

**Institut für Höhere Studien (IHS), Wien
Institute for Advanced Studies, Vienna**

Reihe Osteuropa / East European Series

No. 55

Financing Private SME in Bulgaria

Todor Balabanov

**Bestellen Sie jetzt: Codex. Die neue
Publikationsreihe über die Rechtslage
in den Reformstaaten Ungarn,
Polen, Slowenien, Tschechien
und Slowakei.**

Ja, senden Sie mir ein Codex-Jahresabonnement: Eine Länderanalyse: öS 4.290,- (inkl. MWSt)
 Zwei Länderanalysen: öS 7.480,- (inkl. MWSt) Drei Länderanalysen: öS 8.800,-
 Alle vier Länderanalysen (Ungarn, Polen, Slowenien, Tschechien und
Slowakei): öS 11.000,- (inkl. MWSt) Polen Slowenien Tschechien und Slowakei

Name:

Adresse:

Kupen einsenden an: Bank Austria
Postfach 35
A-1011 Wien

Bank Austria

Financing Private SME in Bulgaria

Todor Balabanov

Reihe Osteuropa / East European Series No. 55

March 1998

Todor Balabanov
Institut für Höhere Studien
Stumpergasse 56, A-1060 Wien
Phone: +43/1/599 91-230
Fax: +43/1/599 91-163
e-mail: balabano@ihs.ac.at

**Institut für Höhere Studien (IHS), Wien
Institute for Advanced Studies, Vienna**

The Institute for Advanced Studies in Vienna is an independent center of postgraduate training and research in the social sciences. The publication of working papers does not imply a transfer of copyright. The authors are fully responsible for the content.

Abstract

This study is looking into the prospects for financing of private Small and Medium Enterprises (SME) in Bulgaria. The options for favourable institutional environment based on a consolidated governmental and private support to this segment of capital market are exemplified through German experience and Hungarian practice. Both the national alternatives and the specific circumstances of district-municipalities of Bourgas, Plovdiv and Smolian are reviewed. Special attention is paid to the opportunities that may open under the new political and economic climate.

Keywords

Financing, SME, institutional building, private sector development

JEL-Classifications

G32

Comments

This is an updated version of a paper prepared for the AEPC-OECD Project "Private Sector Development in Bulgaria". The financial support from Austrian Chancellery's General Directorate GD IV through the AEPC-OECD co-operation framework is gratefully acknowledged.

List of abbreviations

AS&ME	Agency for Small And Medium Enterprises
BAEF	Bulgarian American Enterprise Fund
BARDA	Bulgarian Association of Regional Agencies and Business Centres
BAP	Bulgarian Association for Partnership
BGL	the national currency - Bulgarian lev
BRDA	Bourgas Regional Development Association
BSS	Business Support Structure
DEM	German Mark
EBRD	European Bank for Reconstruction and Development
HUF	Hungarian Forint
IAS	Institute for Advanced Studies
IMF	International Monetary Fund
MO	Membership Organisations
NSI	Bulgarian National Statistical Institute
OECD	Organisation for Economic Co-operation and Development
PHARE	EU programme for co-operation with Eastern Europe
RDA	Regional Development Association
NGO	Non Governmental Organisation
SBID	State Bank for Investment and Development
SME	Small and Medium Size Enterprises
SOE	State Owned Enterprises
SRDA	Smolian Regional Development Agency
UEIC	Union for Economic Initiative of Citizen
UPEE	Union for Private Economic Enterprise
USD	US Dollar

Summary and Introduction

This paper attempts an evaluation of the status and prospects of what seems to be the most important support service for private sector development namely financing capital needs of Small and Medium Enterprises (SME).

The expected synergy effect from consolidated governmental and private support to this growing segment of capital market are exemplified through German experience and Hungarian practice. Both the national options and the specific circumstances of district-municipalities of Bourgas, Plovdiv and Smolian are reviewed in details. The analysis is targeted at identification of opportunities that may open under the new political and economic climate.

It became apparent that as a result of succeeding international programmes for development of Business Support Institutions a number of Non Governmental Agencies have been created and their staff trained to provide support services to local business communities. Services provided are varying both in scope and orientation but they seem to be matching needs.

Due to the financial crises of 1996/97, and related to it collapse of the banking system, the level of lending from SME oriented credit lines was far below expectations. Substantial part of financing needs of SME was supplied by sources outside of official banking system. Among the many factors keeping credit market for SME in bail were: (1) high currency risks for borrowers that were to take in BGL the USD dominated credits, hence carrying the entire currency risk in an inflationary environment, and (2) the non-transparent collateral law and unclear enforcement procedures were. One of the consequences is that many companies prefer direct foreign involvement in form of both equity participation and joint ventures with foreign partners. Therefore, regional schemes for equity investments, as an alternative to the more expensive bank credits, will find their place at the market.

The expected for 1998 mass unemployment can be alleviated by introduction of micro credit lines extendible to those that have a proven interest in establishing own business.

The new Agency for Small And Medium Enterprises (AS&ME) may need to enter negotiations for harmonisation of public and private interests related to SME development. AS&ME is also called to improve the legislative framework for SME operations and to act as intermediary in accessing credit lines but also to improve SME sensitivity to market signals.

AS&ME may also assume some functions in managing several purpose oriented funds. Through the programmes for micro lending Business associations will get into the business of providing insurance schemes for micro credits. It is quite probable that with the time Business Support Agencies may extend credit guarantee schemes to loans beyond micro credit level.

The international support to SME development may be meaningfully used if multiple funding facilities targeted to the specific needs of different SME groups can be set up. Target groups for such programmes can range from the start-up micro businesses to export promotion activities.

The responsibilities sharing between AS&ME and the NGOs in managing such funds will not only create favourable division of duties between governmental and private initiative but will also decrease the dangers of NGO bureaucratisation. The income from credit guarantees schemes will allow Business Support Centres to behave as commercial suppliers of services. It may be worth also mentioning that present funding procedures that is requiring public access to applicants accounts are seen by many as harmful and even dangerous. More confidential credit negotiations may increase the disbursed amount.

In the first part some general considerations about the macro-economic environment for SME operations are presented, followed by a short presentation of the main private sector business support agencies in the above mentioned three district-municipalities and their national association, ending with a short description of the potential credit market as related to the industrial base of the three regions. In the second part the discussion is related to the German and Hungarian experiences for allocating responsibilities to governmental and private sector agencies in financing SME. Then the Bulgarian experience will be summarised followed by conclusions and recommendations.

General considerations

With the recent empowerment of a reform oriented government in Bulgaria the seemingly usual news on economic deterioration are fading away. Following an acute financial crisis in 1996-mid 97 (Table 1) the economy is stabilising surprisingly quickly. Merrill Lynch is forecasting that for 1998 the major economic variables will compare very favourably to other Central European economies. The GDP is to grow by 4%, the inflation will be at the level of 12%, and the expected budget deficit can be as low as around 1% of GDP, these combined with a balanced current account. Moreover the anticipated foreign direct investment next year are to be between 4% and 8% of GDP, following inflows of around 5% in 1997. Structural reforms will be proceeding but will be more difficult. The government has embarked on a privatisation programme which is likely to lead to the majority of the country's state-owned enterprises being privatised during the next two or three years. An ambitious programme of bank privatisation has also been launched: the first bank was sold in July 1997 and most of the others are likely to be sold by 1998 or 1999.

Table 1: Selected economic indicators

	1993	1994	1995	1996	1997 ^{1,2}
Changes in GDP	-1.5%	1.8%	2.1%	-10.9%	-7.4%
Unemployment rate (yearly average)	16.4%	12.8%	11.6%	12.5%	N/A.
Changes in consumer prices	63.8%	121.9%	32.9%	310.8%	566%
Exports (in 10 ⁶ USD)	3,727	3,935	5,345	4,881	5,046
Imports (in 10 ⁶ USD)	4,612	3,952	5,224	4,673	4,841
Current account (in 10 ⁶ USD)	-1,386	-203	-59	117	74
Direct investment (in 10 ⁶ USD)	40	105	82	100	430
Capital account (in 10 ⁶ USD)	-180	29	253	-944	375
Currency reserve (in 10 ⁶ USD)	655	1,002	1,236	483	1,638
Current account (in % of GDP)	-12.8%	2.1%	-0.5%	1.3%	0.8%
Changes of real exchange rate	33.7%	-0.3%	14.7%	-37.7%	..
Budget deficit (in % of GDP)	-10.9%	-5.8%	-6.4%	-13.4%	-6.3%
Changes in Broad Money Supply	47.6	78.6	39.6	124.5	245.4
Primary Interest rate ³	53.6%	72.3%	25.3%	211.8%	6.1% (Sept)

Sources: Andrew Kenningham, NSI, in PARI Daily, 4th of August 1997

Notes: ¹ Preliminary data; ² As estimated by IM; ³ For one month deposits

Despite this progress, enormous challenges remain on the structural side. Problems include significant losses accumulated by both state and private enterprise (although these have fallen since 1996/95) and a private sector which is mostly limited to retail trade.

Many fear that in short term the main issue will be rising unemployment and related to it social tensions. Unemployment is expected to increase from 14.1% in September 1996 (Table 2) to about 15-16% by the end of 1997 and 20 - 25% by the mid 1998. This jump will result from the much delayed structural adjustment and rationalisation programmes that may include closure of many loss making state owned enterprises and reduction of the overblown administration. Although both are urgently needed some sober voices are claiming that the number of unemployed may reach eight hundred thousand people (out of a labour force of 3.1 million) before expected economic recovery may allow for revival of labour market.

One of the major hopes for absorption of unemployed is by accelerated creation of small and medium enterprises (SME). The intended governmental support of this process are many and include:

- Creation of an active Agency for Small and Medium Enterprises
- Support to the Non Governmental Organisations and specifically their involvement in the new SME legislation and in creation of a Credit Guarantee Agency.

- Conception of micro credit schemes for those who decide to open their own business
- Anti-crime campaign to reduce those SME transaction costs that are stemming from racketing, enforced insurance, etc.

This new environment should be seen as a cardinal departure from the indifference and the bureaucratic barriers typical for the previous governments attitude towards SME.

Certainly intentions and reality may be quite different. As mentioned in a latest issue of German newspaper FREITAG¹ due to its slow reaction to EU requests the government has missed the chance to make use of SME related PHARE grants for 1998.

An additional aspect should not be underestimated - it is quite difficult to speak about open financing in an economy that have an estimated shadow economy of between 60% and 400%² of its official GDP.

Despite all these the aims of this study is to reflect positively upon the opportunity set that is unfolding under the new administration in the condition of growing private sector's economic significance.

A. Population and Labour force

The three district-municipalities subject of this overview belong to two administrative regions, namely Bourgas and Plovdiv.

In the region of Bourgas there is an equal share of 9.8% from the Bulgarian total for urban and rural population. For Plovdiv region these figures are 13.8% urban and 15.5% rural population.

In both regions the unemployment rates are above the country average (Table 2) with the urban unemployment rate being higher in Plovdiv while the rural one is leading in Bourgas.

According to the National Statistical Institute (PARI 4 of June 1997) at the end of April 1997 incomes within the state owned enterprises in Plovdiv were at least 50% below Bulgarian average. For the private sector the incomes were even lower by further 30-35% and in most cases private employees were employed without official contracts, meaning without job security, health and pension insurance.

¹ As quoted in the "Fear for the winter - the first 100 days of Kostov's government", PARI daily, 18th of August 1997.

² As estimated by Ivan Tzenov, in "What is feeding the shadow business in this country", PARY daily, 21st of August 1997.

