

MICROCREDITING OF SMEs IN THE REPUBLIC OF SERBIA

National Paper

by

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ECONOMIC SNAPSHOT

Negative effects of the Global Economic Crises caused a general worsening of the business climate which has not been on satisfactory level in the period before 2008, due to war conditions in the 1990s and major political changes after year 2000. Despite positive development which has been achieved in the period after political changes, beginning of transitions in Serbian economy in 2000 and appearance of first effects of the global economic crisis in 2008, economic situation was unfavorable (Beraha, I., and Djuricin, S., 2011). Growth of economic activity in the pre-crisis period was not sufficient to compensate losses which were incurred in 1990s. The growth was based mainly on the expansion of the service sector.

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*. Conclusion that economic growth in the Republic of Serbia during period before and after the Global economic crisis was quite unsuccessful is made according data which are presented in Table No. 1.

Table 1: GDP in Republic of Serbia, 2005-2014

- in EUR -

GDP	2005.	2006.	2007.	2008.	2009.	2010.	2011.	2012.	2013.	I 2014.	II 2014.
GDP (in million)	20,306	23,305	28,468	32,668	28,952	27,968	31,472	29,601	31,994	7,357	7,607 ¹
Real GDP growth (in %) ²	5.4	3.6	5.4	3.8	-3.5	1.0	1.6	-1.5	2.5	0.1	-1.1
GDP per capita ³ in Serbia	6,863	7,532	7,373	7,896	8,038	8,387	8,560	9,192	9,308
GDP per capita in EU-28	21,637	23,190	22,459	21,940	22,525	24,241	24,045	25,975

Source: National Bank of Serbia and UNECE Statistical Division Database

Note: ¹ NBS estimate

² At constant prices of previous year

³ Value of GDP per capita is converted from \$ USD in EUR according to average exchange rate of NBS

During the observed period, Serbia achieved approximately three times lower *GDP per capita* compared to the average of EU countries. Relatively high annual growth rates in GDP were achieved after political changes and before appearance of the Global economic crises. High growth was reached due to low initial economic base. Available data indicate a slight recovery of Serbian economy in 2010. However, it was not enough to achieve the level of the pre-crisis

period. Economy of Serbia entered in a phase of recession in 2012. Real GDP growth rate was -1.5%. Although real GDP growth rate reached a level of 2.5% in 2013, it was very low when comparing to the amount which was recorded in the pre-crisis period.

Export promotion is one of the basic prerequisites for sustainable economic growth and trade liberalization was one of the key pillars of transition in Serbia. The Republic of Serbia continues to record a trade deficit during all observed period, despite positive results achieved with trade liberalization. The effects of the Global economic crisis have caused the decline in exports in 2009 compared to 2008 by 16%. Reasons for permanent recording of the foreign trade deficit can be found in the economic isolation. During economic isolation in 1990s Serbia lost all international markets, started de-industrialization, implemented inadequately privatization and didn't have sufficient inflow of FDI. 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). Poor business climate in Serbia is slightly improved due to reduction of the foreign trade deficit in 2013 and recorded foreign trade surplus in the first and second quarter of 2014.

Table 2: Exports and Imports in Republic of Serbia, 2005-2014

Exports and Imports ¹ in EUR million	2005.	2006.	2007.	2008.	2009.	2010.	2011.	2012.	2013.	I 2014.	II 2014.
Exports	5,329	6,948	8,114	9,577	8,041	9,521	11,147	11,498	13,963	3,305	3,655
- growth rate in % compared to a year earlier	19.1	30.4	...	18.0	-16.0	18.4	17.1	3.2	21.4	16.0	7.4
Imports	9,612	11,970	15,503	18,267	13,098	14,243	16,497	16,993	17,796	4,109	4,563
- growth rate in % compared to a year earlier	0.7	24.5	...	17.8	-28.3	8.7	15.8	3.0	4.7	2.5	4.3

Source: National Bank of Serbia

Note: ¹Starting from 2007 data on exports and imports of goods and services are shown in accordance with BPM6. Data for 2005 and 2006 are shown according to BPM5. Due to methodological incomparability, exports and imports growth rates are not shown. Trade with Montenegro is registered within relevant transactions as of 2003. As of 1 January 2010, the Serbian Statistical Office applies the general trade system of registration of exports and imports which is a broader concept and includes all goods entering/exiting country's economic territory, apart from goods in transit. The Statistical Office has published comparable data for 2007, 2008 and 2009. Previous years are disseminated using the special trade system. Trade with Montenegro is registered within relevant transactions as of 2003. Previous years are disseminated under the special trade system.

In addition to decline in economic activity and foreign trade, macroeconomic instability of Serbia has been further deepened by the growth of public debt. The inherited public debt, after the breakup of Yugoslavia, was a huge burden on the transition path. The effects of transition and the global economic crisis forced Serbia to continue the trend of further borrowing. The effects of the global economic crisis and unfinished transition caused the growth of public debt from 29.3% of GDP in 2008 to 63.8% of GDP in 2013. Macroeconomic business conditions can be worsened by further growth of public debt, as in the first two quarters of 2014.

Table 3: RS public debt/GDP

RS public debt	- in % -										
	2005.	2006.	2007.	2008.	2009.	2010.	2011.	2012.	2013.	I 2014.	II 2014.
RS public debt (external + internal, in % of GDP) ¹	52.2	37.7	31.5	29.2	34.7	44.5	48.2	60.2	63.8	64.9	65.6

Source: National Bank of Serbia

Note: ¹ Government securities at nominal value

Budget deficit in the first quarter of 2014 reached an amount of 8.4% of GDP. It issued implementation of saving measures due to the limited borrowing capacity. The saving measures will largely affect pensioners and public sector employees. The reduction of expenditures on salaries and pensions that are financed from the budget will start from November 2014. Expenditures currently stand at 13% of GDP and 10% of GDP respectively. Savings that will be achieved by reduction of pensions and salaries of public sector employees are around 400 million euro. Current budget deficit is approximately 2.65 billion euro. Savings of 400 million euro will lower budget deficit to 2.25 billion euro.

Table 4: RS budget deficit/GDP

RS budget deficit										- in % -	
	2005.	2006.	2007.	2008.	2009.	2010.	2011.	2012.	2013.	I 2014.	II 2014.
RS budget deficit/surplus (in % of GDP)	0.7	-1.7	-1.1	-1.9	-3.3	-3.5	-4.1	-5.7	-4.8	-8.4	-5.1

Source: National Bank of Serbia

Saving measures that should lead to a reduction of the budget deficit on the other hand can worsen the decades-long crisis that exists in the labor market. Economy of Serbia is characterized by extremely high unemployment rate, which in 2013 was 22.1%.

