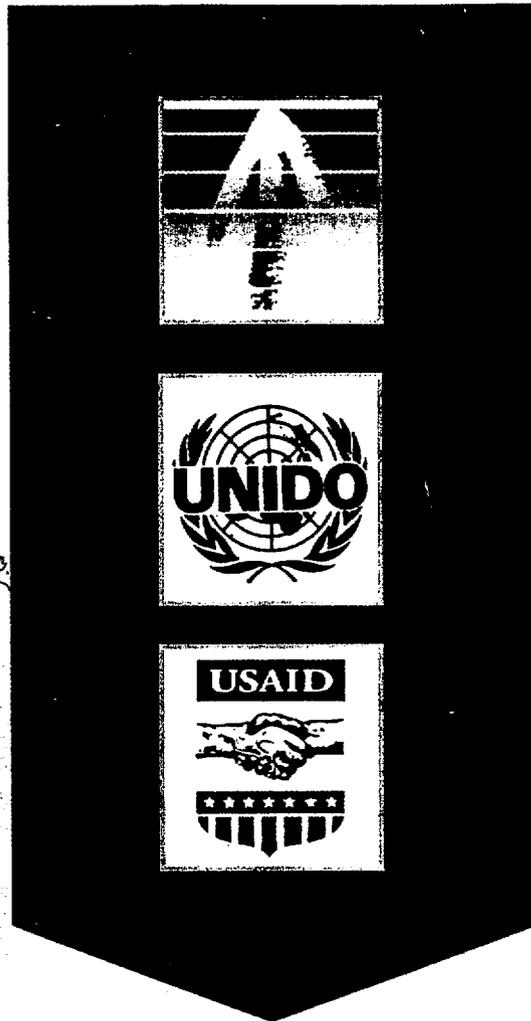


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Policy Advice for SME Promotion

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ANNEX

INTRODUCTION

This report has been prepared by Mr. Shane McAuley, Senior UNIDO Adviser with co-operation and inputs from national and international experts. The project commenced on 1 June 1996 and was completed on 31 August 1997. The Senior Adviser was stationed full-time in Bratislava from 20 October 1996 to 31 August 1997.

The project, which is executed by UNIDO and funded by USAID, has as its objective the strengthening of the capacity of the National Agency for Development of Small and Medium Enterprises (NADSME) to analyse SME sector information, and on the basis of these analyses, to make recommendations to the Government of Slovakia on those changes necessary in policies and in the legal and regulatory framework to promote the SME sector.

The project was designed to:

1. assist in the establishment of an effective information system incorporating economic, financial, marketing and managerial, as well as technical information as a basis for formulating policies for SME promotion;
2. facilitate the formulation and adoption of a clear and comprehensive policy framework and concrete strategy for developing both the economic and technological dimensions for small business development in the Slovak Republic;
3. create awareness with the Ministry of Economy and other concerned Ministries of relevant policies and incentives which exist in other countries for the development and promotion of small business;
4. initiate an effective consultation mechanism among SME representatives, ministries, and institutions in the public and private sectors for formulating and implementing policies, strategies and programmes for small business development.

The project envisaged the full participation of SME representative associations, thus strengthening their role, and this objective was achieved through close co-operation and consultation with the Entrepreneur Association of Slovakia at all stages.

The components in bringing the project to completion were as follows:

- the work of a resident senior UNIDO adviser and a team of national and international experts which focused on designing an effective SME monitoring and information system for Slovakia and the development of a new policy framework for the sector;
- meetings and discussions with institutions capable of contributing to the project;
- study tours to examine support programmes and structures for SME promotion in certain EU member states;
- a major two day workshop to discuss a SME policy framework for Slovakia, which was attended by participants from Slovakia and several other countries;
- specially commissioned research into the views and attitudes of SMEs in Slovakia.
- a series of visits to regional business advisory centres and interviews with individual enterprises so as to gain the widest possible perspective on the issues facing smaller businesses in Slovakia.

The outcome of the project in relation to its two key objectives is as follows:

1. A comprehensive system of monitoring and analysis has been designed and is ready for implementation, provided that the necessary resources are made available by the Government of the Slovak Republic. NADSME, which already undertakes limited monitoring of the SME sector at the request of the Ministry of Economy, does not have the

resources to implement the proposed new system, which is a prerequisite for developing SME policy.

2. The Government of the Slovak Republic adopted new Medium Term Policy for SMEs in February 1997. The policy framework recommendations under this UNIDO project are consistent with the Medium Term Policy and place considerable emphasis on policy refinement and improved structures for SME development. The policy issues covered are law and regulation, access to finance, incentives, taxation and social security, the negative climate for enterprise, advocacy and representation, strategic economic sectors and the institutional support structure for SMEs.

PART A: PROJECT RESULTS AND ACHIEVEMENTS

MONITORING AND ANALYSIS OF SME SECTOR

Project objective and activities

The National Agency for Development of Small and Medium Enterprises (NADSME) was given the task of monitoring Slovakia's SME sector by the Ministry of Economy. Apart from general economic indicators, the information co-ordinated by NADSME relates mainly to numbers of enterprises and their legal forms, sectoral distribution and contribution to industrial output.

The NADSME monitoring system is useful, however, it is not adequate as an instrument for advocating policy change. Effective SME policy development requires high quality data and information by sector and class size of enterprise, on areas such as employment, turnover, value added, exports and labour costs. This project is a response to NADSME's (and Slovakia's) need for a monitoring system to meet these requirements.

The project activities were undertaken with the assistance of an expert group in the areas of statistical analysis, national accounts, data gathering methodology, taxation analysis and data monitoring. The activities comprised:

- identification and review of data at present available;
- an assessment of the quality of existing data;
- a review of how this data could be extracted and integrated into an upgraded system of monitoring and analysis.

Meetings were held with institutions capable of contributing to the objectives of the project. Studies were made of monitoring systems in other European countries and monitoring was also covered by study tours and the workshop held under the project.

Project achievements

The principal project achievements in relation to SME monitoring and analysis were:

- (1) A clear and accurate identification by the project of the sources of data relevant to the SME sector in Slovakia, the classification of this data and an analysis of the problems and issues in converting it for use in a national SME monitoring system.
- (2) A high level of co-operation between NADSME, the Statistical Office of the Slovak Republic (SO SR) and DataCentrum, the statistical branch of the Ministry of Finance, in identifying the issues involved in the planning, implementation and operation of a more advanced SME monitoring system.
- (3) The development of the capabilities of senior staff within NADSME, through training provided under the project, to manage the new monitoring system when implemented thus increasing the capacity to propose policy changes.
- (4) The development of knowledge and awareness by the project participants to SME monitoring in developed market economies through presentation of research results, study tours and contact with international expertise.
- (5) The design of a considerably more advanced SME monitoring system to the highest international standards which, would provide NADSME with the means for access to accurate and relevant data and the ability to interpret sectoral trends and consequently, have at its disposal the basis for SME policy advice to the Government of Slovakia.

- (6) The preparation by the project of a comprehensive set of recommendations for the implementation and operation of the proposed new system.

Part C of this report provides a comprehensive analysis of sources of data, the existing monitoring system and what needs to be done to achieve the significantly upgraded system which is needed. The conclusions and recommendations in relation to monitoring are set out in Section 8.

Implementation

The project has designed a system of SME sector monitoring and analysis and the necessary training has been provided. The skills for implementation, management and operation are now in place. The implementation of the proposed system is indispensable for effective SME policy development in Slovakia.

However, NADSME, which has been given the responsibility for monitoring and analysis of SMEs has not been provided either with the resources or the authority for implementation.

An urgent government commitment is now needed and the Ministry of Economy should take an early initiative to ensure that the recommendations of this report in relation to the new SME monitoring system are accepted and the system implemented.

SME POLICY FRAMEWORK CONCLUSIONS AND SUMMARY OF RECOMMENDATIONS

Project objectives and activities

This project has resulted in a comprehensive set of recommendations for a SME policy framework which addresses the main issues affecting SME development in Slovakia including law and regulation, finance and incentives, representation and advocacy and changes in the policy making and implementation structures.

The project activities included interviews with institutions, representative associations and entrepreneurs, expert assessments of existing policies, study tours and a workshop. Regional visits featured strongly in the programme of activities.

The conclusions and recommendations in relation to the policy framework are set out below and Part D of this report analyses the policy issues in detail.

Conclusions

law and regulation

The enactment of a comprehensive body of commercial law in a comparatively short space of time to meet the needs of Slovakia's new private sector represents a considerable achievement. However, the need to enact so much new law and regulation against the constraints of time and a lack of knowledge, skills and experience in the field of commercial legislation have created problems for all enterprises, but particularly for SMEs.

The problems for SMEs may be summarised as: a substantial burden of regulation; a lack of consistency in administration of law and regulation; an absence of consideration of the effects that new legislation can have on SMEs and a need to cope with frequent changes in laws. The difficulties that law and regulation can pose for SMEs are acknowledged by the Government of Slovakia in its Medium Term Policy for SMEs.

A comprehensive solution to these problems or, at least a response which would significantly ease the burden on SMEs, would involve a systematic simplification of administrative requirements for SMEs, the introduction of a "one stop shop" concept for the registration of new businesses (physical persons) and less complex procedures for legal entities below a certain capital threshold, better training of officials and enforcement of uniform standards in the implementation of law and regulation, effective pre-legislative impact assessment procedures and clearer laws.

It should be acknowledged that steps are being taken to improve the legislative process and consultative procedures with SME representatives. However, considerably more needs to be done to bring about meaningful reform of the legislative and regulatory environment for SMEs.

finance and incentives

New entrepreneurs in Slovakia and other transition countries rarely have personal capital achieved through savings or inheritance. The lack of ownership of personal property and, indeed, of a property market mean that traditional instruments for bank collateral are not available. Even in the case of established SMEs access to bank loans are relatively difficult. Bank resources are restricted due to tight monetary policy and, in any event, banks seem to be not interested in the SME sector, partly on the basis of bad debt experience when loans were approved liberally during the early 1990s.

The result of the lack of finance from traditional sources is a heavy reliance on state support and funds made available through foreign technical support programmes or international credit lines. However, no state support programme, even with substantial backing from abroad, can meet the capital needs of the SME sector. This sector accounts for at least 98% of all businesses and the scale of its capital requirements is such that they must be met primarily from sources outside of official programmes. Some increase in Slovak state support for SMEs is appropriate. However, the reality of the size of investment needs and the logic of the market economy demand that banks and other traditional sources of finance play a much greater role in SME funding.

State support and incentive programmes should be geared towards the achievement of this objective and this means a greater use of instruments such as loan guarantees to encourage bank lending to SMEs and a greater use of tax incentives to encourage investment in enterprises

taxation and social security

The cost of employment is high in Slovakia. It costs an employer nearly two crowns to pay an employee one crown after deduction of tax and social charges. Self employed people are also obliged to pay substantial social insurance and health care contributions and these charges represent a substantial source of complaint.

However, simplistic demands for reductions in charges are not useful. What is required is a researched and considered approach which balances issues such as the level of social protection that entrepreneurs themselves want and the amount of discretion they should be allowed in making their own arrangements.

promoting a more positive climate for SMEs

In relation to the climate for SME development in Slovakia, there are three fundamental problems: 1) a substantial gap in trust and confidence on the part of entrepreneurs towards the state and the various branches of its administration; 2) a serious lack of communication between the education and enterprise sectors and 3) a negative assessment of entrepreneurs in society.

These issues are not confined to Slovakia but are common to the economies in transition. However, it is important that they be addressed and overcome as owners of businesses must have a feeling of confidence in and ownership of the system which provides government and administration, the education sector needs to respond to the needs of those of today's students who will be tomorrow's entrepreneurs and societies that do not support enterprise will fail to match the achievements of those that do.

representation and advocacy for SMEs

Although SME representative associations in Slovakia deserve credit for the work that they are doing on behalf of their members, the main impression must be that there are still considerable difficulties in the whole area of SME representation and advocacy. Low association membership reflects a lack of belief on the part of entrepreneurs that representation on their behalf can be effective. The trade associations themselves lack experience, skills and resources. Most of their work seems to be in reacting to decisions already made than to initiating discussions with ministries in relation to their own priorities. Finally, there is not much evidence of a serious government interest in the views of these associations, partly on the basis of the view that the quality of representations is quite low.

It is not the role of government to promote membership of trade associations nor to accept badly presented and poorly prepared arguments. There is however a case for a structured mechanism

through which dialogue between the representatives of the SME sector and the most appropriate ministries might be developed and maintained. Trade associations in Slovakia will become strong and representative only if they can demonstrate an effectiveness as advocates for enterprise and display a professional approach.

priorities for a greater economic contribution from SMEs

There are a number of priority issues which are of particular importance in strengthening both the SME sector and its contribution to the economy of Slovakia. There is still an imbalance in Slovakia's industrial structure with an excessive reliance on a limited number of excessively dimensioned large scale enterprises. Strategic considerations require a more diversified industrial sector and a greater economic contribution from SMEs. In the industrial sector, this objective may be achieved in four ways: 1) a much greater role for SMEs in subcontracting activities; 2) a significant contribution from SMEs to Slovakia's exports and 3) a company development programme designed to facilitate the development of the SMEs with the potential to become internationally competitive enterprises; 4) there is also potential for services businesses through expanded tourism.

the policy making structure and institutional support

The Ministry of Economy has the responsibility for SME policy. However, the existing structure of the Ministry is not conducive to the achievement of a prominent role for SME policy nor the level of recognition that a sector comprising at least 98% of all enterprises in Slovakia merits. The Ministry is divided into five departments and there is a substantial focus on large scale industry. One of these departments - the Department of Economic Strategy and Policy - is responsible for the SME sector but this department also has many other responsibilities. This apparent lack of status for SMEs within the Ministry may be one of the causes for the widespread perception among SMEs that official policy favours larger enterprises. The Ministry needs to be restructured so that it may function more effectively in promoting the needs of the SME sector. There is also a requirement for the development of an independent policy making capacity within the Ministry which would be independent of outside technical assistance.

NADSME as the agency with executive responsibility for SME policy implementation undertakes a number of activities: monitoring of the sector; advice on SME policy; management of SME support programmes and promotion of SMEs generally. However, NADSME is funded jointly by EU Phare and by the Government of the Slovak Republic, a funding situation which is not permanent. NADSME therefore needs to undertake a strategic long term review to determine its future role and funding.

The Regional Advisory and Information Centres (RAICs) and Business Innovation Centres (BICs), as the regional SME support network, also need a review of their activities. At present, the RAICs and the BICs are financed by Phare and from commercial income, but local direct financial support seems to be inadequate. Effective and well resourced SME advisory services at local level are needed in Slovakia. The RAICs and the BICs will remain for some time as the most appropriate sources of these services, but the services and their funding need to be improved.

Summary of recommendations

law and regulation

1. The Slovak Government Council for SMEs (when established) should initiate, co-ordinate and ensure the implementation of a programme of administrative simplification for SMEs in co-operation with appropriate ministries and agencies.

2. The existing five stage procedure for registration by an entrepreneur as a physical person should be reduced to one stage through the designation of the registration departments of the Ministry of Interior's district offices as "one stop shops" for registration purposes.
3. Registration procedures for smaller companies (legal persons) should be eased through permitting new legal entities with a registered capital not exceeding SKK 1 million (USD 33 000) to register directly with the Register of Companies without having to make application to a court.
4. More effective training should be introduced for officials in relation to the interpretation, implementation and enforcement of complex legislation and regulation, particularly in the area of taxation.
5. Consideration should be given to the introduction of an independent appeals system within the tax administration thus giving an aggrieved taxpayer access to possible remedies outside of the slow and cumbersome courts system.
6. A system of impact assessment should be introduced and operated by the Ministry of Economy in co-operation with the proposed Slovak Government Council for SME under which a full analysis of all proposed legislative measures likely to affect SMEs would be undertaken prior to enactment.
7. As a means of ensuring greater stability, quality and clarity of commercial legislation consideration should be given to the following:
 - more detailed consultation procedures including publication of discussion papers in relation to major issues prior to decisions being taken;
 - wider and more frequent publication of law;
 - the establishment of a specialist central office for drafting new legislation;
 - enactment of a law which would set out interpretative expressions as a means for clarifying legislation and making it more accessible;
 - a thorough indexing and cross referencing of laws;
 - opening a specialist retail outlet for official publications, including laws.

finance and incentives

finance

1. The doubling of the resources provided under the credit support scheme managed by NADSME to SKK 2.4 billion (USD 80 million) through equal contributions from the government and from the commercial funds.
2. Increasing the amounts made available for SME lending from international credit lines, the exchange risk to be accepted by the National Bank of Slovakia.
3. The setting by the Slovak Guarantee Bank of a target of 10 000 new loan guarantees for SMEs for the next two years and agreement between the National Bank of Slovakia, SGB and the commercial banks to ensure the smooth operation of the loan guarantee scheme.
4. The establishment of a voluntary agreement between the National Bank of Slovakia and the commercial banks for the allocation of a minimum of 5 % of own resource lending to SMEs for a five year period, but with no lowering of standards in assessing applications for loans.

incentives

A joint NADSME/National Labour Office approach to identify the number of enterprises started with the assistance of NLO allowances, to provide more publicity for NLO self employment incentives, to encourage their greater use and to examine eligibility criteria to see if it would be useful, perhaps on a regional or sectoral basis, to extend the scheme to prospective entrepreneurs not deemed unemployed.

The retention of existing income tax concessions for new entrepreneurs which allow rebates of 50 %, 30 % and 20 % in the tax liabilities for the first, second and third years respectively, subject to the rebate totals being reinvested in the enterprise, and the extension of the scheme through allowing the entrepreneur the option of selecting any three of the first five years in the life of the enterprise.

The introduction of free depreciation for the acquisition of new equipment required for the operation of an enterprise subject to the imposition a qualifying investment ceiling of SKK 3 000 000 (USD 100 000) per annum.

The introduction of a personal tax investment incentive scheme under which a taxpayer would be allowed to write off annual investments, the total of which would not exceed SKK 100 000 (USD 3 300), in manufacturing and tourism SMEs or in registered funds designated for this purpose.

taxation and social security

It is recommended that a working group be formed comprising representation from SME representative associations, Ministry of Economy, NADSME, Social Insurance Company, National Labour Office, and the health assurance companies to review the various issues affecting social protection for the self employed and to consider whether changes should be made, particularly in regard to allowing a greater degree of personal discretion in determining insurance needs.

promoting a more positive climate for SMEs

1. The establishment of a Task Force comprised mainly of entrepreneurs but with some representation from ministries and NADSME to examine the business environment from a private sector perspective and to set out its agenda for a stronger and more dynamic private sector in Slovakia and which would be provided with the secretarial and consultancy services and access to ministries and other official bodies appropriate to the completion of its work.
2. The development in each region of a dialogue between RAICs/BICs and educational interests to initiate programmes for informing senior second level and third level students of enterprise as a career option and to encourage the introduction of courses which would support the SME sector.
3. The setting of nationally recognised standards for further business education provided by private institutions.
4. The design and implementation by NADSME and the RAICs/BICs of a long term information campaign to win wider public acceptance and understanding of enterprise and support for the encouragement of entrepreneurs.

representation and advocacy for SMEs

It is recommended that a SME Forum comprising senior representatives of the four ministries most concerned with the SME sector: Economy, Finance, Labour and Interior; NADSME and the main trade associations be established to discuss the main policy issues affecting SMEs, including measures under consideration within ministries or likely future developments, and to make recommendations as appropriate.

priorities for a greater economic contribution from SMEs

1. As a first step towards achieving greater co-operation between large scale enterprises and SMEs, the Ministry of Economy and the Slovak Chamber of Business and Commerce

- should undertake a joint initiative through which, all large enterprises could be invited to undertake a full audit of all their activities to identify those operations which could be more profitably undertaken on a subcontract basis.
2. Within the framework of the Export Development Programme, the resources of the Foreign Trade Promotion Fund and of EXIM Bank should be allocated as a priority to SMEs to maximise the opportunities for the diversification of Slovakia's export base and the annual reports of these bodies should highlight the support given to SMEs.
 3. SMEs identified as having the potential to become internationally competitive should be selected for a co-ordinated company development programme through which the resources of the main SME support programmes would be brought together in a focused manner to achieve significant expansion by these enterprises and to build within them the capabilities and strengths needed for their future development.
 4. There should be an intensification of tourism development through a stronger promotional effort in the German speaking market, the greater use of Slovak Guarantee Bank schemes to upgrade facilities for visitors and an initiative by the RAICs and BICs in the main tourism regions to organise training programmes for those service businesses which provide for tourist needs.

the policy making structure and institutional support

It is recommended that:

1. the Ministry of Economy be restructured in response to the need for a higher priority for the SME sector through the establishment within the Ministry of a separate Department of SME or the transfer of SME responsibilities to a reconstituted Department of SME and Tourism.
2. the policy making skills for the SME sector within the Ministry of Economy be upgraded with the objective of achieving an independent policy development capability.
3. NADSME prepare a strategic long term plan for its own development based on the dual principle of the provision of agreed services to government in return for an annual subvention and of commercial services to the private sector.
4. the Ministry of Economy request NADSME to initiate a review of the RAIC/BICs to include an examination and evaluation of the following:
 - the appropriateness and quality of services provided;
 - the usefulness of these services in meeting the needs of: 1) new enterprises and 2) existing SMEs;
 - gaps in services;
 - links with other regional and local institutions which could contribute to SME development;
 - funding and the case for a direct subvention to cover the costs of services to new entrepreneurs;
 - the role of shareholders;
 - sources of sustainable local financial support and the possibilities from commercial services;
 - securing wider local recognition and support.

PART B: THE SME SECTOR IN SLOVAKIA

1. THE SME SECTOR

BACKGROUND TO THE DEVELOPMENT OF THE SECTOR

Prior to 1989, during the era of the planned command economy, the structure of enterprise in Czechoslovakia was one of extreme concentration when compared with neighbouring socialist countries such as the German Democratic Republic, Hungary and Poland. In these latter countries, small businesses were tolerated, particularly in the services sector and in Poland, agriculture remained mainly in private hands. However, in Czechoslovakia, the situation was somewhat different. In industry (source: OECD Economic Surveys-Slovak Republic 1996), there were virtually no small enterprises: more than 90 % of enterprises had more than 500 employees and these accounted for 98.8 % of employment. In 1989, the average size of a representative industrial firm was 2 100 employees which was extremely high when compared with developed market economies or even with the other command economies of Eastern and Central Europe. A typical large enterprise concentrated the whole range of economic activities: from production of electricity, to manufacturing, retail trade and housing facilities.

In Slovakia, this pattern of concentration was probably more pronounced as most industrialisation took place after the Second World War and was directed towards the creation of very large enterprises. The underlying philosophy was based on the pre-eminence of heavy industry in growth and the benefits coming from strong vertical and horizontal integration. This approach excluded the possibility of subcontracting with smaller production units.

Although the problem of industrial concentration still remains, much has changed in Slovakia since 1989. Privatisation started in 1991 under the Czech and Slovak Federation and the first two simultaneous stages of the process which involved smaller units took place mainly in that year:

Stage 1: the restoration of many small units of property to former owners or heirs;

Stage 2: the sale by public auction of small retail and service outlets.

