for financing from small and medium enterprises in Serbia

#### *7.2.3.1 Financing small and medium enterprises in Serbia*

Small and medium enterprises represent only 4% of the total legal entities in Serbia, but they generate 40% of the total corporate revenues in Serbia. Assessing and improving small and medium enterprises access to finance would consequently affect the overall economic performance of Serbia, boost the GDP and, therefore, improve the living standards.

Figure 11 shows that a significant share – nearly a quarter of all respondents (23%) – believed that their business was in a developing stage of its life cycle, indicating that they expected further business growth and an increase in their number of employees. The survey also revealed that around 74% of respondents saw their business in the maturity stage, meaning that they did not envisage significant growth of their company. Only 3% of the respondents saw their company as being reorganised, taken over or in a post-creation phase.

**Figure 11. Development stage of SMEs in Serbia**[67]



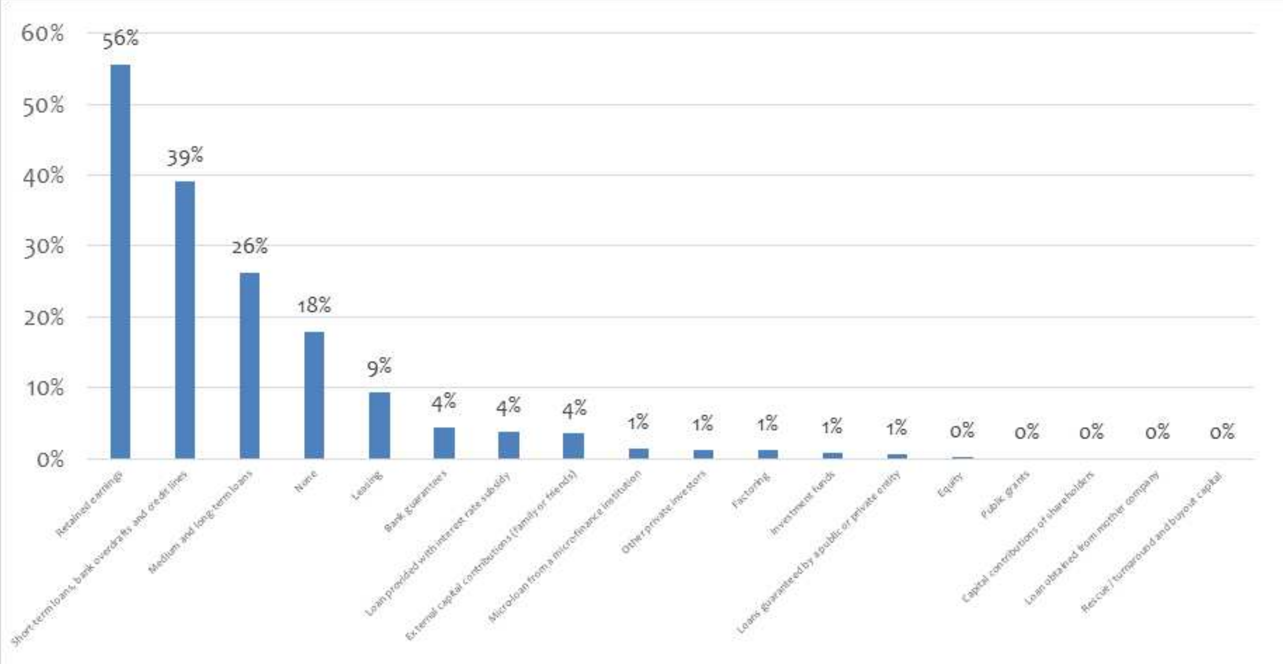

(Source: PwC, SME survey among Serbian SMEs, 2016)

Figure 12 below illustrates that most of the surveyed small and medium enterprises used bank overdrafts and credit lines (39%), and medium to long-term loans (26%), to fund their businesses over the last three years (2014-2016). When compared to micro enterprises, SMEs were more open to loans (30% more companies used loans), leasing (9% compared to 4%), and to subsidised loans (4% compared to 2%). Around 18% of the small and medium enterprises did not use any source of funding, which gives the potential for future growth of funding in Serbia. Similar to micro enterprises, about half of SMEs financed their operations and investment needs through retained earnings, but those SMEs naturally relied more on external sources due to their higher needs in financing than for micro companies.

Around 4% of all small and medium enterprises indicated that they used external capital contributions from family and friends. One percent of respondents used micro-loans from a micro-finance institutions, other private investors, factoring or an investment fund. There were no respondents who used other sources of financing, such as equity, public grants, capital contribution of shareholders, loans obtained from the mother company, and rescue/turnaround and buyout capital.

[67] The number of small and medium enterprises that provided an answer: 340

**Figure 12. Sources of funding used by small and medium enterprises between 2014 and 2016**[68]

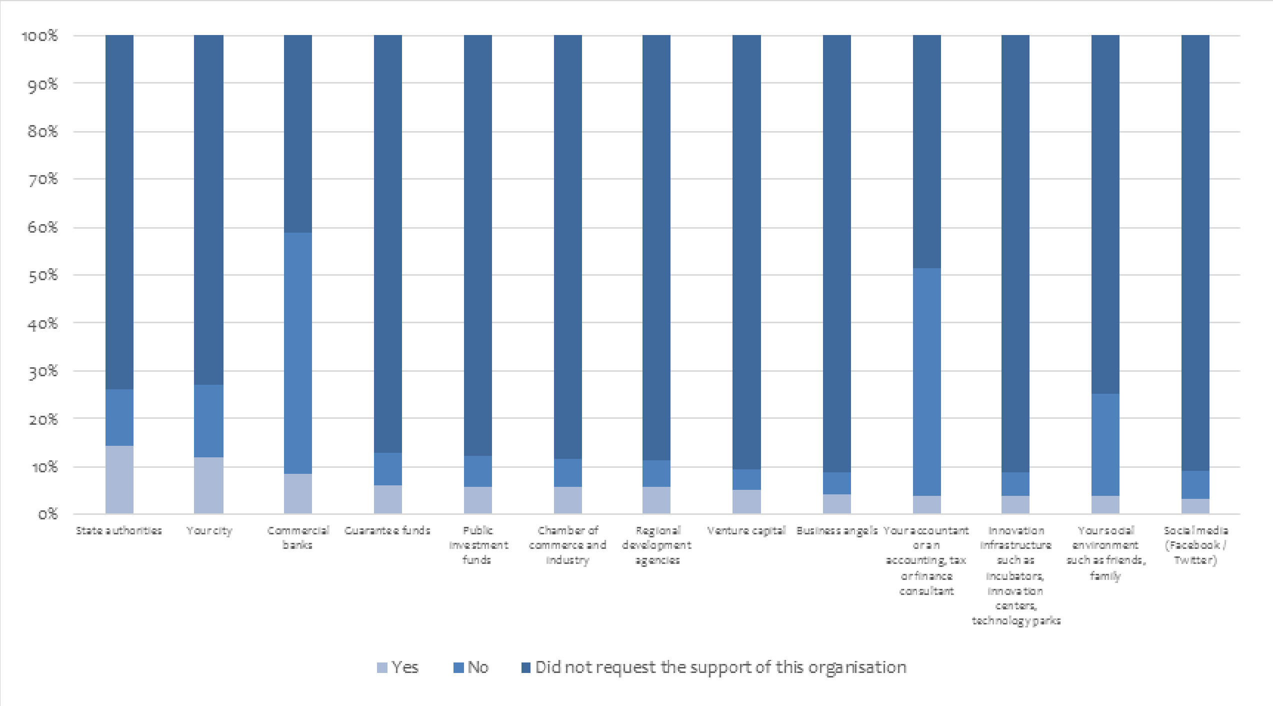



(Source: PwC, SME survey among Serbian SMEs, 2016)

When seeking finance, SMEs most frequently look for support from commercial banks (59% of respondents) and accountants, tax experts and financial advisors (52%). A lower percentage of respondents seek support from the state (26%). Out of those who were seeking support from the state, 14% had a feeling it was not forthcoming, compared to 12% that did not. The situation was similar to that reported by micro enterprises, and so it can be concluded that when enterprises seek financing, they generally do not seek support from the state. Those which did request support considered banks as the most supportive institution. There is a higher share of SMEs that seek support from banks, compared to micro enterprises (59% of SMEs compared to 45% of micro enterprises seek support from banks), and they felt that they did not lack support when requested. A slightly closer and more trusting relationship between SMEs and banks can be linked to a larger asset base, credit history and experience in dealing with financial institutions of the SMEs compared to micro companies.

[68] The number of small and medium enterprises that provided an answer: 340

Figure 13. Feeling of lack of support among small and medium enterprises when seeking finance[69]




(Source: PwC, SME survey among Serbian SMEs, 2016)

Generally, 92% of the respondents faced no difficulties in accessing finance over 2014-2016. In the survey, companies were asked to state how successful they were in accessing different financing sources. The situation was similar to that for micro enterprises where, out of those who used financing, almost all were successful in obtaining it (only 1% unsuccessful). The only difference was that a higher share of SMEs sought financing than in the case of micro enterprises (40% SMEs were seeking support, compared to 20% micro enterprises).

The survey further queried on the perception of sufficient access to finance for different products. Approximately 80% of small and medium enterprises which sought financing have reported sufficient access to short-term loans, bank overdrafts and credit lines, while 68% of small and medium enterprises which sought financing reported sufficient access to medium and long-term loans[70]. These two financial products were also the most relevant forms of financing for SMEs, with 83% and 78% of respondents indicating their relevance. On the other hand, SMEs felt there was a lack of access to investment funds, equity financing and grants, and they also saw them as the least relevant financing sources for SMEs (85% on average).

When focusing on debt financing, 51.5% of small and medium enterprises were successful in receiving loans. For the companies that faced obstacles, these were high interest rates (24.2%), followed by poor credit rating and insufficient collateral or guarantee (18% and 12%), especially for small companies. It is to be noted that high interest rates were more linked to "risk premium" required by the banks than the systemic/macroeconomic situation in Serbia; considering that this situation improved over the past few years according to the market stakeholders. The views of the respondents are in line with the

[69] The number of small and medium enterprises that provided an answer: 340

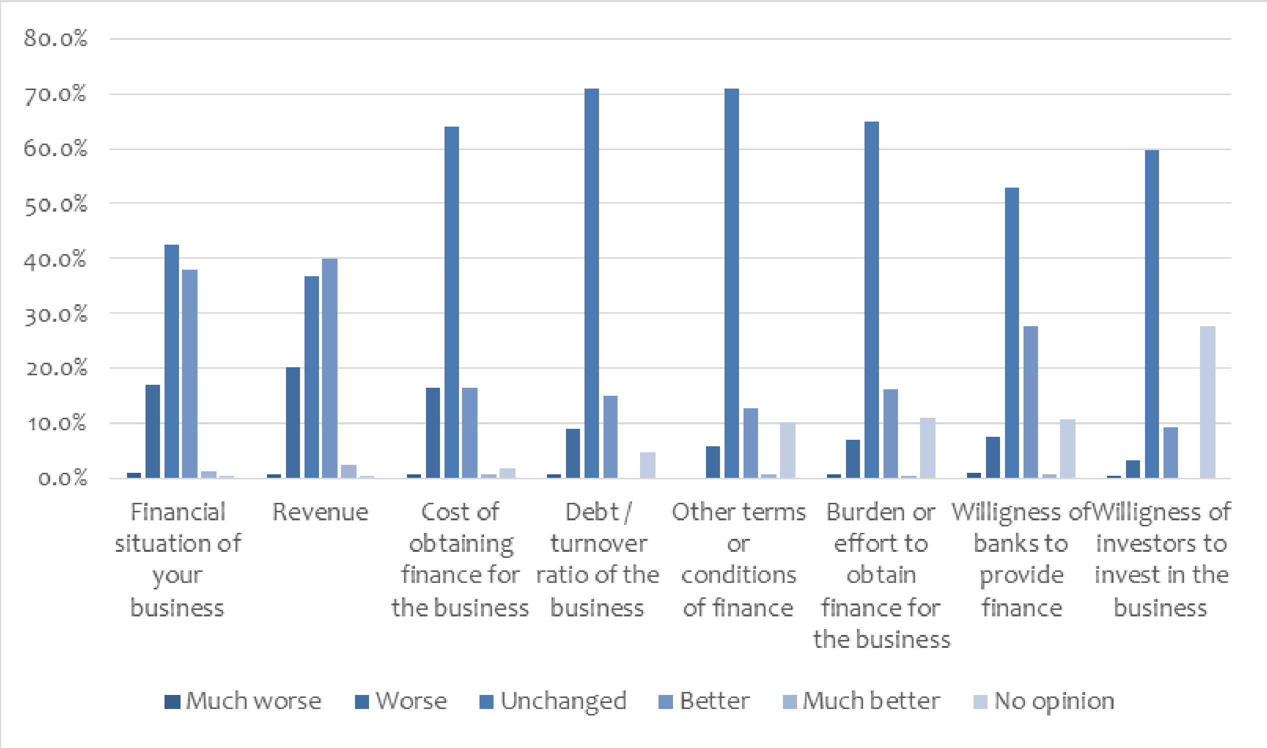
[70] The number of small and medium enterprises that provided an answer: 340

perception in the market: the problem is more to do with the affordability of loans than with access to finance.

Indeed, between 30% and 40% of SMEs were of the opinion that banks' willingness to lend (28%), the financial situation of the company (38%) and revenue (40%) improved over 2014-2016. *These proportions are higher than for micro companies, so this is another signal that the banks in Serbia are more accommodating for SMEs than for micro companies, and that SMEs are showing much better financial performance than the micro companies.*

Figure 14 below illustrates how SMEs perceived changes in loan financing.

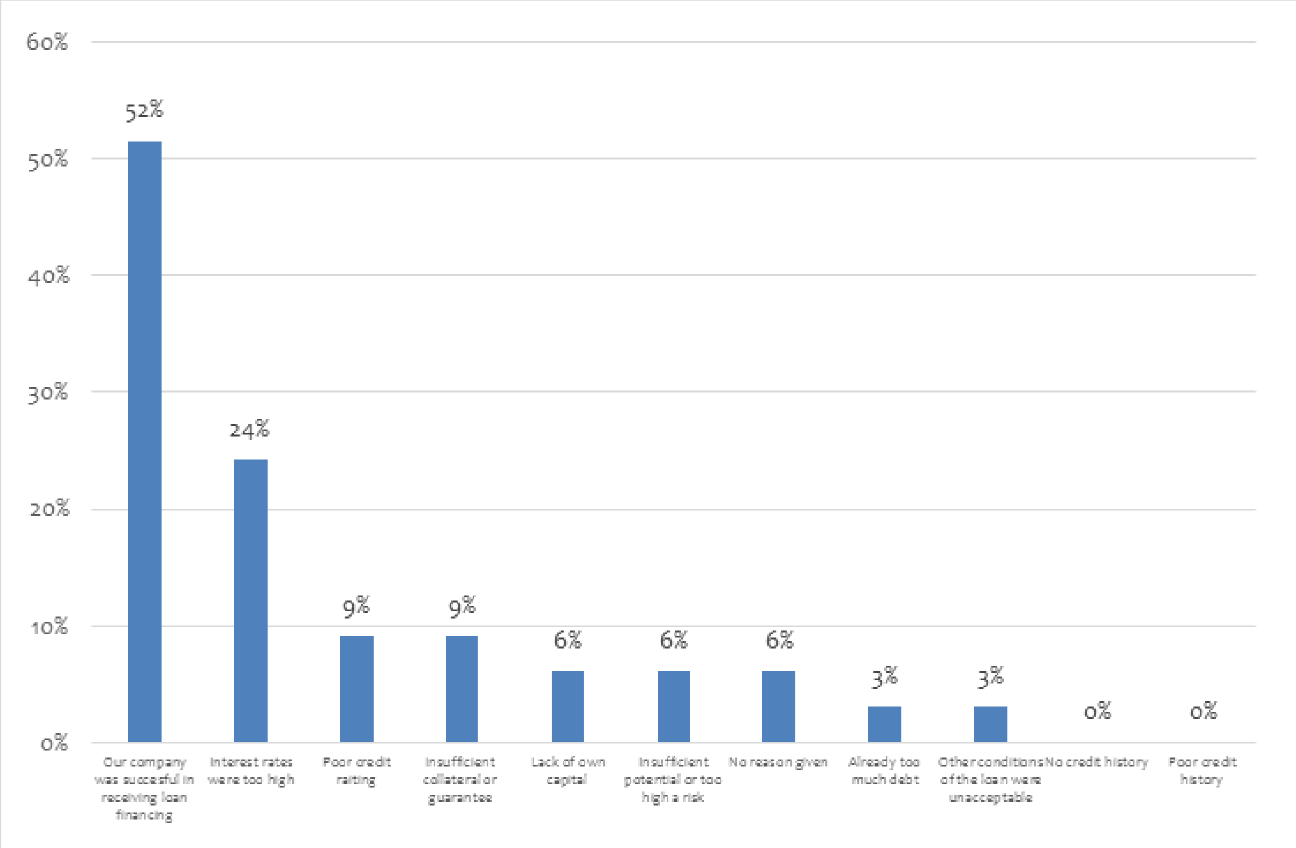
**Figure 14. Perception of change in the conditions of debt financing in 2014 -- 2016 by small and medium enterprises in Serbia**[71]




(Source: PwC, SME survey among Serbian SMEs, 2016)

[71] The number of small and medium enterprises that provided an answer: 340

**Figure 15. Obstacles to loan financing reported by small and medium enterprises**[72]




(Source: PwC, SME survey among Serbian SMEs, 2016)

The above strongly suggests that SMEs have generally less of a problem in accessing finance than micro enterprises do. There is, hence, a feeling of lesser discouragement amongst the SMEs than amongst the micro companies surveyed. Around 17% of SMEs felt always, often or sometimes discouraged in seeking finance over the last three years, as opposed to 26% of micro companies[73].

SMEs were also asked to identify the reasons why they sought financing. Almost two thirds of their financing was used to finance working capital (65%) and almost half of their financing was used to acquire machinery or equipment (55%). Over 10% of financing was used for the purchase or rental of land and buildings, which means that almost 65% of their financing was allocated to investment needs. Only a small proportion of reasons was related to the refinancing, rent of machinery and equipment and other needs (4% each). *This confirms the reluctance of companies to invest in R&D.* Moreover, only 1% of indicated purposes for seeking financing by small and medium enterprises targeted export sales. This percentage is rather low, especially when considering that expansion within the local market is limited and growth largely depends on access to other markets abroad. It is noticeable that the same situation for micro enterprises confirms the relative insularity of the Serbian economy and the reliance of SMEs on the domestic market.

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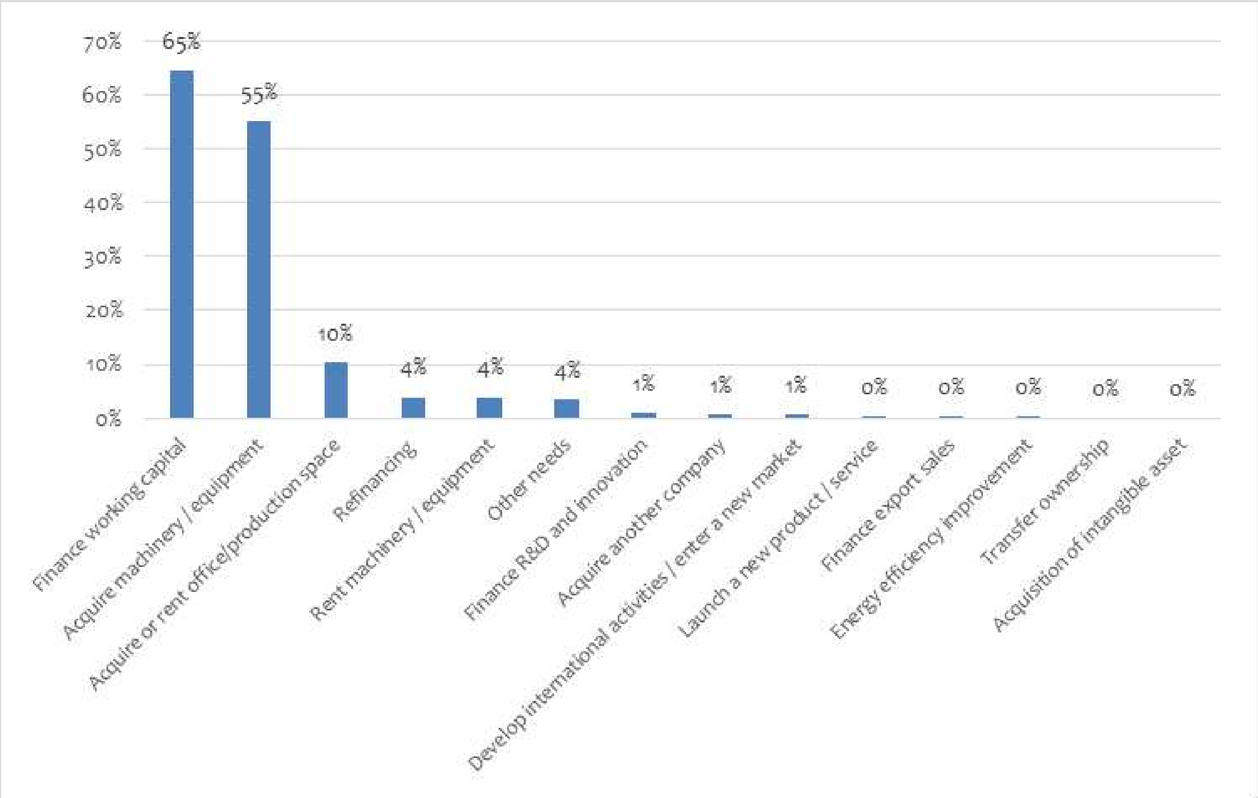
[72] The number of small and medium enterprises that provided an answer: 33

[73] The number of small and medium enterprises that provided an answer: 340

Figure 16. Use of funding by small and medium enterprises over 2014-2016[74]

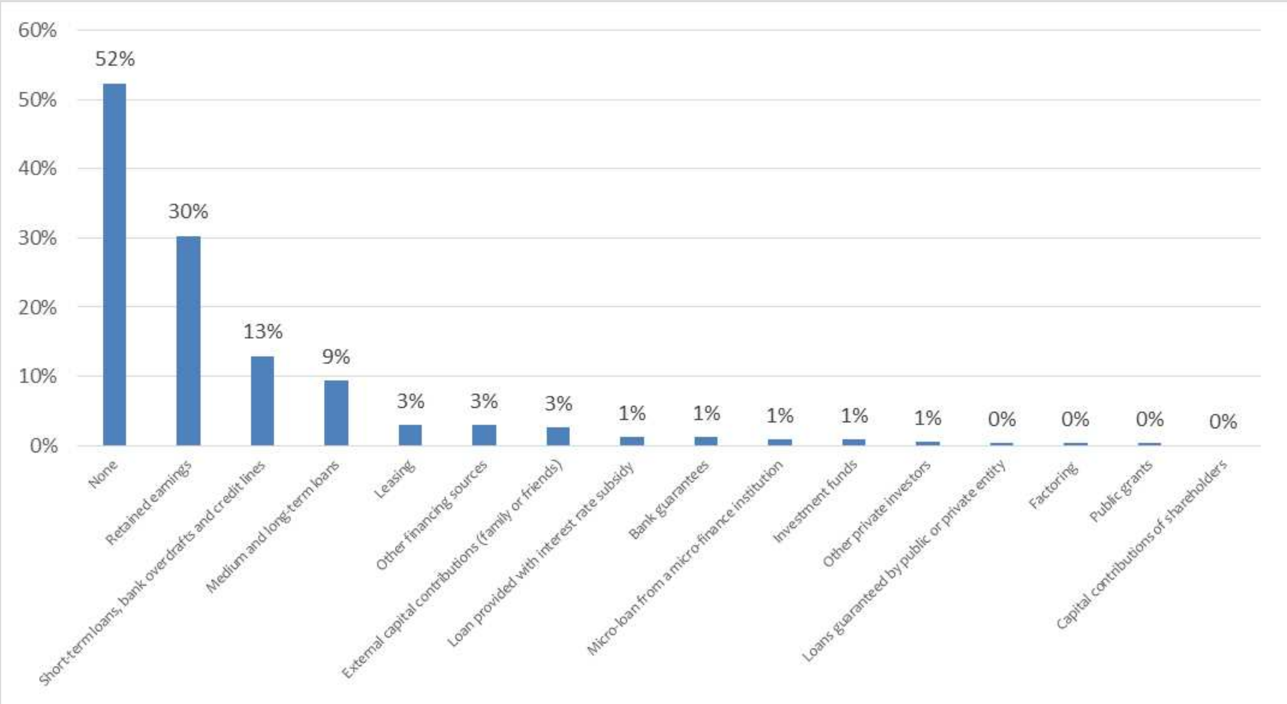



(Source: PwC, SME survey among Serbian SMEs, 2016)

Small and medium enterprises plan to seek similar products in 2017 when compared to the past, as indicated in Figure 17, especially: retained earnings (30%), short-term loans, bank overdrafts and credit lines (13%) and medium and long-term loans (9%). Equity funding from investment funds, other private investors and micro-loans from micro-finance institutions were only mentioned a few times. In addition, other forms of financing, such as loans guaranteed by public or private entities, factoring, public grants and capital contribution of shareholders, were not selected. 52% of the respondents, however, do not plan to use any source of financing in the future.