Table 5: Employment / unemployment rate in Republic of Serbia, 2005-2014

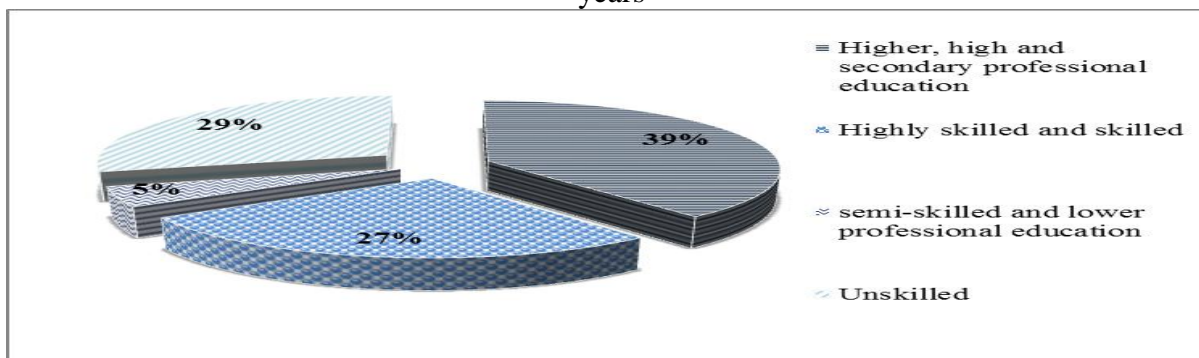
Rate	2005.	2006.	2007.	2008.	2009.	2010.	2011.	2012.	2013.	I 2014.	II 2014.
Employment rate	42.3	40.4	41.8	44.4	41.2	37.9	35.8	35.5	37.7	38.4	39.5
Unemployment rate	20.8	20.9	18.1	13.6	16.1	19.2	23.0	23.9	22.1	20.8	20.3
Activity rate	53.5	51.0	51.0	51.5	49.1	46.9	46.4	47.3	48.4	...	53.5
Inactivity rate	46.5	49.0	49.0	48.5	50.9	41.0	49.3	52.7	51.6	...	46.5

Source: Statistical Office of the Republic of Serbia

Note: The age of 15 years and over

The unemployment rate had a decreasing trend and recorded a value below 20% in the period 2005-2010. However, this trend cannot be assessed as positive. The reduction in the unemployment rate is not only caused with hiring the unemployed labor force. It is also caused by their transitions into category of inactive persons (Djuricin, S., 2011). Also, reduction in the unemployment rate could not be attributed to real GDP growth because in the observed period the economic downturn was recorded.

Graph 1: Unemployed according to level of professional education, the average of the last three years



Source: Statistical Office of the Republic of Serbia

Highly qualified persons and persons with college, university and secondary school education accounted for 27% and 39% respectively in the total number of unemployed in Serbia.

High rates of unemployment and low income of employees are typical for labor market in Serbia. The average net salary in Serbia in 2013 was 388.3 euro. The average net salary per employee increased significantly compared to 2005. The increase in the inflation rate and the retail prices during the observed period annulled positive trend in increasing of net salary. Analyzed by sector, above average wages are earned in sectors which largely remained unprivatized and whose holders are mostly state-owned enterprises.

Table 6: Average net salaries by sectors, 2005-2014

- in EUR -

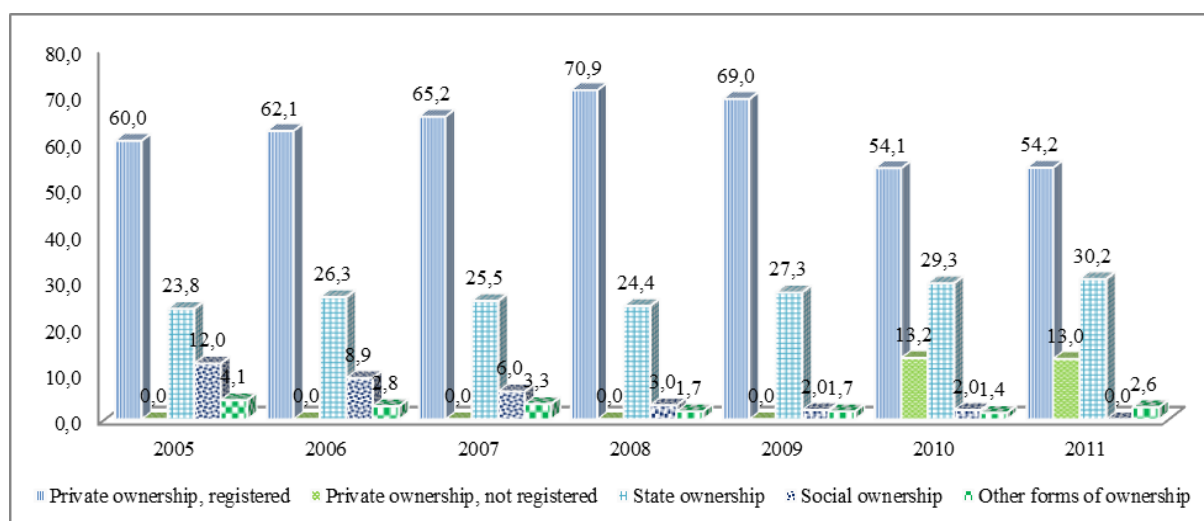
Years	2005.	2006.	2007.	2008.	2009.	2010.	2011.	2012.	2013.	I 2014.	II 2014.
Total	210,2	258,1	347,2	402,1	337,8	331,3	372,5	365,7	388,3	396,1	394,6
Agriculture, forestry and fishing	154,5	194,3	243,7	303,6	275,4	267,8	309,4	318,0	330,6	326,3	325,9
Manufacturing	166,8	209,2	274,2	322,2	270,6	282,0	321,6	316,0	333,3	346,0	344,9
Construction	186,3	231,8	315,7	374,5	292,0	285,9	323,2	306,8	316,0	308,7	338,9
Wholesale and retail trade	187,5	237,3	314,2	377,7	254,3	250,7	279,3	274,7	297,1	298,7	297,6
Transportation and storage	234,5	274,8	349,9	408,8	366,4	360,5	401,3	384,3	405,8	393,8	408,4
Public administration and defense; compulsory social security	272,7	328,5	425,9	475,6	420,4	404,5	458,3	449,3	475,7	468,8	465,1
Education	223,5	268,5	359,9	423,0	379,6	348,1	374,2	360,3	377,9	371,9	379,0
Human health and social care	221,0	265,8	383,8	428,8	384,3	350,8	384,7	366,4	385,5	380,6	381,3

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

Public sector wages are higher, but the private sector generates the largest number of employees. The privately owned companies are generating more than 60% of employees, while public companies and those that have a social form of ownership or have not yet been privatized, generating only 30% of employed persons.

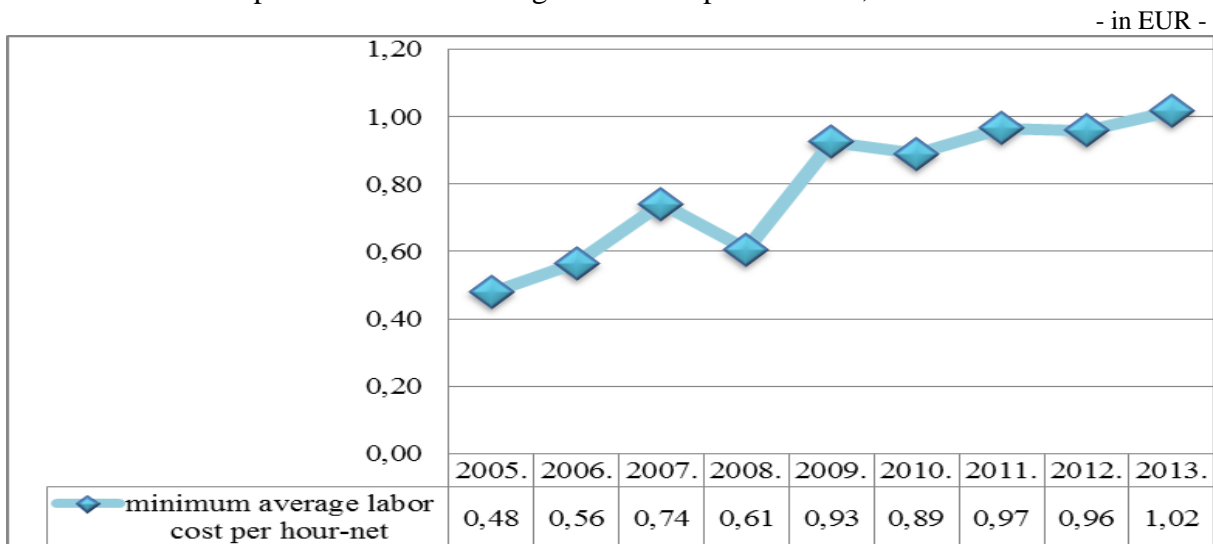
Graph 2: Employed persons by sectors of ownership, 2005-2011



Source: Statistical Office of the Republic of Serbia

The crisis in the labor market has been further deepened by low amount of the hourly minimum wage. Minimum average labor cost per hour in 2013 compared to 2005 increased only 0.54 euro and currently is 1.02 euro.

