



British Embassy
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STUDY OF THE CHALLENGES THAT HINDER MSME DEVELOPMENT IN BOSNIA AND HERZEGOVINA

**Report for the British Council
and Swedish Institute**



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EXECUTIVE SUMMARY

Bosnia and Herzegovina (to be referred to as BiH from herein) is a country whose neighbours include, Croatia, Serbia and Montenegro. BiH is a region that traces permanent human settlement back to the Neolithic age. Culturally, politically and socially, the country has a rich history. Today, BiH maintains high literacy, life expectancy and education levels. It is also one of the most frequently visited countries in the Western Balkans. The country was hit hard by the 2009 global economic crisis. The subsequent fall in Gross Domestic Product (GDP) and a budget deficit resulted in the need for a Stand-By Arrangement (SBA) with the International Monetary Fund (IMF). A second loan was agreed in April 2016. It continues to suffer from a weak fiscal position and large current account deficit, which threatens the government's fiscal sustainability. Three key reasons for the economic imbalance are:

- **A large public sector and limited private wealth creation.**
- **An economy based on consumption rather than production.**
- **An under-performing export sector.**

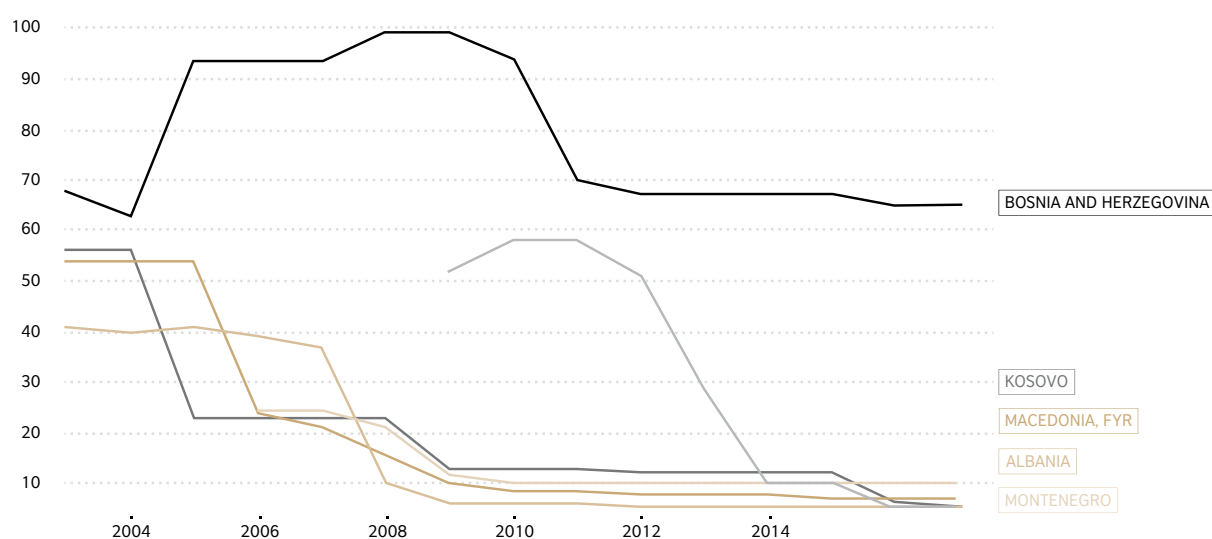
Unemployment in BiH is high, at 25.4% of the working population (2016). This is, however, declining from 27.5% in 2014. It has made sizable progress since 2000 and the end of the Balkan Wars, but would still greatly benefit from raising its rate of economic growth. It is administratively divided into 2 entities. There is the Federation of Bosnia and Herzegovina and Republika Srpska and one self-governing unit, Brcko District. There is limited economic integration between the 2 entities. Despite this, BiH had a GDP of US\$ 18.9 billion in 2016 (constant 2010 value), up from US\$ 17 billion in 2010. It is the second biggest economy in the Western Balkans, behind Serbia.

Increased economic growth needs to be achieved against a background of modest inflows of foreign direct investment. However, total inflows of foreign investment were, in 2016, the second highest value in the region, behind Serbia.

We undertook a survey of aspiring entrepreneurs across BiH. The sample was largely self-selected based on previous telephone surveys where respondents had expressed an interest in entrepreneurship, plus a review of the commercial register and referrals from respondents. The age distribution of aspiring entrepreneurs was under-represented in younger age groups but higher in the 25–34 year old group compared with the population.

Entrepreneurship aspirations are positive. There are problems with structural issues such as ease of forming a company, although important regulatory simplifications (for example in property registration) are still needed. Establishing a business in BiH can be a time-consuming process. According to the World Bank (2018), registering a business can take around 65 days to complete (See **Chart 1** below). Given the complex administrative set-up, it is not surprising the legal and regulatory framework of BiH reflects this situation.

Chart 1. Time required to start a business, male (days)



Source: World Bank (2018)

Results from our survey, indicate five key issues stand out:

1. Access to finance is very challenging and acts as a significant barrier to both innovation and entrepreneurship. There is a particular need for access to affordable seed capital. This is a similar to the challenge being addressed by some of the rural micro-finance programs in Asia.
2. Connection to markets outside BiH and the Western Balkans region is challenging for new entrepreneurs.
3. There is a considerable amount of energy and effort already being injected, but significant scope for improving the skills of entrepreneurial teams.
4. The trading channels and payment methods accepted suggest our entrepreneurs are using basic business models, almost entirely face-to-face and strongly cash-based.
5. Three quarters of all businesses in the survey supplied larger organisations, which may be accounted by the very large public-sector base.

Following President Juncker's 2017 State of the Union address, the European Commission created a set of flagship initiatives and support (the Western Balkans Strategy) targeting specific areas of interest for both the EU and the Western Balkans countries, which were launched in Pristina, Kosovo on Wednesday 28 February. President Juncker met with members of the Presidency of Bosnia and Herzegovina and addressed the Joint Session of the House of Representatives and House of Peoples of the Parliamentary Assembly of Bosnia and Herzegovina.

POLITICAL AND GEOGRAPHICAL BACKGROUND

BiH declared independence from Yugoslavia in 1992 and was admitted as a member of the United Nations the same year. This declaration was the catalyst for the Balkans conflict, a war which lasted until 1995.

During this war, there was considerable ethnic-religious conflict in BiH. The Dayton Peace Agreement had the immediate impact of bringing the inter-ethnic strife to an end. BiH was confirmed as a sovereign state in 1992 (Laurinet, 2011).

BiH is bordered by Croatia to the north and west, Serbia to the east and Montenegro to the southeast. It has 20 kilometres of coastline, and a population of 3,531,159. Its capital is Sarajevo. Its currency is the Bosnian Mark, and in February 2018, the USD: Bosnian Mark conversion rate was 1:1.58.

Bosnian politics in the past two decades has been dominated by the need to adhere to the Dayton Peace Agreement. The highest political authority in the country is the High Representative, who is able to bypass the elected parliamentary assembly and remove officials from office. The Coalition Government is stable, with the last general elections held in 2014 and the Party of Democratic Action governing with a parliamentary majority ever since. The central government's power is limited because the country is largely decentralized and consists of two autonomous entities: the Federation of Bosnia and Herzegovina (Bosniaks and Croats) and Republika Srpska (Serbian). There is limited policy cohesion between these jurisdictions.

On the global stage, BiH is towards the bottom of the various country ranking indices. The Democracy Ranking Association¹ placed it 86th out of 129 countries measured in 2016, and in the lowest 10 improved countries over five years. The Freedom in the World Index gave BiH a 2016 rating of 55 out of 100, defined as a partly free country. Ratings have declined because of (among other things) the country's failure to comply with Constitutional Court decisions, including one prohibiting a referendum in the Republika Srpska, and the high level of corruption in the country. The Economist Intelligence Unit's 2017 Democracy Index rated BiH as a hybrid regime and ranked it as the least democratic of the Western Balkan states, particularly in relation to functioning of government, political culture and freedom of speech (Economist Intelligence Unit, 2017).

BiH's Heritage Foundation ranking (91st globally) also underlines the issues facing the country: the highly decentralized government hampers policy coordination and reform, and excessive bureaucracy, weak rule of law, and market segmentation discourage foreign investment. Public perceptions of government corruption and misuse of taxpayer money motivate many to remain in the large informal economy (Heritage Foundation, 2017).

A Stabilization and Association Agreement with the European Union took effect in 2015 and in 2016, BiH formally applied to join the EU. Since then, it has worked with EU agencies on a detailed reform agenda, within a framework of a number of policies and initiatives launched by the EU to bring the Western Balkans in line with its standards of entry. BiH currently falls very short of these criteria and has not yet reached the standards of candidate status, let alone entry.