In general the districts of Bourgas and Smolian can be seen as representing one of the most advanced and respectively one of the crisis regions of the country in both of which the development of private sector is actively supported by non governmental business support organisations operating under the umbrella of a national association.

Table 2: Urban Population (Upop) over 15 years of age for Bulgaria (BG)

Total, Bourgas; Plovdiv and Smolian (as of September 1996)							
	UPop>15 (1000)	Total labour force	Employed	Unemployed	Activity rate	Employed/ Population	Unemployment rate
BG Total	4643.7	2602.8	2236.2	366.6	56.1%	48.2%	14.1%
Bourgas	248.	138.0	121.4	16.6	55.5%	48.8%	12,0%
Plovdiv	429.8	225,2	209,6	15,6	52.4%	48.8%	6.9%
Smolian	62,9	38,8	32,3	6,6	61.7%	51.3%	16,9%

Source: Employment and Unemployment, National Statistical Institute (NSI), Sofia, 1996

1. Ethnicity

As shown at Table 3 the predominant religion in district municipality of Plovdiv is the Orthodox Christian (with only 8.1 % Moslem) while in Bourgas the Moslems share climbs to 15.6 % and in Smolian the Moslems predominate with a share of 55 %.

Table 3: Breakdown of population according to its religious affiliation

	Christian	Moslem	Other
BG Total	87,0%	12,7%	0,2%
Bourgas	84,2%	15,6%	0,2%
Plovdiv	91,4%	8,1%	0,5%
Smolian	44,8%	55,0%	0,2%

Source: Georgi Fotev, The other ethnoses, M.Drinov Pbl., Sofia, 1994

B. Private Sector Development

Enabled by the quiet revolution of 1989 present day private sector has grown out from the opportunities and scarcities left over by the former state owned command economy. Certainly the availability of skills, the chances to explore long existing niche in services and the filling of the gaps left by inefficient state owned trade outlets created significant opportunities for widespread entrepreneurship. The rate of establishment of private enterprises will be accelerated by the forthcoming restructuring campaign. Till 1996 an estimated 350,000 private firms have grown out of the small scale privatisation, the restitution, the mass and cash privatisation programmes and last but not least there were many genuinely new beginnings in the retail trade, hotels, restaurants, agro-industries, financial and other services sectors. The

legal forms of incorporation of these new entities are generally corresponding to the West European commercial codes and include single-person firms, limited liability companies, joint stock companies, co-operatives, etc.

The potential credit market is based on the structure of industrial assets offered for the mass and cash privatisation campaigns but also on the early restitution.

1. Potential credit market: the Industrial base offered for privatisation

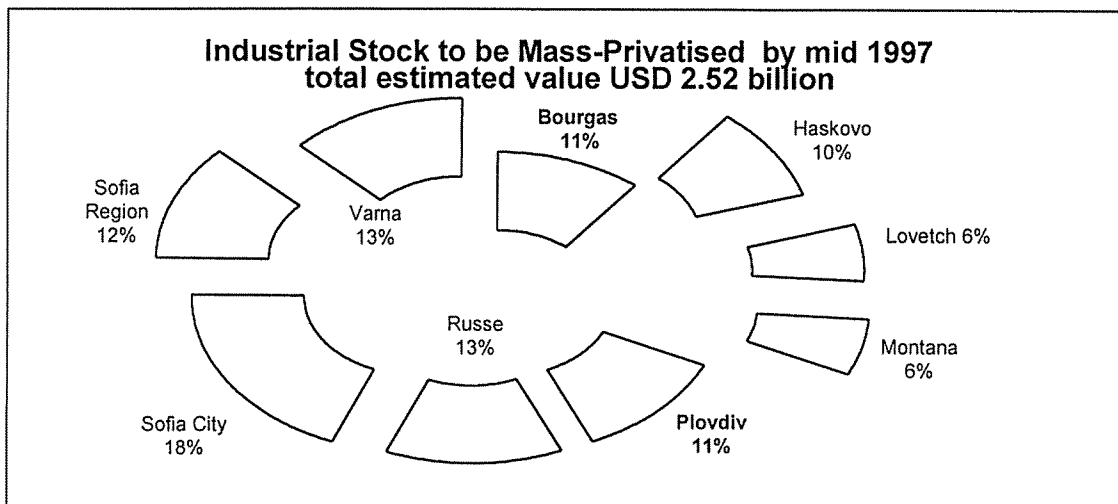
At present the two main privatisation venues are:

- (i) equity against vouchers (mass privatisation) and/or
- (ii) against cash (the preferred method).

While the voucher privatisation is supposed to be completed by mid 1998 the more comprehensive cash privatisation programme will need somewhat longer time span.

Here below the regional structure of industrial assets offered for privatisation in the regions under consideration will be depicted and discussed.

Figure 1: Regional Structure of the Industrial Assets



Source: Bulgarian Foreign Investment Agency, <http://www.geobiz.com/fia/> (1997)

Both regions of Bourgas and Plovdiv retain an equal share (11%) of the capital stock authorised for mass privatisation (see Figure 1) but the assets composition is quite different, e.g., while oil refining, ship building, and sea shore tourism make the economic backbone of Bourgas region in Plovdiv the mining of minerals and non-ferrous metals as well as their processing, engineering industries and mountain resorts are the main economic sectors.

2. Privatisation by restitution

A considerable share of enterprises was re-privatised in the course of 1992-1995 by the way of restitution, i.e., by returning property rights to pre-communist owners of assets. As of the enactment of Law on Restitution (February 21, 1992) till September 30, 1995 around 22,100 sites have been re-privatised, including shops (17% of the value and 47% of the numbers), restaurants, hotels, warehouses, manufacturing enterprises and workshops. Around 87% of those assets are situated in towns and the rest of 13% in villages (Table 4).

Table 4: Structure of the Restituted Assets by the end of 1996

	by value	by number
Shops	17,15%	47,15%
Hotels	2,45%	0,75%
Storehouses	3,03%	4,58%
Administrative buildings	3,15%	1,96%
Cultural facilities	9,79%	1,08%
Floor mills	5,76%	3,62%
Other industrial projects	47,48%	8,08%
Workshops	7,33%	27,14%
Total	96,13%	94,37%

Source: Foreign Investment Agency, 1997, <http://www.geobiz.com/fia/>

3. Regional comparative advantages of mass privatised industries

The potential comparative advantages are classified according to the following set of criteria:

- (I) local resources and raw materials,
- (II) qualified work force,
- (III) established traditions and manufacturing experience,
- (IV) existing production facilities and infrastructure,
- (V) the national and regional policy in support of privatised enterprises,
- (VI) the economic indicators of sectors (average annual growth rate, financial results, foreign currency revenues) for the last year and for the period 1989-1995,
- (VII) the rate of structural change of the branches by regions,
- (VIII) future trends in market shares and development of the privatisation process.

On the basis of the above mentioned criteria sectors are ranked into three levels:

- (+++) with a very good outlook for further development
- (++) with good outlook for further development
- (+) with poor or unclear outlook for further development

Table 5: Regional comparative advantages for the main industries

Sectors	Bourgas	Plovdiv
Mining	+	+++
Non-ferrous metallurgy		+++
Ferrous metallurgy	++	+
Oil-refining industry	+++	
Ship building	+++	
Mechanical engineering	+++	+++
Constructions materials industry	+	+
Food-processing		+++
Agriculture	+++	+++
Tourism	+++	+++

Source: Woergoetter et al., *Investment Opportunities in Bulgaria*, IHS, 1997

C. Non Governmental business support agencies

With the help from EU-PHARE, the UK know-how Fund, the USAID, UNDP and some other donors, 8 business centres and development agencies in the regions of Bourgas, Dobrich, the Mesta region, Pazardjik, Plovdiv, Sofia, Rousse and Smolian have not only been created but their personnel has been trained and along the time it acquired significant experience in providing diversified support to SME in their respective regions. At the time of writing this report two new agencies have been added to the list - those in Stara Zagora and Vidin.

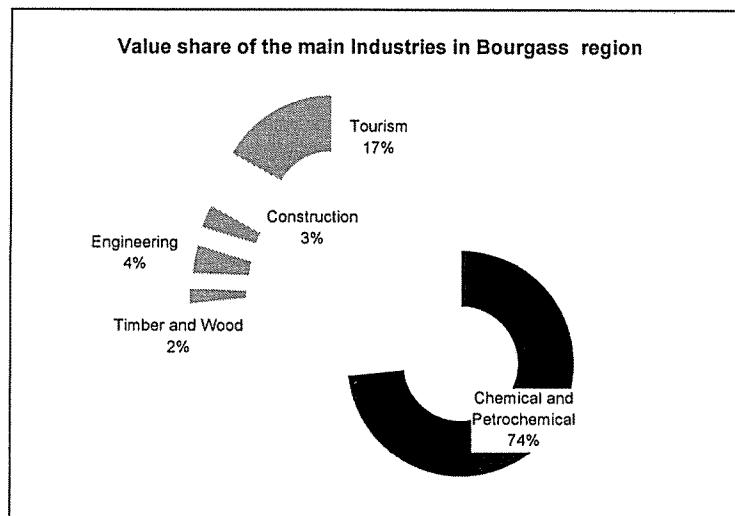
The common feature of all of them is their continued dependence on sponsors support and the practically negligible self generated income, a situation that is bound to change if they intend to establish themselves as commercial service providers.

The description below is based on the statements made by listed agencies and these have not been contested by the reportee.

1. Bourgas Regional Development Association³ (BRDA)

The Bourgas region is situated in the South-east of Bulgaria at the Black Sea coast, with Turkey to the south and the Balkan mountains to the north. Its territory is 7696.5 sq. km. The population of the region is about 441,000. The city of Bourgas is the fourth largest in Bulgaria with a population of 225,000. It has a duty-free zone and a well developed transport network, including the largest Bulgarian port, which specialises in petroleum and petroleum products, a fish harbour, an airport, and the largest transport terminal. The region's beaches, mountains, mineral springs, and mild climate are particularly conducive to the well developed tourism already in existence (17% in Figure 2). Key industrial sectors include petrochemical industry and petroleum refining (74% in Figure 2), metallurgy, transport, engineering, food, wine, tobacco, textiles, mining, and wood working.

Figure 2: Main Industries in Bourgas



Source: Bulgarian Foreign Investment Agency, <http://www.geobiz.com/fia/> (1997)

Established in 1993 with the assistance and financial support of the EU PHARE programme, **BRDA** has worked with various programmes from the European Union, the USA, Israel, Great Britain and others to realise its goals of collecting and studying information on the economy of the region, carrying out programs and projects, assisting private businesses with consultation, marketing the region advantages as well as training private businesses and the unemployed. The activities in support of these goals have included development of information services, establishing a data base with information on the region's SME's, work for attracting foreign investment, encouraging eco-tourism, assisting the first Bulgarian-German joint venture for production of small transport machines, assisting regional businesses in

³ For more information on business in Bourgas or the Association, please contact: Nicolai Chakarov , 1 Cont Androvany St., 8000 Bourgas; Tel: +359 56 45 198; Fax: +359 56 42467.

participating in international fairs and exhibitions, establishing associations of private hoteliers and restaurateurs in Nessebar and Sozopol, and publishing tourist and investment brochures for the region. **BRDA** has organised, in conjunction with foreign assistance organisations, training in Great Britain and other western countries for representatives of Bourgas region including visits to industrial zones and training courses on standards of tourist services, development of fishing tourism, joint activities with the Japanese export-trade organisation, credit opportunities, quality control and management, English language, computer literacy, management of small firms, marketing and financial management.

