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Enhancing SME Performance

Quarterly Report, June 2005

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ABBREVIATIONS

ACE	Agribusiness Competitiveness Enhancement (Project)
AMC	Association of Management Consultants
B&B	Bed and Breakfast
CIPO	Croatian Investment Promotion Outreach (Alliance)
CSERP	Croatian Social and Economic Recovery Project
EBRD	European Bank for Reconstruction and Development
ESP	Enhancing SME Performance
EU	European Union
FDI	Foreign Direct Investment
FINA	Finance Agency
GTZ	German Development Agency
HAMAG	Croatian SME Promotion Agency
HBOR	Croatian Bank for Reconstruction and Development
HPB	Hrvatska postanska banka
IDA	Istrian Development Agency
IT	Information Technology
LAN	Local Area Network
LEDA	Local Economic Development Agency
M&E	Monitoring and Evaluation
MIGA	Multilateral International Guarantee Agency
MoE	Ministry of Economy
NASfH	National Association of Small and Family-run Hotels
PBZ	Privredna Banka Zagreb
PRIMA	Entrepreneurship Center, Split
ROP	Regional Operating Programme
SME	Small and Medium Enterprise
TAPA	Technical Assistance Partnership Agreement

UNDP
USAID

United Nations Development Program
U.S. Agency for International Development

EXECUTIVE SUMMARY

This report covers the third quarter of Enhancing Small and Medium Enterprise Performance (ESP) in Croatia—a private sector development project designed to generate 20,000 jobs and assist 4,000 enterprises around the country.

This quarter, ESP built momentum in its ongoing activities with the display of tangible results that exceeded performance goals for the quarter and (outside of preliminary estimates of job growth) already come close to goals for the first year of the project.

Notably, the quarter also marked the inception of important pilot efforts such as (1) the development of a mezzanine financing product; (2) FDI benchmarking to gauge performance within Croatia and the neighboring EU; (3) an awareness program of the benefits of registering informal accommodations for tourists.

And perhaps most importantly, the quarter illustrated the possibility for sustained service delivery in the area of training and business education, as ESP co-branded select courses, and allowed business service providers to offer such courses at commercial, market rates.

Against this backdrop of activities, the project staff continued to grow their skills and broaden the scope of their work. Considerable effort was paid to direct SME consulting, as well as nurturing relations with ESP partners in order to expand the universe of SMEs indirectly assisted. The project is well poised for further expansion in personnel and its activities portfolio.

PROJECT PURPOSE AND APPROACH

Enhancing Small and Medium Enterprise Performance (ESP)—also called *Poduzetna Hrvatska*—is a private sector development project funded by the United States Agency for International Development (USAID) and implemented by the DAI/Nathan Group, a joint venture.

ESP's primary objective is job creation among 4,000 small and medium enterprises (SMEs). In three-and-half years, the project must generate at least 20,000 jobs through increases in business sales and exports, as well as various forms of financing including loans, leases, equity participation and foreign investment. Owing to the magnitude of the task, ESP operates largely through a network of organizational partners and service providers. Approximately ten percent of the time, ESP works directly with the SMEs themselves. In all instances, ESP eschews direct financial support to organizations and enterprises, concentrating instead on the brokering of information, methodologies and technologies that enhance SME performance. ESP's main project office is located in Zagreb; three regional offices in Osijek, Split and Pula assure nation-wide coverage of SMEs, including in areas of special state concern.

ESP's staff, products and services are grouped into four thematic areas: marketing, business development, SME access to finance, and investment facilitation. ESP's standard tools consist of training, targeted mentoring, publications and referral systems. On occasion, ESP makes use of special events—such as trade fairs—that build off the standard tools of the project.

- The marketing team focuses on improving new market access of Croatian products through assistance with market research, branding, product development and export readiness. The team works largely with individual SMES and groups of SMEs with common problems.
- The business services team focuses on deepening the Croatian market for business and consulting services. The team concentrates on improving the quality and quantity of SME service provision through apex or national organizations, through regional and local partners, and through private suppliers. The business development team also works with individual and clusters to improve business operations through the introduction of new business models and practices.
- The financial services team seeks to improve SME access to finance in Croatia. The team works with financial institutions, business service providers and on occasion SMEs to re-design existing financial products, develop new ones and develop appropriate business plans. The team also helps financial institutions to upgrade their capacity to handle SME financing through advice on credit analysis based on cash flow, credit scoring, streamlined credit approval processes, and the means for identifying good loan clients and diversifying sources of support for loans. The team has established strong working relationships with different financial institutions willing to receive and act on SME referrals from project staff.
- Investment facilitation team concentrates on regional economic development and growth largely through investment attraction and facilitation. Main project partners consist of local and regional economic development agencies, business and industrial parks, technology parks. The team works closely with the Croatian Investment Promotion Alliance (CIPO), the Croatian IPA and the European Investor Outreach program (EIOP) in Vienna to enhance inward investment from the Western European business community.

CROSS-CUTTING RESULTS

Though structured along thematic lines, with four directors managing discrete portfolios, ESP is a matrix project whose results cut across all substantive areas. Consequentially, much of ESP's work

and all of its results entail cross-fertilization, synergies and collaborative teamwork. Table 1 highlights the key results for the quarter.

Table 1. SUMMARY TABLE OF ESP RESULTS

No.	Indicator	Target LOP	Target 2005	Actual Results
1	Number of SMEs assisted	4,000	600	558 as of June 30
2	Number of jobs created among assisted SMEs	20,000	2,000	928 among direct assists, as of June 30
3	Increase in total revenue of assisted SMEs	\$150 M	\$25 M	\$19.7 M among direct assists, as of June 30
4	Increase in export revenue of assisted SMEs	\$20 M	\$3.3 M	\$3.8 M among direct assists, as of June 30
5	Value of foreign direct investment (FDI)	\$80 M	\$ 6 M	\$51.6 M
6	Number of SMEs using new bank financing	2,200	200	310
7	Number of SMEs using new non-bank financing	65	5	19
8	Number of people trained in enterprise growth areas	800	200	536 (47% female)

Reporting on SME revenues—whether from overall sales or from exports—is tricky owing to the lags in the availability of financial data from SMEs. Most SMEs produce financial statements (even internal ones for company review) biannually, very close to the Government’s deadline for submission (specifically April for the 12-month period ending in December of the previous year, and in July for the 6-month period ending in June of the same year). A further lag of three to five weeks occurs as the Government verifies and consolidates the information for official use. This means that ESP can typically report on revenue growth (by all assisted SMES) in June and in September.