In 2016, the EU Commission identified several systemic and structural weaknesses in the Bosnian system that have held back the country's development. It outlined the main criteria that BiH needs to improve or comply with more effectively to reach candidate status standards. These include strengthening the rule of law, public administration and co-operation at all levels of government.

¹ The Democracy Ranking Association is an independent organisation based in Austria, which publishes an annual global ranking of democracies, based on the quality of democracy and other characteristics of the political system as well as performance of non-political dimensions (gender, economy, knowledge, health and environment).

ECONOMIC BACKGROUND

The Organisation for Economic Cooperation and Development (OECD) (SME Policy Index, 2016) noted that “Bosnia and Herzegovina is one of the most volatile economies in the region with an economic structure that remains exposed to external economic fluctuations. External competitiveness is a key issue for the Bosnian economy, with a wage-productivity gap that has widened over the past 15 years due to a steep increase in real wages, which does not reflect an equivalent increase in productivity”. It also has a disproportionately large public sector (725 individual entities), which is unwieldy, expensive to maintain and inhibits private sector growth and entrepreneurship. BiH has a weak fiscal position and large current account deficit, which threatens the government’s fiscal sustainability. There is systemic corruption at all levels (OECD, 2016).

Three key reasons for the economic imbalance have been identified (Goldstein, Davies, and Fengler, 2015):

1. **A large public sector and limited private wealth creation:** public expenditure amounts to nearly half of gross domestic product (GDP) and if state-owned enterprises and costs from corruption are added in, the public sector may be as large as 70% of GDP. The World Heritage Index noted in 2017 that public debt was equivalent to 44.4% of GDP.
2. **An economy based on consumption rather than production.** During the post-war economic recovery, BiH did not create new foundations for sustainable economic growth. Financial inflows and particularly aid and remittances—averaging around 20% of GDP—fueled consumption-based economic growth. As of 2015, consumption remained at over 100% of GDP.
3. **An under-performing export sector.** Exports are worth only 30% of GDP, one of the lowest in Europe and a sign of the country’s weak competitiveness. This stems from the poor business climate, high cost of employment and poor transport connections (World Bank, 2017). BiH is rated among the worst in Europe for all forms of transport by the World Economic Forum (Brookings, 2015).

Overall Economic Environment

BiH had a GDP of US\$ 18.9 billion in 2016 (constant 2010 value), up from US\$ 17 billion in 2010. It is the second biggest economy in the Western Balkans, behind Serbia. The economy is largely service-driven; the service sector accounts for around 40% of GDP. Trade contributes just 16% to GDP and manufacturing 13% (ILO, 2017; World Bank, 2017a). 2015 and 2016 saw very positive growth in GDP of 3.1% each year, giving BiH the second highest growth in the Western Balkans, behind Kosovo (World Bank, 2017a).

The most recent BiH Central Bank bulletin (Q2, 2017) did not give a very positive outlook, although GDP grew in Q1 2017:

“There was no significant increase in economic activity due to the relatively low infrastructure investments and slower implementation of structural reforms. The slowdown in the growth of industrial production on annual basis in the second quarter, compared to the previous quarter, suggests that no significant growth of economic activity can be expected in the second quarter.”

Table 1 shows the post-2008 GDP growth rate for BiH.

Table 1. GDP growth rate

2008	2009	2010	2011	2012	2013	2014	2015	2016
5.6	-3.0	0.9	1.0	-0.8	2.4	1.2	3.1	3.1

Source: World Bank (2017a)

Unemployment in BiH is very high, at 25.4% of the working population (ILO, 2017a; IMF, 2018). This is, however, declining from a peak of 27.5% in 2014. Only Kosovo has a higher unemployment rate in the region. The share of population in employment is the lowest in the region. 2015 estimates suggested

55.1% of males and 33.5% of females over 15 years old were in employment. Youth unemployment is almost 60% and there are significant gender inclusion gaps for both employment and starting a business. Educational levels are below EU standards and companies compete for qualified workers (EBRD, 2017).

There is a large informal sector within the country. Exact data for it are difficult to compile, for obvious reasons, but the International Monetary Fund (IMF) estimates that around 15% of the country's employment, or 10% of the workforce, is within the informal sector. The IMF also estimates that the informal economy will grow with economic growth (IMF, 2016).

Explanations for the size of the shadow economy typically point to the complex and penal tax structures: entrepreneurs face significant obstacles, exacerbated by complex legal and regulatory frameworks and government structures, and non-transparent business procedures. High tax rates on labour discourage the hiring of new workers and increase incentives for unregistered employment. Labour legislation makes it hard to dismiss workers (Heritage Democracy Index, 2018). A consumer study across the Western Balkans region, including BiH (Mastercard, 2017), found that consumer habits at point of sale can help to tackle an element of the shadow economy, through more formalised (and accountable) use of non-cash payments. It also found that there was a strong willingness to do so.

Table 2 shows that GDP per capita has slowly but consistently grown since 2008, although BiH remains the second least prosperous country in the Western Balkans, ahead only of Kosovo. The GDP per capita in BiH, when adjusted by purchasing power parity, is equivalent to 63% of the world's average.

Table 2. Purchasing power adjusted constant US\$ per capita income

2008	2009	2010	2011	2012	2013	2014	2015	2016	9 Yr Growth	4 Yr Growth
9,006	9,014	9,324	9,902	10,182	10,836	11,234	11,713	12,330	36.9%	13.8%

Source: World Bank (2017b)

Compared to its regional neighbours, BiH has a diverse export sector, but raw materials and lower value-added products make up the largest share. Exports of goods and services have increased a little, from 32.8% of GDP in 2012 to 34.3% in 2014 (IMF, 2017a). The total value of exports has also increased slightly over recent years, with total exports now standing at US\$ 5,372 million, a 12% increase from 2010 levels. Exports are primarily manufactured goods (65%), agricultural products (16%), fuels (16%) and other mining products. In total, 71% of total exports go to the European Union, rather than other parts of the Western Balkans. Serbia is BiH's main regional trading partner, receiving 9% of exports (IMF, 2017a). Imports are greater than exports, totalling US\$ 9,130 million in 2016. Overall, BiH has a trade deficit (see **Table 3**), but this is starting to narrow.

Table 3. Percentage surplus or deficit on balance of payments

2008	2009	2010	2011	2012	2013	2014	2015	2016
-14.1	-6.4	-6.1	-9.5	-8.7	-5.3	-7.4	-5.5	-4.5

Source: IMF (2017)

Total inflows of foreign investment into BiH were US\$ 5,327 million in 2016, the second highest value in the region, behind Serbia. BiH's key investors are its near neighbours: Croatia (US\$ 1,215 million), Austria (US\$ 1,067 million), Serbia (US\$ 823 million), Russia (US\$ 615 million) and Slovenia (US\$ 543 million) (IMF, 2017b). Unsurprisingly, there has been very little investment outflow. In 2016, BiH invested a total of US\$ 403 million externally, with key recipients being Germany (US\$ 126 million), Croatia (US\$ 95 million), and Montenegro (US\$ 42 million) (IMF, 2017b). **Table 4** shows the flows, which have gradually reduced from a peak in 2013 to US\$ 5.3 billion in 2016.

Table 4. Foreign direct investment in BiH (US\$ billion current prices)

2009	2010	2011	2012	2013	2014	2015	2016
4.6	4.6	4.9	5.0	6.7	5.3	5.1	5.3

Note: figures are based on outward reporting from counterpart economies.
Source: IMF (2017)

Consumption has risen extremely slowly but consistently since 2014. Before that, it was somewhat static (**Table 5**).

Table 5. Final consumption expenditure in BiH (constant US\$ billions 2010)

2009	2010	2011	2012	2013	2014	2015	2016
17.8	18.1	17.9	17.7	17.7	18.1	18.2	18.4

Source: World Bank (2017b)

Gross domestic capital formation in 2016 was US\$ 3.98 billion (at 2010 value) and has shown signs of consistent growth for the past three years. It has grown by 42% since 2010. BiH is the third highest in the Western Balkans for capital formation, behind Serbia and Albania.

Table 6. Gross capital formation (constant 2010 US\$ billions)

2008	2009	2010	2011	2012	2013	2014	2015	2016
4,638	3,324	2,806	3,201	3,329	3,229	3,493	3,595	3,984

Source: World Bank (2017a)

Role of Small and Medium-Sized Enterprises (SMEs)

There are 33,383 SMEs in BiH. In a market where larger enterprises are suffering stagnation and decline, the SME sector is driving growth. SMEs generated more turnover per employee than larger enterprises, but still provided less value added per employee (EIB, 2016).