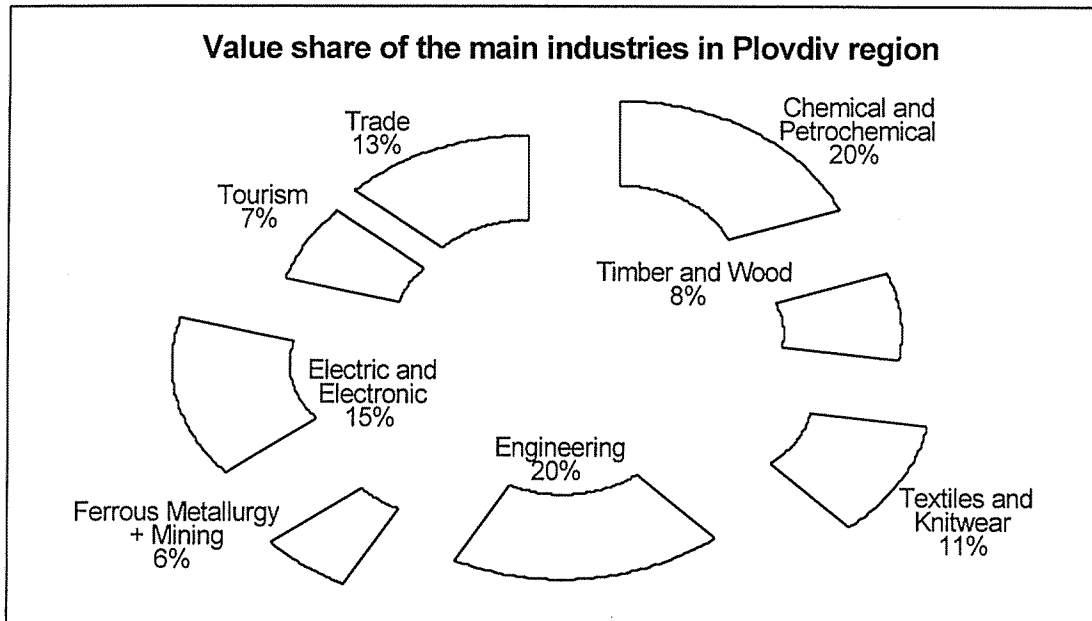
2. Business Support Centre (BSC) for Small and Medium Enterprises - Plovdiv⁴

The district of Plovdiv is located in South-central Bulgaria between the Rhodope and the Balkan Mountains and comprises 6 municipalities, including the city of Plovdiv, the second largest city in Bulgaria. Industries in the region include, see also Figure 3, Chemical and Petrochemicals, Engineering, Electric Equipment and Electronics, Tourism, Food, Textile and Knitwear, but also Cosmetics and Perfume.

The Business Support Centre (BSC) for SME - Plovdiv has been established with the assistance and financial support of the EU PHARE- Programme. In the past years, the BSC has offered seminars on (1) development of the dairy industry, (2) the canning industry, the meat packing industry, (3) the perfumes and cosmetics industry, as well as (4) management of small and medium businesses, (5) state investment policies and financing for SME's, (6) innovations in technology and equipment in the canning industry, (7) registration of patents, know-how, licenses, (7) EC-ISO 9000 standards, (8) energy conservation in the milk, bread and meat producing and canning industries, (9) management of SME's under, a currency board, (10) EC standards for the machine building, food and tobacco, and wine producing industries, and (11) the importance of advertising and package design for SME's.

⁴ For more information on business in the Plovdiv region or the Centre, please contact: Bojidar Penchev, 37 Tzar Boris III Obedinitel Blvd., Pavilion 27, Plovdiv 4018; Tel: +359 32 56 27 40; Fax: +359 32 56 31 75.

Figure 3: Main industries in Plovdiv



Source: Bulgarian Foreign Investment Agency, <http://www.geobiz.com/fia/> (1997)

The Centre also offers courses in (12) accountancy and management, (13) international trade, marketing and strategic planning, (14) taxes and tax regime in Bulgaria, (15) how to start a business, (16) business plan development and financial analysis, (17) technology transfer in the food and tobacco industry, (18) wholesale and retail trade and service industries, (19) application of software products, and (20) new forms of development for SME's including franchising, joint ventures, and opportunities for financing.

Other activities of the centre are:

- infrastructural development of a trade zone for SME in Plovdiv region,
- establishment of an information system and a local business network for SME.

3. Smolian Regional Development Agency⁵ (SRDA)

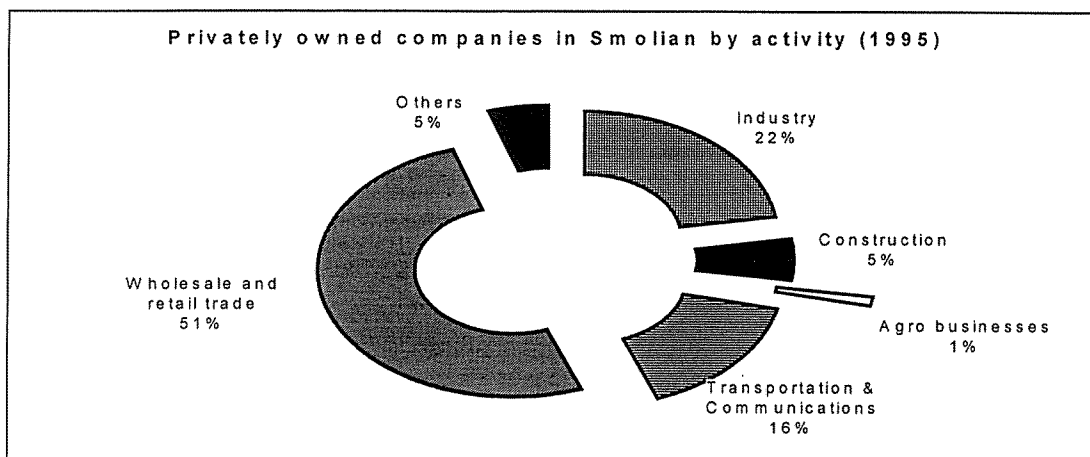
The district of Smolian is located in the centre of the Rhodope mountains bordering Greece to the South and covers an area of about 3500 sq. km. The area has a population of about 160,000 and includes 11 municipalities. Most of the private companies were registered in, Figure 4, the wholesale and retail trade, machine-tools and woodworking machines, knitwear and ready-made clothes, dairy products, paste products and foodstuffs, woodworking and forestry, and **tourism**.

⁵ For more information on business in the Smolian region or the Agency, please contact: Ivo Tzarev, 10 Bulgaria Blvd., PO Box 31, 4700 Smolian; Tel: +3599 301 28 758; Fax: +359 301 28 761.

Because of its favourable climate and location the region, offers opportunities for mountain tourism like skiing, hiking, cycling, sightseeing, ecological tourism, etc. Pamporovo winter ski resort, located near Smolian, offers adequate winter sports facilities but also excellent conditions for hiking, walking and sightseeing tours. Its is also offering top-class hotels, folk-style taverns and a holiday villages.

SRDA has been established and is covering its running expenses with the support of several international programmes including EU PHARE Programme, British know-how Fund and focuses its activities on the small and medium sized enterprises in tourism and agriculture, human resources development, labour market, international co-operation and co-ordination.

Figure 4: Private businesses in Smolian by area of activity



Source: Territorial Statistical Bureau Smolian, Private sector in the Smolian Region for the period 1991-1995, Smolian, 1997

Additional activities include (1) training and consultancy, (2) providing business information, (3) marketing local companies products through the computer system of Euro gushet. It supports tourism development in the region through encouraging the establishment and development of family-owned hotels, publishing of promotional leaflets and brochures, creation of a tourist data base on the hotels with information about their capacity and services, establishing Tourism Information Centres, and preparation of an overall strategy for tourism development. The agency also is:

- publishing a specialised newsletter in Bulgarian and English for potential foreign investors and is preparing an investor's directory for the region,
- taking part in international forums in order to establish contacts with government and non-government bodies and Embassies,
- supporting direct contacts between companies and potential investors,

- encouraging international collaboration and co-operation,
- creating a data base of information about the economic potential in the region which can be used by potential investors, and
- providing exhibition rooms for local companies.

4. Bulgarian Association of Regional Development Agencies and Business Centres⁶

At a higher organisational level is the established in February 1997 association of independent regional and local economic development agencies and business support centres named Association of Regional Development Agencies (BARDA). It brings together representatives from the public and private sectors to promote regional economic and enterprise development. BARDA acts as a forum for co-ordination of information and services, development of joint projects, and attraction of investment, funding, national and international programmes. It provides training and information for its members.

BARDA supports the extension of business centres network within the country and helps to represent the interest of the local and regional business community. It assists with the development of national policies for business and regional development by working closely with the Parliament and the relevant Ministries to further legislative base, liberalise trade and reduce tariffs.

The main presumptions for BARDA operations are based on the expected by mid-1998 privatisation of majority of the state-owned firms and related to it enhanced importance of SME's for Bulgarian economy because through their flexibility and by making use of the locally available potential, SME's are better suited to respond to local needs. As part of their income generating and employment creation strategy, the development agencies and business centres member of BARDA encourage local initiative, diversification and investment. In addition, they are bringing together municipal authorities and the business community to discuss and establish consensus regarding the growth and stimulation of the economies of their regions.

Thus far, BARDA includes business centres and development agencies in the regions of Bourgas, Dobrich, the Mesta region, Pazardjik, Plovdiv, Rousse and Smolian with two new applicants - Stara Zagora and Vidin.

The agencies and centres, employing local personnel, provide support services to businesses and municipalities in their regions including: business consultancy, training, business plan assistance, as well as information on markets, machinery, credit, and investment possibilities, exhibitions, and others. They are also active in stimulating the creation of branch

⁶ For more information on business in BARDA, please contact: Nicolai Chakarov, 1 Cont Androvany St, 8000 Bourgas; Tel: +359 56 45 198; Fax: +359 56 42467

chambers and associations at a local level. Finally, members of BARDA are involved in the development of regional economic and sector strategies. The members of the agencies and centres consist of representatives of the local administration, chambers of commerce, local industrial and business associations and private companies.

Sharing SME assistance between Government and the Private Sector

As far as the approved by the Council of Minister's Ordinance No. 314 from 31st of July 1997 on the establishment of Agency for the Middle and Small Enterprises invoked a quite intensive discussion on what should be the best way of sharing SME assistance between Government and the private sector the problematic may be addressed by referring to the experience gained by German BMZ (Ministry of Economic Co-operation) and GTZ (Agency for Technical Co-operation) through their many years of world-wide programmes for SME support.

Hungarian experience the management of a dedicated fund for micro business financing by the mean of the preferential "START" credit programme will be the second item of this chapter.

A. The German experience

German experience shows that the relationship between government and the private sector is a major factor in developing SME, specifically in determining what role each of these will play in providing services and support to the SME. It is generally accepted that choice of the private sector to implement a number of services should not be based on ideological considerations but rather on what arrangements would be more efficient and effective in delivering quality services and have them more readily accepted by the target group for whom they are intended.

Efforts to attract the private sector and to hand over more and more responsibilities in supporting small enterprises are generally based on the assumption that such organisations:

- a) have greater access to the target group of potential beneficiaries and a broader appreciation of the needs of small enterprises.
- b) services offered by such organisations have greater acceptance by their client enterprises rather than those offered by a government for which firms generally harbour suspicions and have reservations as to their intentions.
- c) are less prone to direct political influences although it would be unrealistic to suppose that such organisations may not be influenced politically in different ways. However, the politi-

cal influences in government structures tend to permeate public institutions down to such detailed matters of implementation as management, staffing and budget.