Graph 3: Minimum average labor cost per hour-net, 2005-2013

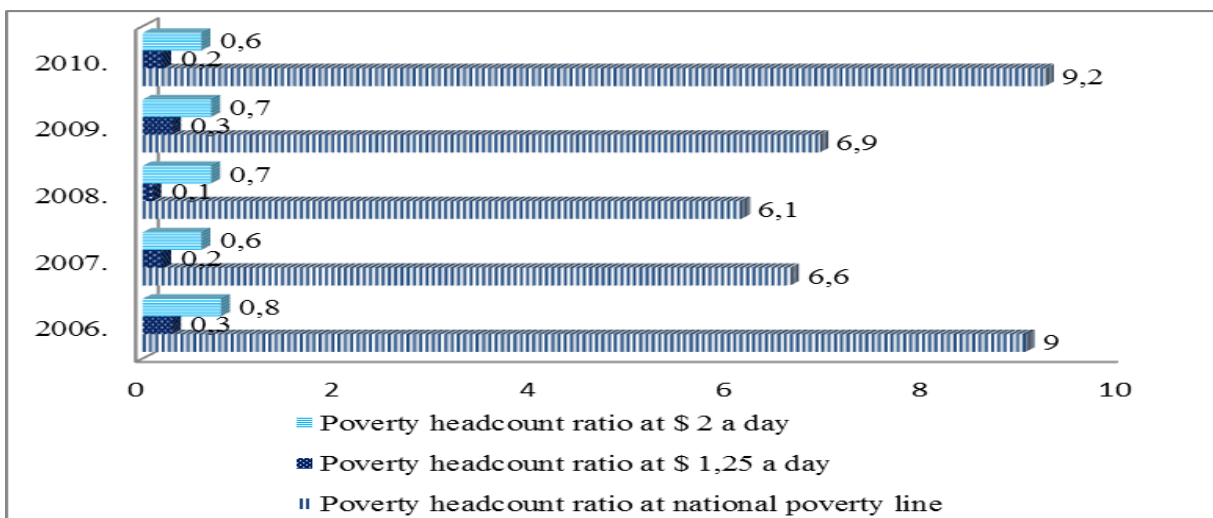


Source: The legal database, available at: <http://www.paragraf.rs/onama.html>

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

High unemployment, low labor cost and overall macroeconomic situation have resulted in the growth of the poverty rate. The poverty rate measured by the percentage of the population living below the national poverty line was 9.2% in 2010.

Graph 4: Poverty headcount ratio (% of population)



Source: World Bank, Development Research Group, available at: <http://www.indexmundi.com/facts/topics/poverty#Poverty rates>

According to the latest available World Bank data, 0.2% and 0.6% of the population lives in Serbia with less than \$ 1.25 a day or \$ 2 daily, respectively.

CHARACTERISTICS OF THE SME SECTOR

Converting the SME sector in a significant segment of the economy is a part of the transition process of Serbia's economy. The SME sector of Serbia is characterized by a dynamic development until the beginning of the Global economic crisis. This is the result of an active policy entrepreneurship and low starting base. The effects of the Global economic crisis caused worsening of all performances of the SME sector. Its flexibility and adaptability at the same time represented the only real bearers of economic recovery, growth and development. The size and flexibility of SMEs allowed them to easily and quickly adjust to changes on the market (Eric D., et al., 2012, p. 20). The importance of this sector can best be seen through its participation in the basic macroeconomic indicators of the national economy.

SMEs in total number of enterprises in Serbia participate with an average of 99.8% in the last ten years. According to the latest available data, SMEs generate 65.1% of the employed, 65.4% of turnover, 55.8% of GVA, 51.5% of exports and 60.2% of imports of non-financial sector of Serbia.

Looking at the national level, SMEs are employing 54.3% of total employment, achieved 49.8% of exports, 58.2% of imports and has a share of 33% in GDP of Serbia.

Table 7: Indicators of the development of the SME sector

Indicators	2005.	2010.		2011.		2012.	
	Non-financial sector	Non-financial sector	Totaleconomy	Non-financial sector	Totaleconomy	Non-financial sector	Totaleconomy
Number of enterprises	99.7	99.8		99.8		99.8	
Number of employees	59.0	66.4	45.4	65.3	45.1	65.1	45.3
Turnover	65.5	65.3		65.5		65.4	
Gross value added	54.1	55.9		55.2		55.8	
Gross domestic product			33.0		33.0		33.0
Export	39.0	46.6	44.5	48.5	46.5	51.5	49.8
Import	64.0	54.3	52.3	55.8	52.7	60.2	58.2

Source: Ministry of Economy and Regional Development and National Agency for Regional Development

Development indicators show that participation of SMEs in the total number of enterprises increase by 0.1% compared to 2005. According to available data, the share of SMEs in total employment in the non-financial sector has grown by 6.1%, GVA by 1.7% and exports by 12.5% comparing with data from 2005. Decrease was recorded in its share in total exports by 3.8% and in business activity through lowering of the total turnover by 0.1%.

If we observe enterprises by company size, there were no significant changes compared to the previous year. Compared to the pre-crisis period the number of micro enterprises increased slightly. According to the latest available data, share of micro-enterprises in the SME sector accounted for 96.3%. Typical share for small and medium enterprises in SMEs are 3% and 0.7% respectively. SMEs dominate in all observed indicators of development, although the micro enterprises are the most numerous. Small and medium enterprises generated 53.8% of the employed, 60.7% of turnover, 61.6% of GVA, 77.0% of exports and 74.5% of imports in the SME sector.

Table 8: Business indicators the SME sector by size

- in % -

Indicators	2008.			2009.			2010.			2011.			2012.		
	Micro	Small	Medium	Micro	Small	Medium	Micro	Small	Medium	Micro	Small	Medium	Micro	Small	Medium
Number of enterprises	95.7	3.4	0.9	96.1	3.1	0.8	96.3	3.0	0.7	96.3	3.0	0.7	96.3	3.0	0.7
Number of employees	47.2	22.8	30.0	47.3	23.0	29.7	47.3	23.9	28.8	45.6	24.9	29.5	45.2	25.1	28.7
Turnover	42.0	29.9	28.1	42.5	28.1	29.5	40.1	29.9	30.0	39.4	30.6	29.9	39.3	31.1	29.6
Gross value added	39.9	27.8	32.3	39.8	27.4	32.8	39.4	28.6	32.0	38.5	29.0	32.5	38.4	28.7	32.9
Export	23.4	27.6	48.9	24.0	24.9	51.1	26.4	28.0	45.7	24.0	28.8	47.2	23.0	28.6	48.4
Import	26.1	39.1	34.8	25.8	34.7	39.5	25.0	36.3	38.6	25.6	38.3	36.0	25.5	37.8	36.7

Source: Ministry of Economy and Regional Development and National Agency for Regional Development

Statistical data about business demography, which indicate the degree of progress in the development of entrepreneurs, testify that a company formation rate is lower and company closure rates are higher. The rate of new enterprises in 2012 decreased by 10.3% compared to 2006, while the closure rate increased by 1.9%.