[74] The number of small and medium enterprises that provided an answer: 279

Figure 17. Expected source of funding in 2017 indicated by small and medium enterprises[75]




(Source: PwC, SME survey among Serbian SMEs, 2016)

According to all respondents' views, the three most important factors that limit growth in Serbia are: (1) regulatory framework (44% of all respondents), (2) poor collection of receivables (38%) and (3) limited demand in the local market (32%).

### *7.2.3.2 Quantification of potential demand by small and medium sized companies in Serbia*

The quantification of demand for financing for small and medium enterprises has been calculated for the two size categories together. The following quantification of demand from these companies uses the methodology described in Chapter 7.2.1 for the following financial products:

- Short-term loans, bank overdrafts and credit lines
- Medium and long-term loans

Similar to micro enterprises, small and medium enterprises have not indicated amounts that can be appropriately used for the quantification of the potential demand for other financial products, such as leasing and factoring.

After implementing all the steps of the methodology, the average potential demand for each product from a single small or medium enterprise is provided for 2017. For short-term loans, the average demand amounts to EUR 57,143. The average amount has also been computed for medium and long-term loans (EUR 124,750), as given below.

[75] The number of small and medium enterprises that provided an answer: 340

Table 17. Annual demand for financial products by small and medium enterprises in Serbia in 2017

| | Average finance to be sought by a single small or medium enterprise (EUR m) | Finance to be sought by the total population of small or medium enterprise (EUR m) |
|---|---|---|
| Short-term loans, bank overdrafts and credit lines | 0.057 | 308 - 340 |
| Medium and long-term loans | 0.125 | 671 - 742 |

(Source: PwC analysis, 2016)

In order to estimate the demand from the whole population of small and medium enterprises, the average amounts were multiplied by the number of enterprises (50% of the total number of small and medium enterprises as it was communicated in the interviews that this percentage of small and medium enterprises is bankable), and a variation of -5% and +5% was applied.

Small and medium enterprises in Serbia need both short-term and long-term financing. Importantly, the average amount of medium and long-term loans (EUR 124,750) to be sought in 2017 is nearly twice as high as for short-term loans (EUR 57,143). The shortage of financing in small amounts may prompt companies to request larger amounts of longer tenor to cover both investment and working capital needs for a few years (the latter being normally covered by short-term loans for a period of one year).

*Potential demand for equity financing from the SME population in Serbia*

The estimate of demand for equity financing in Serbia can only be indicative and needs to be qualified by factors such as the capacity of the SMEs successfully to pitch projects to investors, the ability of the SMEs to be well supported by a suitable network – e.g. SME sectoral networks, innovation hubs, incubators, accelerators – and the investors interest in the sector.

Some equity funds are available on the Serbian market (described in Chapter 7.1). However, SMEs have limited experience or even awareness of both equity funding and how this funding could benefit their businesses. Moreover, the companies are not prepared to give up part of their company ownership via VC-type investments. Factors like moderate innovativeness and insularity of the market, and a small size of many businesses, leave relatively few Serbian companies interested in financing innovation or significant growth. *Hence, it could be argued that new equity supply would not automatically trigger high-quality demand.* However, availability and dissemination of success stories might encourage SMEs to develop their capacities and grow in order to become more investable.

The estimate of demand for equity financing in Serbia will mainly remain qualitative, since it is recognised that quantifying demand for equity may depend on many contextual factors, such as: the capacity of SMEs to pitch their projects and attract investors, the ability of SMEs to be well-supported by a suitable network, and the interest of investors in the sector.

In contrast to debt products that can support a very wide range of potential companies in terms of size and sectors with their working capital and investment needs, equity financing is only appropriate for a small subset of companies. These potential investments could be attractive for equity investors but only if other conditions are first met. For this reason, it is important to define the prerequisites sought by investors. For early stage financing, the profile of the entrepreneur and his or her educational or professional background are important, as well as the viability and scalability of the business. The level of innovation deriving from the business is a priority along with defining growth perspectives before considering the size of the company or even the sector.

### 7.2.4 Principal Component Analysis (PCA)

Principal Component Analysis (PCA) is an advanced statistical procedure (cf. Box 1) that has been used in this study to support the analysis of demand. The PCA is widely used to analyse big data sets with the aim of structuring and simplifying the data to analyse. With the PCA, the initial data can be reassembled into a small number of main variables called "principal components". When analysing SMEs' access to finance, the correlation of these principal components with an SME size captures all the relevant information that can be shown in one simple graph. This facilitates the identification of the main characteristics of each SME size and helps compare between the SME size categories.

As the analysis of demand for financing done in this section describes each SME size category, the PCA helps better to understand the correlation between SME responses to the survey questions within each SME size category. Different variables from the survey have been taken into consideration to conduct the PCA, including: the perception of change in the turnover of the enterprises, the sources of financing used over 2014-2016, the use of the financing obtained over 2014-2016, and the reasons behind the difficulties in seeking finance over 2014-2016. Furthermore, the main characteristics of each SME size category over 2014-2016, what they anticipated to happen in 2017 (e.g. the sources of financing considered for 2017), and the use of the financing to be sought in 2017, have all been considered for each SME size category.

The PCA conducted in Serbia indicates that micro-enterprises, small enterprises and medium-sized enterprises have different behaviour patterns in terms of: the sources of financing used in the past, the use of financing, and the reasons behind their problems in seeking and obtaining finance. The paragraphs below explain the methodology used to perform the PCA, and the three PCAs conducted for each SME size category in Serbia.

The methodology used to perform the PCA to assess the demand for financing for each SME size category in Serbia is described in the box below.

**Box 1: The rationale behind using the Principal Component Analysis and its methodology**

The Principal Component Analysis (PCA) enables the analysis of correlations between different variables and helps determine if a specific population group (here a SME size category) acts in a very different way from other population groups (i.e. the other SME size categories in the present ex-ante study).

The PCA represents correlations graphically[76], as determined by the distance between **individuals** and different **variables**. In the analysis of SMEs' access to finance, the individuals are the SME size categories (micro-enterprises, small enterprises and medium-sized enterprises) and the variables are, for instance, the perception of change in turnover of the enterprises, the sources of financing used in the past, the use of financing obtained

[76] The correlation of every point on the axes that will be defined during the analysis expresses the quality of the representation of this point *vis-à-vis* the axes. It takes values between 0 (corresponding to the total lack of correlation with the entire set of variables) and 1 (corresponding to a strong correlation with the entire set of variables). If this value is close to 1, then the point is well represented on the axes.

in the past, and the reasons behind difficulties in seeking finance.

The outputs of the PCA are to:

- Visualise and analyse the behaviour of each individual (i.e. each SME size category in comparison with the other size categories)
- Visualise and analyse the correlations between the variables and each individual, and to
- Measure the distance between each individual and each of the variables

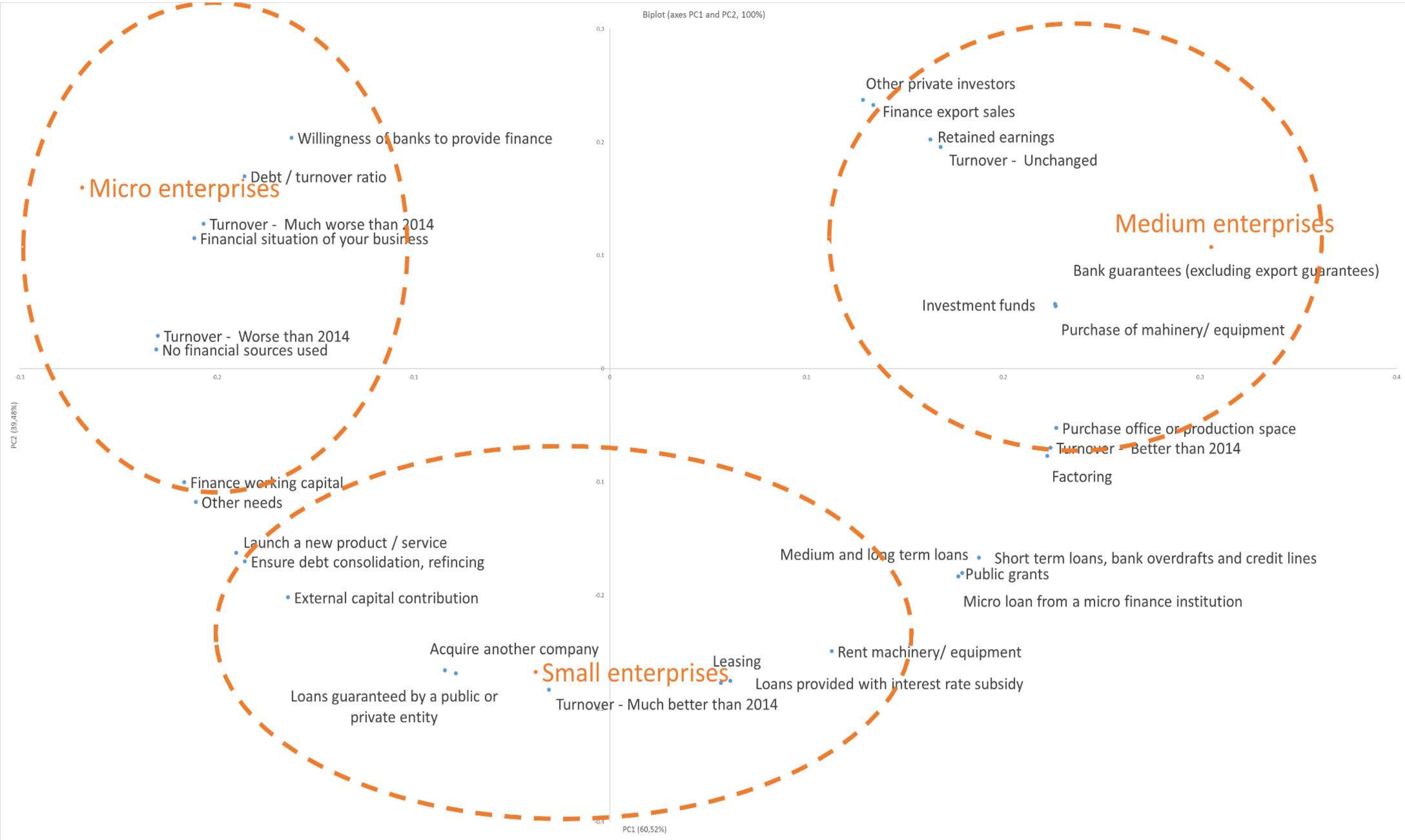
The PCA simultaneously fulfils the following two objectives.

The first objective of the PCA is to **project the individuals on axes** called factorial axes. The first factorial axis (F1) corresponds to a composite variable which helps differentiate each of the SME size categories (the individuals).

The second objective of the PCA is to **define and graphically project the variables** (called principal components) through a linear combination of the initial variables in order to obtain the highest possible variance between these variables. The analysis will then focus on the principal components which have the strongest variance (eigenvalues), implying the highest correlation with the closest individual(s). On this basis, clouds of individuals may be determined and they indicate the closest variables with the highest correlation with the individual in a specific cloud, as illustrated in Figure 18 below.

Finally, the PCA can establish a **proximity map** between the individuals and the variables. This proximity map enables one to observe all the data considered on a two dimensional map and to identify trends. The positioning of the individuals allows visualising if they have heterogeneous or homogeneous behaviours according to their representativeness on the axes. The most interesting variables to analyse to understand the behaviour of an individual are the ones which are rather close to this individual, because this short distance indicates that these variables are well-correlated with the analysed individual. *If some variables are close to an individual, then this individual is strongly influenced by these variables. On the other hand, when some variables are far from an individual, it means that its behaviour is not influenced by these variables, or that these variables contradict its behaviour.* Hence, the closer a variable (such as a specific source of financing) is to an SME size category (e.g. a micro-enterprises), the more this SME size category is influenced by this variable and/or perceive this variable as relevant to its access to finance in Serbia.

**Figure 18. Proximity map of the SMEs per size according to their sources of financing and financing needs in Serbia**



*Principal component analysis for micro enterprises*

Micro enterprises sense an overall deterioration of their turnover over 2014-2016: 37% of micro enterprises (617 observations) declared their turnover worse or much worse in 2016 than in 2014, contrary to the 25% of small enterprises (49 observations) and 15% of medium enterprises (21 observations). Moreover, 36% of micro enterprises (604 observations) did not observe any change in their revenues. Hence, almost ¾ of them observed stabilisation or deterioration in their turnover.

More than ¼ of micro enterprises declared not to have used any source of financing in the last three years 2014-2016 (29% of them, compared to 22% of small and 13% of medium-size enterprises).

We should note that some source of financing were only used by micro enterprises, and not by small and medium enterprises, but in such a small part that they were not considered relevant for the analysis: capital contribution of shareholders (3 micro enterprises), loan obtained from parent company (1 micro enterprise), rescue/turnaround and buyout capital (1 micro enterprise).

Micro enterprises, as the other categories of enterprises analysed, used the financing they had obtained mainly to finance working capital (65% of micro enterprises, compared to 65% of small and 64% of medium enterprises). The purchase of machinery equipment is also an important investment (48%), which seems nevertheless to be preferred by micro enterprises to the rental alternative (2%, compared to 4% of small and 3% of medium-size enterprises).

Only a small part of micro enterprises reported past problems with obtaining finance (14%, i.e. 225 micro enterprises compared to 9 medium-size and 19 small enterprises which reported such problems). Thus, the most relevant problems for the micro enterprises seem to be the financial situation of their business (40%), an unfavourable debt/turnover ratio (6%) and, consequently, the banks unwillingness to provide finance (28%).

*Principal component analysis for small enterprises*

Small enterprises declared an overall improvement of their turnover, with 37% of them reporting better revenues in 2016 than in 2014, and 4% much better revenues (compared to 1% of micro enterprises). Together with 35% that declared unchanged turnover, $^3/_4$ of the small enterprises in Serbia observed stabilisation or improvement in their turnover.

Small enterprises used over 2014-2016 more loans provided with an interest rate subsidy (5% compared to 2% of micro enterprises and 3% of medium enterprises), loans guaranteed by a public or private entity (1% of small enterprises compared to 0% of micro and medium enterprises), external capital contribution (6% of small enterprises compared to 4% of micro and 1% of medium enterprises), and leasing (12%, compared to 4% of micro and 6% of medium enterprises). Of note is the finding that microfinance products appear to be more relevant for small enterprises (2% of them used this source of financing) than for medium (1%) or micro enterprises (not relevant). The same appears for public grants.

Ensure debt consolidation is an aspect of use of funds relevant for small enterprises (5%), more than for micro (4%) or medium-size enterprises (2%). The alternative of renting the machinery instead of purchasing it is not widely considered among small enterprises (4%) but still has the higher consideration if we consider the other two categories of enterprises (only 2% of micro enterprises and 3% of medium enterprises).

Unfortunately, it proved impossible to analyse the reasons for which small enterprises obtained financing, since 91% of them reported not to have encountered any problems with it.

*Principal component analysis for medium enterprises*

Medium-size enterprises reported very stable revenues with a tendency to improvement compared to 2014. Indeed, 84% of them reported stability or improvement in their turnover, divided into 40% reporting unchanged revenues (compared to 36% of micro enterprises and 35% of small enterprises) and 44% declaring better revenues (compared to 25% of micro enterprises and 37% of small enterprises).

Compared to small and micro enterprises, medium-size enterprises seem to have more use for financing: only 12% of them declared not to have used any financial sources over 2014-2016, compared to 29% of micro enterprises and 22% of small enterprises. Retained earnings were a financing source for more than $^{2}/_{3}$ of medium-size enterprises. Loans are also widely used, with 39% of medium enterprises using short term loans, bank overdrafts and credit lines, and 26% using medium or long term loans. Moreover, 8% of medium enterprises used bank guarantees (excluding export guarantees), and 2% used funds from private investors – the sources of finance that seem to be more difficult to obtain for micro or small enterprises (0% and 1% of micro enterprises 2% and 1% of small enterprises, respectively).

Over 2014-2016, medium-size enterprises sough finance mainly to purchase equipment and machinery (61%) and to finance working capital (64%). The need to pay for office or production space is higher for the medium enterprises than for the other two categories (for 11% of medium enterprises vs. for 10% of small and for 7% of micro enterprises).

Unfortunately, it is not possible to analyse other sources of financing (equity financing) and uses of financing (the need to improve energy efficiency) given a very low number of observations (only 1 observation).

Just as indicated above for the small enterprises, it has proved equally impossible to analyse the reasons for which the medium-sized enterprises obtained financing, since 94% of them reported not to have encountered any problems with it. To test the robustness of the analysis, another run of the PCA was undertaken considering the difficulties of SMEs to obtain financing. The resulting graph is almost identical to the one presented above.

## 7.3 Financing gaps

### 7.3.1 The rationale behind financing gaps

**The estimated supply** of financial products presented in Chapter 7.1 is based on: market trends, publicly available data (i.e. the literature review/research), and the estimates of market stakeholders. It could, therefore, be argued that the estimated supply figures can be considered more straightforward and objective due to the fact that market stakeholders have the expertise to provide such insights based on the liquidity and overall conditions of the institutions they represent.

**The estimated demand** for financial products presented in Chapter 7.2 is based on the survey answers provided by SME owners or managers, and is it related to their knowledge of their respective markets and the perspective of their company. In the present study, financing gaps are first calculated by subtracting the estimated supply from the potential demand.

The following points have to be taken into account when assessing the financing gaps based on potential demand.

- ***Potential demand may not actually translate into business action***. SMEs express their expectations and intentions when answering the survey. These intentions may, however, not be acted upon in the coming months or years for several reasons. SMEs may be discouraged from seeking finance, because of the credit terms offered by the banks (e.g. collateral, interest rates including the risk premium), or because of SMEs' difficult financial situation. SMEs may also change their growth strategy and decide to postpone investments.

- **A specific nature of the Serbian economy**. Serbia is a relatively small country with some distinct characteristics of its financial market that need to be taken into account when analysing the gaps. Although the financial market in Serbia is dominated by the banking sector, the banks are very cautious when it comes to lending. This is reflected by the very high interest rates compared to the EU averages. At the same time, the banks in Serbia are only willing to lend to enterprises with sufficient assets and a strong credit history. This attitude makes it extremely difficult to obtain financing for new companies or for any innovative, ergo more risky, endeavours. As a result, a considerable part of enterprises, particularly the micro companies, has to rely on informal sources of financing, or on the personal assets of the business owner, to collateralise their loans. Especially for micro-enterprises, this environment nurtures a conservative mentality towards financing needs, and some amounts may be understated because of this mentality. The same factors also need be taken into account with regard to small and medium-sized enterprises. The fact that these companies are solely dependent on the banking sector for their financing implies that most companies that are growing in size depend on the owners' or shareholders' assets. In that sense, ***even if these companies do have access to finance, their dependence on the banking sector has to be perceived as a market failure and taken into account, even in the absence of financing gaps per se.***

- **A total lack of supply of some financing products**. In Serbia, there are financing products, such as microfinance and equity, the supply of which, and the demand for which, are very small or non-existent. It has to be taken into account that the total absence of supply also implies a very low awareness of these products on the demand side. *Consequently,* ***the demand (or the lack thereof) for these specific products expressed by the SMEs in the survey should not necessarily be considered realistic, since the SME respondents have had no relevant experience of these products.***

- **A limited knowledge of financing sources and products**. Most of the SMEs have reported in the survey that they do not plan to obtain financing in 2017, or that they are planning to use their undistributed profits. One of the reasons for this could be that they are not aware of the possibilities offered by the financial market, or that they do not have sufficient knowledge on how to seek and obtain a specific type of financing. This proves that there might be **hidden demand** in the market. *Consequently,* ***the demand for the debt products provided by the banking system may remain high, while other, more sophisticated products could be more appropriate to the SMEs' actual financing needs, going forward. This also has to be considered a market failure, as the main demand for financial products from SMEs in Serbia seems to be artificially skewed towards one type of product only, i.e. bank credit (loans of different tenor).***

- **The absence of financing gaps does not mean that companies have an easy access to financing**. Small and medium enterprises in Serbia are often asset-based and may not have problems with providing collateral to commercial banks. On the other hand, the omnipresence of banks in Serbia and the lack of other financing sources may prevent smaller enterprises from accessing bank financing because they cannot post sufficient collateral. This situation creates a vicious circle for smaller companies: to grow and develop (i.e. acquire tangible and intangible assets), they need bank credit, which they cannot get, since they do not have the assets and collateral required by the banks. **This phenomenon can also be considered a market failure for small SMEs in Serbia.**

- **Lack of previous investment due to the crisis**. The financial and economic crisis forced SMEs to reduce their investment and sometimes downsize their business. Given the expected positive GDP trend for the coming years, the SMEs might be willing to make the investments they have previously forewent. This situation may motivate SMEs to seek long-term loans for investment while seeking short-term loans to cover their ongoing needs for working capital. The demand for financing in 2017 may consequently be high and might abate during the year, if the growth forecasts are revised downwards.

All these market conditions create a tendency for SMEs incorrectly to assess their financing needs, or to request financing which is needed in longer term. ***As a result, the financing gaps calculated with the potential supply and the potential demand estimates should not be perceived by policy makers as the amounts that should be covered in a single year, or as gaps which have to be bridged by financial instruments in order to catalyse private financing for SMEs.*** **The gaps are an indication of the financing needs in the overall Serbian economy, according to the methodologies described in the present report and the market constraints experienced by the SMEs in Serbia.**

#### *7.3.1.1 Methodology to compute financing gaps with estimated supply and potential demand*

The methodology to calculate the financing gaps uses the estimated supply and the range of potential demand calculated in the previous chapters of this study for each SME size category and each financial product.

For each financial product considered per SME size category, two steps have been followed: first, the minimum estimated supply is subtracted from the lower figure of the potential demand. Second, the maximum estimated supply is subtracted from the higher figure of the potential demand.

For each of the subtractions, when a positive number is obtained, a financing gap is identified. If a subtraction provides a negative number, it means that, under certain circumstances, the estimated supply for 2017 may cover the potential demand for the considered financial product.

This gap computation methodology is followed for two categories of SMEs: (1) micro enterprises and (2) small and medium enterprises, and for three financial products: (1) short-term loans, (2) medium and long-term loans and (3) equity market for both micro and SMEs.

