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## Small and medium size companies competitiveness in Croatian regional framework

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**53<sup>rd</sup> Congress of the European Regional Science Association  
Palermo, Italy, 27<sup>th</sup> – 31<sup>st</sup> August, 2013**

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Zagreb Chamber of Economy**

**Small and medium size companies competitiveness in Croatian regional framework**

**Abstract\***

The small and medium enterprises (SMEs) sector represents an important part of the Croatian economy. In 2011, SMEs achieved a share of 50.2% of gross domestic product (GDP), 65.5% of employment and 42% of Croatian exports. In this paper we will elaborate the importance of SME sector in Croatia, as well as present the institutional and legislative frameworks; describe distribution of competences for making policy decisions and the actual implementation of those decisions at the level of state institutions; availability of support to the SME sector.

The approach to the analysis of regional policy in Croatia is to concentrate on three main areas. 1. assessment of the overall policy framework for regional development, including the current legal framework in particular policies, legal acts and regulations, 2. assessment of the institutional and administrative capacity in place, 3. appraisal of the types of regional development instruments currently deployed and their effectiveness in dealing with development needs at national, regional and local level. Paper will concentrate on small and medium size companies competitiveness in regional framework.

The national development strategy sets the context for balanced regional development both at national and sub-national level as well as draws attention to development needs of the 'assisted areas' as well as counties highlighting their different development profiles. It brings together the main analytical parts: policy framework, institutional context and finally an assessment of the existing development interventions on county, NUTS 2 and assisted areas level. Paper will deal with economic performance of SME's on regional level and indicate the role of national and regional supporting measures in development of that sector.

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**Key words:** SME's competitiveness on regional level; O43 – Institutions and Growth; R11 – Regional Economic Activity; Growth, Development, Environmental Issues, and Changes; R12 – Size and Spatial Distributions of Regional Economic Activity

## **1. National Development Strategy**

The significance of the national development strategy is in setting the framework for balanced regional development at national and sub-national level, as well as in drawing attention to development needs of the ‘assisted areas’ and counties by highlighting their different development profiles.

### **1.1. Policy framework**

Ministry of Regional Development and EU Funds<sup>1</sup> (until 2011, it was the Ministry of Regional Development, Forestry and Water Management) is the main institution in charge of regional development. It is responsible for the implementation of the policies for balanced regional development, for the further development of the less developed regions in the Republic of Croatia and for reducing the regional development imbalances at national level. The Ministry is also responsible for planning the regional development policies and the establishment of an integrated system for planning, programming, management and financing regional development; improving cross-border, interregional and transnational cooperation; preparation of priorities and perennial strategic and operational documents for the use of EU funds and other international sources of funding for regional development initiatives; and for ensuring effective coordination with the units of local/regional self-government and with other stakeholders.

#### The Regional Development Strategy

In order to sustain balanced regional development in Croatia, the Ministry continued to execute the main objectives set in the Regional Development Strategy of the Republic of Croatia<sup>2</sup> in 2010. The importance of the Strategy is in raising the welfare of all Croatian regions and in reducing lagging behind the EU’s average. The goals established in the Strategy are directed to social-economic development of the Republic of Croatia, decrease of regional development inequalities and strengthening of development potentials of those areas of the country which are falling behind in development in order to increase competitiveness. The main objective of the regional development policy is to contribute to social-economic development of the Republic of Croatia, pursuant to the principles of sustainable development by creating of preconditions which shall allow all parts of the country to strengthen competitiveness and to realize own development potentials.

#### Main strategic objective of the Regional Development Strategy

The achievement of the Strategy’s main objective is related to the fulfillment of three specific goals - development of county and statistical regions, development of supported areas and development of border areas.

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<sup>1</sup> [www.mrrfeu.hr](http://www.mrrfeu.hr)

<sup>2</sup> Regional Development Strategy of the Republic of Croatia 2011-2013 was passed in 2010 by the Ministry of Regional Development, Forestry and Water Management.

## 1. Development of County and Statistical Regions

The main aim of this objective is based on the need for better connection of central level development priorities to the needs of statistical regions and local and regional self-governments in Croatia. The available funds are intended to be spent to contribute to the achievement of national, regional and local development objectives in a coherent and integrated manner. The results of this process are recognizable through the county development strategy, county development projects, joint development projects, and through the development of statistical regions which are an important tool for directing financial resources of developing counties and statistical regions.

In order to implement the identified goals, the Strategy indicates two main components that regulate the planning and management of development at two levels:

- Statistical Region Level – with the aim of defining development priorities at the NUTS 2 level<sup>3</sup>. According to the EU classification, regions in the Republic of Croatia are divided into three NUTS 2 regions: North-western Croatia with 6 counties, Central and Eastern (Pannonian) Croatia with 8 counties, and Adriatic Croatia with 7 counties.
- County Level – with the aim of defining development priorities at NUTS 3 level, which are, in line to EU classification, local self-government units in Croatia.

## 2. Development of Supported Areas

The main aim of this objective is to secure support to all areas with social and economic difficulties in the Republic of Croatia for the purpose of increasing and optimally utilizing their development potential and resolving the case of their development difficulties. The Supported Areas<sup>4</sup> are those regional self-government units with the development index value lower than 75% of the national average, and local self-government units with the development index value lower than 50% of the national average.

The main goal of this objective is to contribute to even regional development by helping supported areas to achieve quicker social-economic development and through that, reduce falling behind other areas of the Republic of Croatia.