Private Sector organisations, referred further as NGO, are more likely to be staffed by those with industrial and business experience and so should be able to offer more practical "hands-on" assistance. The strengthening of private sector organisations through transferring the implementation of a number of services to these bodies can be the basis for an appropriate division of responsibility and co-operation between private sector and government in providing together a realistic programme of support for small enterprises. The conclusions could be that there are specific functions and responsibilities that are best left to government and others which in an ideal situation in a more advanced economy may be carried out more effectively by the private sector and its representative organisations.

For example the **government** is to provide the legal and fiscal framework in which small enterprises will have to operate. It is expected to initiate, in consultation with the SME and their representative bodies, the incentives and environment needed to stimulate small enterprise development. Governments will be responsible for setting financial policies and taxation. The policy framework will be a basic factor in determining the economic and financial well-being of small enterprises.

Among the responsibility of government are to provide basic education and skills training and to establish and operate an educational and vocational training network to guarantee an adequately trained and skilled labour force. It may delegate some of these responsibilities to institutions outside the government, in the private sector or to independent institutions, but in the final analysis government must have an overlook on allocation of resources so that to ensure an adequate volume and quality of training.

Governments usually, through its public agencies, endeavour to disseminate information on programmes and schemes for regional development, on effort to promote more exports and the incentives and assistance it is offering for enterprise development. Some more enlightened governments may help to forge links between business enterprises and the research and technological development being undertaken in institutions of higher learning and public financed research centres.

Table 6: Roles of Service Providers to SME

	Government	Private Sector Representative Organisations, Chambers, etc.	Private Sector On Commercial Basis
FINANCIAL	Grants, soft loans Subsidies, tax reliefs Export insurance Help with credit guarantees Savings facilities Information	Special Insurance policies Credit guarantees Credit unions Mutual funds Preparing applications for bank finance Help in credit assessment Bulk purchasing	Export and other insurance Banking Hire purchase/leasing Factoring - debt collection, credit rating Securities markets
ADVICE AND INFORMATION	On regulation and legislation Economics and statistics Management advice (basic) Referrals to appropriate bodies Contact services (specialised, e.g. export)	Promoting of sub-contracting. Info on regulations. Tax and legal advice Market and export info Basic consultancy Referrals to appropriate bodies Contact services in broadest sense, office services	Legal and accounting Special market data Consultancy Personnel recruitment
TECHNOLOGY	Technology transfer Referrals for technological help	Info on sources of new technology Referrals	Licensing Contract R&D
TRAINING	Basic education Basic commercial & management skills. Training of new entrepreneurs. Basic technical skills	Skills up-grading, including setting of qualifications and standards Management development	Specific commercial and management skills, e.g. languages, secretarial, export mgt.

Note: The above is a proposal for breakdown of roles in provision of services for SME suitable for a middle-income country in a transitional phase of transferring more responsibilities of services to the private sector. It is based mainly on experiences in North America, UK and other European countries. The Private Sector in Bulgaria may be still too weak to undertake most if not all these roles. However it should be regarded as the desirable breakdown of roles (with minor variations) at which to aim.

Source: Levinsky Jacob, Private Sector Support for Small Enterprises - Some Conclusions, International Small Business Series 16, University of Göttingen, 1993

As seen from Table 6 the small enterprises, if they are to develop successfully, need a variety of services and forms of help. Apart from access to finance, they need assistance to upgrade their technology and skills in order to make most effective use of financial help that may become available. They need help on how to make their operations more efficient and to improve the management of their enterprises and how better to market their products. In short, small enterprises need support services to whom they can turn for information, advice and assistance.

Table 6 gives also a broad outline of what might be the respective roles in provision of services between the:

- Government,
- Private sector consisting of:
 - firms working on a commercial basis, e.g., consultancy companies, banks, etc., and
 - membership organisations, i.e., business centres, chambers of commerce, etc.

As the private activities develop, the private sector organisations can and should take over more and more of the direct provision of support services.

While "advocacy" may be the prime role for private sector membership organisations they also must keep their members informed on legal and taxation matters and on the availability of all forms of assistance that are being offered from whatever sources. They need also to provide information on new technologies and data that could be of assistance in the production and marketing of products and services. Private sector membership organisations (MO) would also be expected to provide training opportunities in the upgrading of skills to complement the governments basic training schemes. Limited direct counselling and consultancy for small firms would also be within the province of the programmes of MOs. The degree to which organisations are able to offer effectively such services at an acceptable quality level would differ from country to country. It might take time before a private sector organisation in a particular country would be able to offer all such forms of direct help to meet the needs of its members.

Private sector Membership Organisations usually also see as their role the forging of linkages between private small enterprises and government procurement and/or in sub-contracting with larger firms or with overseas partners for joint ventures or for obtaining technological help.

1. Help with Finance for Members

Because of lack of resources, finance is usually a much sought after form of help where it is most difficult for private sector organisations to provide assistance. Some such organisations may have at their disposal limited enterprise development funds made available by the business sector, from which small amounts of equity or credits for special purposes can be offered. Some NGOs including membership organisations do become involved with the provision of limited credit programmes with funding provided from external sources. In addition, a few of the more sophisticated private sector organisations may attempt the development of a financial institution or bank of their own, or in co-operation with some other banking organisation more favourably disposed to the small enterprise sector. More often private sector organisations would lack the resources to develop financial institutions on their own and would be advised rather to attempt linkages with commercial or development banks or particular financial institutions such as co-operative, peoples, savings or development banks.

Well established organisations that have achieved status and credibility can hope to reach a point where their recommendations for assistance in preparing applications of member entrepreneurs for finance to banks can be of great help and even decisive in the attitude taken by the bank to the request. In Bulgaria non of the existing associations (NGOs) has achieved this position. It takes a long time and persistent efforts to attain that degree of credibility in relations with financing institutions. The associations often face the problem of striking a balance between the desire to be of help to their members and analysing the request for financing from a similar objective perspective to that of a bank in examining a loan request. Organisations have to have experienced well qualified staff and adopt a clear policy to give its support and recommendations only to "bona fide" genuine applicants and viable projects. This is essential in order to achieve that position of credibility with the banks which will allow the organisations to be of real assistance to their members in securing financing.

Since in many cases lack of collateral is the major impediment to small firms obtaining bank loans, a more appropriate initiative by private sector organisations might be to develop credit guarantee or insurance schemes to assist members who apply for bank financing but are unable to satisfy collateral requirements. Craft Chambers in Germany and similar organisations in other European countries combine with local authorities and sometimes with those banking institutions that are more disposed to favour the small enterprise sector (e.g. co-operative or savings banks) to develop credit guarantee schemes which they help to administer. It should be recognised this is a sensitive and complex scheme.

Such credit guarantee schemes should be embarked upon only after careful preparation with sufficient "back-up" funding and after extensive consultation with the banking institutions that are expected to use the scheme. For Bulgaria, donor agencies especially the programs of PHARE USAID, UNDP and some German foundations offer both "matching" funding and advice on the setting up of such guarantee schemes.

Guarantee schemes in the final analysis are only worthwhile if they provide financing to small enterprises who would not otherwise be able to obtain finance, for lack of adequate collateral. They face a major "hurdle" in obtaining the agreement of the banks to use them. In present day Bulgaria banks view these schemes with suspicion, lacking confidence that the "guarantees" will really be paid out in the event of a default.

2. Direct Private Sector Support

Apart from services offered by private sector organisations based on membership, many support activities are offered directly by the private sector on a commercial basis. This includes more comprehensive consultancy services, help and advice in the financing of investments and working capital through the banking institutions and in some cases transfer of technology through brokers or firms involved in marketing such forms of help. As industry and the economy develops a greater proportion of services would be provided on a commercial basis. Even those provided through the membership based private sector organisations would tend to acquire a more commercial character. A study of Hungarian experience in developing a network of commercial offers may be quite useful in this respect

a) Counselling and Advisory Services

This usually refers to direct advice and assistance given to individual enterprises to improve technical and management aspects of their operations. The term can be confusing because some organisations include under this heading what might generally be described as information.

Direct consultancy to individual enterprises is a costly business. Small enterprises are generally neither willing nor able to pay more than a modest fee, if anything. High quality consultancies require well paid staff and costly "backup" services. It would be inadvisable and unfeasible financially either for government or private sector organisations to maintain a large permanent staff of qualified consultant personnel so as to offer longer consultancies to individual enterprises whether members or not. This would be true even if some modest fees were paid by those receiving consultancy.

Because of the high costs of providing individual consultancies to a single firms, efforts have been made to offer advice and assistance on a collective base thus reaching a wider number of beneficiaries with less cost. Some organisations, e.g., the Business Support Centre for Small and Medium Enterprises in Plovdiv, have brought together groups of entrepreneurs from the same sector, e.g. clothing, footwear, bakeries, metal working, etc. to discuss common problems and exchange views on how to manage different aspects of their businesses. Apart from the reduced costs of dealing with a number of beneficiaries as against the high costs of dealing with one enterprise at a time, this approach has the additional advantage of

generating an effective interchange so that businessmen learn from one another's experience. It is sometimes argued that these small scale businessmen are too secretive and competitive to reveal a great deal in the presence of those in the same line of business. This can present a problem but with skilful guidance of such groups this mutual distrust can be overcome when participants realise the benefits for all of a frank exchange.

Apart from the group approach, consultancy groups can prepare written material on specific techniques of management which could be used in individual enterprises without too much adaptation. Accounting systems, cost control, production planning, plant layouts, sometimes on a sectoral basis, are examples where suitably prepared material can be combined with direct individual advice and assistance.

Consultancy work can also be cheapened and made more effective through a judicious combination with training.

Most important of all consultancy or extension services of support organisations should regard themselves as "referral agents" primarily, directing or as it is now sometimes called "sign posting" those with difficulties towards persons and organisations who can provide specialised help, even though this may be at some cost.

Most consultancy services are subsidised in some form. In Germany, the government provides a grant for over 50% of the salaries of those working in the Craft Chambers on consultancies for small enterprises. In other cases a fund is available to provide a proportion - usually around 50% of the costs of hiring private consultants - who have offered to work at a favourable fixed rate. There are strong arguments in favour of **relating any grant from governments for advice and consultancy to performance**, so that a subsidy is given for each consultancy undertaken, rather than a blanket support grant for this work without relation to the quantity or quality of the service offered.

3. Private Sector Organisations Structure

Private sector organisations representing industry and commerce will as has been already stated vary from country to country according to the special conditions prevailing. Although they vary in character they can broadly be divided into membership and non-membership organisations. The latter would refer to what are commonly called Foundations, namely organisations supported with resources from large scale business or wealthy, prominent individuals providing financial and non-financial help to the small enterprise sector. The "enterprise agencies" in the UK, through which large enterprises help small businesses usually on a local basis, is an example of such organisations.

Representative membership organisations would include such bodies as Chambers of Commerce and Industry, Federations of Employers and Entrepreneurs of Businessmen, Small Enterprise Associations organised on a regional, provisional or sectoral bases and in a few cases special craft organisations or chambers. Unfortunately in Bulgaria a situation may be emerging that fragmented organisations will be attempting to appeal to the same target group even in the same localities, e.g., Bulgarian Association for Partnership, Bulgarian Association of Regional Agencies and Business Centres, Union for Private Economic Enterprise, Union for Economic Initiative of Citizen, etc..

In Germany under conditions of obligatory membership there are 57 district Craft Chambers (Handwerkskammer - HWK) with an average membership of 13,000 each. The smallest Chambers have 4000 to 5000 members and the largest 25,000 - 30,000.