Table 9: The rate of establishment and closing in SMEs sector

- in % -

Rate	rate of establishing	rate of closing
2006.	22.3	10.6
2007.	20.7	12.1
2008.	18.0	13.2
2009.	15.2	11.9
2010.	13.7	13.9
2011.	13.0	15.3
2012.	12.0	12.5

Source: Ministry of Economy and Regional Development and National Agency for Regional Development

Results of the research “Status, needs and problems of small and medium enterprises and entrepreneurs” which was conducted by the National Agency for Regional Development in the period October-November 2013 indicate that the largest number of companies plan to maintain the same level of business activity in the next three years. 53.2% of companies intend to maintain the same level of business activity while 35.4% of them planning to expand them. 58.1% of entrepreneurs plan to have the same level of business in the future, while 50.7% of medium-sized enterprises are interested in the expansion of its business activities.

Reducing the volume of business and plans for closing have 3.2% of firms, while only 1.4% of entities are planning to leave their businesses to others. Plans for closing operations or its abandonment are common for entrepreneurs. 4.6% of entrepreneurs planning to quit their business, while 2.1% of them planned to leave their business activities to other companies or entrepreneurs.

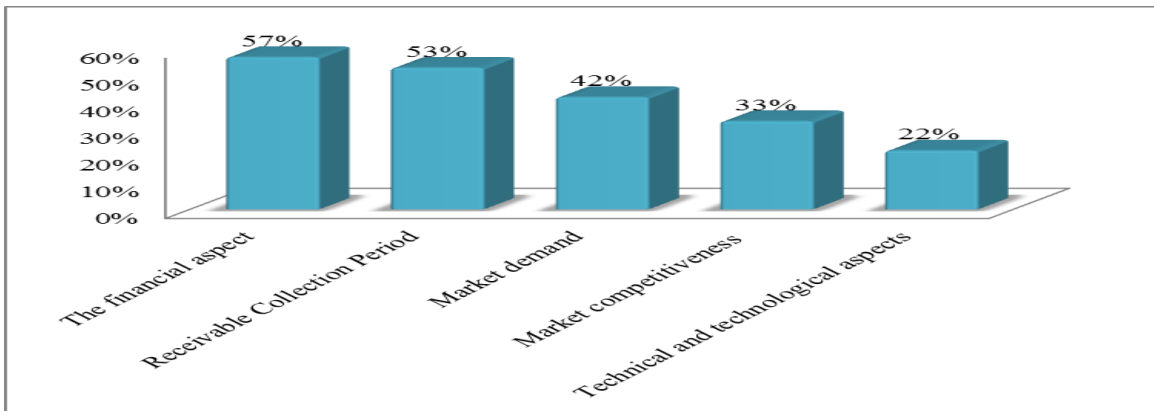
Table 10: Business plans of enterprise in the next three years

Business plans	Micro	Small	Medium	Entrepreneurs	Total
Expansion of activities	34.7	42.3	50.7	29.0	35.4
The same business level	54.0	48.0	40.0	58.1	53.2
Reducing business volume	3.6	3.0	1.3	3.3	3.2
Closing a business	2.4	1.7	4.0	4.6	3.2
Transferring business to others	1.1	0.9	0.7	2.1	1.4
I do not know / no answer	4.2	4.1	3.3	2.9	3.6
Total	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Economy and Regional Development and National Agency for Regional Development

Growth and development of SMEs are faced with numerous difficulties because they want to ensure the survival on market. Aspects of operations like provision of the necessary sources of financing, debt collection, growth in demand, market competition and technical-technological development would create better business results and safer development in future.

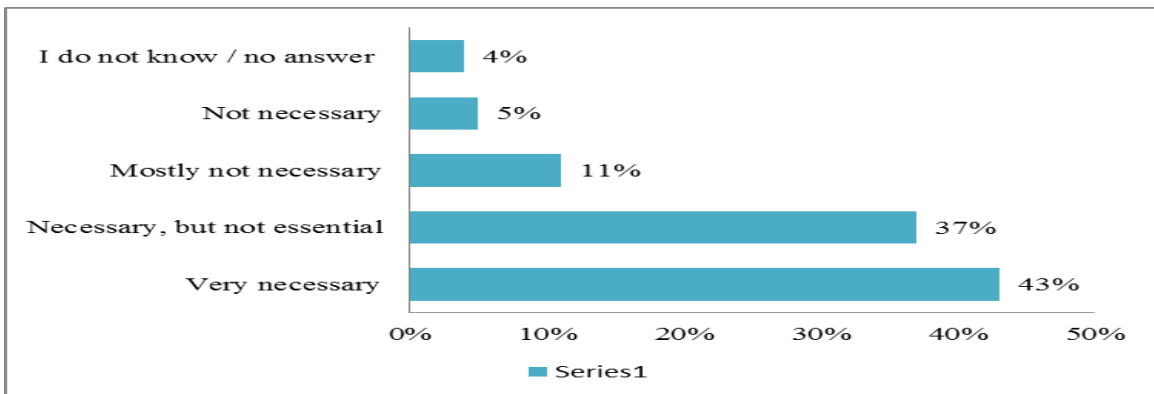
Graph 5: Aspects of business that first should be improved
- 5 most frequently answers -



Source: Ministry of Economy and Regional Development and National Agency for Regional Development

Financial support is considered to be essential for survival, growth and business development by 43% of entrepreneurs, and necessary but not essential by 37% of entrepreneurs. Financial support is largely unnecessary or completely unnecessary in the opinion of 11% and 5% of entrepreneurs, respectively.

Graph 6: The extent to which you need financial support in the business

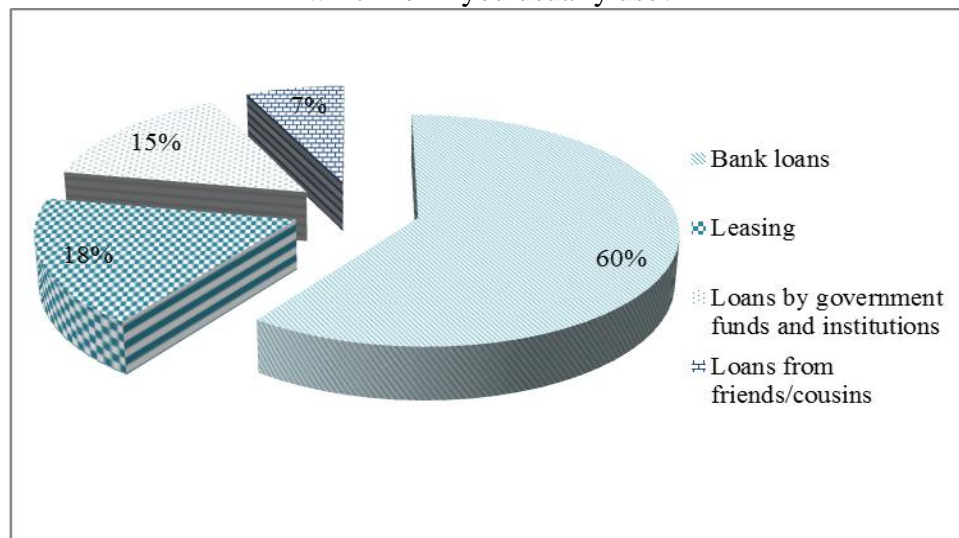


Source: Ministry of Economy and Regional Development and National Agency for Regional Development

The largest number of SMEs relies on their own sources of funding in the initial stages of development. However, in the later stages of the life cycle, when capital needs exceed internal capabilities of the owner, large number of SMEs is facing with growing need for the use of external sources of financing. Net cash and retained profit are internal sources of funding which are commonly used. Their availability is characteristic of the later stages of the life cycle. From informal external sources of financing SMEs commonly used funds raised from family and friends. In the case of use of formal external financing sources entrepreneurs use traditional forms of borrowing such as loans from commercial banks and leasing, and less on venture capital funds.

According to the survey which was conducted in year 2010 by the Institute of Economic Sciences and the Serbian Chamber of Commerce, bank loans are used by 60% of SMEs. 18% of SMEs use leasing and 15% of companies use loans from state-owned funds and institutions. Borrowings from friends use 7% of SMEs and funds from the guarantee funds use 1% of them. Loans from commercial banks companies often use for financing investments, working capital and inventory, and leasing from commercial banks use to acquire new equipment.