The results of this privatisation process were reinforced by new business commencements to the extent that in Slovakia, independent since 1 January 1993, the SME sector now plays a major role in the economy.

THE ROLE OF SMEs IN THE ECONOMY

There are more than 280 000 SMEs in Slovakia, comprising the self-employed and legal entities. In 1996, there was a total of 2 036 400 employees in the private and public sectors. According to the Statistical Office of the Slovak Republic, the number of employees in the SME sector amounted to 561 426 or 25 % of total national employment. When the country's 280 000 or so self-employed are taken into consideration, it is clear that SMEs now account for some 37 % of those at work. The growing significance of SMEs is illustrated by the fact that employment in industrial enterprises with between 25 and 500 employees increased from 155 000 (representing a 28 % share of total industry employment) in 1993, to 201 000 employees (39 % share) in 1995 (Statistical Yearbook of the Slovak Republic).

Further indications of the progress of the SME sector are available from the NADSME publication "State of Small and Medium Enterprises - 1996" which states that small enterprises-defined as having from 1 to 24 employees-accounted for 4.9 % of output in industry, 16.8 % in building construction, 16.4 % in the road carriage of freight and 25.8 % in retail sales. For the

same year, medium enterprises - defined as having from 25 to 500 employees - accounted for 24.8 % of output in industry, 38.3 % in building construction and 34.3 % in road carriage of freight. SMEs also accounted for 46.4 % of the total volume of investments.

However, although the SME sector has made considerable progress, the economic structure of Slovakia is still quite different from that of a typical market economy. There is still a considerable degree of industrial concentration. An OECD analysis of the top 20 enterprises in Slovakia shows that for 1994, they accounted for 30% of gross national output.

2. GOVERNMENT AND INSTITUTIONAL SUPPORT FOR THE SME SECTOR

THE MINISTRY OF ECONOMY AND OTHER INSTITUTIONS

The Ministry of Economy has primary responsibility for the formulation and implementation of state policy for SME development including the co-ordination of support measures. A major function of this Ministry is the preparation of legislation to facilitate the development of the SME sector. The Ministry of Economy implements support measures for SMEs mainly through the NADSME. The activities of NADSME, which has the function of project management unit under the EU Phare Programme for funds allocated to Slovakia's SME sector, are described in more detail below.

In addition to its policy role and the co-ordination of the activities of NADSME, the Ministry of Economy operates a number of other programmes of interest to SMEs including support for tourism and reduction of energy consumption.

Certain other ministries and institutions also have SME responsibilities. For example, the National Labour Office operates a Fund for Employment which is financed entirely from within Slovakia through contributions from employers (3 % of wages) and employees (1 % of wages). Seventy per cent of this SKK 8 billion fund is designated for new job creation through interest free refundable and non-refundable grants to SMEs and the remaining 30% finances retraining of unemployed persons including new business commencements from within this category. Another example is the Slovak Guarantee Bank (SGB) which commenced operations in 1991 as a specialised bank with the task of developing and supporting the private sector, particularly SMEs, through the provision of loan guarantees. The SGB also provides loan guarantees under the EU Phare Programme in co-operation with NADSME.

THE ROLE OF NADSME

NADSME was established by the Ministry of Economy in 1993 in accordance with a government resolution of the same year. It is the primary agency with responsibility for SME policy implementation in Slovakia. The Board of NADSME is comprised of representatives of ministries and from institutions with an interest in SME development (for example, the Slovak Chamber of Commerce, the Association of Entrepreneurs and the Union of Craftsmen). The agency funds its activities from two main sources, the state budget of Slovakia and the EU Phare Fund.

NADSME is the national counterpart for this project.

The main responsibilities of NADSME are:

- monitoring and analyses of the SME sector;
- to recommend to government the policy and strategy necessary for the development of the small and medium enterprise sector;

to identify and analyse the barriers to enterprise development and to suggest ways to eliminate them;

- to co-operate with financial institutions on credit and guarantee schemes aimed at the stimulation and development of small and medium enterprises in the Slovak Republic;
- to support Regional Advisory and Information Centres (RAICs), co-operate with Business Innovation Centres (BICs) and other business advisory services in the Slovak Republic with the aim of developing the management, marketing, financial and technical skills necessary for the successful development of small and medium sized businesses;
- to co-operate with existing European economic and business information networks and databases;
- to promote enterprise awareness among the public through advertising campaigns, the publication of information material and the organisation of conferences, seminars and exhibitions;
- to manage European Commission aid to the SME sector in the Slovak Republic;

NADSME co-ordinates a network of regional centres and has number of specialised departments and subsidiary operations:

Regional Network of NADSME

The regional network of NADSME comprises Regional Advisory Information Centres (RAIC) and Business Information Centres (BIC). One of the main objectives of these centres is to support development of SMEs in Slovakia's regions. The RAICs and BICs provide a comprehensive package of advisory, information and training services. These services include assistance with the preparation of business plans in a form acceptable to banks and other sources of funding and consulting services and information in the areas of management, marketing, taxation, accounting and legislation. A key role of these centres is the organisation of comprehensive consulting and training programmes, in co-operation with the regional Labour Offices, for unemployed persons who intend starting their own businesses. The RAICs and the BICs have the legal status of non-profit associations of legal persons.

Euro-Info Correspondence Centre (EICC)

The main mission of the EICC is to obtain and provide information requested by domestic and foreign enterprises (e.g. information on relevant legislation, financial and banking operations, or direct requests to find partners for co-operation). The EICC fulfils the basic information function for Slovak business entities on EU developments and participates in the existing European mechanisms for the provision of support to businesses. The participation of the EICC in the network of 220 Euro-Info-Centres located throughout the member states of the EU and in those states seeking membership is a major advantage.

Subcontracting Exchange of Slovakia

The Subcontracting Exchange of Slovakia (SES) was founded by NADSME with assistance from UNIDO in 1994 as a non-profit organisation. The main mission of SES is to facilitate co-operation, particularly between large companies (as contractors) and small and medium enterprises (as sub-contractors). The principal focus is on achieving co-operation between foreign (mainly European) and Slovak partners. The activities of SES include partner identification, information services in relation to Slovak industries and companies, monitoring production capabilities and facilitation of co-operation between Slovak companies and foreign partners and assisting in the participation of SES members at international trade fairs.

Seed Capital Company

The goal of the Seed Capital Company (SCC) is to make financial investments in start-up enterprises and in existing small and medium companies entering new areas of business. The SCC investments are of a risk capital nature as the entrepreneurs themselves are not required to provide guarantees. The funds available to SCC are provided under the Phare programme.

PART C: MONITORING THE SME SECTOR

3. THE CASE FOR A COMPREHENSIVE MONITORING SYSTEM

Monitoring of SMEs involves the collection and interpretation of data and information relevant to the development of the sector and having in place the institutional means for the effective operation of this process and the presentation of its results. As monitoring is linked closely with policy development, some institutions may combine both functions.

High quality statistics are the first requirement for an effective monitoring system. Accurate and objective statistical information which is trusted by the public underpins the functioning of a democracy. A modern developed economy must have available impartial information compiled according to the best statistical standards and methodology for planning and development purposes. This requirement applies to all sections of society including the business sector.

High quality, accurate and up-to-date information on the activities of business enterprises is essential to good economic management. The business sector itself benefits from sound economic management as it contributes to a stable economic environment helping to maintain low inflation, low interest rates and low budget deficits. The economic forecasts which underpin such management depend crucially on the current economic indicators as a key input.

In recent years, policy makers in mature market economies have focused greater attention on the development of small and medium sized enterprises as a means for improving economic performance. SMEs, particularly those in the services sectors, are making a significant contribution to economic development and now account for the bulk of new jobs being created in most countries. It is, therefore, essential that the economic contribution of SMEs be measured with reasonable accuracy and that trends be identified and interpreted correctly.

This task to be done well, requires a complex set of data and information in relation to various aspects of economic performance. In the case of SMEs themselves, policy makers should have, as a very minimum, high quality information on:

1. the number of enterprises by sector and size class of enterprises;
2. employment by sector and size class of enterprises;
3. turnover by sector and size class of enterprises.

The co-operation of SMEs is vital to the development and maintenance of an effective monitoring system. Accurate data and information can be of direct benefit to businesses themselves - for example in the preparation of business plans, seeking loans from credit institutions or equity from private or institutional investors, researching market opportunities and assessing competitive threats.

4. MONITORING OF SMEs - INTERNATIONAL COMPARISONS

BACKGROUND

Sophisticated monitoring of the SME sector has not been a priority for most governments. Indeed, it is only in the last fifteen years or so that SMEs have become the focus for positive political action in developed market economies in recognition of their economic contribution. In

the European Union, 75 per cent of the jobs created in the non-primary economy between 1989 and 1992 were in small and medium sized enterprises.

The relative lack of official interest in SMEs until fairly recently, the dynamics of the sector, the sheer numbers of enterprises and the wide variety of categories and sizes, and the difficulties and expense in gathering high quality data have all contributed to a situation whereby the means for monitoring the sector in many countries fall far short of perfection. National statistics offices have not generally organised their activities in ways which have had the SME sector as a focus in its own right. This is the background against which governments are framing policies for the development of their smaller enterprises.

The relative neglect in relation to official sources of information and the difficulties attached to others are shown by the following illustrations from the Netherlands and the United Kingdom:

A large proportion of the enterprises which appear on relevant registers in the Netherlands are not actually active businesses and exist only 'on paper', as entrepreneurs do not always report when they cease trading or change sectors. This means an overstatement of the actual number of firms in operation and an underestimate of the mortality rate.

In the United Kingdom the need to register for VAT is subject to a minimum turnover threshold which is regularly adjusted. Therefore, many new enterprises do not appear on the VAT register. Yet, this register is a widely used means for monitoring SME progress.

In 1991, the 'International comparison of SME statistics', published by the Natwest Bank (UK), stated that 'the basic rule in the analysis of SME statistics is that they are everywhere suspect'. Comparative SME statistics between countries are fairly recent and standardisation of definitions and coverage are still some way off. However, consistent with the increased priority being accorded to SMEs, more and more administrations are looking to ways of improving their SME monitoring activities.

Virtually all governments now allocate responsibility for SME affairs to a specific minister who has the support of a SME section or department within his or her ministry. This relatively recent SME policy infrastructure is leading to a new focus on improved data and information for monitoring purposes. Sources of information include the Trade Register (in certain countries), the VAT Register, the Social Security Register and National Statistics Offices. None of these Registers was designed specifically for SME purposes and the information they provide in relation to SMEs can be contradictory and inadequate. However, developments such as efforts to combine different tax registers in some countries - VAT, Corporation Profits Tax and Income Tax - and the requirement of Eurostat for the implementation of standard business registers by the Statistical Offices of EU member states should lead to gradual improvement.

MONITORING OF SMEs IN SELECTED EUROPEAN UNION STATES

In this section the means employed for monitoring SMEs in four European Union countries are described and discussed:

Netherlands

The Netherlands Authorities actively monitor their SME sector. Each year since 1988, the Dutch Ministry of Economic Affairs has commissioned a report entitled "The State of Small Business in the Netherlands 19--", which is prepared by a private research company.

The 'State of Small Businesses in the Netherlands' report places considerable emphasis on the comparative situation of smaller Dutch enterprises in relation to those of other EU member states. This report covers issues such as:

- SME sector characteristics
- registration trends in new enterprises
- survival rates
- employment
- exporting trends among SMEs
- legal forms
- administrative burdens.

This report draws on a number of sources of information: official statistics, business registrations, the work of research institutes, Netherlands business surveys, Chambers of Commerce and Industry, and Eurostat. Features of the Dutch SME environment are a relatively high business survival rate and a greater level of new job creation than in most European countries. The problems and potential of the SME sector are now taken very seriously in the Netherlands. In 1995, the Ministry of Economic Affairs published "Jobs through Enterprise", a paper setting out government proposals for the encouragement of enterprise. In addition, a ministerial committee (The Competitive, Deregulation and Quality of Legislation Committee) is in place to achieve a reduction in the legal and regulatory burden on SMEs.

United Kingdom

The lack of a compulsory registration system for self employed people or sole traders in Britain rules out a source of information available in some other European countries. Moreover, the existence of turnover thresholds for compulsory registration adds to the limitations of the VAT system as a source of SME information, when added to the number of categories which are VAT exempt.

Official sources of SME related information in the United Kingdom are:

- Department of Employment Labour Force Survey, published every quarter, which identifies changes in self-employment and in total employment, including SMEs.
- Companies Registration Office: There are separate Offices for England and Wales, Scotland, and Northern Ireland.
- Inland Revenue (the UK tax administration), a major source of information on SMEs based on VAT and annual returns for income and corporation taxes. The limitations of VAT have been outlined above and in the case of the self-employed, returns of income may include sources other than profits.
- Department of Trade and Industry (DTI) Statistical Bulletin: The Department of Trade and Industry is the ministry responsible for small business in Britain but it has many other responsibilities as well. The DTI Statistical Bulletin contains occasional SME related statistical information, such as numbers of firms by employment size. This ministry has a Small Firms Statistics Unit, which undertakes interpretative work on information from other sources such as the Inland Revenue, and also publishes an annual 'Small Firms in Britain Report'.
- Central Statistical Office (CSO) which, in addition to its own samples and surveys, administers the Inter-Departmental Business Register (IDBR) which was established in 1993. The main role of this register is as a sampling frame for official enquiries but it can be used for analyses of the United Kingdom business population. The Register holds information on all businesses registered for VAT and all businesses operating a PAYE (Pay as you earn) income tax scheme. It records each business's employment, turnover and industrial classification. Employment is taken from the Census of Employment or, if the business has been sampled more recently, from a CSO enquiry. Failing that, it is estimated from PAYE returns. Turnover also comes from a CSO enquiry, or direct from VAT returns.

Although the establishment of the Inter-Departmental Business Register (IDBR) is a useful addition to the mechanisms for monitoring SMEs, there are still problems in relation to the accuracy of SME statistics, particularly in relation to enterprises with no employees. This smallest class size of enterprise is most open to error. Unlike the other class sizes it is not just a count of enterprises on the IDBR but also includes an estimate of the number of enterprises that do not appear on the register. The latter depends on the self-employment estimates, which are subject to sampling errors, and the reliability of the assumptions about self-employed people in partnerships. A further source of uncertainty in the estimates of this class size is the extent to which the classification of individuals as self-employed is consistent in the IDBR, the Labour Force Survey and the Survey of Personal Incomes. These reservations are fairly important, as approximately 72 % of United Kingdom SMEs have no employees.

Other useful sources of SME monitoring information in the United Kingdom are commercial bank publications such as Barclay's Small Business Bulletin and the Natwest Review of Small Business Trends. The 'Quarterly Report on Small Business Statistics' published by the Bank of England, the UK Central Bank, is particularly interesting. This report draws from a wide variety of sources, both public and private sector, and includes material on such issues as company performance, self-employment, the business environment, business commencements and failures, and sources of finance. A feature of the report is its emphasis on the results of attitude surveys such as the 'Most Important Problems Facing Small Firms' and the 'Small Business Confidence Index'. The sources from which the Report is compiled include surveys by UK banks, major accountancy practices, research institutes, Chambers of Commerce, and official statistical and other information.

The United Kingdom was one of the first countries in Europe to research the needs and economic potential of small business. In the mid-1980's, the Government published a policy document entitled 'Lifting the Burden' which made various proposals for the deregulation of the small business sector and was probably the first official document of its kind in Europe.

Austria

The Federal Ministry of Economic Affairs has particular responsibility for the development of SME policy in Austria, preparing legislation for the encouragement of SMEs and implementing measures for the promotion of the sector. This ministry publishes a bi-annual report on the state of SMEs, which it submits to the National Assembly (parliament), and other SME related material.

Sources of SME related information in Austria are:

- Austrian Central Statistical Office which gathers and publishes information on matters such as company numbers, employment, sectors, sizes and categories, and production and investment.
- Austrian Federal Economic Chamber which publishes member statistics by legal form, sector, industry and region.
- Institute for Small Business Research which publishes 'Gewerbestrukturbericht' (report on the structure of SMEs) and contributes to 'Mittelstandsbericht' (report on SMEs) which is published by the Ministry of Economic Affairs. This Institute, also publishes quarterly reports on the crafts and services sectors.

In Austria, there are also several private trade protection societies which provide information on the credit standing of firms and also on the development of certain industries.

Ireland

There are similarities between Ireland and the United Kingdom insofar as legislation governing the formation of businesses is concerned. The Companies Acts for both jurisdictions are similar and Ireland has no system of compulsory registration for the self employed and sole traders. In

In the absence of a total business census it is very difficult to assemble precise information, for example, as to the total number of non-incorporated businesses. The tax collection system is a much used source of information on SMEs, but there are limitations resulting from such matters as VAT thresholds and exempt categories.

However, Ireland has seen considerable official emphasis on the encouragement of the SME sector. A very significant development was the establishment of the Task Force on Small Business which published its report in 1994. The majority of task force members were people in business, but there was Civil Service representation drawn from the relevant ministry which also provided the required secretarial support. The Task Force looked at all of the major issues affecting business in Ireland and published a comprehensive set of recommendations for improvement and reform.

In relation to the issue of monitoring, the Task Force commented that consistent with the low priority accorded small business in Ireland in the past, statistics on small enterprises were available only on a limited piecemeal basis and that this was clearly an unsatisfactory situation. The Task Force also stated that it was difficult, if not impossible, to formulate adequate policy for the small business sector in the absence of a proper data base on matters such as the number of small businesses, their sectoral distribution, their employment levels, and their start-up and failure rates.

The main sources of statistical information on small business in Ireland are:

- The Central Statistics Office (CSO) which conducts annual censuses of enterprise in industry and construction as well as periodic censuses of services enterprises. The industry census is confined to enterprises in which at least three persons are engaged and the construction census to enterprises in which at least 20 persons are engaged; the occasional services censuses are not subject to any equivalent enterprise size threshold, but are limited to enterprises operating from permanent business premises. A major disadvantage of these surveys is that restrictions in their coverage reduce their usefulness as a guide to the number of businesses in operation. The CSO acknowledges complaints in regard to the lack of statistics relating to the services sectors of the economy and enquiries in these areas will be extended in future years.
- The Revenue Commissioners (tax authorities) provide the most comprehensive estimate of the size distribution by employment of Irish enterprises and, through the operation of the VAT system, they also provide the best available information on the sectoral distribution of businesses. However, there are limitations. Estimates as to the number of businesses are affected by factors such as partnerships, which are not subject to income tax but where the partners are taxed as individuals, and by persons who may have more than one business but are subject to one income tax assessment. The main drawback with VAT as a source of SME information is that not all businesses are registered for this tax.
- The Industrial Development Agency undertakes an annual employment survey which, though highly accurate, is confined to manufacturing and internationally traded services such as software, financial, technical, training, data processing and publishing.

As part of its response to the Task Force Report, the Government in June 1994 established a Small Business and Services Division or section within the Department (Ministry) of Enterprise and Employment with responsibility for co-ordinating state activities in relation to SMEs, the preparation of policy proposals for SME development and the publication of an annual report on the SME sector.

With regard to monitoring, a number of steps have been or are being taken which should lead to a better flow of higher quality information in respect of SMEs while, at the same time, reducing the administrative burden on businesses. These measures include:

- the implementation of an upgraded business information system, but limited to the sectors covered by the employment survey conducted by the Industrial Development Agency
- a joint CSO-Revenue Commissioners Working Group to improve co-operation and collaboration between the two organisations. The CSO recognises that the Revenue Commissioners offer the greatest untapped potential for statistical purposes. The Revenue Commissioners also have a project underway to combine the main existing tax registers - VAT, Income Tax and Corporation Profits Tax - which should result in a considerable improvement in the quality of data and information in relation to SMEs.
- the preparation of a Central Business Register by the CSO in compliance with Eurostat requirements. It is envisaged that this register will eventually encompass all businesses. The CSO will then have the facilities to readily manage the number of surveys sent to various small businesses. Work on the completion of this register, which is now taking place, may take a year or more to complete.

MONITORING OF SMEs IN CEE COUNTRIES

The central statistics office of hardly any country in Central and Eastern Europe publishes data by size class of enterprises. However much more data are - or will be made - available than are currently published.

The number of enterprises by sector and size class is collected in all countries. The same holds for employment and turnover by sector and size class, but the latter is estimated in Slovenia.

Value added by sector and size class is collected in six out of ten countries (Estonia, Hungary, Latvia, Lithuania, Poland and Romania), is estimated in Slovenia and will be available in 1997 in Slovakia and the Czech Republic.

Labour costs by sector and size class are collected in the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Romania and are estimated in Slovenia.

Data on exports by sector and size class are collected in Hungary and in Romania, are estimated in Slovenia and in Slovakia and in the Czech Republic from 1997, probably as an estimate.

In the framework of comparative research on the developments of the economic and size class structure of the enterprise sector, it is of essential importance that enterprises are classified by sector and size class in the same way.

In 6 out of 10 countries enterprises have been classified according to international NACE classification since the construction of the current business register. In Poland NACE was introduced in 1995, in Lithuania, the NACE classification will be available from 1996 onwards and in Estonia and Latvia from 1997 onwards.

Although data by size class are published hardly anywhere, in almost all countries data by size class according to current EU size class boundaries (0-9, 10-49, 50-249, 250+) can be produced. In some cases time and costs related to the production of data by size class might constitute a problem, since current computer programmes need to be reconstructed.

More serious problems with regard to the production of data by size class exist only in Latvia, in which in conformity with domestic law size class 0 (self-employed persons) does not exist, since the entrepreneur is counted as an employee. Size classes in this country are thus not totally comparable to other countries. More or less the same holds for Slovenia, in which self-employed persons without legal identity are deliberately excluded from the statistics.

To which degree are the enterprise statistics in Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic, and Slovenia comparable?

At first sight, definitions and data collection methods seem to vary a lot between the countries. On the other hand, an impressive convergent tendency with regard to methodologies is apparent, resulting in the situation that:

- By the end of 1997 all countries except the Czech Republic will have a full obligation for registration and/or have an additional check at the tax register with regard to the identification of natural persons undertaking economic activities.
- Also by the end of 1997, all countries will use NACE or a compatible nomenclature as a method of classifying economic activities.
- Regarding a breakdown by size classes, all countries can apply the currently used boundaries of the EU by 1997, although two countries - Latvia and Slovenia - will have some deviation with regard to size class 0 or the self employed.

Compared to the current situation with regard to the production of enterprise statistics in the countries of the European Economic Area, the situation in Central and Eastern European countries is encouraging. Procedures with regard to enterprise statistics are improving so rapidly in the Central and Eastern European countries studied, *that it is possible that the situation at the end of this decade will be even more favourable than in the EU, where national traditions and practices seem to inhibit further convergent developments.*

Moreover, apparent problems which cannot be solved in the data collection phase at short notice, can almost always be solved in the data management and analysis phase. The availability, quality and comparability of statistical data on the enterprise sector therefore seem to be no serious obstacle to the extraction of information on a standard basis to facilitate comparisons between national SME sectors, including those of EU member states.

THE EUROPEAN OBSERVATORY FOR SMEs

The Annual Report of the European Observatory of SMEs monitors the progress of the SME sectors in all 18 member states of the European Economic Area and Switzerland. The Observatory Project was established in 1992 to provide the European Commission with structured information for its policy making activities in relation to SMEs. In addition, it was intended that the information provided would be of assistance to national governments in framing their own SME policies and to various organisations in the business sector.

