

# STRENGTHENING INSTITUTIONAL ARCHITECTURE TO SUPPORT THE SMALL-MEDIUM ENTERPRISES TO MAKE MACEDONIAN ECONOMY MORE COMPETITIVE IN GLOBAL CHALLENGES

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## ***Abstract***

*The problem of low competitiveness is permanently present in the economy. The increase of the competitive ability in the economy, also in Macedonians enterprises is a very complex problem that requires more comprehensive and long-term measures for its solution. It needs certain engagement of state institutions, the enterprises and as well as the higher education and science. The institutional architecture for the support of the SME (small-medium enterprises) sector was implementing different strategies in a wide range of policies that define and create an environment for SME. The results are: Macedonia is top business reformer, ranking a 6<sup>th</sup> place in the ranking of 183 economies on ease of starting a business.*

**Key words:** SMEs, entrepreneurship, institutional architecture, competitiveness

## **Introduction**

In this era of globalization, wireless technology, innovations and increased competition, the reality calls for a new function of the state, which will, by implementing more active policies, foster the competitiveness of the economy, the creation of a favorable and interactive business environment, and attract foreign investments. This goal can only be achieved through nourishing an entrepreneurial spirit, innovation, various forms of interconnecting of the businesses inside the industry, and clustering. This means supporting the companies in the process of internationalization and approaches to new markets via export promotion and international marketing, as a contemporary approach to international trade that allows for streamlining and coordination of the business activities.

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“The center of a modern society, economy and community is not technology. It is not information. It is not productivity. It is the managed institution as the organ of society to produce results ... Management is the specific function, the specific instrument to make institutions capable of producing results” wrote Peter Drucker in *Management Challenges of the 21st Century* (Drucker P., 1999). Drucker’s ideas were the panacea for institutional giants of his time, and the business climate of the 80s was ripe for adopting them. In this context, he treated both innovation and entrepreneurship in the “new entrepreneurial economy” as practices, decisive duties that could be controlled best in a systematic work environment.

Internationalization of small and medium enterprises (SMEs) in the form of export promotion has been an important element of the Macedonian government policies for a number of years. One of the strategic priorities of the Government of the Republic of Macedonia is the determination to increase the economic growth and the competitiveness on a permanent basis. The creation of a proactive integrated economic policy is in line with the improvement of the policy to enhance the competitiveness of the corporative sector.

Macedonia is a relatively small economy in Europe but offers possibilities for investment in a diversified range of sectors. Areas that are suitable for investors considering doing business in Macedonia include the automotive sector, IT, healthcare, food processing and agribusiness. Other sectors in which there is potential for investment include tourism, real estate, chemicals and energy. A public investment program has increased investment in infrastructure and certain sectors such as transportation, energy, water, education and health. Serbia, Germany, Greece, Italy and Bulgaria are the main destinations for exports from Macedonia.

Macedonia has a long tradition in apparel manufacture, having supplied the former Yugoslavia as well as many major brands and retailers throughout Europe. The industry is an important source of employment for Macedonia with 102.474 employed in 2010 (State Statistical office of RM, 2011) in this sector. It is also a significant exporter with average annual exports exceeding \$2,846 million, where the structure of exports in 2008 per types of products shows that the largest portion of the exported value has been realized by the following groups: “iron and steel”, “clothing”, “food”, “other semi-finished products” and “fuels”. As in previous years, this year we can draw the same conclusions - that the Macedonian economy is concentrated in several sectors. The share of aforementioned groups of products is 77.98% of the total exports of the Republic of Macedonia, which reaffirms the aforementioned conclusion. The remaining group of products, whose share in the total export of the Republic of Macedonia is 22.02%, are products

that create high added value.

For the last decade, the industry has suffered a slow decline in both exports and employment, exacerbated recently as a result of economic recession in key export markets. Macedonia struggles to compete in its main type of production—cut make trim (CMT)—when compared to other production locations (e.g. Asia), except in market segments where quality and lead time are as essential as price. Many companies in the Macedonian apparel industry are looking to move upstream, into full package, private label or own design/brand manufacturing where companies can add more value to customers and/or capture higher margins by taking on new roles in the design and production process.

The small and medium sized enterprises are the carriers of the economic development. They generate over of 60% GDP and employ 75% of the total amount of employees. The Government of the Republic of Macedonia will continue with the financial support and improvement of the regulatory framework for the development of the small and medium sized enterprises.

During 2010, there were signals for post-crisis recovery in the labor market in the Macedonian economy, manifested by an increase in the number of employees by 1.3% compared to 2009. Similar paths of movement are registered in the other indicators on the condition of the labor market. The employment rate rose by 0.3 percentage points compared to 2009 and reached 38.7% for 2010. Favorable shifts in the labor market during the year indicate a gradual recovery in this segment of the economy, which is consistent with the improved economic situation and increased aggregate demand. However, a certain part of the growing employment may be a result of other factors such as increased transfer of employees from the informal to the formal sector of the economy under state stimulus policies, especially those aimed at supporting the rural development. Given the simultaneous rise in labor demand and supply, the average unemployment rate in 2010, declined by 0.1 percentage points and equaled 32.1%. However, unemployment is still high, despite its downward trend and positive shifts in the labor force. Along with the low labor productivity, they are the main reason for the insufficient growth of disposable income, and also disable a more dynamic (than the achieved) growth of inflows based on funds of the employees. (NBRM, 2011)

### **Business climate and competitiveness**

Enhancing the Competitiveness of the Macedonian Products and Services, the Program for Development of SME's Entrepreneurship, Competitiveness and Innovativeness, Program for Attracting Investments in the Republic of Macedonia, Program for Clustering Support and

Development, as well as several sectorial strategies and programs are some of programs for better business climate of Macedonian Government.