This year, being the first year of project operations¹, is a bit different than subsequent ones, as initial baseline data becomes available for all SMEs in May. While ESP staff can project revenue growth quarterly, owing to their work with directly assisted SMEs, no reliable point of comparison exists for indirectly assisted SMEs until early August (or three quarters into the calendar year). Table 1 reflects the lacuna in information for this quarter by reporting on only the growth in revenues of SMEs directly assisted by the project. (Later reports will be able to capture performance in the broader universe of SMEs supported by the project.)

¹ ESP commenced operations in September 2004.

Despite this shortcoming, ESP is able to track the performance of SMEs in a variety of ways, without ignoring SMEs assisted indirectly.

Indirect assists grow from targeted interventions by ESP staff with Croatian partners, whether commercial, non-profit or governmental. ESP's engagement occurs upfront as the project staff works with partners on the development, refinement, segmentation or broader reach of products or services. Generally, ESP's engagement is short and focused, simulating in many ways the dynamics of the private sector. On occasion, however, sustained ESP involvement is required to cement an arrangement (as was the case with the improved point of sale facility provided by PBZ and NAFSH). Once the product/service is ready, the partner provides it to SMEs without direct involvement of ESP. During the quarter ending in June, indirect assists numbered 164 and culminated in a range of results, as follows.

- ESP's referrals to business service providers resulted in four factorings by Adriatic Zagreb.
- ESP's assistance this winter resulted in a sustainable program of converting SME depositors into first-time borrowers at PBZ. This quarter, an additional 72 SMEs borrowed \$1.4 million in working capital from PBZ. (As a group, these SMEs employ 677 people and generated \$38.6 million in sales and \$3.7 million in exports during 2004.) ESP will track their continued use of loans, noting their graduation to long-term loans for business expansion.
- ESP's assistance to HAMAG's in upgrading its loan guarantee systems increased the pace of guarantees granted—from 6 last quarter to 15 this one. As such, ESP is helping HAMAG streamline its operations in a fashion similar to the SBA's preferred lenders program, in order to allow attainment of some 50 to 100 new guarantees during the year.
- ESP's persistence and focused negotiations during the past two quarters resulted in two clear benefits for the members of the Association of Small and Family-run Hotels NAFSH: first, these hotels obtained a bulk discount for credit card use from PBZ (at the same rate extended to large hotels); second, they became systematically linked with local producers of specialty food for their restaurants and specialty shops, further enhancing their niche marketing prospects with tourists from other countries.

Direct assists tend to be broader interventions for ESP than indirect ones. Generally, they cut across several ESP technical practices/components over longer periods. Consequentially, ESP's portfolio of direct assists is in an expansion mode (with the count of 57 SMEs reflecting a running total since project start-up). The starting point in ESP's direct assistance is often the provision of working capital through a referral to a factoring company, followed by a mix of services in long-term financing, marketing and operations. Success stories include the following:

- Sigma, a metal company in Pula employing 95 workers, produces two product lines: bicycle frames and metal frames for chairs. After beginning to export bicycle frames to the EU in 2000, Sigma quickly rose to become the third largest supplier of frames to the EU. Organizational structure did not follow the rapid growth of recent years and Sigma is also feeling the pressure of inexpensive Chinese competitors from both product lines. After attending ESP's training course in Operations Management, Sigma committed to enrolling in Deloitte's Twenty Keys program. The program will address Sigma's organizational needs and boost its competitiveness by adding more flexibility in the manufacturing process in order to have more responsive, short production runs. Results of the intervention will be not only to avoid the elimination of numerous jobs but to actually increase employment by 20 workers.
- GumiImpex is a rubber molding company that also retreads tires and represents several major tire manufacturers. Founded in 1970 in Varazdin, GumiImpex employs 140 workers and is building a

daughter company for rubber recycling that will provide 130 new jobs by the end of 2005. The company is geared for change and recognizes the need to add a middle management to the company's organizational structure in order to increase efficiency. To this end, ESP kicked off its subsidized consulting program in cooperation with the Association of Management Consultants and matched a consultant to assist GumiImpex with creating the proper structure for middle management. Although the engagement went beyond the 20 days that ESP agrees to co-finance, the assistance proved so valuable to GumiImpex that the company continued to pay 100% of the consultant's fee beyond the twenty days (an additional twenty days). At the end of the contract, GumiImpex was so satisfied with the consultant that it decided to offer her a second contract in the fall to be paid 100 percent by the company.

Lastly, 184 SMEs participated in ESP's spring-summer training program, which covered 15 topics, 60 percent of which was co-branded with ESP partners:

- Three courses fully developed by ESP and taught by practitioners (on strategic planning, operations management, and packaging & labeling);
- Five courses developed and offered directly by ESP staff (on FDI facilitation, investor services, interviewing loan applicants, accessing financing, and establishing profit centers);
- Four courses developed in collaboration with partners such as MicroGrupa (on market segmentation, market positioning, cost accounting, and employee incentive systems);
- Two courses offered by partners with ESP support (on exchange risk management, the basics of entrepreneurship); and
- The piloting of one course on EU-accession grants/funds. This course awaits final decisions of the Government regarding the process by which grant funds will be made available in Croatia. These decisions are expected this fall, giving applicants a fairly narrow window in 2005 for submitting applications.

All these courses provide concrete, practical advice to SMEs that points them to appropriate, reasonable measures for capturing near-term business growth. As such, the courses proved to be popular among participants. More than 20 percent attended more than one course. After attending the course on operations management, one company (SIGMA, profiled above) stated that its operations would be currently optimal had it learned the importance of balanced, controlled growth three years ago.

