

Đuričin Sonja PhD

Research Associate

Institute of Economic Sciences, Belgrade

Jovanović Olivera, MA

Junior Researcher, Institute of Economic Sciences, Belgrade

Erić Dejan PhD,

Full Professor, Dean, Belgrade Banking Academy, Belgrade

E-mail: sonja.djuricin@ien.bg.ac.rs

THE ROLE OF MICROFINANCE IN DEVELOPMENT OF SMEs IN REPUBLIC OF SERBIA

ABSTRACT

The importance of microfinance is in availability of funding business for those segments of the population with difficult access to conventional means of business financing from banking sector. Microfinance represents a way of funding which can create new jobs and reduce the proportion of socially vulnerable population. The existing model of microfinance in Serbia has a limiting effect on its efficient operation and satisfaction of demand for micro credits. The paper aims to point out the importance of microfinance as a support for the development of SMEs in the Republic of Serbia. A research subject is current economic development, characteristics of the SME sector, legislative framework on the microfinance, government program for supporting microfinance, major microfinance institutions in Serbia and national models of microfinance.

Keywords: SME sector in Serbia, microfinance, microfinance institutions

JEL Classification: G21, G23, O16

ECONOMIC SNAPSHOT

According to the fact that GDP is quite reliable indicator of economic development, it can be good measure of a country's economic progress, especially if it is expressed *per capita*.

Table 1: GDP in Republic of Serbia, 2016-2018.

GDP	2016.	2017.	2018.
GDP (in million)	36,758	40,291	42,954
Real GDP growth (in %)	3.3	2.0	4.4
GDP per capita in Serbia	5,208	5,739	6,152
GDP per capita in EU-28 ¹	38,304	35,731	/

- in EUR -

Source: Statistical Office of the Republic of Serbia and UNECE Statistical Division Database

Note: ¹ Value of GDP per capita is converted from \$ USD in EUR according to average exchange rate of NBS

The value of GDP in the Republic of Serbia is growing in absolute terms in the period 2016-2018. The highest growth of 4.4% was recorded in 2018. Although GDP per capita is growing, it is far below the EU-28 average. During the observed period, Serbia achieved approximately seven times lower GDP *per capita* compared to the average of EU countries.

During economic isolation in 1990s Serbia lost all international markets, started de-industrialization, implemented inadequately privatization and didn't have sufficient inflow of FDI (Eric D., et al., 2014, p. 139). For these reasons, many factories were closed, industry was destroyed and competitiveness of domestic products and services were weakened (Beraha, I., and Djuricin, S., 2011). In recent years, Serbia has recorded decline in the value of the trade deficit. The depreciation of the trade deficit is mainly the result of more

intensive FDI inflows. In the reporting period in absolute terms increases the value of both exports and imports. Exports are growing slower than imports by an average of 3.1 percentage points in the period 2017-2018.

Table 2: Exports and Imports in Republic of Serbia, 2016-2018.

Exports and Imports (in EUR million)	2016.	2017.	2018.
Exports	17,870	20,364	21,810
- growth rate in % compared to a year earlier	11.9	8.2	8.3
Imports	19,638	23,019	25,468
- growth rate in % compared to a year earlier	6.7	11.1	11.6

Source: Statistical Office of the Republic of Serbia

The inherited public debt, after the breakup of Yugoslavia, was a huge burden on the transition path. The value of public debt decreases and amounts to 67.8%, 57.9% and 53.8% of GDP, respectively in the period 2016-2018.

Table 3: RS public debt/GDP, 2016-2018.

RS public debt	2016.	2017.	2018.
RS public debt in % of GDP	67.8	57.9	53.8

- in % -

Source: Government of Republic of Serbia

The labor market in the best way reflects the economic trends. According to the definition of the Statistical Office of the Republic of Serbia (Statistical Yearbook of the Republic of Serbia, 2019):

- Employment rate is the share of employees in the total population aged 15 and over,
- Unemployment rate is the share of the unemployed in the total number of active population,
- Activity rate is the share of active population in the total population aged 15 and over,
- Inactivity rate is the share of inactive persons in the total population aged 15 and over.