## 3. Development of Border Areas

The main aim of this objective is to ensure suitable measure for even and sustainable development of local and regional self-government units, and to encourage cross-border cooperation. "The Development of Border Areas" strategic objective is based on logic of European integration and the reduction of negative impacts of state borders by establishing an efficient system of integrated border management and by stimulating cross-border

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<sup>3</sup> Decision on the classification of local and regional self-government units according to the development units, Official gazette No. 153/2009

<sup>4</sup> Regional Development Strategy of the Republic of Croatia, 2010, pg. 80

cooperation. Territorial cooperation (cross-border, transnational and intraregional) is particularly important for the sustainable development of Croatian border area because of the shape of Croatian territory and the length of its border.

This objective shall create a basis for the development of a coordinated, systematic and strategically directed cooperation at a local, regional and central state level with partners from the neighbouring countries and other regions of the European Union in order to reduce negative impact of borders and promote social and economic cohesion. The objective will be achieved by strengthening cross-border, transnational and intraregional cooperation with common local and regional initiatives, while taking into account objectives of economic and social cohesion.

### **1.2. Assessment of the existing development interventions on county, NUTS 2 and assisted areas level**

Existing development interventions on county, NUTS 2 and assisted area level that are making positive contribution to the regional development are: tax reduction for citizens and enterprises, Croatian Bank's for Reconstruction and Development favourable loans, Croatian Agency for Small Businesses loan guarantee programme, measures regarding bettering a poor demographic situation such as development of construction sites intended for building houses, and providing support for the construction of buildings. Table 1 is providing an overview of current measures for counties, NUTS 2 regions and assisted areas level.

On the other side, the existing measures that need to be left out are the measures with low financial impact for the beneficiary, such as the measure for exemption from administrative fees upon application of intellectual property rights (patents and trademarks) or measures with a discouraging effect on entrepreneurship, such as the measure of raising the fee for utilization of mineral raw material.

**Table 1:** *Existing measures for counties, NUTS 2 regions and assisted areas level*

<b>Measure</b>	<b>Sub-measure</b>
<b>Measure 1: Tax deduction for corporate income tax payers</b>	Deduction for corporate income tax on agricultural and fisheries activities
	Deduction for corporate income tax on all activities other than agricultural and fisheries
<b>Measure 2: Self-employment tax deductions</b>	Reduction in the tax base for the payers of self-employment income tax
<b>Measure 3: Loans to economic agents under preferential terms</b>	Preferential lending terms for investing in assisted areas
<b>Measure 4: Guarantees to economic agents</b>	Guarantees issued for the loans of commercial bank and Croatian Bank for Reconstruction and Development to economic agents within the areas of special state concern
<b>Measure 5: Incentives for major investment projects</b>	Non-repayable grants for investments of considerable economic interest
<b>Measure 6: Adaption of the existing incentive</b>	Harmonization of the Programme of Incentives to SMEs

<b>programmes for the development of SMEs</b>	incentives with the level of development of regional and local units
<b>Measure 7: Tax relief for employees</b>	Increased monthly personal deduction of income tax
<b>Measure 8: Measures aimed at strengthening the fiscal capacity of units of local and regional government</b>	The compensation for the exploitation of mineral resources
<b>Measure 9: Creation of special development programs for aided areas</b>	The program for the demographic renewal of assisted areas
	The program for strengthening the educational capacity of the assisted areas
	The program for attracting investors in the assisted areas
	The program of development of regional clusters

*Source: Regional Development Strategy of the Republic of Croatia, 2010, pg. 103*

## **2. SMEs Environment in Croatia**

The overall economic situation in Europe still remains fragile four years after the global financial crisis which hit in 2008. The major economies experienced poor economic performance manifested in high rates of unemployment, a sovereign debt crisis, and increasing imbalances in trade and government deficits. Croatia's macroeconomic performance has been severely affected since the start of the global financial crisis – the economy has stagnated, the rate of growth is negative, gross domestic product (GDP) growth rate in 2012 is -1.8%, the average registered unemployment rate reached 20.4%<sup>5</sup>.

Small and medium enterprises (SMEs) in Croatia represent 99.7% of all enterprises. SMEs sector in Croatia in 2011 achieved a share of 50.2% of GDP, 65.5% of employment and 42% of Croatian exports<sup>6</sup>. According to these data, it is evident that SMEs sector in Croatia represents an important part of the Croatian economy. These enterprises make up a significant part of the economy through participation in employment, in creation of GDP and exports.

### **2.1. Importance of the small and medium enterprise sector in Croatia**

General overview of SME's in Croatia

Criteria for classification of entities in the SME sector in Croatia are defined by the Accounting Act and the Small Business Development Promotion Act. As indicated in the table below (Table 2), the Accounting Act and Small Business Development promotion Act do not have a harmonized number of employees' criterion for classification of SMEs in Croatia.

However, the Small Business Development Act has, from May 2012, harmonized the categorization of size of enterprises in the Act with the criteria applied by the European Union

<sup>5</sup> The Croatian SME Observatory Report, 2013.

<sup>6</sup> SME Report for Croatia 2012.

(Table 3), with the purpose of enabling higher quality analysis and comparison of the SME sector in Croatian and EU countries.

In this paper, the data on employment includes aggregate data on number of employees in crafts businesses and SMEs. All the other analyses are focused exclusively on the SME sector, excluding crafts businesses, while micro enterprises are included in the small enterprises category.