The co-branded courses, furthermore, are an important step towards sustainable business education, embedded in value chains. The training series co-branded with MicroGroupa, for instance, was offered to the public on a full commercial basis (with costs recuperated through attendance fees and profits realized). MicroGroupa will continue offering the courses at differentiated, market-driven rates (marketing courses, 700 Kn + VAT; financial courses, 900 Kn + VAT), and plans to broaden the range of courses based on ESP recommendations and inputs in future years.

SIGNIFICANT EVENTS

As the second quarter of the project, this period concentrated on (1) continued consolidation of ESP's network of partners; and (2) the detailing and launching of interventions.

Outreach to organizations with a mandate similar to that of ESP remained a priority this quarter, with five Technical Partnership Agreements (TAPAs) signed with the following entities:

- ***HBOR, the Croatian Bank for Reconstruction and Development.*** Founded in 1992 with the objective of financing the reconstruction and development of the Croatian economy, HBOR provides funding for commercial bank loans and makes direct loans to SMEs on concessionary terms (lower interest rates, longer repayment terms and longer grace periods). HBOR has a

number of special loan programs aimed at various categories of SMEs (such as those in areas of special state concern, that hire ex-soldiers, those owned by female entrepreneurs, and the like). As the development bank in the country, HBOR has both the mandate and flexibility to pilot innovative SME financing programs. ESP will work with HBOR on credit scoring for start-up companies (which commercial banks will not consider for loans), redesign of credit processes, ESP referrals, and the design of new financial products such as mezzanine financing or hybrid/subordinated debt.

- **Regional Development of Agency of Porin**, one of the first highly active regional agencies in the country, and a keystone organization in the coastal area between Istria and Dalmatia. ESP will help the Agency to enhance its service potential through expanded market reach and through targeted training for SMEs poised for graduation or recently graduated from incubators.
- **LEDA-Sisak**, a local development agency located in an area of Croatia hard hit by the war, and currently suffering from reliance on old technologies, poor understanding of market demand, and an aging workforce. Initially, ESP will help the country to market four of its industrial and entrepreneurial zones (each contained in the county's ROP): Komunalna zona and Obrtnicka zona in Sisak; Gospodarska Proizvodna zona in Popovaca; and Poslovana zona in Kutina. In addition, ESP will assist public-private sector groups prepare for EU grants available through the ROP framework.
- **Hrvatska postanska banka (HPB)**, the last state-owned bank in the country with approximately \$1 billion in total assets, two branches, and the possibility of opening additional branches in post office outlets. HPB historically served individuals and large enterprises (both state-owned and private). It just established a SME department, based the strategic decision to target SMEs. ESP will provide HPB loan officers with a range of training as well as exposure to credit scoring for start-ups (for credit rating), facility scoring (for deciding on loan applications), and client mining (for generating micro loans).
- **Horizonte Venture Management**, a venture capital firm with a number of funds covering Austria (as of 1985), Slovenia (1991), BiH (1997) and the counties of the former Yugoslav Republic (2003). Horizonte anticipates that most of this last fund will be invested in Croatian companies. Horizonte looks to make investments in the range of €1 to 2 million, although it will invest as little as €500 thousand, as long as the projected ROE and IRR is at least 25 percent. Originally, Horizonte sought high tech companies in Croatia, but it now also seeks companies in less "sexy" industries, such as food processing, construction and car parts. ESP has already referred Jet Control, a producer of electronic devices for remote control of jet skis. Outside of referring SMEs for possible equity financing, ESP will supply assistance with new product development.

Within ESP's four thematic components, outreach and technical interventions also occurred, which either generated key results or laid the foundation for notable developments later in the year. Key milestones are follow, by component.

MARKETING

Important developments include the following:

- Buyer agent visits conducted for 19 ESP and ACE specialty food producers in three regions to enhance export readiness and export sales potential
- Total of 66 SMEs qualified and signed up for ANUGA (including 31 signed up this quarter), from a short list of 89 SMEs

- Association of Specialty Food Producers established, to service the buyer/trade needs of SME participants at ANUGA.
- Roadmap developed for HUP's National Center for Clusters, to broaden SME growth in select subsectors (small boat furnishings, protective clothing, office equipment and agricultural equipment)
- Membership services upgraded for the Exporters Association, through survey of members' needs, circulation of trade opportunities (buyers' requests), and customized research off the Global Trade Database.
- Company-level cooperation commenced with the Italian Institute for Foreign Trade, covering 8 SME growth opportunities in the wood, footwear, food, and tourism sectors

BUSINESS DEVELOPMENT

Key results include the following:

- 47 SME assessments conducted by ESP staff; 30 percent of the assessments used ESP's upgraded rapid company assessment process to diagnose issues tied to capital structure, product lines, production capacity and needs in marketing, financing and business services
- Spring-summer training completed, with 184 SMEs trained in 15 business topics in 34 courses by ESP staff and partners; 60 percent of the topics offered under an ESP-partner co-branding
- Survey conducted of 150 informal accommodations along the Croatian coast; ascertained a 40 percent level of interest in the conversion to formal B&Bs or pensions and ancillary registration of 300 jobs in the tourism sector
- Operational policies, procedures and working documents completed, for HAMAG's voucher program supportive of SME consulting services; initial vouchers to be launched in October
- Operating pipeline of cost-shared consulting assignments established, under the management of the AMC, with one recent graduate (GumImpex), three approved consultancies (ARGUS, Obrt Za Proizvodnju, Metalnih Konstrukcija), and three prospects

FINANCIAL SERVICES

Key accomplishments include the following:

- County-driven regional guarantee funds established to broaden support of regional development
- New hybrid financing product developed, for HBOR to facilitate SME expansion and greenfield investments
- Credit scoring and deposit mining criteria refined, at financial institutions (VABA, HBOR, HPB) to further expand SME financial services
- Credit and sales training materials prepared, for training relationship managers at financial institutions (HPB)

INVESTMENT AND REGIONAL DEVELOPMENT

Highlights include the following:

- \$16 million in FDI secured, through a joint venture between Snaidero (one of the top five kitchen manufacturers in Europe) and Trokut (a Croatian wood processing concern); investment focused on the reconstruction of the existing sawmill in Lipovljani, expansion of the mill's drying capacities, and construction of a new factory for the production of high-quality doors; production is expected to start in the second quarter of 2006, generating an additional 120 jobs
- Investment facilitation pipeline sustained, through assistance to 9 foreign investors that collectively represent an estimated \$34 million in investment and 400 to 600 in new jobs; 70 to 80 percent of all new investment is to be export-oriented
- MIGA-CIPO network directly supported, with interactive investor services to two Austrian concerns (Soriz and Oberndorfer); these companies seek to invest around \$14 million and generate approximately 100 jobs in high-value horticulture and production of concrete construction materials
- FDI benchmarking exercise launched, to rate FDI facilitation capacity across Croatia and against EU standards, and to strategically enhance investor services and increase Greenfield investments in the country
- Keystone conferences held, to orient and enhance the capacity of the Croatian FDI-facilitation community, in Bjelovar for 130 participants; in Sibenik for 4th SME conference for 60 participants; and in Donji Miholjac (Slavonia) for 20 members of city council.

PROJECT MANAGEMENT AND COORDINATION

Critical developments consisted of the following:

- Quarterly staff training, held in Zagreb, focused on the supply and demand of ESP services.
- ESP guidelines prepared and disseminated to streamline and standardize further working relations and responsibilities across project offices, while taking into account the specialized needs of ESP end-clients: companies and partners; the guidelines covered communication protocols, information management, relationship management, and activity/events planning.

ESP worked effectively with other USAID projects, with

- ACE and ESP collaborating on participant training program to expand exports
- LGRP and ESP collaborating on FDI benchmarking to enhance zone use and management for FDI and economic growth
- CIPO Alliance, MIGA and ESP collaborating on investor site visits and investor information requirements to increase FDI
- Privatization and ESP discussing timing, modalities of business planning for TLM spin offs

Lastly, ESP worked closely with donors on several fronts:

- UNDP/UNOPS on the transfer of the EU's loan guarantee program to HAMAG, and the concurrent upgrading of HAMAG's capacity for efficient management of such programs
- WB on areas of cooperation regarding the new CSERP program, to include (1) technical input and planning advice to relevant regional partners on the preparation of one or more of the five ROPs to be financed by CSERP for Dubrovnik-Neretva, Virovitica-Podravina, Osijek-Baranja, Split-Dalmatia, and Bjelovar-Bilogora; and (2) assessments of potential SME recipients of

CSERP grants, along the line currently undertaken by ESP to gauge directly assisted SMEs. A formal meeting is planned with CSERP's management staff for the fall

- EBRD regarding leveraging off the BAS through ESP's referrals of qualified SMEs for the financing of consulting services up to €10,000; ESP staff will serve as technical supervisors and intermediaries between the consultants and the SMEs; this arrangement deepens ESP's ability to support and track targeted SME growth, and complements ESP's own pilot program of direct consulting support through the AMC.

STATUS OF WORK PLAN ACTIVITIES

The following discussion concentrates on activities outside of the individual and group SME consulting that occurs regularly under ESP.

MARKETING

According to the work plan, this component concentrates on export sales, domestic sales and distribution channels. This quarter, the marketing team concentrated largely on overcome constraints to exports of specialty foods.

The marketing team focused on providing technical guidance to food producers in practical ways. First, the team developed a two-part "participant training program" to address the lack of understanding among Croatian food processors of the demands of external or exports—including the product, volume and pricing requirements set by consumers and buyers outside of Croatia. With foreign buyers and buyer agents as trainers, the program mixed seminars with consultative labs focused on the actual products of participants. The first part of the program consisted of visits by buyers to SMEs around the country for in-depth consultations, acquisition of samples for possible placement in export markets, and possible broadening of buyer-seller relations within select SMEs. A total of 19 companies participated in this activity, about half of which also participated in the formal participant training program, held in Opatija in early July. This second part of the program consisted of three days of lectures, demonstrations, and presentations, interspersed with activities focused on the products themselves. The final participant list for the formal training comprised 46 SMEs, whittled down from an initial list of over 100 producers identified by ESP and ACE.

Second, the marketing team attended the one-day courses on basic packaging and labeling, featured in ESP's training calendar for food producers around the country. The team members amplified through their own work experience worldwide on the examples of good and bad packaging presented by the formal trainer, and they held one-on-one product discussions with participants after each course.

Against this background of trainings for food producers in Croatia, the team continued its preparations for ANUGA. The team held its compulsory briefing program for ANUGA participants, with interactive sessions on compliance, certification, and export-readiness, as well as specific recommendations regarding product, packaging and labeling improvements for producers that arrived with display samples. After a multi-month period of assessment, review and mentoring, the team then enrolled 66 companies for ANUGA, based on the companies' preparedness for the international fair and compliance with Croatian tax laws. Arrangements also commenced on the tendering of marketing materials (product catalog) and the design and construction of the stand.

To ensure consistency in representation, and appropriate follow-up to buyer interest at ANUGA, the marketing team arranged for the registration of an Association of Specialty Food. The Association will represent the longer-term interests of SMEs exhibiting at ANUGA 2005, including preparations for participation in ANUGA 2006. Using ANUGA 2005 as an example of a cluster activity, the

Association will pursue over the next couple of quarters grant funding from the Croatian Ministry of Economy to cover its operating expenses for the first year.

In tourism, the team facilitated the first filming trip of the Geo-Heritage Group, focused on promotion of sustainable, community-based tourism along the Dalmatian coast in Croatia, including many of the niche tourism products identified by ESP. ESP staff oriented the film crew as it arrived in Zagreb, as well as provided contacts and logistical support through the Split office. In addition to promoting environmentally sound tourism, the film will feature tourism opportunities—including stays at small and family-run hotels—that will generate revenues for Croatian hotel owners and tour operators.