The unemployment rate had a decreasing trend and recorded a value below 16% in the period 2016-2018. Reduction in the unemployment rate could be attributed to real GDP growth because in the observed period the economic growth was recorded.

Table 4: Employment / unemployment rate in Republic of Serbia, 2006-2018.

RS public debt	2016.	2017.	2018.
Employment rate	55.2	57.3	58.8
Unemployment rate	15.9	14.1	13.3
Activity rate	65.6	66.7	67.8
Inactivity rate	34.4	33.3	32.2

Source: Statistical Office of the Republic of Serbia

Highly qualified persons and persons with high and secondary professional education accounted for 44% in the total number of unemployed in Serbia. Highly skilled and skilled persons, Semi-skilled persons and persons with lower professional education accounted 23% and 3% respectively in the total number of unemployed in Serbia. Unskilled persons accounted 30% in the total number of unemployed in Serbia.

Table 5: Unemployed persons, according to the level of professional education, 2018.

Unemployed persons	2018.
Higher, high and secondary professional education	44
Highly skilled and skilled	23

- in % -

Semi-skilled and lower professional education	3
Unskilled	30
Total	100

Source: Statistical Office of the Republic of Serbia

The average net salary in Serbia in 2018 was 421 euro. The average net salary per employee increased by 8% compared to 2017. The increase in the inflation rate during the observed period annulled positive trend in increasing of net salary. Inflation is moving around 2% on average in the past six years. Analyzed by sector, above average wages are earned in sectors which largely remained unprivatized and whose holders are mostly state-owned enterprises (Eric D., et al., 2014, p. 141).

Table 6: Average net salaries by sectors, 2017-2018

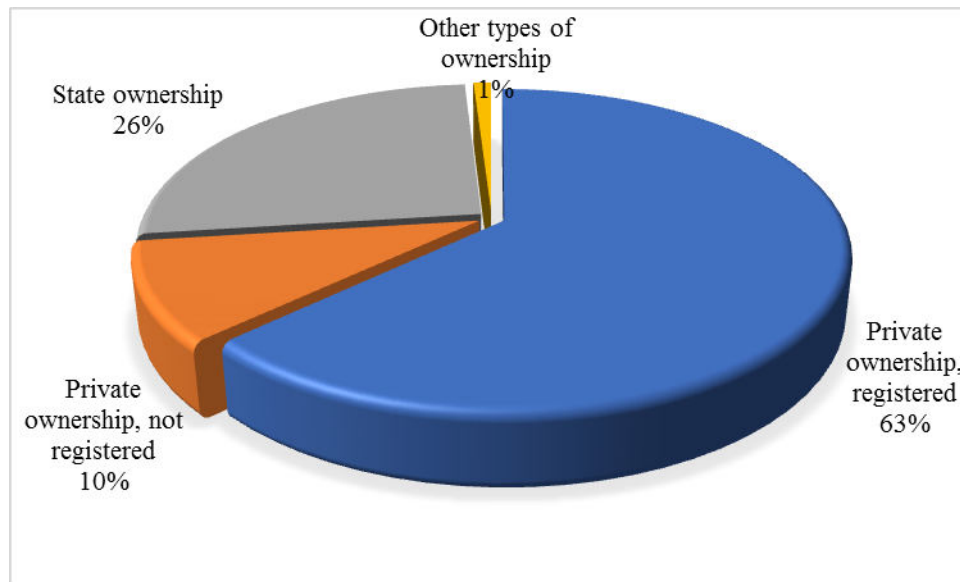
			- in EUR -
AVERAGE NET WAGES AND SALARIES	2017.	2018.	% increase / decrease
REPUBLIC OF SERBIA	389	421	8
Agriculture, forestry and fishing	342	364	6
Mining and quarrying	610	651	7
Manufacturing	374	384	3
Electricity, gas, steam and air conditioning supply	638	683	7
Water supply; sewerage, waste management and remediation activities	340	372	10
Construction	351	371	6
Wholesale and retail trade; repair of motor vehicles and motorcycles	307	354	15
Transportation and storage	399	385	-4
Accommodation and food service activities	240	268	12
Information and communications	760	705	-7
Financial and insurance activities	707	767	8
Real estate activities	440	426	-3
Professional, scientific and technical activities	600	516	-14
Administrative and support service activities	318	367	15
Public administration and defence; compulsory social security	405	493	22
Education	345	440	28
Human health and social work activities	346	417	21
Arts, entertainment and recreation	318	352	11
Other service activities	286	328	14