Overall, BiH has seen a slight increase in the number of SMEs across the last six years and the OECD's SME Policy Index (2016) suggests that the total number of SMEs increased slightly from 20,196 in 2010 to 23,381 in 2013. These figures need to be viewed with caution, because they are not fully consistent with the latest official statistics shown in Table 7. If both sets of figures are correct, there has been a massive increase in business numbers over the past three years, which seems unlikely.

The services sector predominates in BiH, accounting for 46.2% of all enterprises. Other sectors are trade (30.5% of all enterprises), manufacturing (13.5%), construction (6.1%), agriculture (2.4%), and mining and electricity generation (1.2%) (EIB, 2016). BiH has seen little improvement in its competitiveness over recent years, slipping down from 82nd in 2007 to 103rd in the most recent Global Competitiveness Index (WEF, 2017).

The OECD (SME Policy Index 2016) identified a number of barriers to SME growth and development, particularly top-heavy bureaucracy, regulation, limited online delivery channels (e.g. online tax and VAT submission) and little cohesion or consistency between legislative districts within the country. This makes the application and delivery of operating licences and registration fragmented and complex (OECD, 2016).

Start-up processes are also cumbersome and costly. According to the World Bank (2017c), starting a business in BiH requires 12 procedures, takes up to 68 days, costs 14.8% of income per capita and requires a paid-in minimum capital of 28.0% of income per capita, well above the average for the Western Balkans and Turkey. The total cost of business registration is about EUR 500.

Table 7 shows the business structure for companies by the number of people they employ. Excluding public sector administration, 31% of all businesses can be classified as opportunity-focused (professional, technical or advice services, or requiring high capital investment), and 69% are household-focused (defined as low investment retail, trade or production aimed at households). In total, 74% of all businesses are micro-businesses, with one to nine employees. This table does not include approximately 150,000 self-employed individuals, who are excluded from official statistics. Country national statistical sources vary, because some countries include self-employed within their definition of SMEs. There is no official national definition for SMEs within BiH.

Table 7. SME structure: number of employees by business activity

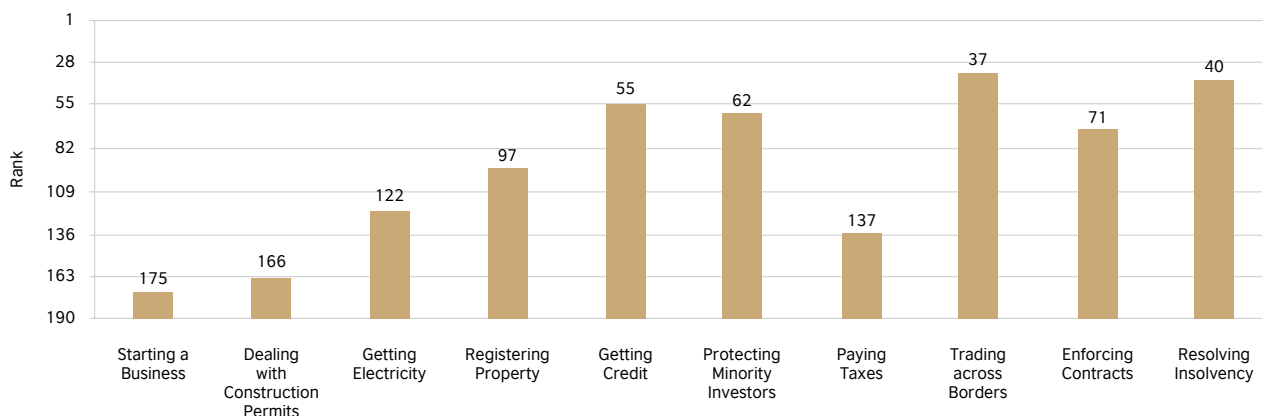
		Number of employees					
		Total	1 to 9	10 to 19	20 to 49	50 to 249	250 +
Total no. of enterprises		33,718	25,003	3,368	2,844	2,113	335
Opportunity-Focused	Manufacturing	4,606	2,841	660	542	461	98
	Financial and insurance activities	216	127	14	16	36	23
	Information and communication	1,046	809	114	72	43	7
	Professional, scientific, technical	2,478	211	107	38	2	4
	Arts, entertainment, recreation	1,391	1,241	61	53	29	7
	Real estate activities	847	789	31	17	9	1
	Electricity, gas, steam and air con	181	139	5	12	8	16
	Water supply, sewerage, waste management, remediation activities	361	154	52	82	68	4
	<i>Total opportunity-focused</i>	<i>10,184</i>	<i>6311</i>	<i>1044</i>	<i>832</i>	<i>656</i>	<i>167</i>
Household-Focused	Construction	2,032	1,352	278	247	143	9
	Wholesale and retail trade, repair of motor vehicles	9,797	7,908	987	570	269	41
	Transportation and Storage	1,928	1,464	262	129	57	10
	Accommodation, food services	835	603	107	90	33	2
	Education	1,474	395	109	482	481	6
	Human health and social work	1,048	669	128	77	136	36
	Administrative and support services	839	664	72	56	37	7
	Agriculture, forestry, fishing	179	112	18	24	14	11
	Other service activities	2,519	2,437	46	28	8	0
	<i>Total household-focused</i>	<i>20651</i>	<i>15,604</i>	<i>2,0071</i>	<i>1,703</i>	<i>1,178</i>	<i>122</i>
Public administration and defence		725	138	114	196	227	48

Source: Authors own analysis on World Bank (2017d)

Ease of Doing Business

The latest 'Doing Business' report (World Bank, 2018) shows that BiH has dropped five places since 2017 and is now ranked 86th globally. A number of metrics are used to generate these rankings, including starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. BiH's rankings for each of these is shown in **Chart 2**.

Chart 2. Ease of doing business in BiH



Source: World Bank (2018)

BiH scores less well against the metrics used to gauge 'ease of starting a business', and is ranked 175th globally, against its previous position of 174th (World Bank, 2018). This drop followed two years of rises in ease of doing business. From 2007–2015, however, BiH's ranking had fallen from 95th to 107th place (World Bank, 2018). The improvements were a result of reforms that have made doing business easier, including the reduction of paid-in minimum capital requirements for Limited Liability companies, increased efficiency of the notary system and abolition of tourism community fees (World Bank, 2018).

There are initiatives to set up business clusters or technology parks in BiH, supported by international funding, and motivated by the well-documented belief that these are the most effective environment for growth, innovation and competitive capacity. As far back as 2012, three innovation centres were mooted (primarily science-based, as part of the FP7, COST and EUREKA programmes funded by the EU) in Banja Luka, Zenica and Mostar. Website searches suggest that these are no longer operational.

A number of business incubators have been established within BiH and more are planned. One of the biggest incubators is NBR: Nezavisni Biro za Razvoj (Independent Office for Development). It is a registered non-governmental organization, established in 1998 and based in Modriča, and participates actively in the national Incubators Network. It is currently implementing two EU-funded cross-border cooperation projects to improve entrepreneurial infrastructure in the region. Its objectives are to provide work spaces and business support services and liaise between businesses and local communities (www.nbrudruzenje.org).

Other incubators have been established regionally, in Trebinje, Sarajevo, and "Lipnica" Tuzla. Another significant player is Adria Incubator, an IPA European project offering an online platform for SMEs in the Adriatic area including BiH. It aims to encourage competitiveness and innovation in businesses in the tourism and agri-food sectors. It promotes awareness of the various credit lines and facilities available to businesses (www.adriaincubator.eu). In March 2017, a regional collaboration was also announced under the the Regional Cooperation Council (RCC), to establish the Western Balkans Research and Innovation Centre (WISE), covering Albania, BiH, Croatia, Montenegro, Serbia, Kosovo and Macedonia.

EDUCATIONAL SYSTEM

BiH suffers from a skills shortage. In 2009, a World Bank study found that one third of managers of exporting companies cited skills shortages as a problem in doing business. Despite the high unemployment rate, firms claimed that finding qualified employees was a key problem (World Bank, 2009). There is also evidence of a “brain drain” to more developed countries, highlighting a disconnect between the education system and commercial pre-requisites, and a lack of incentive for young people to stay and work in BiH:

“Bosnia’s biggest challenge is in terms of human resources. First, the educational system must provide young people with stronger skills in fields that tend to be associated with innovation such as engineering and computer science. Second, young people with relevant skills must be persuaded to stay in Bosnia rather than go abroad. The continuation of ongoing reforms related to the business environment will be helpful in this regard as would a reduction in political tensions. The emergence of a venture capital finance industry would also encourage potential entrepreneurs, armed with the knowledge that there are funding options available, to start companies.” (EIB, 2016)

There is little current infrastructure to support adult education in BiH, with the process currently not separate from standard secondary education. The European Training Foundation (2016) outlined the issue as:

“Vocational secondary schools continue to carry the main responsibility for adult education. Issues such as the accreditation of institutions engaged in the training and education of adults and their certification remain key problems for entities offering training such as NGOs, regional development agencies and private training providers. Vocational schools organise training for adults mostly in the form of formal education programmes for those who did not finish regular school and who want to increase their employment opportunities by acquiring qualifications and certificates. Training for adults takes place on the basis of the same curricula and methodology used in regular education in vocational schools. Hence, adult education does exist but it is not viewed as a separate education element within the institutions.”