**Table 2:** Review of the classification of entities in the SME sector according to the Accounting Act and Small Business Development Promotion Act

Accounting Act	Small Business Development Promotion Act
<p><b>Micro enterprises</b> are not classified.</p>	<p><b>Micro enterprises:</b></p> <ul style="list-style-type: none"> <li>• Total assets 2,000,000.00 EUR</li> <li>• Revenue 2,000,000.00 EUR</li> <li>• Average number of employees during business year: less than 10</li> </ul>
<p><b>Small enterprises</b> are those that do not satisfy two of the following conditions:</p> <ul style="list-style-type: none"> <li>• Total assets 4,333,333 EUR</li> <li>• Revenue 8,666,666 EUR</li> <li>• Average number of employees during business year: 50</li> </ul>	<p><b>Small enterprises:</b></p> <ul style="list-style-type: none"> <li>• Total assets 10,000,000.00 EUR</li> <li>• Revenue 10,000,000.00 EUR</li> <li>• Average number of employees during business year: less than 50</li> </ul>
<p><b>Medium enterprises</b> are those satisfying at least two out of three conditions for small enterprises:</p> <ul style="list-style-type: none"> <li>• Total assets 17,333,333 EUR</li> <li>• Revenue 34,666,666 EUR</li> <li>• Average number of employees during business year: 250</li> </ul>	<p><b>Medium enterprises:</b></p> <ul style="list-style-type: none"> <li>• Total assets 10,000,000.00 - 43,000,000.00 EUR</li> <li>• Revenue 10,000,000.00 – 50,000,000.00 EUR</li> <li>• Average number of employees during business year: more than 50 and less than 250</li> </ul>

Source: SME Report for Croatia 2012, pg. 12

**Table 3:** Criteria of classification of small business entities

Type of business entity	Number of employees	Annual revenue in million EUR	Assets (active/long-term assets) in million EUR
	EU / Croatia	EU / Croatia	EU / Croatia
<b>Micro</b>	0-9	2	2

<b>Small</b>	10-49	10	10
<b>Medium</b>	50-249	50	43

Source: SME Report for Croatia 2012, pg. 13

The size structure of Croatia's SME sector has been relatively stable over 2010 and 2011. As indicated in the Table 4, the share of small and medium size enterprises in the total number of enterprises has increased by 0.1%.

SME sector has been affected by the difficult economic situation which Croatia experienced in recent years. The total number of active SMEs has fallen from 96,383 units in 2010, to 90,831 units at the end of 2011, which is a reduction of 5.7%. The biggest drop is in the category of medium enterprises (6.3%), followed by small enterprises (5.7%), while decline in the category of large enterprises was 4.3%.

**Table 4:** Enterprise structure regarding enterprise size in 2001, 2010 and 2011

	<b>2001.</b>		<b>2010.</b>		<b>2011.</b>	
	<b>Number of entities</b>	<b>%</b>	<b>Number of entities</b>	<b>%</b>	<b>Number of entities</b>	<b>%</b>
<b>SME sector</b>	<b>56,416</b>	<b>99</b>	<b>96,383</b>	<b>99.5</b>	<b>90,831</b>	<b>99.6</b>
<i>Small enterprises</i>	54,213		95,004		89,539	
<i>Medium enterprises</i>	2,203		1,379		1,292	
<b>Large enterprises</b>	<b>571</b>	<b>1</b>	<b>375</b>	<b>0.5</b>	<b>359</b>	<b>0.4</b>
<b>Total</b>	<b>56,987</b>	<b>100</b>	<b>96,758</b>	<b>100</b>	<b>91,190</b>	<b>100</b>

Source: SME Report for Croatia 2012, pg. 14

Apart in the number of entities, SMEs have a significant share in Croatian GDP. As indicated in the Table 5, share of SMEs in GDP in 2011 is 50.2%, which is a decrease of 1.4% compared to 2010. In addition, SME sector has increased its importance in exporting term, accounting for 42% of all exports in 2011, compared with 41.1% in 2010. Total revenue generated by exports of Croatian enterprises increased in 2011, with the largest growth achieved by small enterprises (growth of 20.5% compared to 2010).



**Table 5: Enterprise size, GDP share and exports share in 2010 and 2011**

	Enterprise size					
	Small		Medium		Large	
	2010.	2011.	2010.	2011.	2010.	2011.
<b>GDP (000 EUR)</b>	26.573.180	25.497.648	14.604.100	14.919.500	38.581.046	40.020.273
<b>GDP (share)</b>	33.3%	31.7%	18.3%	18.5%	48.4%	49.8%
<b>Exports (000 EUR)</b>	2.282.353	2.751.546	2.515.621	2.626.310	7.078.055	7.433.010
<b>Exports (share)</b>	20.1%	21.5%	21.0%	20.5%	58.9%	58%

Source: SME Report for Croatia 2012, pg. 14

SMEs employment make a significant contribution to the employment of Croatian economy, as 65.5% of total employment is achieved by this sector. The data of employment in 2011 (Table 6) indicates that the employment in medium enterprises is slightly increasing, while in large enterprises is stagnating, and in small enterprises has decreased by 6.9%. By comparing the average number of employees in small and medium enterprises it is noticeable that the average number of employees in small enterprises is between 4 and 5, while in medium enterprises is 123 (the average number of employees in medium enterprises has increased by 8.3%, compared to the year 2010).

**Table 6: Employee structure in SMEs sector in 2010 and 2011**

Type of enterprise	2010.			2011.		
	Number of employees	%	Average – number of employees in enterprise	Number of employees	%	Average – number of employees in enterprise
<b>Small</b>	415.320	48,3	4,4	386.692	46,4	4,3
<b>Medium</b>	157.147	18,3	114,0	159.616	19,1	123,5
<b>Large</b>	287.341	33,4	766,2	287.035	34,5	799,5

Source: SME Report for Croatia 2012, pg. 15; The Croatian SME Observatory Report, 2013, pg. 8

#### Overview of SME's on a regional level

Existing administrative division of the Republic of Croatia fulfils EUROSTAT's criteria on division of the state into area units for statistics on the level<sup>7</sup>: NUTS 1 - the whole Republic of Croatia; NUTS 2 – Republic of Croatia is divided into three NUTS 2 regions (North-western Croatia with 6 counties, Central and Eastern (Pannonian) Croatia with 8 counties, and Adriatic Croatia with 7 counties); and NUTS 3 – local self-government units.