### 7.3.2 Financing gaps for loans for micro enterprises

Access to mainstream banking products tends to be limited for micro companies, as banks require a good credit history of the owner, larger turnovers, lower levels of debt financing, and sufficient invested equity. Micro enterprises that cannot fulfil these requirements, seek financing from informal sources (e.g. family and friends), because they lack sufficient credit history and collateral.

The quantitative estimate of the financing gaps based on the potential demand from micro enterprises in Serbia is summarised in the table below.

**Table 18. Potential financing gaps per financial product for micro enterprises in 2017**

| | Potential demand (EUR m) | Estimated supply (EUR m) | Financing gap (EUR m) |
|---|---|---|---|
| Short-term loans, bank overdrafts and credit | 429 - 474 | 196 – 217 | 233 - 257 |

| | | | |
|---|---|---|---|
| lines | | | |
| Medium and long-term loans | 1,293 – 1,430 | 589 – 651 | 705 - 779 |
| **Total** | 1,722 – 1,904 | 785 – 868 | 938 – 1,036 |

(Source: PwC analysis, 2016)

These gaps are subject to the limitations described in the previous paragraphs, but they provide an indicative view of the total potential financing needs of micro enterprises in the country.

Overall, the micro enterprises problems in accessing debt financing may also be explained by their difficulties in defining their needs and formulating a clear business plan for the future. This is probably due to the lack of managerial skills that entrepreneurs have when launching their businesses. It also reinforces the need for improved institutional support when micro enterprises develop after three or four years of existence, since this growth implies new and different difficulties. In order to cope with these challenges, business owners may need support in order to define the most appropriate financing sources and products for their development.

### 7.3.3 Financing gaps for loans for small and medium enterprises

Small enterprises represent a much smaller segment of the SME population than micro enterprises in Serbia. According to the findings presented in the previous chapters, small companies do have access to bank financing. They are perceived as clients of interest by the banks, and they have some experience and knowledge required in loan applications. The majority of small enterprises indicated that they have not faced obstacles when seeking finance. Yet, some of them have indicated that the cost of financing and other terms and conditions required by the financial institutions are a growing cause of concern to them.

Medium enterprises represent an even smaller segment of the SME population in Serbia. Like other sizes of SMEs, the medium enterprises have favoured short-term loans over medium and long-term loans during the past few years.

According to the gap analysis for small and medium enterprises, financial institutions seem to be addressing the demand for loan products from small and medium enterprises since the supply for both medium and long-term loans and short-term loans exceeds the demand in 2017.

However, the lack of gaps can be misleading. Indeed, the banking system focuses on small and medium enterprises, because they have assets and are more suitable clients than micro enterprises; however, the dominance of the banking system that appears as the only financing source for SMEs has to be considered as an important market failure. As already mentioned, the limited choice of financing products causes SMEs to collateralise their assets and damage their balance sheets. Moreover, the complete dependency on banking financing makes the market sensitive to external shocks related to the banking environment, as was experienced in EU countries.

In addition to these weaknesses of the Serbian banking sector, a lack of demand may manifest itself because SMEs generally feel discouraged from seeking financing, as they are aware that they cannot meet bank risk criteria or they have a lack of knowledge about market opportunities. It can, therefore, be concluded that there is *hidden demand* in the market.

The SMEs complete dependency on bank financing makes the financial market in Serbia sensitive to external shocks related to the banking environment, as has been experienced in the EU countries. This dominance of the banking system has to be considered an important market failure in the absence of other, alternative, feasible and competing sources of finance in Serbia.

### 7.3.4 Financing gaps for equity market for micro, small and medium enterprises

The quantitative estimate of the financing gap for equity market for micro, small and medium enterprises in Serbia, is summarised in the table below.

Table 19. Potential financing gap for equity market in 2017

| | Potential demand (EUR m) | Estimated supply (EUR m) | Financing gap (EUR m) |
|---|---|---|---|
| Private equity/Venture Capital/Accelerator | - | 28-33 | n/a |
| Technology Transfer funds | - | 7 | n/a |
| **Total** | **-** | **3540** | n/a |

(Source: PwC analysis, 2016)

Results of the survey show no demand for equity financing and consequently no gap. However, care should be taken when interpreting the results. As previously stated in the report, lack of the demand for equity financing was probably due to a lack of knowledge and awareness of micro and SMEs about the equity market in general. Equity market development is at the beginning stage and companies are still not aware of the market players and benefits that this type of financing could offer to them. Additionally, high level of retained earnings may be a sign for equity financing need by both micro and SMEs, as large amount of equity is invested back by the owners, into the business.

## 7.4 Review of the lessons learnt

The term "Financial Instruments" usually refers to three main financial products (i.e. loans, guarantees and equity) defined by the EC either in the context of the five European Structural and Investment Funds (ESIF[77]), or the EU off-the-shelf financial instruments[78], or the SME Initiative[79]. As such, the design,

[77] The ESIF include: the European Regional Development Fund (ERDF), the Cohesion Fund (CF), the Social Fund (SF), the European Agricultural Fund for Rural Development (EAFRD), and the European Maritime and Fisheries Fund (EMFF), with a dedicated EU funds allocation to the Youth Employment Initiative (YEI), see: https://cohesiondata.ec.europa.eu/funds

[78] The E&U off-the-shelf (i.e. ready to use, pre-cleared for state-aid) FIs include: a portfolio risk sharing loan (RS Loan), a capped portfolio guarantee, a renovation loan, a co-investment facility, and an Urban Development Fund, see: https://www.fi-compass.eu/news/2016/07/new-shelf-financial-instruments-business-and-urban-development

[79] "The SME Initiative is a joint financial instrument of the EC and the EIB Group (the European Investment Bank and European Investment Fund) which aims to stimulate SME financing by providing partial risk cover for SME loan portfolios of originating financial institutions. Alongside the European Structural and Investment Funds ("ESIF") resources contributed by the Member States, the SME Initiative is co-funded by the European Union

operation of FIs (including their pricing, state-aid compliance, etc.) and FI implementation options has to follow specific rules laid down in the respective EC regulations. As Serbia is not an EU member yet, the lessons learnt pertaining to the use of FIs in this country will be different from those experienced by the EU members which implemented FIs in the 2007-2013 programming period and/or are implementing them over 2014-2020.

Stakeholder interviews, literature review/research and the SME survey, carried out for the present study, have all provided information on the lessons learnt in the use of FIs in Serbia, summarised below:

- **Serbia has limited experience in the use of FIs**. The dominant financial product is a short-term loan used to finance working capital (mostly in the form of an overdraft or revolving credit line). Loans provided by local banks are mainly available to established companies with a transparent financial statement, a good credit history and rating.
- **Equity financing and microfinance are almost non-existent in Serbia**. Due to the lack of a regulatory framework, the market did not attract a sufficient number of private investors to support SMEs. Due to the lack of microfinance institutions, there is a perception in the market that microfinance is similar to microcredit provided by banks. Any new microfinance initiative should ensure that the distinction is clearly articulated. The equity market is still in its infancy with a few local and regional players. The SME survey for this study has clearly shown that equity instruments have not been used by the SMEs in Serbia so far, and virtually no demand has been reported for the near future.
- **The existing FIs are suitable for some SMEs only**, with the most underserved SMEs being micro companies (mostly entrepreneurs, sole traders) and traditional start-ups. They belong to the non-bankable population due to their inability to meet high risk criteria of the local banks. Most of these companies rely on their own assets which are usually insufficient for loan collateral. A small part of the start-up, innovative companies is supported by the local VC funds and/or regional accelerators.
- **Technical assistance and non-financial support** have proved to be amongst the most powerful tools to enhance access to finance and use of FIs by SMEs. There is very low awareness of FIs by SMEs in Serbia, and so the banks, together with state institutions, should focus more on promoting FIs to local SMEs. Based on the experience in other markets, this could be best achieved by the organisation of educational/informative seminars and workshops, supported by marketing campaigns (e.g. billboards, media adverts) to reach as many SMEs as possible.
- **The lack of training and technical skills amongst entrepreneurs and employees** has also been identified, causing concern about the level of technical knowledge possessed by new business owners. While some support measures are being implemented, none to date have been used for training and mentoring purposes to help with the more technical aspects of running a business, e.g. writing a business plan or negotiating with financial institutions.
- **The use of many financial intermediaries**, especially for portfolio guarantee schemes, has proved helpful in to increasing awareness of the use of FIs for SMEs in other countries, with the added bonus of improved competition between the intermediaries, which has often improved the overall lending conditions for SMEs.
- **Banks expressed interest in achieving regulatory capital relief via implementation of guarantee and debt products subsidised by the state** in stakeholder interviews for this study. The provision of regulatory capital relief should be carried out in a way that is compatible with the national

through COSME and/or Horizon 2020 resources as well as EIB Group resources", see: http://www.eif.org/what_we_do/guarantees/sme_initiative/index.htm legislation and the regulatory framework, and in close cooperation with the national regulator. In accordance with the Basel regulatory framework for capital requirements, the benefit of capital relief can be fully utilised when the entity providing the guarantee enjoys the maximum credit rating (e.g. the International Financial Institutions, such as the EIF, EIB, EBRD, etc.).

- **Country-specific equity funds, especially in smaller and less attractive economies, usually experience fundraising problems**. It is, therefore, important to consider whether local institutional investors will be able to invest in such equity funds. If not, tailor-made equity instruments need to be considered and additional financial incentives for investors needed (e.g. capped returns of public investors, fixed return vs hurdle, first-loss coverage for seed investments, etc.)
- **Strong and committed local teams**, or international teams with substantial capacity on the ground, have been shown to **help an equity instrument** achieve its desired impact.

## 7.5 Value Added of potential Financial Instruments

Given the market failures identified in the previous chapters, the qualitative value added of financial instruments is significant in many respects, including:

- A more responsible approach, better performance and financial discipline at final recipient level when FIs are used compared to non-reimbursable assistance
- Simplicity in obtaining assistance: a financial intermediary, such as a bank implementing a portfolio guarantee instrument, is fully mandated to provide the instrument to SMEs without the need to obtain any further approval from the guarantee fund
- Stimulation of a new generation of entrepreneurs in the innovative sector through the accelerator, seed funds and/or technology transfer instruments
- Introduction of entirely new instruments, such as accelerators, technology transfer, microcredit or social-impact investing FIs
- Supporting the build-up and modernisation of the financial system, including also non-banking financial institutions previously not used as intermediaries, by using new instruments and gaining new SME customers
- Creating competition among banks, fund managers, and other intermediaries which, as shown in the past, usually leads to better terms for the final recipients, i.e. the SMEs
- The direct leverage effect of deploying public funds on the market is supplemented by the indirect effect of stimulating greater interest of private investors in a country or sector they would not have considered otherwise, potentially leading to further investments undertaken by them in the future

Furthermore, other aspects to be considered are the typical characteristics of FIs, namely their revolving nature, the leveraging of private funds by public funds on the market, and the fact that they encourage efficiency among final recipients. These and other aspects are given in more detail in the table below, showing the value added of FIs over grants.

Table 20. Value added of FIs compared to grants

| | Average finance to be sought by a single small or medium enterprise (EUR m) |
|---|---|
| Leverage creation | FI enables additional support to be channelled to enterprises, public administrations and more generally final beneficiaries, with a potentially greater financial |

| | |
|---|---|
| | impact than grants, due to their ability to attract additional public and private sector resources, thus multiplying the effects of funds and national/regional contributions (e.g. each EUR invested creates a multiplying effect which increases resources available to final beneficiaries). According to published research, such leverage effect is even more prominent for smaller countries like Serbia that are traditionally less attractive for international investments. |
| Revolving nature | As funds are repaid over the life of an FI project, they become available to finance additional projects. In such a way, the use of FIs can promote the long-term recycling of public funds and they potentially enable the reinvestment of funds at the level of the country, helping achieve better value for public money. |
| Encourage efficiency | FIs can encourage efficiency among final beneficiaries through greater financial discipline and a heightened awareness of the need to repay loans (unlike grants). This factor emerges also as an "assurance of quality" of the project. In other words, FIs encourage companies to grow and become more competitive. |
| Create capacity building | FIs use can help build institutional capacity through partnerships between the public and private sectors. The use of FIs can boost the involvement of financial intermediaries/institutions in implementing EU regional policy and can encourage pooling of expertise and know-how, e.g. to improve the quality of projects. Additionally, the creation of public-private synergies ultimately results in an alignment of interests between public and private actors, taking the best out of both. On the one hand, they enable the pursuit of public policy objectives, which characterises public institutions, and on the other, they bring in the commercial market mechanisms accompanying private investors. |
| Ensure better technical assessment of projects | The TA assistance to be financed out of an FI could ensure a better technical assessment of projects as to ensure that oversized and/or unsuitable projects are excluded from support. |
| Create confidence in the market | The use of FIs may encourage investors to invest (more) in projects which are not attractive without public intervention, since such types of investments are considered too risky from normal private financial |

institutions. This is particularly important for relatively small start-ups active in high-risk sectors (e.g. high tech, ICT) which, especially in the context where private investors are reluctant to take any risks, would not have access to finance for their low disposable collateralisation.

(Source: PwC Analysis, 2016)

## 7.6 Additional Public and Private Resources

Financial instruments offer the possibility to channel additional investments into the FI, leveraging on the initial resources provided.

The table below illustrates the sources and types of financing available to SMEs in Serbia that could constitute additional public and private resources. The list has been drawn based on the information presented in the supply side analysis, and it has to be considered indicative, as it has been developed on the basis of the information gathered from various sources, described before, for this report.

Table 21. Potential additional public and private resources to consider

| | Product | | | | | |
|---|---|---|---|---|---|---|
| | TA | Grant | Loans | Guarantee | Equity | Microfinance |
| Commercial banks | | | X | X | | X |
| The Development Fund | X | X | X | X | | |
| Innovation fund | X | X | | X | X | |
| Serbian Development Agency | X | X | X | X | | |
| AOFI | X | | X | X | | |
| HORIZON 2020 | | X | X | X | | |
| COSME | | X | X | X | | |
| WB EDIF | X | | X | X | X | |
| EaSI | | | X | X | | X |
| Venture Capital Funds | | | | | X | |
| Private Equity Funds | | | | | X | |
| Business Angels | | | | | X | |

| | Product | | | | | |
|---|---|---|---|---|---|---|
| | TA | Grant | Loans | Guarantee | Equity | Microfinance |
| Microfinance institutions | | | | | | X |

(Source: PwC analysis, based on the materials collected in the supply side chapter)

As recommended in the ex-ante assessment methodology, after consideration of the value added, it is important to ensure consistency with other forms of state interventions aimed at promoting business investment in SMEs, including grants and interventions at other political levels. The underlying principle is that FIs should not be created and deployed if they are going to duplicate the efforts of existing public support or result in crowding out the private sector, and while some overlap might occur, it should be avoided where possible.

At national level, the implementation of FIs should be coherent with the existing national SME strategies.

The existence of support for SMEs investments from regional level instruments and from the EU, such as Horizon 2020 and COSME, should also be considered in order to avoid the duplication of investment efforts and to maximise complementarity.

Moreover, the possibility of combining FIs with grant schemes should also be considered. Grants are likely still to be needed to support business development in Serbia, and they can be particularly useful when used to provide technical support, e.g. preparation of viable business plans, and for capacity building for potential final recipients of FIs.

# 8 Delivery and management of financial instruments (Building Block 2)

The ex-ante access to finance assessment, carried out in Building Block 1, shows that an FI could be set up in order to fill (at least part of) the identified gap and address the related market failures in each of the selected investment areas. This section presents the proposed investment strategy, including the governance options, based on the findings of the ex-ante assessment.

The main objectives of the MoE to implement FIs are:

- To take advantage of the revolving nature of FIs, which will re-cycle the invested financial resources. Once returned, these resources may be reinvested in addition to other funds.
- To achieve leverage from IPA funds. FIs are expected to attract additional public and private capital into supported projects.
- To promote long-term development and implementation of supported projects. The MoE wants to encourage public administration and SMEs to plan financially self-sustainable investments to produce long-term economic, social, and environmental benefits.

## 8.1 Proposed investment strategy and expected results

To alleviate market failures and suboptimal investment situations – especially with regard to microfinance, portfolio guarantees, and equity financing for SMEs – technical assistance and business support will need to be key features of any successful investment strategy for Serbia.

There are three immediately implementable financing tools that may be set up to expand Serbian SME's access to finance (two financial instruments and a Technical Assistance support facility which would consist in grant):

- **An accelerator facility,** which would invest into the share capital of final recipients, combined with technical assistance for mentorship and product development expenses. The fund would provide equity and quasi-equity financing to innovative SMEs at the early stage of their development. This facility could be used to provide finance in support of SMEs commercialising their products or services.
- **An SME portfolio guarantee instrument** with reduced or no guarantee fee under *de minimis* aid, combined with interest rate subsidies also under *de minimis* aid for the same loan. The fund would provide the banks in Serbia with guarantee coverage at the SME loan portfolio level, possibly with particular focus on micro-enterprises and start-ups. This FI would be provided to banks lending to SMEs as financial intermediaries, and not to individual SME borrowers, in order to alleviate the existing credit constraints for SMEs on the Serbian financial market.
- **A support facility for SMEs,** which would provide technical assistance, grants, disseminate business knowledge, and provide advisory services to SMEs, including micro-enterprises. The key purpose of the facility would be to build on the capacity of the existing local network (e.g. Chamber of Commerce, Regional Development Agencies and similar) in order to provide SMEs with a comprehensive overview of all the existing financing opportunities and to help tailoring their individual financing strategies. This TA facility could be also provided to commercial banks that were not dealing much with micro-enterprises in the past to raise their awareness on the importance of micro enterprises and their needs.

In addition to the three solutions mentioned above, two other financial instruments could be theoretically envisaged in the field of microfinance. These two financial instruments are:

- **A microfinance capital enhancement (equity) fund** could be developed to support any new non-banking microfinance institutions.
- **A microfinance First-Loss Portfolio Guarantee (FLPG) fund** would provide micro-loans to already established SMEs and traditional entrepreneurs currently cut off from credit supply (or any financing of their entrepreneurial activity).

The effective setup of these two financial instruments is, however, contingent on the implementation of the enabling legislation. This legislation is not on the agenda for 2017. Thus, the two financial instruments covering the field of microfinance could not be put in place in the form mentioned above. The setup of a microfinance capital enhancement (equity) fund is strictly conditional on the vote of the enabling law. As for the microfinance first-loss portfolio guarantee, although it cannot be put in place in the form of a specific fund, the corresponding financing amounts could be partially re-allocated to the SME portfolio guarantee instrument which would enlarge its' scope to address, at least in part, the needs of the SMEs which would have applied to the microfinance First-Loss Portfolio Guarantee (FLPG) fund had this opportunity been available.

### 8.1.1 Microfinance Capital Enhancement (Equity) Fund

Microfinance market is underdeveloped in Serbia. This is mainly due to the lack of a regulatory framework for microfinance and other non-banking credit institutions. The analysis and the findings of this report show that microfinance is a particularly weak link in the supply of finance to SMEs in Serbia. This instrument would be structured as a direct investment vehicle into the capital structures of new non-banking microfinance providers in Serbia. It would be managed by a Microfinance Capital Enhancement Fund manager. The main objective of this instrument would be to enhance the capital base of new non-banking microfinance providers in Serbia in order to bolster their overall microlending capacity.

The availability of this financial instrument is contingent on the implementation of the corresponding legislation authorising the microfinance institutions of full right to be set up in Serbia. This fund would then support any new non-banking microfinance institutions that could be set up once the enabling regulatory framework is established in Serbia. However, the corresponding legislation is not anticipated for 2017, and possibly in further years. Thus, the financial instrument is solely mentioned for the sake of consistency among the other recommended FIs and the need for it should be further reviewed should the regulatory framework be implemented.

#### *8.1.1.1 Value added of the FI*

The present report estimates the financing gap for micro-enterprises at around EUR 1 bn in 2017. The microfinance capital enhancement fund would contribute to reducing this gap by helping non-banking microfinance providers achieve sustainable lending volumes in the medium to long-term. Qualitatively, the value added of this FI would consist in:

- Helping promote entrepreneurship
- Supporting creation of new enterprises, in particular for social inclusion purposes

#### *8.1.1.2 Target market*

All new non-banking microfinance providers in Serbia.

#### *8.1.1.3 Target final recipients*

Micro-enterprises from traditional sectors in Serbia.

#### *8.1.1.4 Risks and advantages related to the implementation*

The main risk is that microfinance regulation may not be ready in 2017, in which case this FI could be developed in anticipation of the incoming regulatory framework, or – alternatively – it could be implemented afterwards.

#### *8.1.1.5 Leverage*

The expected leverage of this instrument would need to be assessed through market testing with potential non-banking microfinance providers.

#### *8.1.1.6 Implementation options*

- The percentage of the public contribution in the financing of each operation would vary depending on the risk profile of each microfinance provider
- The manager of the microfinance capital enhancement fund would be an independent entity that makes all investment decisions/divestment as a professional manager, economically and legally independent from the Managing Authority
- The governance of the microfinance capital enhancement fund should include mechanisms to avoid potential conflicts of interests
- The details of the Call for Expression of Interest should ensure that the microfinance capital enhancement fund manager has the necessary licence(s) to operate as an equity fund manager in Serbia

#### *8.1.1.7 Envisaged combination with grant support*

None.

#### *8.1.1.8 Potential monitoring indicators*

The following potential monitoring indicators could be used in order to track and estimate the added value of the financial instrument:

- Number of supported micro-enterprises
- Number of newly created micro-enterprises
- Number of new jobs created and sustained in a defined period of time
- Leverage

### 8.1.2 Microfinance First-Loss Portfolio Guarantee (FLPG) Instrument

A portfolio guarantee is widely used by the EIB Group across the EU and outside its borders. However, a portfolio guarantee dedicated to microfinance has not been implemented so far. A first-loss portfolio guarantee would provide an incentive for the local financial intermediaries and, as legislation permits, microfinance institutions, to engage in lending to SMEs (and in particular micro-entreprises) thanks to the guarantee absorbing a share of the underlying risk. The fund would provide a portfolio guarantee for SME loans of up to EUR 25,000, with a reduced or no guarantee fee under *de minimis* aid, combined with interest rate subsidies also under *de minimis* aid for the same loan. The guarantee would be provided to the bank – or a microfinance institution – at the loan portfolio level, and not to the individual borrowers who would be assuming their liabilities in full. Collateral requirement is a major obstacle to SME lending in Serbia. This constraint hinders, in particular, lending to newly created traditional SMEs, making it a barrier to the development of entrepreneurship in Serbia. A portfolio guarantee provided to a financial intermediary could address this problem. The objectives of this FI are to:

- Foster SME creation by removing barriers to credit financing for established or newly-created traditional SMEs, in particular by lowering the risk related to lack of collateral
- Complement the existing guarantee instruments (which are project-based guarantees and not portfolio guarantees)
- Support working capital financing and investment.

The suggested microfinance first-loss portfolio guarantee cannot be put in place in the form of a specific fund in absence of the enabling legislation, which is not expected to be in place in 2017. However, the corresponding financing needs could be partially addressed by the SME portfolio guarantee instrument which would cover, at least partially, the needs of the SMEs seeking microfinance loans.

#### 8.1.2.1 Value added of the FI

In an emerging economy like the one of the Republic of Serbia, the risk is much higher than in the economies of the euro area due to a set of macroeconomic (political instability, higher inflation, exchange rate risk) and microeconomic (less developed financing markets and banking sector) factors. These risk factors severely restrict lending to the SMEs at large and even more so for the micro-entreprises segment. They also represent an obstacle to the creation of new SMEs, as a potential entrepreneur without collateral anticipates a refusal from the credit institutions (banks). A first-loss portfolio guarantee dedicated specifically to microfinance would address the issue of the lack of collateral and therefore potentially boost entrepreneurial activity. It would also help develop the microfinance institutions following the implementation of the corresponding legislative and regulatory framework. One significant benefit of this FI is to allow people currently unemployed and not able to post collateral, but who have a sound business idea, to set up in business. The portfolio guarantee fund would be expected to cover at least a portion of the around EUR 1 billion estimated financing gap for the micro-enterprises in 2017. Qualitatively, the value added of this FI is expected to be in:

- Job creation
- Creation of new enterprises
- Reduction of unemployment
- Reduction of poverty
- Risk sharing with the private sector

#### 8.1.2.2 Target market

This FI would be targeted on sole traders, microenterprises, and small companies in all sectors.