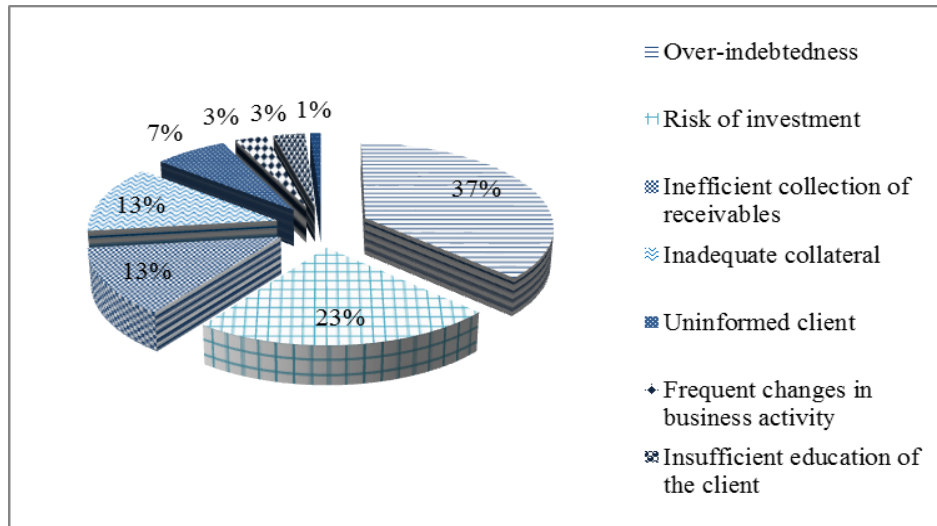
Graph 7: Distribution of responses to the question: From the external sources of financing, which form you usually use?



Source: Eric, D., et al., 2012, p. 71

Problems that arise in the case of financing SME by loans can be divided into two groups. The first group consists of problems that banks are facing when lending money. They are consequence of the size, characteristics and specific needs of SMEs. Survey results show that 37% of surveyed banks consider over-indebtedness as the main problem of clients, 23% is asset risk, 13% inadequate system of debt collection and inadequate collaterals, 7%, insufficient information of the client and 3% frequent changes in activities of clients and their insufficient training.

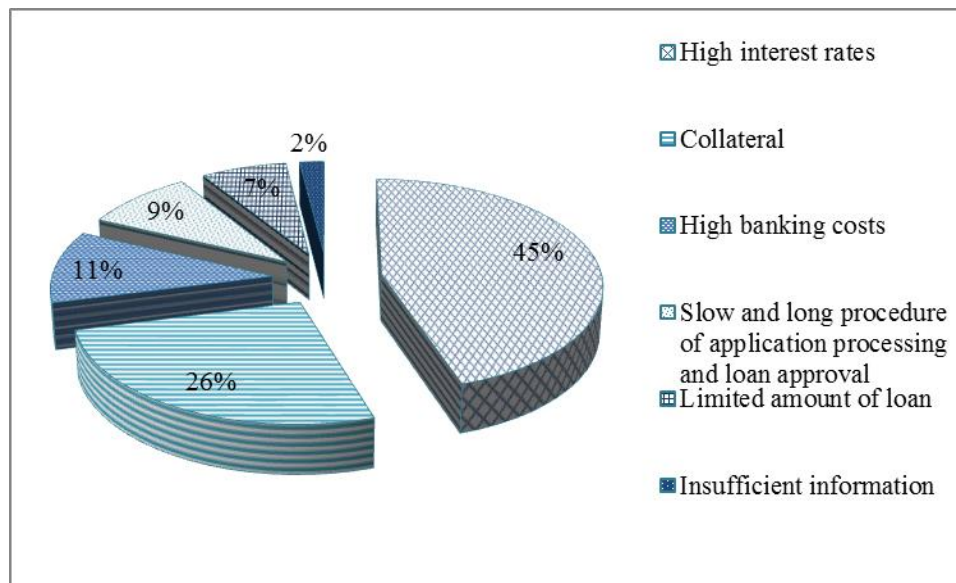
Graph 8: Distribution of responses to the question: What are the most common problems of banks while approving loans to SMEs?



Source: Eric, D., et al., 2012, p. 92

Another problem that arises in the funding of SMEs refers to the difficulty that companies have in the case of using bank loans as external financing sources. In this survey, 45% of all surveyed SMEs indicated that their biggest problem is the high interest rate when using the bank loan, 26% collateral, 11% of the high banking costs, 9% of slow and long procedures of application processing and loan approval, 7% limited amount of credit and 2% of insufficient information.

Graph 9: Structure of responses to the question: What are your greatest problems while using bank loans?



Source: Eric, D., et al., 2012, p. 47

The difficulties which occur in case of using bank loans particularly affect SMEs which are at the beginning of life cycle as well financial weak individuals who have the ambition to develop their entrepreneurial ideas and their own business. Needs for financial support in early stages of development and in the realization of entrepreneurial ideas of financially weak individuals had resulted in the development of specific types of financial services. Those financial services are start-ups and micro-loans.

- **Start-up loans** – Available source of funding in the start-up phase of the development is extremely small. Financing by borrowing from commercial banks is used only in cases when it is necessary at the beginning of this stage of development. Financing start-up phase of development with bank loans is limited due to poor credit capabilities of companies and limited data about financial performance of their business enterprise. Banks often don't want to lend money to the companies at the time of their establishment, so the most significant source of funding in the start-up phase are personal savings, loans from family, friends, business angels, government support programs and international institutions.

Also, we should keep in mind that a few years Serbian central bank – National Bank of Serbia follow restrictive monetary policy. From the one side level of bank loans to the business sector are limited. From the other side, due to the global crisis, the level of risk increases. Rate of non-performing loans rise from 11% in 2008 up to 23% in 2014.

“Business angels” are considered as one of the finest sources of financing in the start-up phase of development because they provide the necessary capital and the necessary experience and skills. Although funding through “business angels” is limited to companies that have a high potential for growth and development, inadequate application of them in Serbia is primarily based on a poor level of information available to potential users and lack of their prevalence. According to the survey, only 2% of the surveyed SMEs are familiar with this form of financing in Serbia (Eric D., et al., 2012, which is partly the consequence of absence of the long history of “business angels” network in our region.

Regarding support of government institutions in the initial stage of development of SMEs it is necessary to mention the start-up loans which are provided by the Fund for the Development of the Republic of Serbia. SMEs can apply for the long-term start-up loans for construction, extension, reconstruction, renovation, rehabilitation, purchase of office space, manufacturing and industrial facilities or for the purchase of new equipment in the Development Fund of Serbia. Start-up loans are granted under exactly conditions, persons up to 55 year old who are not employed in the public enterprises or public institutions, in the amount from 2.500 to 12.500 EUR for entrepreneurs, or 4.200 to 25.000 EUR for legal persons for a period of 5 years. The grace period is one year, an annual interest rate is 2% if the funds are provided, and if the funds are not provided annual interest rate is 3%. For orderly repayment of loan the different instruments can be used as collateral: promissory notes of the client, first mortgage on real estate and contract surety.