INTERNATIONAL ACTORS AND SUPPORT

The key external actors include:

The European Union: through accession preparations.

The World Bank: through dedicated projects. It has provided funding to the government of BiH, as well as supporting a number of policies and projects in the country. In 2017 alone, the World Bank approved six policies to begin in BiH, ranging from infrastructure investment to strengthening both the banking sector and employment among certain groups. The last project that specifically targeted SMEs was in 2009, and aimed to improve SME access to finance.

The European Bank for Reconstruction and Development (EBRD) has been responsible for a number of funding programmes to support SME growth, including the SME Competitiveness Support Facility (EBRD, 2015), by providing support for local lenders. To date, the EBRD has started 144 projects in BiH, with € 2,028 million invested there since 1996. The current portfolio covers € 970 million, 75% of which is in infrastructure.

EBRD's Country Strategy 2017–2022 identified the key priority areas to address the challenges facing BiH, and promote growth. It will provide funding at project levels to:

- Enable capacity-building and scaling-up of the private sector, while promoting commercialisation of public utilities and supporting privatisation of viable state-owned enterprises to enhance competitiveness;
- Support development of key transport and energy cross-border links with a view to promoting regional integration and enhancing resilience of the economy; and
- Support energy efficiency and renewable energy generation, helping municipalities to upgrade quality of services and promote a green economy.

The IMF, which signed a funding agreement of € 553.3 million in 2016. Until then, the IMF had not been very involved in BiH. Delegates undertook a mission to BiH in December 2017, where an agreement was formed for the IMF to complete a review of the country's performance. Following the review, the IMF plans to invest a further € 76 million in BiH from 2018, mainly in infrastructure projects.

CURRENT GOVERNMENT POLICIES ON ENTREPRENEURSHIP

There is no clear government strategy infrastructure in place that sets out a clear set of objectives and actions on entrepreneurship. For a period, BiH was the only country in the Western Balkans without a dedicated agency in charge of SME policy. This has been addressed with the installation of the Federal Ministry for the Development of Entrepreneurship and Crafts, an indication that the Government is becoming more engaged with the need to support SME entrepreneurs and deliver the policy and incentivisation that has been lacking to date (OECD, 2016).

The stated mission of the Ministry (Federal Ministry for the Development of Entrepreneurship and Crafts, 2018) is:

“Monitoring the implementation of the law and the legislation regulating the conditions and the way of doing business of small business enterprises, monitoring the situation in the field of entrepreneurship and proposing, coordinating and implementing measures and activities for systematic development of entrepreneurship through promotion, training, information, professional assistance, formation of incentives, building of institutional support, encouragement of innovators and harmonisation of legal regulations”

Despite this, there has been little real progress in the provision of support services to SMEs, and no adequate government strategies. Most information on investments and starting a business is provided by donor bodies. SME portals exist, but contain limited information (OECD, 2016). Examples of intended strategies that have not effectively materialised include an emergent science strategy. The *Strategy on Scientific and Technological Development of the Republika Srpska* and its action plan (2012–16) stressed the need to align strategic and legal regulations with the European standards in science and innovation. It was re-drafted in 2015, for the period 2012–22, but did not present any concrete proposals for support measures. Only 0.22% of national GDP was spent on research and development in 2016 in BiH, a decrease on the amount spent in 2012 (OECD, 2016).

Similarly, an export growth strategy for the period 2012-15 was drafted, but never put in place. The Foreign Trade Chamber of BiH (<http://komorabih.ba/en/>) is a trade body and does not develop anything in the way of policy. It is also seen as less effective than it could be, with insufficient budget and resources to truly act as an export promotion agency (OECD, 2016).

A key, authoritative current strategy document, Bosnia and Herzegovina Country Strategy 2017–2022 (EBRD, 2016) set out a series of priorities and desired outcomes. As the country’s major financial stakeholder, the EBRD will expect the government to deliver these within the support frameworks, intentions and initiatives that have been established, including:

- The New Reform agenda, designed to bring about change, with additional leverage from re-engagement with the EU;
- Support already provided by the EBRD to high-performing SMEs to improve capabilities and scale up;
- Support from reform-minded municipal government champions;
- Re-energising the privatisation process;
- The regional transport connectivity agenda, Berlin process;
- Support from government to improve regional links (including a motorway corridor to EU markets);
- Third Energy Package;
- Establishment of the World Bank Coordination Auction office;
- Energy directives from the EU; and
- Regional renewable energy/energy efficiency initiatives.

The EBRD’s desired outcomes for BiH for 2022 are:

- Capabilities
 - Robust and capable SME/corporate sector (including companies led by women);
 - Improved skills and quality standards for SMEs;
 - Improved investment climate;
 - Decreased state ownership; and
 - Commercialised and efficient municipal services.

- Transport
 - Improved quality/availability and equal access to transport infrastructure;
 - Improved regional connectivity of energy infrastructure; and
 - Improved climate resilience of transport infrastructure.
- Energy:
 - Improved power generation from renewable sources;
 - Increased energy efficiency in the residential and public sector;
 - Improved water efficiency and waste water treatment;
 - Reduced air pollution; and
 - Improved road safety.

The adoption of the 2018–2020 Economic Reform Programme for BiH in January 2018 is an important government commitment to these outcomes. It includes a medium-term macroeconomic and fiscal framework, with fiscal measures, and a comprehensive structural reform program to improve the country's growth and competitiveness (EBRD, 2018).

Government incentives to encourage entrepreneurship

A number of incentives exist, or have been offered in the past to support business start-ups (Government of Bosnia and Herzegovina, 2017). They include:

- Tax subsidies for training, retraining and the recruitment of employees with high school or college diplomas;
- Small loans and grants available to start-up companies in a range of different industries, with specific eligibility criteria, especially agricultural and craft-related enterprises;
- Specialised “free zones” where companies can import goods without paying VAT; and
- Low (10%) corporate tax rate.

BANKING SYSTEM AND ACCESS TO FINANCE

A large number of financial institutions operate in BiH relative to its small size. Most of these, however, are foreign-owned, which is likely to account for the stability of the financial infrastructure. **Table 8** shows the number of financial institutions operating there.

Table 8. Financial institutions in BiH

	2013	2014	Q3 2015
Banks	27	27	27
Leasing companies	8	7	8
Micro-credit organisations	19	19	19
Stock markets	2	2	2

Source: EIB, (2017); Central Bank of Bosnia and Herzegovina, (2018); interviews with local experts

All banks work with SMEs to some degree, though some tend to focus on the larger end of the market. Until recently, there has been little legislative encouragement for venture capital/private equity investment in the country. Opinions vary on the banking system's ability to provide sufficient credit to the SME sector. The EIB (2016) estimated that the total supply of loans available to SMEs matches demand (and was growing in line with economic growth) and that the rejection rate for loan application was low (3.8%). However, it acknowledged there were funding gaps in some areas, particularly for start-ups and 'informal' businesses.

Lenders face difficulties with asymmetric information, where they do not have enough information or knowledge to evaluate a company (Steglitz and Weiss, 1981). This can create particular difficulties for young companies, because they face restrictive entry qualifications for formal funding of any nature. These include minimum length of trading restrictions that make it impossible for a start-up to get credit, very low risk profile, high collateral requirements and very small loan values on offer (EIB, 2016).

The lack of accessible alternatives, and poor awareness of options available, mean that bank financing is the primary source of capital for SMEs. An above-average number of companies access bank finance compared to other countries in south-eastern Europe. According to one survey (EBRD, 2014b), 66.3% of companies have an outstanding loan/credit line, compared to a regional average of 49% (OECD, 2016). **Table 9** summarises the constraints faced by firms.

Funding for companies under 2 years old is especially challenging, because banks like to build a lending track record before opening lending flows. In many cases, lending requires collateral, and this is normally around 200% of the value of the loan. A further problem relates to the relatively high interest rates charged to SMEs (Moder and Bonifai, 2017). Estimating the funding gap for companies over the first two years of life is difficult. Using some "rules of thumb", we estimate that there is an annual funding need of between EUR 40 million and 50 million in BiH.