Lastly, the team worked on improving services by two membership organizations: the Exporters Association (a nascent body still struggling with its mandate); and HUP (a more mature organization with a variety of service centers). In the case of the Exporters Association, the team assisted with launching core services (such as tailored market research off a Global Trade Database, and broad circulation of specific buyer requests), while helping the Association plan for a survey of member needs to better identify and prioritize other, more specialized services. In the case of HUP, the team developed a roadmap for HUP's National Center for Clusters, defining proactive engagement on the part of HUP and ESP, in nurturing SME and cluster growth in various subsectors (production/manufacturing of furnishings for small boats, garment/protective clothing, office equipment, agricultural equipment). Work plan elements include cluster formation, cluster capacity-building, and cluster services (such as SME assessments, SME referrals to business service providers, and occasional direct assistance). The team embarked immediately on an illustrative example of cluster services with a company capability assessment for SMEs involved in garment/protective clothing.

BUSINESS SERVICES

This component envisions assisting SMEs indirectly through partners and commercial vendors (or business service providers), and directly through targeted technical assistance and training. To cement relations with partners, the business services team spent much of the quarter in substantive discussions with ESP partners on the issue of service provision, co-branding, and product development. From these discussions, in tandem with internal ones among ESP staff, the team drafted a list of products and services to offer partners in the guise of a prospectus (or menu of options; see Annex A). A final round of discussions with partners will result in the final selection of scheduling of programs among partners for the fall-winter of 2005-06.

Within the broader context of innovative programming with partners, the team launched one tied to tourism with the Association of Small and Family-run Hotels (NASFH). This program sponsors the conversion of informal accommodations in Croatia and, thereby, supports the generation of several hundred jobs in a sector characterized largely by seasonal and informal employment. The program—endorsed by the Ministry of Tourism as “groundbreaking”—consists of the development of three products to underpin the registration of numbers of tourist accommodations and jobs, particularly along the coastline of Croatia. These products are (1) a manual on the benefits and process of registration for owners of unregistered accommodations; (2) a survey of 300 unregistered establishments along the coast of Croatia; and (3) a report/action plan guiding NASFH through the measures needed to encourage registration. NASFH is committed to wide distribution of the manual, as well as subsequent steps for ensuring as many registrations as possible. As of this writing, the Ministry of Tourism, the Tourism Board and NASFH have approved the manual, and the survey is half way done. The preliminary survey results confirm a significant level of interest in converting informal establishments into B&B accommodations or pensions.

The team continued to oversee various programs to deepen the market for professional services, specifically SME consulting services. AMC's cost co-share program has graduated one SME, has

accepted three, and is currently considering the applications of three others. HAMAG's voucher program has its policies, procedures and documentation scripted; it currently awaits approval from the Ministry of Economy to proceed with the formal launch of vouchers. MicoGrupa's "executive training" program, with four of its courses now co-branded with ESP, expects to continue upgrading and broadening its offerings with ESP's involvement.

The team oversaw the successful implementation of ESP's spring-summer calendar of training courses. Noteworthy of ESP's training this quarter was the growing momentum of co-branded and third-party training under the ESP banner. Under the former category, for example, training materials on employee motivation prepared by the business services team for MicroGrupa's seminar series in Split. Under the later categories appears the training sessions on exchange rate management by PBZ or basic training ("Introduction to Entrepreneurship") for nascent entrepreneurs by the Entrepreneurial Center in Osijek.

Lastly, the team spent considerable time working with ESP staff on the refinement of the project's methodology for rapid assessments of SMEs. Now that the project staff had been engaged in SME diagnostics for a few months, they were in better position to appreciate nuances in approach, in screening criteria, and in the range of possible solutions. Accordingly, the business services team refined and disseminated ESP's internal SME assessment form, trained the staff in its use and commenced a weekly triage of assessed companies to ascertain those to be assisted directly by ESP staff and those to be referred to ESP partners.

FINANCIAL SERVICES

This component concentrates principally on increasing SME access to bank (credit) and non-bank (non-debt) finance; ancillary to these efforts is the introduction of new financing products and improvements in the institutional/policy environment governing SME financing. This quarter, the financial services team focused largely on ESP's financial partners, helping them to improve or refine credit scorecards, deposit mining, and other techniques for increasing SME borrowers. For instance, the team worked with HBOR staff on credit scoring for start-ups and SMEs of different sizes; HBOR then endorsed the scorecards for consistent application, effective July 1st. The team, furthermore, prepared for VABA a credit-scoring manual, which was folded into the bank's official credit policy and became cornerstone in the bank's credit system.

The team also spent considerable time upgrading skills within smaller or less experienced banks through the development and offering of training courses, largely designed to orient loan officers unfamiliar with the key characteristics of SMEs. The courses covered five topics: (1) Prospecting, Sales and Client Management, (2) Basic Credit—the 5 Cs, (3) Ratios and Trend Analysis—Getting Behind the Numbers, (4) Best Lending Practices for Loan Officers—DOs and DON'Ts, (5) How to Interview a Loan Applicant; and (6) Using Credit Scorecards. A full-service package, the team's training materials contained power point presentations, hard-copy handouts, teacher notes and case studies for a thoroughly interactive training experience.

The financial services team continued technical support for HAMAG's loan guarantee systems, with a second trip by ESP's advisor to guide implementation of an action plan endorsed by ESP and HAMAG. The advisor covered institutional and procedural upgrades and mentored HAMAG's new hire in her day-to-day responsibilities regarding the fund. Additionally, the advisor continued to endorse healthy working relationships (or efficient public-private partnerships) with banks in order to increase HAMAG's volume of guarantees (set at 500 for the year by the Ministry of Economy).

With HBOR's consensus, the team organized the development of a new hybrid financing product to facilitate SME expansion and greenfield investments in Croatia. The product (mezzanine financing or

a suitable equivalent) addresses an important gap in Croatia's financial landscape with respect to long-term capital needs that are greater than what lenders can provide and investors can afford. Product development started in June, in a two-phased, "assess-and-design" approach that culminates in materials detailing in full the product, its application, and the roles/responsibilities of HBOR staff involved in its usage. ESP staff will then follow-up with training and mentoring as needed.

Lastly, the team continued its intensive consultations with municipalities, counties and RDAs regarding the establishment of guarantee funds to support SME growth. The team presented to the Economic Office of Split County Economic Office (SCEO), for instance its model for regional loan guarantee funds. The team also reviewed SCEO's preliminary approach and design documents for a new regional fund, making suggestions for enhanced operational efficiency.