In France there are 104 Chambers of small businesses and crafts established under public law and to which all firms with less than 10 employees in one of 96 listed trades and professions are obliged to belong. Employment size, it should be noted, is not used as defining membership of Craft Chambers (HWK) in Germany, rather belonging to a specified list of trade and crafts. Although there are HWK members with hundreds of employees, the average statistically is eight employees per member. Statistically it appears the French Chambers have on average a smaller number.

No special qualification certificate is required in France to start a business as in the case in Germany. In the UK and USA, also there is no such restriction on starting a small business. However in France the Chambers play a larger role in vocational training and apprenticeships than in the USA or UK

In both France and Germany apart from the Small Business Chamber (HWK in Germany) there are separate Chambers of Commerce and Industry for larger businesses.

While it is difficult to specify staffing requirements since this will depend on the number and type of activities undertaken and services provided, it would appear from the experiences in Europe that a minimum of 10 professionals with suitable supporting staff would be required to run an effective programme of services for its members for an organisation of each 2000-3000 members.

There are a number of major issues which need to be addressed as to the structure of membership of these organisations. Again it is difficult to prescribe clear guidelines to suit all circumstances although a recognition of the factors involved can be helpful in deciding what is most appropriate in particular circumstances.

Among the major questions are:

- a. Is it better to create and operate larger organisations in which businesses of all sizes are members or to have organisations set up to cater for different size of membership?
- b. Should membership be encouraged on a voluntary basis or is it advisable to introduce legislation to give public status to certain organisations and oblige all those belonging to certain groups which the organisations are supposed to represent to become members?
- c. How can one best organise these membership organisations to ensure that the leadership is fully responsive to the desires and needs of the members to minimise internal conflicts, fragmentation and the development of authoritarian controls by small groups or individuals?
- d. What safeguards can be developed to ensure that these organisations play their full role in the promotion and strengthening of new enterprises and do not limit their activities solely to protecting and supporting those firms already in operation?
- e. What is the most effective relationship between these organisations and government and public bodies to ensure that they work co-operatively for the national benefit?
- f. How can one ensure adequate staffing and finance to facilitate the effective operation of membership organisations and the delivery of quality support services. What is the most desirable and appropriate composition of sources of financial support?

The above may not be all the major issues but they comprise some of the central more pertinent questions that need to be resolved to ensure effective operation of the private sector organisations.

B. The Hungarian Preferential “START” credit programme

It is obvious that one of the most important areas of assisting small business is providing available financial resources to them. At the moment preferential credits are the most important outside financial sources for small business in Hungary.

The target group of such a programme is the start-up micro businesses, and the objective is providing financial sources for start-ups and new micro enterprises and promoting new business entries.

For this reason the Hungarian government with the financial assistance of Germany launched the "START" credit line programme in 1991.

1. Description

The German government provided a preferential credit to Hungary to develop the Hungarian economy and promote starting businesses. The credit line was opened in 1991 as part of an aid programme. The amount provided was DEM 100 million. The agreement with the German government was signed on 13 May, 1991. The Hungarian government agreed to provide the same amount as the German government, so the credit line was doubled to the equivalent of DEM 200 million.

The START-credit programme is maintained during the whole credit period, i.e. the available money is used as a fund.

Conditions for receiving the loan

The applicant has to fulfil the following conditions.

- must be a sole proprietor doing this as a main job · has been in business for less than 3 years
- has not received start credit before
- his/her own contribution must be at least 30%, of which 10% cash.

The maximum duration period of the loan is 8-15 years depending on the purpose of the credit. The interest rate is 75% of the basic interest rate + 2% of the credit amount for banking expenses.

Credit guarantee is also available if the applicant has not sufficient collateral.

The Hungarian Foundation for Enterprise Promotion manages a guarantee fund totalling about 10% of the whole credit line.

User fee and cost

The user has not more costs than in the case of a regular credit application.

The total price of the loan received is below inflation. In other words this programme provides loans with negative real interest rate.

Budget expenditure related to servicing "START" credit programme

The programme has no specific expenditures since it is realised through the banking system, and banks' fee (2%) is included in the payments of the debtor.

The programme is based on an agreement between the German and the Hungarian government, and decrees issued by the Hungarian government.

2. Cost-benefits Analysis

Costs

1) Interest rate and exchange rate losses covered by the central budget

The central budget must cover the difference between market and preferential interest rate through the National Bank of Hungary.

Since the interest rate of the loans given are below inflation and market interest rates losses should be covered. Another item of losses is the difference between the exchange rate at the time the credit was issued by the German government and the time of paying it back. This cost is approximately 10% per year of the amount lent.

2) Failures and bad credits

If debtors can not pay back the credits and collateral do not cover losses banks may loose money. Otherwise debtors loose the money. All unsuccessfully launched business should be considered as losses.

3) Guarantees drawn

About 5% of the credit issued is covered by a special guarantee funds. Guaranties drawn from the fund are again losses. By the end of 1995 guarantees were drawn in 29 cases. This is less than 1 % of the more than 4 thousand loans.

4) Transaction costs

Transaction costs of the National Bank of Hungary should also be computed as cost of the programme. The Bank does not make separate calculations for this, but the amount should be below 1 % of the total credit line.

Benefits

The benefit of the programme is creating successful small business units. Roughly 4200 loans have been given since 1991. The accumulated amount of loans was over HUF 10 billion at the end of 1995. Failure rate is low, it does not exceed 2%.

The START credit programme has contributed to starting more that 4 thousand micro businesses which have much stronger financial position than the average micro business in Hungary.

3. Evaluation of the “START” Programme

Strengths

- 1) The START credit programme provides assistance for micro business at a very important area; it makes financial sources available at a very low cost. This was done in a period when the stock of micro credits provided under market conditions was declining.
- 2) The programme is integrated in the banking system, which means an additional control over loans issued.
- 3) The failure rate is low, debtors could expand their activity and expand their income to pay back the loan.
- 4) The financial sources of the programme have not been reallocated for other purposes, the programme keeps assisting micro business.

Weaknesses

- 1) Preferential credits are in contradiction with a consequent monetary policy, basic principles should be ignored to maintain refinancing the loans.
- 2) Cheap credits may disturb financial markets. The amount available is necessarily limited, the price of the loan is fixed. Market forces can not work and influence the credit conditions.
- 3) There might be suspicions of corruption about the allocation mechanism and practice.
- 4) The programme depends on outside financial sources, therefore credit supply may vary in time.

The success of the START credit programme depends very much on the decision making mechanism, i.e. how efficiently credit applications are selected. Information on this is very limited, but the low failure rate indicates that allocations were not totally wrong.

The programme is an important mean to promote the development of the micro business sector. It became the most important outside financial source for micro business in the last two years.

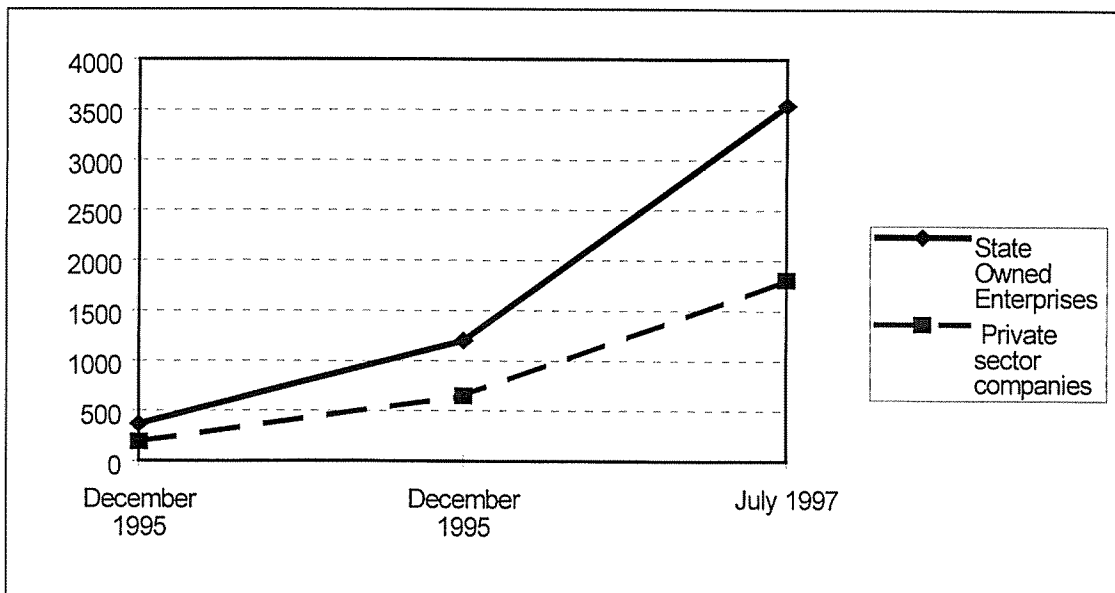
Bulgarian specifics in Financing SME

There are basically two classifications of Bulgarian SME according to:

1. the **number of employees** - for better definition see Annex III, and
2. the **turnover** with three subgroups: (1) the small firms with turnover below BGL 75 million/year are to be paying licensing fees instead of taxes, (2) the medium sized firms with yearly turnover of around BGL 300 million are to be taxed 10% below the normal rate, and (3) the normal firms that are supposed to pay full rates, namely according to the Law on Income Tax at present the "normal" taxation to the central government is 36% with additional 6.5% going to the local municipalities.

The present appalling lack of credit activities is mainly due to the recent credibility crises of Bulgarian banking system that has been broadly publicised elsewhere. This crisis came in parts from the non-transparent and partially profane loan disbursement practices which basically were oriented mostly to satisfy "friendly" needs. As seen from Figure 5 this practice has led to an explosion of companies indebtedness that is consisting mostly of non-performing loans. According to the National Statistical Institute private businesses in Bulgaria are quite de-capitalised, namely their financial liabilities are 4.7 times higher than their own capital.

Figure 5: Companies Indebtedness in Billion BGL



Source: Ivan Angelov, Why there is neither investment nor credit activity, PARI, 15th of September 1997

This lack of credibility to the banking system had different expressions and consequences. For example the very creation of a State Bank for Investment and Development, that is supposed to transfer German experience in SME financing to Bulgaria, had been questioned by

the potential donors on the ground of a lack of national policy towards the SME. Although it has been recognised that this bank is very much needed because this type of SME finding will cover an important gap in the SME support system, there was an expressed fear that under the previous socialist dominated government the bank can be easily turned into a source of subsidies towards loss making and inefficient state companies. The new governmental policy towards widespread privatisation and elimination of all kind of subsidies is reducing the objections. According to the expert from the German programme TRANSFORM Mr. Hanko von Knobelsdorf the Bank may be operational as soon as by March 1998.

A. Credit lines for SME

1. Commercial lines

One of the main financier active in providing credit lines to SME is the **Bulgarian-American Investment Fund** (BAEF) was established 1992 with a purpose of:

- a) encouraging entrepreneurship and the start up of new businesses;
- b) establishing of joint ventures;
- c) promoting Bulgaria's investment opportunities to US and other Western investors;
- d) providing management and industry assistance;
- e) assisting in the privatisation of state enterprises;
- f) broadening the understanding of private enterprise among managers, government and the Bulgarian public.