<sup>7</sup> Regional Development Strategy of Republic of Croatia, 2010.

Assisted areas are the Areas of Special State Concern, and are including three categories: Areas occupied during the war, Areas suffered war damages and Areas meeting specific criteria of underdevelopment<sup>8</sup>.

Following the NUTS 2 classification, the greatest number of SMEs is in the North-western Croatia region, where the total number of SMEs counts for 58.7% of all enterprises in that region, with City of Zagreb on the forefront with 30.177 enterprises (Table 7). This region is followed by the Adriatic Croatia region, where the total number of SMEs counts for 46.6%, headed with Split-Dalmatia region; while SMEs in Central and Eastern (Pannonian) Croatia region represent 37.5% of all enterprises, headed with Osijek-Baranja region.

In terms of employment, SMEs in Adriatic Croatia region count for 63.1% of total employment in that region, compared with 59.6% in Central and Eastern (Pannonian) Croatia region, and 50.8% in North-western Croatia region.

**Table 7: Number of enterprises and employment by county and region in 2012**

	Number of enterprises				Employment			
	<i>Small</i>	<i>Medium</i>	<i>SMEs (total)</i>	<i>Total (SMEs, large, crafts)</i>	<i>Small</i>	<i>Medium</i>	<i>SMEs (total)</i>	<i>Total (SMEs, large, crafts)</i>
<b>North-western Croatia</b>	<b>41.942</b>	<b>680</b>	<b>42.622</b>	<b>72.588</b>	<b>177.767</b>	<b>73.776</b>	<b>251.543</b>	<b>495.409</b>
<b>% (out of total enterprises)</b>	<b>57.8</b>	<b>0.9</b>	<b>58.7</b>	<b>100.0</b>	<b>35.9</b>	<b>14.9</b>	<b>50.8</b>	<b>100.0</b>
City of Zagreb	29.731	446	30.177	45.388	113.494	44.899	158.393	345.327
Koprivnica-Križevci	1.092	19	1.111	2.679	6.402	2.086	8.488	17.880
Krapina-Zagorje	1.299	33	1.332	4.001	7.709	4.309	12.018	18.806
Međimurje	2.009	43	2.052	3.661	12.439	7.104	19.543	25.454
Varaždin	2.370	52	2.422	5.396	15.099	6.893	21.992	38.661
Zagreb	5.441	87	5.528	11.463	22.624	8.485	31.109	49.281
<b>Central and Eastern (Pannonian) Croatia</b>	<b>10.830</b>	<b>232</b>	<b>11.062</b>	<b>29.533</b>	<b>61.114</b>	<b>28.824</b>	<b>89.938</b>	<b>150.866</b>
<b>% (out of total enterprises)</b>	<b>36.6</b>	<b>0.9</b>	<b>37.5</b>	<b>100.0</b>	<b>40.5</b>	<b>19.1</b>	<b>59.6</b>	<b>100.0</b>
Bjelovar-Bilogora	1.161	30	1.191	2.629	7.052	3.604	10.656	16.336
Brod-Posavina	1.150	30	1.180	3.807	6.906	3.329	10.235	17.559
Karlovac	1.501	19	1.520	3.703	8.188	2.193	10.381	16.959
Osijek-Baranja	3.347	66	3.413	7.971	17.636	7.487	25.123	43.162
Požega-Slavonia	494	14	508	1.547	2.977	2.345	5.322	8.719
Sisak-Moslavina	1.360	27	1.387	3.790	7.450	4.655	12.105	19.764

<sup>8</sup> Croatian regional strategy in the framework of the EU accession process, 2006, pg. 3

Virovitica-Podravina	613	14	627	2.055	3.420	1.351	4.771	8.552
Vukovar-Srijem	1.204	32	1.236	4.031	7.485	3.860	11.345	19.815
<b>Adriatic Croatia</b>	<b>34.288</b>	<b>356</b>	<b>34.644</b>	<b>74.442</b>	<b>116.778</b>	<b>42.376</b>	<b>159.154</b>	<b>252.202</b>
<b>% (out of total enterprises)</b>	<b>46.1</b>	<b>0.5</b>	<b>46.6</b>	<b>100</b>	<b>46.3</b>	<b>16.8</b>	<b>63.1</b>	<b>100.0</b>
Dubrovnik-Neretva	3.125	42	3.167	6.453	10.406	4.793	15.199	21.005
Istria	8.307	67	8.374	16.440	21.146	7.660	28.806	48.944
Lika-Senj	529	8	537	1.757	2.541	612	3.153	5.390
Primorje-Gorski kotar	7.985	84	8.069	16.691	30.476	10.501	40.977	65.427
Split-Dalmatia	9.958	96	10.054	20.581	35.418	11.544	46.962	75.710
Šibenik-Knin	1.710	23	1.733	4.945	6.056	2.574	8.630	12.835
Zadar	2.674	36	2.710	7.575	10.735	4.692	15.427	22.891

Source: *The Croatian SME Observatory Report, 2013.*, pg. 37-40

According to the Global Entrepreneurship Monitor (GEM)<sup>9</sup> research and the Total Entrepreneurial Activity (TEA) index for 2011, an increase of activity in start-up of business venture in all regions has been identified. Regions with the highest level of activity in start-up of business ventures (North-western Croatia and Adriatic Croatia) also have the highest GDP per capita (North-western Croatia GDP per capita is EUR 9.345,67 and Adriatic Croatia EUR 9.730,86) and have the lowest unemployment rate (North-western Croatia 14.93% and Adriatic Croatia 16.43%) (Table 8).