INVESTMENT AND REGIONAL DEVELOPMENT

This component concentrates currently on foreign direct investment (FDI), with ESP's engagement in domestic investment and business climate issues driven by actual FDI facilitation. This quarter entailed continued support of FDI promotion entities (in and outside of Croatia), as well as direct services to investors.

Investor services have become the main element of the team's efforts largely but not exclusively on behalf of various FDI bodies (such as the Croatian CIPO alliance, the national IPA, and the MIGA office in Vienna), as illustrated in the following examples:

- Early in the quarter, the team established a formal link with the Austrian Trade Commission in Zagreb. The link was effectively tested this quarter through the handling one investor query, which required the team to interface with the various FDI facilitation entities in Croatia. In less than five days, the team obtained 11 serious responses from Croatian FDI agents, including three in areas of special state concern. The Commission as well as the potential investor expressed great satisfaction with the number, speed and quality of the responses.
- For the past few months, the team has been advising the City of Nova Gradiska on attracting foreign investors to its new industrial park. A concrete opportunity arose in the form of an Austrian construction concern called Angerlehner Hoch-und Tiefbau, with a presence in Split, and an interest in establishing a pipe manufacturing facility in the northern part of the country. The team assisted the City with investor requests for information, site visits, follow-requests for data, and the drafting of sundry official documents. As of this writing, Angerlehner has signed an investment memorandum with the City and plans on building a \$4 million plant, with an expected annual turnover of \$7.5 to \$10.5 million (of which at least 20 percent would be exported).
- Since January, the team has been working closely with a Canadian manufacturer of industrial strapping materials on the identification of an appropriate brownfield or greenfield investment site within a 35 kilometer radius of Zagreb. As an international company with direct customers throughout North America, the Caribbean, the EU, Japan, India and Australia, Caristrap wants a location with strong infrastructure and excellent access to national and international transport nodes. The team provided Caristrap's Croatian representative with data on possible sites, facilitated site visits, and supported discussions with local authorities. In February, the company's president signaled formal corporate commitment to establishing a plant (see letter in the ESP project files). More recently, the company established a local presence and hired three staff.

With a view to building capacity for FDI facilitation in Croatia in the near- to-medium-term view, the team launched a benchmarking exercise to compare FDI performance across regions in Croatia as well with the EU. The work—which concentrates on six ESP partners responsible for FDI handling in

Croatia—entails the development of benchmarks (for assessing, rating performance), scorecards (for providing feedback) and action plans (for implementing needed changes in a prioritized fashion). The work also envisions training ESP project staff in diagnostics, so that assessments can eventually extend beyond the initial group of six. Lastly, owing to the emphasis accorded by the Croatian Government (at all levels) to zones, the work will pay particular attention to their role and possible potential for attracting FDI to Croatia.

Continuing as in its capacity as senior advisors to Government, the team serves as a working member of the new national working group on FDI, spearheaded by the State Office for Development Strategy. For this forum, the team has been supporting the development of a FDI perception survey to gauge investors understanding and attitudes towards Croatia’s climate for FDI.

Often as an adjunct to advisory services, the team organizes and/or participates in meetings, often but not exclusively, on behalf of Government bodies, for the benefit of the Croatian FDI community. Most notably among these events are two—(1) the one-day workshop in Bjelovar on the importance of FDI for economic growth and development in Croatia for 130 participants from around the country; and (2) the three-day SME Conference held in Šibenik where ESP served as a conference sponsor, participated in panel discussion on cluster formation/growth, manned information booth on ESP services, and presented ESP program to some 60 potential SME clients in a separate breakout session.

PERFORMANCE, MID-STREAM CORRECTIONS

The quarter revealed systematic improvements in staff performance, as well as one nagging problem. On the positive side, the project completed its reconfiguration of the Split office, with the eagerly awaited arrival of a regional manager (with strong experience in company diagnostics and the management of partner relations) to lead operations in the region. In addition, owing to the project’s commitment to training and retooling, ESP’s staff performance showed continuous improvement, with growing compatibility in approaches and results across project offices. However, the new Director of Business Services (despite relevant regional exposure, appropriate technical experience, and generally strong references) has been unable to perform to the level required since his arrival as a replacement in mid-April. A final decision regarding possible replacement will occur in July, with the arrival of the project’s permanent Chief of Party.

STATUS OF BUDGET EXPENDITURES

Table 3 presents project expenditures, as invoiced to-date. At the end of June, they amounted to \$2,677,736.49 or 14 percent of the total contract value (\$19,170,704).

On June 22, 2005, USAID increased the total obligated amount by \$3,200,000 to \$10, 146,024. Project expenditures amounted to 26 percent of the new obligated amount.

Table 2. ESP FINANCIAL RESULTS

<i>Category</i>	<i>Amount Budgeted</i>	<i>Cost Incurred as of the end of the Previous Quarter</i>	<i>Costs Incurred this Quarter</i>	<i>Total Costs Incurred To-date</i>	<i>Budget Balance</i>	<i>Percent Expended of Total Budget</i>

CLIN 1	\$ 16,942,142	\$ 1,612,108.90	\$ 1,713,026.80	\$ 2,553,161.28	\$ 14,388,980.72	15 %
CLIN 2	\$ 2,228,562	\$ 74,231.24	\$ 50,343.97	\$ 124,575.21	\$ 2,103,986.79	6 %
Total	\$ 19,170,704	\$ 1,686,340.14	\$ 1,763,370.77	\$ 2,677,736.49	\$ 16,492,967.51	14 %

LIST OF ACTIVITIES PLANNED FOR NEXT QUARTER

In addition to on-going activities, additional major activities planned under each area for next quarter are as follows, by component.

CROSS-CUTTING

- Provide start-up support for a regional development authority for Dalmatia to better position the region for economic growth and EU accession.

