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## **ENTREPRENEURSHIP AND FINANCING: THE EVIDENCE OF MACEDONIA<sup>74</sup>**

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### **Abstract**

There is an absence of general platform to define the entrepreneurship. Yet, it is a common sense that it presents a concept which is closely related to financial risks. In this line, the small and medium sized enterprises (SMEs) are still experiencing considerable difficulties in sustaining their importance for economic development. The paper describes the sources of financial support to the SMEs in Macedonia, and simultaneously identifies the most applied sources of financing. Moreover, it elaborates the importance of the Macedonian Bank for Development Promotion (MBDP) in providing financial support in terms of financing start-ups, providing medium and long-term loans to SMEs, financing exports, extending export credit insurance, and the management and implementation of international credit lines. The analyzed data set covers the period 1999-2013. The main findings reveal that the MBDP has a substantial role in development of entrepreneurship in general in Macedonia.

**Key words:** Entrepreneurship; Financing; SMEs; Macedonian Bank for Development Promotion; Macedonia.

### **INTRODUCTION**

In a contemporary society, the economics defines the entrepreneurship as one of the most profound factor for growth and development. Generally, the

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entrepreneurship is defined as usage of new possibilities, whose results are due to introduction of innovation in the economic activity – in the production, exchange and consumption of goods and services. In this line, an entrepreneur is a person who innovates and introduces innovations in the economic activity.

There is an inevitable relationship between the entrepreneurship and small and medium-sized enterprises (SMEs). They have dominance of approximately 98% of the total number of enterprises in a country, regardless the level of its economic development. Among the SMEs, it is noticeable the share of the micro-firms (up to 10 employees), as well as the share of the small firms (between 10-50 employees). On the other hand, the share of the medium-sized enterprises (between 50-150 employees) and the big companies (over 250 employees) is by far lower. In this respect, the SMEs participate even with 99.8% of total number of enterprises active in the non-financial sector in the EU-27 countries, while the micro-firms participate with 91.8% (Eurostat, 2008). Moreover, the SMEs contribute to the job-creation within the business, particularly in the non-financial sector by creating 67% of total employment in the EU-27 countries and with 58% in the creation of the value added.

In Macedonia, the SMEs as well as the entrepreneurship, started to develop significantly after the country's independence. Out of 75,497 active business entities in Macedonia, 75,294 or 99.7% are SMEs (State Statistical Office, 2010). Consequently, the SMEs have predominant role in employment and value-added, as well as in the creation of the GDP in Macedonia.

Concerning other aspects of SMEs development, one may note their importance in supporting and introducing innovation, using entrepreneurial skills of employees, support to local and regional development etc. Consequently, the SMEs and the entrepreneurship are factors that enhance stable and sustainable development of modern economies. Therefore, it is not surprising the fact why the governments pay much attention to the policy of supporting SMEs. In this line are the institutional, educational as well as the consultancy measures for the SMEs support. Furthermore, there are established national agencies for SMEs, regional centers, business-incubators, technological parks, clusters, local economic development offices, and so forth. Yet, the financial support to the SMEs is still an important measure particularly in the case of establishment and development, due to numerous limitations and risks, mainly from financial aspect. The variety of risks derive from the fact that the SMEs have a lack of: economies of scale, diversified assortment, skilled and educated management, limited options for bank loans etc. resulting with limited

access to finance. Accordingly, the governments assess the possibilities to establish mechanisms at central and local level in order to provide financial support to the SMEs. In many countries worldwide there are governmental specialized financial institutions, like state development banks, guarantee funds etc.

In the early phase of the transition, the SMEs in Macedonia developed rapidly and evoked the issue for ensuring financial support under favorable conditions. Namely, the financial problems at the time being were namely present due to two reasons: (i) the nominal interest rates were extremely high and (ii) there were no alternative approaches and sources for SMEs financing. Therefore, the Government of Macedonia decided to establish the Macedonian Bank for Development Promotion (MBDP) with two sectors: (a) a sector for SMEs support and (b) a sector for export support. Up-to-day, the MBDP managed to ensure important credit lines from international and domestic sources for SMEs development, and to launch them in accordance with bank's mission and strategic priorities.

## **1. LITERATURE REVIEW**

There is a large body of literature referring to the financing sources of SMEs. Some authors pay attention to the importance of the informal financing sources, particularly in the early phases of their business development. According to Birch (1987), there were approximately 800,000 small businesses in the USA in the middle of the 80s, seeking for 25,000 US\$ for an individual start-up, or approximately 20 billion US\$ in total. In such a case out of those 800,000 newly established enterprises, 300,000 continues rapidly to develop, it provokes the need for 25,000 US\$ each, so the total amount for financing the SMEs is estimated around 27-28 billion US\$ per year. 80% of the total amount (around 22 billion US\$) derives from the informal sources of financing (Birch, 1987, p. 79). In this line, one may note the findings from another interesting research in which on the sample of 500 the fastest growing businesses in the USA, almost 70% refers that the start-up financing comes from the founders' savings, 20% is from relatives and friends, while only 8% is bank loans (Filipovski, 2007, p. 205).