Table 9. Funding constraints in BiH

	Firms Facing Finance Constraint	Loan Rejected	Too Complex	Interest Rate	Collateral Needs	Poor Loan Terms (Amount / Time)	Expect No For Answer	Collateral Greater Than
Bosnia Herzegovina	35%	13,8%	20,7%	55,2%	5,2%	1,7%	3,4%	200%

Source: Moder and Bonifai (2017)

For many businesses, where there is neither available collateral nor the attraction of being in a high technology sector, it is likely to be challenging to bridge this gap from conventional lenders without the support of state guarantee programs. The EU COSME program guarantees play an essential role in helping free lending flows. The Q2 Central Bank Bulletin showed that there is a trend towards credit growth in the retail and SME sector, although this should be viewed within a context of an increase in non-performing loans in 2017.

Alternative Finance Sources

Alternative sources of funding are available to SMEs, although these are neither well-known nor sufficiently well-resourced to make an impact. They include:

Western Balkans Enterprise Development and Innovation Facility, an EU-funded initiative headed by the European Investment Fund, which aims to increase the finance available to SMEs. It has four main pillars (one of which provides technical rather than financial support):

- **WB EDIF Guarantee Facility (WB EDIF GF):** providing guarantees to financial intermediaries operating in Western Balkan countries, to encourage them to increase their lending to SMEs.
- **Enterprise Innovation Fund:** supporting new or expanding innovative SMEs in the Western Balkans, by providing equity finance through local fund management companies. A full list of the intermediaries supported by the EIF is available from http://www.eif.org/what_we_do/where/ba/index.htm.
- **Enterprise Expansion Fund:** supporting the expansion of SMEs with high growth potential in the Western Balkans.
- **Support Services Facility:** technical (non-financial) assistance to Western Balkan governments to implement policy reforms that support innovative and high growth SMEs.

Business Angels Networks: as yet, there are few angel investor networks operating within BiH. Private investment in SMEs is primarily from outside organisations. There may be private investors in the country, but no active groups from which SMEs could seek funding (EIB, 2016).

Leasing is little used in BiH, and awareness is very low; penetration is 1.7% of GDP (EIB, 2016).

Small Enterprise Assistance Funds: The government offers a number of grants to SMEs engaged in technological industries, but these are few in number and value. SMEs are not generally able to rely on assistance from government funds (EIB, 2016).

Venture capital is not particularly well supported at government level, and has low awareness among SMEs. It is perceived to be an under-utilised form of funding, but is likely to grow. The main international venture capital fund active in BiH is the Enterprise Innovation Fund (<http://www.wbedif.eu/about-wb-edif/enterprise-innovation-fund-enif/>), which aims to support innovative SMEs.

The stock exchanges, Sarajevo Stock Exchange and Banja Luka Stock Exchange, are not relevant or effective sources of funding for SMEs (EIB, 2016).

LOCAL SUPPORT ORGANISATIONS

European Bank for Reconstruction and Development

<http://www.ebrd.com/work-with-us/advice-for-small-businesses/bosnia-and-herzegovina.html>

The EBRD works through partners when dealing with smaller companies, and provides a network of consultants and advisers who can be accessed on a co-payment basis.

Balkan Environmental Association

<http://benaweb.gr/>

The Balkan Environmental Association is a think-tank that advises on ways to improve the environment of the Western Balkans. It works with SMEs by, for example, hosting conferences to help them develop in a more sustainable way.

European Training Foundation

<http://www.etf.europa.eu>

The European Training Foundation (ETF), based in Turin, is an established European Union agency that focuses on enabling vocational training for both entrepreneurs and workers in developing countries. It provides online resources and runs workshops across several countries, and has been operational since 1994.

Enterprise Europe Network

<http://een.ec.europa.eu/about/branches/bosnia>

The Enterprise Europe Network is a co-operative of business centres and foundations supported by the EC to disseminate relevant information to SMEs. It has many partners across BiH, making it an accessible way to help SMEs with advice, support and opportunities for international partnerships.

Balkan Small Business Association

<http://www.mbb-org.eu/en/>

Based in Bulgaria, the Balkan BSA works regionally, primarily with small businesses that have a craft focus, to provide training and business support. It publishes studies showing how businesses can promote themselves.

Chamber of Economy of the Federation of Bosnia and Herzegovina

<http://www.kfbih.com/eng>

The Chamber is a business and professional association which organises a number of conferences, exhibitions and presentations to enrich, support and represent the interests of its entrepreneur members. It also provides a networking platform for members and partnerships for new start-ups.

SECO Entrepreneurship Program

<http://bit.ly/2CNGbTV>

The Entrepreneurship Program aims at strengthening the entrepreneurship ecosystem in six targeted countries. The program works with relevant ecosystem organizations and supports them in improving their business model and acceleration programs and thus their performance.

Help

<https://www.help-ev.de/en/country/bosnia-herzegovina/#c579>

Help initially began work in BiH to provide relief for war-stricken areas, but has now expanded this remit to include trying to build general prosperity with a focus on refugees and minority groups. It provides both financial support and business training for small businesses.

Peer-to-Peer Networks

Peer-to-peer networks are essentially online and newer. It is likely that more will spring up in the near future, but two key networks are:

- **Start Us Magazine** <https://magazine.startus.cc>
Start Us is a magazine and online hub that aims to connect entrepreneurs across Europe. The magazine will often feature articles on issues affecting BiH and allows SME owners and employees to connect with each other. The website also contains a job board.
- **Networks** <http://networks.ba/v2/>
Networks is a business networking site in the centre of Sarajevo. It offers a space where entrepreneurs can meet, or use office space and also holds training events and provides business support.

SURVEY RESULTS: THE ENTREPRENEUR PERSPECTIVE

Introduction

A programme of primary research, with telephone interviews among potential/new business start-ups was undertaken specifically for this project across the six Western Balkans states, to provide a regional overview of entrepreneurial activity and explore individual experiences of and attitudes to setting up and running a business. The programme allows us to look individually at each market, and also compare the experiences and attitudes of entrepreneurs in BiH to those of their peers across the region. As part of this programme, 100 interviews were carried out in BiH between mid-December 2017 and early January 2018.

Profile of respondents

For the purposes of this report, we refer to the respondents as entrepreneurs. It is, however, pertinent to appreciate how they actually see themselves, as this may be an indicator of their potential growth and future success:

- 39% described themselves as entrepreneurs;
- 61% described themselves as self-employed;
- Nobody described themselves as businesspeople.

Table 10 shows the age band and levels of education, by self-description.

Table 10. Age band and level of education, by self-description

Q1: Which age band do you fall into?	Total	Entre-preneur	Self-employed
Sample size	100	39	61
Under 25	17%	21%	15%
25–34	41%	31%	48%
35–44	42%	49%	38%
Q2: What is the highest level of education you achieved?			
No higher education after school leaving age	68%	62%	72%
Technical qualification or higher	32%	38%	28%

Respondents were equally split between those intending to start a business in the next 12 months (50%) and those who had set up a business in the last two years (new start-ups). Of those who already ran their own businesses, 32% were employing two or more staff.

The survey focused on young entrepreneurs under the age of 45. Within the sample:

- 17% were under 25 years old;
- 41% were aged 25–34; and
- 42% were aged 35–44.

The highest level of education achieved, and self-description by age is shown in **Table 11**.

Table 11. Education level and self-description, by age group

Q2: What is the highest level of education you achieved?	Total	Under 25	25–34	35–44
Sample size	100	17	41	42
No higher education after school leaving age	68%	71%	59%	76%
Technical qualification or higher	32%	29%	41%	24%
Q10b: Would you describe yourself as:				
An entrepreneur	39%	47%	29%	45%
Self-employed	61%	53%	71%	55%

Respondents were fairly well e-connected and engaged with the world of business. On a daily basis, they stayed abreast of news/current affairs (Q25) via:

- online media using a desktop or laptop 27%
- online using a smart phone 43%
- printed media (publications/press) 17%

They also engaged with a range of current/topical affairs, for instance, news and events relating to their business sector (45%), the local economy (41%), national politics (42%) and foreign affairs (48%).

In total, 14% of new businesses were setting up or had set up in opportunity-focused sectors (defined as technical, professional and creative arenas or sectors requiring large capital investment), rather than household-focused businesses (directly servicing and selling to households, or producing goods which will be used by households) (**Table 12**).

Table 12. Percentage of businesses in each sector

Business activity	Total	
Sample size	100	
Opportunity focused	Professional, scientific and technical activities	6%
	Manufacturing	6%
	Information and communication	2%
Healthcare focused	Wholesale and retail trade; repair of motor vehicles and motorcycles	34%
	Agriculture, food production and trade	22%
	Agriculture, forestry and fishing	20%
	Education	5%
	Accommodation and food service activities	4%
	Other production/trade/construction/transport	4%
	Transportation and storage	2%
	Health care	2%
	Administrative and support service activities	1%
	Other service activities	20%

Business scope and operations

Respondents' businesses were largely focused on their local regions. Fewer than 10% were exporting or importing (**Table 13**).