It is important to stress that there are also other government programs for stimulating competitiveness, but these are being implemented by other ministries and institutions such as: the Program for Scientific and Research Activity, Technological Development and Technical Culture, the Top Management Project, etc. Under the “Program for Enhancing the Competitiveness of the Macedonian Products and Services” several support activities are already being carried out for co-financing the introduction of quality standards by companies, promotion of their products and services, support for industrial design and patent application, participation on international fairs and other promotion events worldwide. Macedonia is a member of the World Trade Organization (WTO). The country also belongs to the United Nations and the Council of Europe. Macedonia has had candidate status for entry to the European Union since 2005. A Stabilization and Association Agreement with the EU signed in 2001 gives Macedonia access to EU markets. Bilateral trade agreements have been signed with Ukraine, Turkey and the European Free Trade Association (EFTA). Macedonia is also a member of the Central European Free Trade Agreement with some neighbouring countries. A number of bilateral investment protection and promotion agreements have been concluded, mainly with European countries.

Governments and businesses are interdependent, and when it comes to international business, this interdependence has grown even further by the globalization of economy.

Businesses are run on the basis of market forces, but that does not undermine the necessity of their facilitation by the governments. Market and government, both complement each other in this regard. *Tax Convention.* A flat rate tax of 10% applies to corporate and personal income in Macedonia. Non-resident companies doing business in Macedonia are subject to tax on their income derived from sources in Macedonia. Business profits of a non-resident company are taxed if it is deemed to have a permanent establishment in Macedonia, this being an office or other fixed place of business generally as defined in the OECD Model. A permanent establishment may also exist if a non-resident provides services in Macedonia for more than 90 days in any twelve month period. If a non-resident company does not have a permanent establishment in Macedonia a 10% withholding tax applies to payments of dividends, interest or royalties from Macedonia.

The standard rate of value added tax (VAT) in Macedonia is 18%. A reduced 5% rate of VAT applies to food, drinking water and certain agricultural inputs including fertilizers. Exemptions from VAT include financial services, insurance, healthcare, education and international transport. Exports of goods and services and supplies made in free trade zones are zero rated. Non-residents do not

normally have to account for VAT, and supplies from abroad are taxed using a reverse charge mechanism operating by the recipient of the supplies in Macedonia.

The Republic of Macedonia has a number of really extraordinary advantages for investigation and country development:

- Favorable strategic and geographic location on the crossroad of the two main European transportation corridors;
- Highly liberalized foreign trade policy
- Implementation of various bilateral agreements which enable local producers to have free access to the European and other markets. This makes Macedonia a highly competitive production and export platform;
- Stable monetary environment with the lowest inflation rate in the region and stable domestic currency;
- Favorable tax conditions for investors; income tax for companies was reduced from 15% to 10%;
- Technological industrial zones were established where investors are exempted from payment of income tax, VAT, customs duties and other fees for a period of 10 years;
- Highly qualified labor force, which is also among the most competitive in Europe;
- Implementation of high standards in the corporate governance;
- Implementation of EU standards for public procurement, competition, state aid, standards for products, and in many other areas;
- Promotional activities for potential investors in the tourism;
- *E-Business* – for the companies to complete procedures in a more convenient and less costly manner.

Macedonia has signed a number of bilateral double taxation agreements with countries in Europe and the Middle East region. These agreements allocate taxing rights between the signatories and provide maximum rates for withholding tax on income derived from the contracting states. They also include a dispute resolution mechanism where taxation arises that does not conform to the provisions of the agreement.

### **Conclusion**

The center of a modern society, economy and community is not technology. It is not information. It is not productivity. It is the managed institution as the organ of society to produce results. Management is the specific function, the specific instrument to make institutions capable of

producing results. This goal can only be achieved through nourishing an entrepreneurial spirit, innovation, various forms of interconnecting of the businesses inside the industry, and clustering. This means supporting the companies in the process of internationalization and approaches to new markets via export promotion and international marketing, as a contemporary approach to international trade that allows for streamlining and coordination of the business activities.

By providing affordable financing to private sector SMEs in underserved markets, the Government in Republic of Macedonia seeks to build the capacity of SMEs to expand production, access new technology, improve competitiveness, reach wider markets, increase profits, and achieve long-term commercial sustainability. *The institutional architecture for the support of the SME (small-medium enterprises) sector has taken shape in the form of the Macedonian Government, The Chamber commerce, Department for Entrepreneurship and Competitiveness in the Ministry of Economy and the Agency for Promotion of Entrepreneurship of the Republic of Macedonia (APERM), responsible respectively for defining SME policies and their implementation. The goal is to help and improve Macedonian SME, its competitive position within the global market place.* By supplementing investments with technical assistance, Small Enterprise Assistance Funds (SEAF) aims to help develop business and management skills, improve corporate governance and transparency, and formalize legal structures, business structures, and tax reporting. The development of a vibrant and sustainable SME sector will help to generate new employment, export revenues, and government tax revenues; stimulate economic growth; promote free markets; improve social welfare; and contribute to political stability in developing countries.

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