#### 8.1.2.3 Target final recipients

The implementation of this portfolio guarantee would allow non-banking microfinance providers and banks to expand their microlending, i.e. some SMEs that were previously cut off from the lending could benefit from it, both in terms of lower interest rates and from access to funds they did not have before. Sole traders, microenterprises, and small companies in traditional sectors in early development stages (seed, creation, and development) would benefit from this instrument, which would guarantee microloans of up to EUR 25,000.

#### 8.1.2.4 Risks and advantages related to the implementation

- Reduction in the level of collateral required by commercial banks/non-banking microfinance providers from borrowers (especially the newly created Micro enterprises and larger SMEs)
- Reduction in interest rates required for microloans (as compared to regular loans which does not benefit from the guarantee)
- Guarantee costs potentially below the market (depending on the arrangements agreed between a Fund of Funds potentially set up to manage this FI and financial intermediaries before launching this instrument)
- Possibility for a grace period longer than the one usually offered by financial intermediaries on the market (depending on the arrangements agreed between a Fund of Funds potentially set up to manage this FI and financial intermediaries before launching this instrument)
- Access to technical assistance provided by the support facility for SMEs outlined in this chapter
- The main risk is that microfinance regulation may not be implemented in Serbia in 2017

#### 8.1.2.5 Leverage

The expected leverage of this type of instrument would typically range between 5.0x - 5.7x.

#### 8.1.2.6 Implementation options

- The First-Loss Portfolio Guarantee (FLPG) dedicated to microfinance would cover the first losses of the portfolio of SMEs created by a financial intermediary (a microfinance institution or a bank). The benefits provided to a financial intermediary would be transferred to the target groups (i.e. new entepreneurs, e.g. sole traders, start-ups, MSMEs,): new microloans (previously unavailable) and better borrowing conditions (lower collateral requirements, lower interest rates, longer maturity and longer grace periods) would be available
- This product is a portfolio guarantee provided to financial intermediaries selected through a Call for Expression of Interest. This product would be provided as a risk-sharing instrument where the financial intermediary assumes part of the risk
- This guarantee would cover the losses resulting from default events on microloan capital and interest repayment experienced by financial intermediaries
- The types of financing that could be covered by this guarantee are investment financing (fixed assets) and working capital
- If funding from IPA is used to fund this portfolio guarantee, the monitoring and reporting processes set up by financial intermediaries would need to ensure the follow-up and tracking of IPA funding

- Handling or applications, analysis, documentation and provision of microloans to the final beneficiaries would have to be handled by financial intermediaries according to the existing and required market procedures. Financial intermediaries would, therefore, have direct credit agreements with the final beneficiaries.
- This products could also be structured as a counter-guarantee

#### *8.1.2.7 Envisaged combination with grant support*

This product would be provided to a selected number of financial intermediaries which would be selected through a Call for Expression of Interest. This FI would be offered alongside other guarantee instruments that are not portfolio guarantees.

#### *8.1.2.8 Potential monitoring indicators*

The following potential monitoring indicators could be used in order to track and estimate the added value of this financial instrument:

- Number of new SMEs created
- Number of micro-enterprises and small companies supported
- Average amounts provided
- Total amounts provided
- Leverage

### 8.1.3 Accelerator facility

In Serbia there are currently very few equity of quasi-equity funding facilities (venture capital, accelerators, private equity funds). Thus, the innovative SMEs have limited financing opportunities (including the newest agreements of EIF with banks under InnovFIn), which obviously precludes the creation and development of the innovative segment of the Serbian economy. Given the usual risk profile of this type of SMEs, their access to credit is even more restrained than for the traditional SMEs or micro-firms in general.

The accelerator facility would provide equity and quasi-equity FIs to innovative SMEs at the early stages of their development. This facility could also be used to provide finance in support of SMEs commercialising their products or services. The financial instrument under consideration would involve a co-investment product providing equity financing to SMEs financing (equity and quasi-equity) at the early stage of their existence and ensure the technology transfer. The objectives of this FI would be to:

- Strengthen equity financing and quasi-equity financing for companies in pre-seed, seed, creation, development and turnaround stages
- Support the companies in any stage, based on a good business plan
- Strengthen the capitalization of SMEs with high growth potential in Serbia (innovative or traditional)
- Encourage the structuring of capital market in Serbia, including Business Angels
- Fill the lack of the existing equity financing supply in the country (business angels, investment funds, etc.) and attract, among others, outside investors who currently do not operate in Serbia

### *Value added of the FI*

While it is difficult to quantify at this stage the expected impact of such a facility, it is possible to assess qualitatively that the expected effects would be important, both in terms of jobs and economic growth as the current financing conditions almost preclude the launching and development of innovative SMEs. In the long run, this facility could represent a major opportunity for the Serbian economy to diversify and move in the upper segments of the production value chains. The main value added areas expectedly generated by the implementation of this financial instrument is as follows:

- Promoting entrepreneurship
- Improvement of companies' projects
- Creation of new innovative enterprises
- Possibility to focus on special categories of final beneficiaries (in terms of investment amounts and SME development phases)
- Risk sharing with the private sector (co-investment funds)

### *Target market*

All types of nascent SMEs in all sectors.

### *Target final recipients*

Start-ups and innovative SME in the pre-seed, seed, creation, development and turnaround stages. The focus of the accelerator facility would be small innovative SMEs at the very early stage of their existence (creation or early development).

### *Risks and advantages related to the implementation*

- Part of the investment will come from the financial intermediary (co-investment funds) in the SMEs capital using IPA resources, its own resources and attracting other investors to mobilize its own resources
- Access to support provided by the support facility, for example: access to an incubator facilities and coaching by an experienced entrepreneur, support in conducting market research, feasibility studies and "market testing" as well as information on other existing mechanisms for the development of innovation and/or entrepreneurship in general
- Its purpose is to create synergies with other venture capital and investment funds as well as attract investors from Serbia and abroad

### *Leverage*

The expected leverage of this type of instrument would be in the region of 1.0 – 1.1x.

### *Implementation options*

- The percentage of the public contribution in the financing of each operation will vary depending on the phase of the SMEs in its life cycle
- The manager of the co-investment fund will be an independent entity that makes all investment decisions/divestment as a professional manager, economically and legally independent from the Ministry of the Economy
- The governance of the co-investment funds should include mechanisms to avoid potential conflicts of interests within the manager co-investment funds

- The details of the Call for Expression of Interest shall ensure that the financial intermediaries have the necessary permissions and approvals in Serbia to exercise the activities as a fund manager
- The selection of the financial intermediary will cover the provision and blending of both equity financing and quasi-equity financing
- The groups targeted include SMEs of all development stages (seed, creation, development and turnaround stages) using funding from IPA
- Financial intermediary needs to make sure that the follow-up and tracking of funding is ensured

#### *Envisaged combination with grant support*

The financial instrument could draw on the IPA funds and be blended with funds provided from other financing sources (grants or loans). Grants are usually provided in the initial phase (when the company is in the idea generation stage and creation of prototypes). The accelerator facility would support companies to commercialise these ideas pr prototypes (in the ready to be marketed stage).

#### *Potential monitoring indicators*

The following potential monitoring indicators could be used in order to track and estimate the added value of the financial instrument:

- Number of SMEs supported (micro, small and medium enterprises)
- Number of supported entrepreneurs
- Number of newly created SMEs
- Number of employees in SMEs at the time of inclusion in the portfolio
- Leverage

### 8.1.4 SME Portfolio Guarantee Instrument (FLPG)

A First-Loss Portfolio Guarantee (FLPG) portfolio guarantee is a financial instrument widely used by the EIB Group across the EU and outside its borders. It aims at providing the local financial intermediaries with the incentive to expand their portfolios, as the guarantee absorbs part of the underlying risk of events of default. The fund could provide a portfolio guarantee, capped at portfolio and loan levels, and would be offered with a reduced or no guarantee fee under the de minimis aid, combined with interest rate subsidies, also under the de minimis. The FLPG guarantee would be provided to the financial intermediary at the portfolio level, but not to the individual borrowers who would be responsible for repayment of their individual loans. Collateral requirements made by lenders are a major barrier to SME financing by banks in Serbia. An FLPG portfolio guarantee provided to financial intermediaries would complement other guarantee products currently offered on the market (including offers by Banca Intesa and ProCredit under EIF programmes) and contribute to the easing of the credit constraints for SMEs on the Serbian financial market at present. This instrument could also be structured as a counter-guarantee.

The main objectives of this FI are to:

- Remove the barriers to loan financing experienced by traditional entrepreneurs and SMEs, consisting in high collateral requirements from the banks and high interest rates charged by the banks
- Complement the guarantee instruments currently available on the market

- Support working capital financing and investment

#### *8.1.4.1 Value added of the FI*

In an emerging economy, the risks associated with SME lending are relatively higher than in the more advanced economies due to macroeconomic (political instability, higher inflation, exchange rate risk) and microeconomic (less developed financing markets and the banking sector) factors. Hence, a portfolio guarantee instrument would help limit the risk premium associated with micro enterprises and larger SME lending. In addition, a portfolio guarantee would boost the development of the banking sector by helping the local financial intermediaries grow their balance sheets. The proposed portfolio guarantee instrument would be expected to cover at least a portion of the approximately EUR 1 billion estimated financing gap for the micro-enterprises in 2017. Qualitatively, the value added of this FI would consist in:

- Promotion of traditional entrepreneurship
- Job creation
- Creation of new enterprises
- Reduction of unemployment
- Reduction of poverty
- Risk sharing with the private sector
- Use of knowledge and expertise of a financial intermediary in selecting and financing projects, SMEs, and entrepreneurs

#### *8.1.4.2 Target market*

This FI would cover all SMEs in all sectors.

#### *8.1.4.3 Target final recipients*

The implementation of the portfolio guarantee would allow the banks to expand their lending, i.e. some SMEs that were previously deemed “unbankable” could benefit from it in terms of lower collateral and interest amounts required. SMEs from all sectors and sizes, and in all development stages (seed, creation, development and turnaround), could benefit from the instrument. Particularly, focus would be on traditional SMEs.

Risks and advantages related to the implementation

- Reduction in the maximum level of collateral required by the commercial bank to the SME/entrepreneur
- Reduction in the interest rate required for the loan (as compared to a loan, which does not benefit from the guarantee)
- Guarantee costs potentially below the market (depending on the discussion between the FoF potentially set up to manage the FI and the financial intermediary prior to launching the instrument)
- Possibility for a grace period longer than the one usually applied by the financial intermediary market (depending on the discussion between the FoF and the financial intermediary prior to launching the instrument)

- Access to technical assistance provided by the support facility for SMEs mentioned in the previous section.

#### 8.1.4.4 Leverage

The expected leverage depends on the type of SMEs supported and the size of the portfolio, and could range between 5.0x - 5.7x.

#### 8.1.4.5 Implementation options

- The First-Loss Portfolio Guarantee (FLPG) will cover the first losses of the portfolio of SMEs created by the selected financial intermediary. These benefits provided to the financial intermediary (i.e. the commercial bank) will be transferred to the target groups (i.e. SMEs, start-ups) as lower collateral requirements, lower interest rates, longer maturity and longer grace period. It will be discussed during the negotiations with the financial intermediary.
- This product is a portfolio guarantee provided to a financial intermediary that will be selected through a Call for Expression of Interest. This product is to be provided under a risk-sharing instrument where the financial intermediary also bear a part of the risk.
- This guarantee may cover the losses (losses related to the non-payment of the capital and the interests of the loan) that the financial intermediary may have
- The types of financing that could be covered by the guarantee are investment financing (fixed assets) and working capital financing
- If funding from IPA is used to constitute the guarantee fund, the monitoring and reporting processes set up by the financial intermediary need to make sure that the follow-up and tracking of funding from IPA is ensured;
- Steps relative to the reception, analysis, documentation and provision of loans to the final beneficiaries will have to be handled by the financial intermediary, according to the existing and required market procedures. The financial intermediary will therefore have a direct credit relation with the final beneficiary.

#### 8.1.4.6 Envisaged combination with grant support

This product would be provided to a limited number of financial intermediaries, which would be selected *via* a Call for Expression of Interest. It would enable coexistence with existing guarantee instruments, which are not portfolio guarantees.

#### 8.1.4.7 Potential monitoring indicators

The following potential monitoring indicators could be used in order to track and estimate the added value of the financial instrument:

- Number of SMEs supported (with a split between micro-enterprises, small enterprises, medium-sized enterprises)
- Number of entrepreneurs supported
- Number of employees employed in the SME at the inclusion of the SME in the portfolio
- Total amount provided to SMEs
- Leverage effect

### 8.1.5 Support facility for SMEs (Technical Assistance)

A specific issue identified through the SME survey is the limited knowledge of financial instruments in general amongst the SMEs in Serbia, in particular micro-enterprises. In addition, the survey pointed out that many SMEs refrain from applying for financing to banks as they expect – rightly or wrongly – to be refused. This self-imposed exclusion from the banking system might apply to SMEs with viable business projects but with poor business plans to support them. Some SMEs are also unaware of all the existing financing opportunities on the market.

Accordingly, a key feature of any successful investment strategy for FIs deployment in Serbia would need to provide technical assistance and institutional business support to deal with these central issues. Such a feature would take the shape of the facility. The role of this facility would be to act as a "one-stop-shop" for SMEs who may require assistance in identifying financing opportunities, developing business plans and structuring financing proposals. The facility would provide this type of technical assistance, and also seek to disseminate business knowledge and provide capacity building to the financial institutions, who may seek to participate in the financial intermediary market in the SME sector in Serbia. By providing the SMEs with a comprehensive overview of all the existing financing opportunities (private and public) and providing mentoring support, the facility would also help tailoring the individual financing strategy of the SME in order to fit its specific needs and constraints and thereby not only increase the likelihood of the SMEs successfully accessing the finance they require but also increase the potential pipeline of investments for the proposed financial instruments.

The facility would seek to leverage on the existing business accelerator and technical assistance resources currently existing in Serbia (e.g. Chamber of Commerce and regional development agencies). It may for example, also include a panel of expert advisers who would provide their technical and financial insight and knowledge to the applying SMEs.

While not a full-fledged financing instrument, the support facility is a key feature of the successful investment strategy, an enabler seeking to maximise the impact of all the existing and prospective sources of financing.

The facility would also provide a grant and tutoring/mentoring to promote and provide knowledge and skills to financial intermediaries and final beneficiaries for the use of financial instruments and products of the Investment Strategy. The funds dedicated to the support facility may originate from the funds dedicated under the Instrument for Pre-Accession (IPA). The objectives are to:

- Support and promote the development and implementation of the Financial Instruments in Serbia
- Improve knowledge related to the existence and operation of the Financial Instruments in Serbia
- Support of financial intermediaries in the management of Financial Instruments and final beneficiaries with the use of products granted through these instruments
- Support of the existing economic supporting networks (chambers of commerce, main innovation actors)
- Raise awareness of commercial banks of the importance of micro enterprises in the economy and their needs
- Decrease mismatch between the financing offer provided by the financial sector and the industry needs.

#### 8.1.5.1 Value added of the facility

In the survey conducted as part of the assessment of the SMEs' financing needs, up to 65% of the SMEs indicated they will not solicit any type of financing for 2017. While for some of the SMEs this reflects the absence of any investments plans, for the majority it refers to the belief (sometimes probably wrong) that they would not be able to get any funding from the banks or other institutional sources. In addition, some of the SMEs simply lack knowledge about some of the financing sources. The support facility would enable those SMEs whose business models and investment plans are sound to apply for financing. The gain that is possible to achieve thanks to the facility is difficult to estimate, even qualitatively. However, even if a quarter of the SMEs that currently do not seek any funding were able to apply for funding and be able to get it, it would have a large positive impact on the Serbian economy in terms of investment, GDP growth and job creation. Among the main expected benefits there are following:

- Improved technical skills and knowledge of financial intermediaries managing Financial Instruments
- Improving the technical quality and overall documentation submitted by SMEs and entrepreneurs
- Improved monitoring of financial operations carried out by financial intermediaries
- Support for the coordination of stakeholders supporting the economy of the country
- Coordinated use of IPA funds in parallel with (i) grants and (ii) financial products supported by Financial Instruments

#### 8.1.5.2 Target market

While the support facility for SMEs is likely to reach out to all types of SMEs, the largest impact is expected for the micro enterprises and the smallest SMEs. Indeed, these entities are both the least likely to have knowledge of all the existing funding opportunities and those that are likely to have difficulties in accessing them. The impact of the facility would go through a wider diffusion of information and the technical assistance in designing an efficient and sound business plan. The support facility will also provide technical assistance to the financial intermediaries engaging with the SMEs, notably with micro-entreprises.

#### 8.1.5.3 Target final recipients

- Financial intermediaries whose skills and knowledge on the use of the Financial Instruments should be further developed; and therefore potentially: commercial banks, investment funds and, potentially, institutions offering microfinance (if legislation is adapted accordingly), selected through a Call for Expression of Interest for each Financial Instrument
- The final beneficiaries, recipients of financial products granted through Financial Instruments, proposed in the Investment Strategy; therefore potentially: SMEs (including young innovative companies), entrepreneurs, beneficiaries of loans eligible for financing energy efficiency projects (private and public entities)

#### 8.1.5.4 Risks and advantages related to the implementation

- Expected benefits and services by financial intermediaries:
    - Improving their capacity to identify projects, prepare and examine documentation, set a suitable financing offer and finally follow the SME and / or entrepreneur

    - Support in monitoring and reporting financial transactions in order to comply with European regulations

- Expected benefits and services by the final beneficiaries:
    - Financial and operational support in the preparation and setting up projects that can be supported by funding through Financial Instrument:  market feasibility studies, project preparation support for energy efficiency and urban and territorial development projects, energy audit, development of business plans
    - Operational support in the funding application: preparation of documentation, preparation for the meeting with the bank/ investment funds, assistance in drafting specific documentation to apply for funding
    - Support for the management and monitoring of the project once funding is obtained
    - Support from different relevant institutions, e.g. accelerators for start-ups, mentoring schemes, different promotion possibilities (participation on fairs outside the country, memberships in different associations… )

#### *8.1.5.5 Leverage*

Not applicable.

#### *8.1.5.6 Implementation options*

- This facility is intended to provide technical support service to financial intermediaries and final beneficiaries within the framework of managing a financial instrument or of obtaining a financial product provided via Financial Instruments
- For example, technical support, mentoring or methodological guidance in preparing a project of an SME (e.g. market research, feasibility studies, energy audits and preparing documentation for a request for funding)
- This facility should be managed or supervised by the country services in order to avoid any conflict of interest with the management of the Financial Instruments: the aim is to differentiate the support services dedicated to SMEs for access to financing (through the support facility for SMEs) and a loan made by a financial intermediary whose decision must be made independently and according to the existing standard procurement procedures
- This facility can also structure and build support for the main stakeholder that support the Serbian economy (e.g. chambers of commerce, innovation actors in the country)

#### *8.1.5.7 Envisaged combination with grant support*

Not applicable.

#### *8.1.5.8 Potential monitoring indicators*

- Number of SMEs supported (with a split between micro-enterprises, small enterprises and medium-sized enterprises)
- Number of entrepreneurs supported
- Number of new SMEs created

### 8.1.6 Proposed allocations to the Financial Instruments and the support facility for SMEs

| No | Financial Instrument | Proposed contribution EUR m | Funding Source |
|---|---|---|---|
| 1 | **Microfinance Capital Enhancement (Equity) Fund [strictly contingent on the new law authorizing microfinance]** | 40 | TBD |
| 2 | **First Loss Piece Portfolio Guarantee (FLPG) for Microfinance [strictly contingent on the new law authorizing microfinance; otherwise, the amount of EUR 20 m re-allocated to the SME Portfolio Guarantee (FLPG)]** | 20 | TBD |
| 3 | **Accelerator facility** | 20 | TBD |
| 4 | **SME Portfolio Guarantee (FLPG)** | 20<br><br>[in the immediate term, the EUR 20m of the FLPG for microfinance would be also included, leading to a total amount of EUR 40m] | IPA II |
| 5 | **Support facility for SMEs (Technical Assistance)**<br><br>TA to disseminate business knowledge and provide advisory services to SMEs<br><br>Capacity building of Regional Chamber of Commerce and Regional Development Agencies to support for micro-enterprises and microfinance; blending/synergies with EaSI | 5<br><br>[indicative amount] | TBD |
| | **TOTAL** | **105** | |

The EUR 5m figure for the Support facility for SMEs (Technical Assistance) is an indicative amount covering the setup of the facility and the compensation for the work described in Section 8.1.5 over a three year period. It is assumed that it would need to include salary and over-head costs to support the day-to-day resourcing of the facility. It should also include provision for the establishment of a consultancy framework to provide both capacity building for financial intermediaries, expertise, and technical and financial advice for SMEs. This indicative budget should be further reviewed as the exact terms of reference for this framework are defined in detail. It is also recommended that it should be evaluated in year-3 and, depending on the outcome of this evaluation, potentially be extended, in line with the investment period of the financial instruments.

IPA II funds, amounting to EUR 20m are intended to be used in the guarantee facility for the next 2-3 years. In the future, there will be a continuous need for additional capitalization.

## 8.2 Options for the governance structure of the Financial Instruments

The management of the FIs described above can take several governance forms. In the case where an FI is set up at national level, there are three options that the MoE can choose from as the most suitable implementation arrangement. The management of the FIs could be entrusted to one of the following entities:

1. An existing public entity, e.g. the Serbian Export Credit and Insurance Agency (AOFI), the Development Fund of Serbia or the Serbian Development Agency
2. A new entity set up in Serbia to provide management of FIs, governed by public or private law

   or
3. The European Investment Fund (EIF)

Options 1 and 2 above would help improve local capacity and transfer of institutional knowledge to a Serbian entity (i.e. the AOFI, Development Fund of Serbia or the Serbian Development Agency, or a new entity). Option 3 could help with arguably faster implementation of some of the proposed FIs, subject to EIF's capacity and cost-benefit considerations.

The relative pros and cons of the three governance options are outlined in the table below:

Table 22 Financial instruments governance options, Pros and Cons

| Option | Entity | Pros | Cons |
|---|---|---|---|
| 1 | Serbian Export Credit and Insurance Agency (AOFI), Development Fund of Serbia or Serbian Development Agency | • Provides local capacity building and institutional knowledge transfer | • Achieving operational readiness to manage FIs will likely require some time<br>• The cost of establishing and running additional service by the AOFI or the Serbian Development Agency/Fund |
| 2 | New entity set up to manage FIs | • Provides local capacity building and institutional knowledge transfer<br>• The ability to develop a tailor made solution | • Achieving operational readiness to manage FIs will require more time than in Option 1<br>• The cost of setting up and running the new entity |
| 3 | European Investment Fund (EIF) | • Could be operational within a relatively short period of time<br>• Expertise & experience in managing FIs and funds of funds | • Less local capacity building and institutional knowledge transfer compared to Options 1 and 2<br>• |

Source: PwC analysis, 2016

The support facility for SMEs would be managed outright by the local entity.

For the governance structure of the proposed FIs, the MoE has a further choice to make: a "two-stage" FoF or a "one-stage" FI with direct contracting of financial intermediaries:

- An FI implemented through one or more financial intermediaries
- An FI implemented through a Fund of Funds structure

## 8.3 Proposed governance structure for the Financial Instruments in Serbia

Based on the analysis from the present ex-ante assessment, setting up of a Fund of Funds (FoF) is an implementation option that is considered to present the best potential for adding value and maximising leverage in the Serbian economy. The final decision concerning the governance structure of the Financial Instruments, however, is entirely at the discretion of the Ministry of Economy (MoE).