MARKETING

- Initiate training in tourism product-development and marketing for up to 100 regional tourism bodies, inbound tourism operators, and SMEs
- Deliver training by buyer agents (accompanied by consulting labs on product samples), to enhance SME understanding of buyer requirements and distribution channels in external markets

BUSINESS SERVICES

- Monitor and support HAMAG's program for certifying consultants
- Develop prospectus of products and services for ESP partners; use prospectus as basis of consultations with partners regarding ESP's technical interventions in the late 2005-early 2006

FINANCIAL SERVICES

- Establish mutual assistance relationships with leasing and non-bank companies to broaden SME access to non-bank financial products and services
- Refine mezzanine financing product for use in Croatia; develop materials defining the product and its use; provide training to HBOR loan officers
- Continue intermittent support to HAMAG on its system of loan guarantees
- Introduce credit scoring and deposit mining services to banks embarking on or expanding SME portfolios, such as Hrvatska Potanska Banka and Zaba Bank; deliver credit and sales training for their relationship managers (loan officers)
- Support establishment of regional guarantee funds in Split/Dalmatia and Varazdin regions

INVESTMENT AND REGIONAL DEVELOPMENT

- Continue to meet/coordinate with MIGA on FDI demand priorities—facilitate site visit of serious investors
- Continue to expand ESP's own FDI facilitation pipeline—supporting investors with a range of investor services, linked as often as possible with inputs from and participation of Croatian FDI partners
- Build off results of FDI benchmarking exercise; hold workshops and training events; support the development of operational and marketing plans by partners; investigate areas of possible input from external sources such as FIAS or MIGA; support possible communication products by sundry groups.
- Serve as advisor to Croatia's IPA and Ministry of Economy on FDI—comment on pending laws

ANNEX A. ESP PRODUCTS FOR PARTNERS



ESP offers a range of products for co-branding, partial or complete sponsorship, and regular use or eventual adoption by partner organizations. Our fall/winter array of products for 2005 consists of twelve training courses and six services. We invite you to review the following listing of products and choose those that best meet your organizational mandate and goals for the remainder of 2005. Our ability to provide these products will be based on overall demand from all our partners, and, on occasion, we may have to discuss the number, type and timing of the products.

Unless otherwise noted below, all these products are available for use starting in late September.

Training Courses

Operations Management for SMEs: a two-day course on enhanced productivity through quality control, basic standards, and functional alignment of resources. The course covers documentation of work flows, effective inventory management, timely servicing of equipment, and balanced allocation of inputs (i.e., labor, capital and other). Through visual aides and interactive exercises, the course presents a range of tools for planning and monitoring production processes.

Strategic Planning for SMEs: a two-day course on managing growth and profits through long-term visioning and planning. The course goes beyond mission statements and goals to define the factors and indicators tied to company growth. In a case study of a Croatian company that grew in five years from 0 to 50 employees, the course applies 10 different strategic planning tools in addition to permitting “what if” scenario analysis.

Packaging and Labeling for Food Processors: a one-day course for SMEs on product branding and packaging for enhanced sales. The course presents the latest trends with respect to consumer expectations, graphic design, and product packaging for food items. Through photographs and samples, the course offers owners and managers in food processing the key to product differentiation to compete in one of the most dynamic markets in the world.

Financing SMEs: A one-day course on financing options for SMEs covering the basic products available in today’s market (e.g., loans, leasing, factoring, equity infusions, and investments). The course covers the minimum requirements demanded by offerors of each product, as well as application procedures currently in use. A short case study allows participants to better identify the various financing constraints faced by SMEs.

Cost Accounting for SMEs: a one-day course on the calculation and use of unit costs for planning and monitoring production. The course covers the various approaches to cost accounting (i.e., standard, variable and activity-based). Through interactive exercises, the course demonstrates how cost accounting can improve performance through adjustments in production.

Market Segmentation and Positioning for SMEs: a one-day course on understanding the relationship between marketing and markets. The course uses the four Ps of marketing (product, price, promotion and place) as a point of departure for discussing how to determine the most appropriate target segment(s) for a company’s products. Stressed is the importance of occupying a unique position for a company’s products in the minds of the target audience. Through examples and

interactive exercises, the course demonstrates how to segment, target and position a company and its products in the minds of consumers.

Market Research for SMEs: a half-day course on the importance of market research from qualified sources, whether trained company staff or qualified business service providers. The course explains the importance of market research to business diversification and growth. Through interactive exercises, it explains the difference between primary and secondary research, and how SMEs can capture the most relevant information for their own decision-making through strategic outsourcing of this function. This course will be available starting in January 2006.

EU Pre-accession Funds for partners: a two-day course for organizations working with public and private groups to access various pre-accession funds (such as PHARE) through proposals and grant applications. The course covers the official institutions, policies, procedures and paperwork tied to each Fund. Through interactive exercise, the course illustrates the full tendering process for each Fund and explains the strategy behind successful bids.

Public Relations for partners: a half-day course on media use by organizations. Through role playing and interactive exercises, the course explains how to define issues for media coverage, how to attract media to press conferences and other events, and how to handle media during and after events—in a word, how to manage effectively relations with various media sources.

Rapid SME assessments for partners: a one-day, training-of-trainers course for organizations on company diagnostics. The course features the rapid assessment tool developed by ESP during its first months of operations as a means of understanding quickly and efficiently constraints to SME growth. The course leads participants through the elements of the assessment process, while providing examples of concrete problems and success stories encountered by ESP staff.

International Standards for partners: a two-day, train-the-trainers course on the international system of standards used in the European Union, as well as regional and local standards used in the Balkans and Croatia. The course covers the institutions that establish the standards, as well as the standards themselves, explaining how high-quality, market-relevant standards for materials, products, systems, and services help businesses grow. The course also addresses the process of conformity assessments, and the process of measuring up to the specifications of various standards.

Investor Services for partners: a one-day course on how to best service customers that happen to be investors. The course concentrates on the key characteristics of effective investor service: preparedness, timeliness, accuracy and consistency. Through examples and interactive exercises, it addresses how to understand investor motivations/needs, define investment sites, map out procedures for handling investors, sustaining contact with investors, and providing timely feedback to investors and other parties affected by investments.