Table 13. Field of operations of businesses surveyed

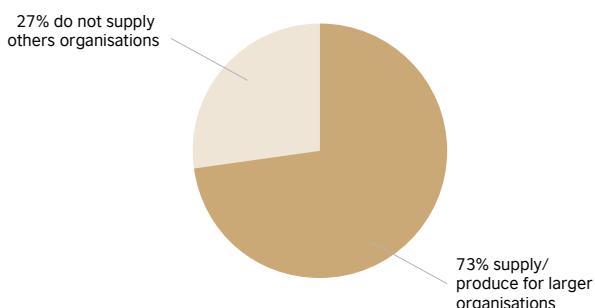
Q9: Do you (expect to)...	Total
Sample size	100
Operate only within BiH	88%
Q9c: Where do you operate within BiH? Sub-sample size	88
At a national level	16%
At a local level	84%
Export goods/services to other countries Sample sizes too small for meaningful breakdown of destinations	9%
Import goods/services from other countries Sample sizes too small for meaningful breakdown of destinations	4%

Working within a supply chain

Three quarters of all businesses in the survey supplied larger organisations (**Chart 3**).

Chart 3. Businesses as part of a supply chain

Q6: Does your business make products or supply services that will be used by other, larger, organisations?



The key industry sectors in which these businesses operate are shown in **Table 14**.

Table 14. Industry sectors in which businesses operate

Q6a: Which industry sectors does your [intended] business service or supply?	Top 5 sectors
Sample size	73
Food and beverage processing	23%
Vehicles	15%
Consumer goods	14%
Agriculture	11%
Perfumes/cosmetics	10%

Business trading models

The trading channels and payment methods accepted indicate that these entrepreneurs are using very simple and probably unsophisticated business models, almost entirely face-to-face and strongly cash-based (**Table 15**).

Table 15. Accepted forms of payment

Q7. Does (will) your business?	Total
Sample size	100
Have a digital (online) interface with customers	8%
Have a telephone-based interface with customers	6%
Serve your customers face-to-face/in person	99%
Q8: And do (will) you accept payments ...?	
Sample size	100
Online (via payment cards)	16%
Over the telephone (via payment cards/bank debits)	8%
Through automated bank credits/cheques	15%
In cash	99%

Motivations for setting up a business

A key motivation for setting up a business among our entrepreneurs was the need to earn a living, often to offset unemployment, particularly for those who described themselves as self-employed.

Those who saw themselves as entrepreneurs were more likely to have longer term financial goals, although age and lifestage were also likely to affect their objectives. Entrepreneurs were on average, a few years older than the self-employed respondents (**Table 16**).

Table 16. Motivation for setting up a business

Q10a: What are your key motivations for setting up your own business?	Total	Self-description	
		Entrepreneur	Self employed
Sample size	100	39	61
Opportunity to make money	56%	64%	51%
Offset unemployment	47%	41%	51%
To build financial independence	42%	51%	36%
Utilising skill sets	42%	54%	34%
Providing long term financial security for family	29%	46%	18%
Natural progression	18%	31%	10%

41% had started up a business in an area that was familiar to them, or within their skill sets. A further one in three were influenced by their family in their choice of business. Not many had chosen their business as a result of the availability of incentives (**Table 17**).

Table 17. Reasons for choice of business sector or type

Q5b: Why have you chosen to start a business in this specific activity?	Total
Sample size	100
It is my profession/skill set	41%
Encouraged by family/the experience of others	35%
It is easy to set up a business doing this	30%
It is cheap/low cost to set up a business doing this	15%
I am seizing a good opportunity	13%
Continuing/extending a family business	12%
There are incentives available to set up a business doing this	8%

Perceptions of the business climate and business confidence

The process of actually setting up a business had usually been quite swift: 78% had taken less than six months to register their business and obtain any necessary licenses. However, respondents felt that the current (domestic) business climate was somewhat challenging (**Chart 4**).

Chart 4. Perception of the business climate

Q11a. From your position, how would you describe the business climate in this country? (5 point scale)



Entrepreneurs perceived that particular challenges were making the climate unfavourable for businesses, including:

- Low standard of living and consumer spending power 48%
- No state assistance/incentives/guarantees 33%
- Competition (from larger organisations) 22%
- Taxes 15%
- Administration, bureaucracy 7%

(Q11b: in what way is the business climate unfavourable for businesses? Sample size 46)

This was linked to their perceptions of the barriers to business growth, which relate to market/economic pressures (competition, consumer spending) and the administrative and financial cost of doing business (**Table 18**).

Table 18. Perceived barriers to doing business

Q12. What do you perceive is the biggest barrier to (setting up) (growing) a business? (open-ended, grouped responses)		
Rank	Sample size	97
1	Economic situation, crisis, small purchasing power	54%
2	High taxes, administration, paperwork	16%
3	Fear of failure, risk	15%
4	Poor market/lack of buyers	10%
5	Lack of support from the state and municipalities	7%
6	Many competitors	5%
7	Lack of ideas	2%

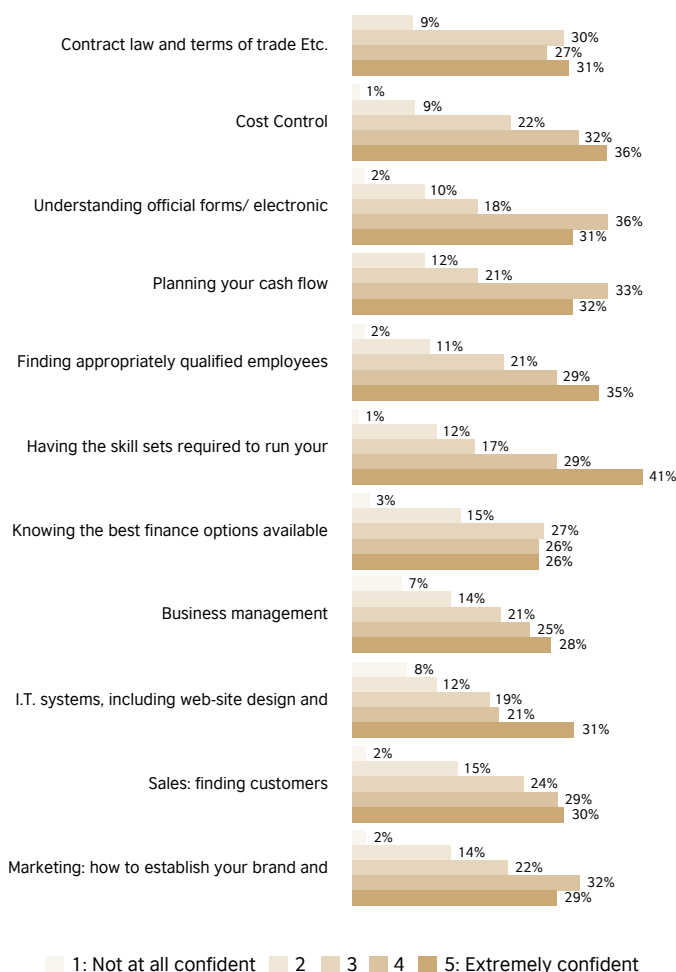
Levels of confidence

It is significant that the barriers to growth identified by respondents were generally external to their own business, rather than internally-generated. **Chart 5** shows that entrepreneurs were quite confident about most aspects of setting up and running their businesses, especially those areas that they could control.

They were less confident about regulatory and bureaucratic measures and identifying the best finance options.

Chart 5. Levels of confidence in aspects of running a business

Q13. How would you describe your own level of confidence in each of these aspects of setting up/running a business? (Sample size 100)



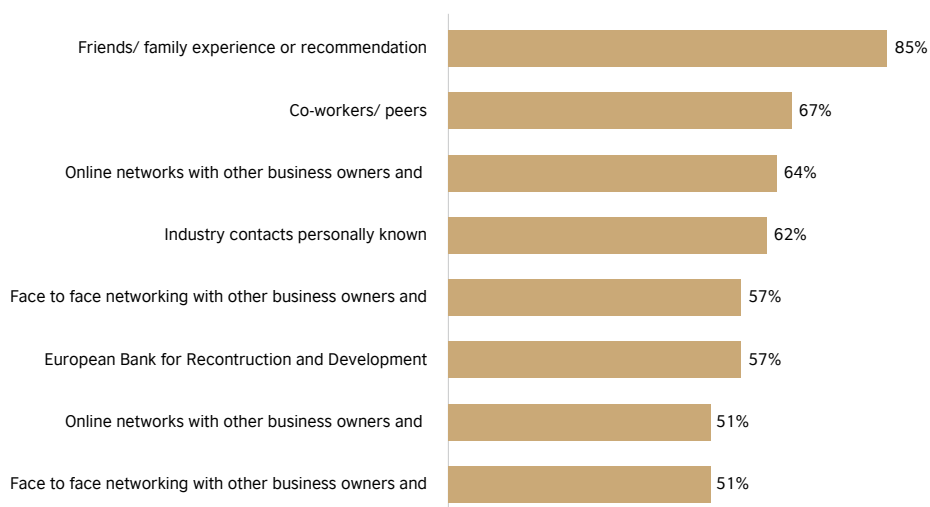
Advice and Support

Our entrepreneurs were more likely to turn to those around them in the first instance for advice and support, and especially to people with similar experiences. **Chart 6** shows that family and friends are likely to be the first port of call for advice, and that interacting face-to-face is considered ideal. Many entrepreneurs would also find online resources appealing.