In addition, GEM research indicated regional differences in entrepreneurs' attitudes about intentions to start a business venture. The largest number of entrepreneurs that have expressed the intention to start a business venture in the next three years and are seeking an opportunity to start a business venture in the next 6 months are in the North-western Croatian and Adriatic Croatia region. GEM research indicates that the number of entrepreneurs who intend to start a business venture in the next 3 years is significantly increasing in all three regions, but the number of entrepreneurs who see an opportunity to start a venture in the next 6 months is, compared to the year 2010, stagnating or declining.

Increase in business venture start-up activity is accompanied by the indicator of decrease of unemployment, which confirms the fact that creation of preconditions for starting business ventures represents an important lever in addressing the issue of unemployment.

<sup>9</sup> Global Entrepreneurship Monitor 2002-2011: What makes Croatia a (non)entrepreneurial country?, 2012

**Table 8:** *GDP per capita in 2010 and unemployment rate in regions in 2011*

	<b>GDP per capita (EUR)</b>	<b>Unemployment rate %</b>
	<b>2010.</b>	<b>2011.</b>
<b>North-western Croatia</b>	9.345,67	14.93
<b>Central and Eastern (Pannonian) Croatia</b>	6.603,13	27.89
<b>Adriatic Croatia</b>	9.730,86	16.43

Source: *Croatian Bureau of Statistics, 2013; Global Entrepreneurship Monitor Report, 2012.*

## ***2.2. Institutional and legislative framework for the small and medium enterprise sector in Croatia***

Institutional support for SME's in Croatia

The main area of activity of governmental, non-governmental and business support institutions is in framing relevant legislation and developing policies that are supporting SMEs, providing financial support to the SMEs, providing basic forms of support to entrepreneurs and business persons in the form of general advice, training, support to technology based new enterprises, and help with project applications.

GEM research on the assessment of the government policies (priorities and support) towards regulatory framework and programs indicates that government programs for entrepreneurship in 2011, when compared to recent years, were slightly better than government policies towards priorities and supports, but the grades are still below the average of other countries included in the research. The greatest criticism to government policies refers to the absence of appropriate support of growing businesses.

An assessment of the business support organizations in Croatia<sup>10</sup> indicates that the need for business support organizations in developing and delivering products and services appropriate to enterprises consistent with their position in the growth cycle is still big. Business support organizations have difficulty in meeting the demand from entrepreneurs and managers for specific and higher-order services, marketing plans, investment and project appraisal, and support to product development; as well as business support organizations have to focus on developing their capacity to deliver support to entrepreneurship and businesses to enhance managerial competence in relation to strategic planning and innovation.

In accordance to the Global Competitiveness Report<sup>11</sup>, business support institutions in Croatia have to receive support that is focusing on strengthening the support and providing higher and better quality assistance, developing new services, and ensuring that unmet demand at certain locations within Croatia is fully addressed.

<sup>10</sup> Capacity Building of Business Service Professionals and Business Support Institutions, 2012

<sup>11</sup> The Global Competitiveness Report, 2013

### *Regulatory environment in Croatia*

Regulatory environment in Croatia does not stimulate the development of small and medium enterprise sector, because, according to the Doing Business Study<sup>12</sup>, the length and complexity of regulatory procedures still remain the greatest obstacles in business activity start-up. The obstacles induce a domino effect in other spheres of business activities, such as an increase in corruption.

The study also indicates that no progress has been made in the quality improvement of regulatory environment in Croatia; as well as the negative trend is visible in regulations for enterprise start-up, obtaining construction permits, property registration, credit funds, protection of investors and execution of contracts. The progress has been made in access to electricity and payment of taxes.

The number of acts that constitute the regulatory framework for SMEs in Croatia is 15; while the number of acts relevant for investment processes is 13; number of acts for the tax system legislation is 9; and the number of principal acts of the customers system is 2 (Table 9).

**Table 9:** *Regulatory environment in Croatia – the list of Acts in 2012*

<b>Regulatory framework for SMEs in Croatia</b>	<b>Acts relevant for investment processes in Croatia</b>	<b>Acts relevant for tax system legislation in Croatia</b>	<b>Acts of the customs system</b>
<ul style="list-style-type: none"> <li>• Small Business Development Promotion Act</li> <li>• State Aid Act</li> <li>• Act on Amendments to the State Aid Act</li> <li>• Companies Act</li> <li>• Ownership and other Proprietary rights Act</li> <li>• Act on Investment Promotion and Development of Investment Climate</li> <li>• Foreign Exchange Act</li> <li>• National Payment System</li> <li>• Concessions Act</li> <li>• Capital Market Act</li> <li>• Crafts Act</li> <li>• Trade Act</li> </ul>	<ul style="list-style-type: none"> <li>• Free Zones Act</li> <li>• Act on Public Private Partnerships</li> <li>• Accounting Act</li> <li>• Audit Act</li> <li>• Competition Act</li> <li>• Public Procurement Act</li> <li>• Environmental Protection Act</li> <li>• Physical Planning and Building Act</li> <li>• Labour Act</li> <li>• Consumer Protection Act</li> <li>• Bankruptcy Act</li> <li>• Enforcement Act</li> <li>• Act on Deadlines for Settlement of Financial Obligations</li> </ul>	<ul style="list-style-type: none"> <li>• General tax Act</li> <li>• Contributions Act</li> <li>• Profit Tax Act</li> <li>• Regulation on Profit Tax</li> <li>• Income Tax Act</li> <li>• Value Added Tax Act</li> <li>• Regulation on Value Added Tax</li> <li>• Real Estate Transfer Tax Act</li> <li>• Excise Duties Act</li> </ul>	<ul style="list-style-type: none"> <li>• Customs Act</li> <li>• Customs Tariff Act</li> </ul>