The aim of the Observatory Project is to prepare an independent annual report which gives a structured overview of European SMEs in both quantitative and qualitative terms.

Such an overview requires a common basis for comparison of national SME trends. The standard package of data by size class and sector on economic activity used by the Observatory in its annual report contains the number of enterprises, employment, turnover, exports, value added and labour costs. This does not mean that all of these variables are available in each of the 19 countries covered by the Observatory. In the case of some countries only the number of enterprises, employment and turnover are available through Eurostat (see Section 5). The outstanding variables are estimated by the Observatory on the basis of partial information derived from national sources.

At present, this Observatory serves as the most comprehensive basis for international comparisons between the SME sectors of Western Europe and, for this reason, offers the most appropriate model for the design of an upgraded SME monitoring system for Slovakia.

OUTLOOK FOR MONITORING

Although the above selection of countries is limited, it is fairly clear that more sophisticated national models for SME monitoring are being developed but that the emphasis will remain on data derived from other existing sources.

The question as to which data should become available on a permanent or recurrent basis in order to allow researchers to present useful information to policy makers responsible for the economic development of a country as well as to other stakeholders, depends on:

- choices made by the government with respect to policy priorities
- number and characteristics of policy instruments (to be) implemented
- macro economic situation (sector structure, main trade partners, etc.)
- the needs to make international comparisons

A comprehensive analytical framework for SME data analysis contains at least four domains of analysis:

1. Enterprise performance
2. Enterprise behaviour
3. Business environment
4. Policy for the SME sector

The extent to which governments will invest in developing data analytical frameworks for their SME sectors will be determined by national SME policy priorities and the ease with which data may be extracted from existing sources. In relation to the statistics aspect of monitoring, the requirements of Eurostat will lead eventually to the collection, processing and presentation of more standardised data at a certain level in respect of the SME sector throughout the European Union.

5. THE IMPACT OF EUROPEAN UNION REGULATIONS AND EUROSTAT

EUROSTAT AND SMEs

Eurostat is the Statistical Office of the European Communities and its work covers a wide range of topics divided into nine categories: general statistics; economy and finance; population and social conditions; energy and industry; agriculture, forestry and fisheries; external trade; distributive trade, services and transport; environment; research and development.

In the case of SMEs and larger enterprises, Eurostat publishes "Enterprises in Europe" which provides information on matters such as the number of enterprises in the European Union, size, turnover, contribution to the employment market and dates of formation and closure.

There is therefore a considerable emphasis on the part of Eurostat on harmonised data to facilitate meaningful comparisons for each EU member state. This requirement for harmonisation has resulted in a number of directives to national statistics offices setting out ways in which data should be collected and processed.

Eurostat defines a SME as an independent enterprise within the class sizes: 0, 1 to 9, 10 to 49, and 50 to 249 employees. In relation to enterprises generally, the variables required by Eurostat are number of enterprises, employment, turnover (total sales) and value added at factor cost. There is acceptance by Eurostat that the lack of data in relation to classes 0 and 1 to 9 employees makes them less suitable for the same quality of analysis as the other employment classes.

THE DEVELOPMENT OF BUSINESS REGISTERS

The European Union's proposals for the harmonisation of statistical information on businesses in member states are set out in "Council Regulation (EEC) No. 2186/93 of 22 July 1993 on Community Co-ordination in drawing up business registers for statistical purposes" which in 11 articles and 2 annexes defines for EU countries:

- extent and content of registers for statistical purposes;
- minimum periodicity of their updating;
- access to registered data while conforming with data protection requirements;
- access to other administrative or legal files (registers) for statistical purposes;
- rules and timetable for the implementation of the regulation;
- procedures related to the application of the regulation.

The essential requirement is that the registers will be compiled of:

- all enterprises carrying on economic activities contributing to gross domestic product (GDP) at market prices,
- the legal units responsible for those enterprises,
- the local units dependent on those enterprises.

There is an extensive list of the information that the registers should contain including basic items such as name and address, date of commencement of operations, activity codes, net turnover from the sale of goods and services or allocation by sales class size, and net assets.

To facilitate implementation of the regulation, Eurostat is compiling a 'Recommendations Manual for Business Registers' designed for the guidance of statistical offices in member states. The manual is subject to approval by a special 'Business Registers Committee'.

JUSTIFICATION FOR BUSINESS REGISTERS

The justification provided by Eurostat for business registers may be summarised as follows:

1. The Single Market increases the need to improve statistical comparability in order to meet EU requirements. Common definitions and descriptions have to be adopted for enterprises and other relevant statistical units.
2. There is a growing need for information on the structure of enterprises, a need which current statistics within the EU are not able to meet.
3. Within an economy, business registers for statistical purposes are a necessary tool for keeping track of structural changes brought about by such activities as joint ventures, partnerships, buy-outs, mergers and take-overs.
4. Some statistics are not currently available, particularly in sectors with many small and medium-sized enterprises, such as services, due to a lack of registers for statistical purposes.
5. Business registers are one element in reconciling the conflicting requirements for increased information on enterprises and easing their administrative burden, in particular through the use of existing information in administrative and legal registers - especially in the case of SMEs.
6. Business registers for statistical purposes represent a basic element of systems of information on enterprises, making it possible to organise and co-ordinate statistical surveys by providing a sampling base, possibilities of extrapolation and means of monitoring replies from enterprises.
7. The statistical collection system covering trade in goods and services between member states necessitates a register of those persons required to give information and it would be

desirable if that register could be derived from a central register of enterprises used for statistical purposes.

Eurostat had hoped to have the business registers fully in place by 1 January 1997 but most member states are still only at the stage of developing their national registers and the focus of Eurostat is now on achieving the greatest possible progress in the shortest time. There is an acknowledgement that business registers represent a long and costly development for each member state. However, it is fairly clear that the objective will be achieved and the statistics offices of countries that aspire to join the EU, including Slovakia, are assembling business registers in line with EU requirements.

6. MONITORING OF SMEs IN SLOVAKIA

THE MONITORING SYSTEM

NADSME was given the task of monitoring Slovakia's SME sector by the Ministry of Economy. The main sources of quantitative data used by NADSME are the Statistical Office of the Slovak Republic, DataCentrum (the data collection and processing branch of the Ministry of Finance), the Registry of Companies and the Trade Register. The detailed results are included in the State of Small and Medium Enterprises, a report published annually by NADSME and adopted by both government and parliament. The evaluation of results is mainly quantitative.

Apart from standard general economic indicators, the information co-ordinated by NADSME and published annually in relation to the SME sector comprises: number of entrepreneurs nationally by district and by region; sectoral distribution and analysis of SMEs; structure of SME sector by legal form of enterprise, contribution of SMEs to production output; births and deaths of SMEs by broad industrial sector and by legal form (from 1995 onwards).

There are a number of factors which inhibit the development of the monitoring system:

1. NADSME's monitoring role is an additional responsibility which was not included in its original terms of reference and for which extra resources were not provided
2. the data and information available to NADSME do not provide a basis for meaningful comparison between the SME sector in Slovakia and other countries
3. NADSME in law has the status of a association of legal persons (non-profit company) and does not have the right to obtain data and information directly from official sources. Requests must be routed through the Ministry of Economy to the Statistics Office
4. There is no research link with the monitoring system

COMPARISON BETWEEN EUROPEAN OBSERVATORY SMEs STANDARD DATA PACKAGE AND INFORMATION PUBLISHED BY NADSME

A comparison between the standard package by size class and sector of economic activity used by the European Observatory of SMEs in its annual report and that produced by NADSME is as follows:

European Observatory	NADSME
1. Number of enterprises by sector and size class of enterprise	Number of enterprises by legal form, regional distribution of sole traders or physical persons, births and deaths of SMEs by broad industrial sector and by legal form (since 1995). The number of enterprises by class size is provided but not by sector. There is a percentage breakdown of small enterprises (up to 24 employees) by sector of economic activity.
2. Employment by sector and class size of enterprise	Employment by sector and four class sizes The class sizes are different from those recommended by Eurostat: Eurostat: 0,1-9,10-49,50-249 NADSME: -,1-10,11-24,25-99,100-499 However, the Statistics Office is changing classifications to conform with Eurostat.

3. Turnover by sector and size class of enterprise	Percentage share of output for SMEs by sector. Statistical Office publishes turnover by sector for class sizes of enterprises in 2 above, only from the class size 20 employees and upwards (before 1997 from class size 24 upwards).
4. Exports by sector and class size of enterprise	Not published
5. Value added by sector and class size of enterprise	Not published Estimates of value added by SMEs have been prepared within the Statistical Office.
6. Labour costs by sector and class size of enterprise	Not published Statistical Office publishes output figures by sector and class size as in 2 above. Figures for employment and average monthly wages are similarly published.

There is therefore a gap between the standard package developed for the European Observatory on SMEs and the data published by NADSME in relation to Slovakia. Moreover, there are difficulties in relation to data sources on births and deaths of enterprises and their overall numbers, arising from substantial differences between registers of enterprises held by different institutions in Slovakia.

However, the existing and potential sources of data in Slovakia are such that the basis exists for a high quality SME monitoring system. For example, the efforts being made by the Statistics Office to upgrade its own enquiries and to adapt to Eurostat requirements will add to the potential for improved monitoring of SMEs.

THE SOURCES OF DATA RELEVANT TO SMEs IN SLOVAKIA

In the case of Slovakia, there are a number of sources from which SME data and information may be obtained and some of which could serve as a basis for an improved monitoring system. The main actual or potential sources of data are as follows:

1. the business licensing and registration system;
2. the Statistical Office of the Slovak Republic;
3. DataCentrum;
4. Social Insurance Company;

1. Business licenses and legal persons

the registration system

An essential first requirement for the production of enterprise statistics is the existence of an enterprise register, as a fundamental starting point for the production of business data of any kind.

In Slovakia, businesses are operated by sole proprietors who require only a business license or by legal persons entered on the Commercial Register e.g. a limited liability company, which has to go through a process of registration in addition to obtaining a business license.

The regulations for the commencement of an enterprise including business licences and registration procedures for legal entities are set out in more detail in Part C. For monitoring purposes, the important consideration is that there is a record of virtually every enterprise through the licensing and registration system.

The registers maintained under this system are of importance because they are the main sources for updating on a monthly basis the statistical register (RSU) of the Statistical Office of the Slovak Republic.

Those administrative registers are:

- Registry of Companies or Commercial Register from which the records of commercial legal entities are transferred to the RSU.
- Trade Register from which the records of unincorporated licensed enterprises (sole traders) are transferred to the RSU. This Trade Register is held by the small business departments of the district offices of the Ministry of Interior.

limitations of licensing system for monitoring purposes

In 1996, there were 241,199 trade licensees (which were not legal entities) and 10,486 licence holders with prescribed qualifications. In theory, this system should be the means for accurately measuring numbers of new business commencements and closures and the total number in operation. However there are difficulties:

- people may start a business without a license (black economy);
- people may have a license without being in business;
- people may have more than one license and just one business;
- people may have one license and more than one business;
- people may have had a business, ceased their business activities and still have a license without going to the local office in order to cancel their registration.

This means that the Trade Register is a very poor source of information for the Register of Statistical Units. It would take a great deal of work to make the Trade Register up-to-date and - even more - to keep it up-to-date. The conclusion would be that additional sources should be found to get an improved input for the Register of Statistical Units.

2. The Statistical Office of the Slovak Republic

overview of SME data collection and processing activities

The methodology for data collection and processing employed by the Statistical Office of the Slovak Republic is still evolving but there is considerable emphasis on meeting the requirement to ensure international comparability of statistical indicators in line with the methodology used within the European Union.

Commencing with the results for 1997, all Statistical Office publications will adopt the following business size-categories as expressed by intervals of numbers of employees: 0 - 9; 10 - 19; 20 - 24; 25 - 49; 50 - 249; 250 - 499; 500 - 999; 1000 and more. In addition, there are estimates covering sole traders (physical persons not entered on the Commercial Register).

Statistical data are collected as follows:

1. through full-scale monthly surveys covering enterprises with 20 or more employees (before 1996 with 25 and more employees) enrolled in the Commercial Register. These surveys also cover the value of production;
2. through quarterly surveys of enterprises with up to 20 employees (before 1996 with up to 25 employees) entered on the Commercial Register. These surveys are based on sampling;
3. by a qualified estimate of private entrepreneurs - sole traders not entered on the Commercial Register - and of their employees. This survey is undertaken once a year based on a sample.

At present, discussions are under way concerning the size structure of enterprises by number of employees and their classification among small, medium and large enterprises as this can vary between different sectors.

The Statistical Office uses the following indicators for sampling surveys in selected branches of Slovakia's economy to monitor the development of small and medium-sized enterprises:

Industry:

- production of goods at current prices
- average number of employees
- average monthly wage (only for enterprises with 25 or more employees)

Construction:

- building output at current prices
- average number of employees
- average monthly wage (with the exception of tradesmen)

Road transport:

- performance in tn/km.
- average number of employees (with the exception of tradesmen)
- average monthly wage (with the exception of tradesmen)

Trade:

- retail sales at current prices
- average number of employees
- average monthly wage

Other market services:

- receipts at current prices
- average number of employees
- average monthly wage

In relation to value added by SMEs, the Statistical Office has made estimates and proposals have been prepared for improving the quality of these estimates. Modifications to Statistical Office questionnaires will facilitate a higher standard of data from the end of 1997.

Register of Statistical Units (Business Register)

The Register of Statistical Units (RSU) which is maintained by the Statistical Office includes both businesses which are legal entities or sole traders (physical persons) which have their headquarters in the Slovak Republic and operate within its territory. The objective of the Statistical Office is to achieve a RSU which complies with EU standards by the end of 1999.

The Statistical Office of the Slovak Republic receives all recommendations prepared by Eurostat in connection with business registers and is endeavouring to implement them in the compilation of its own RSU.

The main sources of RSU updating on a monthly basis are:

1. Register of Companies or Commercial Register from which the records of legal units are transferred to the RSU;
2. Trades Register from which the records of sole traders (physical persons) are transferred to the RSU.

Each new enterprise, whether a legal or a physical person is assigned an identification number of eight digits preceded by the letters IČO. This IČO number remains in place during the

lifetime of the enterprise to which it is allocated and may not be reallocated if the enterprise ceases activity. This set of identification numbers has been created by the Statistical Office and numbers from the set may be assigned by the registry courts in the case of legal persons and the local offices of the Ministry of Interior in the case of physical persons.

Statistical Office priorities in relation to RSU

The Statistical Office regards solutions in the following areas as necessary to the achievement of its objective of achieving a EU compatible RSU by the end of 1999:

- to fix rules for enrolled legal units operating above an enterprise (holding company), relations between an enterprise and local units of the enterprise - locations where the enterprise undertakes economic activities;
- to ensure, from the methodological and technological points of view, identification of units in the RSU as belonging to a group of legal units, group of enterprises and group of local units;
- to harmonise the RSU and its source administrative registers (Register of Companies and Trades Register) and with the Tax Register in relation to commonly held units;
- in the area of RSU operational technology, to solve the problem of the transition from the RSU databases maintained on a decentralised basis at regional offices of the Statistical Office to a central database at headquarters and the relationship of this central database to the regional offices through the computer network.
- to harmonise the legal rules governing the enrolment of legal units operating and having a headquarters in the Slovak Republic

3. DataCentrum

The role of DataCentrum

DataCentrum is the data collection and processing branch of the Ministry of Finance. Its functions include data processing and the development of databases in the following fields:

- state revenues and expenditures;
- tax and customs information;
- annual reports from all types of commercial and other entities (balance sheets and profit loss accounts);
- statistical information.

The sources of data are:

closing accounts through the tax offices

Each year, licensed traders (physical persons) are obliged to complete two forms and submit them to the tax authorities:

- an annual closing account of four pages giving financial information (turnover, profit and loss etc.) for his or her enterprise and
- a tax declaration also containing four pages.

This closing account which contains no tax information is sent to DataCentrum by the Tax Office. At present, the closing account contains no provision for information in relation to employment.

Similarly, DataCentrum receives all closing accounts for registered legal persons, whether commercial or non-commercial.

There is one exception to the rule in relation to closing accounts. An entrepreneur (physical person) has two options for claiming expenses for tax purposes. He may claim either his actual

expenses or 25 % of his turnover. In the event of choosing the latter option, an entrepreneur is not obliged to complete a closing account.

revenue expenditure and state budget:

Central data processing of state revenues and expenditures is undertaken in the central databases of the Ministry of Finance.

tax and customs information:

A complete database with processed tax information is provided by the Central Tax Office and a partial database with processed customs information is delivered by the Central Customs Office. Discussions are taking place with the Central Customs Office with a view to upgrading its database.

statistical information:

The statistical register of organisations maintained by the Statistical Office and selected information from statistical publications are inputted and stored in DataCentrum databases.

The main objective in building up this information centre is the development of complete databases for use in budgetary analysis and economic forecasting. The processed information from DataCentrum is required by the Ministry of Finance in framing economic and fiscal policy.

The work of DataCentrum enables it to provide the Ministry of Finance and other institutions with information under the following headings:

- a) direct taxes
- b) indirect taxes
- c) state revenues expenditures and national income
- d) accounts

Issues arising from the work of DataCentrum

(i) A high level of errors

Within the framework of its accounting information system, DataCentrum undertakes the data processing of annual reports and tax returns from legal entities and sole traders. Checking of annual reports and returns including balance sheets and profit and loss accounts shows a high incidence (approximately 50 %) of errors due to the following reasons:

- incorrect or missing identification numbers (ICO, personal number)
- incorrect form filling;
- incorrect rounding;
- incorrect units of measurement;
- typing errors;
- duplicated forms;
- use of incorrect forms;
- duplicated and multiplied registrations in tax and statistical registers.

A form with errors is returned to the enterprise for amendment, a considerable source of frustration both to the entrepreneur and DataCentrum.

(ii) Different registration numbers

A feature of the business and tax registration systems in Slovakia is that a different identification number (preceded by the letters IČO) is allocated to each new enterprise by the Tax Office from that provided by the Statistical Office and allocated to each new licensed physical person

or legal entity, which constitutes an obstacle to the harmonisation of registers. A concern of the Statistical Office already mentioned, is to harmonise its RSU register with the tax register in relation to commonly held units.

(iii) Discrepancies between the tax register, the statistical register and the number of licences

The numbers of enterprises contained in the tax register are much lower than in the statistical register. These differences occur although the sources of new entrances to both registers are the Trade and Commercial Registers, which between them record all new business ventures in Slovakia.

This problem is further compounded by the fact that tax register includes enterprises that have ceased trading, whereas in the case of the Statistical Office RSU such enterprises are removed from the RSU into an archive register.

The number of closing accounts for physical persons was 207 000 for 1996, yet there were 241 199 licenses in existence during the same year, a shortfall of 34 000 between the numbers of closing accounts and trade licenses. The extent to which this shortfall is a result of the exemption from a requirement to submit closing accounts for entrepreneurs who claim 25 % of their turnover as expenses is not clear.

(iv) Lack of sectoral information

Although DataCentrum receives closing accounts for each enterprise, the tax declaration itself is confidential to the Central Tax Office and DataCentrum receives a tax database in coded form only with anonymous identification information of all accounting units and subjects. Therefore DataCentrum does not have information on tax paid by enterprises either by sector or by class size.

4. The Social Insurance Company

In Slovakia, the Social Insurance Company register offers the best potential source of data on enterprise commencements and closures and the number of enterprises.

The Social Insurance Company (SIC) is responsible for the administration of social security in Slovakia. Cover is compulsory for all persons in paid employment, including the self-employed. The SIC believes that it has the capacity to provide figures to a 99 % accuracy in respect of the employed population.

According to SIC it would have the means to identify the number of new businesses that commenced in any given time and the number of closures. There is also a relationship with the licensing system, in that each new business licensee is obliged to register with the SIC within eight days. The SIC is obliged to pursue unregistered licensees. There is also a requirement for a business that has ceased trading to deregister with the SIC so that it may be exempted from the obligation to continue social security payments. This requirement could be the basis of a very effective means of monitoring enterprise closures.

At present, the Social Insurance Company has no input into the SME monitoring activities of NADSME. However, the fact that it is in contact with every legitimate business in Slovakia through the compulsory social insurance system, both in respect of proprietors and employees, makes it uniquely qualified to participate in the development of a high quality SME monitoring system.

The use of the social security register as an additional source of enterprise data is quite usual in several EU countries and these registers and files are used by Eurostat as an input for its own database as part of the 'Enterprise in Europe' project.

7. NADSME AND MONITORING

Some of the inadequacies in the present monitoring system and the contradictions between NADSME's role of having national responsibility for SME monitoring and its lack of resources and authority for implementation have already been described. This report contains recommendations designed to address these issues.

An overall view in relation to the role of NADSME with regard to monitoring, analysis and research for SME sector is also appropriate under the headings of:

- data about SMEs: what kind of data should be collected, by whom, which variables, how to store, how to manage, etc.;
- SME research: what kind; who should carry it out; the role of NADSME, etc.;
- the programming of data collection and SME research;
- NADSME as a "Centre of Excellence"

DATA ON SMEs

In this section suggestions for the data bases to be established at NADSME are discussed. The recommendations made are based on the assumption that NADSME will be the central agency within the Slovak Republic with regard to data and information on SMEs and with regard to co-ordinating and monitoring all government financed SME research.

Four types of data bases are distinguished.

(A) Macro-economic database

NADSME should have access to a set of macro-economic variables as a framework to more specific analysis regarding small business. To give an obvious example: researchers should have access to series with price indices to be able to deflate time series with regard to turnover of small firms. The content of the database should refer to the general accepted indicators on the national economy and the business cycle. NADSME should make an effort to obtain these data from one of the institutions which already construct and maintain these types data such as the Statistical Office, the National Bank of Slovakia and the economic research departments of commercial banks. It would be wasting resources if NADSME were to undertake work in this area by its own staff.

(B) Basic business database by size class

NADSME should be able to monitor the relative position and the relative performance of SMEs and large enterprises in the various sectors of the Slovak economy. This requires a general economic database with a minimum of important variables by size class: number of enterprises, employment and turnover. This database would contain aggregated data, i.e. no data on individual firms.

The use of aggregated data should be undertaken carefully to prevent serious misinterpretations. This relates especially to studying growth rates using data on firms classified by firm size. Statistical artefacts are used quite easily to derive certain trends.

(C) Database with panel data

In order to be able to monitor behaviour of entrepreneurs, performance of individual businesses and the impact of policy instruments set in place, a database with panel or sample data would be very useful. The analysis of aggregated databases (as proposed under B) does not allow definitive conclusions with regard to individual behaviour and performance of firms. Panel data could fill this gap.

The usefulness of aggregated database by firm size is beyond debate. However, several historic examples in various countries have illustrated that false conclusions might be reached, with regard to individual performance of firms.

(D) Ad-hoc databases

Frequently policy issues will arise which will call for specific (survey) research focusing on specific but not necessarily recurring issues. Examples: opinion and anticipated reaction of the business sector with regard to policy options such as changes in fiscal policy with regard to investments, increase in energy prices or joining the European Union. Data to be collected for such a research project should be stored in a database for at least five years, as they may be useful in any future project.