Services

Road show by ESP Service Providers: a half-day event showcasing the services and work of up to six ESP's business service providers. Possible topics include: factoring, benchmarking, food safety, workforce analyses/development, market research, IT/internet, and graphic design. The final selection of topics would be the partner's.

Company Diagnostics: rapid (under three hours) assessments by ESP of select SMEs with clear growth potential. To be considered for diagnostics, SMEs must at a minimum have 20 full-time employees, a stable business history of at least three years, and dynamic owners with a record of investing in their company. Each case will be considered by ESP staff based on its own merits.

Technical Assistance for Regional Operational Programme (ROP): a one-day workshop for partners involved in developing or implementing ROPs. The workshop provides tailored, technical guidance as partners work through various planning or operational aspects of their program. Particular attention is paid to public sector-private sector efforts.

Technical Assistance for Regional Guarantee Funds: a one-day workshop for partners interested in establishing regional guarantee funds to spur economic development. The workshop explains how regional funds can be different from national ones and systematically covers the purpose, structure and operational parameters of regional funds.

Technical Assistance for Development of New Niche Market Tourism Products/Initiatives: a one-day workshop for regional tourism service providers, tourism development authorities, and SMEs that wish to collaborate in developing new tourism products. Each workshop concentrates on a well-defined product opportunity (such as inn-to-inn, culinary tours, in-land adventure, and meetings/conferences/special events). The workshop covers discussions of ESP's own market profile for use in Croatia, along with examples of ongoing initiatives elsewhere in Europe. The focus throughout workshop will be on the product itself and capturing more tourists through proper positioning, as a means of spurring appropriate product launches by the most committed Croatian groups.

Investor/Business Roadmap: a user-friendly, web-based, searchable database providing business and economic information for foreign/local investors and businessmen. The database offers current information on the Croatian business climate, regional economic trends, and sectoral developments. In addition to presenting investor profiles on the most viable top-ten sectors for investment, it provides contact information on Croatian business service providers.

ANNEX B: List of Reports & Deliverables

ESP's cumulative (NOTE TO JIM: it may be a bit much to retain a cumulative listing) list is presented in Table 2. (NOTE TO Jim: The binder on work products should be consulted to see if I missed any, and also fill in dates)

Table 2. ESP'S DELIVERABLES AND REPORTS

Title	Author	Date
Work Plans		
First Annual Work Plan (October 04- September 05)	Roger Manning (Nathan staff)	11/05/04
Quarterly Reports		
Quarterly Matrix/Report, October- December 04	Paola Lang, DAI staff	
Quarterly Matrix/Report, January – March 05	Paola Lang, DAI staff	
Monthly Reports		
October 04	Charles Conconi, Nathan staff	
November 04	Paola Lang, DAI staff	
December 04	Paola Lang, DAI staff	
January 05	Paola Lang, DAI staff	
February 05	Paola Lang, DAI staff	
March 05	Paola Lang, DAI staff	
April 05	Paola Lang, DAI staff	
June 05	Paola Lang, DAI staff	
Consultant Reports		
M&E Plan and Operating Manual	William Millsap, Social Impact Consultant (later revised by Paola Lang)	12/29/05 (7/20/05)
IT Systems Manual	Sani	?
HAMAG Certified Consultant Program: Training Materials, Operating/procedural Manual and Final Report	Paul Moran, DAI consultant	12/25/05
Institutional Upgrade of HAMAG – Technical Assistance with Assumption of the UNDP/EU Guarantee Fund: Initial Report and Action Plan	Mary Miller, DAI staff (STTA)	?
Survey on Corporate Governance	Economic Institut (STTA)	?
Tourism Market Study	Alan Saffery, Nathan consultant	?
Institutional Upgrade of HAMAG – Technical Assistance with Assumption of the UNDP/EU Guarantee Fund: Interim Report	Mary Miller, DAI staff (STTA)	5/12/05

HAMAG Voucher Program: Operational Manual and Start-Up Materials		?
Benefits of Registering Informal Accommodations		
Hybrid Financing Product		
FDI Benchmarking		
ESP Work Products		
Credit Scoring Model (VABA)	Tocher Mitchell, DAI staff	1/25/05
Deposit Mining	Tocher Mitchell, DAI staff	1/25/05
Guidelines on Local Guarantee Schemes	Tocher Mitchell, DAI staff	1/31/05
List of Business Service Providers	Darije Josic, ESP staff	1/26/05
Strategy Paper: Loan Products	Tocher Mitchell, DAI staff	3/1/05
Strategy Paper: Credit Enhancements	Tocher Mitchell, DAI staff	3/1/05
Briefing to Companies Exhibiting at ANUGA	Michelle Morgan, Nathan staff	4/1/05
Spring 05 Training Program Guidelines	Marko Slunski	4/1/05
Credit Scoring Model for SME Start-Ups	Tocher Mitchell, DAI staff	5/5/05
Credit Scoring Manual	Tocher Mitchell, DAI staff	5/27/05
Annual Report of the Association of Small and Family-Run Hotels	Tatjana Horvath, ESP intern	7/12/05
Product Offerings for ESP Partners	Paola Lang, DAI staff	7/12/05
Cost-Shared Consultancies through the AMC: Final Reports		
Gumi-Implex		
Training Courses		
AMC: EU Accession	AMC consultant	

ESP/Deloitte: Operations Management		4/1/05
ESP: Strategic Planning		4/1/05
ESP: Packing and Labeling		4/1/05
ESP: EU Accession Grants		4/1/05
		4/1/05
ESP/MicroGrupa: Market Positioning	Glenn Surabian, Nathan staff	5/9/05
ESP/MicroGrupa: Market Segmentation	Glenn Surabian, Nathan staff	?
ESP/MicroGrupa: Cost Accounting	Marko Slunski, ESP staff	?
ESP/MicroGrupa: Employee Incentives	Darije Josic, ESP staff	
ESP/PBZ: Foreign Exchange Risk Management	PBZ staff	?
ESP: Company Diagnostics	Glenn Surabian, Nathan staff	?
ESP: sundry bank training course (Need dates from Tocher)	Tocher Mitchell, Ivan Pilepic	?