The role of the informal sources of financing of the SMEs in the developing countries where the financial markets are still undeveloped is substantial. This addresses the transition countries as Macedonia as well. Moreover, in the early stage of the transition period in Macedonia, the informal sources of financing of the SMEs (3F money) were dominant over the formal sources i.e. bank loans. That was the time when due to high interest rates, the SMEs actually did not have any access to finance (Fiti et

al, 2007, p. 247-248). Furthermore, one may note the importance of sources of equity and debt capital for SMEs. Baron and Shane (2007) as well as Filipovski (2007) point out the following sources of equity financing: Personal savings by the entrepreneur; Sources from family and friends; Sources from the business partners; and Risk capital.

In this line, the banks are the main source of debt capital, supplemented by leasing and factoring. The leasing of the SMEs brings two very important advantages: (i) By hiring equipment from a leasing-firm, they are protected from the out-of-date; and (ii) It enables the costs to be spread over longer period (Filipovski, 2007, 209; Ros et al, 2010, p. 620). Furthermore, the banks contribute even up to 70% in the financing of the SMEs; the second-ranked is the leasing with 24%, the public financial institutions with 11%, business-angels with 4%, official venture funds with 2% etc. (Jekkel, 2006, p. 5).

## **2. METHODOLOGY AND RESEARCH FRAME**

The research encompasses the usual methods applied by the economics in the first line the methods of induction and deduction, which are particularly used to investigate the size of loans granted by the MBDP. Furthermore, the paper poses a comparative analysis based on stylized facts obtained from desk-research and available sources of secondary data (Yearly Reports and Financial Reports of the MBDP). The data set covers the period 1999-2013. Since the quantitative analyses do not always disentangle key facts necessary for pointing out concluding remarks regarding particular issues, analyses based on qualitative approach are additionally introduced. The idea is to evaluate the effects of the MBDP's work in terms of financial support to the SMEs in Macedonia.

## **3. DEVELOPMENT OF SMEs IN MACEDONIA**

Macedonia, as many other former socialist countries, started with the development of SMEs in the process of transition. Based on various changes in the economic and political system of the country, the process of spontaneous entrepreneurship was initiated. On the other hand, the establishment of a large number of new SMEs was an expected reaction of the citizens due to interrupted social and economic security caused by transition, privatization and growing unemployment (Fiti et al, 2007, p. 224). The dynamic of registering new SMEs was particularly intensive in the period from 1990 until the end of 1993, followed latter by smaller intensity (due to the embargo) and gaining in force once again in 1996. The Kosovo

crisis in 1999 did not have any meaningful influence on the establishment of new SMEs. The registration almost stopped in 2001 when the war conflict in Macedonia started, but continued in 2002 again. At the end of 2004, there were more than 172,000 SMEs in Macedonia (APPRM, 2005). However, soon after, it was detected that a large portion of the newly created SMEs are inactive entities, or only 49,123 (29%) were active. According to the sector structure, in the early transition period, the largest number of SMEs belonged to the trade sector (even 67% of the SMEs in 1993). Later on, the firms gradually shifted from trade to manufacturing, construction and other services out of trade. Until 2004, the share of SMEs in the trade sector was substantially reduced compared to 1993, getting to 54% (APPRM, 2005). Concerning the regional aspect, the largest part of the SMEs is concentrated in Skopje, Bitola, Kumanovo, Prilep, Ohrid, Strumica and Tetovo.

In 2004, based on the changes within the Company Law, Macedonia adopted the methodology for classification of the enterprises based on the size, proposed by the EU Commission. According to this methodology, the enterprises are classified upon three criteria. The first criterion (number of employees) is accepted in Macedonia and consequently there are micro, small, medium and big enterprises. The other two criteria (size of the turnover and total amount of the assets) are adjusted to fit Macedonia's conditions. Hence, a small enterprise in EU is an entity with a yearly turnover of 10 million EUR, while in Macedonia it should have only 2 million EUR.

In 2013, there were 75,227 enterprises in Macedonia, out of which 99.9% or 75,139 are SMEs. In this line it should be noted that the SMEs are significant not only for having the dominant share of total entities in Macedonia, but for employing more than three-quarters of the workforce (221,323 or 81.2%). Furthermore, the SMEs generate more than two-thirds of the overall value added (1,530 mil EUR or 68.1%). Additional conclusion arises in the line of sectorial changes in the SMEs in Macedonia. Namely the trade has decreased its share for additional 17% compared to 2012. Moreover, the manufacturing, construction and transport have a common share of 26%, while the Information and communication, Financial and insurance activities, as well as Professional, scientific and technical activities contribute with 10%.