BAEF portfolio increased from USD 800,000 in 1993 to USD 11.8 million in 1996. BAEF has the following lending outlets intended for SME:

- **Programme "Nachala" (Beginning)**, inaugurated 1993, has offices in Sofia, Plovdiv, Velingrad, and Pleven and up to 1996 has been operating a programme for micro-lending (below USD 20,000 at interest rate of 15%/a) to the SME. For the period it disbursed 413 loans amounting to USD 2,536,889 with Plovdiv taking around USD 500,000. Due to the unbearable currency risk to its customers, e.g., only during 1996 the BGL depreciated from BGL75/USD at the years begin to BGL 2,500 by the years end, the lending operations have been temporarily cancelled. Recent effort centred on networking with borrowers, better loan portfolio management and on improvement of loan disbursement procedures including start up credits for would be entrepreneurs. The programme has an excellent record in terms of loan collection.
- **Programme "Compass"**, a venture with South Shore Bank of Chicago and four Bulgarian banks was set up to provide loans to the SME of up to USD 75,000. Since its inception the program has approved 81 loans and disbursed 63 for a total of USD 3.2 million having a

portfolio balance of USD 1,330,434 by September 1996. Two of these loans were disbursed to SME located in the municipality of Smolian and 4 to those located in Plovdiv. This programme has recently also run into difficulties due to (a) non-compliance of its Bulgarian partner banks with their obligations, to (b) currency oscillations and related to them non performing loans but also due to (c) blunt corruption. Despite all these difficulties BAEF management decided to continue its Bulgarian operations by establishing an own BAEF limited-form bank for minimising in-country exposure and by using only non Bulgarian depositors. An emphasis was also put on staff training in risk assessment, portfolio administration and collection procedures.

- **the Hotel loan programme** has extended credits to 5 private hoteliers in Smolian and to 12 in Bourgas.

Another commercially based option for SME financing is offered by EBRD and resulted in a creation of number of funds with EBRD equity participation (for the list of funds see Annex II). Partially due to the cumbersome project financing procedures (see Table 7 below) their services were not as much demanded as initially assumed. This lending applications of SME are normally intermediated by specialised project preparation companies which in Bulgarian case are unfortunately not only quite few in numbers but also their services are both not well advertised and the demand for them is not really rampant.

Despite all difficulties related to accessibility of financing a substantial part of the 48,100 SME (with less than 50 employees) that have had access to credits over the period 1991-1995 have made use of some of the above facilities. The results of a survey of around 220 small and medium companies from the municipalities of Bourgas, Plovdiv and Smolian⁷. shows that the demand for credit is substantial, i.e., 30% of the respondents have applied for credits.

⁷ The full scale survey results are presented in another report from this series tentatively named "Private sector development: A comparative study on the municipalities of Smolian, Plovdiv and Bourgas in Bulgaria".

Table 7: Extracts from EBRD guidelines for financing of small to medium projects:**Funding requirements**

The criteria on which a project will be considered by any financial intermediaries are very similar to those applied to the granting of credits or equity investments by the EBRD directly. Some of the principal requirements for smaller projects to qualify for funding are set out below:

- The project sponsor must have a proven track record in the proposed line of business.
- The project must be funded with a significant equity contribution, normally 35 per cent. Funds are available either in local or hard currency depending on the financial intermediary. If funding is provided in hard currency, the project must demonstrate the ability to generate hard currency or the ability to absorb increases in local currency financing costs should there be any depreciation during the loan period.
- Funds are not available for majority state-owned companies or for government - guaranteed projects.
- Identification, credit analysis and supervision of loans or investments will be carried out with due regard to ecology and environment.

Additional guidelines, specific to project funding via investment or venture capital funds, are as follows

- Funds will be used to finance specific projects or investment programmes for the creation, modernisation or working capital requirements of portfolio companies.
- There will be limit at to secondary market transactions.
- Funds will not be available for speculative investment activities.

Please be aware that these are general guidelines and as each fund or bank has specific requirements and preferred loan limits, it is recommended that you make an initial contact by phone or fax with the appropriate financial intermediary before compiling a full business plan.

2. Non-commercial credit line

Another major credit line for small and medium sized projects was managed jointly by the EU PHARE programme and the Ministry of Industry which up to 1st quarter of 1997 succeeded disbursing only around ECU 4 million out of the totally available ECU 7 million. The main features of this line of credit are presented in Table 8. The access to this credit line has been renewed for the period after 1997 but the conditions seem to remain harsh. A recent discussion⁸ is outlining some of the problems related to this extended credit line. These include: (i) 25% minimal own financing of the applicant; (ii) collateral amounting to 125% of the required amount of credit, guaranteed with long term assets like real property, machines and equipment, governmental bonds, precious metals, company's deposit, etc.; (iii) current interest rate at the Central Co-operative Bank in the range of 12% - 15%. In addition the managers of this credit line are stressing that due to the credits long term nature there is substantial banking risk which is being remedied by request to applicants for detailed and voluminous documentation, e.g., technical-economic justification, forward contracts for guaranteed sale of produced goods, etc. In case of approval the credits are extended in ECU, they are transferred to the recipient in BGL equivalent and then are to be repaid in ECUs so that the whole currency risk is being carried by the credit taker, namely the SME.

⁸ In "How to gain access to a PHARE credit?", PARI daily from 22nd October 1997.

Table 8: The PHARE program Credit Line for Small and Medium-Sized Enterprises

The PHARE program of the European Commission (EC) in association with the Bulgarian Ministry of Industry has agreed to make available funds to support the development of commercially viable and profitable small and medium-sized enterprises (SME). The aim is to contribute to employment, economic growth, and generation of exports by financing their investment requirements with long term loans.

Under the supervision of the Bulgarian National Bank Bulgarian banks currently participating in the SME Line of Credit Programme are: **(1) Bulgarian Post Bank; (2) Central Co-operative Bank and (3) Expressbank**

The principal terms and conditions covering loans granted under the terms of this project are:

Purpose: Only investment projects are eligible

Amount: Up to 100 000 ECU (approximately 125 000 USD)

Own Capital: The borrower should provide at least 25% of the project costs

Lending Period: Maximum 5 years, plus a possible grace period of up to two years

Interest: Interest rate based on market rates (three months ECULIBOR⁹ plus a margin)

Collateral: The borrower is expected to provide acceptable collateral throughout the period of financing

Currency: Lending will be denominated in convertible foreign currency; Repayment may be in foreign currency in case of export project or, subject to certain conditions, in BGL

Who is Eligible to Receive a Loan? Who Should Apply:

The programme is tailored to meet the needs of small and medium-sized enterprises (no more than 500 employees)

Priority Projects:

- Export oriented companies will be given strong priority
- Projects in manufacturing, transport, agro-processing and tourism
- Private enterprises and those about-to-be privatised
- State-owned enterprises which demonstrate commercial viability
- Projects creating new employment

Inappropriate:

Agriculture, trade and **Projects real estate development projects**

How Do You Get a Loan?

First, check with the loan conditions list overleaf to see if you are eligible to receive a loan.

Then contact one of the listed banks and ask a credit officer for information on the EC-PHARE SME Credit Line Programme.

Discuss with the credit officer whether your project is suitable for receiving an investment loan. To complete your application you will need documents like:

1. Financial Statements; 2. Articles of Association; 3. Commercial Registration; 3. Tax Registration; 4. VAT Registration; 5. Declaration of Association ; 6. Feasibility Analysis

⁹ ECU LIBOR is the interest rate at which ECU deposits are offered in the London interbank market.

3. The regional dimension

As related to the local operational environment the entrepreneurs in the three district municipalities have ranked their concerns, see also Table 9, in the following sequence:

- 1) Lack of political and economic stability,
- 2) Lack of reliable legal base and taxation rules,
- 3) Negative attitude of local administration to SME needs and demands,
- 4) Difficult access to credits and
- 5) The lack of direct subsidies.

While the first three hurdles are of political and legislative nature the last two are related to the difficult access to financing. Although businesses were ready to pay relatively high interest rates for their credits the lending conditions seem to have been quite restrictive and inappropriate for companies trying from one side to establish themselves at the restricted and volatile market place and from the another side forced into the shadow economy by uncertain taxation rules, hostile bureaucracy and the pressure exerted upon them by diverse racketing groupings.

It may be worth now to concentrate on some local issues by sketching SME operating condition in one of our district municipalities, namely Smolian. As mentioned above this is one of the crises regions with higher than the Bulgarian average unemployment level and lower than the average incomes and salaries. This is also the region with very high quota of male emigration. According to the territorial statistical bureaux in 1995 the 4,276 privately registered companies in the district-municipality of Smolian had around 13,500 employees or 3.15 employees per outlet. The average monthly turnover per employ was reported to be USD 320. As shown at Figure 4 most of these private firms were in retail and wholesale trades (51%) followed by industry (22.3%), transportation (14.9%) and construction (5.4%).

Most of the money were made in the trades (58.6% of total private sector income) and construction (12.5%) while industry (with 19.3%) and transportation (6.9%) were among the losers in term of income generated per company. Although, due to unclear ownership rights, the hotels and restaurants are not adequately represented in the private sector statistics their income makes substantial part of regions wealth generation. The same applies for aggro businesses which seem to be quite innovative and flexible in both their operations in financing practices. These include a number of self help schemes within the Agricultural Credit Co-operatives. Around 33 co-operatives with more than 100 members each are operating in the region and recently have formed a federation to better represent their rights. These grass root organisations have been formed with a substantial support of the PHARE programme by providing office equipment, know-how and paying salaries of the office personnel. The experience gained along this development programmes has shown that slowly these co-opera-

tives are becoming self sustainable due to the income generated by their lending operations. Provided that Bulgarian banking system succeed in its consolidation effort the experience accumulated by the co-operatives may be also quite useful in extending loan guarantees to the fellow members.

Another quite innovative development in Smolian relates to the creation of an association of hoteliers and restaurateurs. Given the past, quite successful, history of the region as winter and summer resort there will be two major issues this association will be faced with: (1) to find a way to better the marketing of its services and (2) to find reasonable priced financing to recapitalise the desolate hotel and recreational base.

Related to the first issue are activities headed by the Smolian Regional Development Agency to advertise regions beauties and virtues all over Europe. This activity will be financially supported by the UK know-how fund and some other EU agencies. One of the hurdles of the region - the difficult access to the area - may be resolved by the end of 1998 when the Bulgarian - Greek check point at Roudozem is supposed to make Smolian a Mediterranean City. It may sound unfamiliar but Smolian is located some fifty kilometres away from the Greek coast with all its established tourist infrastructure. After opening this check point the expectations are that the common Bulgarian-Greek economic space will revive regions fortune.

The second issue - the financing one - is also intimately linked to the opening to the neighbouring EU member state - Greece. While the present real estate prices are very low by any mean it seems that present boom in construction is quite linked to this expected opening to Europe. In a sense present activities of Smolian Regional Development Agency may be seen as a preparatory to the forthcoming integration with Europe that may turn one of the Bulgarian crisis regions to a flourishing place, albeit with different set of private companies hopefully offering higher value added services.