Among the numerous international institutions, World Bank is one of the most important sources of financial and technical assistance in Serbia. One of the many forms of support to SMEs in Serbia is financing start-up projects worth up to 50 thousand euro. SMEs which operate less than

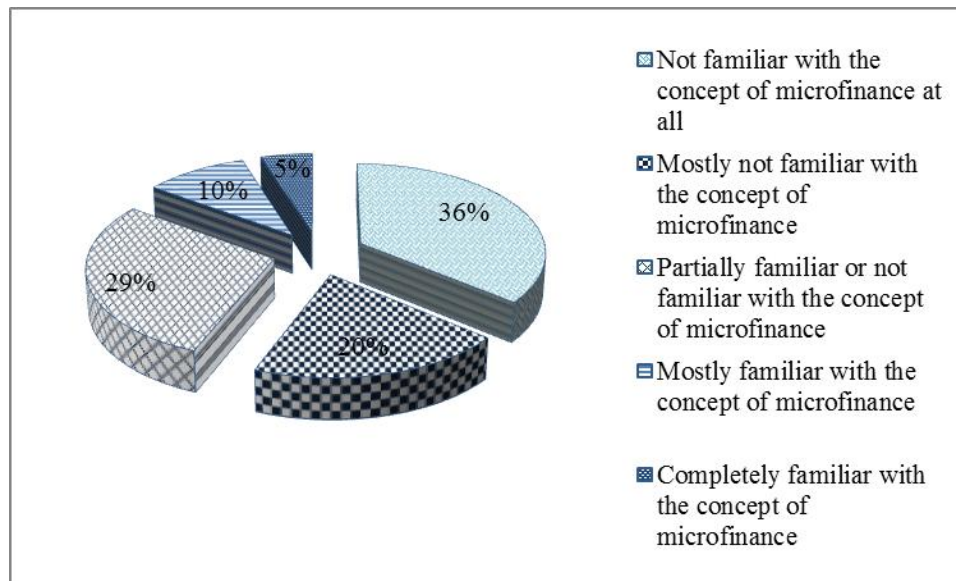
2 years can apply with start-up projects for European Commission funding which are available as a part of the Entrepreneurship and Innovation Programme (EIP). The approved loan amount is up to 25 thousand, and participation is not required. Loans are granted for a period between 1 and 5 year, a grace period is a maximum 12 months. The nominal interest rate is 7.50% + six-month EURIBOR, or the effective interest rate ranging from 9.72 to 10.09% plus fix fee in amount of 1-1.5% of the loan. Lien on the property that is acquired by means of loans is needed when funding the start-up projects in this way.

- **Micro credits** – Microcredit is other type of financial services that was developed as a response to the absence of possibility of using the funds of commercial banks by poor individuals who have the ambition to develop their entrepreneurial ideas. Preparation of “National paper on micro financing of SMEs in Serbia” which deals with legislation framework on the microfinance, government program of supporting microfinance, major microfinance intermediaries / institutions and models of microfinance of SMEs, requires a precise definition of the terms microcredit and microfinance which some researchers not define as a synonym (Elia M., 2006; Eric D., et al., 2012, p. 65).

Micro credits are only part of micro financing. Microfinance includes micro crediting and other services, such as micro-savings, micro-insurance, money transfer, etc. (Elia M., 2006, p. 70). The first forms of micro-crediting were recorded in the Grameen Bank in Bangladesh, founded in 1976 by Muhammad Yunus who awarded the Nobel Peace Prize in 2006 for contribute to the economic development and providing help for millions of poor.

The next presented results of research are about familiarity of SMEs with the concept of microfinance. 36% of SMEs surveyed are not familiar with the concept of microfinance at all, while 20% are mostly not familiar with the concept of microfinance.

Graph 10: Distribution of responses to the question: To what extent did you familiar with the concept of microfinance (as the mechanism by which a bank or entities outside the banking or microfinance institutions, provide small loans at relatively informal way?)



Source: Eric, D., et al., 2012, p. 138

29% of surveyed SMEs are partially familiar or not familiar with the concept of microfinance, 10% are mostly familiar with the concept of microfinance, and only 5% of SMEs are completely familiar with the concept of microfinance.

LEGISLATIVE FRAMEWORK ON THE MICROFINANCE

Microfinance represents a way of funding which can create new jobs and reduce the proportion of socially vulnerable population. The current economic situation in Serbia is unsatisfactory according the distinct levels of unemployment and a high percentage of the population living below the poverty line. 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. First of all, microfinance institutions are geared towards providing a permanent and sustainable funding of poor entrepreneurs or small companies, due to the characteristics of their business. These clients are not able to fulfill the necessary requirements for obtaining financial loans in the banking sector, often treated as high-risk companies, with insufficient capital and opportunities to finance repayment of the loan. The conditions for obtaining loans of commercial banks for this kind of financing are unfavorable. Therefore, SMEs in Serbia are faced with the highest price of loans in the region, the lack of long-term sources of funding and poor compliance range of banks and financial needs of this category of enterprises.

Low interest of the banks in financing this sector can be found in the problems facing SMEs, concerning repayment of the loan and the high risk of default. According to the OECD study from 2013, the interest rate of loans for SMEs is, in average, is higher by 4% in ratio to interest rates for large companies because of problems in the supply side of funds from commercial

banks and side of demand due to the risk of repaying the loan (high NPL). In recent years commercial banks adapted their range of services to modern market requirements which included an intensive development of SME sector. Financial instruments such as factoring, guarantee schemes and other alternative forms of financing in Serbia have just started to develop. Companies are not sufficiently informed about their significance, and only few of them use all benefits from microfinance, so their development is slowed.

One of the most influential factors to the slow development of microfinance in Serbia can be the absence of a legal framework for microfinance. "The Banking Act" came into force in 2010 and regulations of banking sector started to be very rigorous. The new law is harmonized with European Union regulations and with the characteristics of their business in the EU. Previous act "The law on banks and other financial institutions" adopted in 2005 and was the first law to regulate the banking sector of Serbia after major political changes and the beginning of reforms in the legal system.

Banking legislation which regulates banking operations of domestic and foreign commercial banks disabled functioning of microfinance institutions Current law define that only commercial bank is permitted to accept saving deposits and makes lending especially to the SME sector. This creates a "partnership" between the existing microfinance institutions in Serbia 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. Operating costs now increase, an interruption in the work of microfinance institutions exists and administrative procedures become even more complicated.

Instead to facilitate obtaining loan, the existing legislation required from client necessary documentation in limited time and resources. The mentioned banking act treats microcredit as "cash loans" or "consumer loans" and orders to be secured with 122% of the capital, which significantly reduces the possibility of distributing microfinance institutions funds (MFIs) (Popovic-Pantic S., 2012).

The above-mentioned problems indicate that the development of microfinance in Serbia is slow and difficult. Since there is no legal framework for the implementation of micro-finance support, removing administrative barriers and improving the legal framework are part of the "Strategy for the development of entrepreneurship and SME sector in the period 2014 to 2020". The new strategy is aligned with the elements of the document "The May 2011 Commitment" which seeks to improve the competitiveness of SMEs. The absence of legislation has resulted in inadequate development of microfinance in Serbia.

The absence of legislation has resulted in inadequate development of microfinance in Serbia. The estimated effects of establishing adequate and effective legislative framework for microfinance in Serbia would be as follows (Strategy for the development of entrepreneurship and his competitiveness for the period 2014 till 2020, Government of Republic of Serbia, 2014):

- 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.

GOVERNMENT PROGRAM FOR SUPPORTING MICROFINANCE

High levels of unemployment and poverty disabled a number of residents in Serbia to access credit products of commercial banks. In order to stimulate self-employment and entrepreneurial spirit, the Government of the Republic of Serbia has developed a range of instruments through, directly or through the lender creditworthy entity provides the ability to obtain necessary funding.