In the first years of the transition period, the SMEs sector was developing spontaneously, without any substantial governmental support or planned policy measures. Yet, as the number of the SMEs grew and their contribution to the country's development became more meaningful, special institutions for support to the SMEs and the entrepreneurial process were established.



Despite the fact that Macedonia during the transition has an increased number of SMEs and meaningful institutional support, yet the conclusion is that there is a lack of SMEs. Namely, today there are approximately 35 active SMEs on 1,000 inhabitants, while the critical point is 50-60. This means, a large number of current SMEs in Macedonia has weak innovative approaches and has modest export results. Additionally, the institutions whose general aim is to provide support to the SMEs and the entrepreneurship in Macedonia are with limited capacity (UNDP, 2006).

#### 4. LIMITATIONS OF SOURCES FOR FINANCING SMEs

In the early phase of the transition process, despite the rapid development of newly established SMEs, the sources for financing were very limited. Actually, up to 1996, only two sources for financing SMEs in Macedonia were present: (i) 3F money; and (ii) Bank loans. After 1996, the Government mobilized the foreign credit lines, while the debt capital was not present.

Table 1. Financial limitations for the SMEs in Macedonia, Slovenia and Bosnia and Herzegovina (%)

| Types of financial limitations                             | Macedonia | Slovenia | Bosnia and Herzegovina |
|--|-----------|----------|------------------------|
| High credit costs  | 63        | 44       | 62                     |
| High value of mortgages                                    | 54        | 41       | 54                     |
| Indifference of banks for SMEs                             | 55        | 24       | 46                     |
| Long time to obtain a credit                               | 55        | 22       | 45                     |
| Very high bank expenses for processing the credit requests | 51        | 29       | 45                     |
| Bank administrative procedures                             | 50        | 25       | 44                     |
| Reject of financial request                                | 57        | 13       | 41                     |
| Average  | 55        | 28       | 48                     |

*Source:* Bartlett and Bukvic. (2002), p. 25.

Concerning Macedonian banking over the transition, it may be noted that it was in a process of rehabilitation and consolidation. After its independence, the banks were faced with huge problems particularly in servicing foreign exchange-denominated deposits and substantial share of bad loans in the banks' portfolio. Consequently, the banks lost their credibility among citizens and business entities.

Table 1 presents the key findings from perception of the surveyed enterprises towards their general financial limitations (Bartlett and Bukvic, 2002, p. 25). It is noticeable that the financial obstacles for the Macedonian SMEs are by far larger compared to other two investigated countries. In the

same line is the conclusion that the financial limits for the growth of the SMEs have the highest rank compared to other potential obstacles (taxation, administrative regulations, legal aspects, lack of institutional support) (Bartlett and Bukvic, 2002, p. 34).

In order to overcome the detected limitations for further development of the SMEs and the entrepreneurship in Macedonia, the Macedonian Bank for Development Promotion was established in 1998.

## 5. MACEDONIAN BANK FOR DEVELOPMENT PROMOTION

The MBDP is the only state developmental bank in Macedonia, established in 1998, with a constitutional capital of 15 million EUR and structure upon the concept of the German Development Bank KfW. It is interesting to note that the first idea when establishing the MBDP was to support the export of the Macedonian firms, the one not supported by the International Monetary Fund (Trpeski, 2009, p. 473-477). In general, MBDP supports SMEs because in the frames of enterprises which produce to export, substantial part belongs to SMEs.

Table 2. Credit lines from MBDP own funds, 2013

| Credit line                                     | Amount in EUR   | Repayment period                                     | Interest rate |
|---|---|--|---------------|
| Financing of small and medium sized enterprises | 15,000-500,000  | Up to 8 years, grace period of up to 1 year included | 6.5%          |
| Financing of export oriented production         | 15,000-2,000,000 through banks and up to 1,000,000 direct lending | Up to 2 years  | 6%            |
| Permanent working capital financing             | 30,000-300,000  | up to 3 years  | 6.5%          |

Source: Annual report 2013 (MBDP, 2014, p. 24)

Table 2 presents the credit lines from MBDP own funds. Namely, starting from 1999 until 2013, MBDP created several active credit lines for SMEs financing originating from own funds. In 2013, 25 projects of SMEs were supported by these credit lines mostly in the field of manufacturing, transport and export oriented companies, with a total amount of 1,906,088 EUR.