The suggested FoF would use financial resources available to Serbia within the Instrument for Pre-Accession (IPA), together with other public and private funds. The MoE would appoint a FoF manager and set up a "strategic supervisory committee", whose remit would be to ensure that economic strategies for the FIs, as defined by the MoE, are followed by the FoF manager.

The recommended Fund of Funds would be initially composed of two compartments:

- An accelerator facility; and
- An SME portfolio guarantee Instrument

The support facility for SMEs would be managed separately by the Managing Authority (the MoE) or an entity appointed by the MoE.

The FoF structure could attract other public and private investors at the level of (i) the sub-fund, (ii) the financial intermediaries (if several by sub-funds) and (iii) the projects.

### 8.3.1 Key roles and responsibilities of the proposed governance structure

The FoF structure involves the following stakeholders and their roles and responsibilities:

- **Ministry of the Economy**: responsible for the management of IPA resources.
- **Strategic supervisory committee:** is the supervisory body of the management of the FoF. The investment committee incorporates representatives of the MoE and other potential co-investors, whenever applicable.
- **FoF manager:** delegated by the MoE to implement the Investment Strategy of the FoF. FoF manager is responsible for the internal administration of the FI in relation to the performance of the Fund actions. In particular, the activities that can be performed by the FoF manager include:
    - Pursuit of the strategy set out in the investment strategy
    - Launch and manage one or more calls for expression of interest in order to identify and select one or more financial intermediaries. Under this respect, it will:
        - Review and, where appropriate, further evaluate the Business Plans submitted by the financial intermediaries

- ◦ Negotiate the Operational Agreement with the financial intermediaries
- ◦ Monitor and control of the operations in accordance with the terms and conditions of the applicable operational agreement
- ◦ Reporting to the Strategic supervisory committee on the progress of the various operations
- ◦ Treasury management of the balance of the Funds

Please note that the FoF cannot distribute funding (and consequently financial products) directly, but always through a financial intermediary that would have been previously selected via "open, transparent, proportionate and non-discriminatory procedures" (Article 38 (5) CPR).

- **Financial Intermediaries** selected by the FoF manager, responsible for implementing investment strategies in the specific priority areas through investing in projects. The Financial Intermediary must ensure that the financed projects are viable from an economic, social and technical point of view, and that they meet the eligibility criteria established. In view of that, the financial intermediary must analyse the associated risks, the financing structure and the income foreseen for the parties involved in the projects in order to establish the conditions required for the participation of the fund in the financing of these projects.

### 8.3.2 Advantages of the Fund of Funds structure

A Fund of Funds structure enables a rationalisation and optimisation of the different Financial Instruments. This, in turn, implies cost reduction in the set-up and management of the different instruments, creation and leverage of synergies between the instruments, synergies in the set-up and management of the Calls for Expression of Interest for the selection of financial intermediaries, possibility to harmonise the management, follow-up and reporting modalities. It also allows an optimisation of FIs treasury management. From the management, monitoring and reporting perspective, a FoF gives more flexibility to manage Financial Instruments compared to an option of distributing FIs into four separately managed structures.

For the reasons listed above, this report recommends setting up a dedicated Fund of Funds for SME support in Serbia. The box below details the role of a Fund of Funds.

**Box 2: The role of a Fund of Funds**

**Rationale**

A Fund of Funds can be set up as a separate legal entity or as a separate block of finance. It is an optional function in a fund structure, providing advantages where:

i) There are multiple underlying funds and the ability to divert/re-allocate funds based upon performance would be beneficial

ii) There is a need for bespoke additional management and monitoring capacity and expertise

iii) The ability to or manage funds on an arms-length basis

iv) Where possible, interest generation to offset fee management costs is desirable

**Function**

The key tasks of the Fund of Funds are as follows:

• Holding the assets of the Fund of Funds, including carrying out temporary cash management of idle funds not yet invested in financial intermediaries and managing drawdowns from the Managing

Authority/investors (as appropriate);

• Procuring financial intermediaries through a transparent and competitive process, carrying out due diligence on fund manager proposals;

• Providing input into the design of project development capacity and technical assistance solutions where needed by the financial intermediaries and final recipients;

• Refining/revising the Fund of Fund Investment Strategy, in the event of changed market conditions and policy priorities;

• Providing support in relation to the development of state aid solutions and liaising with the European Commission where needed to facilitate the implementation of the Investment Strategy;

• Entering into Funding Agreements with the financial intermediaries for making investments from the Fund of Funds. These Agreements will also specify how the financial intermediaries will invest in projects; and

• Monitoring and reporting on the actions of the financial intermediaries and their investments in underlying projects.

**Governance structure**

The activities of the Fund of Funds are typically overseen by an Investment Board.

The Investment Board will, broadly, be responsible for overseeing the implementation of the Fund of Funds and its Investment Strategy, which includes approving or rejecting recommendations made to it by its advisors. Membership of Investment Boards normally includes independent expert members. Specific advice in relation to the composition and appointment of the Investment Board is necessary in relation to the ensuing balance sheet treatment of the Fund of Funds. For the avoidance of doubt the Investment Board does not take project investment decisions.

The Investment Board would normally perform the following tasks:

• Approve or reject any amendments or revisions to the Investment Strategy;

• Approve or reject the proposed financial intermediary appointment;

• Approve or reject the business plan of each financial intermediary;

• Approve or reject the Operational Agreement for each financial intermediary;

• Oversee the performance of the financial intermediaries, consider progress against the objectives of the Investment Strategy, including non-financial returns and commitment and deployment milestones, consider methods to accelerate deployment of funds;

• Oversee efforts to secure co-financing and leverage for each financial intermediary;

• Approve or reject recommendations to re-allocate funds between the financial intermediaries; and

• Approve or reject recommendations to create further financial intermediaries.

The role of financial intermediary(ies)

The key roles envisaged for the financial intermediary manager(s) would broadly be:

• Development and origination of the project pipeline;

• Invest in and lead the negotiation and structuring of financial deals in viable projects which fit within the agreed investment strategy of the relevant sub fund and the overarching Fund of Funds;

• Monitor compliance and risk in accordance with EU rules (as appropriate);

• Secure co-financing and leverage (combination of fund and project level) as applicable

• Manage the portfolio of investments to ensure the achievement of expenditure, output and financial return targets;

• Recommend and manage appropriate exit strategies from project investments;

- Perform fund administration tasks, including ESIF reporting requirements (where relevant).

The terms and conditions for investment in a financial intermediary by the Fund of Funds will be negotiated under a specific Funding Agreement. This will include, among other things, the business plan, the financial intermediary investment strategy, monitoring of implementation, exit policy and winding up provisions. The Agreement will also oblige the financial intermediary to fully comply with relevant regulations, state aid rules and the investment strategy. After presentation of the key terms and conditions to the Investment Board for approval, signing of the Funding Agreement with the sub fund will follow.

The rules for eligible management costs and fees under the Common Provisions Regulation and the Commission Delegated Regulation are detailed in a Guidance Note written by the European Commission82. This Guidance Note only concerns the European Structural and Investment Funds, not the IPA Funds. This Guidance may however serve as benchmark for Candidate countries willing to use IPA Funds under financial instruments. This Guidance Note could be adapted to suit specific circumstances and simplified in the context of Serbia.

## 8.4 State-aid implications

EU and Serbian national legislation allows a single body to grant both a financial product (such as a loan or an equity product) and a grant. In addition, the Investment strategy needs to setup Financial Instruments and grants in a comprehensive manner. In that perspective, grants may be used for:

- Technical assistance for SMEs in view of:
  - Improving their knowledge, business and management skills
  - Helping them for their application for financing, either “usual” financing or Financial Instruments
  - Provide mentoring in the design of the business plan
  - Provide networking
- Awareness-raising materials for Financial Instruments, such as:
  - Awareness-raising events for the tendering process and launch of the Financial Instruments
  - A quick manual presenting the Financial Instruments available for the different target groups in all the areas
  - A physical one-stop-shop informing the SMEs on their financing options according to their needs, their phase in the lifecycle and their perspectives (e.g. equity financing for innovative start-ups)

# 9 Specification of the expected results

## 9.1 Establishing and quantifying the expected results of the FIs

At this stage in the planning process, it is not possible to go into extensive detail regarding the expected results that might be achieved by an FI as the nature of the projects covered by the FIs varies considerably. The results to be achieved also depend on the kind and the size of the firm implementing the investment, the sector in which it operates, but also on the objectives of the projects, its specific technical requirements, its duration, etc. Consequently, calculating expected results in a reliable and realistic way appears not possible at this stage.

## 9.2 Contribution to the strategic objectives

The corporate sector's capacity to invest is one of the key drivers of the economic development of an emerging economy. The relatively less developed local financial markets and the banking sector limit the ability of the local SMEs to borrow, raise capital, and subsequently invest and develop. These constraints can be only partially alleviated by the inflow of foreign private capital. Yet, even with foreign capital inflow, attracted by relatively higher returns in Serbia, is only part of the solution, as it has its own limitations. One of them is the foreign exchange risk and the corresponding premium, which increases the cost of borrowing for the corporate sector in general and even more so for the SMEs. Thus, the role of financial instruments in addressing the relative shortage of funding for SMEs is paramount.

Consequently, financial instruments are expected to help meet the following four strategic objectives:

- Boost the investment, GDP growth and employment in Serbia by enhancing and extending access to finance for the SMEs in all sectors
- Favour the upward move of the Serbian economy in the value chain by encouraging and accompanying the creation, setup and development of innovative SMEs
- Raise the awareness of the Serbian corporate actors, i.e. SMEs and financial intermediaries, of the existing financing opportunities and further develop their financial knowledge and expertise
- Address the important issue of youth employment, in particular by encouraging and supporting entrepreneurial activity

The present report suggests two financial instruments and one support facility for SMEs, each of which would create strategically important added value for the Serbian SMEs and for the Serbian economy at large.

- **Accelerator facility** taking the form of investments into the share capital of final recipients combined with technical assistance for mentorship and product development expenses. The fund would provide equity and quasi-equity FIs to innovative SMEs at the early stage of their development. This facility could also be used to provide finance in support of SMEs commercialising their products or services.
- **SME portfolio guarantee instrument** with reduced or no guarantee fee under *de minimis* aid combined with interest rate subsidies also under *de minimis* aid for the same loan. The fund would

provide the banks in Serbia with guarantee coverage at the SME loan portfolio level, possibly with particular focus on micro-enterprises. This FI would be provided to banks lending to SMEs as financial intermediaries, and not to individual SME borrowers, in order to alleviate the existing credit constraints for SMEs on the Serbian financial market.

- **Support facility for SMEs**, which would provide technical assistance, disseminate business knowledge and provide advisory services to the SMEs, including micro-enterprises. The key purpose of the facility would be to provide the SMEs with a comprehensive overview of all the existing financing opportunities and to help tailoring their individual financing strategy.

## 9.3 Monitoring and reporting

The three main objectives related to the monitoring and reporting on the FIs are:

- Enhancement of the transparency regarding the implementation of FIs
- Allowing better assessment of the overall performance of FIs
- Regularly updating the relevant stakeholders on the progress in financing and implementing the FIs

The monitoring and reporting provisions have a twofold purpose. They help the relevant authorities meet the reporting requirements defined by the providers of funds. They should also provide a complete overview of the operations and of the volumes of funding involved to help the authorities adjust/adapt their investment strategy during implementation.

To ensure that all the relevant information is reported in a consistent and comparable way and can, where necessary, be consolidated and aggregated, the authorities could use a standard model for the reporting included in the relevant Implementing act.

Two basic elements are indispensable with respect to the monitoring system suggested:

- Result and output Indicators to monitor the progress of the FIs
- Standard financial indicators to assess the performance of the funds

The reporting schedule could be organised as follows:

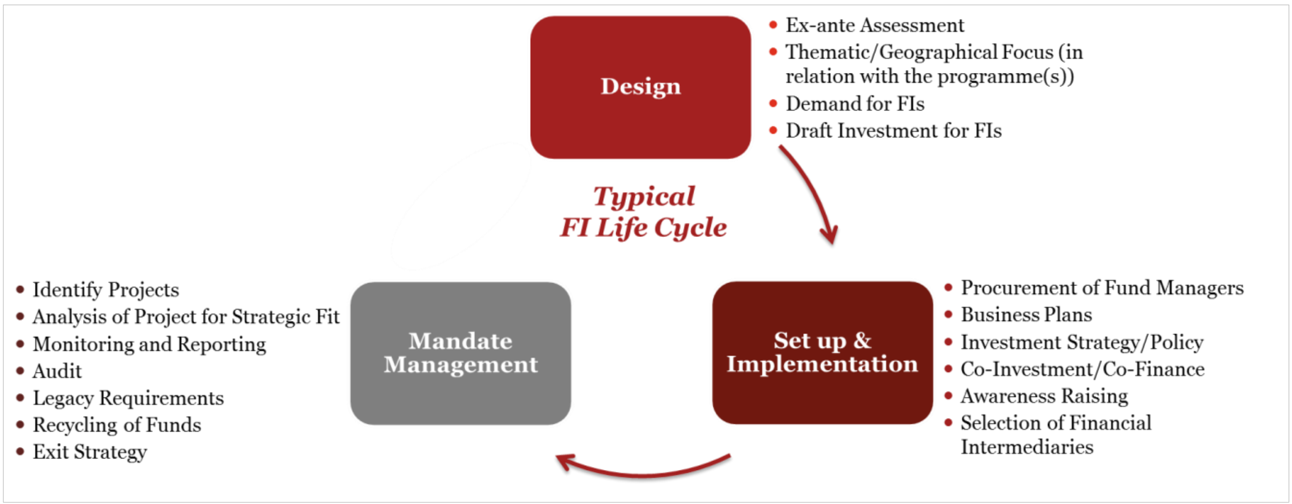
- **On a monthly basis** for key data, such as total amounts disbursed, number of loans approved/signed/disbursed, total number of SME supported
- **On a quarterly basis** for more fine-tuned information, such as the split between different types of projects

If some of the defined indicators are not at the expected level of achievement, the authorities could consider either revising the funding agreement, or launch another call to select other financial intermediaries, or modify the FIs/products offered.

## 9.4 An outline of an action plan for the implementation, monitoring and evaluation of financial instruments

The EU regulatory framework presents an opportunity to increase the use of FIs, including beyond the EU borders. In this context, it is helpful to have a clear understanding of the processes underpinning a typical FI life cycle. The EIB Financial Instrument Guide describes the different steps of the FI life cycle and of the related services that should be carried out[80], as illustrated in the figure below:

Figure 19. FI life cycle



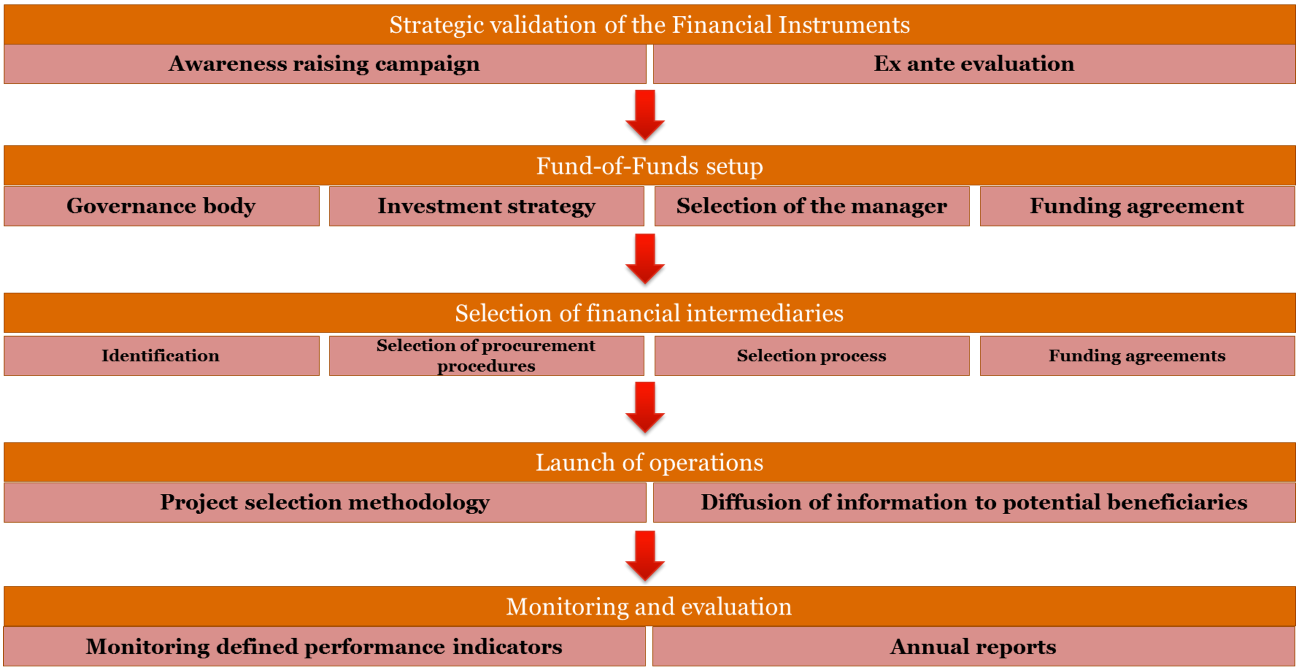

Source: PwC analysis, 2016

The term "life cycle" refers to the existence of a clearly defined start and end in the use of an FI. An FI aims at establishing a sustainable investment capacity in the long term, beyond the operation of the FI itself. Thus, any structure put in place should be based on a sustainable, long-term operational capacity. To this end, the design phase covers an ex-assessment, including a draft of the Proposed Investment Strategy, which offers an analysis of the governance and implementation options for the FI. The design phase is followed by the implementation and mandate management phases.

The figure below shows a typical plan of action required to set up a fund of funds.

[80] EIB (2013), Assignment 29: Strategic UDF Investing and Project Structuring, Appendix 1: Financial Instrument Guide: Setting up and implementing Financial Instruments.

**Figure 20. An action plan for FIs implementation**




Source: PwC analysis, 2016

# 10 Provisions for the update and review of the ex-ante assessment

The market conditions and the investment trends may change before and in the course of the implementation of the FI. As a result, Article 37 (2) (g) CPR requires the ex-ante assessment to comprise provisions for its revision and update, in case the MA considers that the conclusions of the ex-ante assessment no longer match the new market conditions.

More specifically, the main drivers of change to which the MA should pay attention and which may require an update are the following:

- **Poor accuracy of the proposed targets compared to observed results**
- **Inadequate volume of the support scheme compared to observed demand** (e.g. a situation where the volume proposed for the FIs is too low to meet the new demand)
- **Miscalculation of the risk taken by the FI**: it may occur that the risk profile of an FI is significantly higher than expected. This would imply the FI to incur significant losses, hence compromising its revolving nature
- **Changes in the political settings**
- **Improvement of the Serbian economic conditions** (with a corresponding shift the supply of funding upward or increase the demand of funding with ambiguous implications for the resulting financing gap)
- **Market failures are fully addressed and there is no need for intervention**

In addition, given the background of this study, an update of the ex-ante assessment may be required following the results of a call for expression of interest initiated by the MA and seeking to identify suitable projects for the support by means of FIs. The need for update and review of the assessment could be followed through:

- Regular reporting/monitoring of the FI (at least annually)
- Through ad hoc or planned evaluations (e.g. ongoing evaluations)

It is important to mention that following the conclusion of the updated ex-ante assessment, the MA should take action, if required, to improve the strategic fit of the FIs. This procedure is both initiated and performed at the discretion of the MA (MoE) alone.

# 11 Conclusions

In the course of the analysis undertaken in this report, financing gaps were identified for different categories of SMEs.

The two financial instruments suggested to address the existing gaps in the SME access to finance in Serbia are:

- **An Accelerator facility** taking the form of investments into the share capital of final recipients combined with technical assistance for mentorship and product development expenses. The fund would provide equity and quasi-equity FIs to innovative SMEs at the early stage of their development. This facility could also be used to provide finance in support of SMEs commercialising their products or services.
- **SME portfolio guarantee instrument** with reduced or no guarantee fee under de minimis aid combined with interest rate subsidies also under de minimis aid for the same loan. The fund would provide the banks in Serbia with guarantee coverage at the SME loan portfolio level, possibly with particular focus on micro-enterprises. This FI would be provided to banks lending to SMEs as financial intermediaries, and not to individual SME borrowers, in order to alleviate the existing credit constraints for SMEs on the Serbian financial market. In addition to these two financial instruments, the study suggests putting in place a Support facility for SMEs. The latter would provide technical assistance, disseminate business knowledge and provide advisory services to the SMEs, including micro-enterprises. The key purpose of the facility would be to provide the SMEs with a comprehensive overview of all the existing financing opportunities and to help tailoring their individual financing strategy.

The analysis of the SMEs access to finance also identified microfinance as one of the areas where financial instruments could be impactful and bring added value. Thus, the study sketches two additional potential financial instruments addressing the needs of SMEs in the field of microfinance: a Microfinance Capital Enhancement (Equity) Fund and the Microfinance FLPG Fund. However, the setup of these two FIs is contingent on the implementation of the enabling legal framework, which is unlikely in 2017. The Microfinance Capital Enhancement (Equity) Fund has to be postponed until the corresponding regulation exists. As for the Microfinance FLPG, its' objectives could be partly fulfilled within the existing banking sector, with the amounts envisaged for the Microfinance FLPG re-allocated to the SME portfolio guarantee instrument.

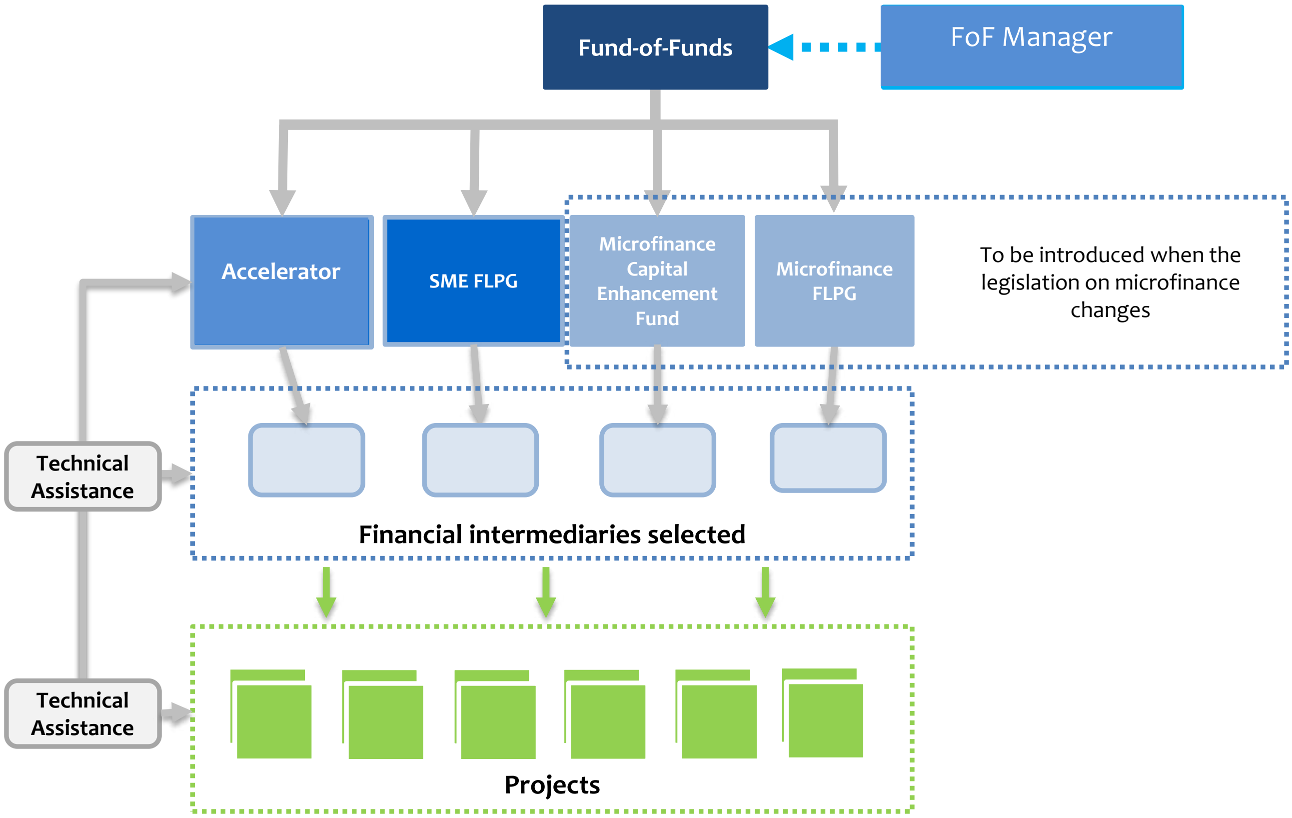
A support facility for SMEs (Technical Assistance) would help to underpin the implementation of the financial instruments. It would provide expertise and technical/financial advice to SMEs and capacity building support to financial intermediaries.