Table 9: Attitude to their operational environment expressed by local entrepreneurs

	Bourgas	Plovdiv	Smolian
Macro Issues:			
Lack of political and economic stability	of highest concern	of highest concern	of highest concern
Lack of reliable legal base and taxation rules	rated as high	rated as very high	rated as high
Difficult access to credits	rated as high	rated as very high	rated as very high
Lack of direct subsidies	rated as high	rated as very high	rated as very high
Understanding of macro economic issues	rated as very high	rated as very high	rated as high
Impact of the business environment on market opportunities:			
Availability of transports and communication	highest rating	second high	indifferent
Attitude of the local administration	rather negative	negative	negative
Attitude to partnerships	very positive attitude	positive attitude	positive attitude
Attitude to competition	positive attitude	neutral	quite positive attitude
% of SME with short financial planning horizon	65.8%	78.7%	71.6%
Support services:			
Management advise	recognised demand willing to pay	recognised demand low willingness to pay	recognised demand low willingness to pay
Marketing & advertising	rated as very high 83% need the service	rated as high 72% need the service	rated as very high 77% need the service
Business contacts	rated as 1st priority 82% need the service	3 rd place 65% need the service	2 nd place among districts 80% need the service
Quality management	rated as 1 st priority 71% need the service	lower rating 61% need the service	low rating 50% need the service
Partner search and information on opportunities	rated as high priority	lower rating	rated as very high priority

Source: compiled by the author from the findings of Todor Dimitrov, "Private sector development: A comparative study on the municipalities of Smolian, Plovdiv and Bourgas in Bulgaria"

B. Trends in developing support structure for improved SME financing

According to the Union for Economic Initiative of Citizen (UEIC)¹⁰ due to banks reluctance to extend credits to the SME they are forced to operate in a financial vacuum. Despite some positive developments at local level, as for example the creation of credit co-operatives, there is an urgent needed to change the Law of banks and credits which is forbidding to any other organisation but the banks to manage credit lines. It was also made clear that while in many other Central & Eastern European countries a number of specialised funds are working to satisfy SME financing needs in Bulgaria even some of the established funds have been decapitated by the lack of legislative support and governmental indifference. One of the solutions may be the establishment of a Guarantee Fund for credits to SME. In this respect the experience gained by the workings of numerous Hungarian SME related instruments, including the preferential START programme, may be quite suitable to the Bulgarian needs and specifically in extending the role of private sector in providing support to SME development.

Another NGO - the Bulgarian Association for Partnership /BAP/ - is suggesting financing of small business to be taken over by the local credit co-operatives in close co-operation with the State Bank for Investment and Development /SBID/. BAP also active in proposing amendments to the Co-operative Law and new procedures for SBID's lending activities. BAP is also contributing to the government's programme for encouragement of small and medium-size businesses and the war on corruption.

BARDA by the virtue of its regional dimension is well positioned to assume a bigger role in supporting these micro credit lines. One of BARDA assignments may be to provide start up training to the potential entrepreneurs and linking the level of micro credit to the success of this training.

C. The regulations framework for SME financing

The regulations specific to the SME encouragement are:

- Decree on the encouragement and support of SME from 1991
- establishment of a dedicated SME fund in 1991
- creation of a Bank for Investments and Development

Many governmental institutions and organisations, e.g., the Council of Ministers, the Bulgarian National Bank; the Ministry of Industry, etc., were entrusted with the implementation of SME related programmes but apparently there were little political will for real involvement with the SME problems. The around 90 support service companies which were intended to

¹⁰ Published in PARI Daily from 26th of September 1997.

provide support services, i.e., advice and training, to the SME turned out to be quite isolated from their customer base and the demand for their services was relatively low.

The critique to the implementation of these SME related regulations can be summarised as:

- Inadequate framework and institutions
- Most of the decisions remained on paper
- Lacking co-ordination and focus
- Many faulty programmes

This is not to say, however, that local SME were operating under a "veil of ignorance". In contrast they could well anticipate the attention of all powerful "insurance" companies who, after a period of watching their revenue and expenses were making their offers for protection fees, insurance instalments or bluntly racket. It is quite well known secret that one of the impediment to the development of reliable business relations is the pressure imposed on the economic agents by these racketeers, best represented by the so called "insurance" companies, e.g., VIS-2 and SIC, etc. According to the present Interior Minister these companies are being scrutinised for illegal activities and will be required to define precisely the scope of their future businesses operations.

The hope of many SME is indeed that both the present and the future administrations will have the stamina to handle this sensitive and quite dangerous issue.

Another main issue was the instability and the lack of transparency of various rules, procedures, laws, governmental commitments as well as various bureaucratic delays. In addition the breach of confidence was enlarged from frequent discretionary decisions on the part of officials that were altering or nullifying implicit or explicit contractual commitments.

One of the most controversial "innovations" of the previous socialist dominated government was the "forward" taxation rule meaning that the businesses were obliged to pay taxes not on the actual but on the expected turnover. The implementation of this rule certainly diminished the compliance with taxation rules and generally worked in support of the shadow exchanges, thus reducing the taxable base. The latest legislation is envisaging more favourable taxation for most of the SME and especially for the small retailers and services.

A new discussion sprang out of the recent decision to register as VAT eligible only the companies with annual turnover exceeding USD 50,000 hence allowing them to enjoy tax credit on the 22% VAT. According to this rule those SME that are below this level of turnover will be practically excluded from VAT reimbursement and their goods will be overcharged by the amount of the non deductible taxation.

Some of the drawbacks listed above are in process to be eliminated, e.g.,

- the new government is reducing the redundant and duplicating bureaucracy,
- the new Agency for SME is working on national strategy and practices in support of SME,
- in line with the ongoing bank consolidation a network of funding organisation is being created
- the elaboration of procedures for evaluation of the effectiveness and the efficiency of different programs is taking place

The Agency for Small And Medium Enterprises, conceived as a body combining public and private interests on development of SME, will have a major role to play in reflecting upon SME needs and interests. It is intended to contribute to the improvement of the legislative framework for the SME, to act as their intermediary in accessing credit lines and in general to improve SME sensitivity to market signals. The creation of a bundle of support services needed for reduction of entry barriers and for improvement of the environment for innovation and retraining are also part of this Agencies' terms of reference.

The Law on Banks and Credit Activity is seen by many as quite protective of the interest of creditors while at the same time exposing the Banks to significant risks of default. Given the slowness of Bulgarian law enforcement system as related to debt collection the creditors are posed to profit from delayed payments or from outrage default while the banks are deprived from effective means to collect their receivables.

Incentives/Disincentives for black market operations

The previously mentioned survey of 220 local companies revealed that 62 % of those in Plovdiv, 56 % in Bourgas and 58.7% in Smolian are in favour of the existence of a "grey economy". The incentives for such an attitude are quite strong and include:

- the generally negative attitude to governmental authority whose formation started during the times of Bulgaria being part of the Turkish empire and justified itself by the communists repulsion of market;
- the quite inadequate and volatile taxation rules;
- the lack of openly available sources for financing - the people seem to be declining declaration on the source of their initial capital;
- the quite slow redefinition of property rights;
- the fear of unfriendly visit by the racketeers if company's real income becomes known even to the tax authorities.

So, there are plenty of reasons to avoid taxation and it seems that for the time being the incentives to register income are not that many.

In this respect the present funding procedures that are requiring open access to companies accounts as a precondition for opening a credit line will be seen by many companies as harmful and even dangerous. It seem that more confidential credit approval procedures between private banks and the applicants for credit may increase the amount of disbursement.

References

- Bourgas Regional Development Association with the assistance of EU PHARE programme 1997: Investing in Bourgas Region: A Background for Investment.
- Bulgarian American Enterprise Fund Annual Reports for 1995 & 1996.
- Bulgarian Foreign Investment Agency (1997): Official Web Site: <http://www.geobiz.com/fia/>
- Bulgarian National Institute of Statistics (1997): Statistical Manual 1997, Sofia.
- Dimitrov, Todor (1997): "Private sector development: A comparative study on the municipalities of Smolian, Plovdiv and Bourgas in Bulgaria," Contribution to AEPC-OECD Project on "Private Sector Development in Bulgaria", IAS, Vienna.
- European Commissions (1997): Opinion on Bulgaria's Application for Membership of the European Union; DOC/97/11; Brussels, 15th of July.
- Kallay, Laszlo (1997): Micro Business Financing - Hungary "Preferential START credit programme, Institute for Small Business Development.
- Kenningham, Andrew (1997): Leveraging off the Deutsche Mark, Merrill Lynch, July.
- Levinsky Jacob (1992): Proposals for a Private Sector Support System for Small and Medium Enterprises in Developing Countries, International Small Business Series 9, University of Göttingen.
- Levinsky, Jacob (1993): Private Sector Support for Small Enterprises - Some Conclusions, International Small Business Series 16, University of Göttingen.
- NACHALA Foundation Annual Report 1996.
- Territorial Statistical Bureau Smolian, Private sector in the Smolian Region for the period 1991-1995.

List of interviewed Persons:

- Nicolay Chakarov, Chairman of the Bulgarian Association of Regional Agencies and Business Centres (BARDA) and Director of Bourgas Regional Development Association (BRDA), Friday 11th of July 1997, Bourgas
- Ivo Tzarev, Director Smolian Regional Development Agency, Monday 7th of July 1997
- Richard Minns, EC-PHARE SME, Friday 11th of July 1997 Bourgas
- David Barton, EC-PHARE Regional Development Projects, 8th July 1997, Sofia
- Biser Bachvarov, executive director "Nachala" Fund - subsidiary of Bulgarian American Enterprise Fund (BAEF), 15th of July 1997
- Chavdar Selveliev, President of the "Association for Building Partnership", 14th July 1997
- Peter Alexandrov, Investment Analyst, BAEF Compass Program, 9th of July 1997

Annex I: On the legal, regulatory and institutional environment

The Law on Specific Pledges (State Gazette issue #100 of 1996)

The Law provides for the pledges without transfer of collateral. The contracts for pledge concluded as per Art.26 and Art.37 of the Law on Banks and Credit Activity and as per Art.12 of the Law on Economic Activity of Foreign Persons and on Protection of Foreign Investment continue to be in force and are subject to the provisions of the Law on Specific Pledges.

The contract is concluded in written form (in the event of pledging stocks of a commercial company or pledging of a business enterprise it should be in written form and the signatures should be notarised). The pledging party can only be a trader or a person under Art. 2 of the Commercial Code.

Pledges can be made on receivables, book entry securities, movable property (except for ships and aircraft), stocks of companies, a combination of receivables, of machines and equipment, of goods and raw materials, business enterprises. The collateral secures the receivable as well as the interest and indemnification due on it.

The pledge should be filed with the central registrar of specific pledges in order to make it effective against third parties. The sales contract with retention of ownership until the payment, the leasing contract and the receivership should also be filed with the registrar. Otherwise they cannot be made effective against the creditor on whose behalf a pledge has been made on the sold, leased or received property. Other circumstances which should be filed as per the law e.g. pledged book entry securities are filed with the central depository while pledged business enterprises and stocks of commercial companies are filed with the trade registrar. In this case they are made effective by their filing in the other registrars. The filing is valid for the period of five years and may be extended before the said period expires.

The secured receivable can be specified individually or generically, it can be conditional or future one. The pledge continues to have effect on the secured receivable if the latter is pledged again. In general, every person against whom the pledge can be made effective acquires the rights over the pledged property and the status of a pledging party. The pledging party not only retains possession of the pledged property but he also has the right to use it and dispose of it. The pledged property can also be specified generically or as a future one.

The legal regulation of the specific pledges enables, in case of default, the creditor to be satisfied by the sale of the collateral or by the proceeds from its alienation, or, if they cannot be detached from the remaining property of the pledging party, by their price equivalent. The creditor who intends to begin or to quit proceeding should file this circumstance in the regis-

trar and notify the pledging party. The creditor has the right to sell the pledged property himself without the intervention of an officer of the court. In case of a pledged stock of a commercial company, the creditor has the right to announce the termination of the pledging party's participation in the company.

The Law on Notaries was enforced on 6 January 1996 (published in State Gazette issue #104 of 1996). It stipulates the legal standing of notaries and the organisation of the notary activity. The notaries in Bulgaria now have the right to perform this activity as private notaries. A notary chamber is to be established with a registrar containing data of all notaries. The notaries will continue to carry out all actions envisaged by the law but also will have the right to draft documents, provide consultations, to execute wills and manage property, etc.