Source: Statistical Office of the Republic of Serbia

Note: Value of net salaries is converted from RSD in EUR according to average exchange rate of NBS

The private ownership registered companies are generating 63% of employees, while state ownership registered companies, private ownership, not registered companies and other types ownership companies, generating 26%, 10% and 1% of employed persons, respectively.

Graph 1: Employed persons by d type of ownership, 2018.

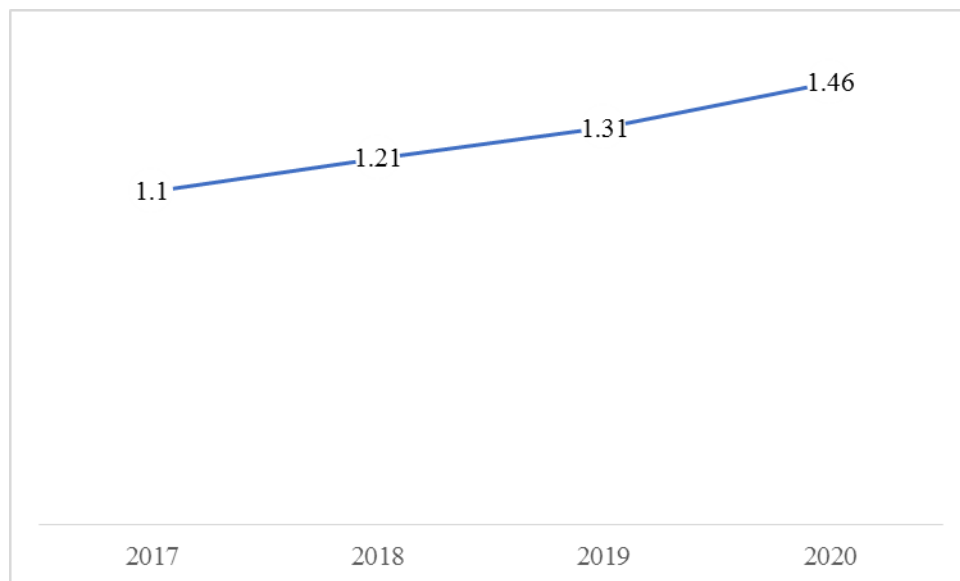


Source: Statistical Office of the Republic of Serbia

Also, the labor market characterized by slow growth amount of minimum average labor cost per hour. Minimum average labor cost per hour in 2020 compared to 2017 increased only 0.36 euro and is currently 1.46 euro.

Graph 2: Minimum average labor cost per hour-net, 2017-2020

- in EUR -



Source: The legal database, available at: <http://www.paragraf.rs/onama.html>

Note: Value of Minimum average labor cost per hour is converted from RSD in EUR according to average exchange rate of NBS

The current economic situation in Serbia is unsatisfactory primarily according to a high percentage of the population living below the poverty line. Overall macroeconomic situation has resulted in the high of the poverty rate. Based on Survey of Income and Living Conditions (SILC), 24.5% of the population in Serbia are at risk of poverty. At the same time, there is a high degree of variability in living standards within the country.