Regarding the management of the suite of products proposed, it is recommended that a modular approach is followed. For the first years of implementation of the FIs, consideration could be given to entrusting their management of the Fund of Funds to EIF. However, the role of EIF in such a structure would be subject to further discussion with EIF, as a next phase in the development of the proposed instruments.

This approach would enable faster setup and implementation of the financial instruments. The support facility (Technical Assistance) for SMEs and financial intermediaries could be managed outright by the local entity.

For the implementation of the proposed FIs, the recommended governance structure is a Fund-of-Funds.

**Figure 21. Outline structure of the Fund of Funds that may be implemented in Serbia**




Source: EIB, 2017

# 12 Ex-ante assessment completeness checklist

| Ex-ante requirement | Addressed in this Report |
|---|---|
| **General** | |
| 1. Understand the rationale for an increased use of FIs and consider the experience gained with FIs in the 2007 – 2013 period. | **Chapter 7** |
| 2. Understand the different types of FIs available, the possible implementation arrangements and the different possible flows of investment contributions | **Chapter 8** |
| 3. Define the scope and the time frame of the ex-ante assessment | **Introduction** |
| 4. Check the consistency with the Partnership Agreement and the Programme Strategy Preliminary considerations | **Introduction** |
| **Article 37 (2) a** | |
| 1. Identify the market problems existing in the country or region in which the FI has to be established | **Chapter 7**<br>**Chapter 5** |
| 2. Analyse the gap between supply and demand of financing and by identifying sub-optimal investment situations | **Chapter 7**<br>**Supply side - Chapter 7.1**<br>**Private sector supply - Chapter 7.1** (description of banks' offer)<br>**Public sector supply - Chapter 5.4**<br>**Demand side - Chapter 7.2**<br>**Financial Products**<br>***Products (e.g. Loans)* Chapter 7.2** |
| 3. Quantify the investment gap to the extent possible | **Chapter 7.3** |
| **Article 37 (2) b** | |
| 1. Identify the quantitative and the qualitative dimensions of the value added of the envisaged FI and compare it with the added value of alternative approaches | **Chapter 7.6**<br>**Chapter 8** (quantitative dimension of the value added of FI) by product/FI:<br>**Chapter 8.1** (value added, target market and financial recipients (FRs), financial products, risks, leverage, implementation options) by product/FI:<br>**Chapter 8** (qualitative value added) |

| | |
|---|---|
| 2. Assess the consistency of the envisaged FI with other forms of public intervention | **Chapter 8.1** |
| 3. Consider the State aid implications of the envisaged FI | **Chapter 8.4** |
| **Article 37 (2) c** | |
| 1. Identify additional public and private resources to be potentially raised by the FI and assess indicative timing of national co-financing and of additional contributions (mainly private) | **Chapter 8.1** (additional public and private resources to be potentially raised by the FIs) by product/FI: |
| 2. Estimate the leverage of the envisaged FI | **Chapter 8.1** |
| 3. Assess the need for, and level of, preferential remuneration based on experience in the relevant markets | **Chapter 8.1** |
| 4. Choose an approach for alignment of interest with private co-financing | **Chapter 8.1** (financing structures for each FI demonstrating proposed instruments and private co-financing) |
| **Article 37 (2) d** | |
| 1. Gather relevant available information on past experiences, particularly on those that have been set up in the same country or region in which the envisaged FI will be established; | **Chapter 5** |
| 2. Identify the main success factors and the main pitfalls of these past experiences; | **Chapter 5** |
| 3. Use the collected information to enhance the performance of the envisaged FI (e.g. mitigate and reduce risk, ensure a faster set-up and roll-out of the FI). | **Chapter 8** (Recommendations) |
| **Article 37 (2) e** | |
| 1. Define the level of detail for the proposed investment strategy maintaining a certain degree of flexibility | **Chapter 8** (financing structures for each FI), providing for adjustments resulting from FI specifics, MA decision on level of targets to be achieved, recommendations on FI adjustment triggered by estimated and actual demand and market conditions) |
| 2. Define scale and focus of the FI consistently with the results of the market assessment and the value added assessment, in particular by selecting the financial product to be offered and the target final recipients | **Chapter 8.2** (detailed information on FIs)<br>**Summary information on FIs – Chapter 8.1**<br>**Summary information on Final Recipients – Chapter 8.1** |
| 3. Define the governance structure of the FI, by selecting the most appropriate implementation arrangement and the envisaged combination with grant support | **Chapter 8.2**<br>**Implementation structure (entities and arrangements)** – Chapter 8.3 (for FIs) and Chapter 8.3 (for other instruments (TA, grants)<br>**Summary information on combination with grants** - n/a |
| **Article 37 (2) f** | |

| | |
|---|---|
| 1. Establish and quantify the expected results of the FI by means of result indicators, output indicators and FI performance indicators as appropriate | **Chapter 8.1** |
| 2. Specify how the envisaged FI will contribute to deliver the strategic objectives for which it is set up | **Chapter 9.1** |
| 3. Define the monitoring system in order to efficiently monitor the FI, facilitate reporting requirements and identify any improvement areas | **Chapter 9.3** |
| **Article 37 (2) g** | |
| 1. Define the conditions and/or the timing in which a revision or an update of the ex-ante assessment is needed | **Chapter 10** |

# 13 Annexes

# 1. Annex – Bibliography


| Document | Date of publication | Hyperlink |
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# 2. Annex – List of interviews

Interviewed stakeholders are indicated in the table below.

| Stakeholder group | Institution interviewed |
|---|---|
| Public Administration and State Managing Authorities | Ministry of Economy |
| | National Bank of Serbia |
| | Serbian Development Agency |
| | Agency for Export Insurance and Financing (AOFI) |
| | Vojvodina development fund |
| | Guarantee fund of autonomous province of Vojvodina |
| | Ministry of Finance |
| | Innovation Fund |
| | Ministry of Education, Science and technological development |
| Associations | Chamber of Commerce and Industry of Serbia |
| Commercial banks and financial institutions | Direktna Bank |
| | UniCredit Bank |
| | Banca Intesa |
| | Raiffeisen Bank |
| | European Investment Bank |
| | European Investment Fund |
| | European Bank for Research and Development |
| Venture Capital Funds | South Central Venture |
| | ICT Hub |
| | Startlabs |
| Private Equity Funds | Blue Sea Capital |

## 3. Annex – Interview guide

Below is presented the interview guide that was used to interview stakeholders. When each interview was conducted this guide was fine-tuned and adapted according to the interviewee's experience and knowledge related to SME access to finance in Serbia.

**A. Current market situation and understanding**

- What would you estimate is the market demand (market size) for financing of SMEs in Serbia (in million EUR)?
    - Overall demand?
    - Demand from companies that fulfil the required conditions for obtaining financing?
- What is your perception of the current situation of access to financing for SMEs?
- What financial instruments exist to support SME access to finance?
- What are the strengths, weaknesses, opportunities and threats of the existing financial product offers for SMEs?
- In your opinion, what are the specific obstacles:
    - that financial institutions face: cost, market acceptance of new products, regulatory problems, guarantees, better conditions offered by other actors outside Serbia, project bankability (weak/lacking quality of documentation & business plans)?
    - that SMEs are facing with when trying to access financing?

**B. The future of SME in Serbia**

- In your opinion, which sectors in Serbia will develop the fastest in the coming years? Based on this, are there any foreseeable changes in terms of which sectors will be getting financing in the future?
- What are the emerging trends in financing SMEs in terms of:
    - financial instruments offered by the private sector,
    - financial instruments offered by the public sector,
    - regulatory framework?
- In your opinion, what are the main challenges in financing of SMEs in the future?
- Does market demand surpass the current supply? If yes, by how much?

**C. Proposed improvements for improved access to financing for SMEs in Serbia**

- In your opinion, what role should public financing play in helping SMEs access finance in Serbia?
- What are the most effective models for financing SMEs (both public and private)?
- Considering the existing financial instruments on the Serbian market, how could new Financial Instruments best support access to finance for SMEs (replacing existing ones, offering a new product etc.)?

# 4. Annex – Questionnaire for the online survey

The questionnaire used for the survey, conducted for the Ex-ante assessment in Serbia, is presented below.

a) English version

1. *In which territorial area is the main business activity of your company based? (Please select from the list below)*

- Belgrade Region
- Vojvodina
- Sumadija region and West Serbia
- South and East Serbia

2. *In which sector does your business primarily operate? (Please select from the list below. State activity that company is performing in reality, if it is different from the registered one)*

- Agriculture, forestry and fishing
- Mining and quarrying
- Manufacturing
- Electricity, gas, steam and air conditioning supply
- Water supply; sewerage, waste management and remediation activities
- Construction
- Wholesale and retail trade; repair of motor vehicles and motorcycles
- Transportation and storage
- Accommodation and food service activities
- Information and communication
- Financial and insurance activities
- Real estate activities
- Professional, scientific and technical activities
- Administrative and support service activities
- Public administration and defence; compulsory social security
- Education
- Human health and social work activities

- Arts, entertainment and recreation
- Other service activities
- Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use
- Activities of extraterritorial organisations and bodies

3. *Do you export?*

- Yes (10% of turnover)
- Sometimes
- No

4. *Over the last three years (2014, 2015, 2016), on average how many full-time staff or full-time staff equivalent ("FTE") were working in your company? (Please select from the list and answer for each year)*

| | 1 - 9 employees | 10 - 49 employees | 50 - 249 employees | 250+ employees |
|---|---|---|---|---|
| 2016 | ○ | ○ | ○ | ○ |
| 2015 | ○ | ○ | ○ | ○ |
| 2014 | ○ | ○ | ○ | ○ |

5. *At which growth phase would you currently position your company / activity?*

   - Initiation [business model is created, no commercial activity]
   - Creation [commercial activity initiated, product not marketed]
   - Post-creation [activity has begun, no profit]
   - Development [profitable growth phase]
   - Maturity [stable activity with frail or stagnant growth]
   - Reorganisation [implementing or planning future restructuring processes in order to become profitable]
   - Takeover / transfer to new ownership/ buy-out

6. *How did the following factors change in 2016 compared to 2014, in your opinion? (Please indicate your answers in the fields provided below)*

| | Much Worse | Worse | Unchan ged | Better | Much Better | No Opinion |
|---|---|---|---|---|---|---|

| | | | | | | |
|---|---|---|---|---|---|---|
| The financial situation of your business | ○ | ○ | ○ | ○ | ○ | ○ |
| Turnover | ○ | ○ | ○ | ○ | ○ | ○ |
| The cost (interest, fees and other) of obtaining finance for your business | ○ | ○ | ○ | ○ | ○ | ○ |
| The debt/turnover ratio of your business | ○ | ○ | ○ | ○ | ○ | ○ |
| Other terms or conditions of finance (e.g. loan maturity, collateral levels, etc.) | ○ | ○ | ○ | ○ | ○ | ○ |
| The burden or effort to obtain finance for your business | ○ | ○ | ○ | ○ | ○ | ○ |
| The willingness of banks to provide finance | ○ | ○ | ○ | ○ | ○ | ○ |
| The willingness of investors to invest in your business | ○ | ○ | ○ | ○ | ○ | ○ |

7. *Over the last three years (2014, 2015, 2016), which source(s) of financing has your company used? (Please indicate all the sources of finance you have used)*

- Micro-loan from a micro-finance institution (< 25.000 EUR), not banks
- Short-term loans, bank overdrafts and credit lines (< 1 year)
- Medium and long-term loans (> 1 year)
- Loans guaranteed by a public or private entity
- Loan provided with interest rate subsidy
- Loan obtained from parent company
- Leasing
- Bank guarantees (including export guarantees)
- Factoring
- Investment funds
- Venture capital funds, i.e. capital provided by investors acting together in a fund set-up for the purpose of providing finance to start-up and small businesses
- Business Angels i.e. individuals investing in start-ups and entrepreneurs and often providing mentoring
- Technology transfer funds
- Equity, i.e. direct investment in company share, from national, regional or foreign institutions
- Rescue / turnaround and buyout capital
- Mezzanine or hybrid financing, *i.e. debt convertible in company share under specific agreement* (combining loans and equity)
- Public grants
- Corporate bonds
- Other private investors
- Private grants or donations
- Retained earnings
- Capital contributions of shareholders
- External capital contributions (family or friends)
- Other financing sources

- None

8. *How successful were you in obtaining each type of the products listed below over the last three years (2014, 2015, 2016)?*

*Please indicate the level of success for each of the following sources, where "partially successful" refers to not getting the requested amount or receiving it with unsatisfactory terms.*

*Whatever was not ticked in Q6 should be ticked as "N/a" in this question*

| | Successful | Partially Successful | Unsuccessful | N/a |
|---|---|---|---|---|
| Micro-loan from a micro-finance institution (< 25.000 EUR), not banks | ○ | ○ | ○ | ○ |
| Short-term loans, bank overdrafts and credit lines (< 1 year) | ○ | ○ | ○ | ○ |
| Medium and long-term loans (> 1 year) | ○ | ○ | ○ | ○ |
| Loans guaranteed by a public or private entity | ○ | ○ | ○ | ○ |
| Loan provided with interest rate subsidy | ○ | ○ | ○ | ○ |
| Loan obtained from parent company | ○ | ○ | ○ | ○ |
| Leasing | ○ | ○ | ○ | ○ |
| Bank guarantees (including export guarantees) | ○ | ○ | ○ | ○ |
| Factoring | ○ | ○ | ○ | ○ |
| Investment funds | ○ | ○ | ○ | ○ |
| Venture capital funds, i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses | ○ | ○ | ○ | ○ |
| Business Angels i.e. individuals investing in start-ups and entrepreneurs and often providing mentoring | ○ | ○ | ○ | ○ |
| Technology transfer funds | ○ | ○ | ○ | ○ |
| Equity, i.e. direct investment in company share, from national, regional or foreign institutions | ○ | ○ | ○ | ○ |
| Rescue / turnaround and buyout capital | ○ | ○ | ○ | ○ |
| Mezzanine or hybrid financing, *i.e. debt convertible in company share under specific agreement* (combining loans and equity) | ○ | ○ | ○ | ○ |
| Public grants | ○ | ○ | ○ | ○ |

| | | | | |
|---|---|---|---|---|
| Corporate bonds | ○ | ○ | ○ | ○ |
| Other private investors | ○ | ○ | ○ | ○ |
| Private grants or donations | ○ | ○ | ○ | ○ |
| Retained earnings | ○ | ○ | ○ | ○ |
| Capital contributions of shareholders | ○ | ○ | ○ | ○ |
| External capital contributions (family or friends) | ○ | ○ | ○ | ○ |
| Other financing sources | ○ | ○ | ○ | ○ |

9. *For what purpose did you seek finance in the last three years (2014, 2015, 2016)? (Please select one or more options from the list below)*

    - Finance working capital
    - Ensure debt consolidation, refinancing
    - Acquire another company
    - Purchase of machinery / equipment
    - Purchase office or production space
    - Rent machinery/equipment
    - Launch a new product / service
    - Develop international activities / enter a new market (geographic expansion)
    - Finance export sales
    - Finance R&D and innovation
    - Transfer ownership (e.g. financing exit of partner from business)
    - Acquisition of an intangible asset
    - Improve energy efficiency of your company
    - Other needs

10. *During the last three years (2014, 2015, 2016), in your opinion, what were the reasons for any difficulties in obtaining finance that you experienced? (Please indicate one or more options from the list below).*
    - The financial situation of your business
    - The cost (interest and other) of obtaining finance for your business
    - The debt / turnover ratio of your business
    - Other terms or conditions of finance (e.g. loan maturity, collateral levels, covenants, guarantee, conditions, duration, etc.)
    - The burden or effort to obtain finance for your business
    - The lack of expertise of your team to find or negotiate the best option
    - The limited availability of equity investors
    - The difficulties related to file the application
    - The willingness of banks to provide finance
    - Corruption
    - Not applicable: Our company did not experience any difficulties

11. *Over the last three years (2014, 2015, 2016), have you ever felt discouraged from seeking finance, because of requirements (collateral, interest rates) or because of difficult financial situation?*

*(Please indicate one or more of the options listed below)*

- Never
- Rarely
- Occasionally
- Often
- Always

12. *Over the last three years (2014, 2015, 2016), what type of guarantee did you provide for your loan(s)?*

*(Please indicate one or more of the options listed below.)*

- Owner's assets
- Family and friends
- Company assets (collateral on building or other company premise)
- Promissory note
- Warranty
- Pledge on movable property, stocks of goods, the subject of acquisition

- Business partners
- Mutual guarantee schemes such as cooperatives
- Other guarantee schemes (Private, public, national or regional)
- Other institution
- Not applicable: Our company did not use loan financing or did not need to provide collateral

13. *Over the last three years (2014, 2015, 2016), which do you believe were the reasons for being unsuccessful - or partially unsuccessful - in receiving loan financing? (Please indicate one or more of the options listed below)*

- Poor credit rating
- Lack of own capital
- Insufficient collateral or guarantee
- Insufficient potential or too high a risk (of the business or project)
- Already too much debt
- No credit history
- Poor credit history
- No reason given
- Interest rates were too high
- Other conditions of the loan were unacceptable (e.g. maturity, covenants)
- Not applicable: Our company did not request loan financing or was successful in receiving loan financing over these years

14. *Did you experience changes in bank financing terms and conditions over the last three years (2014, 2015, 2016)? (Please indicate any changes per option provided)*

| | **Increased** | **Decreased** | **Unchanged** |
|---|---|---|---|
| Interest rates | ○ | ○ | ○ |
| Other costs related to the loan (other than interest rate) | ○ | ○ | ○ |
| Amount of the loan / credit line available | ○ | ○ | ○ |
| Maturity of the loan | ○ | ○ | ○ |
| Collateral requirements | ○ | ○ | ○ |
| Contractual issues related to the loan / Information requirements, etc. | ○ | ○ | ○ |

15. *Over the last three years (2014, 2015, 2016), what sources of equity finance* (i.e. direct investment in company share) *did you use? (Please indicate all the equity sources you have used for the time period 2014-2016)*
    - Existing owners
    - Directors in your company who were not previously shareholders
    - Other employees of your business
    - Family, friends or other individuals
    - Venture capital funds i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses
    - Business angels i.e. individuals investing in start-ups and entrepreneurs and often providing mentoring
    - Mezzanine or hybrid financing, i.e. debt convertible in company share under specific agreement (combining loans and equity)
    - Initial Public Offering (IPO) or other stock market offerings i.e. the first issue of shares by a private company to the public in order to generate capital
    - Banks
    - Other financial institutions e.g. subsidiaries of banks
    - Other companies
    - Public equity funds
    - Other equity finance source
    - Not Applicable: Our company did not seek equity finance in these years

16. *What amount of loan and equity financing did you SEEK during the last three years? (Please provide an estimate in thousands of EUR of the financing amount sought for loan and equity)*

| | 2014-2016 (thousands EUR) |
|---|---|

| | |
|---|---|
| Debt (all types of loan or credit) | |
| Equity finance (all types of equity and mezzanine financing) | |
| Grants or subsidies | |

17. *What amount of loan and equity financing did you OBTAIN during the last three years? (Please provide an estimate in thousands of EUR of the financing amount obtained for loan and equity)*

| | 2014-2016 (thousands EUR) |
|---|---|
| Debt (all types of loan or credit) | |
| Equity finance (all types of equity and mezzanine financing) | |
| Grants or subsidies | |

18. *Do you feel you have sufficient access to the following financing sources in Serbia?*

| | Yes | No | Type of financing not relevant to me |
|---|---|---|---|
| Micro-loan from a micro-finance institution (< 25.000 EUR), not banks | | | |
| Short-term loans, bank overdrafts and credit lines (< 1 year) | | | |
| Medium and long-term loans (> 1 year) | | | |
| Loans guaranteed by a public or private entity | | | |
| Loan provided with interest rate subsidy | | | |
| Loan obtained from parent company | | | |
| Leasing | | | |
| Bank guarantees (including export guarantees) | | | |
| Factoring | | | |
| Investment funds | | | |
| Venture capital funds i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses | | | |
| Business Angels i.e. individuals investing in start-ups and entrepreneurs and often providing mentoring | | | |

Technology transfer funds

Equity from national, regional or foreign institutions i.e. direct investment in company share, from national, regional or foreign institutions

Rescue / turnaround and buyout capital

Mezzanine or hybrid financing i.e. debt convertible in company share under specific agreement (combining loans and equity)

Public grants

Corporate bonds

Other private investors

Private grants or donations

Retained earnings

Capital contributions of shareholders

External capital contributions (family or friends)

Other financing sources

19. *Please select the FIVE forms of financing you prefer.*

- Short-term loans, bank overdrafts and credit lines (<1 year)
- Medium and long-term loans (> 1 year)
- Loans guaranteed by a public or private entity
- Loan provided with interest rate subsidy
- Loan obtained from parent company
- Leasing
- Bank guarantees (including export guarantees)
- Factoring
- Investment funds
- Venture capital funds i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses
- Business Angels i.e. individuals investing in start-ups and entrepreneurs and often providing mentoring
- Technology transfer funds
- Equity, i.e. direct investment in company share, from national, regional or foreign institutions
- Rescue / turnaround and buyout capital
- Mezzanine or hybrid financing, i.e. debt convertible in company share under specific agreement (combining loans and equity)
- Public grants
- Corporate bonds
- Other private investors
- Private grants or donations
- Retained earnings
- Capital contributions of shareholders
- External capital contributions (family or friends)

- Other financing sources

20. *What amount of each of the following financing sources do you intend to request in **2017** (Amount in thousands of EUR)? (If not applicable leave blank)*

| | (thousands EUR)<br>**2017** |
|---|---|
| Short-term loans, bank overdrafts and credit lines (< 1 year) | |
| Medium and long-term loans (> 1 year) | |
| Loans guaranteed by a public or private entity | |
| Loan provided with interest rate subsidy | |
| Loan obtained from parent company | |
| Leasing | |
| Bank guarantees (including export guarantees) | |
| Factoring | |
| Investment funds | |
| Venture capital funds i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses | |
| Business Angels i.e. individuals investing in start-ups and entrepreneurs and often providing mentoring | |
| Technology transfer funds | |
| Equity i.e. direct investment in company share, from national, regional or foreign institutions | |
| Rescue / turnaround and buyout capital | |
| Mezzanine or hybrid financing i.e. debt convertible in company share under specific agreement (combining loans and equity) | |
| Public grants | |
| Corporate bonds | |
| Other private investors | |
| Private grants or donations | |
| Retained earnings | |
| Capital contributions of shareholders | |
| External capital contributions (family or friends) | |
| Other financing sources | |

21. *For what purpose is this financing being sought? (Please indicate one or more options)*