Ad-hoc surveys which might be needed to address actual policy issues would greatly benefit from the other databases discussed above. The other databases would allow policy makers and researchers to get a first idea of the empirical situation. This relates to subject matter as well as to the sectors within the business which would be affected. Therefore the available data in the regular databases would be instrumental in designing the ad-hoc surveys with regard to topics, measurement of variables and samples to be drawn. These ad-hoc surveys might then be implemented by NADSME itself or subcontracted to other parties, such as commercial market research companies or small business research units at universities.

SME RESEARCH

In this section recommendations with respect to SME research are presented. It is critical to understand that 'information' is more than just data or statistics. Those data have always to be interpreted and analysed by experienced researchers. *Policy making without proper knowledge about the reality, based on independent research, is useless and might even be contra-productive.*

In order to provide policy makers with an ongoing flow of relevant information for their policy preparation and policy implementation task, there should be a small group of experienced SME researchers in a central organisation within Slovakia. Their task would be to conduct *basic SME research*. Basic SME research can be characterised as macro- and meso-economic research aimed at providing decision makers with quantitative information about structure and development of SMEs and large firms, including clarifications and explanations of those structures and developments. It is very important that this basic SME research be carried out on a permanent basis, which means: by a permanent staff.

It is recommended that the *basic SME research*, as described above, be carried out on a permanent basis within NADSME for the following reasons:

1. Capacity building of staff (SME research is a complex specialisation of economic research and getting experienced staff for SME research would reinforce the potential of NADSME staff to become the national SME experts);
2. Building up databases by size class of enterprises (time series!);
3. Establishing and following enterprise panels;
4. Building SME models (economic models of the Slovak economy by size class of enterprises).

It would be wasting time and money if those activities were to be outsourced to different organisations, as the synthesis between setting up databases, developing models and carrying out research would develop good researchers into good SME researchers, which would be able to provide policy makers with an ongoing stream of independent information.

This project advises that basic SME research should be financed by the government and should nevertheless be conducted in a fully independent way. That means that the government would have no influence on the scientific process nor on the formulation of the research findings.

Outcomes of basic SME research should be made available to other interest groups in the country (thus building up a permanent SME knowledge infrastructure). There is a mixture of means available to disseminate such information:

- reports
- brochures
- press releases
- press conferences
- articles in newspapers and professional journals
- workshops and conferences
- newsletters
- CD-ROM, on-line (Internet), etc.

Basic SME research to be conducted by NADSME should include:

- management of aggregated data received from the Statistical Office (filling in the gaps in the data with the help of additional estimates);
- management of data in relation to one or several enterprise panels to be received from SO SR (one could think about a 'general enterprise panel' and a 'starters panel');
- analysis of data: describing structure and development of the different size classes in each sector and trying to find explanations for differences between size classes, sectors and years;
- developing models of the Slovak economy by size class of enterprises and improving those models on a permanent basis with the help of new data and new insights;
- drafting an annual report about the State of Small Business in the Slovak Republic;
- carrying out any specific research, based on aggregated or panel data, on the request of the Government, for instance an ex-ante evaluation of policy instruments;
- building up time series of data.

Research other than basic research to be financed by the government should be carried out on a commercial basis. It is up to the government to decide whether NADSME could be involved in that type of research as well. In that case the public procurement (including drafting the terms of reference for the research projects) should be done outside NADSME and NADSME should apply commercial tariffs. Through competition, this would definitely improve the quality of NADSME's research capabilities. If NADSME would not participate in commercial SME research projects it could definitely play a role in project preparation (drafting the terms of reference), managing the public procurement procedures, monitoring and evaluating the projects.

Based on the outcomes of all SME research financed by the government (both basic and commercial) NADSME could make recommendations to the government for policy instruments to be implemented or adjusted. It should take into account experiences with SME policies in other countries (so-called best practices); both efficiency and effectiveness of possible new policies should be judged ex-ante.

PROGRAMMING OF DATA COLLECTION AND RESEARCH

Based on the main principles of the country's SME policy, NADSME should develop a recurrent three years 'Basic SME Research Programme'.

After approval of the Basic SME Research Programme, NADSME should develop a recurrent three years 'Data-collection and Data-storage Programme' as well as a recurrent three years 'SME Model Building Programme'. These programmes should be adjusted each year.

In the beginning, NADSME should concentrate on collecting, managing, storing and analysing the following data: the number of enterprises, employment and turnover (all by size class of

enterprises and sector of activity). In a later stage, the number of variables should be extended, depending on the choices to be made by policy makers and thus reflected in the Data Collection and Data-storage Programme. Examples of additional variables are: value added, export, level of education of the work force, investments, wages and salaries, capital stock, output by category (investment goods, intermediate products, consumer goods), innovations, R&D, income of self employed, etc. (all by size class of enterprises).

NADSME as “Centre of Excellence“

NADSME should become a ‘Centre of Excellence’ with respect to information about SMEs in the country. To that end it is recommended to:

- recruit staff members experienced in economic research and/or data management and preferably regarding SMEs;
- recruit staff members with a focus on policy oriented research and a proven ability to translate research outcomes into policy recommendations;
- establish a documentation centre with general economic and specific small business publications, also from abroad (this could be an extension of the Euro Info Correspondence Centre);
- stimulate the orientation of staff members on small business economics through the publication of scientific articles (also in international literature), presenting papers at conferences, organising workshops about specific SME related issues, etc.
- set up a ‘quick service’ facility: civil servants from different ministries should be allowed to ask NADSME for information about SMEs even if that would mean that some additional analysis of data had to be done. The Ministry of the Economy would decide whether such a facility is offered to non governmental organisations free of charge.

8. SME MONITORING - CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

The conclusions of this report in relation to the current state of SME monitoring in Slovakia and the potential for upgrading the system are as follows:

1. the need for a government commitment

The expected output from this project was a system of monitoring and analysis as a basis for formulating policies for the SME sector.

The project has achieved the design of a new system appropriate to Slovakia’s needs through the work of the expert team appointed under the project and through bringing together or meeting with the various institutions which are the sources, actual and potential, of SME data.

The understanding, experience and skills have been developed by this project to implement and operate the proposed system. Although some technical assistance may still be desirable in relation to conformity and compatibility with EU norms, it is clear that the skills and expertise for implementation and operation of the system are now available in Slovakia.

However, there are two major elements missing which are stumbling blocks to implementation: 1. The Government of the Slovak Republic has given NADSME the responsibility for the monitoring and analyses of the SME sector without any additional resources. The proposed new system cannot be implemented until the necessary resources are provided. 2. There are several ministries and institutions whose co-operation will be needed for full implementation and a government decision is the most effective way of meeting this requirement.

A government commitment to implementation is now needed.

2. the inadequacies of the existing system

The current system gives useful information in relation to numbers of enterprises, employment and turnover. However, the monitoring information presented by NADSME to government and parliament is not adequate for effective SME policy making needs. Data on such vital issues as value added, contribution of SMEs to exports and the performance of SMEs in different economic sectors is not being provided through the system.

3. the potential for an upgraded system

The project has identified several sources of potential high quality data and information in relation to the SME sector in Slovakia which could be used to far greater effect in the development of a highly sophisticated monitoring system of the type which all governments are going to need when making their own SME policies.

It is not only that these sources exist, but their own systems and operations are improving in ways that are or could be made more responsive to the needs of SME monitoring. One major example is the work of the Statistical Office in developing the Register of Statistical Units which will be of considerable future benefit.

The means for an upgraded system are in place with assistance from this project.

4. conflicts between registers

An essential first requirement for the production of enterprise statistics is a business register. There are several registers of businesses in Slovakia held by the Ministry of Interior, the Statistical Office and the Central Tax Office but there are substantial and unexplained differences in relation to the numbers of businesses contained in each register. These differences need to be identified, clarified and corrected, even if this will be a long term exercise.

The potential offered by the Social Insurance Company registers for SME monitoring needs to be exploited.

5. a defective structure

The current system whereby NADSME has been given national responsibility for SME monitoring but without the resources nor the authority to directly obtain data from the Statistical Office, and other institutions is a contradiction that should be resolved.

6. upgrading the system

Government decisions now need to be made on an upgraded SME monitoring system involving the full participation of those institutions which have a contribution to make. NADSME, which has particular responsibility for the development of the SME sector in Slovakia and has been appointed by the Ministry of Economy to undertake monitoring activities, should be the natural focus for co-ordinating the upgrading of the system.

The first requirement is for a government decision to implement the proposed new SME monitoring system, to formally appoint NADSME as the co-ordinator and manager of the system and to request the main relevant institutions: the licensing and company registration authorities, the Statistical Office, DataCentrum in co-operation with the Central Tax Office, and the Social Insurance Company to work with NADSME in the planning, implementation and operation of the system.

The next stages are for NADSME to co-ordinate the planning of the system with the other participants, to determine the priority inputs required and how they can be obtained.

7. linking SME monitoring with research

There is another requirement which is closely linked to SME monitoring and policy development. An effective monitoring system will indicate the significant trends in the SME sector. However, high quality research is often needed to interpret these trends, the attitudes and plans of entrepreneurs, SME activities in different economic sectors and future threats and opportunities. SME research facilities are very limited in Slovakia at present but need to be developed either in the public sector e.g. NADSME, Academy of Science or through commissioned research from private agencies or educational institutions. It would be better if NADSME had its own basic research capability.

8. comparing the Slovak SME sector on international basis

The present monitoring system offers only a partial basis for making comparisons between the SME sector in Slovakia and those of other countries and the gaps have been identified by the project. The capacity to make meaningful international comparisons requires the introduction and implementation of the SME data package used in the European Observatory of SMEs: number of enterprises, employment, turnover, exports, value added and labour costs - all by size class and sector of economic activity.

9. NADSME as a centre of excellence

Linked to the upgrading of the SME monitoring system is the potential to develop NADSME as a national centre for high quality monitoring and research into SME issues, thus providing Slovakia with a system of SME monitoring of a quality equal to the best in any EU member state.

RECOMMENDATIONS

Upgrading the system

1. that the Ministry of Economy initiate the process of establishing the proposed upgraded SME monitoring system by submitting an appropriate proposal to the government after consultation with the proposed main participants: NADSME, Ministry of Interior (licensing and registration), Ministry of Finance, DataCentrum, Central Tax Office and Social Insurance Company;
2. that a permanent Enterprise Data Committee be established, preferably chaired by the Ministry of the Economy. Members of such a Committee could be high level representatives of the Ministry of the Economy, the Ministry of the Interior, the Ministry of Finance, the DataCentrum, the Statistical Office of the Slovak Republic and the Social Security authorities. NADSME should be secretary of the Committee. The aim of the Committee would be to develop a proper system of enterprise data registration and collection and to develop rules and regulations for the different organisations (describing their tasks and responsibilities).
3. that NADSME's existing role be extended to co-ordination and management of the new system with the right to seek data and information directly from the other participants;
4. The Statistical Office of the Slovak Republic (SO SR) should have the final responsibility for the collection of enterprise *data* and thus for the 'Register of Statistical Units' (RSU). In close co-operation with SO SR, NADSME could have the responsibility for the provision of *information* about the business sector, and for monitoring and analysis. The responsibility of SO SR for the RSU should guarantee that overall figures are consistent with the national economic framework. Through the co-operation with NADSME, SO SR should be encouraged to incorporate size variables in all relevant data gathering activities of SO SR. Sound co-operation between SO SR and NADSME would bring about a more efficient and more effective use of scarce Government resources;

5. that NADSME and the other participants (in co-operation with the proposed Enterprise Data Committee) agree on the structure and operation of the monitoring system, the priority data and its retrieval and presentation and the designation of a section in each of the participating organisations that would be responsible for managing inputs to the system;
6. It should be clear what definition of an 'enterprise' is used. As much as possible the EU directives and recommendations should be applied. A local unit (establishment) of an enterprise may be considered as an economic entity, even if it has no legal status;
7. When the size of enterprises is taken into account, it should be clear whether the number of employees or the number of people employed in a business are taken into account. The latter includes the self employed entrepreneur and the family workers if they are employees.
8. that areas where technical assistance might be appropriate for the upgrading and development of the system be identified;
9. that mechanisms be developed for maintaining contact with Eurostat and monitoring institutions within the European Union Member States and in Central and Eastern Europe;
10. that an evaluation of the upgraded system be undertaken after three years of operation.

Harmonisation of registers

1. that priority be given to identifying differences between the statistical register (RSU) and its source administrative registers (Trade Register and Register of Companies) and to ensuring implementation of required new corrective procedures and to the harmonisation of the statistical register with the Tax Register with regard to commonly held units;
2. that the Social Insurance Company registers be used as an additional source of data on business commencements and closures and on the numbers of enterprises.

Exporting by SMEs

that DataCentrum and the Central Customs Office reach agreement on more complete data so as to provide information on trade, particularly exports by SMEs in the different economic sectors.

Simplification and improvement of data inputs (into forms going to DataCentrum)

1. In order to overcome the 50% or so level of errors in closing accounts submitted to DataCentrum, the closing account and tax declaration form should be amended to incorporate an adequate explanatory note on how to complete the form correctly.
2. The number of employees in an enterprise should be included in the closing account.
3. Closing account and tax declaration forms should be redesigned to improve clarity of information.
4. Design special application software to facilitate more accurate and standard presentation of closing accounts from SMEs.

NADSME as co-ordinator of SME monitoring and research

1. that NADSME be designated the national centre for the co-ordination of all state sponsored SME monitoring and research activities;
2. that NADSME be provided with the means to continue the development of these internal capabilities to effectively manage the SME monitoring system and to initiate or directly undertake research projects as appropriate.

PART D: A POLICY FRAMEWORK FOR THE SME SECTOR

9. SME POLICY DEVELOPMENT IN EUROPE

SME policy within the European Union

The trend towards greater recognition for SMEs is very evident within the European Union. For example it is now common in EU Member States that governments are legally obliged to prepare or sponsor regular reports on SME development and to present such reports to parliament. These reports are a useful mechanism for ensuring regular and consistent attention to SME issues. In some countries, a junior or deputy minister may be assigned responsibility for SMEs or there may be a SME parliamentary committee or commission at legislative level.

Although these developments may not be wholly adequate in relation to the central economic importance of the SME sector, they have taken place mainly within the last fifteen years and represent considerable progress for SMEs. It is also clear that the process of an ever greater focus on the policy requirements for the SME sector is now well established and will continue.

Although considerable differences exist between the EU Member States, there is a tendency towards SME policy convergence with an emphasis on the following priorities:

- simplify and improve the administrative and regulatory business environment;
- improve the financial environment for enterprise;
- help SMEs to internationalise their strategies, in particular through better information services;
- enhance SMEs' competitiveness and improve their access to research, innovation, and training;
- promote entrepreneurship.

SME policies within Central and Eastern Europe (CEE)

The countries of Central and Eastern Europe have also recognised the importance of the SME sector and its vital contribution in the process of successful transition to fully developed market economy status. All of these countries, including Slovakia, have formally allocated SMEs a central role in their economic restructuring programmes. Although there are substantial differences between the CEE countries in relation to size and relative economic performance, the need for effective policies designed to achieve a climate and support structure conducive to SME development is a common and fundamental issue.

The national SME policies put in place by CEE governments since 1989, like those within the EU, reflect a fairly high level of convergence. This trend towards convergence is a result of a similar analysis of the problems and of the most appropriate solutions and, also reflects the role of external technical assistance strongly influenced by the higher policy priorities now accorded to the SME sector by governments in Western Europe and similarities in approach between them.

SME policies as a national responsibility

Although trends towards convergence should be recognised, it is important to understand that policies for the SME sector are primarily a matter for national governments and, indeed, regional and local administrations. The European Commission's Third Multiannual Programme calls on Member States to reinforce and co-ordinate their policies in favour of SMEs but says also that 'most measures for SMEs need to be taken at Member State level, as close as possible to business itself'.

The relevance for Slovakia is that developments and trends in individual EU Member States and CEE countries should be monitored and the tendency towards convergence taken into account when formulating policy for Slovakia's own SME sector. However, the future success of Slovakia's SMEs will largely depend on well focused policies appropriate to Slovakia's own needs and circumstances and on how those policies are implemented. SME policy is very much a national responsibility.

10. SME POLICY ISSUES IN SLOVAKIA

POLICY DEVELOPMENT

The SME policy priorities for Slovakia are generally in line with those of neighbouring CEE countries. The overall statement of policy is set out in the Programme of Complex Support for SMEs in the Slovak Republic passed by the government in May 1993. This programme has as its aim the creation of a favourable environment for the development of SMEs through financial, institutional and legislative means.

These means of support are defined as follows:

- **Financial:** . A system of direct and indirect financial support for start-up and expanding SMEs;
- **Institutional:** A network of various support institutions, notably NADSME, the RAICs and BICs;
- **Legislative:** The creation of a legal framework of state and non-state support for SMEs, the basis for which is the Act on State Support for SMEs.

The policy development process has continued. In the early part of 1997, the Government of Slovakia adopted a new medium term SME policy with the objectives of:

- improving the legislative environment;
- increasing the economic contribution of SMEs to GDP;
- increasing the number of SMEs;
- new job creation by SMEs;
- developing the management capabilities of entrepreneurs;
- reducing regional inequalities;
- improving SME co-operation with large companies;
- increasing the number of technology based SMEs and the take-up of new technologies by SMEs.

Additional specific measures to meet these policy objectives have not been announced, but there will be a requirement for a greater commitment to improving the environment for SMEs, the allocation of more resources, and the upgrading of the SME sector as a focus for policy priority.

The Medium Term Policy provides for the establishment of a Slovak Government Council for SME which will have a co-ordinating function and will guarantee that SME interests will have the full attention of the Slovak Government. This Council will also have the responsibility of reconciling the viewpoints of various ministries in relation to SME matters.

In offering its own contribution to the development of a policy framework for SMEs, this UNIDO project has taken full account of the Medium Term Policy now adopted.

BACKGROUND TO SME POLICY IN SLOVAKIA

The vital basic requirements for the development of a healthy SME sector are: (1) a strong level of new business commencements and (2) the expansion of existing SMEs or at least, their survival. Meeting these requirements is best achieved through a combination of good macroeconomic management, from which all businesses benefit, and appropriate policies targeted on the SME sector itself. Slovakia is one of the better performing economies in transition. Although there are problems in relation to the industrial structure and a substantial balance of trade deficit, there is also a growing economy, a single figure inflation rate and a high level of public and business confidence in the Slovak Crown. It is also obvious that Slovakia now has a substantial SME sector, even if there are gaps in the data and information in relation to SMEs.

Many new enterprises have commenced in recent years, which must reflect favourably on Slovakia's SME support policies. However, it is also clear that there are still difficulties in the overall environment for SMEs in Slovakia when compared with EU Member States, that SMEs face a number of significant problems and burdens which could be eased at no great cost to ministries or other branches of the administration and that more targeted and refined policies need to be implemented to facilitate the next phase of SME development and ensure the sector's continuing and growing contribution to the national economy.

The stress on the *next phase of SME development* is important as policy measures to date have tended to emphasise the SME sector as a whole and have had as their objective the development of SMEs generally rather than SMEs in strategic branches of the economy, although there has been some additional encouragement for businesses in activities such as production and tourism. The policy emphasis to date has been entirely correct, as the priority was to establish a SME sector in the first place, an objective which has been achieved. However, in the eighth year of transition towards a full market system, SME policy makers need to identify more clearly what Slovakia wants from its SME sector, to focus on the areas of economic activity that are of most strategic importance to the overall economy *and the role of SMEs within them* and, in that context, to develop policies designed to achieve the greatest possible SME contribution to economic objectives. The new Medium Term Policy is a major step in that direction.

In framing policies for SMEs, it is also crucial to have a clear understanding that although they can be a dynamic source of employment growth and wealth creation, they are inherently weaker than larger enterprises and more vulnerable to failure. In the EU, some 50 % of SMEs fail within the first five years of commencement.

THE POLICY ISSUES

The main policy issues to be faced in the achievement of SME objectives in Slovakia are a reflection both of the transition effect from a centrally planned command structure and of the status of smaller businesses in any market economy. These issues, as identified by this UNIDO project, are as follows:

(1) Difficulties in law and regulation

Constant changes in law and regulation are a major source of frustration. Inconsistencies in their implementation are a further cause of aggregation to SMEs. There is a lack of impact assessment mechanisms and a belief among entrepreneurs that commercial legislation is framed mainly with the interests of large scale enterprises in mind. There are widespread complaints in relation to different interpretations of laws and regulations by local tax offices.

(2) Difficulties with finance for SMEs

Although there are a number of mechanisms in place to provide financial support for SMEs in Slovakia, including Phare schemes administered through NADSME, there are still considerable difficulties and complaints in relation to issues such as availability of funding for new enterprises, access to bank loans for SMEs generally, the unwillingness of banks to provide loans for a term exceeding one year, very high interest rates, requirements for collateral of a value greatly in excess of the amount of the requested loan and long delays in decisions on loan applications.

(3) A lack of incentives for SME development

Although there are some measures in place to encourage SME development such as National Labour Office grants for unemployed people who want to start their own businesses, income tax concessions for the first three years in the life of a new enterprise and special SME loan schemes administered through NADSME, the range and availability of incentives for entrepreneurs in Slovakia is quite limited.

(4) A taxation and social security system that discourages employment and enterprise

The taxation and social security system in Slovakia tends to make the cost of labour relatively expensive. In effect, it costs a Slovak employer nearly two crowns to pay an employee one crown. The social security system places a particularly heavy burden on the self employed.

(5) The persistence of an overall negative climate for enterprise

The overall climate for enterprise is still quite negative. There is a widespread belief among entrepreneurs of adverse public administration attitudes towards them. Research has shown that many entrepreneurs are opposed to or unaware of government SME support programmes. The links between the education and SME sectors are poorly developed. There is still a negative perception in Slovak society towards entrepreneurs who are sometimes regarded as an anti-social element.

(6) A fragmented structure of advocacy and representation on behalf of SMEs

There are at least five principal representative organisations or associations for SMEs in Slovakia. However, most enterprises are not members of any association. Representation on behalf of SMEs is fragmented. The views of representative associations are often presented after a law has been passed or a government decision has been made. This tendency to react in response to decisions already made rather than to develop their own independent proposals means that these associations do not make a major input into the policy decision making process for the SME sector.

(7) An inadequate focus on strategically important sectors and activities

There is only a limited focus on strategic sub-sectors where SMEs have the potential to make a very substantial contribution to the economy, including foreign exchange earnings. Examples include tourism related businesses and engineering sub-supply and components. Large scale enterprises should, in their own interest, develop and support sub-contracting arrangements with SMEs. The export potential of SMEs needs to be exploited to a greater extent than at present.

(8) The absence of a strategy for building strengths and capacities within medium sized manufacturing enterprises

There are several programmes in Slovakia for the support of SMEs but there is not a co-ordinated approach designed to build the internal management, marketing and technical capabilities and strengths within medium sized enterprises which would enable them to develop as interna-

tionally competitive companies. In the case of the limited number of SMEs with identified expansion potential, a company development approach is needed which would bring together the various assistance programmes: technical consultancy, interest subsidies, loan guarantees and export marketing in co-ordinated support for achieving the targets set out in the business plans of these enterprises. There should be a total focus on the needs of the enterprise.