DEVELOPMENT OF THE SME SECTOR

The SME sector is a very important segment of the economy, especially in low- and middle- income countries. According to World Bank Data, Serbia is ranking as upper middle-income country, with 6,880 USD GDP per capita (WB, 2018). Even the data tell the other (better) part of the story of the development of the national economy, the discrepancy between the social welfare of different income groups is still present. One of the potential solutions for improving the social status of inhabitants is to create a perspective extern environment for the development of entrepreneurship and small and medium sized entities. Dynamic development of the SMEs sector was until 2008, when World economic crises occurred. This crisis caused numerous negative effects on all entities, but the most affected were entrepreneurs, due to the lack of financial funds for business recovery. Despite that, the flexibility and size of this sector allow him to accept the market changes easily and quickly (Erić et al., 2014).

During the last ten years, small and medium sized entities and entrepreneurship represented over 99% of all active enterprises. Also, during that period, they employed over 2/3 of employees in nonfinancial sector. In 2017, the SMEs participated with over 25% in creation of GDP in Serbia. According to the last available data, SMEs generate 65.6% of turnover, 56.7% of GVA, 39.5% of export, 54.5% of import and 66% of employed in non-financial sector in Serbia.

Table 7: Indicators of the development of the SME sector

- in % -

Indicator	Non-financial sector			
	2014	2015	2016	2017
Number of enterprises	99.8	99.8	99.9	99.9
Number of employees	64.8	65.7	65.7	66.0
Turnover	65.4	66.3	65.1	65.6
Gross Value Added	56.0	57.7	56.2	56.7
Export	44.8	44.1	40.8	39.5
Import	57.0	56.5	56.3	54.5

Source: Ministry of Economy and Statistical Office of the Republic of Serbia

Main indicators for analysis of the development of the SMEs sector are number of enterprises, number of employees, turnover, gross value added, export and import. The share of employees in this sector increased for 1.8 percentage points from 2014 till 2017 which is significant indicator of business attractiveness, especially in the domain of entrepreneurship in the non-financial sector. Even the highest share of turnover was in 2015 as well as the share of GVA (66.3% and 57.7%, respectively), the SMEs also reduce the share in total export for 11% points and the share in total import for 4% points. The decline was higher in export than in import.

Indicators given in the table above can be compared with those presented in previous research conducted for the period 2005 till 2012, by Erić et al. (2014). The main changes are noticed in the export and import shares. Both values were higher in 2012 than in 2014 (51.5% and 60.2%, respectively). Compared to the latest data, the share decreased for 20% in export and for points and for 10% points in import.

If we observe enterprises by company size, there were no significant changes compared to the official available data. The number of entrepreneurs increased for 5% in 2017 compared to 2016. In the same year, the number of micro enterprises increased for 3%. According to the last available data, entrepreneurs accounted for 72.0% and micro-entities 24.3% of the total number of enterprises in the SMEs sector. The following number leading to conclusion that people in Serbia prefer to create their own business ideas and start new business. The turnover also increased in micro, small and medium sized enterprises in 2017 compared to 2016. The detailed results are given in the table below.