<sup>12</sup> Doing Business 2013 – Smarter Regulations for Small and Medium-Size Enterprises, 2013

<ul style="list-style-type: none"> <li>• Court Register Act</li> <li>• Act on the Nation Classification of Economic Activities</li> <li>• Act on Services</li> </ul>			
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*Source: SME Report for Croatia 2012, pg. 27-2*

### Availability of support for the small and medium enterprise sector

Availability of support – programs and policies – for SMEs sector in Croatia are aligned with the Small Business Act of Europe from 2008<sup>13</sup>, which reflects the Commission’s political will to recognize the central role of SMEs in the EU economy and puts into place a comprehensive SME policy framework for the EU and its Member States. The Small Business Act applies to all independent companies which have fewer than 250 employees (99% of all European businesses), with the aim of improving overall approach to entrepreneurship, permanently the “Think Small First” principle in policy making from regulation to public services, and promoting SMEs’ growth by helping them tackle the remaining problems which hamper their development.

Croatia is monitoring deviations from expectations defined by the Small Business Act through SBA Fact Sheet, annual EU report that analyses changes in trends in the environment and regulatory framework at the national level for SMEs; and through SME Policy Index, which monitors implementation of the Small Business Act for Europe through 108 indicators which provide a framework for evaluation of national policies for SMEs.

According to the analysis of the SBA Fact Sheet for Croatia<sup>14</sup>, Croatia is still significantly behind the EU member states in the quality of entrepreneurial environment. In terms of the entrepreneurship, Croatia’s performance is still slightly below the EU average (2% lower than in the EU); whilst in terms of giving businesses second chances Croatia’s performance is significantly below the EU average, as it takes more time and money to close a business compared with the EU. In the extent of administrative burden of SMEs, SBA Fact Sheet reported that Croatian business have to comply with a lot of government regulations. Responsive administration is another area where Croatia has been having difficulties in recent years – it takes half the time needed in the EU to start a business (7 days), initial capital paid in is relatively lower, costs of 14% of the claim to enforce contracts in Croatia, actual cost of starting a business is almost twice as high as in the EU and it takes almost three times longer to transfer property. In the area of state aid and public procurement, Croatian performance is judged by the availability of e-procurement, which is twice as limited as in the EU. Croatia is also performing below the average in the area of environment and internationalization, whilst the area where is performing above the EU average is in the area of access to finance.

<sup>13</sup> Source: [http://ec.europa.eu/enterprise/policies/sme/small-business-act/index\\_en.htm](http://ec.europa.eu/enterprise/policies/sme/small-business-act/index_en.htm), 2008

<sup>14</sup> Source: [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2012/croatia\\_en.pdf](http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2012/croatia_en.pdf), 2012

Current national and regional policies and programs in Croatia that regulate and stimulate SME sector are:

- **Strategy for Development of Entrepreneurship 2013 – 2020**
- **Strategic Plans for the period of 2012 – 2014**
- **Regional Development Strategy of the Republic of Croatia, 2011 – 2013**
- **Plan for Promotion of Entrepreneurship and Crafts for 2012 – Entrepreneurial Impulse**
- **Strategy for Development of Women Entrepreneurship in the Republic of Croatia 2010-2013**
- **National Strategy for Entrepreneurial Learning 2010 - 2014**
- **Cluster Development Strategy in the Republic of Croatia 2011 - 2020**
- **Program of measures for simplification of business of small business entities**

### **2.3. The source of financial support for the development of small and medium enterprises in Croatia**

The main sources of financial support to the development of SME sector in Croatia are banking sector, credit unions, venture capital funds, informal forms of financing such as business angels, and government incentive programs and subsidized credit lines.

According to the SBA Fact Sheet for Croatia, access to finance is the only area in which Croatia is performing above the EU average. Conditions for credit-based financing have improved more than in the EU, only 17% of SMEs reported a deterioration in access to public financial support (compared to the EU average of 22%), 14% of SMEs claimed that banks were less willing to provide loans (compared to the EU average of 27%), credit information is better than in the EU, while the strength of legal rights is slightly below the EU average.

On the other hand, the results of GEM research indicated that, in terms of access to money, Croatia is around the average of countries involved in the GEM research<sup>15</sup>, and in most years it is below the average (Table 10). SMEs are focusing on traditional sources of financing, such as bank loans, while micro-finance is very limited. Most of the loans are given to medium sized businesses, and the share of micro and small enterprises in the total loan portfolio is estimated at around 8%, which is less than EUR 3 billion<sup>16</sup>. A lower focus on non-

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<sup>15</sup> The number of countries involved in GEM Research in 2012 was 54.

<sup>16</sup> SME Financing Gap Assessment in Croatia, 2010

traditional sources of financing such as venture capital funds and business angels is due to the limited supply of such sources in the Croatian financial market.