The appeal of engaging with like-minded individuals resonates strongly with the findings of the British Council's programme: *encouraging youth entrepreneurship in the Western Balkans project September 2015 – March 2016* and suggests there would be plenty of take-up for local, targeted programmes and resources that are effective in improving skill acquisition, preparedness and motivation among young entrepreneurs.

Chart 6. Sources of advice and support

Q14. Here are some sources that people might turn to for support and advice when setting up and running a business. Please tell me how appealing each one is to you? (Sample size 100)



It is likely that young entrepreneurs are often working in isolation without ready access to expert business advice, and their trusted advisers are 'subject-specific' or family (**Table 19**).

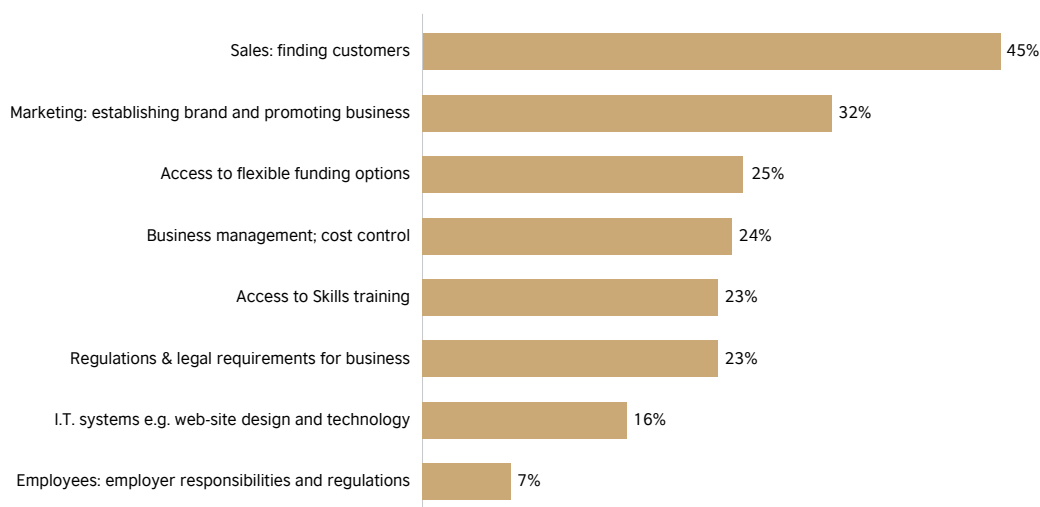
Table 19. Most trusted advisers

Q18. Who are your most trusted advisers?	Total
Sample size	100
Personal friends and family	53%
My college/employees	16%
Accountant	16%
Financial adviser	13%
Lawyer	2%

Our entrepreneurs were particularly interested in learning about or obtaining support for marketing and sales. Other aspects of business management and governance were not highlighted as much as in other parts of the region, possibly because of the size and nature of these businesses. A quarter of respondents wanted to understand more about the funding options available to them (**Chart 7**).

Chart 7. Subject matter of advice and support required

Q16. If you could access training and support on any of the following, which would you be likely to take up? (Sample size 100)



Our respondents reinforced the need for a range of mechanisms through which they could access advice and support. There was a particular appetite for in-person training courses, and these entrepreneurs were less interested in more informal networking opportunities (Table 20).

Table 20. Desirable forms of advice and support

Q17. What form of advice and support delivery would be helpful to you?		Ranking
Sample size	100	
In-person training courses	52%	1
Financial incentives	44%	2
Online resources e.g. downloadable content; online training and chat facility	26%	3
Mentoring	23%	4=
Peer-to-peer support	23%	4=
Networking	16%	6
Access to incubators/innovation hubs	5%	7

Future ambitions

Respondents were optimistic about their growth and development plans. Over the next two years, the majority planned to expand their products or service lines and invest in business assets and staff (**Table 21**).

Table 21. Future ambitions and plans for expansion

Q19a. How likely will you be to access the following over the next 2-3 years? % saying likely/very likely		Ranking (most likely)
Sample size	100	
Purchase or leasing business assets (equipment, vehicles etc.)	72%	1
Hiring staff	63%	2
Product or service development costs	62%	3
Legal expenses	50%	4
Premises/office relocation	49%	5
Opening new markets at home or abroad	46%	6
Expanding business	45%	7
Patenting	34%	8

Unsurprisingly, business growth was perceived to be primarily dependent upon the development of a customer base. However, fewer than one in three entrepreneurs identified the need for an injection of capital to achieve growth (Table 22).

Table 22. Drivers for success

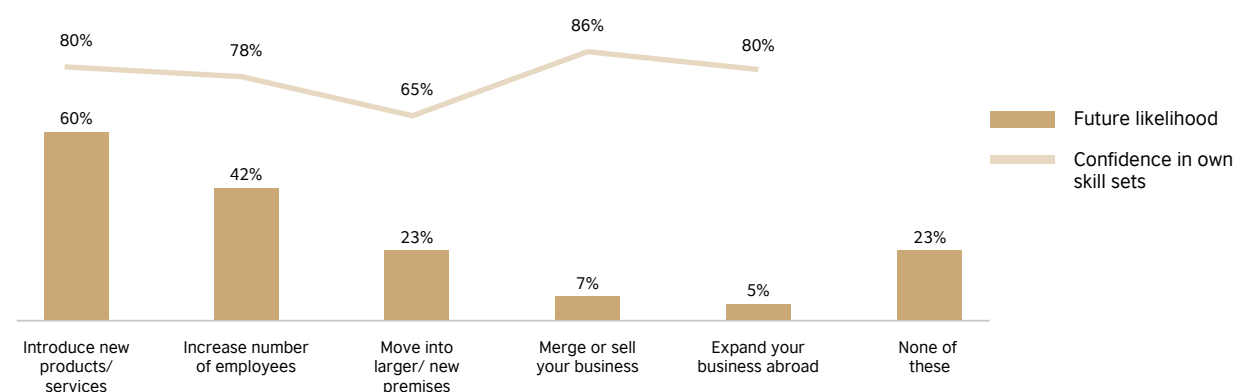
Q23. Thinking about the next 2-3 years, what do you perceive to be the key drivers for success in your business?	Total	Ranking
Sample size	100	
More customers	68%	1
Product/service development	33%	2
Capital injection	31%	3
Increased skill sets/employee training	19%	4
Change of premises	10%	5

Our survey respondents were ambitious about the future, and largely confident of their ability to achieve their ambitions (**Chart 8**). This can only be seen as a positive trend for the future, but such ambitions also need to be supported.

Chart 8. Ambitions and levels of confidence

Q24a. Thinking ahead 2 - 3 years, it is your ambition to do any of the following?

Q24b. At this stage, how confident are you that you have the knowledge and skills sets to enable you to do this? (Sample size 100)

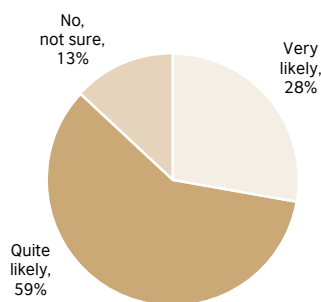


Access to Finance

Compared to their peers in other Western Balkans countries, Bosnian respondents were less likely to expect to seek access to finance in the next two to three years (**Chart 9**). This may be because they consider it extremely difficult to obtain funding, because 59% said that this was the case, whilst only 12% felt it was easy (Q21c).