The institutional framework of the Republic of Serbia in the area of providing financial support to the SME sector from public sources, through grant funds or through loans under the competitive conditions are: the Ministry of Economy and Regional Development, RS Development Fund of the Republic of Serbia, Development Fund of AP Vojvodina, the Guarantee Fund of the Republic of Serbia (in the period 2003 - 2009 independently operated and in 2009 was annexed to the Development Fund of the Republic of Serbia), Guarantee Fund of AP Vojvodina, the Agency for Insurance and Financing export, Agency for Foreign Investments and Export Promotion and the National Employment Service. Providing financial support to SMEs through mentioned institutions is regulated by the following laws and regulations: the Budget Law (The Official Gazette of the Republic of Serbia No. 110/2013), Law on Public Agencies Act (The Official Gazette of the Republic of Serbia No. 18/2005 and 81/2005), A Development Fund of the Republic of Serbia (The Official Gazette of the Republic of Serbia No 36/2009, 88/2010 and 119/2012), Law on the Guarantee Fund RS (The Official Gazette of the Republic of Serbia No. 55/2003) etc.

Various programs for SMEs and awarding grants only partially reduce the problem of access to finance of vulnerable entities and individuals. In the current macroeconomic circumstances national economic development programs are still the largest financial support to small and medium-sized enterprises, registered farmers, households and unemployed. But, according to macroeconomic indicators this is unacceptable for two reasons.

The first reason is stated in the document "Financing the growth of small and medium-sized enterprises", which is based on research that was conducted by USAID in 2012. This document specifies current disadvantages of state financial support to SMEs and which are as follows:

- Programs of support are not integrated in the strategic documents of the Republic of Serbia, which causes inconsistency of the current situation with the plans,
- Too large diversification of financial instruments,
- Lack of transparency in communication with the SME sector,
- Under-utilization of the existing banking infrastructure in all commercial banks.

The second reason lies in the fact that the provision of funding for self-employment and entrepreneurial spirit from the budget of the Republic of Serbia is unsustainable in the long run. Reasons for that is growing budget deficit in near future. The role of government is to facilitate, rather than direct services to microcredit. The key thing that government can do for microcredit

is to maintain macroeconomic stability, avoid limiting of interest rates, and not to offer unsustainable, subsidized loan programs (often with a high degree of omission) that deform the market for banks and for microcredit providers (Gies D, 2010, p. 83). In accordance with recommendations for improving the support financing of the SME sector, including the emphasis on the importance of microfinance the Government of the Republic of Serbia should develop a strategic document whose implementation would allow:

- Improving of the enforcement procedure (protection of lenders is of great importance for a healthy credit environment, whether they are classical or micro-credit loans),
- Simplification of financial regulations for the activities of SMEs,
- Developing alternative sources of financing to SMEs (development of non-bank financial institutions as an alternative form of financing),
- The suitability of financial products of the banks to the needs of SME sector,
- Strengthening services that provide support to lending and increasing their availability (development of quality expert witnesses, property appraisers, integration of all information from financial institutions in a single database).

The Government of the Republic of Serbia should take a major role in creating an environment in which will be possible for microfinance institutions to survive, grow and develop. But the Government must not be the only option in the process of obtaining funding by credit incompetent entities. 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.

Experience shows that private providers of microcredit are much more effective than the state Government, and that the model “profit micro-crediting” is superior to “non-profit models” (Ibid). According to the example of good practice, the Government of the Republic of Serbia should provide macroeconomic stability and create an environment for the development of profitable providers of microcredit which is characterized by servicing clients without additional funds from donors or government subsidies. Economically weakened Serbia, which is not in a position to develop a non-profit microcredit sectors, should invest all efforts in order to encourage the development of micro-financing institutions in the private sector.

MAJOR MICROFINANCE INSTITUTIONS IN SERBIA

The absence of legislation has resulted in inadequate development of microfinance in Serbia. Development of several microfinance institutions (MFIs) in Serbia have started with a lack of interest from banks for money borrowing. MFIs give the credit support to low-income families, start-ups and micro-enterprises. The existing microfinance institutions in Serbia perform their activities through banks. MFIs are giving them the available funds to the commission. Banks make payments of loans while microfinance institutions perform all other tasks related to finding clients, technical application processing, control of use of loans etc. These institutions perform most of activities in the process of loan granting. Banks formally appear as credit providers due to legal restrictions (Eric D., et al., 2012, p. 141). Microfinance institutions that are operating in Serbia are: Micro Fins- DBS Ltd., Agro Invest Holding and Micro Development Limited.

- **Micro Fins - DBS Ltd Belgrade** – is a microfinance institution that was founded in 2007. The main activity of this institution includes micro crediting of people who are self-employed and classified as entrepreneurs. According financial needs of entrepreneurs which are spread throughout Serbia, Micro Fins Ltd has several offices: Belgrade (main office), Sabac, Subotica, Novi Sad, Subotica, Sombor, Kikinda, Pancevo, Kragujevac, Cacak, Jagodina, Krusevac and Kraljevo. This MFI currently employs 30 workers. In the near future Micro Fins is planning to expand its business to other cities who pointed out the need for financial fund in Serbia.

Micro Fins business involves the granting of micro credit to clients who have a good business idea but don't have sufficient money to start up a new business or expand the existing one. Placement of granted loans is carried out in cooperation with selected commercial bank. It is paid in dinars on the customer's account in bank. Loan repayment amount is same through the repayment period. This is good facility for entrepreneurs who can planning their cash flow and creating market development strategy.

Micro Fins loan officers have an obligation to conduct interviews with each candidate before approving the submitted application. In this way, officers evaluate the quality of business ideas, current business environment and future development. Also, the officers visit clients in the field, make estimates of their business sustainability and check the data provided in the application form. After determining the quality of all information, loan officers present all requirements for a loan to the credit committees. The documentation can be forwarded to a commercial bank for the payment if the loan is approved. All credits are issued based on the deposit model. Micro FinS may request cancellation of the contract and refund the total amount of the loan before deadline. Cancellation may be caused if there are some irregularities such as violations of the requirements of the Loan Agreement or giving incorrect data in application form.

- **Micro Development Ltd.** - is a microfinance institution that satisfies financial needs of small entrepreneurs and poor population in order to achieve adequate socio-economic and living conditions in Serbia. It was founded in 2009 and after 6 years in business employs 19 workers. It is one of the most experienced microfinance institutions in Serbia which took over operations of the “Fund for micro development” and has continued with the realization of projects. MFI operating on the territory of 14 municipalities in central and southern Serbia and create more balanced regional development in 2014. Since 2013, Micro Development Ltd. became a member of the European Microfinance Network (EMF). Sources of microcredit programs are United Nations High Commissioner for Refugees (UNHCR), International Committee for the Red Cross (ICRC), the Danish Refugee Council in cooperation with Danida and UN-HABITAT.

The development goals of Micro development Ltd are: contribution to poverty reduction through the inclusion of vulnerable groups in society, small business development and job creation. The specific goals are: providing income, improving the quality of housing and education for poor people, refugees, the Gypsies. At the same time, it is necessary to provide sustainable access to financial services for population groups that have limited access to the formal financial institutions. These groups are mostly entrepreneurs and small businesses which funds for business development are very small. Also, for commercial banks they don't represent a

sufficiently attractive and reliable segment for funding. For these reasons, the micro-loans are customized for such categories of enterprises. Loans can be granted for the purchase of fixed or variable working capital and for starting up a new job. A simple procedure for obtaining a loan reduces administrative barriers and saves time and money. The applicants, next to entrepreneurs, may be unemployed persons and farmers. The approved loan is paid in dinars, not indexed and with fixed interest rate during the repayment period.

- **Agro Invest Holding** – is a branch of the *Vision Fund International*, a fund which is consisting of institutions in 42 countries, with a total portfolio of USD 373 million, 626,000 clients and a 96.7 % high rate of loan repayment. This institution started operating in Montenegro in 1999. The business is expanded to Serbia in 2001. Today it employs 147 workers.