(9) A need to upgrade the policy making function for the SME sector

Government policy for any sector is formulated by the relevant minister with the advice and support of the civil servants attached to his or her ministry. The effectiveness of any new policy depends on the quality of the advice and information on which it is based. The SME policy making process needs a new impetus and a redefinition of the roles of the Ministry of Economy and NADSME as the main national institutions with responsibility in the process. There is a need to determine where the SME sector now stands in relation to national economic policy priorities.

11. LAW AND REGULATION

BACKGROUND TO THE LEGISLATIVE FRAMEWORK FOR SMEs

The changes in the economic and political systems of the former Czechoslovakia in 1989 were accompanied by a requirement to provide equal status for the private sector with other forms of ownership. Prior to 1989, legal provision for the private sector was virtually non-existent. Recognition of private enterprise was first acknowledged by the adoption of an amended constitution for Czechoslovakia and subsequently in the Constitution of the Slovak Republic, adopted on 1 September 1992, which also conferred equal recognition on all forms of ownership.

During the past seven years more than 1000 laws, regulations or other government measures were passed to facilitate the development of the private sector. This body of law and regulation represents a considerable achievement. However, a task of this magnitude, accomplished in a relatively short time against a background of a lack of experience in law and regulation for a market economy, has raised problems for SMEs in Slovakia, just as in other transition economies.

These problems are identified in the Medium Term Policy for SMEs and eight major pieces of legislation are suggested for reconsideration.

LAW AFFECTING SMEs IN SLOVAKIA

Structural reform in relation to the legal position of private enterprise was achieved by the adoption of the following:

1. the Constitution of the Slovak Republic, which put all forms of ownership on an equal basis and
2. the Commercial Code of 1 January 1992, and as subsequently amended, which is the principal commercial legal framework on which business activities are based. The Commercial Code states basic law in regard to such matter as:
 - form of business entity,
 - investment in business,
 - Companies Registry,
 - contractual relations,
 - competition.

These two core or basic elements of law have given a legal structure to commercial activity in Slovakia and are supported by:

- The Act on Private Business (105/90);
- The Act on Sole Traders (455/91).

These laws regulate the legal forms of various types of business entities, the two most common being:

1. physical persons not registered in the Commercial Register (a sole trader with a business licence) and
2. companies registered in the Commercial Register.

The SME sector is, of course, affected by the full range of commercial law, but there is a widespread perception among SMEs in Slovakia that commercial legislation is adopted primarily to meet the requirements of large scale companies rather than the 280 000 or so SMEs that constitute at least 98% of the country's enterprises. This perception arises from favourable tax treatment for investors in large scale enterprises undergoing privatisation and measures such as the Act on Revitalisation which has as its objective the turnaround of certain selected large enterprises by means of restructuring and waiving their liabilities, including tax liabilities, which will, according to critics, result in inequality of taxable entities.

In addition to the SME perception that commercial legislation is focused primarily on the needs of large scale enterprises, there are four main areas of concern in relation to law and regulation for SMEs in Slovakia:

1. the burden already imposed on SMEs and the possibilities for simplification,
2. the difficulties arising from a lack of consistency in the administration of law and regulation,
3. the lack of impact assessment;
4. the need to cope with frequent changes in laws.

REDUCING THE LEGISLATIVE AND ADMINISTRATIVE BURDENS ON SMES

For several years now there have been efforts by governments in the United States and the member countries of European Union to find ways of reducing the burden of law and regulation on SMEs. These moves are a recognition of the reality that an increasing by unfair burden was being imposed on smaller enterprises, that a considerable amount of management time was being devoted to filling forms and complying with regulations at a considerable cost to smaller businesses and that the potential contribution of SMEs to economic development was being adversely affected.

Research has shown that the cost of compliance with laws and regulations is relatively higher for smaller than for larger enterprises as the following two examples indicate:

1. United Kingdom 1989 survey on complying with VAT regulations

Taxable Turnover (GBP 000s p.a.)	Compliance Costs as per cent of Taxable Turnover (mean percentage)
0 - 20.5	1.94
20.5 - 49.9	0.78
50 - 99.9	0.52
100 - 499.9	0.42
500 - 999.9	0.26
1 000 - 9 999.9	0.04
10 000 and over	0.003
Overall weighted mean	0.69

Source: Cedric Sandford et al. 1989 Administrative and Compliance Costs of Taxation

2. Netherlands survey of the average costs of administrative burdens per class size, enterprise and employee, 1993 (in ECU) for enterprises

Number of employees	Cost per enterprise	Cost per employee
0	2 800	0
1 - 9	12 100	3 500
10 - 19	20 500	1 500
20 - 29	47 100	1 400
50 - 99	62 000	900
100 or more	171 000	600
All size classes	9 800	1 800

Source: Administrative Burdens in Enterprises 1993 - EIM Small Business Research and Consultancy.

Among the most promising ways identified for reducing the administrative burden on smaller businesses are:

- to introduce size thresholds in order to exempt the smallest enterprises from regulations or requirements;
- to reduce the frequency of reporting requirements so, for example, that a form required on a monthly basis might be made bimonthly, quarterly, bi-annual or annual requirement;
- to consolidate forms with two, three or more related forms being redrafted and merged in to one;
- to introduce shorter, simpler versions of forms for smaller businesses.

One area of deregulation that is receiving particular attention in many European countries and has relevance for Slovakia is the potential for reducing the administrative steps and time delays in the registration of new enterprises. The trend is towards a one stop registration procedure for the new entrepreneur (physical person) with the completion of all formalities at one centre.

Easing the legislative burden on SMEs and deregulation is as relevant for Slovakia and its neighbouring countries in transition as it is for developed market economies. The Slovak Government Council for SMEs, when established, should initiate, co-ordinate and ensure the implementation of a programme of administrative simplification for SMEs in co-operation with appropriate ministries and agencies. Streamlined registration procedures are one area where rapid improvement could be achieved - both for sole traders (physical persons) and companies (legal persons) prior to implementation to the proposed overall simplification programme.

Starting a business as a sole trader (physical person)

a) the requirements

A person who wishes to commence a business as a sole trader in Slovakia must follow a series of procedures before he or she may commence trading and register with five different institutions. These procedures are as follows:

- register as a sole trader by obtaining a business license
- register for taxation
- register with Social Security Company for retirement and for income during illness
- register with one of nine recognised companies for health insurance
- register with the National Labour Office for insurance against unemployment.

Registration for physical persons

Slovakia's system of registration for sole traders is administered by the Ministry of the Interior. An individual who wishes to go into business as a sole proprietor is obliged to file an applica-

tion for a license at the registration department of the district office of the Ministry of Interior. Two different kinds of licenses are available: a general business license and a special license.

To obtain a general license, an entrepreneur must complete an application form which asks for some statistical information and the following two questions: whether he or she has any criminal record and what are his or her qualifications for the business to be started. Sole proprietorships requiring general licenses are divided into three categories:

1. Unrestricted, most licenses are of this type;
2. Hand work, for example baker, wood worker;
3. Restricted, for example electrician, accountant .

Even if an applicant has no experience in the activity for which a license is sought, it may still be possible for him or her to obtain a license if a properly qualified person to act as a manager or as an adviser to the business is available.

To obtain a special licence an applicant generally needs to have special training or education. Usually these licenses will be issued only with the permission of some office of the central government. These licenses control types of businesses where greater responsibility is required. All professional licenses for doctors, attorneys, accountants and veterinarians are covered by special licence. Other types of businesses covered by special licences are: marketing of weapons, marketing of poisonous materials, funeral directors, trucking, private detectives and private police.

When a license is granted, the holder must undertake the remaining four stages in the registration process: tax, social security, health insurance and Labour Office.

A sole trader who ceases business must surrender his or her license within a specified time.

b) The issues

An entrepreneur commencing business in a European Union Member State will be required to comply with administrative procedures under at least some of the following headings:

- obtain a general license (Austria, Belgium, Germany, Netherlands)
- obtain a special license (health, environment, safety at work, food legislation etc.)
- register in a Trade Register
- register at tax office
- register with industrial insurance board
- register with national health insurance.

The burden varies from country to country. In the United Kingdom and Ireland registration with the tax authorities only is all that is needed while in some countries additional procedures to those listed above are required.

What is important is the trend towards simplification of procedures for a person wishing to start business as a sole trader. Italy, Portugal and Sweden have introduced simplification measures. In Austria, the number of trades requiring simple notification to obtain a license has been extended thus reducing the number of activities for which evidence of qualifications is needed. In France, the "one stop shop" concept has been introduced.

The licensing system in Slovakia has support from within the SME sector itself on the grounds that it gives an increased sense of security in business dealings. Among the reasons put forward in defence of the licensing system are:

1. A license is a badge of respectability in that it is evidence that the owner of a business does not have a criminal record;
2. The Trade Register of license holders is a useful source of information on potential business contacts in a country where other methods of seeking information such as credit or status reports are not well developed.

In Slovakia, unlike many other countries, a sole trader is not required to register with the Chamber of Commerce, which means that one traditional source of business information is not as extensive as elsewhere.

While general support for the licensing system itself is understandable there is scope for reducing the administrative burden imposed on new entrepreneurs by the full registration process through working towards the *one stop shop* concept whereby the licensing office would notify the tax and other authorities, thus dispensing with the requirement for further separate registration processes. A five stage registration process would be reduced to one stage, thus greatly simplifying the procedure for the new entrepreneur.

Changes in the existing application forms would be necessary to implement the proposed simplified registration system. The existing national birth number could serve as basis for common identification among the five registration authorities.

In relation to health insurance, a new entrepreneur has the obligation at present to register with one of nine officially recognised insurance companies of his or her choice. Under the new system the choice of health insurance company would need to be notified to the licensing authorities on registration.

Starting business as a Legal Person

a) the requirements

All business entities under the Business Law are formed by filing the organisation documents with and obtaining approval by the local judge of the Registry Court. This Court, known as 'Registračný súd' is one department of the justice court system.

Businesses started by legal persons might take the form of a partnership, a limited liability company or a joint stock company. All of these organisations are considered legal persons under Slovak law. To form this kind of entity, the parties must prepare the formation documents which are to govern the terms of their agreement. Then they must execute their documents in the presence of a notary. Once that step is completed, the new entity may obtain a business license for the type of business to be commenced. Once the license is obtained, the legal entity is further required to file an application before the Registry Court. When the application is completed and approved by the Court, the business is entered in the Commercial Register and may begin operations.

b) the issues

It is generally accepted that, particularly in the case of SMEs, registration of a private limited company should be cheap, accessible and simple. On this basis the Slovak system does seem complex and there may be scope for simplification. There are also complaints of frequent delays in the process.

One approach, in the case of a smaller private company with a registered capital not exceeding SKK 1 mil. (USD 33 000), might be a system whereby the rules and powers of the company together with a sworn declaration of a lawyer and the names, addresses and consents of the founding parties as well as a statement of nominal capital be accepted as the necessary papers for direct submission to the Register of Companies.

LACK OF CONSISTENCY IN LAW AND REGULATION

There can be a pronounced lack of consistency in the application of laws and regulations. This is a logical consequence of numerous pieces of legislation and regulation being adopted and, also, a lack of experience and knowledge on the part of those responsible for drafting, enacting and implementing law and regulation appropriate to the needs of enterprise.

These are complaints in relation to registration of businesses as well as compliance with tax and other contribution liabilities (filling forms and constant changes to forms, notarisational offices at different addresses and frequent changes of address) and a belief among SMEs that bureaucratic procedures are becoming more and more time consuming, partly as a result of this lack of consistency.

There are particular difficulties in the area of taxation where it is quite common for an item to be accepted as a tax deductible expense by one regional or local tax office but not by another.

The reasons for these taxation administration problems may arise from inadequately drafted and unclear laws, the difficulties of tax officials in administering these laws and coping with frequent changes to them and the amount and quality of training that these officials have received in relation to taxation of business.

In cases such as these, there is the possibility of recourse to the courts which are recognised as being fair and independent. The courts frequently make judgements in favour of entrepreneurs. However, the courts are understaffed and proceedings are slow and cumbersome, and therefore not a practical alternative for SMEs.

In areas of complex legislation such as taxation which have a major impact on the SME sector, it is important that officials receive adequate information and training in each new law and regulation, to include implementation and interpretation.

In the case of taxation, it might be appropriate to introduce an appeals procedure within the tax system. This could be done through the appointment of Appeals Commissioners, trained tax experts, who would be independent tax auditors. Such a system would allow enterprises an opportunity to quickly appeal an unfair assessment and, in time, encourage standard interpretation of tax laws.

Similar appeals procedures exist within many tax systems. Although an integral part of the national tax offices in countries where they operate, these appeals structures when managed in a recognisably independent manner, increase the entrepreneurs feeling that he is being dealt with fairly and speedily, enforce standard interpretation of tax laws by officials through decisions on appeals and reduce pressure on the courts system.

The longer term solutions of problems of consistency in laws and regulation are a simplification of administrative requirements, the 'one stop shop' concept for registration, better training of officials and the enforcement of uniform standards, effective impact assessment and clearer laws. These two latter issues are discussed in the following subsections.

ASSESSING THE IMPACT OF LEGISLATION ON SMES

Just as governments have come to recognise that compliance with existing law and regulation imposes a substantially greater burden in terms of personnel, time resources and costs on smaller businesses than on larger ones, there is an increasing concern to ensure that future law and regulation takes full account of the impact on SMEs.

The response of several governments has been to introduce impact assessment procedures whereby all proposed new commercial legislation or other legislation likely to affect business is subjected to analysis to determine the possible consequences for SMEs.

One example is that of the Netherlands where a ministerial committee (the Competitive, Deregulation and Quality of Legislation Committee) is in place to:

1. undertake a critical look into existing regulations as they affect enterprise;
2. look at ways to decrease the administrative burden and
3. carry out a detailed examination of proposed new legislation to prevent measures where the cost would be greater than the advantages.

Reference has already been made to the need for the proposed Slovak Government Council for SME to initiate a programme of administrative simplification for SMEs.

A system of impact assessment in relation to future law and regulation should be introduced with responsibility for its operation allocated to the Ministry of Economy, in cooperation with the proposed Slovak Government Council for SME.

The overriding concern should be to ensure that, before legislative or other measures likely to affect SMEs are proceeded with, a full and systematic analysis of their impact on these enterprises should be undertaken. This requirement would broadly operate in the following way:

- There would be a statutory obligation on ministries or agencies sponsoring legislative or other measures likely to affect the SME sector to undertake an analysis of their impact on small and medium enterprises;
- Such analyses would be required to adhere to guidelines to be developed by Ministry of Economy. Other ministries would be encouraged to seek the advice or assistance of the Ministry of Economy in undertaking the analyses;
- Before a measure proceeded to final consideration and decision, the observations of the Ministry of Economy would be required on the impact analysis that had been undertaken by the ministry or agency sponsoring the measure;
- In the event of a difference of opinion between the ministry or agency sponsoring a legislative or other measure and the Ministry of Economy about the need for an impact analysis, the observations of the Ministry of Economy should be obtained before the matter proceeded to final consideration and decision.

TOWARDS A MORE STABLE LEGAL ENVIRONMENT

Constant changes in laws have been a typical feature of legislation since the end of 1989. During 1995, a total of 128 amendments or pieces of legislation were enacted to influence and improve the business environment for SMEs. Tax laws have been amended many times and income tax legislation alone has been changed 15 times since 1992.

As already stated, changes of this frequency have been made inevitable by the need of put a legal infrastructure in place for the private sector. However these constant changes are a source of frustration to entrepreneurs and a more stable legislative environment is now required.

In the State of Small and Medium Enterprises 1995 (NADSME) it is stated that 'there is a general demand for such as organisation of the legislation process so that at least basic general acts are more lucid and understandable. It is also requested that fuller versions of these laws are published more frequently'.

The pressure to meet the requirement for a large volume of law and regulation for the private sector has been met. The need now is for less, but better new commercial law. Progress is being made in improving the quality of the legislative process. Slovakia has lately adopted a statute concerning the procedures to be followed in the making of Laws - the Act on Rules of Procedure of the National Council. Whilst the law has been passed the rules relating there to have not yet been drawn up which obviously affects implementation of the law.

In relation to commercial law, the process of consulting with SME interest groups is in its early stages, but as is discussed in Section 15 - Representation and advocacy for SMEs, considerable progress remains to be achieved.

The consultative procedures could however be strengthened by ensuring that prior to fundamental legislation being enacted - a genuine public discussion ensued. Government discussion and decision papers (Green and White Papers) are a feature of many parliamentary systems and could be issued by the Slovak Government in relation to major policy matters and the public invited to make submissions regarding their content. Such a system could be introduced and particular interest groups could be consulted prior to legislation being passed affecting them. In the field of commercial law this consultative process would reinforce impact assessment procedures.

If the consultative process appears to be improving (albeit slowly) regarding the legislative procedure there still appears to be serious difficulties regarding both the consistency and clarity of legislation. The promulgation of the law is also still minimal.

Drafting of legislation is a legal skill which is difficult to learn and requires continual practice. Drafting is undertaken in ministries which wish to introduce law. Little legal professional input is obtained. Consideration should be given to creating a central drafting office manned by trained lawyers who would be able to develop a skill in drafting legislation and would have greater knowledge of the totality of legislation since all law would have been drafted by that office. This process could be developed in stages starting with commercial law.

Consideration should also be given to enacting a law which would clearly set down interpretative expressions which would have a common meaning through subsequent legislation. This would clarify law and make it more readily comprehensible.

The publication and promulgation of law is a problem not only in developing states but also in developed countries. The American Bar Association and US Congressional Representatives have undertaken certain work which involves attempting to promulgate law by the Internet and place laws on disc. Undoubtedly the computerisation of laws should be undertaken so that such can be accessed quickly. However, more fundamental and painstaking work should be undertaken in indexing the laws and cross-referencing amendments in legislation, although this would be an enormous task. As a first step, work could be undertaken on commercial law.

Consideration should also be given to the opening of a Government Publication Service which could be a commercial service with a shop as a sales outlet, which would enhance the promulgation of laws.

RECOMMENDATIONS ON LAW AND REGULATION

The recommendation for improving the legislative and regulatory environment for SMEs are summarised as follows:

1. The Slovak Government Council for SMEs (when established) should initiate, co-ordinate and ensure the implementation of a programme of administrative simplification for SMEs in co-operation with appropriate ministries and agencies.
2. The existing five stage procedure for registration by an entrepreneur as a physical person should be reduced to one stage through the designation of the registration departments of the Ministry of Interior's district offices as 'one stop shops' for registration purposes.
3. Registration procedures for smaller companies (legal persons) should be eased through permitting new legal entities with a registered capital not exceeding SKK 1 million (USD 33 000) to register directly with the Register of Companies without having to make application to a court.

4. More effective training should be introduced for officials in relation to the interpretation, implementation and enforcement of complex legislation and regulation, particularly in the area of taxation.
5. Consideration should be given to the introduction of an independent appeals system within the tax administration thus giving an aggrieved taxpayer access to possible remedies outside of the slow and cumbersome courts system.
6. A system of impact assessment should be introduced and operated by the Ministry of Economy in co-operation with the proposed Slovak Government Council for SME under which a full analysis of all proposed legislative measures likely to affect SMEs would be undertaken before being proceeded with.
7. As a means of ensuring greater stability, quality and clarity of commercial legislation consideration should be given to the following:
 - more detailed consultation procedures including publication of discussion papers in relation to major issues prior to decisions being taken;
 - wider and more frequent publication of law;
 - the establishment of a specialist central office for drafting new legislation;
 - enactment of a law which would set out interpretative expressions as a means for clarifying legislation and making it more accessible;
 - a thorough indexing and cross referencing of laws;
 - opening a specialist retail outlet for official publications, including laws.

12. FINANCE AND INCENTIVES

DIFFICULTIES IN ACCESS

Access to finance for SMEs in Slovakia is an area of considerable difficulty. A survey undertaken in 1995 by a Slovak research company indicated that problems with finance are viewed by entrepreneurs as one of the main obstacles to starting and developing a business.

A lack of accumulated private capital and a low allocation of bank resources for SME lending have resulted in a considerable reliance on state support and funds made available through foreign technical assistance programmes for SME financing.

PROBLEMS IN SOURCING FINANCE FOR NEW ENTERPRISES

The traditional sources of finance for new start up enterprises are likely to include the following:

- (1) personal capital of entrepreneur acquired through savings and, perhaps, inheritance;
- (2) financial support from relatives;
- (3) loan finance from a bank achieved on the basis of an established relationship with the new entrepreneur as a private customer with a personal savings account and the availability of collateral, for example, a mortgage on the entrepreneur's private residence.

Personal assets of the entrepreneur either for direct investment in his or her new business or to serve as collateral for loan finance are therefore fairly important to get an enterprise started. In most cases, the total capital available to a new entrepreneur would be fairly limited and, inevitably, the great majority of new enterprises have modest beginnings. Reaching the stage where the new entrepreneur has enough capital to launch his or her new business can be a long process, even in the most highly developed market economies.

If private capital is an important requirement for starting a new enterprise, then there are particular difficulties in transition economies such as Slovakia. There is still not very much private capital available.

In Slovakia, there has always been a tradition of personal savings. Prior to 1990, the Slovak Savings Bank was the only institution for private savings and it is still the dominant institution in this field. However, personal savings prior to 1989 were often of a forced nature due to a lack of the types of consumer goods that would have attracted customers. The devaluation of the Czechoslovak Crown by 50 % in 1991 halved the external value of savings at a time when the demand for imported consumer goods was becoming well established and which, if anything, has intensified during the last few years. Earlier savings have been very substantially eroded through personal consumption.

Other sources of financial support, such as from within his or her own family, which might be available to a new entrepreneur in market economies are more difficult in Slovakia, partly due to a lack of private capital, and, also due to unfamiliarity with enterprise and negative attitudes towards the concept.

Bank finance for a new enterprise in the absence of personal collateral is not easy to obtain anywhere. In Slovakia, it is impossible. One significant source of collateral (and capital) is home ownership which accounts for between 50 % and 70 % of the total housing stock in Western European countries and which often enables new entrepreneurs to raise some capital for his or her business through the use of mortgage facilities, sometimes a second mortgage. Under Slovak law mortgages are now possible but there are still no specialist mortgage institutions. The conditions and procedures for obtaining mortgages are very restrictive. Most house or apartment purchases when they take place are still for cash, which means that large numbers of people on salaries and wages are kept out of the housing market and denied the opportunity to build personal capital through home ownership in the absence of a functioning mortgage system. It will take many years to develop this type of collateral.

Even if collateral were more widely available, there would still be problems with availability of bank loans for new SMEs, due to monetary policy and other lending priorities. The reality in Slovakia is that many enterprises are started by people with very little money of their own and without bank support. This pattern increases the risk of enterprise failure and of restricting the growth of profitable new businesses through undercapitalisation.

PROBLEMS IN SOURCING FINANCE FOR EXISTING ENTERPRISES

Existing enterprises, provided that they are profitable, generally find finance easier to obtain. Reasonable profits should allow for some retained earnings as a means of financing further business development. Banks find it easier to deal with existing businesses, particularly where there is an identifiable track record. However, just as in the case of new enterprises, Slovak banks have very few resources allocated to established SMEs other than through their role as a channel for SME funding by state and foreign support programmes.