- Finance working capital
- Ensure debt consolidation, refinancing
- Acquire another company
- Acquire land / building
- Rent land / building
- Acquire machinery / equipment
- Rent machinery / equipment
- Launch a new product / service
- Develop international activities / enter a new market (geographic expansion)
- Finance export sales
- Finance R&D and innovation
- Transfer ownership
- Acquisition of an intangible asset
- Other needs

22. *When looking for finance, do you feel you lacked support from:*

| | Yes | No | Did not ask for support from this organisation |
|---|---|---|---|
| Your city | | | |
| State authorities | | | |
| Guarantee funds | | | |
| Public Investment funds | | | |
| Venture capital funds i.e. capital provided by investors acting together in a fund set up for the purpose of providing finance to start-up and small businesses | | | |
| Business angels i.e. individuals investing in start-ups and entrepreneurs and often providing mentoring | | | |
| Commercial banks | | | |
| Chamber of Commerce and Industry | | | |
| Social Media (Facebook/Twitter… ) | | | |
| Support networks | | | |
| Your accountant or an accounting, tax or finance consultant | | | |
| Innovation infrastructure such as incubators, innovation centers, technology parks, cluster | | | |
| Your social environment such as friends, family | | | |

23. *Please choose THREE most important factors limiting business growth in Serbia and rank them by importance (1-3):*
*1 = most important factor; 3 = least important factor*

- Limited demand in local market
- Limited demand in foreign markets
- Limited availability of suitable new personnel
- Loss of existing personnel
- Business transfer problems e.g. inheritance
- Cost of labour increasing
- Inability to finance necessary investment into equipment
- Products getting outdated (R&D necessary, product lead time)
- Difficulty keeping up with technological change
- Change in the competition (as new entrants in the market)
- Price competition / small margins
- Unfair competition, e.g. dumping
- Regulatory framework (related to issues such as labour code, public procurement procedures, tax regulation)
- Lack of fiscal incentives
- Not enough supply of financing
- Available financing not appropriate to your need
- Corruption
- Do not see constraints (nothing ticked above)

b) Serbian version

*1. U kojoj teritorijalnoj oblasti se nalazi sedište Vaše kompanije u Srbiji?*

- Beograd
- Vojvodina
- Region Šumadije i Zapadne Srbije
- Region Južne i Istočne Srbije

*2. Koja je primarna delatnost Vaše kompanije? (Izabrati sa liste. Navesti stvarnu delatnost bez obzira na registrovanu delatnost u APR-u)*

- Poljoprivreda, šumarstvo i ribarstvo
- Rudarstvo
- Prerađivačka industrija
- Snabdevanje električnom energijom, gasom, parom i klimatizacija
- Snabdevanje vodom, upravljanje otpadnim vodama, kontrolisanje procesa uklanjanja otpada i slične aktivnosti
- Građevinarstvo
- Trgovina na veliko i trgovina na malo; popravka motornih vozila, i motocikala
- Saobraćaj i skladištenje
- Usluge smeštaja i ishrane
- Informisanje i komunikacije
- Finansijske delatnosti i delatnost osiguranja

- Poslovanje nekretninama
- Stručne, naučne, inovacione i tehničke delatnosti
- Administrativne i pomoćne uslužne delatnosti
- Državna uprava i odbrana; obavezno socijalno osiguranje
- Obrazovanje
- Zdravstvena i socijalna zaštita
- Umetnost, zabava i rekreacija
- Ostale uslužne delatnosti
- Delatnost domaćinstva kao poslodavca; delatnost domaćinstava koja proizvode robu i usluge za sopstvene potrebe
- Delatnost eksteritorijalnih organizacija i tela

*3. Da li ste izvoznik?*

- DA (najmanje 10% prihoda)
- POVREMENO
- NE

*4. Koliko je u proseku bilo stalno zaposlenih ili zaposlenih sa punim radnim vremenom u Vašoj kompaniji u prethodne tri godine (2014, 2015, 2016)? (Izabrati sa liste i dati odgovor za svaku godinu)*

| | 1 - 9 zaposlenih | 10 - 49 zaposlenih | 50 - 249 zaposlenih | 250+ zaposlenih |
|---|---|---|---|---|
| 2016 | ○ | ○ | ○ | ○ |
| 2015 | ○ | ○ | ○ | ○ |
| 2014 | ○ | ○ | ○ | ○ |

*5. U kojoj je fazi razvoja Vaša kompanija u ovom trenutku?*

- Faza inicijacije (poslovni model je kreiran, nema komercijalne aktivnosti)
- Faza stvaranja (komercijalna aktivnost započeta, proizvod nije lansiran na tržište)
- Faza post-stvaranja (aktivnost započeta, nema pozitivnog rezultata)
- Faza razvoja (Profitabilna faza rasta)
- Faza zrelosti (stabilna aktivnost sa rastom koji stagnira)
- Reorganizacija (implementiran ili planiran budući proces restrukturiranja radi ostvarivanja profitabilnosti)
- Preuzimanje/prenos novom vlasniku/otkup

*6. Po Vašem mišljenju, kakvo je kretanje sledećih faktora u 2016 u poređenju sa 2014? (Molim navesti odgovore u previđena polja ispod)*

| | Mnogo lošije | Lošije | Nepromenjeno | Bolje | Mnogo bolje | Neodređeno |
|---|---|---|---|---|---|---|
| Finansijska situacija kompanije | ○ | ○ | ○ | ○ | ○ | ○ |
| Promet | ○ | ○ | ○ | ○ | ○ | ○ |
| Troškovi finansiranja kompanije (kamata, naknade banke i ostali | ○ | ○ | ○ | ○ | ○ | ○ |

| | | | | | | |
|---|---|---|---|---|---|---|
| troškovi) | | | | | | |
| Odnos ukupnog duga naspram prometa kompanije | ○ | ○ | ○ | ○ | ○ | ○ |
| Ostali uslovi finansiranja (npr. period otplate kredita, visina kolaterala, itd.) | ○ | ○ | ○ | ○ | ○ | ○ |
| Poteškoće i napori oko dobijanja sredstava za finansiranje | ○ | ○ | ○ | ○ | ○ | ○ |
| Spremnost banaka da obezbede finansije | ○ | ○ | ○ | ○ | ○ | ○ |
| Spremnost investitora da investiraju u Vaš biznis | ○ | ○ | ○ | ○ | ○ | ○ |

*7. U prethodne tri godine (2014, 2015, 2016), koje je sve izvore finansiranja koristila Vaša kompanija? (Molim navesti sve izvore finansiranja koji su bili korišćeni)*

- Mikro krediti od strane institucije za mikrofinansiranje (< 25.000 eur), koje nisu banke
- Kratkoročni krediti, pozajmice na tekućem računu (overdraft) i kreditne linije (< 1 god)
- Srednjoročni i dugoročni krediti (> 1 god)
- Krediti garantovani od strane javne ili privatne institucije
- Subvencionisani krediti (subvencija kamate)
- Kredit od matične kompanije
- Lizing
- Bankarske garancije (uključujući garancije za izvoz)
- Faktoring tj. otkup potraživanja
- Investicioni fondovi
- Fondovi preduzetnog kapitala (Venture capital fond), tj. fond koji se sastoji od investitora koji zajedno ulažu svoj kapital radi finansiranja start-up firmi i malih preduzeća
- Poslovni anđeli tj. fizička lica koja ulažu sopstveni kapital , znanje i iskustvo u mlada preduzeća
- Inovativni fondovi za transfer tehnologije
- Ulaganje u vlasnički kapital od strane nacionalne, regionalne ili strane institucije
- Restrukturiranje i otkup kapitala
- Mezanin finansiranje ili mešovito finansiranje tj. dug koji može da se pretvori u akcije (vlasnički kapital) pod posebnim uslovima
- Bespovratna sredstva od strane državnih institucija
- Korporativne obveznice
- Ostali privatni investitori
- Privatne donacije ili bespovratna sredstva od strane privatnih kompanija
- Neraspoređena dobit
- Kapitalni doprinosi akcionara
- Spoljni doprinosi kapitala (porodica ili prijatelji)
- Ostali izvori finansiranja
- Nijedan
- Pozajmica osnivača
- Cross border krediti

*8. Koliko ste bili uspešni u dobijanju finansijskih sredstava (po vrstama) u prethodne tri godine (2014, 2015, 2016)?*

*Molim navesti nivo uspešnosti za svaki od izvora gde se „delimično uspešan" odnosi na nemogućnost dobijanja traženog iznosa ili dobijanja sredstava pod nezadovoljavajućim uslovima.*

*Sve što nije primenjivo označiti sa n/a.*

| | Uspešan | Delimično uspešan | Neuspešan | N/a |
|---|---|---|---|---|
| Mikro krediti od strane institucije za mikrofinansiranje (< 25.000 eur) | ○ | ○ | ○ | ○ |
| Kratkoročni krediti, pozajmice na tekućem računu (overdraft) i kreditne linije (< 1 god) | ○ | ○ | ○ | ○ |
| Srednjoročni i dugoročni krediti (> 1 god) | ○ | ○ | ○ | ○ |
| Krediti garantovani od strane javne ili privatne institucije | ○ | ○ | ○ | ○ |
| Subvencionisani krediti (subvencija kamate) | ○ | ○ | ○ | ○ |
| Kredit od matične kompanije | ○ | ○ | ○ | ○ |
| Lizing | ○ | ○ | ○ | ○ |
| Bankarske garancije (uključujući garancije za izvoz) | ○ | ○ | ○ | ○ |
| Faktoring tj. otkup potraživanja | ○ | ○ | ○ | ○ |
| Investicioni fondovi | ○ | ○ | ○ | ○ |
| Fondovi preduzetnog kapitala (Venture capital fond), tj. fond koji se sastoji od investitora koji zajedno ulažu svoj kapital radi finansiranja start-up firmi i malih preduzeća | ○ | ○ | ○ | ○ |
| Poslovni anđeli tj. fizička lica koja ulažu sopstveni kapital , znanje i iskustvo u mlada preduzeća | ○ | ○ | ○ | ○ |
| Inovativni fondovi za transfer tehnologije | ○ | ○ | ○ | ○ |
| Ulaganje u vlasnički kapital od strane nacionalne, regionalne ili strane institucije | ○ | ○ | ○ | ○ |
| Restrukturiranje i otkup kapitala | ○ | ○ | ○ | ○ |
| Mezanin finansiranje ili hibridno finansiranje tj. dug koji može da se pretvori u akcije (vlasnički kapital) pod posebnim uslovima | ○ | ○ | ○ | ○ |
| Bespovratna sredstva od strane državnih institucija | ○ | ○ | ○ | ○ |
| Korporativne obveznice | ○ | ○ | ○ | ○ |
| Ostali privatni investitori | ○ | ○ | ○ | ○ |
| Privatne donacije ili bespovratna sredstva od strane privatnih kompanija | ○ | ○ | ○ | ○ |
| Neraspoređena dobit | ○ | ○ | ○ | ○ |
| Kapitalni doprinosi akcionara | ○ | ○ | ○ | ○ |
| Spoljni doprinosi kapitala (porodica ili prijatelji) | ○ | ○ | ○ | ○ |
| Ostali izvori finansiranja | ○ | ○ | ○ | ○ |

*9. U koju svrhu ste tražili finansijska sredstva u prethodne tri godine (2014, 2015, 2016)? (Molim izabrati jednu ili više opcija sa liste ispod)*

- Finansiranje obrtnog kapitala (npr. zaliha)
- Refinansiranje postojećih obaveza
- Kupovina drugog preduzeća
- Kupovina opreme
- Poslovno proizvodni prostor
- Lansiranje novog proizvoda/usluge
- Razvoj međunarodnih aktivnosti/ Ulazak na novo tržište (geografska ekspanzija)
- Finansiranje izvoza
- Finansiranje istraživanja i razvoja (R&D) i inovacija
- Transfer vlasništva (npr. isplata partnera ukoliko želi da istupi iz kompanije)
- Akvizicija nematerijalnih sredstava
- Unapređenje energetske efikasnosti Vaše kompanije
- Ostale namene

*10. Po Vašem mišljenju koji su bili razlozi za sve poteškoće koje ste imali pri dobijanju finansijskih sredstava u prethodne tri godine (2014, 2015, 2016)? (Molim izabrati jednu ili više opcija sa liste ispod)*

- Finansijska situacija Vaše kompanije
- Troškovi finansiranja kompanije (kamata i ostali troškovi)
- Odnos ukupnog duga naspram prometa kompanije
- Ostali uslovi finansiranja (npr. period otplate kredita, visina kolaterala, garancije, kovenanti itd.)
- Poteškoće i napori oko dobijanja sredstava za finansiranje
- Nedostatak stručnosti tima da nađe ili ispregovara najbolju opciju
- Ograničena dostupnost investitora u kapital
- Poteškoće vezane za podnošenje zahteva
- Spremnost banaka da obezbede finansije
- Korupcija
- Nije primenjivo: Naša kompanija nije imala nikakve poteškoće

*11. Da li ste prethodne tri godine bili obeshrabreni da tražite sredstva za finansiranje (2014, 2015, 2016) zbog uslova finansiranja (visoka kamata, sredstva obezbeđenja) ili prezaduženosti?*
*(Molim izabrati jednu ili više opcija sa liste ispod)*

- Nikada
- Retko
- Povremeno
- Često
- Uvek

*12. U prethodne tri godine (2014, 2015, 2016), koje vrste garancija ste morali da priložite da biste dobili kredit?*
*(Molim izabrati jednu ili više opcija sa liste ispod)*

- Sredstva vlasnika
- Porodica i prijatelji
- Sredstva kompanije (hipoteka na zgradi ili nekoj drugoj nekretniini firme)
- Jemstva
- Menice
- Zaloga (na pokretnim stvarima, zalihama robe, predmetu kupovine...)
- Poslovni partneri
- Garancijske šeme npr. kooperative
- Druge garancijske šeme (Privatne, javne, nacionalne, regionalne)
- Ostale institucije
- Nije primenjivo: Naša kompanija nije imala kreditno finansiranje ili nije morala da priloži kolateral

*13. Tokom prethodne tri godine (2014, 2015, 2016) koji su, po Vašem mišljenju, bili razlozi zašto niste bili uspešni (ili ste bili delimično uspešni)pri dobijanju kredita? (Molim izabrati jednu ili više opcija sa liste ispod)*

- Loš kredini rejting
- Nedostatak sopstvenog kapitala
- Nedostatak kolaterala ili garancije
- Nedostatak potencijala ili previsok rizik (poslovanja ili projekta)
- Visok nivo trenutnih zaduženja
- Nema kreditne istorije
- Loša kreditna istorija
- Nema razloga
- Visoke kamatne stope
- Ostali uslovi za kredit su bili neprihvatljivi (npr. ročnost, kovenanti)
- Nije primenjivo: Naša kompanija nije imala kreditno finansiranje ili je bila uspešna u dobijanju kredita u prethodne tri godine

*14. Da li su banke menjale uslove finansiranja kredita u prethodne tri godine (2014, 2015, 2016) (Molim odrediti za svaku opciju)*

| | **Povećano** | **Smanjeno** | **Nepromenjeno** |
|---|---|---|---|
| Kamatne stope | o | o | o |
| Ostale troškovi kreditiranja (isključujući kamatne stope, naknade) | o | o | o |
| Iznos dostupnog kredita/kreditne linije | o | o | o |
| Period trajanja kredita | o | o | o |
| Zahtevani kolaterali (obezbeđenje) | o | o | o |
| Ugovorne stavke vezane za kredit/ Zahtevane informacije itd. | o | o | o |

*15. Da li ste tražili dodatnja ulaganja u firmu u prethodne tri godine (2014, 2015, 2016) i kojim putem ste izvršili to ulaganje? (Molim navesti sve vrste ulaganja koja ste koristili u periodu od 2014 do 2016)*

- o Postojeći vlasnici
- o Direktori u Vašoj kompaniji koji prethodno nisu bili akcionari
- o Ostali zaposleni u Vašoj kompaniji
- o Porodica, prijatelji i druga fizička lica
- o Fondovi preduzetnog kapitala (Venture capital fond), tj. fond koji se sastoji od investitora koji zajedno ulažu svoj kapital radi finansiranja start-up firmi i malih preduzeća
- o Poslovni anđeli tj. fizička lica koja ulažu sopstveni kapital , znanje i iskustvo u mlada preduzeća
- o Mezanin finansiranje ili hibridno finansiranje tj. dug koji može da se pretvori u akcije (vlasnički kapital) pod posebnim uslovima
- o Inicijalna javna ponuda (IPO) ili druge ponude na berzi tj. prva emisija akcija od strane privatne kompanije za javnost kako bi se generisao kapital
- o Banke
- o Ostale finansijske institucije npr. podružnice banaka
- o Ostale kompanije
- o Javni fondovi za ulaganje u vlasnički kapital
- o Ostali fondovi za ulaganje u vlasnički kapital
- o Nije primenjivo: Naša kompanija nije težila ka ovakvoj vrsti finansiranja prethodnih godina

*16. Koji iznos kredita i ulaganja u vlasnički kapital, kao dve vrste finansiranja, ste tražili tokom poslednje tri godine?(Molimo Vas da date procenu iznosa za finansiranje traženog za kredit i ulaganja u kapital u hiljadama evra)*

2014-2016
(u hiljadama EUR)

| | |
|---|---|
| Dug (sve vrste zajmova ili kredita) | |
| Ulaganje u vlasnički kapital (sve vrste ulaganja u vlasnički kapital kao i mezanin finansiranje) | |
| Bespovratna sredstva ili subvencije | |

*17. Koji iznos kredita i ulaganja u vlasnički kapital, kao dve vrste finansiranja, ste dobili tokom poslednje tri godine?(Molimo Vas da date procenu iznosa za finansiranje koji ste dobili za kredit i ulaganja u kapital u hiljadama evra)*

| | 2014-2016 (u hiljadama EUR) |
|---|---|
| Dug (sve vrste zajmova ili kredita) | |
| Ulaganje u vlasnički kapital (sve vrste ulaganja u vlasnički kapital kao i mezanin finansiranje) | |
| Bespovratna sredstva ili subvencije | |

*18. Da li smatrate da imate dovoljan pristup sledećim izvorima finansiranja u Srbiji?*

| | Da | Ne | Vrste finansiranja nisu relevantne za mene |
|---|---|---|---|
| Mikro krediti od strane institucije za mikrofinansiranje (< 25.000 eur) | | | |
| Kratkoročni krediti, pozajmice na tekućem računu (overdraft) i kreditne linije (< 1 god) | | | |
| Srednjoročni i dugoročni krediti (> 1 god) | | | |
| Krediti garantovani od strane javne ili privatne institucije | | | |
| Subvencionisani krediti (subvencija kamate) | | | |
| Kredit od matične kompanije | | | |
| Lizing | | | |
| Bankarske garancije (uključujući garancije za izvoz) | | | |
| Faktoring tj. otkup potraživanja | | | |
| Investicioni fondovi | | | |
| Fondovi preduzetnog kapitala (Venture capital fond), tj. fond koji se sastoji od investitora koji zajedno ulažu svoj kapital radi finansiranja start-up firmi i malih preduzeća | | | |
| Poslovni anđeli tj. fizička lica koja ulažu sopstveni kapital , znanje i iskustvo u mlada preduzeća | | | |

Inovativni fondovi za transfer tehnologije
Ulaganje u vlasnički kapital od strane nacionalne, regionalne ili strane institucije

Restrukturiranje i otkup kapitala
Mezanin finansiranje ili hibridno finansiranje tj. dug koji može da se pretvori u akcije (vlasnički kapital) pod posebnim uslovima
Bespovratna sredstva od strane državnih institucija
Korporativne obveznice
Ostali privatni investitori
Privatne donacije ili bespovratna sredstva od strane privatnih kompanija
Neraspoređena dobit
Kapitalni doprinosi akcionara
Spoljni doprinosi kapitala (porodica ili prijatelji)
Ostali izvori finansiranja

*19. Molimo Vas odaberite PET izvora finansiranja koje preferirate.*

- Kratkoročni krediti, pozajmice na tekućem računu (overdraft) i kreditne linije (< 1 god)
- Srednjoročni i dugoročni krediti (> 1 god)
- Krediti garantovani od strane javne ili privatne institucije
- Subvencionisani krediti (subvencija kamate)
- Kredit od matične kompanije
- Lizing
- Bankarske garancije (uključujući garancije za izvoz)
- Faktoring tj. otkup potraživanja
- Investicioni fondovi
- Fondovi preduzetnog kapitala (Venture capital fond) tj. fond koji se sastoji od investitora koji zajedno ulažu svoj kapital radi finansiranja start-up firmi i malih preduzeća
- Poslovni anđeli tj. fizička lica koja ulažu sopstveni kapital , znanje i iskustvo u mlada preduzeća
- Inovativni fondovi za transfer tehnologije
- Ulaganje u vlasnički kapital od strane nacionalne, regionalne ili strane institucije
- Restrukturiranje i otkup kapitala
- Mezanin finansiranje ili hibridno finansiranje tj. dug koji može da se pretvori u akcije (vlasnički kapital) pod posebnim uslovima
- Bespovratna sredstva od strane državnih institucija
- Korporativne obveznice
- Ostali privatni investitori
- Privatne donacije ili bespovratna sredstva od strane privatnih kompanija
- Neraspoređena dobit
- Kapitalni doprinosi akcionara
- Spoljni doprinosi kapitala (porodica ili prijatelji)
- Ostali izvori finansiranja

*20. Koliki iznos sledećih izvora finansiranja planirate da tražite u 2017 (Iznos u hiljadama evra)? (Ukoliko nije primenljivo, ostavite prazno)*

| | (u hiljadama EUR) 2017 |
|---|---|
| Kratkoročni krediti, pozajmice na tekućem računu (overdraft) i kreditne linije (< 1 god) | |
| Srednjoročni i dugoročni krediti (> 1 god) | |
| Krediti garantovani od strane javne ili privatne institucije | |
| Subvencionisani krediti (subvencija kamate) | |
| Kredit od matične kompanije | |
| Lizing | |
| Bankarske garancije (uključujući garancije za izvoz) | |
| Faktoring tj. otkup potraživanja | |
| Investicioni fondovi | |
| Fondovi preduzetnog kapitala (Venture capital fond) tj. fond koji se sastoji od investitora koji zajedno ulažu svoj kapital radi finansiranja start-up firmi i malih preduzeća | |
| Poslovni anđeli tj. fizička lica koja ulažu sopstveni kapital , znanje i iskustvo u mlada preduzeća | |
| Inovativni fondovi za transfer tehnologije | |
| Ulaganje u vlasnički kapital od strane nacionalne, regionalne ili strane institucije | |
| Restrukturiranje i otkup kapitala | |
| Mezanin finansiranje ili hibridno finansiranje tj. dug koji može da se pretvori u akcije (vlasnički kapital) pod posebnim uslovima | |
| Bespovratna sredstva od strane državnih institucija | |
| Korporativne obveznice | |
| Ostali privatni investitori | |
| Privatne donacije ili bespovratna sredstva od strane privatnih kompanija | |
| Neraspoređena dobit | |
| Kapitalni doprinosi akcionara | |
| Spoljni doprinosi kapitala (porodica ili prijatelji) | |
| Ostali izvori finansiranja | |

*21. Za koje svrhe ćete tražiti ovo finansiranje ? (Molimo Vas navedite jednu ili više opcija)*

- Finansiranje obrtnog kapitala
- Refinansiranje postojećih obaveza
- Sticanje druge kompanije
- Sticanje zemljišta / zgrade
- Iznajmljivanje zemljišta/zgrade
- Sticanje mašina / opreme

- Iznajmljivanje mašina / opreme
- Lansiranje novog proizvoda / usluge
- Razvoj međunarodnih aktivnosti / ulazak na novo tržište (geografska ekspanzija)
- Finansiranje izvozne prodaje
- Finansiranje istraživanja i razvoja (R&D) i inovacija
- Prenos vlasništva
- Akviziciju nematerijalnog ulaganja
- Ostale potrebe

*22. Kada Vam je potrebno finansiranje, da li Vam je ikada nedostajala podrška od strane nekog od navedenih (na koga niste mogli da se oslonite):*

| | Da | Ne | Nisam tražio podršku od stane ove organizacije |
|---|---|---|---|
| Vašeg grada | | | |
| Državnih organa | | | |
| Garantnih fondova | | | |
| Javnih investicionih fondova | | | |
| Fondova preduzetnog kapitala(Venture capital) tj. fond koji se sastoji od investitora koji zajedno ulažu svoj kapital radi finansiranja start-up firmi i malih preduzeća | | | |
| Poslovnih anđela tj. fizička lica koja ulažu sopstveni kapital , znanje i iskustvo u mlada preduzeća | | | |
| Komercijalnih banaka | | | |
| Privredne komore i industrije | | | |
| Društvenih mreža (Facebook / Twitter… ) | | | |
| Mreža podrške (npr. Regionalne razvojne agencije, Privredna komora Srbije) | | | |
| Vašeg računovođe ili konsultanta za računovostvo, porez ili finansije | | | |
| Inovativne infrastrukture kao što su inkubatori, centri za inovaciju, tehnološki parkovi, klasteri | | | |
| Vašeg socijalnog okruženja kao što su porodica, prijatelji | | | |
| Poslovnih partnera | | | |

*23. Molimo Vas izaberite 3 najvažnija faktora koji ograničavaju poslovni rast u Srbiji po važnosti i rangirajte ih po važnosti:*

*1 = najvažniji faktor; 3 = najmanje važan faktor*

- Ograničena potražnja na domaćem tržištu
- Ograničena potražnja na stranim tržištima
- Ograničena dostupnost odgovarajućeg novog osoblja
- Gubitak postojećeg osoblja
- Problemi oko prenosa poslovanja npr. nasleđe
- Povećanje cene rada
- Nemogućnost finansiranja neophodnih ulaganja u opremu
- Zastarelost proizvoda (Neophodno ulaganje u istraživanje i razvoj(R&D), životni ciklus proizvoda)
- Poteškoće održanja koraka sa tehnološkim promenama
- Promena u konkurenciji (novi akteri na tržištu)
- Cenovna konkurencija / male marže
- Nelojalna konkurencija, npr. Dumping, siva ekonomija
- Regulatorni okvir (u vezi sa pitanjima kao što su zakon o radu, postupci javnih nabavki, poreska regulativa)
- Nedostatak fiskalnih podsticaja
- Nedovoljna snabdevenost izvorima finansiranja
- Dostupni izvori finansiranja nisu prikladni za Vaše potrebe
- Korupcija
- Ne vidim ograničenja (ništa nije štiklirano iznad)

# 5. Annex – The banking market

The banking sector in Serbia consists of 30 credit institutions with 1,730 organisational units and 24,257 employees. Seven banks are domestically owned (six banks state-owned and one privately owned) and 23 are foreign-owned, majority of them being Italian, Greek, Austrian and French. Highest market share in term of total assets have foreign banks (76.1%); state-owned banks have 18% share and domestic privately-owned 5.9%.