Table 8: Business indicators the SME sector by size

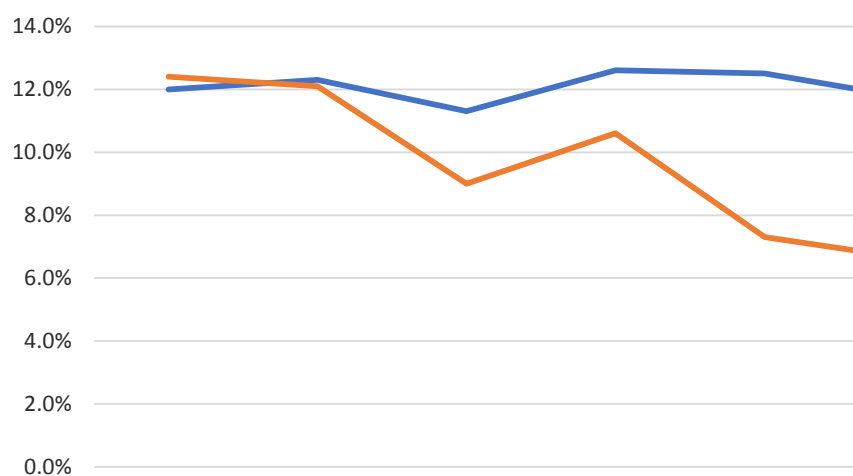
	2016				2017			
	Entrepreneurs	Micro	Small	Medium	Entrepreneurs	Micro	Small	Medium
Number of enterprises	243,590	84,105	10,154	2,263	257,267	87,012	10,583	2,372
Number of employees	247,775	154,073	203,681	232,003	257,872	157,890	213,380	244,320
Turnover*	1,116,068	1,476,356	1,952,475	2,064,981	1,215,327	1,515,631	2,133,418	2,299,722
Gross Value Added*	284,154	188,521	328,364	411,480	314,434	200,126	359,489	451,679
Export*	16,400	137,432	183,997	331,430	17,846	140,763	195,364	362,672
Import*	15,109	249,021	409,609	506,525	16,720	255,551	450,030	534,084

Note: * in thousands

Source: Ministry of Economy and Statistical Office of the Republic of Serbia

Business demography indicate the development of the SMEs sector though several additional indicators such as rate of establishing or rate of closing entities. In 2017, the rate of establishing was the highest in 2015, while the rate of closing was the lowest in 2017. The detailed review of business demography indicators is given in the following chart.

Chart 3: The rate of establishment and closing in SMEs sector



Source: Ministry of Economy and Statistical Office of the Republic of Serbia

In 2017, the rate of establishment is higher than the rate of closing indicating that business environment in Serbia is improved and with much more possibilities for success and business development. More dynamic was entrepreneurial sector because inhabitants are more likely to start their own business, but at the same time the rate of closing is significantly lower than in previous years (the ration between those rates was less favourable).

According to official data about the number of new entities opened in period 2010-2017 it can be concluded that in average over 60% of them survive first two years and that enterprises are more likely to have business success and higher survival rate compared with entrepreneurs (Ministry of Economy, 2018). Higher survival rates for all entities can be reached with adequate financial support. Better access to different sources of financial support (banks as well as national institutions) and simple administrative procedure will ensure more financial funds for the SME sector.

Table 9. Business demography by selected sectors

Sector	Established	Closed	Net effect	Survivor rate (2015/2017)
Agriculture, forestry, and fisheries	681	374	307	79.6%
Manufacturing Industry	6,553	4,144	2,409	97.6%
Construction	4,174	2,163	2,011	74.5%
Trade	8,310	6,596	1,714	73.0%

Source: Ministry of Economy

LEGISLATIVE FRAMEWORK ON MICROFINANCE

Small and medium-sized enterprises in Serbia are faced with the poor compliance range of banks and financial needs of this category of enterprises. There are no laws on microfinance in Serbia. The development of microfinance in Serbia is slow and difficult. Non-banking financial institutions are unable to provide loans. To provide loans, non-bank financial institutions use an intermediary. An intermediary is a bank that takes high guarantee deposits for its service. This creates a "partnership" between the existing microfinance institutions and commercial banks. Although there are advantages of this type of business, any internal changes in the partner's bank leads to a re-negotiation and creating new conditions for cooperation between the two organizations (Eric D., et al., 2014, p. 150). Instead to facilitate obtaining loan, the existing legislation required from client necessary documentation in limited time and resources (Ibid).

The process of granting micro credits in Serbia is carried out in several steps (Eric D., et al., 2012, p. 141; Eric D., et al., 2014, p. 153):

- Contacting to microcredit organization and getting information about the conditions for granting a loan,
- Creating of business plan and fill out the questionnaire with the assistance of a MFIs expert - a preliminary assessment of viability and creditworthiness of the customer,
- Apply for a loan,
- Loan approval and his payout by the intermediary commercial bank and
- Monitoring and consulting of microfinance institutions.