There seems to be little or no research on the profitability of small and medium enterprises in the transition economies including Slovakia. This may be due to the fact that SMEs are still a fairly new phenomenon whose performance is still difficult to measure. However, full implementation of the monitoring system, the subject of the first part of this report, should enable this type of research to take place.

For the moment, it is probably valid to assume that SME profitability in Slovakia is not sufficient in many cases to generate the funds required for further investment due to inadequate time

to build up reserves in a country where private enterprise has been legal for only seven years, the effect of initial undercapitalisation and the combination of high tax and social insurance contributions on the ability to achieve substantial retained profits.

There may also be sources of venture capital available for investment in profitable enterprises which would both provide additional resources and strengthen their balance sheets. There is a small venture capital sector in Slovakia comprising five or six funds which make up the membership of SLOVCA (Slovak Venture Capital Association). However, the venture capital business in Slovakia is still in its infancy. Entrepreneurs in general are poorly informed about what financing through venture capital investments means. There is an anxiety that allowing outside investors to participate in their enterprises may affect their independence, resulting ultimately in loss of control.

STATE SUPPORT PROGRAMME AND INTERNATIONAL CREDIT LINES

The main components of the state support programme administered through NADSME and the Slovak Guarantee Bank are:

Loan Finance

Credit Support Programme

A total of SKK 1.2 billion (USD 40 million) has been contributed in two tranches by the Slovak government, Phare and four Slovak commercial banks. It is intended that the amount contributed will operate as a revolving fund. Under this scheme the maximum loan is SKK 5 million (USD 165 000), the term is up to five years and interest is charged at the National Bank of Slovakia discount rate plus 2.5 %. As at 31 December 1996, the total number of loans allocated under this programme was 459 and the amount allocated totalled SKK 1,3 billion (USD 42,5 million).

Small Loan Scheme

Under this scheme, introduced in 1994, ECU 1 million (USD 1,08 million) was allocated by Phare to provide "soft" loans of up to SKK 800 000 (USD 26 500) to qualifying small entrepreneurs. This scheme now operates as a revolving fund.

Microloan Scheme

This new scheme funded from Phare resources provides for loans of up to SKK 300 000 (USD 10 000) at favourable rates of interest to enterprises employing up to ten people and which have been active for up to two years.

State Schemes through the Slovak Guarantee Bank

The Slovak Guarantee Bank (SGB) is a state owned specialist institution which has a particular role in supporting SMEs. In addition to providing loan guarantees, the SGB is also the channel for state interest subsidy schemes for the SME sector. The SGB operates a variety of state funded interest subsidy schemes for SMEs cover tourism, energy saving, usage of domestic raw materials, transport and agriculture. In general, the subsidies approved cover up to 70 % of interest costs. As at 31 December 1996, a total of 408 loans had been approved involving a commitment of SKK 466 million (USD 15,5 million)

Loan Guarantees

The SGB operates a number of loan guarantee programmes. The two programmes of most relevance to SMEs are: (1) the Programme of Support to SME and (2) the Phare Loan Guarantee scheme co-ordinated by NADSME. As at 31 December 1996, loan guarantees had been approved as follows:

	No. of guarantees	Total allocation SKK
Programme of Support to SME Phare Loan Programme	1748	3,86 billion (USD 128,6 million)

Venture Capital

The Seed Capital Company, Ltd., was established by NADSME and began operation in October 1995. The company manages the Seed Capital Fund which was authorised to make equity investments up to SKK 5 million (USD 165 000) in small and medium enterprises in Slovakia especially to the following sectors: production, production services and active tourism. As at 31 December 1996, the Seed Capital Company had approved investments amounting to SKK 19,6 million (USD 650 000).

Employment Subsidies from National Labour Office

The recently established National Labour Office (NLO) which administers the registers of unemployed persons and of job vacancies also provides a range of employment subsidies. The two principal schemes are: (1) creation of new jobs and (2) provision of employment through public works. Under the scheme for creation of new jobs, an enterprise may receive a subsidy comprising interest free refundable and non refundable grants of up to SKK 200 000 (USD 6 500) for each additional new job created. The NLO new job creation scheme budget for 1996 was SKK 1.27 billion. Both SMEs and large scale enterprises qualify under this scheme. The NLO schemes are financed through a levy on the self employed and employees.

The new job creation scheme also assists unemployed people who want to start their own enterprises through the provision of non refundable grants of SKK 200 000 (USD 6 500) to qualifying applicants. Approvals of grants for self employment may be linked with 'start your own business' training courses operated by RAICs and BICs, with participants funded by the NLO. Information as to the number of new business commencements is not provided.

International Credit Lines

The European Investment Bank and the National Bank of Slovakia signed an agreement through which ECU 28 million (USD 30,25 million) were allocated to finance small and medium projects with a credit limit spanning from ECU 40 000 (USD 43 000) to ECU 20 million (USD 21,5 million). The credit is provided to cover up to 50 per cent of the investment costs. The remaining 50 % will need to be invested from the resources of the entrepreneur investor or by credits from other financial institutions. The credit currency is ECU and the credit is extended in a currency denomination designated by the borrower who bears the exchange rate risk. As at 31 December 1996 a total of 72 loans had been approved.

Credits from EXIM Bank of Japan amounting USD 42 million are designed to finance development projects including modernisation, renovation and reconstruction to increase productivity and efficiency. The loans are designed to cover a maximum of 70 % of investment costs with the balance financed by the entrepreneur from other resources including also the credit support programme. This credit is denominated in Slovak crowns: none of the loans can exceed the equivalent of USD 5 million. As at 31 December 1996, a total of 216 loans had been approved.

SLOVAK BANKS AS A SOURCE FOR FINANCE FOR SMEs

According to the State of Small and Medium Enterprises 1996, the volume of bank credits for small and medium sized enterprises was low and static during 1996, influenced also by a demand for high guarantee coverage.

There are few realistic alternatives to bank finance for SMEs in Slovakia, due to the lack of accumulated capital through savings and from other sources. However, access by SMEs to bank loans remains extremely difficult due to the restrictive monetary policy operated by the National Bank of Slovakia, the commercial banks' own experience of loan defaults in the early 1990s, the inability of many SMEs to meet bank requirements for collateral and a lack of interest on the part of some banks in the SME sector. In fact it is doubtful if bank lending to the SME sector exceeds 3% of their total resources (other than those made available through state support programmes).

The banks themselves may lack assessment skills in dealing with loan applications. It also has to be conceded that there is strong criticism from within banks in relation to the very poor quality of most business plans received.

When loans are available, they are usually for a terms of up to one year and often at interest rates exceeding 20 %. Collateral accepted by the banks usually exceeds value of the loan by a substantial margin.

It also seems as if the operation of the Slovak Guarantee Bank schemes has not been fully developed and there may be a reluctance on the part of some commercial banks to avail of loan guarantees to any great extent.

THE ISSUES IN FINANCING SMEs

The issues in financing Slovakia's SMEs are:

1. improving access to owner's capital for new enterprises and facilitating the retention of profits by existing businesses for further reinvestment. (This issue is examined in the next subsection which examines the role of incentives.)
2. an extension of the state support programme with the primary focus on securing greater bank participation in SME funding and of international credit lines.
3. achieving the co-operation of the banks for the commitment of a higher proportion of their own resources to SME lending.

Although the range of facilities provided under the state support programme and the international credit lines is extensive, the impact on the SME sector is limited. The total number of loans approved (1 200 approximately) and loan guarantees granted (1 748) does not signify a major impact on Slovakia's 280 000 or so SMEs.

This programme could be extended and improved as follows:

1. a doubling of the resources of the credit support programme to SKK 2,4 billion (USD 80 million) through a joint allocation of funding by the government and the commercial banks (USD 20 million each) on the basis that loans to SMEs would be at 2,5 % above the National Bank of Slovakia discount rate;
2. more use of international credit lines with the exchange risk absorbed by the National Bank of Slovakia to encourage borrowing by SMEs;
3. a significant extension of the loan guarantee schemes from a total of 1 748 at the end of 1996 to a more realistic level of 10 000 guarantees during the next two years. Loan guarantees are becoming an increasingly favoured form of SME support in many countries as governments are ultimately obliged to commit resources only in the event of a guarantee being called. The number of guarantees (1 748) in Slovakia is very low and compares unfavourably with 29 000 in neighbouring Austria.

There is also a definite role for the National Bank of Slovakia (NBS) in bringing together the Slovak Guarantee Bank and the commercial banks to correctly identify and assess present difficulties with loan guarantees and propose practical solutions.

However, a greater independent commitment should be made by the commercial banks themselves to a higher proportion of SME lending from their own resources. Lending to SMEs can be profitable. In addition to a commitment of an extra USD 20 million through participation in the proposed extension of the credit support programme, the National Bank of Slovakia should encourage a voluntary commitment from the commercial banks to allocate a minimum of 5 % of their own resources to SME lending for a five year period. However, loans should not be approved at the expense of lowering bank loan assessment standards.

The cost of bank finance for SMEs is another difficult issue, but it is hard to envisage an easy solution as long as the NBS is obliged to continue its present restrictive monetary policy.

There are no easy solutions to finance for SMEs, but implementation of the following recommendations would result in a definite improvement.

RECOMMENDATIONS

- a doubling of the resources of the credit support programme for SMEs to SKK 2,4 billion should be implemented through agreement between the government and the commercial banks;
- international credit lines for SME lending should be increased with the National Bank of Slovakia absorbing the exchange risk;
- a target of 10 000 guarantees for SME should be set for the Slovak Guarantee Bank over two years;
- there should be a voluntary agreement between the commercial banks and the National Bank of Slovakia for the allocation of a minimum of 5 % of commercial bank own resource lending to SMEs for a five year period.

INCENTIVES TO ENCOURAGE SME DEVELOPMENT

the case for incentives

There is an argument that the optimum environment for enterprise is one where there is political and social stability, good economic management and a reasonable level of taxation. In this type of environment, the essential incentive for the entrepreneur is the freedom to run his or her own enterprise and retain most of the profits without being subjected to an excessive degree of regulation or to high levels of taxation and social security contributions. In this ideal business scenario, there should be no role for a programme of formal incentives to encourage enterprise.

It is true that new enterprises are started because the entrepreneur believes that market demand for the products and services of the new enterprise are large enough to sustain the new business.

Incentives, thus, play a comparatively small role in this process. However, they are important for creating awareness and to balance out disadvantages and unfavourable circumstances. It is for these reasons that many countries operate incentive schemes for SME development, although these schemes are often confined to strategic economic sectors.

The entrepreneur's motives for starting a business and the factors that influence his or her decision are the same whether in transitional or developed market economies. However, in transition countries such as Slovakia, the overall business environment is still relatively more difficult and the case for SME incentives is proportionately greater. The consequences of the suppression of private initiative over several decades require a significant measure of state discrimination in favour of SMEs.

Incentives in Slovakia

There are several types of incentive but they revolve essentially around schemes of (1) financial support aimed directly at enterprises in the form of grants, assistance with loan finance through interest subsidies and tax concessions, (2) loan guarantees to encourage bank lending for SMEs and (3) promotion of investment in SMEs either by individuals or venture capital funds through specific relieves in personal taxation.

Slovakia already has a system on incentives in the first and second categories. The National Labour Office (NLO) grants, soft loans available under the state support programme and SGB loan guaranteed have already been described.

However, there are few tax incentives for entrepreneurs in Slovakia with the significant exception of income tax concessions for new entrepreneurs. A new entrepreneur may be granted a reduction of 50% of income tax in respect of the first year of operation, 30% in respect of the second year and 20% in respect of the third year, on condition that the tax saved is reinvested in the enterprise within three years.

In some countries, tax concessions are favoured to encourage reinvestment by enterprises and to assist their cash position. For example, production enterprises may be allowed free depreciation of assets which permits investment write off for tax purposes within a term of the enterprise's own choosing, usually one trading year if profits allow. Free depreciation usually applies to equipment rather than buildings. For smaller companies there may be a special low rate of corporation tax on profits up to a certain level.

The third category of incentive is for the promotion of investment in SMEs. To encourage the greater availability of risk capital for investment in SMEs, many governments now operate personal incentive schemes which permit an individual taxpayer to write off investments in qualifying enterprises at his or her marginal or highest rate of income tax. The usual restrictions are that there is an annual ceiling on the amount a taxpayer may invest, a limit on the cumulative permitted total of investment in any one enterprise, regulations concerning the size of a qualifying enterprise and the economic sector in which it operates. This type of incentive does not exist in Slovakia.

Incentive priorities

The resources of the state are limited and, therefore, business support programmes and incentives should be targeted in such a way as to ensure that they result in a genuine contribution to the economy as a whole. Consistent with this approach, the priorities for support package for Slovakia's SME sector at present should aim at ensuring an optimum cash flow, particularly for new businesses.

An enterprise is at its most vulnerable during its early years. In Slovakia, the NLO allowance of SKK 200 000 for qualifying unemployed people starting their own businesses and the substantial income tax concessions for the first three years in the life of an enterprise represent an enlightened approach towards new small enterprise, as do initiatives such as the microloan scheme.

However, there is no information provided as to the number of enterprises that commenced with the assistance of the NLO allowances, which means that their contribution cannot be measured. Moreover, the income tax concessions apply only to the first three years in the life of an enterprise when profits may be relatively low and expenses fairly high, as is often the case in the early stages of a new business. There are few concessions in relation to depreciation.

There is also a case for the use of personal tax incentives to encourage investment in enterprise.

RECOMMENDATIONS

Improvements which could be effected that would considerably benefit the cash position of new enterprises and thus enhance the prospects of their survival are:

- a joint NADSME/NLO approach to identify the number of enterprises started with the assistance of NLO allowances, more publicity for the scheme, greater encouragement of its use and an examination of eligibility criteria to see if it would be useful, perhaps on a regional or sectoral basis, to extend the scheme to prospective entrepreneurs not deemed unemployed;
- the retention of the existing income tax concessions for new enterprises and on the same conditions requiring further investment in the enterprise, but providing the entrepreneur with the option of selecting any three of the first five years of the business;
- the introduction of free depreciation for the acquisition of new equipment required for the operation of an enterprise. This method of depreciation would enable an enterprise to write off expenditure for tax purposes over as short a time as one year or until such time as sufficient profits had been generated to cover the cost of the investment. To restrict the cost to the state of this proposed concession and to ensure that it is of relatively greater benefit to SMEs, it is suggested that a qualifying investment ceiling of SKK. 3 million (USD 100 000) be imposed for any one year in the case of an enterprise;
- tax investment incentive scheme should be introduced with provision for an annual personal investment limit of SKK 50 000 and the scheme should be restricted to manufacturing and tourism enterprises, as earners or potential earners of foreign exchange.

Incentives for the generation of finance for equity investment in SMEs are available in a number of countries (Belgium, France, Ireland, United Kingdom) with beneficial results. A typical example is the Business Expansion Scheme (BES) under which a person may write off an investment in a qualifying enterprise or in a designated fund for investment in enterprises at his or her marginal rate of income tax. A number of safeguards are attached to these schemes: there is a personal investment limit; qualifying enterprises must be legal persons: enterprises in which investments may be made are usually in sectors of strategic economic importance; qualifying companies must be below a certain size; there is a maximum investment per company and the investment must be made for a minimum of five years. A scheme of this type in Slovakia would strengthen the country's infant venture capital structure.

13. THE IMPACT OF THE TAXATION AND SOCIAL INSURANCE SYSTEMS ON SMEs

HOW INCOME TAX AND SOCIAL INSURANCE OPERATE

Following reforms introduced in 1993, the tax system in Slovakia comprises:

- 1) income tax;
- 2) value added tax;
- 3) consumption tax (alcohol, tobacco, hydrocarbons);
- 4) property tax;
- 5) road tax.

Income tax and social insurance contributions combined impact most directly on enterprises.

Income taxes affect two basic types of taxpayers: individual and legal. Legal entities are subject to a 45 % tax rate, 5 % of which may be used for further investment and in which case, the direct tax burden becomes 40 % of total income. Individuals or physical persons are taxed according to their incomes at rates of between 15 and 42 %. In the case of employees, personal income tax and all obligatory insurance contributions are deducted by the employer.

Licensed entrepreneurs (sole traders) may claim deductible expenses either on the basis of 25% of gross income or actual expenses supported by receipts. The income tax structure after deductible expenses is as follows:

From (SKK)	To (SKK)	Rate
	60,000	15%
60,000	120,000	9,000 SKK + 20% above amount in Col. 1
120,000	180,000	21,000 SKK + 25% above amount in Col. 1
180,000	540,000	36,000 SKK + 32% above amount in Col. 1
540,000	1,080,000	151,200 SKK + 40% above amount in Col. 1
1,080,000	and higher	367,200 SKK + 42% above amount in Col. 1

In addition to income tax, there are substantial compulsory insurance contributions. All employers are obliged to pay an insurance contribution that equals 38 % of each salary and to withhold from the earnings of the employee an additional sum of 12 %. Owners of companies are obliged to make appropriate deductions from their own salaries. Insurance cover is provided for health, disability, unemployment and pensions.

The combined income tax and compulsory insurance systems make the cost of employment fairly high in Slovakia. In effect, it costs an employer offering an average wage nearly two crowns to pay an employee one crown as shown by the following example:

	Employer pays SKK	Employee receives SKK
Average annual wage	85 000	85 000
add Employer's social insurance contribution (38%)	32 000	
less Employee's social insurance contribution (12%)		10 000
Income Tax (SKK 9 000 + 20% in excess of SKK 60 000)		14 000
Totals	117 000	61 000

Ratio 1,9 : 1 (Based on 1995 average annual wage)

Each self employed taxpayer is responsible for the payment of social security and health care levies. The amount to be deducted is 50 % of monthly income, based upon the previous year's tax return and within specified minimum and maximum limits (minimum is defined as the minimum wage- currently SKK 2 750 per month - and maximum as eight times this minimum or SKK 33 000 per month). Social and health insurance contributions are treated as an expense which is deductible for tax purposes.

The size of the social and health insurance contributions is a matter of considerable complaint on the part of self employed people in Slovakia. Although there is a comprehensive system of social benefits, the various insurance contributions are regarded as another form of tax rather than as part of a genuine insurance system. An entrepreneur who had achieved an income of SKK 396 000 (the maximum monthly limit multiplied by twelve), after deductible expenses, in a tax year would find him or herself paying half this amount in insurance contributions the following year spread over 12 monthly payments and that would be prior to calculation of income tax.

THE ISSUES ARISING FROM THE COST OF SOCIAL PROTECTION IN WESTERN EUROPE

High levels of social benefits and the expectation that they could continue without reference to their increasing costs was the norm in Western Europe until comparatively recently. Comprehensive benefits, including pensions, were and are funded by national social systems to which both employers and employees contribute. The employer pays the larger contribution. The high levels of contributions required are adversely affecting the costs and availability of employment in Western Europe against the background of an increasingly competitive global trading environment.

Self employed people also contribute to social insurance funds but, in some countries, at lower levels of contributions in return for restricted benefits. For example, self employed people might have the autonomy to make their own private health insurance and pension arrangements.

A strain on these social security systems is becoming evident for a number of reasons:

- (1) Labour costs in Western Europe are becoming increasingly uncompetitive in an international free trade environment when compared with countries which have more flexible labour market policies, including both lower social security contributions and benefits.
- (2) Increased unemployment in Western Europe, partly due to industrial restructuring and the need for many companies to become more competitive, is adding to the costs of social security systems.
- (3) Improved longevity and the elderly as a higher proportion of the population are adding to the burden of funding national pension schemes.
- (4) The higher levels of expensive technology in medicine and the fact that an older population has a greater demand for health services is putting considerable cost pressures on these services.

International competitive pressures, the increasing cost burden of maintaining social security systems in their present form, more intense funding difficulties and the negative impact of high levels of insurance contributions on new employment are forcing governments to review the level of social protection that can be afforded and the means of finance.

Among the issues under review are:

- more reliance on privately funded pension schemes;
- lower benefits, for example in the case of the longer term unemployed;

- greater cost efficiencies in the operation of health services;
- allowing categories such as the self employed to opt out of state schemes and make their own private health insurance and pension arrangements;
- stricter enforcement of social security regulations in order to reduce fraud.

Although the increasing cost burden of these systems is the fundamental issue, there are other considerations which raise questions with regard to the appropriateness of current structures. The social security systems now in operation were devised mainly in the late 1940s when large scale institutional employment and careers spanning 40 years with the one employer were considered normal. The changing environment of work: more people employed in smaller enterprises; a growing proportion of self employed and more frequent career changes indicate greater scope for individual responsibility in determining levels of social protection required and greater competition in its provision.

These are difficult and delicate but unavoidable issues in all developed market economies and they need to be faced in Slovakia as well. In this regard, the various interested parties in Slovakia will have the opportunity to observe the ways in which these issues are tackled within EU Member States during the coming years.

REDUCING THE TAX AND SOCIAL INSURANCE COST BURDEN ON SMEs

On its own, the burden imposed by income tax in Slovakia on entrepreneurs or on the cost of employment is not excessive. It is with social and health insurance costs that the real problems arise.

However, simplistic demands on the part of entrepreneurs and their representative trade associations for reductions in contributions would not be useful. What is required is a researched and considered approach which deals with issues such as:

- the level of social protection that entrepreneurs actually want for themselves;
- the extent to which self employed people should be responsible for deciding their own insurance cover requirements;
- whether voluntary insurance should be permitted at the entrepreneur's own risk;
- the scope for private provision of some services on a competitive basis;
- the extent to which the contributions of entrepreneurs might be subsidising other categories and whether this could be regarded as reasonable.

It would also be legitimate for trade associations to demand a review of the costs of running the various health and social services to include value and efficiency.

These complex issues are not going to be resolved rapidly but a first significant stage in the process could be initiated by the formation of a working group comprising representatives of trade associations, Ministry of Economy, NADSME, Social Insurance Company, National Labour Office and the health insurance companies to look at the various issues affecting social protection for self employed people and consider whether changes could be made.

Ultimate responsibility for significant change in this area rests with government but the suggested working group approach would at least provide a basis for informed decision making.

Social protection for employees is a wider issue in which the costs of social protection need to be balanced against the competitive cost of labour and would be best resolved in line with European trends.

It is recommended that a working group be formed to address the issues of social security for the self employed.

14. PROMOTING A MORE POSITIVE CLIMATE FOR SMEs

SME ATTITUDES TOWARDS GOVERNMENT AND ADMINISTRATION

a lack of SME confidence in public administration

There is a substantial gap in trust and confidence on the part of entrepreneurs towards state, and, perhaps towards regional administration. Research by the Economic Institute of the Slovak Academy of Science has shown that only 2 % of entrepreneurs are satisfied with state support programmes for SMEs, 22 % are unaware of these programmes and 64 % value them negatively.

The reasons for these negative reactions by the SMEs surveyed are as follows:

1. a view that SME support programmes are verbal and not real;
2. negative experiences when applying for credit;
3. a perception of a high tax burden that handicaps the development of enterprises;
4. a lack of sources of finance and credit for SMEs.

The research shows particular concern in relation to frequent changes in legislation and a lack of consistency in application. 'The legislation is chaotic and was made by politicians, not by businessmen' was a comment made by one SME respondent and was representative of the views expressed. Different interpretations of tax laws by regional tax offices were a major source of complaint.