Notaries will collect carry out the activities envisaged by the law upon consideration which will be specified in a tariff approved by the Council of Ministers. The Law on Notaries required amendments to be made to the Law on Juridical Power. They envisage a new position, filing officer, to be established with every district court. He will carry out the notary actions concerning all entries, notifications, and removals from the entry books.

Latest amendments to the **Law on Value Added Tax**. The amount of the tax is a constant value of 22 per cent (up from the 18per cent before 1 July 1996). Tax registration is obligatory for all natural and legal persons, local and foreign, with an annual taxable turnover exceeding 7,5m leva. If it does not exceed that amount, the registration is optional. The amended Art. 30 provides the opportunity for companies whose tax credit exceeds the amount of tax due to recover the difference. This should be done within 30 days of submission of the declaration. The new Art.50, para 7 envisages a shorter period for recovery - within 15 days of submitting the declaration - if for the last 12 months the person's export transactions exceed 50per cent of the total value of his transactions for the said period irrespective of the date of his registration as per the law. The latest amendments to the regulation on the application of the law on value added tax repeal Art.50A which provided for a recovery within 5 days for export of goods by persons approved by the Ministry of Finance.

The **Law on Profit Tax** was enforced on 1 July 1996. It fully repeals the provisions of Decree #56 on economic activity. According to the new law profit tax is paid by all local legal persons and the foreign persons with a place of business in Bulgaria to the amount of the profit made from carrying out business activity on the territory of the country. Foreign persons with a place of business outside Bulgaria shall pay tax on their income derived in the country.

There are two types of profit tax:

- Profit tax to the state budget to the amount of 36per cent, respectively 26per cent if the taxable amount does not exceed 2,000,000 leva; and
- Profit tax to the municipalities to the amount of 6.5per cent

The tax base of the profit tax to the state budget is the financial result transformed for tax purposes decreased by the amount of the tax to the municipalities. The tax revenue on which profit tax to the municipalities is paid will be the financial result transformed for tax purposes.

The law also envisages other types of taxes:

- Dividends and income from shares as per Art.30, interest, copyright and license royalties, payments made for technical services, sale of movable property, financial long-term assets, and other types of income as per Art. 32 from sources in Bulgaria are taxed at 15per cent of their gross amount;
- Tax on the increase of the wage bill which is only applicable to commercial companies with more than 50per cent state-owned or municipal capital. The taxation is based on the proportion between the increase of the wage bill and a certain base amount. The tax rates vary between 15per cent and 600per cent.

The law envisages also some tax incentives:

- The companies with state-owned or municipal capital of up to 33per cent after their privatisation pay no profit tax to the state budget during the first three years and only 50per cent during the following two years. This clause is applied from 1 July 1996 to 31 December 2001 irrespective of the privatisation date. Companies which were privatised before the law was enforced on 1 July 1996 enjoy the tax incentives for the remainder of the five-year period.

The "tax holiday" also applies for:

- companies with registered capital of no less than US\$5m and at least 50 per cent foreign participation if they invest in fixed assets at least 50 per cent of the tax allowance;
- co-operatives and their enterprises (established according to the Law on co-operatives as a special legal form for the local and foreign natural persons to carry out business activity in the country);
- companies employing labour rehabilitated or disabled persons.

Annex II. List of funds with EBRD equity extending loans to SME

BNP Dresdner Bulgaria AD

The recently established BNP Dresdner Bulgaria AD is a fully licensed commercial bank, which is able to handle all banking services from FOREX operations to issuing letters of credit and short-term loans for export clients.

BNP Dresdner Bulgaria AD
pl. Narodno Sabranie 11
BP 11, 1000 Sofia, Bulgaria
Contact: Mr Xavier de Beausse
Tel: +359 2 981 8208/980 1237
Fax : +359 2 981 6991/980 5224

Bulgarian Investment Bank

EBRD equity participation

BIB offers corporate finance advisory services and project financing to private Bulgarian and joint-venture companies in all sectors.

Bulgarian Investment Bank
ul. Serdica 20,
1000 Sofia, Bulgaria
Contact: Mr Gerasimos K Tsiaparas,
Executive Director; Mr. Penyo
Hadjiev

Alternative sources of finance

Executive Director; Mr. Anastasios D
Tsamis, Executive Director
Tel: +359 2 980 1210/980 4543
Fax : +359 2 981 6525

Caresbac Bulgaria AD

EBRD equity participation

This investment company will invest in small and medium - sized private companies. It focuses on majority Bulgarian-owned companies in the agribusiness and light manufacturing sectors, with an emphasis on the export sector. Its investments typically range from US \$ 50,000 to US\$ 250,000.

Caresbac Bulgaria AD
ul. Oborishte 45
1504 Sofia, Bulgaria
Contact: Mr. Gregory Robinson, Director
General; Ms. Julieta Hubenova, Investment
Officer;
Mr Hristo Mihaylovski, Investment Officer
Tel/Fax: +359 2 441 987/467 270/462 042

EuroMerchant Balkan Fund

EBRD equity participation

This fund will invest in local companies as well as joint ventures established between Bulgarian companies and foreign sponsors in all sectors. Preferred average investment sizes US\$1 million but it will consider as little as US\$ 250,000. Preferred maximum investment is US\$4 million.

EuroMerchant Balkan Fund
Global Finance SA
Bld Vitosha 39, Etazh 1
1000 Sofia, Bulgaria
Contact: Mr. Christos Katsanis, Regional
Chief Executive
Tel: +359 2 980 1619
Fax: +359 2 805 900

or

EuroMerchant Balkan Fund
Global Finance SA
Akadimias 17
10671 Athens, Greece
Contact: Mr. Angelos Plakopittas,
Managing Director
Tel: +30 1 36 22 096/64 50 83 23
Fax : +30 1 36 27 766

First Investment Bank Ltd

Bank-to-bank loan

This bank will provide loans to investment projects by privately owned businesses, or public sector companies, other than utilities, which are commercially managed, operating in a competitive market, and subject to local bankruptcy laws, and which are implementing a programme to achieve private ownership.

First Investment Bank Ltd
ul. Stefan Karadja 10
1000 Sofia, Bulgaria
Contact: Mrs. Maya Georgieva,
Vice President, International Relations
Tel: +359 2 981 3091
Fax : +359 2 981 0269

Annex III. Some definitions

What is a Small and Medium-sized Enterprise (SME)?

The term SME covers a wide variety of definitions and measures and there is no official or universally accepted definition of an SME.

The definitions and their basis vary widely among countries, but the most common definitional basis in OECD countries is employment -- in general an SME has less than 500 employees, although many countries use a lower cut-off, say 300 or 100 employees.

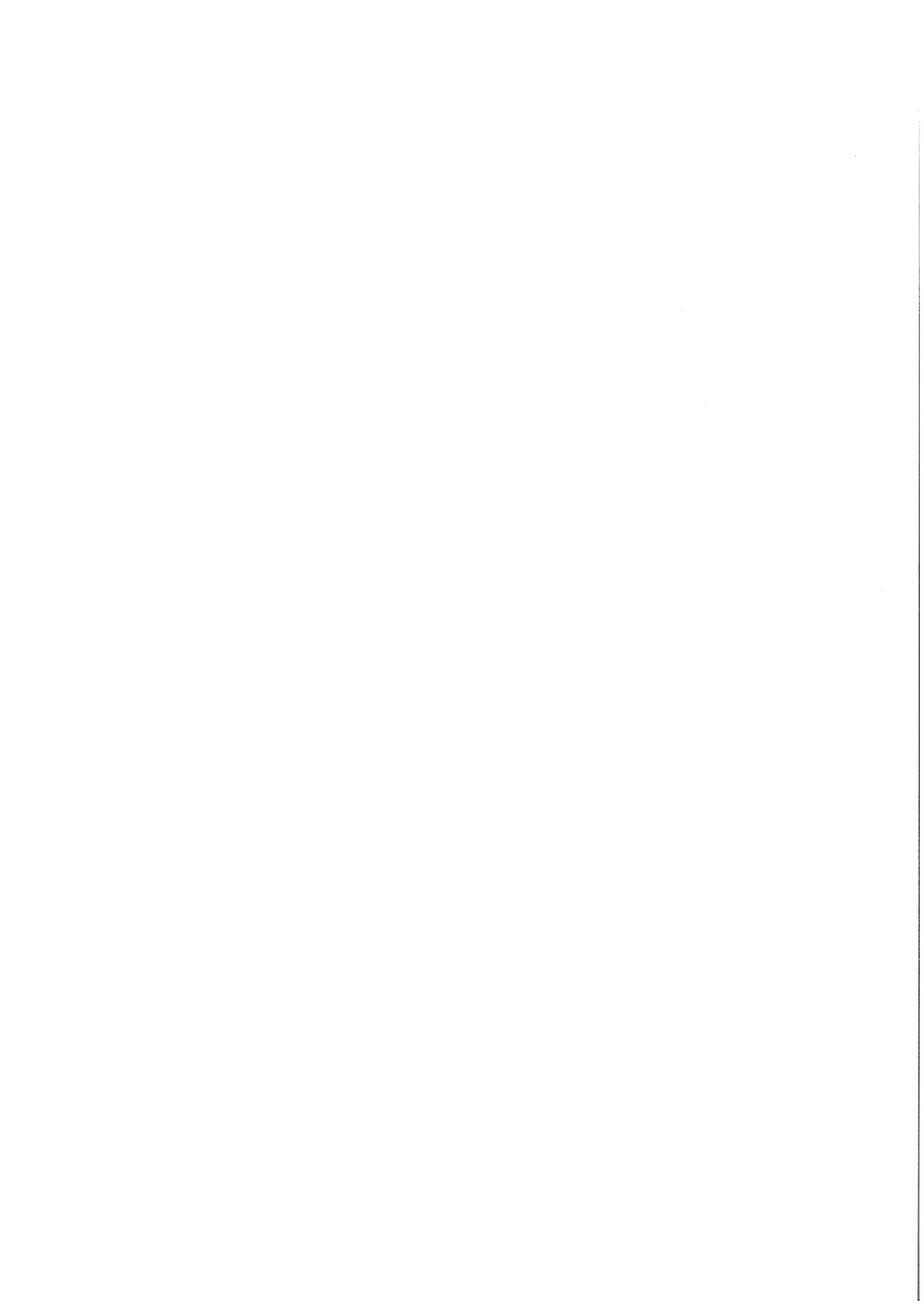
Some countries differentiate between manufacturing and services SMEs – with a services SME usually defined to be smaller than a manufacturing one.

Some countries distinguish between autonomous SMEs and those SMEs that are connected to a larger enterprise or group, or identify an SME in terms of management structure (personal involvement of the owner or family-owned, for example).

Finally, statistical definitions of SMEs often differ from those used for policy implementation purposes; for example although a firm with 600 employees may not be regarded as an SME for statistical purposes, it may still be able to gain access to public support programmes designed for SMEs.

The main feature of an SME is that it is "not large", in the sense that an SME is not in the core of the largest 10 or 20 per cent of firms in that market or industry. This leads to a rough convention for categorising SMEs:

- * micro: 1 - 4 employees;
- * very small: 5 - 19 employees;
- * small: 20 - 99 employees; and
- * medium: 100 - 500 employees.



Institut für Höhere Studien
Institute for Advanced Studies

Stumpergasse 56

A-1060 Vienna

Austria

Phone: +43-1-599 91-149

Fax: +43-1-599 91-163

e-mail: woergoet@ihs.ac.at