Removing administrative barriers and improving the legal framework are part of the "Strategy for the development of entrepreneurship, SME sector and competitiveness in the period 2014 to 2020". In accordance with the strategy, the estimated effects of establishing adequate and effective legislative framework for microfinance in Serbia would be as follows:

- Poverty reduction (65% of users will be out of the poverty),
- Self-employment and job creation for the poorest,
- Reduce dependency of social welfare,
- Increase in government revenue due to the development of the SME sector,
- Promotion of Regional Development.

Establishing an adequate legal framework will regulate micro finance activity and allow them to operate like other MFIs in Europe. Development of legal framework for MFIs will contribute to the development of entrepreneurship, SME sector and overall economic progress.

NATIONAL PROGRAMS FOR SUPPORTING THE DEVELOPMENT OF SMEs

Because small and medium enterprises are considered as essential part of economic growth and achieving regional equalities, Zubović and Jovanović (2019.) showed that financial support is identified as a common barrier of successful business in several South-eastern Europe countries classified as low- and middle- income. Especially in agriculture, importance of institutional support is crucial for their development on the domestic but on the foreign market, as well (Jovanović, 2016.). Entities cannot achieve the competitiveness level without appropriate funds for investment in the production.

Commercial banks often prepare a wide number of conditions that enterprises must fulfil if they want to obtain the loan. Those conditions are considered to be very unfavourable for many of them, so owners often do not want to take part in such procedures because the chance for getting the loan is very small compared to bigger companies. In line with that, the Government of the Republic of Serbia decided to prepare adequate institutional framework to support entrepreneurship and the development of small business. A set of instruments was prepared during last ten years, and one of the results presented in the paragraph before indicating that the effects of that policy is quite positive. Higher rates of establishment and survival are the best indicator that can confirm the importance and significance of appropriate national support to small business development.

Financial support is provided by the following institutions: Ministry of Economy, Development Fund of the Republic of Serbia, Development Fund of AP Vojvodina, Guarantee Fund of AP Vojvodina, Development Agency of Serbia, Regional Development Agency Eastern Serbia, Regional Agency for the development and EU integration Belgrade, Agency for Agricultural Payment and National Employment Service. Providing financial support to SMEs through mentioned institutions is regulated by the following laws and regulations: Law on a Development Fund of the Republic of Serbia (The Official Gazette of the Republic of Serbia No 36/2009, 88/2010, 119/2012 and 5/2015), Law on Public Agencies Act (The Official Gazette of the Republic of Serbia No. 18/2005, 81/2005 and 47/2018), Law on the Guarantee Fund of AP Vojvodina (The Official Gazette of the Republic of Serbia No. 124/2012), Law on Investment (The Official Gazette of the Republic of Serbia No. 89/2015 and 95/2018), Law on Agriculture and Rural Development (The Official Gazette of the Republic of Serbia No. 41/2009, 10/2013 and 101/2016), etc.

The importance of entrepreneurs for economic growth in overall is confirmed by adopting and implementing several strategies by the Government of the Republic of Serbia. Furthermore, the Government declared that 2016 is the “*Year of the Entrepreneurship*”. Institutional support included six different categories with 16 billion of dinars (one third is grants or subsidies).

Main types of financial support were:

- Programs of financial support to entrepreneurs who start-up business
- Programs of non-financial support to entrepreneurs who start-up business
- Programs for improving business
- Programs for business growth and development
- Programs for support to export

- Programs for innovations.