Interviews with entrepreneurs carried as part of this project tend to support the findings of the Academy of Science research.

As part of the preparation process for its Comparative Analysis of SME Strategies, Policies and Programmes in Central European Initiative Countries (CEI) project, UNIDO commissioned the European Foundation for Enterprise Research (EFER) to provide information, via its bi-annual survey, on a number of SME issues.

The EFER survey found that in the transition economies of Central Europe most entrepreneurs felt that those who operated the regulatory environment did not really understand small business. A substantial number of businesses in each country saw the attitude of the government, regulatory officials and managers of state enterprises as being negative towards private business and profit making. The survey seems to suggest that this environment is regarded as particularly negative in Slovakia and Hungary.

There is a need to overcome the sense of exclusion that SMEs feel in relation to the legislative, regulatory and administrative environment in which they are obliged to function, to give them a genuine voice in shaping that environment and a share in its ownership. In the longer term, the full participation of the SME sector is essential to the effective operation of the policy making process. In the near term, a very significant gesture is needed which would represent a significant first step in this process.

a task force to build confidence

A *Task Force* approach, if properly structured, would be a highly effective way of obtaining directly the views of enterprise on what policy for the SME sector should be and of giving SMEs a feeling of ownership in shaping the environment for business. This *Task Force* would be comprised mainly of entrepreneurs but with support from and participation by relevant ministries and NADSME and would look at the major SME issues and set out an agenda for the sector from a SME perspective. The motto would be *business knows best what is best for business*. The *Task Force* would be dissolved on completion of its work.

There is a successful precedent. In 1992, the Government of Ireland, in response to constant lobbying by the SME sector for a greater voice and more effective policies, established a *Task Force on Small Business* comprising 14 entrepreneurs and two senior civil servants. The government provided the Task Force with full secretarial resources, a consultancy budget and the right of access to all ministries, where especially designated resource persons were required to deal positively with all requests for information and furnish responses to issues such as the implications that might arise from implementing specific recommendations that the *Task Force* might have under consideration.

The autonomy and independence of the Irish *Task Force* were important considerations. Although trade associations were consulted in relation to its formation, each *Task Force* member was deemed to be participating in his or her own right and not as a representative of any interest group. The *Task Force* set its own agenda, decided its own priorities and determined its own programme of work. The five topics selected for particular attention were: 1) raising money; 2) rewarding risk; 3) reducing legislative and administrative burdens; 4) assistance for small businesses and 5) new policy structures for the SME sector. In March 1994, the *Task Force* published its report, having identified 120 practical steps which it said should be taken to help smaller firms. The government responded in 1996 by setting out its own position in relation to the *Task Force* recommendations, which it divided into four categories: 1) fully accepted; 2) partly accepted; 3) still under consideration and 4) rejected and the reasons why.

There is a general consensus that this *Task Force* exercise did a great deal to achieve a climate of improved relationships between the Irish SME sector and government ministries and has brought about a better mutual understanding between both sides.

A SME TASK FORCE RECOMMENDATION FOR SLOVAKIA

A *Task Force* comprised mainly of entrepreneurs should be established to examine the business environment from a private sector perspective and set out recommendations for a stronger and more dynamic SME sector in Slovakia.

The *Task Force* should have a clear majority of business people, but with some representation from ministries and NADSME. The Ministry of Economy should ensure the provision of adequate secretarial services and consultancy resources for the *Task Force* and a technical referral panel comprising senior civil servants from relevant ministries should be formed to which specific issues could be referred as they arise. It is important that the entrepreneurs on the Task Force should be independent and not seen to represent particular trade associations. However, trade associations and RAICs/ BICs could be consulted in relation to the identification and selection of potential members.

The agenda for work should be determined largely by the *Task Force* itself but it should be expected to cover such major topics as the legal and regulatory environment, finance for SMEs, the promotion and encouragement of new small businesses, obstacles to enterprise expansion and how to overcome them and the impact on SMEs of the taxation and social security systems.

The objective of the *Task Force* should be to ensure the permanent place of the SME sector at the forefront of public policy development by means of a structured partnership between appropriate government institutions and SMEs themselves, which would achieve an effective and fully recognised role for the SME sector in the design of policy, more focused and upgraded policy capabilities and responsive implementation mechanisms.

The output expected from the *Task Force* would be a comprehensive and practical policy statement prepared by SMEs themselves setting out the steps required to achieve a greater economic

contribution from and improved operating environment for the SME sector and the means for monitoring implementation.

The activities of the *Task Force* would be determined by its programme of work but the sequence might be as follows:

- decide on agenda and select topics for examination;
- advertise for submissions;
- split into working groups based on topics;
- research issues to include interviews with individual businesses;
- hear views of interested parties in public and private sectors;
- prepare sections of draft report with recommendations;
- refer draft recommendations for technical assessment;
- prepare final report and request government response.

The credibility of this exercise and the achievement of the objective of giving SMEs a feeling of ownership in the policy making process should depend critically on a reasonably rapid and fully considered response to the *Task Force's* recommendations.

RELATIONSHIPS BETWEEN THE SME AND THE EDUCATION SECTORS

the gap between education and enterprise

In none of the countries (including Slovakia) covered by the UNIDO SME Policy Research Project in Central Europe was much attention given to the creation of enterprise culture via the education system. This lack of emphasis is probably an accurate reflection of slow progress in adapting education systems in transition countries to the needs and realities of the market economy. Although education systems remain mostly under state control there is growing private involvement, particularly at third level. There are two issues in relation to SMEs and public education: (1) starting and developing one's own business as a valid career option, which must include an understanding of the role of enterprise, and (2) adapting the education system to provide the skills needed by the market economy.

In Slovakia, contact between the SME support network and the education system seems limited and inadequate. Against the background of transition and the fact that today's students are tomorrow's entrepreneurs, there needs to be more promotion of the enterprise option within the education system. This need is also particularly relevant to a better integration of enterprise with Slovak society.

More contact is needed between RAICs/BICs and second and third level education institutions within each RAIC/BIC region. The significance of second level institutions is that senior students here are at an age when career choices are made and they should be provided with information on the opportunities and implications of running one's own business. RAICs and BICs are best placed to meet this need. In third level institutions, career choices may have hardened, particularly among those following more specialised courses. However, there is still considerable potential and, indeed, a necessity for the promotion of entrepreneurship among young people who are at a more mature level.

There is also the importance of encouraging appropriate third level institutions to develop a greater orientation towards the support of enterprise. In relation to the SME sector, third level institutions need to understand that:

- the education sector has a vital role in ensuring that students are fully aware of career options and opportunities that reflect contemporary market realities, including starting one's own business;

- there is growing competition in education, state resources may not be available as in the past and those institutions capable of responding most effectively to the new market environment, including the requirement for business education, are most likely to succeed;
- business related degree courses are an integral and significant component of the education system in market economies and will be increasingly needed in Slovakia;
- educational institutions that can support an ability to meet the needs of enterprise tend to receive support in return; for example: student bursaries, endowments, sponsorship of specific courses and research projects;
- institutions that have business success stories among their own graduates will always attract support;
- 'starting your own business' is an increasingly serious option for young people and there is an education market opportunity through the provision of appropriate high quality business courses.

It should be acknowledged that courses in business are now available in some public third level institutions. However, the adequacy of this response needs to be considered against the background of the emergence of a new private sector further education market. The real impetus for business education of interest to SMEs comes from new private institutions which offer courses in subjects such as management, data processing and foreign languages. According to the *Small Business in Transition Economies* report, published by OECD in 1996, there were 170 further training companies in Slovakia, but, as in other transition countries, a lack of information as to the rate of take-up and quality of the various forms of training and education provided by these suppliers. Standards against which businesses or prospective entrepreneurs could assess the services provided by companies offering such further education courses are not widely available, due to a lack of nationally recognised qualifications such as Chamber of Commerce examinations as in many EU countries.

education for enterprise in Western Europe

The role of education in encouraging and supporting enterprise is receiving greater attention in Western Europe as part of the process of recognising that an increasing proportion of the population will become self employed rather than have long careers with large institutions.

The 1995 Report of the European Observatory for SMEs contains the following comments in relation to education and SMEs:

- Educationalists recognise the socio-economic importance of SMEs, and acknowledge that education can stimulate entrepreneurship by, amongst other things, the development of entrepreneurial skills. In addition, students and graduates have shown explicit interest in entrepreneurship itself and education relating to it. Co-operation between educational institutions and SMEs can improve the attention to, and quality of, education relating to entrepreneurship.
- A number of barriers to the encouragement of entrepreneurship in education exist. Education has become too academic and theoretical, it puts too little emphasis on the development of practical and personal skills and is often too narrow, that is, not sufficiently multi-disciplinary. The business related education that does exist, concentrates on large enterprises and wage earning, rather than on entrepreneurship. Furthermore, teachers are generally unfamiliar with entrepreneurship and SMEs.

RECOMMENDATIONS FOR INTEGRATING EDUCATION WITH ENTERPRISE

Each RAIC and BIC should, in its own region, establish a dialogue with the main education institutions to develop a programme for informing senior second level and third level students of

enterprise as a career option and to encourage the development of courses which would support the SME sector.

In relation to private sector further business education, it is clear that it fills a market need and has a definite contribution to make, but a nationally recognised system of standards needs to be set in place so that enterprises and students may have confidence in the quality of the courses on offer and an awareness may be developed of those institutions which do not meet the standards established.

PUBLIC ATTITUDES TOWARDS ENTERPRISE

negative perception of entrepreneurs

The NADSME publication '*State of Small and Medium Enterprises 1995*' states that entrepreneurs are still assessed negatively in society and are sometimes regarded as an anti-social element. These negative attitudes towards enterprise persist in spite of efforts by bodies such as NADSME to promote a positive image of business. Surveys have indicated that negative assessments of entrepreneurs may arise from client or customer experiences and from perceptions of a lack of high standards in dealings between entrepreneurs themselves.

These attitudes are not confined to Slovakia but are still very much a feature of economies in transition. Among the findings of the EFER survey commissioned by UNIDO are indications that society as a whole in the CEI countries is still hostile to small business. There are variations between countries. On balance the attitude of citizens towards profit making and private business was seen to be more negative than positive in Slovakia, the Czech Republic and Poland but more positive in Slovenia and Hungary.

The reasons for this public hostility towards entrepreneurs may include the following:

- (1) The transition process towards a market economy, including privatisation and the restructuring of enterprises, brings greater uncertainty into the lives of many people in relation to such important personal issues as job security, material well-being and self esteem. Unemployment is a difficult issue almost everywhere but perhaps most of all, in countries where it was almost entirely unknown before 1990. Against this background, it may be hard for some people to accept the disparities in wealth and incomes that are generally viewed in developed market economies as the natural outcome of private enterprise and competition.
- (2) Success as a result of hard work and entrepreneurial initiative may not always be appreciated. There may be a view that people who strive to get ahead are taking the rightful share of others. Ambitious business people, therefore, may have to cope with the problem of overcoming the flaw of being a winner.
- (3) The pressures towards conformity in the former command economies reduced scope for the expression of such individual traits as achievement, striving, ambition and initiative. These characteristics are indispensable to entrepreneurship but, in the circumstances of countries such as Slovakia, may be viewed still by some sections of society as undesirable and not conducive to social harmony.

It is important that these attitudes towards enterprise be understood and recognised as a barrier to SME development, as community support and a positive perception of business are important factors in encouraging the emergence of new entrepreneurs. It is therefore necessary for NADSME and other relevant institutions to explain publicly the role and benefits of SMEs and to understand that they are dealing with a longer term issue.

NADSME already has a promotional programme but the extent to which it is having a public impact needs to be reviewed. The 1st Conference on Small and Medium Enterprises was held in

December 1995, with wide participation by entrepreneurs, representatives of ministries and SME support institutions. Among the conclusions from this conference was that NADSME should increase its co-operation with the media to achieve more coverage for the SME sector. In 1995, NADSME also launched PODNIKANIE (Business), a monthly newsletter with a circulation of 5 000 which is issued to businesses and circulated through outlets such as RAICs and BICs. However, the impact of this promotional effort has been limited.

There is still very little coverage of the SME sector in the general media. This matter needs to be addressed through the design and implementation of a programme aimed at securing public understanding of the role and contribution of smaller enterprises. Such a programme should be seen as complementary to PODNIKANIE which is aimed mainly at a readership directly interested in business.

RECOMMENDATIONS FOR PROMOTING A POSITIVE IMAGE OF ENTREPRENEURSHIP

NADSME and the RAICs/BICs should jointly design and implement a long term information programme to win wider public acceptance and understanding of enterprise and support for the encouragement of entrepreneurs. This programme should operate at both national and regional level. The emphasis in operating the programme should be the promotion of positive public attitudes to enterprise through the presentation of accurate news and information.

NADSME would undertake a co-ordinating role, ensure SME coverage through the strengthening of links with the national media, provide back-up services (for example, the organisation of media training courses for RAIC/BIC staff) and include a section of the results of the programme in its annual report.

The RAICs and BICs would operate the programme in their own regions. The regional dimension is of major importance as the potential exists at that level for presenting news and information to which people can relate in a more tangible way. Good local stories are always of more interest and offer the most practical means for developing a better public understanding of enterprise. Well presented and regular news items covering topics such as the official opening of a new enterprise, a quality or an export award for a local company, business success stories with profiles of entrepreneurs and the contribution of SMEs to new jobs in the region would help bring about positive change in the climate for business.

Each RAIC and BIC should have a member of staff with responsibility for ensuring that the public is informed, particularly through the media, of SME developments within his or her RAIC/BIC region. This person might have other responsibilities such as forging links with the education sector. These activities would add further pressure to RAIC/BIC budgets but they should also result in their revenue generating activities becoming better known to potential users.

While no branch of the media should be excluded from this programme, it seems that the printed press - newspapers and magazines - offer the best prospects for successful coverage. The number and variety of outlets (publications) is greater than in the broadcast media. It is also likely that there would be greater interest from within the printed media in reporting on enterprise, including SME developments, and more potential contacts among journalists.

For co-ordination and evaluation purposes, each RAIC and BIC should advise NADSME regularly of its activities under this programme and of coverage achieved.

15. REPRESENTATION AND ADVOCACY FOR SMEs

REPRESENTING SME INTERESTS

The representation of the views of SMEs and advocacy on their behalf to the various branches of the administration: parliament; ministries and regional authorities constitute a legitimate and important activity. This process is also known as lobbying and may take such different forms as the presentation of a written submission to a ministry on a particular issue, making a case to a parliamentary committee or informal briefings of members of parliament or senior civil servants. Although it is usually confined to the public sector, large private institutions such as banks may also be subjected to lobbying.

Virtually every interest group in society is involved in some form of lobbying in the pursuit of its own interests. The SME sectors in many countries have become effective at making their voices heard through strong and well focused representative associations. It is quite usual for representative associations to be involved in the policy process to the extent that they have *de facto rights* of consultation in many cases. In Western Europe, it would now be almost unthinkable for a government to make to major policy or legislative changes affecting SMEs without first fully consulting the larger SME representative associations. These associations make representations on a wide variety of issues, including:

- levels of taxation;
- social costs incurred by employers;
- the role of SMEs in public procurement;
- legislation affecting SMEs: health and safety; unfair dismissals; vocational training; environment etc.;
- compliance with regulatory and administrative requirements;
- improving access to capital for SMEs;
- seeking or improving SME incentive programmes;
- encouraging more positive bank attitudes towards SMEs.

As part of the transition process in Slovakia, associations representing SMEs have emerged and are lobbying on behalf of their members. There are now at least five associations representing SMEs in Slovakia. However, overall membership is quite small and the process of representation is still at an early stage of development.

EXAMPLES OF LOBBYING IN SLOVAKIA

Examples of representation on behalf of SMEs in Slovakia were provided by the Entrepreneur Association of Slovakia (EAS). EAS was formed as a professional representative body for private entrepreneurial activities in the Slovak Republic and tries to promote and defend the interests not only of its members, but of the entrepreneurial community in general. The main activities of EAS include dialogue with the executive and legislative bodies, elected representatives, trade unions and other employment organisations.

In EAS, there has been for some time an expert Advocacy Group - entrepreneurs and top managers of private companies. In addition to the base members - seven lawyers and economists - there are other members who may participate in work on specific topics. The *Advocacy Group* monitors the legal situation as it affects SMEs, drafts new proposals, either entire legal norms or amendments to existing legislation, prepares positions and comments on legislative and other government proposals. The standpoints of EAS are also explained to individual Members of Parliament for promotion by them in parliamentary discussions.

In all its lobbying activities, the EAS works through its members in the Legislative Council of the Government, Association of Employers Unions and Corporations, The Council for Economic Development of Slovakia, Board of Directors of the National Labour Office, Export Council of the Government, Boards of Directors of Social Insurance and General Health Insurance, Board of Directors and Board of Supervisors of National Agency for Development of Small and Medium Size Enterprises.

Among the issues on which EAS has lobbied and has claimed some success are draft legislation income tax, VAT, capital markets and retroactive increases in the founding capital of enterprises.

EFFECTIVENESS OF SME REPRESENTATION

Although the EAS and other SME representative associations deserve credit for the work that they are doing on behalf of their members, the main impression must be that there are still considerable difficulties in the whole area of SME representation and advocacy. Low association membership reflects a lack of belief on the part of entrepreneurs that representation on their behalf can be effective. The trade associations themselves lack experience, skills and resources and are often poorly focused. Most of their work seems to consist of reacting to decisions already made rather than developing their own independent approach. There is rivalry between the associations rather than a unified approach in matters of mutual interest. Finally, there is not much evidence of a serious government interest in the views of these associations, partly on the basis of the view that the quality of representations is often quite low. However, there is evidence of willingness to consult on legislation.

The issues that need to be tackled to improve the effectiveness of representation on behalf of SMEs include:

- a shift on the part of the trade associations away from reacting to government decisions and towards becoming part of the process leading to changes in policy;
- making a distinction between legislation which is often an expression of policy and policy itself;
- identifying the limited number of really crucial issues facing their members and developing intelligent and well thought out policy approaches towards them, including the practicalities of implementation;
- identifying the key institutions or parts of institutions (for example, sections within ministries) which have a significant impact on SMEs and working at developing long term relationships with them;
- developing a lobbying approach based on intelligent argument as to the benefits that changes sought would bring rather than on simple demands for concessions;
- adopting a fully professional approach to all lobbying activities including good presentation of a case, ensuring that all trade delegation participants at a meeting are well briefed on the issues involved, arriving punctually and displaying a willingness to listen to government or ministry arguments;
- co-operation and resource sharing (for example, in research) between trade associations in the pursuit of common objectives;
- building up membership through the ability to demonstrate achievements.

SME representative associations in Slovakia will become strong and representative only if they can demonstrate an effectiveness as advocates for enterprise and display a professional approach. It is a demonstration of the ability to achieve results that will attract an expanded membership.

THE GOVERNMENT RESPONSE TO REPRESENTATION

If trade associations have the responsibility to make a case for their members, government also has the responsibility of listening and responding to representations on behalf of SMEs, particularly in view of their critical economic importance. Therefore, if there is disagreement and a ministry rejects a case presented, those affected should be advised of the reasons in a full, considered and open manner. There is a similar onus on trade associations to understand that in the longer term, it is intelligent argument that works.

It is not the role of government to promote membership of trade associations nor to accept badly prepared and poorly presented arguments. There is, however, a justifiable case for a structured mechanism through which a dialogue between the representatives of the SME sector and the most appropriate ministries might be developed and maintained. An essential input into good policy development is the capacity to understand the opinions and perspectives of those whom it will affect.

There is a recommendation earlier in this report for a *Task Force* to enable small and medium sized enterprises to set the agenda from their perspective. There is also a need for a more permanent structure which would supplement the everyday process of representation by bringing ministries and trade associations together on a more formal basis to discuss SME issues and further develop the policy agenda. It is just as important to bring the main ministries together with *each other* to encourage a co-ordinated view of the SME sector as it is for them to meet regularly with the trade associations. Similarly, the effect of bringing the main trade associations together should also be beneficial.

RECOMMENDATION FOR A SME FORUM

An appropriate mechanism would be a SME Forum comprising senior representatives from the four ministries whose activities have most impact on the SME sector from NADSME and from the main SME trade associations. In the case of ministries, the representatives should have sufficient seniority to ensure that issues raised by the Forum receive serious attention. The ministries are: Economy; Finance; Labour; Interior. There should be an independent chairperson and the Ministry of Economy as the ministry with principal responsibility for SME policy should provide secretarial facilities.

The Forum should meet every two months or every quarter and confine itself as much as possible to main policy issues, including measures under consideration within ministries or likely future developments, and make recommendations as appropriate. By adopting this priority approach, the Forum could seriously and efficiently deal with the major issues affecting SMEs. Co-ordinated policy development by ministries would be encouraged and the trade associations would be in the position to make their views known prior to important decisions being made, rather than react afterwards. Senior civil servants would receive at first hand the views of the SME sector on the important issues affecting it and the SME representatives would benefit from the exchange of views and develop a better appreciation as to the complexities of policy making and how to make arguments for change.

This forum would complement the work of the proposed Slovak Government Council for SME.

16. PRIORITIES FOR A GREATER ECONOMIC CONTRIBUTION FROM SMEs

THE MAIN PRIORITIES

There are a number of priority issues which are of particular importance in strengthening the economy of Slovakia. These issues are:

- the potential of large scale enterprises and SMEs to co-operate to their mutual benefit, particularly in the area of subcontracting;
- developing SME exports;
- a particular focus on SMEs with growth potential;
- SMEs in tourism.

LARGE SCALE INDUSTRY AND THE SME SECTOR

Although the company size structure has changed considerably since 1989 and now approximates more closely with that of developed market economies, there is still a considerable degree of industrial concentration in Slovakia. The OECD Economic Survey of the Slovak Republic 1996 stated that the 20 largest enterprises in Slovakia had combined sales for 1994 equal to 30% of gross national output. Most of these enterprises are still in the public sector. The OECD also commented that although average employment per industrial enterprise fell from 1 280 in 1990 to 320 for 1995, this number is still quite high when comparisons are made with developed market economies. Comparative average industrial enterprise employment figures for selected countries are as follows:

Japan	2
Germany(West)	44
USA	52
Former USSR	750
Former East Germany	320

The substantial decline in average enterprise employment for Slovakia is a consequence both of the number of new SME business commencements and of deconcentration arising from the privatisation of large state enterprises. The reasons for the continuing comparatively high levels of concentration are as follows:

- (1) The process of new SME commencements is not yet fully mature.
- (2) The integrated structure of enterprises prior to 1989 means that there is not a tradition of subcontracting which is a major feature of market economies.
- (3) There are still large over-dimensioned enterprises in Slovakia, particularly in the processing of metals and the manufacturing of metal goods and base chemicals, which have not yet undergone restructuring.
- (4) The past emphasis on heavy industry has resulted in Slovakia being relatively deficient in producing consumer goods or high precision equipment.

The industrial structure of Slovakia with its bias towards relatively large enterprises undertaking virtually all of their operations in-house means that the kinds of links between large scale enterprises that are a common feature of developed market economies and which are indispensable to business competitiveness are not a significant feature of Slovakia's industrial sector.