Chart 9. Likelihood of seeking funding in the next few years

Q19. How likely are you to seek funding in the next 2 3 years? (Sample size 100)



Q19b. What do you envisage you will need funding for? (Sample size 87)

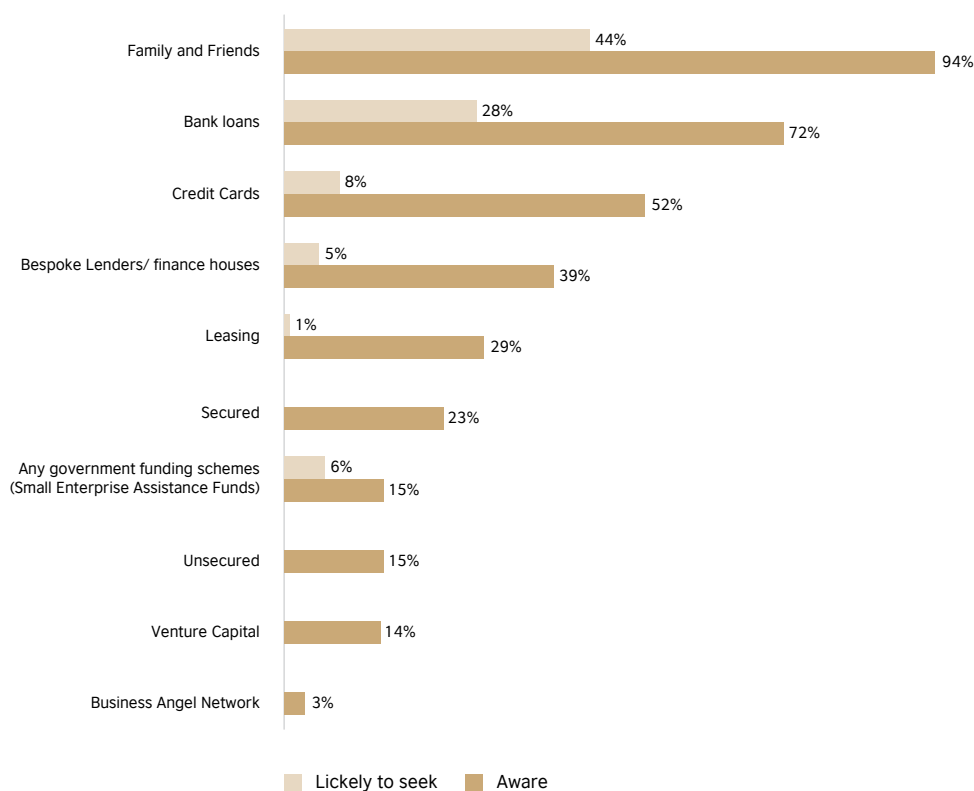
1	Product or service development costs	39%
2	Working capital/cashflow	38%
3	Purchase or leasing of business assets	37%
4	Hiring staff	28%
5	Premises/office relocation	15%
6	Opening new markets at home or abroad	9%
7	Legal expenses	9%
8	Patenting	5%

Chart 10 shows that awareness of any form of official finance other than bank loans is low. It follows that entrepreneurs regard banks as the only place to seek funding for their expansion plans. They are therefore more likely to use informal sources (family and friends) for funding.

Chart 10. Awareness and use of forms of funding

Q20. Which of these forms of funding are you aware of? (Sample size 100)

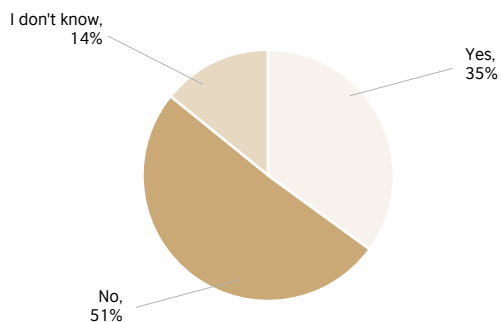
Q21a. Which form of funding would you be most likely to seek? (Sample size 100)



In total, 35% of respondents felt that the ability to offer trade credit terms would enable them to expand their business (**Chart 10**). Most felt it could provide a fair or great boost to their business.

Chart 11. Effect of trade credit

Q8b. Would your business expand if you could offer trade credit? (Sample size 100)



This concludes the findings of the primary research undertaken specifically for this project, involving 100 telephone interviews with new or prospective business start-ups in BiH. Fieldwork was undertaken in December 2017 and January 2018.

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ANNEX I – ESTIMATION METHODOLOGY FOR EARLY STAGE LOAN DEMAND

Overview

We have sought to separate out the loan demand for an MSME or a self-employed person's first two years of operation. This is often the most difficult and challenging period to fund, because lenders suffer from extreme information asymmetry. These businesses lack an audited trading/tax declaration record, credit rating data is likely to be sparse and the lending officer may have no detailed sector or local environment knowledge. The problems of information asymmetry have been highlighted by Stiglitz and Weiss (1981).

We have sought to estimate this “funding gap” by adopting a “bottom up” approach, estimating funding needs for MSMEs and self-employed people differently, on the basis that their funding needs are likely to differ. Our estimates are very rough and need further research and rigorous testing. We have included them because they are indicative pointers to the sufficiency or otherwise of existing schemes to support entrepreneurs in their first two years of activity.

Self-Employment

Self-employed people were an important component of our survey results. We assumed that each self-employed person would require seed capital or initial finance equal to three months of the 2015 euro current price per capita GDP for their home country. We took the data for this from the IMF (2018). We converted US\$ from the IMF date to Euro at 1.1998 US\$ = 1 EUR (an approximate 2017 year-end rate). The number of new self-employed people is based upon 5% of the self-employed population joining/leaving self-employment each year. The self-employed numbers were from the International Labour Organisation (2017).

MSMEs

For new SMEs, we assumed a blanket requirement of EUR 5,000 for their start-up capital needs in the first year. For the number of businesses being registered, we relied on World Bank data (World Bank, 2017c).

Year One Seed Capital

Taking these together, we calculated the seed (or first year) capital requirement by country, shown in **Table A.1**.

Table A.1 Western Balkans seed capital requirement for first year of operations

Number of New Limited	New Self Employed Estimate	Euro Per Cap GDP 2015	Seed Per Limited Liability	Seed Per Self Employed	Limited Liability Seed	Self Employed Seed	Total Est Seed Req
2,679	30,000	3,280	5,000	820	13,395,000	24,600,790	37,995,790
2,814	7,000	3,489	5,000	872	14,070,000	6,106,259	20,176,259
3,993	4,000	2,922	5,000	730	19,965,000	2,921,811	22,886,811
5,686	9,000	4,046	5,000	1,011	28,430,000	9,102,698	37,532,698
2,818	1,000	5,388	5,000	1,347	14,090,000	1,346,977	15,436,977
8,236	43,000	4,365	5,000	1,091	41,180,000	46,922,483	88,102,483
Total					131,130,000	91,001,017	222,131,017

Source: Authors

Year Two Calculation

For year two, we assumed that 25% of the new MSMEs would reach the growth phase, and that those MSMEs would require the average MSME loan value for their country. The average SME loan value was taken from Table 11 in Hauser et al., (2016).

For the remainder of companies and self-employed people, we made the blanket assumption that those that survived their first year would have grown but not have reached full cash self-sufficiency. They were therefore likely to require additional finance equal to the entire (for all firms) amount required in the first year. These parameters give the calculated requirement for Year 2 in **Table A.2**.

Table A.2. Year 2 start-up finance requirement

Number of New Limited Liability companies	New Self Employed Estimate	Average Loan Size	% Year 2 Full Loan Demand	Total Fast Growers	Total Rest	Grand Total Year 2
2,679	30,000	35,668	25%	23,888,643	37,995,790	61,884,433
2,814	7,000	34,409	25%	24,206,732	20,176,259	44,382,991
3,993	4,000	30,507	25%	30,453,613	22,886,811	53,340,423
5,686	9,000	45,052	25%	64,041,418	37,532,698	101,574,116
2,818	1,000	47,519	25%	33,477,136	15,436,977	48,914,112
8,236	43,000	25,753	25%	53,025,427	88,102,483	141,127,910
Total Year 2				229,092,968	222,131,017	451,223,985

Source: Authors

Total First Two Year Finance Requirement vs Total MSME Lending By Country

We took these findings and combined them into **Table A.3**, then compared them to overall SME lending in each Western Balkans state. The overall MSME lending figures come from Table 14 in Hauser et al. (2016).

Table A.3. Total entrepreneur first two year finance requirement vs total MSME lending by country

Number	Euros	%	Millions Euros				
			Total SME Loan Demand	Seed Year 1 Est. Demand	Early Stage Year 2 Est. Demand	Total Early Stage Est. Demand	SME Loan Demand % Early Stage
111,059	35,668	36.0%	1,426	38	62	100	7.0%
186,341	34,409	51.5%	3,302	20	44	65	2.0%
45,985	30,507	52.2%	732	23	53	76	10.4%
70,453	45,052	40.1%	1,273	38	102	139	10.9%
22,313	47,519	52.8%	560	15	49	64	11.5%
280,845	25,753	61.8%	4,470	88	141	229	5.1%
Regional Total In Millions Euro			11,763	222	451	673	5,7%

Source: Authors

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