The primary goal of this MFI is the progress of economy, reducing poverty and increasing employment in underdeveloped areas. Agroinvest Holding is an intermediary between the commercial banks and the small businesses that has difficult direct access to financing. The most popular credits are used for the launch and promotion of small business in the areas of trade, services and agriculture, but also for the reconstruction of industrial and office space. Small businesses become successful enterprises using the granted loan they increase incomes and create new jobs. Also, very often situation is use of the services of MFI in several business cycles. 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. This is the way to achieve a more balanced regional development because equal opportunities are provided to all, not only to selected regions. Income level also has influence to the selection of the target group and gives priority to the categories of the population with low incomes and unemployed. Besides vulnerable people and entrepreneurs from rural areas, micro-enterprises that have good business idea and development plan can also use these loans.

The absence of a clear institutional framework which regulates operation of microfinance institutions in Serbia is a big obstacle to wider use and promotion of this method of providing funds for small businesses.

MODELS OF MICROFINANCE OF SMEs

Microfinance institutions have consultants who help each client to understand the loan terms, fill out questionnaires, prepare a business plan and prepare the necessary documentation. Microfinance institution makes a decision to approve the loan if client successfully implemented all the pre-preparatory actions and if his business idea is proven to be economically justified. The final decision on granting credit is made by the cooperation bank. Microfinance institutions will monitor and control appropriate use of funds after payment of the loan and the beginning of its use.

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

- 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.

Three microfinance institutions operate in Serbia. A detailed overview of the products of each of them will be presented. MicroFins-DBS offers a micro-loan from 50,000 RSD to 200,000 RSD with the equal interest rate, repayment period from 9 to 24 months. Possibilities of utilization of these loans are diverse. The primary goal is the improvement of living standards and the development of private initiative and entrepreneurial spirit. The process of applying for loan is simple and fast. The client is obliged to provide the report to the Credit Bureau, confirming its creditworthiness and associated guarantees. The minimum loan amount is 50,000 RSD and the maximum loan amount is 200,000 RSD. The collateral depends of the amount of loan. It is necessary to provide a minimum one guarantee from a guarantor who works in the public sector if the amount of the loan doesn't exceed 160,000 RSD. It is necessary to provide a minimum two guarantees from guarantors who are employed in the public sector if the loan amount is ranging from RSD 160,000 to 200.000 Management of MFIs considers this type of loan collateral very good because the stability of jobs in the public sector is higher than in case of jobs in the private sector.

Table 11: Summary of microcredit products „Micro FinS- DBS Ltd“ in 2014

Loan products	Amount of credit - RSD	Repayment period - month	Interest rate	Annuity - RSD
1	50,000	9	3.29%	6,508
2	50,000	12	3.29%	5,110
3	80,000	9	3.29%	10,415
4	80,000	12	3.29%	8,177
5	100,000	12	3.29%	10,221
6	100,000	15	3.29%	8,553
7	110,000	15	3.29%	9,409
8	110,000	18	3.29%	8,195
9	120,000	15	3.29%	10,265
10	120,000	18	3.29%	8,940
11	160,000	18	3.29%	11,920
12	160,000	24	3.29%	9,745
13	170,000	18	3.29%	12,665
14	170,000	24	3.29%	10,354
15	180,000	18	3.29%	13,410
16	180,000	24	3.29%	10,963
17	200,000	24	3.29%	15,226

Source: „MicroFins-DBS“,

http://www.microfinsdbs.co.rs/index.php?option=com_content&view=article&id=6&Itemid=12&lang=sr

Interest rate of the micro credit program „Micro Development Ltd“ is not shown in this presentation, because it depends on the commercial banks that will pay off the loan. Micro development Ltd in its assortment offers financial and non-financial services, in order to support entrepreneurs. This support is presented in Table 12. Non- financial services are some kind of advices and are related to the development of knowledge and skills through certifications, creation of business plan development, market researches, marketing advices etc.

Table 12: Summary of microcredit products „Micro Development Ltd“ in 2014

Loans product	Amount of credit - RSD	Repayment period -month	Loan purpose	Users
Micro Clasic	20,000-500,000	6-36 month	<ul style="list-style-type: none"> • basic or capital funds for small business activities • for other household needs (scholarship, heating, health etc) 	beginners in business, employees who are engaged in complementary activities, farmers-entrepreneurs
Micro Entrepreneurs	20,000-500,000	6-36 month	<ul style="list-style-type: none"> • purchase of fix assets, raw materials or • capital funds for business activities 	entrepreneurs who have registered business for longer than three months, registered farms

Source: „Micro development“ Ltd, <http://www.mikrorazvoj.rs/kreditni-program>

Agroinvest Holding gives recommendations to partner bank on behalf of the client with intend to get facilities in loan granting. Recommendations are mainly intended to promote small businesses in the areas of production, handicrafts, agriculture, trade and other. Loans are paid in Serbia's dinars, not indexed. The maximum amount of credit is 400,000 thousand. The maximum amount of 400,000 RSD can be granted in the case where a customer takes a credit in several business cycles. The collaterals are required, regardless of the amount of credit. Include notes signed by the guarantor, the administrative orders on salaries and pensions, banking accounts, pledge on movable property - or on agricultural machinery etc.

Table 13: Summary of microcredit products Agroinvest Holding in 2014

Loans product	Amount - RSD	Repayment period - month	Loan purpose	Users	Interest rate
Agro Credit	50,000-200,000	6-24 month	<ul style="list-style-type: none"> • Agricultural credit can be used to satisfy the needs of elementary and revolving funds, such as the enlargement of livestock, machinery, fruit and vegetable crops, greenhouses, irrigation systems, hail and other equipment. 	All farmers and agricultural registered or unregistered farms that have an established way of producing a minimum of one year in rural areas.	2.9956%
Business Credit	50,000-200,000	3-24 month	<ul style="list-style-type: none"> • Purchase of fixed assets and working capital in production, trade and services 	Small entrepreneurs who mostly live in rural areas and have a job with a potential for development and expansion activities that can provide additional revenue realization.	2.9956%
Start up Credit	50,000-200,000	3-24 month	Starting a family business in the country, with the idea of further growth and development of family farms	Clients with the idea for business in rural areas	2.9956%
Consumers Credit	50,000-120,000	6-18 month	<ul style="list-style-type: none"> • Agricultural credit can be used to satisfy the needs of elementary and revolving funds, such as the enlargement of livestock, machinery, fruit and vegetable crops, greenhouses, irrigation systems, hail and other equipment. 	All farmers and agricultural registered or unregistered farms that have an established way of producing a minimum of one year in rural areas.	2.9956%

Source: Agro Invest Holding, <http://www.agroinvest.rs/agroinvest/index.php/sr/nain-rada/nai-proizvodi-srbije>

Presentation of the microfinance institutions in Serbia and their product range enable to determine their general characteristics. They are summarized as follows (Eric D., et al., 2012, p. 140):

- Easy access to credit without administrative procedures and conditionalities,

- Loans are intended for entrepreneurs and micro-enterprises to start up a business and can be approved in very small amounts (not exceeding EUR 5,000),
- Microcredit institutions lend money to clients in Serbia's dinars, not indexed, with elimination of the currency risk for the client,
- Microcredit institutions are characterized with high rates in repayment of loans (over 95%). It is a result of strong relationships with clients, care and support to the development of their business activities,
- Microcredit organizations provide various types of assistance and support to their clients through education, training, making better communication and cooperation with them. This provides higher repayment rates in granted loans,
- Microcredit institutions show a high degree of social responsibility,
- Micro-lending is not regulated by law. Due to this fact microcredit institutions are forced to operate through commercial banks which charge high rates for their services. It directly affects the interest rate of micro-credits and increases the cost of borrowing.

Survival of microfinance institutions in Serbia, whose product range becomes richer, testifies to the fact that banking profits can be realized even in association with the high-risk groups of clients. If importance of MFIs can be recognized by the state, creation of an adequate legal framework will contribute to their development. An adequate legal framework will regulate micro finance activity and allow them to operate like others MFIs in Europe. Development of legal framework for MFIs will contribute to the development of entrepreneurship, SME sector and overall economic progress.

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