Every program has own characteristics and it is based on necessities and problems facing by owners of small business. But, one question must be raised in the near future – are those programs effective? Evaluation of such policies is still missing, especially in the domain of the quantifying the effects of government support. Implementation of quantitative methods can contribute to better distribution of funds. Maybe the effects of funds will be higher if they can be transferred to other sector of economy instead of current. Also, national government support in some cases can be considered as safe way to get funds for business and some owners loses their entrepreneurial spirit. The Government must not be the only option in the process of obtaining funding by credit incompetent entities (Erić et al., 2014). Developing of a legal framework that would provide ability of non-depository institutions to perform a non-bank lending will attract foreign direct investment, enable job creation and encourage the strengthening of the entrepreneurial spirit.\

Even the micro crediting is one of the programs for support of the development, especially for people with low income, it means that all over the world this instrument is used to bridge the gap between different income groups as well as to improve market position of small and medium sized entities. Microfinance institutions can be smaller non-profitable, non-governmental or large commercial banks (Veselinović, Drobnjaković, 2015.). According to Kovačević (2014.), the the microfinance institutions can be divided into following categories, by their nature:

- For profit small/medium sized microfinance institutions
- Mainstream banks operating microfinance windows
- Public entities operating microfinance windows
- Greenfield entities
- Dedicated microfinance vehicles often set up for a limited period of time, that invest in.

The main clients for significant number of banks in Serbia are enterprises or corporation with stable market position and good financial performances. Only few of them consider financing of micro entities or start-up enterprises because high risks of failure. Erste Bank is one of them who offers a program for financing entrepreneurs, social entities as well as social organization. Their program „*Step by step*“ is very interesting because provides not only financial support but also administrative and technical advices in running business. The client or users of loans can be enterprise which operate on market not longer than two years, and have up to 9 employees. They can apply for two types of loans: Investment loans and loans for permanent working capital. *Raiffeisen Bank* started to approve loans for start-ups and small business from February 2020 as part of „*National Program to Promote Entrepreneurship and Self-employment concept*“.

Table 9: Microfinancial support to start-up and micro-business by banks in Serbia in 2020

Bank	Loans	Clients	Amounts
Erste Bank	Loans for Investment, Loans for permanent working capital	Start-ups and entities up to 9 employees, up two years of business	No limit defined
Raiffeisen Bank	Loans for permanent woking capital	Micro and small entities, up to 24 months of business	Up to 30,000 euros
UniCredit Bank	Loans for Investment, Loans for permanent working capital	Start-ups, micro and small entities, up to 24 months of business	Up to 30,000 euros
Poštanska Štedionica	Loans for Investment, Loans for permanent working capital	Start-ups, micro and small entities, up to 24 months of business	Up to 30,000 euros

Source: Authors

According to official public data in Serbia were present three non-bank microcredit institutions – AgroInvest, Micro-Development Fund and MicroFinS that operated through local banks. Only AgroInvest still have a web-site with more details about their activities. Official data available in Serbian Business Registrar Agency database shows that Micro-Development Fund (Mikro razvoj doo) was closed in 2016 (decision No. BU 10687/2016). All of them were focused on rural areas of Serbia.

Agro Invest as an affiliate of Vision Fund International start to operate in Serbia in 2005. Their aim is to support economic progress in undeveloped areas. Their mission is to serve and to empower rural families with high-quality financial services and support programmes.

Agroinvest Holding is an intermediary between the commercial banks and the small businesses, especially from undeveloped areas, that has difficulties to get financial support. The most popular credits are in the areas of agriculture, but also, they can be used in other sectors such as trade and services. Use of these loans presents a good practice of microfinance support to small business. Rural development is one of the national goals and it can be achieved through equal and stable development of small business and entrepreneurship. Loan programs are mainly intended for entrepreneurs who operate in rural areas, because their market position is inferior when compared to those who operate closer to the major cities and business areas.

Unfortunately, in Serbia still do not exist clear institutional framework which regulates operation of microfinance institutions. That represents a big challenge and main problem for wider use of microfinance support programmes. One of the consequences of the lack of regulation is closing of Micro-Development Fund in 2016.

Despite following absence of legislative framework, lack of research about microfinancing is important to notice. The last research about potential using of microfinance in business was conducted in 2012, and till now there is no clear evidence about real effect of using microfinance support of banks and non-banks institutions. The further research needs to be done because of the estimation of the effects of loans (from banks) on business performances. With evidence-based policy recommendation, it can be much easier to change the legislative and future microfinance framework.

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Sunset at the Lake Balaton

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