**Table 10:** *Access to money, Croatia and GEM countries, 2006-2011*

Year	Croatia	GEM average	Best	
2006	2.68	2.67	4.3	USA
2007	2.66	2.88	3.85	Israel
2008	2.78	2.44	3.09	Norway
2009	2.41	2.46	3.3	Malaysia
2010	2.42	2.39	3.43	Malaysia
2011	<b>2.26</b>	2.44	3.5	Switzerland

*Source: Global Entrepreneurship Monitor Report, 2012, pg. 79*

The main sources of financial support for the development of SME sector in Croatia are as follows:

- Banking sector

The market of banking sector loans and services intended for SMEs in Croatia is highly developed. Almost all banks in Croatia offer loans to SMEs in a wide range of products and services: loans for tourism services, young people, women, new technologies, Croatian war veterans, export, investment, working capital, and start-ups.

According to the Croatian National Bank's Annual Report<sup>17</sup>, the banking sector has disbursed 38.896,6 million EUR in 2011, out of which 42.1% was disbursed to companies. Compared to the year 2010, a 2.4% increase of banking sector's disbursement to companies was recorded in 2011. However, the loans provided by banking sector to companies have decreased in 2012. From March 2012 until March 2013 the loans to the companies have decreased for 9.7%, compared to 2011<sup>18</sup>.

- Credit unions

Credit unions in Croatia are the providers of microcredit services. According to the Croatian National Bank's Annual Report, 22 credit unions operated in 2011, with 7.588 million EUR in assets.

The members of the Croatian Association of Credit Unions have disbursed 4,868 loans in total amount of 20.833.861 EUR in 2011, which is an increase of 88% in relation to 2010, when 4.065 loans with total value of 11.058.628 EUR were disbursed<sup>19</sup>. Average loan amount disbursed by credit unions in Croatia was 4.279 EUR in 2011, compared to 2.720 EUR in 2010 and 2.853 EUR in 2009.

In addition, the main problems indicated for the state of microfinance in Croatia are the lack of guarantees for loans, inadequate offer of banking products and services, demanding loan

<sup>17</sup> Annual Report 2011, Croatian National Bank, 2012.

<sup>18</sup> Croatian Banking Association Analysis in 2013, Croatian Banking Association, 2013

<sup>19</sup> SME Report for Croatia 2012, pg. 36



documentation, too high interest rate, and the lack of information among users regarding financial products<sup>20</sup>.

- Venture capital funds

The Croatian version of venture capital funds is the Economic co-operation funds (ECF), which represent a public-private partnership between the Government of the Republic of Croatia and the private sector comprised of large institutional investors. The main aim of this fund is to encourage the development of venture capital funds in Croatia, as well as to stimulate the Croatian economy by providing access to an additional source of long-term capital. The Ministry of Entrepreneurship and Crafts paid 22 million EUR to ECF in order to help ECF to recapitalize investments of private investors<sup>21</sup>.

As a result, 266 thousand million EUR is available to Croatian companies in the next five years through the following funds: Alternative Private Equity ECF (80 million EUR), Honestas ECF (20 million EUR), Nexus ECF (50 million EUR), Quaestus Private Equity Kapital (70 million EUR) and Prosperus ECF (45 million EUR).

The disadvantage of this form of financing is that procedures related to analysis and approval of financing are extremely complex and take a lot longer (six to nine months on average) when compared to other forms of financing. Information about conditions of venture capital funds financing in Croatia is provided through the Croatian Private Equity and Venture Capital Association whose members are the following venture capital funds: Quaestus Private Equity, Alternative Private Equity, Nexus Private Equity Partners, Prosperus invest and Honestas Private Equity Partners.

- Business angels

Croatian Association of Business Angles is CRANE (Croatian Angel Network), a non-profit association which connects entrepreneurs that need capital for their business ventures and business angles – successful entrepreneurs and corporation leaders who want to magnify their earned money with investments in projects in their starting age. CRANE was established in 2008, and until 2011 has invested in 11 projects with the total amount of 843.279 EUR (Table 11).

**Table 11:** *CRANE investments from 2008 to 2011*

	<b>Number of projects / investments</b>	<b>Amount (EUR)</b>	<b>Average investment amount (EUR)</b>
<b>2008.</b>	1	240.000	240.000
<b>2009.</b>	3	137.200	45.733
<b>2010.</b>	2	150.866	75.433

<sup>20</sup> Survey conducted by the Croatian Bank for Reconstruction and Development (HBOR) and SMEs and Entrepreneurship Policy Center (CEPOR) in 2010. The number of participants in the survey was 255 (bank representatives, civil servants, member of the academic community and students, experts on economic development, representatives of entrepreneurial support institutions and other participants).

<sup>21</sup> SME Report for Croatia 2012, pg. 33

<b>2011.</b>	5	315.213	63.042
<b>Total</b>	11	843.279	76.661

*Source: SME Report for Croatia 2012, pg. 40*

- Government incentive programs and subsidized credit lines

Government of the Republic of Croatia implements measures indirectly through promotion of investments and directly through loan programs, with a purpose of promoting development of SME sector. Government's measures implemented in 2011 are part of the SME Promotion Programme, through which the Ministry of Economy, Labour and Entrepreneurship approved 5.400 aids in the amount of 26.513.075 EUR. The aids were approved within the following projects: Strengthening small business competitiveness; Competitiveness through innovation; Competitiveness of the most successful "Gazelles"; Women entrepreneurship; Entrepreneurship of young people, start-ups and disabled people; Entrepreneurship in culture; Cooperative entrepreneurship; Clusters; Construction of entrepreneurial zones; Business support institutions; Education for entrepreneurship; Promotion of development of crafts; Additional training and retraining in crafts; Development of traditional and artistic crafts; Promotion of entrepreneurship; Internationalization of Croatian economy; and Strengthening international competitiveness<sup>22</sup>.