In North America, Japan and the European Union, there is a clear and substantial interdependency between small and large enterprises expressed mainly through sub-contracting relationships.

The growth in subcontracting reflects the tendency of large scale enterprises to concentrate more and more on their core activities and to rely on outside producers for a substantial range of components. The reason for the growth in subcontracting is simply that it has been shown to add to the competitiveness of large scale enterprises by offering them the following advantages:

- substantial cost savings, particularly in the case of smaller production runs;
- the flexibility provided through the ability to source from a choice of competitive suppliers;
- the availability of better quality components from specialist workshops.

However, subcontracting is now going beyond the production of parts and components as large scale enterprises in developed market economies seek outside contractors to undertake a growing range of specialist service activities.

Right through the value chain, from raw materials to customers, services play an increasingly important role. For example, information processing, marketing and customer services are high value added activities that no longer require to be co-located with production activities in the value added chain and can be exploited as large industrial enterprises seek to sub-contract or outsource such functions.

The long term dynamic elements of a modern economy are 'soft' factors such as education, training, research, innovation, management and marketing. These are all service activities and are being increasingly purchased on a consultancy basis by larger enterprises. Manufacturing is changing and former in-house activities are becoming stand alone businesses, and important in their own right as real generators of growth.

These developments illustrate the scale of the challenge facing those larger enterprises in Slovakia that still have to undergo the restructuring process.

The Medium Term Policy for SMEs has improvement of SME co-operation with large companies as an objective. There is already a spin off project operated with the support of NADSME. However, the whole spin off effort needs to be intensified so that Slovakia may achieve a more balanced industrial structure, including strong subsectors in areas such as metal fabrication and engineering - activities in which Slovakia has a comparative advantage.

RECOMMENDATIONS

As first step to achieving greater co-operation between large enterprises and SMEs, the Ministry of Economy and the Slovak Chamber of Business and Commerce should undertake a joint initiative through which all large enterprises would be invited to undertake a full audit of all their activities to identify those operations which could be more profitably undertaken on a subcontract basis.

EXPORTING BY SMES

the imbalance in Slovakia's exports

Slovakia's balance of trade is now in substantial deficit. A trade surplus of \$100 million for 1995 became a deficit of \$2,01 billion for 1996. Figures to date for 1997 show the persistence of the trade deficit. The main reasons for the trade deficit are: (1) the high level of demand for cars and other consumer goods in Slovakia; (2) the failure of exports to keep pace with imports; (3) the high import content in Slovak exports and (4) the low value added content of exports.

According to research undertaken by the Slovak Chamber of Business and Commerce, imports account for 70 % of Slovak exports while domestic raw materials account for only 30 %. Metallurgical and chemical products feature strongly among Slovak exports, but these are extremely price sensitive. According to OECD, approximately half of Slovakia's exports could be classified as price sensitive products.

The relative concentration of Slovakia's industrial structure is reflected in the pattern of its exports. Total Slovak exports for 1996 amounted to SKK 270 billion, (USD 9 billion) an increase of 6 % on the previous year. Only five companies accounted for 28 % of all exports. A further 22 % of exports were achieved by 34 other companies. *Thirty nine companies were responsible for half of all exports.*

The top five exporters were :

- VSŽ Košice, steel;
- Slovnaft, oil refining;
- Matador Púchov, tyres;
- Duslo Šaľa, chemicals;
- Volkswagen, automobile products.

Volkswagen is one of the most significant foreign investors in Slovakia but the other four of the five leading exporters illustrate the dependence of Slovakia on heavy industry.

Slovakia is therefore in a very vulnerable trading situation and needs to increase its exports and range of producers. However, new initiatives are being taken in this regard.

New measures to boost exports

The establishment of **Foreign Trade Promotion Fund** from January 1st 1997, the adoption of the **Slovak Export Development Programme** in March 1997 and establishment of **EXPORT-IMPORT (EXIM) Bank** which has the role of providing medium and long term export loans (approved by parliament in February and expected to start operation by the end of 1997) should considerably enhance the institutional environment for increased exports by enterprises and provide appropriate incentives and services to promote exports.

The Export Development Programme is the direct responsibility of the Ministry of Economy and is financed mainly from Phare funds and later, on several of its components will be co-financed by contribution from the Trade Promotion Fund. The main target group are firms with export capacity and potential, especially those in private sector.

The components of this programme are:

export information, export marketing, product development, enterprise and sectoral development, training development of support institutions and services and enhancement of export environment.

The work programme and operational strategy for the Trade Promotion Fund is under preparation and its main goals will be:

- enhancing effective trade representation in major markets,
- contributions to promotional activities abroad including possible sharing of costs for participation of Slovak producers at fairs and exhibitions,
- contributions to studies related to increasing export performance of Slovak producers,
- loans for payments of customs and related expenses connected with the imports of advanced technologies,
- cost sharing related to transferring know-how for domestic exporters, importers and trade representatives.

The Trade Promotion Fund provides substantial scope both for enhancing the activities of the Export Development Programme and for the long term sustainability of its activities. While emphasising that its functions and role are not yet completely defined, it is expected that the Fund will work closely with the Programme in the implementation of certain activities. (There have been successful examples in other programmes financed by Phare where similar Funds supported specific activities which were initiated by the programme, e.g. generic promotion of Slovak wine in the UK market.)

There is also the SPE-Export credit insurance company.

Under the Export Development Programme up to 600 SME enterprises have been identified which are viewed as capable of exporting.

Although this programme must be warmly endorsed, there are genuine fears among SMEs that the resources of the Foreign Trade Promotion Fund and of EXIM Bank will be allocated mainly to large enterprises.

Apart from the issue of how SMEs feel about the possible allocation of these resources, the reality of Slovakia's critical need for a diversified export base require substantial support for SMEs both from the Foreign Trade Promotion Fund and EXIM Bank.

RECOMMENDATIONS

It is recommended that Foreign Trade Promotion Fund and EXIM Bank resources be allocated as a priority to exporting SMEs and that their annual reports highlight support given to SMEs.

A FOCUS ON SMEs WITH GROWTH POTENTIAL

Many of Slovakia's small enterprises are likely to develop slowly due to a lack of capital and management expertise. The SMEs capable of becoming internationally competitive are likely to be found among the 600 or so enterprises already identified as having export potential.

The needs of these enterprises will emerge as:

- the development of 'soft' assets in the main areas of management;
- access to capital for expansion;
- enhanced capability for product and process development.

Enterprises with potential to become internationally competitive should be identified as candidates for a company development programme through which the facilities of the various SME support programmes would be channelled in a unified and co-ordinated way to maximise the development prospects of each participating enterprise.

The elements of the programme would be:

- business plan, to be prepared by the enterprise with consultancy assistance;
- a diagnoses of company needs in terms of management, marketing, product and process development and quality assurance, and an assessment of financial needs (this diagnoses could be provided under the aegis of the Agency for Industrial Development and Revitalisation);
- recruitment of management personnel with financial support from National Labour Office;
- soft loan finance from banks with the support of SGB guarantees;
- support for export promotion from EXIM Bank and Foreign Trade Promotion Fund.

The total focus of the company development programme would be on the needs and potential of the enterprise. The programme should be co-ordinated by NADSME.

RECOMMENDATIONS

The identification of those medium sized companies with the greatest potential to become internationally competitive and a co-ordinated support programme to help achieve their expansion plans.

TOURISM AND SMEs

tourism in Slovakia

Slovakia's scenery, facilities for outdoor activities, cultural and architectural heritage and its geographical location in Central Europe make it an attractive tourism destination. In fact, tourism has increased rapidly since 1989. The number of border crossings by foreign tourists entering Slovakia doubled between 1993 and 1995. There has also been an expansion of outward tourism as more Slovak citizens travel abroad. However, the balance in favour of Slovakia is positive and net tourism receipts contributed USD 300 million to the country's current account for 1995, but fell to USD 250 million for 1996.

Although tourism represents 3,5 % of Slovakia's GDP, comparisons with Austria and other neighbouring countries suggest that there is still considerable scope for further development.

A country's tourism 'product' comprises all or some of the following elements: accessibility (easy and affordable to reach), natural amenities (mountains, rivers, lakes, forests, beaches, coastline etc.), outdoor facilities (winter sports, swimming, mountain walks, fishing etc.), heritage (historical sites and town centres, museums and galleries), a friendly environment in which tourists are genuinely welcome as visitors and not regarded simply as a source of revenue and, finally but most important, quality and value of services (hotels and other forms of accommodation, restaurants and other catering outlets, shopping, entertainment, transport and tourism information).

Slovakia has most of the ingredients necessary for the successful development of its tourism industry as a major foreign exchange earner. It is easy to reach, most prices are low compared with Western Europe, the natural amenities and cultural heritage are considerable and people are helpful and friendly. The problems are that the promotion abroad of Slovakia as a tourism destination is limited and there is still a considerable way to go in upgrading facilities and improving the range and quality of services available to visitors.

The responsibility for the provision of services and facilities for tourists is very much a matter for SMEs, for example in accommodation and catering. Although improving, the availability of accommodation and other services for tourists in many parts of Slovakia is still basic and inadequate. In relation to tourist accommodation, the issue is not one of capacity. In fact, official figures show occupancy rates for hotels and other facilities at under 30 %. The problem is that much of the accommodation available is not of an acceptable standard when compared with competing tourism destinations. There are also excellent and well run restaurants in Slovakia, but not enough. Classification of services for tourists is still in its infancy.

tourism policy development

There has always been investment in tourism facilities in Slovakia. Until 1989, the responsibility for developing the tourism infrastructure and services was limited under the centrally planned economy to state and co-operative enterprises and institutions. Since 1989, tourism policy has been developed within the framework of the market economy. In 1991, a new tourism development programme was introduced by the Ministry of Economy in co-operation with the Slovak Guarantee Bank. The aim of the Support Programme for Development of Tourism is the

promotion of quality and the upgrading of the tourism infrastructure and services. This programme has been amended twice since its introduction.

Under the programme, selected projects that contribute to higher quality and improvements in services to tourism are supported through non-repayable grants covering up to 70 % of the basic interest accrued (maximum \$100 000 for one project). Fifty five projects were supported through this programme.

In 1995, the Slovak Agency for Tourism was established to co-operate with regional associations and entrepreneurs, to participate in tourism fairs and advise foreigners about investment possibilities in Slovak tourism.

The development of tourism in Slovakia requires intensified promotion abroad, and more investment in facilities and improved professionalism at home.

Proximity and a fairly good knowledge of the German language in Slovakia indicate Germany, Austria, a combined market of 90 million people with a high per capital GDP, as a priority region for promoting tourism to Slovakia.

While investment to date in Slovakia's infrastructure is acknowledged, more is needed. The facilities of the Slovak Guarantee Bank, both in interest subsidies and loan guarantees need to be intensified.

A higher standard of professionalism is required from small and medium sized accommodation and catering businesses, which are often the main point of contact for visitors in all tourism destinations. In the main tourism regions BIC and RAICs should take the initiative in consulting with tourism related businesses and organising appropriate training courses.

RECOMMENDATIONS

- An intensified promotion campaign in the German speaking market
- an extension of SGB schemes for investment in tourism facilities;
- BICs and RAICs in regions with tourism potential to organise training programmes for tourism related businesses, mainly in accommodation and catering.

17. THE POLICY MAKING STRUCTURE AND INSTITUTIONAL SUPPORT

THE INSTITUTIONS

There are three main elements in the policy making and broad institutional support structure for SMEs in Slovakia:

- (1) The Ministry of Economy which has overall responsibility for SME policy;
- (2) The National Agency for Development of Small and Medium Enterprises as the main institution for executing SME policy and the provision of policy advice;
- (3) The BICs and RAICs with responsibility for implementing SME support at regional level.

Ministry of Economy

The Ministry of Economy is one of the largest ministries within the Slovak administration. Prior to 1989, this ministry operated more than 600 state enterprises. Economic transformation, privatisation and restructuring has reduced this number by at least two thirds. The goal of government economic policy is to turn over the remainder of enterprises to the private sector with the exception of certain strategic industries, in which the state intends to maintain a

'golden share', such as energy and gas transit. This development is also changing the role and functions of the ministry, from direct control over enterprises to the creation of an economic environment, legislative instruments and strategic development of the economy.

The Ministry is divided into a number of departments:

- Economic Strategy and Policy;
- Fundamental Sectors (energy and extractive industries);
- Machinery and Electrical Engineering and Chemical and Consumer Industries;
- Tourism;
- Trade Policy.

Responsibility for the SME sector rests with the Department of Economic Strategy and Policy. However, this department has many other responsibilities as well including: the development of economic policy; the quantification and projection of regional, ecological and social aspects of economic development and processing them into proposals for structural changes; regional policy and analysis; science and technology in the industrial sectors of the economy and international co-operation in this field; the functioning of state management in the areas of technical testing and measuring of standards and co-ordination of all activity in the area of industrial and legal protection.

The Department of Economic Strategy and Policy was responsible for the preparation of the recently adopted Medium Term Policy on SME which was undertaken with technical assistance sponsored by the British Know How Fund. The policy role and function should be further strengthened through the implementation of the recommendations of this project.

There are two issues which arise in relation to the Ministry of Economy:

(1) The priority of the SME sector within the Ministry:

The Ministry of Economy is the logical centre for the development of SME policy and there is also the commitment to the establishment of the Slovak Government Council for SME which should result in an enhanced status for the SME sector in the policy development and implementation process.

However, it is reasonable to ask whether SME issues could ever get the attention that they merit, given their critical importance to the overall economy, if responsibility for the sector is only one of many functions in one department of a very large ministry. This concern is particularly valid, having regard to the responsibility of the Ministry for most of Slovakia's large scale industry, as well.

The Ministry's responsibility for larger industry is very much reflected in its organisational structure. The imbalance in the structure of the Ministry is probably one of the reasons that smaller enterprises feel a lack of official concern for their interests.

It seems that there is a strong case for a separate Department of Small and Medium Enterprises within the Ministry, or at the very least a restructuring to combine responsibility for SMEs with that for tourism, a sector dominated by SMEs. Such a restructuring would be in line with what has already happened in several Western European countries, where the SME policy function within appropriate ministries has been significantly upgraded.

(2) The capability for independent SME policy formulation:

The Ministry of Economy (and NADSME) have received considerable technical assistance in relation to SME policy advice. However, the stage has not yet been reached in which the Ministry has the independent capability to develop SME policy without external assistance. Policy

development is a continuing process and a key responsibility for all ministries. There will always be specialist topics on which advice from outside is needed but there is a fundamental requirement for a ministry to have substantial internal capabilities for policy development in its own areas of responsibility. Governments rely ultimately on their ministries for high quality and impartial advice, a skilled analysis of the issues involved in considering a new policy initiative and the implications arising from implementation.

The proposed restructuring within the Ministry of Economy to give the SME sector a higher priority and more effective voice would be of limited benefit unless accompanied by the development of a genuine independent SME policy making capability

RECOMMENDATIONS

It is recommended that:

- (1) the Ministry of Economy be restructured in response to the need for a higher priority for the SME sector through the establishment of a separate Department of Small and Medium Enterprises or the transfer of SME responsibilities to a reconstituted Department of SME and Tourism.
- (2) the policy making skills for the SME sector within the Ministry be upgraded with the objective of achieving independent policy development capability.

National Agency for Development of Small and Medium Enterprises

NADSME was founded by the common initiative of the Slovak Government and the EU Phare programme. It was established an independent foundation but has now been converted into a non-profit making company in order to comply with recent changes in Slovak law in relation to foundations. The role of NADSME is the support and development of small and medium enterprises. The Agency is managed by a Board of Directors and is mandated to co-ordinate all activities in support of SMEs in the Slovak Republic at international, national, regional and local level. The responsibilities and activities of NADSME are described in detail at the beginning of this report (Section 2).

The main responsibilities are: monitoring of the SME sector; advice to government in relation to SME policy and strategy; analysing barriers to SME development and suggesting ways for their removal; to co-operate with credit institutions in relation to SME credit and loan guarantee schemes; to support RAICs and BICs; to co-operate with European business information and data networks; to promote enterprise awareness among the public and to manage European Commission aid for SMEs in Slovakia. The Agency also has a number of specialist activities: Euro- Info Correspondence Centre (EICC), Subcontracting Exchange of Slovakia and the Seed Capital Company.

The operations of the Agency depend to a considerable extent on Phare support which will continue for some time. However, it is appropriate to consider the role and funding of the Agency over the longer term. Many countries have agencies such as NADSME to undertake executive functions and offer services to the SME sector, which are inappropriate to ministries. The financing of these agencies is often a combination of state support and income generated from services for which fees are charged.

In the case of NADSME, it seems as if the longer term arrangement should take the form of a contract with the state (Ministry of Economy) in return for agreed services, which would include:

- monitoring of the SME sector and the provision of research services (for which recommendations have been made in Part B of this report.);

- provision of policy advice based on monitoring and research;
- acting as advocate for SME interests;
- co-ordinating state support programmes for the SME sector;
- providing information and back up to regional SME support networks;
- promoting awareness of enterprise among the public;
- maintaining and developing links with SME support institutions abroad.

In addition to services to be provided under contract to the state, NADSME should be free to develop commercial services which would benefit SMEs, particularly in the information field and internationally. Although not operated on a full commercial basis existing services such as EICC and the Subcontracting Exchange of Slovakia provide an illustration as to how such activities could be developed.

RECOMMENDATION

It is recommended that NADSME prepare a strategic long term plan based on the dual principle of the provision of agreed services to government in return for an annual subvention and the provision of commercial services to the SME sector and submit that plan to the Ministry of Economy as a basis for discussion.

RAICS and BICs

The activities of the Regional Advisory Information Centres(RAICs) and Business Innovation Centres (BICs) have been described in Section 2 of this report. They constitute the regional SME support network through the provision of advisory, information and training services.

RAICs and BICs are non-profit making companies established with Phare support. The founding partners or shareholders in these centres are typically local municipalities, large scale enterprises, banks and educational institutions. The main sources of funding are Phare (approximately 40 % of the total) through NADSME and income received from services provided, for example, training and information. One source of income from training services is the National Labour Office which assists unemployed people interested in starting their own businesses in attending RAIC/BIC courses. There are courses on a comprehensive range of business topics. There is also assistance with the preparation of business plans. The information services include Kompass Directories and the Brussels based BRE and BC net systems. The RAICs and BICs also promote the NADSME administered loan schemes for SMEs in their own regions.

Essentially, RAICs and BICs are the regional catalysts for SME development in their own regions. Although experience varies by region, it seems as some fairly common problems are as follows:

- a lack of follow through support from founding shareholders;
- a weak impact by some RAICs/BICs on local banks which often seem unaware of SMEs;
- a low level of contact with local large scale enterprises and a lack of emphasis on developing links between SMEs and bigger companies;
- a limited priority in developing relationships with the education sector;
- a general lack of media promotion.

It is also clear that RAICs and BICs are very committed to SME development in their regions and that the problems highlighted above may stem largely from inadequate resources and an excessive dependence on Phare subventions and income from services.

The longer term role of RAICs and BICs needs to be reassessed and a fresh view taken of their role and funding. It would also be useful to evaluate the quality and relevance of the training courses provided, to see where there is scope for improvement.

Slovakia's regions need the RAIC/BIC advisory services for SMEs as it will be some time before the full network of service providers - accountants, commercial lawyers and business consultants - typical of market economies - is in place. As of now and for the foreseeable future, the RAICs and BICs are the only bodies capable of effectively filling this role.

RECOMMENDATIONS

It is recommended that the Ministry of Economy request NADSME to initiate a review of the RAIC/BIC network to include an examination and evaluation of the following:

- the appropriateness and quality of services provided;
- the usefulness of these services in meeting the needs (1) of new enterprises and (2) existing SMEs;
- gaps in services;
- links with other regional and local institutions which could contribute to SME development;
- shareholder support;
- funding and the case for direct subventions for services to new entrepreneurs;
- sources of sustained local financial support and commercial services;
- securing more local recognition and support.

ANNEX

TECHNICAL CO-OPERATION WITHIN THE PROJECT

1. Technical co-operation staff

National Project Personnel

Igor Bláha NADSME	national co-ordinator
Zuzana Vatráľová	UNIDO administration manager
Pavol Baláž Statistical Office of the Slovak Republic	statistical analysis (national accounts) adviser
Mária Schwartzová Statistical Office of the Slovak Republic	statistical analysis adviser
Michal Solotruk Statistical Office of the Slovak Republic	statistical analysis (data gathering methodology) adviser
Agneša Szucsová DataCentrum	adviser
Radoslav Ćupík	SME research (data monitoring) adviser
Miroslav Knitl Entrepreneurs Association of Slovakia	adviser on administrative and regulatory environment for SMEs
Ludovít Paus Entrepreneurs Association of Slovakia	commercial law adviser
Borislav Petřík Economic Institute of Slovak Academy of Science	adviser on business and economic research
Peter Lukáč Ministry of Economy Slovak Republic	adviser on export services to SMEs
Vladimír Obdržálek Ministry of Economy Slovak Republic	adviser on tourism related SMEs

International co-operation staff

Zeynep Taluy Small and Medium Industries Branch UNIDO	UNIDO backstopping officer
Shane McAuley	senior UNIDO adviser
Michael Irvine Matheson Ormsby and Prentice, Ireland	commercial law adviser

Christian F. Lettmayr
Institut für Gewerbe und
Handwerksforschung, Austria

SME policy development adviser

Rob van der Horst
EIM Small Business Research and
Consultancy, Netherlands

SME monitoring and analysis adviser

2. Training

1. Study tours to Ireland, Netherlands, Germany and Austria which examined SME policy development and monitoring systems in these countries.
2. A two day workshop on SME Policy and Monitoring which reviewed the project findings and debated major SME issues including law and regulation, lobbying and institutional relationships.

3. Reports prepared by experts

Methodological notes on the construction of regional gross domestic products (Baláž)

Questionnaire on earnings and financial indicators of entrepreneurs non-incorporated in business registers - physical persons (Baláž)

Sampling survey of labour force (Baláž)

Statistical survey of labour force (Baláž)

Branch results of small and medium sized enterprises (Schwartzová)

Draft of methodology for conversion of value added in small and medium sized enterprises - including, physical persons (Schwartzová)

Macroeconomic development in the Slovak Republic in 1993-1996 and forecast of development in selected, indicators for 1997 (Schwartzová)

Overview of data on small and medium sized enterprises collected and evaluated by the Statistical Office of the Slovak Republic from sampling surveys (Schwartzová)

Business (statistical) register (Solotruk)

Introduction to DataCentrum (Szücsová)

The analysis of annual account report data processing for legal entities and sole proprietors for 1995 and provisional proposals (Szücsová)

Information on gathering and processing of closing accounts in EU (Szücsová)

Monitoring and analysis of SMEs in the Slovak Republic (van der Horst)

Legal environment for SMEs in Slovakia (Irvine)

Legislative background to business (Kniťl)

Legislative process in the Slovak Republic (Paus)

Position and significance of Union of Entrepreneurs in the legislative process (Paus)

Incentives for SMEs (Lettmayr)

Research into SME attitudes (Economic Institute of Slovak Academy of Science)

Institutional arrangements for SME exports in Slovakia (Lukáč)

Tourism policy in Slovakia (Obdržálek)