In terms of total assets, ten biggest banks account for 76.8% of the total balance sheet. Top five banks are constant market leaders: Banca Intesa, Komercijalna banka, Unicredit Bank Srbija, Raiffeisen Banka and Societe Generale banka Srbija. Banca Intesa maintained a leading position in the top ten banks ranking.

Total assets of the banking sector amounted to EUR 25 billion at the end of 2015, a pre-tax net result was EUR 80 million. Out of 30 banks, 13 had negative year-end result. The profit and loss generating items of the banking sector were highly concentrated. Five banks which posted the highest net profit together made up 79% of total banking sector income, while another five banks with the highest net losses accounted for 85% of total losses.

Key profitability indicators, primarily return on assets and return on equity, showed a slight increase in 2015. This was mainly due to an increase in net interest income and, on the other hand, key negative contribution to the operating result came from higher net expenses from impairment of financial assets and credit risk-weighted off-balance sheet items in 2015, largely triggered by the findings of the special diagnostic studies of banks[81].

All banks are universal banks, providing a wide range of banking services to households and enterprises (micro, SME and large corporates). Most credit institutions possess broad licences allowing them to engage in lending, leasing, factoring and other financial services. Loans remain the most popular form of financing in Serbia, and cover the whole scope of available loan products including standard loans (short-, medium-, long-term and revolving loans), bank overdrafts and various credit lines.

Total assets

In terms of the banking sector asset structure, the dominant share of assets are loans and receivables from clients (54%) followed by currency and deposits with the central bank (17%).

**Table 1. Banking sector assets structure[82]**

| | 31.12.2014 (EUR m) | 31.12. 2015 (EUR m) | % change |
|---|---|---|---|
| **Cash and cash balances with the central bank** | 4,014 | 4,288 | 6.8% |
| **Loans and receivables** | 15,726 | 15,101 | -4.0% |
| ***From banks and other financial organisations*** | 2,021 | 1,462 | -27.7% |

[81] National Bank of Serbia (2016), Banking sector Fourth Quarter Report 2015. Available at: http://www.nbs.rs/internet/english/55/55_4/

[82] Using year-end exchange rate between Serbian Dinar (RSD) and EUR: year 2015- 121.6261, year 2014- 120.9583

| | | | |
|---|---|---|---|
| *From customers* | 13,704 | 13,639 | -0.5% |
| Financial assets | 3,766 | 4,601 | 22.2% |
| Property, plant and equipment and investment property | 553 | 573 | 3.6% |
| Other assets | 486 | 497 | 2.2% |
| **Banking sector balance sheet total** | **24,545** | **25,060** | **2.1%** |

(Source: NBS, Banking sector Fourth Quarter Report 2014 and 2015)

Total net loans

At the end of 2015, total net loans of the Serbian banking sector amounted to EUR 13.44bn. Loans given to private companies represent 48% of total net loans in the banking sector, amounting to EUR 5.85bn. The share of entrepreneurs in total net loans is 2%, amounting to EUR 238.4m.

Table 1. Level of net loans

| | **31.12. 2015 (EUR m)** |
|---|---|
| Finance and insurance | 100.7 |
| Public sector | 256.1 |
| Public enterprises | 1,187.0 |
| Households | 5,153.5 |
| Companies | 5,848.4 |
| Foreign persons and foreign banks | 123.8 |
| Other sectors | 774.0 |
| **Total loans** | **13,443.5** |

(Source: NBS, Banking sector Fourth Quarter Report 2015)

NPLs

The funding source for lending by banks is domestic corporate and household deposits. The liquidity of the banks is high, however, what is holding back lending activity is the high level of non-performing loans (NPLs)[83], mainly concentrated in the corporate sector. The share of NPLs in total gross loans at the end of 2015 was 21.6%, with the corporate sector having the largest share (46.7%). The most

[83] A non-performing loan is defined as the total outstanding debt under an individual loan: (a) where the payment of principal or interest is past due over 90 days, (b) where payments are less than 90 days overdue, but the bank has assessed that the borrower's repayment ability has deteriorated and doubts that the payments will be made in full, and (c) where at least 90 days of interest payments have been added to the loan balance, capitalised, refinanced or delayed by agreement (cf: http://www.nbs.rs/internet/latinica/55/55_6/metodologija_IRP_NPL.pdf).

problematic are construction and real estate industries. The share of NPL loans in case of SMEs was 28.88% in 2014[84].

Gross NPL showed an increasing trend over the last three years (18.6% at the end of 2012 compared to 21.6% at the end of 2015). However, there is a noticeable downward trend in 2016, with the gross NPL share of 19,61% at the end of August. Banks are continuously making efforts to reduce their NPLs through restructuring, write-offs, collection and sales of NPLs. An unofficial NPL rate is even higher and it arises from misclassification of clients by banks.

[84] An OECD Scoreboard, Financing SMEs and Entrepreneurs 2016, available at: http://www.keepeek.com/Digital-Asset-Management/oecd/industry-and-services/financing-smes-and-entrepreneurs-2016_fin_sme_ent-2016-en#.V8g2g9JPoic

# 6. Annex – The Belgrade Stock Exchange

The Belgrade Stock Exchange (known as BELEX) was founded in 1894 in the Kingdom of Serbia and it is currently based in Belgrade, Serbia. It is an associate member of the Federation of European Securities Exchanges (FESE) and a full member of the Federation of Euro-Asian Stock Exchange (FEAS). In 2016, the Belgrade Stock Exchange decided to join SEE Link, a regional network for trading securities sponsored by EBRD.

Services that BELUX currently offers include equity trading platforms, derivative markets, clearing and market data. The stock exchange can only invest in financial instruments issued by the Republic of Serbia, the National Bank of Serbia, local governments, or other relevant institutions. BELEX is includes the Regulated Market and Multilateral Trading Facility (MTP). The regulated market offers shares and bonds in prime listing, standard listing and open market, and shares in SMart listing, while MTP offers shares and bonds. Currently, there are four companies listed in the prime listing, four companies in the standard listing, zero companies in SMart listing, ten companies in open market and eight companies in the MTP. The BELEX15 index is not adjusted for paid dividends, it consist of continuously traded shares. The Belgrade Stock Exchange provides the index membership data.[85]

[85] http://www.belex.rs/eng/

# 7. Annex – Overview of the Fiscal Strategy for 2016 related to the package of services for redundancies

One of the fiscal measures related to the rationalisation in the public sector, relates to optimisation of number of employees in public sector. According to the Fiscal Strategy for 2016, the plan is to reduce the number of employees by approximately 35,000 in 2016, compared to December 2014. It is estimated that the measures will result in a decrease in the level of wages by 3% in 2016, compared to 2015, and the reduction in the number of employees by 5 %[86] in 2017.

It is estimated that about 17,000 people over 50 years old (out of 35,000 that will lose their job), will automatically retire.

The Government prepared a package of services for redundancies[87], due to the expected increase in unemployment (for redundant employees) through the restructuring process and rationalisation of the public sector.

The package of services for redundancies includes several steps, which could be taken prior to the termination of employment or that help people after they become officially unemployed.

Services prior to becoming unemployed are the following:

- Organising a meeting with the management of companies that are faced with redundant employees, and unions
- Organising a general informative meeting with potentially redundant employees at the employer's premises
- Employees can fill in the questionnaire where they choose the measures they find interested in
- Organising seminars for employment through conducting individual interviews with employees, who have declared that they want individual counselling at the employer's premises
- Based on the completed questionnaire and individual interview with a counsellor for employment, the employee will be included in the following:
    - A club for  job search- a five-day program specifically designed for surpluses
    - Workshops for gaining skills for re-employment after job loss
    - Training for entrepreneurship
    - Training for active job search

After being made redundant, the individuals register in the National Employment Service (NES) as unemployed, the priority being to involve them in programmes and measures of active employment, namely:

- The evaluation of employability of individuals

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86 Government of Republic of Serbia (2015), Fiscal Strategy for 2016, available at: http://www.srbija.gov.rs/vesti/dokumenti_sekcija.php?id=45678

87 Government of Republic of Serbia (2015), National plan for employment, available at: http://www.srbija.gov.rs/vesti/dokumenti_sekcija.php?id=45678

- The development of the individual employment plan and determination of measures that are best-suited to the activation and improvement of the employability (workshops for stress management, as a result of job loss, and other measures)
- The provision of information related to the opportunities and advantages of investing severance pay for self-employment, pooling severance packages for employment, use of leasing and franchising etc.

In order to promote faster re-integration into the labour market of redundant workers, NES will focus on visiting employers, especially in the most affected local municipalities, with the aim to collect data on the employment needs.

# 8. Annex – Views of International Financial Institutions on the present study and on SMEs' access to finance in Serbia

Once the present study finalised, three International Financial Institutions have been consulted to collect their views on the study and on SMEs' access to finance in Serbia. The respective feedback is as follows:

### Feedback from The European Bank for Reconstruction and Development (EBRD)

EBRD advised that it would be useful to have the widest reach of SMEs possible for the demand survey (beyond 2,000 out of 100,000 firms in the database), since the more firms reached, the more complete the information on financing needs and availability for SMEs would be. That said, the EBRD found it interesting that the majority of SMEs actually did not indicate major complaints about financing partners. The study presents that many companies simply do not know how to approach banks. EBRD said that this may be correct and efforts should continue to support SMEs in developing their business planning and gaining financial literacy.

The EBRD would like to see further analysis of availability of finance. In the current banking environment, EBRD find that banks often have resources but are finding it difficult to place funds with credible borrowers. This is leading to a downward spiral on interest rates and rapidly reduced profitability in the banking system, but not to an increase in banking for corporates, including SMEs.

EBRD advised that the liquidity in the banking system is not necessarily leading to an expansion of regional or product diversification. EBRD believe banks can be trained and incentivised to consider new products and new classes of borrowers. Their experience has indicated that this type of diversity can be achieved through targeted assistance and targeted (and limited) grant schemes. EBRD have had success with products such as the Energy Efficiency credit lines and Women in Business credit lines which benefit from a mix of TC, grants and funding. If banks are concerned about the high risks or the cost of capital, EBRD might see IFIs taking a share of the risk onto their own balance sheets through portfolio risk sharing arrangements.

In relation to equity – in the introduction it is argued that there is limited demand/need for equity, but in the products, there are proposals to expand equity funding. There have been efforts to increase equity funding through products within the EDIF framework. However, in a period when debt products for better clients are available, there needs to be consideration as to how to make an effective and efficient equity product.

EBRD advised that it has been running the advisory support services for some years and is reaching perhaps 100 SMEs each year. EBRD feel this can be expanded as borrowers of all types definitely lack skills and experience needed to borrow.

EBRD fully agree that micro finance products are not now available,either from banks nor specialised lenders. US AID has been working with the National Bank and Government to liberalise the regulatory regime. EBRD believe this initiative could be worth supporting.

Finally, EBRD believe that there is a need towork together to find the right balance on managing advisory, lending and guarantee programmes. This will depend on the capacity and interest of public and private partners. EBRD has examples of working with both public and private management to manage such funding programmes and can work together on the delivering these products and building capacity of national and municipal development institutions and the private sector.

### Feedback from The World Bank (WB)

The WB have stated that study is rich in detail and provides a good overview of the current status of the Serbian market as well as opportunities and challenges SMEs face in Serbia in accessing finance. Given the WB's involvement in the financial sector in Serbia and supporting the Government in rethinking their development finance efforts, the WB find this to be an extremely useful piece of work.

With an understanding that this is an ex-ante assessment for deploying IPA funding, and not an overall investment strategy for deploying financial instruments more broadly, the WB limited its comments on the proposed possible solutions. That said, the WB do believe that there is a need to look at the study proposals in a broader way, and how they fit into the overall deployment of resources in support of the Serbian business sector. In particular, it would be of great interest to conduct an **access to finance expenditure review.**

The WB note that there are multiple agencies involved in delivering enterprise support, spanning a number of departments, funds, and ministries. While subtle differences do exist which distinguish them from one another, they all share broadly similar objectives. Thus, it appears that SME finance support programs are quite "fragmented," with a relatively large number of different schemes and programs, which are relatively small and in essence quite similar (mostly grants and some subsidized lending). It would appear that there is **scope for consolidation** of some of these programs, perhaps into "windows," which would simplify their administration, simplify the application process for the SMEs, and increase individual program size, potentially making them more visible and relevant. Put differently, while the the ongoing rationale and continued relevance for providing enterprise supports is clear, the justification for the current means of achieving this i.e. employing multiple state agencies, with their accompanying structures and overheads, carrying out activities with broadly similar objectives, is less apparent. Different stakeholders offer their products and services for companies and there seems to be a lack of attempt to understand holistically the problems of the companies (regardless in which sector they operate) during their life-cycles.

Regarding the structure of the business sector, the WB note with great concern that only 4.4% of companies are classified as exporters. From the macro statistics, the WB understand that exports (as a share of GDP) have increased substantially, but note that this is a result mainly of activity in the automotive industry and not of general internationalization of the business sector in Serbia. The goal of the Serbian Government is to boost the export-driven growth, and the SME sector can and should be an engine of this growth. There is **no single perfect model** for this, and it would be useful to look at this area in more detail given some of the unique features of Serbia's export potential. Differing approaches to public finance, national accounting practices, variations in domestic economic conditions and export market requirements all have a role to play in establishing what may be viewed as an appropriate export financing business model. In the WB's view, the best model is one which strikes an appropriate **regulatory balance** between (i) minimizing the risk position of the government; (ii) optimizing the involvement of the commercial banks and private financiers and (iii) meeting the needs of exporting companies.

The ex-ante assessment carefully and diligently identifies possible solutions, and the WIB is glad to note that one of the immediate proposals is to establish an **SME portfolio guarantee FI**. As the WB understand, this FI would be provided to the banking sector lending to SMEs as financial intermediaries (as opposed to individual SME borrowers), in order to alleviate the existing credit constraints for SMEs on the Serbian financial market. Compared to best practice worldwide and in the EU, the WB notice (as does the Report in various parts) a lack of a number of potentially useful instruments that could be deployed on Serbian market. As EIB identified as well, this is probably most evident in the guarantee segment, be it portfolio or counter guarantees. The WB understanding is that the most widespread types of guarantees in Serbia are bank guarantees, and they are personal guarantees, as portfolio guarantees are not developed. Additionally, as the report mentioned too, guarantees of AOFI (export guarantees) are not recognized as state guarantees by the banks (first class collateral); therefore, they do not have a significant effect on risk margins and collateral requirements. In the report supply analysis, EIB mention there is no information on the total value of bank guarantees extended to SMEs. In the WB view, it is extremely important to try to disentangle this, as this may be seen an important instrument given the access to finance barriers are to a great extent related to collateral.

Regarding the proposed governance, the WB advised that the structure depends on many aspects, with the most important being local capacity and willingness. A simple financial structure may prove to be an appropriate option if a particular FI is established focusing on one thematic objective or priority axis. The option of establishing a Fund of Funds (FoF) can be used to manage several FIs in a centralized manner. Countries/MAs have the option to establish FIs through a FoF which can invest in multiple FIs with a thematic or geographical focus. Establishing a FoF allows MAs to delegate tasks to professional fund managers to prepare the investment strategy, negotiate contractual agreements with each FI under the FoF, and monitor the performance of the FI on their behalf. The third option is that the country/MA manages the FI themselves instead of a financial intermediary or via a FoF. This option is used exclusively when the financial product to be provided by the FI is a loan or a guarantee, and it may be an appropriate option if the MA has significant in-house experience and knowledge of FIs. The optimal choice is ultimately the decision of the Government, and should be seen through the **lens of local circumstances and potential to build local capacity.** Regardless of the best-suited governance structure, as the Report points out, it would be crucial to provide technical assistance and develop the necessary capacity in the country. **Issues of capacity and a need for more expertise in both designing and implementing financial instruments remain critical** as their lack can lead to significant risks, including delays in launching and delivering the funds to final recipients and in finding the most appropriate structural arrangements.

In terms of more specific areas of note, the WB find the **limited nature of data availability** striking, including some very basic indicators like the share of SMEs in banks' lending portfolios. A set of recommendations from emerging from the analysis could therefore be to **improve data and statistics on SME finance.**

Further, it may be useful to segment the SME sector by type, and to discuss distinct categories separately; for instance, the WB note that there appears to be **very high demand for financing that would fit an accelerator model among innovative startups and SMEs** (according to data available from the Serbia Innovation Fund), despite there being lagging demand for equity financing in the SME sector on the whole. Even within the innovative SME category, however, lack of exit options may be suppressing demand for equity finance, giving further context for the design of an accelerator facility. Despite this, demand for Innovation Fund programs far outstrips the supply (according to multiple evaluations of Innovation Fund programs), pointing to the need and opportunity to expand on what seems to be working well (at a smaller than optimal scale).

The WB noted that more detailed segmentation could also give further context to the proposed financial instruments to address some of the key gaps in the market. An accelerator facility could potentially address the lack of equity financing. An SME portfolio guarantee instrument could reduce the constraints related to collateral availability. Two additional microfinance FIs also address the gap in microfinance area. In addition, it be helpful if other FIs were briefly discussed and main rationale provided why these would be less optimal for the Serbian market.

Finally, the WB stated that the report aptly identifies the existence of hidden demand, or lack of awareness of financing options; it would be useful if the recommendations section could address issue, for instance by suggesting the deployment of awareness raising and investment readiness programs.

### Feedback from The Kreditanstalt für Wiederaufbau (KfW)

**KFW have advised that the diagnostic part of the report, the identification of the major market failures and the identified development goals to be achieved are in line with KfW findings**.

KFW stated that what is especially relevant is the lack of adequate financing for micro companies coupled with a hidden demand (caused by lack of financial awareness and knowledge). The report did not analyze the entrepreneurs financing needs, which is also an underprivileged sector in terms of access to finance and technical/expert support.

The absence of the microfinance institutions and equity financing limits the offer of the financial instruments exclusively to banks' products.

The latest data on SMEs is from 2014, KfW was wondering if more updated information was available89.

**The proposed financial instruments to expand SMEs' access to finance are in line with KfW's policies but KFW advised that specific attention should be paid to the following issues**:

- The Fund of Fund (FoF) structure proposed to be managed by the EIF could be an adequate umbrella mechanism for supporting SME financing (from micro enterprises to medium-sized enterprises). It is recommendable that the mechanism is further assessed in terms of : (1) The time frame for the implementation of the FoF structure and the steps presented on Figure 20 page 108; (2) The anticipated leverage of the initially invested EUR 20m from IPA funds; (3) The operational costs and their financing, including the cost of a professional fund manager; (4) Since the FoF structure will act as a guarantor for the financial intermediaries (banks) in Serbia, the shareholder structure and the legal structure of the scheme will influence the degree for capital relief for banks in accordance with the National Bank regulations (whichwould eventually influence credit conditions offered by banks to SMEs); and (5) Possible investments in the FoF structure by other public and private investors.

- It might also be feasible to provide funds to EIF who would manage the facility without forming a FoF. That might be financially and time-wise a more optimal solution, but would limit the participation of other investors from the public and private sectors.
- The possibility to extend the mandate of the Accelerator Facility (under a FoF structure) to finance SMEs in seed/creation phases with equity financing. The Serbian market is characterized by a very limited supply of seed financing options, which hinders the possibility of SMEs to establish and evolve from seed to development phases. A part of the IPA funds could be used to mitigate the risk associated with this type of financing. Equity financing in the seed/creation phases would also trigger banking financing and would be complementary to the Serbian Start-Up Facility.
- The technical assistance component is crucial for supporting SMEs, and especially micro enterprises. The mechanism proposed in the report for TA would be adequate. Moreover, a strong institutionalised relationship between the future FoF structure and the local Serbian institutions that will manage the TA component would be essential.

**Overlap with the Republic of Serbia Start-Up Facility**: In order to avoid the duplication and enhance the complementarity of the two financing mechanisms (*i.e.* the SME portfolio guarantee scheme and the Start-Up Guarantee Facility), KFW felt it would be necessary to clearly define the roles and the target groups of both/each mechanisms. This needs to be done in the design phase of both programmes. TA components of both mechanisms should be coordinated as well.

Indeed, on the one hand, KFW stated that the Start-Up Facility aims to support entrepreneurs and companies up to two years after creation (i.e. for the seed/creation phase and the early development phase) to help them establish their business. On the other hand, the proposed SME portfolio guarantee scheme is recommended to be for SMEs older than two years (i.e. for later development phases). Thus, overlaps would be avoided and investment outcomes would be maximized.

KFW advised that it is also necessary to emphasize that entrepreneurship start-up financing requires specific types of financial and technical/expert support (i.a. specific banking products, intensive set-up and monitoring efforts, etc.), coupled with significantly higher probability of losses and consequently a need for specific guarantee structures. All this also needs to be associated with sizable technical assistance, leading to a need for further grant support.

KFW also felt that the envisaged EUR 20m for the SME porftolio guarantee scheme and the EUR 5m for the technical assistance component would be insufficient to bridge the financing gap for both SME financing and support for entrepreneurship start-ups.