- Croatian Bank for Reconstruction and development (HBOR)

HBOR implements financing of SMEs through subsidies credit lines, as well as it provides support to entrepreneurs that are involved in export through loans and insurance of export jobs from commercial and political risks.

During 2011, SMEs had at their disposal 23 loan programs implemented by HBOR. The main programs through which HBOR approves loans for SMEs are: loans for small and medium entrepreneurship in special state care areas and on islands, loans for agriculture, loans for small and medium entrepreneurship for start-up and development of entrepreneurship, loans for small and medium entrepreneurship for tourism, loans for small and medium entrepreneurship for financial restructuring, loans for small and medium entrepreneurship for export and loans for small and medium entrepreneurship for working capital.

In 2011, HBOR granted 1.311 loans with the total amount of 481.329.866 EUR, where the average of the loan amount was 361.630 EUR<sup>23</sup>. This is 15% more when compared to the previous year, 2010.

Additionally, HBOR has introduced new loan programmes which are: Financing, the preparation of agricultural production, Programme for financing candidates for IPARD Measure 101 and Measure 103, and Loan programme for the improvement of liquidity.

- Croatian Agency for SMEs and Investment (HAMAG INVEST)

<sup>22</sup> SME Report for Croatia 2012, pg. 41

<sup>23</sup> SME Report for Croatia 2012, pg. 48

The main activities of HAMAG INVEST are issuance of guarantees, awarding of grants, certification of consultants, co-financing of consulting services, development of business infrastructure and attracting new investment projects into sectors.

The HAMAG INVEST guarantee fund in 2012 amounts for 266 thousand million EUR, where the maximum amount of guarantee issued by HAMAG INVEST in 2011 could have been up to 80% of the loan principal, and the maximum amount of a loan guaranteed for is 2.000.000 EUR. In 2011, HAMAG INVEST issued 112 guarantees with the total investment of 65.902.544 EUR (Table 12).

**Table 12:** *Guarantees issued by HAMAG INVEST and amount of investment covered from 2009 – 2011*

	<b>2009.</b>	<b>2010.</b>	<b>2011.</b>
<b>Number of guarantees issued</b>	106	133	112
<b>Amount of issued guarantees (EUR)</b>	18.324.452	23.754.354	20.568.558
<b>Amount of investments (EUR)</b>	82.896.840	85.122.854	65.902.544

*Source: SME Report for Croatia 2012, pg. 51*

Access of information and advisory services is one of the preconditions for the development of entrepreneurship. The grade of perception of quality of professional infrastructure support for SME sector development in Croatia is in 2011, compared to 2010, lower in relation to other GEM countries (Croatian grade in 2,84, whilst the average in other GEM countries is 3,02 in 2011)<sup>24</sup>.

### **3. Conclusion**

The overall economic situation in Europe and Croatia is still weak - poor economic performance manifests in high rates of unemployment, a sovereign debt crisis, and increasing imbalances in trade and government deficits. The economy in Croatia is stagnating, the rate of growth is negative, gross domestic product growth rate in 2012 is -1.8%, the average registered unemployment rate reached 20.4%.

SMEs in Croatia represent 99.7% of all enterprises. The size structure of Croatia's SME sector has been relatively stable over the year 2010 and 2011. The total number of active SMEs in 2011 is 90,831 units, which is a reduction of 5.7%, compared to 2010. 65.5% of total employment is achieved by the SME sector, and the average number of employees in small enterprises is between 4 and 5, while in medium enterprises is 123. In terms of exports, SMEs have achieved a share of 42% of Croatian exports.

<sup>24</sup> GEM Report 2012, pg. 97

On the regional level, the greatest number of SMEs is in the North-western Croatia region, where the total number of SMEs counts for 58.7% of all enterprises in that region. In the Adriatic Croatia region the total number of SMEs counts for 46.6% and in Central and Eastern (Pannonian) Croatia region represents 37.5% of all enterprises. In terms of employment, SMEs in Adriatic Croatia region count for 63.1% of total employment in that region, compared with 59.6% in Central and Eastern (Pannonian) Croatia region, and 50.8% in North-western Croatia region.

In terms of the financial support, Croatia is performing above the EU average, with the main sources of financial support to the development of SME sector coming from banking sector, credit unions, venture capital funds, business angels, and government incentive programs and subsidized credit lines. In contrast, access and availability of information and advisory services for SMEs in Croatia is graded below the EU average and is provided through business support institutions.

The framework for balanced regional development at national and sub-national level is set in the Regional Development Strategy 2011 – 2013. The main objectives of the Strategy are to contribute to social-economic development of the Republic of Croatia, to strengthen competitiveness and to realize development potentials through the development of county and statistical regions, development of supported areas and development of border areas.

Regulatory environment in Croatia is not stimulating the development of SME sector, since there is a big number of acts that constitute the regulatory framework for SMEs in Croatia; while the regional development in general has good support, as all the laws are directed to the local level, and are recognizing the areas lagging behind in development, as well as are supporting the establishment and development of crafts, cooperatives and SMEs. The main actors in formulation, adoption and implementation of the policy framework for activity of the SME sector are mostly government bodies, chambers and associations. The greatest criticism to government policies refers to the absence of appropriate support of growing businesses.

With regards to the importance of SME sector for Croatian economy and more efficient development, the regulatory framework related to SMEs has to be simplified, professional infrastructure that provides services to entrepreneurs must ensure a wider spectrum and a higher level of services, as well as enhanced coordination between all the institutions responsible for the development of SMEs both at national and regional level is required.

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