Table 3. Terms of loans from EIB

| Investment Loans (226 applications)                  |                        |
|--|------------------------|
| Single credit amount intended to final beneficiaries | 15,000 – 3,500,000 EUR |

|  |  |
|--|--|
| Repayment period                                       | Up to 8 years  |
| Grace period included                                  | Up to 2 years  |
| Purpose  | - Purchasing fixed assets<br>- Investment in intangible assets                                   |
| Loans for permanent working capital (145 applications) |  |
| Single credit amount intended to final beneficiaries   | 5,000 – 666,700 EUR  |
| Repayment period                                       | Up to 3 years  |
| Grace period included                                  | Up to 6 months   |
| Purpose  | Increase of working capital within expansion of company business operations                      |
| Loans for priority projects (7 applications)           |  |
| Single credit amount intended to final beneficiaries   | Up to 6,000,000 EUR  |
| Repayment period                                       | Up to 8 years  |
| Grace period included                                  | Up to 2 years  |
| Purpose  | Providing support to priority projects in the area of industry, education, culture, ecology etc. |

*Source:* MBDP (2014, p. 26-27)

Regarding the credit lines provided by foreign financial institutions, bilateral creditors and other sources, the following were active: EIB credit line, Commodity credit line from Italy (Revolving Fund), SME credit lines from KfW (KMB 1, KMB 2 and KMB 3), as well as the Sustainable energy projects. All programs have identified the financing priorities according to the priorities of the macroeconomic policy of Macedonia (MBDP, 2014, p. 24-26). The brief overview of the main EIB credit lines encompassing the investment loans from EIB, loans for permanent working capital from EIB, as well as the loans for priority projects from EIB, are presented in Table 3. Yet, in the course of 2013, MBDP continued to utilize credit lines from other foreign creditors and donors. Besides the funding from three phases of the loan arrangements with the European Investment Bank (EIB) where the I and II arrangements were fully used, and the III was 95% used, favorable conditions were created for carrying out the IV arrangement in the amount of 100,000 EUR (the realization of this arrangement was foreseen for 2015).

During 2010, from the own resources of the credit line for financing SMEs, 14 loans were launched with total amount of 2,337,000 EUR, out of which 44% was for manufacturing, 21% for services, 15% for furniture production, 9% for food production, 6% for construction and 5% for transport. Furthermore, two loans with a total amount of 60,000 EUR were

launched for working capital. It is interesting to note that in 2010, in the frames of the Program for support of export production the interest rates were decreased from 8% to 7% (MBDP, 2010, p. 20). In 2011, four loans from this program were approved with total amount of 1,606,950 EUR, while from the program for working capital only two loans were approved with total amount of 60,000 EUR.

Consequently, concerning the role of the MBDP in the financing SMEs as well as the entrepreneurship, one may conclude that it was important and progressive. This is based on the facts that this institution was active in the period when the interest rates were extremely high (nominal and real) and when the SMEs sector had limited access to finances from the commercial banks. The MBDP enabled the increase in the bank loan supply in the Macedonian economy and the decrease of the interest rates.

## **CONCLUSIONS AND RECOMMENDATIONS**

Financing SMEs is among the most important issues and problems they are faced with during different phases of their life cycle. In this line, the commercial banks are by far the dominant source of financing, by participating even with 70% in the EU countries. On the other hand, the countries with developed financial system have much more diversified resource structure, unlike the transition countries and countries in development. Namely, the developed countries have a large portion of financing by the risk capital (business-angels and official venture funds), while within the debt capital the leasing and factoring have increasing importance. Completely opposite is the situation within transition countries and countries in development where the noted financing sources have modest participation.

Due to specifics, the SMEs bear a bigger risk for financing which leads to limited access to finances. However, the governments are fully aware that the SMEs are significant business segment with substantial contribution to sustainable economic development. Therefore, they identify measures and activities for supporting the SMEs development and entrepreneurship in terms of institutions and instruments. Hence, there are many public institutions (developmental banks, funds, etc.) which generally present public financial funds for SMEs financing, special programs for subsidizing interest rates of loans for small businesses, various guarantee schemes etc.

Furthermore, it can be concluded that the public financial institutions support the SMEs which have innovative approaches towards their businesses, high developmental potential, and implement projects for

environmental protection, application of renewable sources of energy and improving energy efficiency.

In this line, the following may be recommended in terms of improving the access to finance for the SMEs:

- Introduction of a comprehensive and pro-active approach of lending by commercial banks;
- Improving transparency by SMEs;
- To decrease collateral requirements thus increasing the number of good businesses to be financed;
- Development of micro lending (guarantee schemes);
- More aggressive advertising of export credit insurance and putting tight rules to ensure the sustainability;
- To introduce appropriate fees and legislation in the line of developing export credit insurance;
- To foster development of cross-border leasing, factoring and business angels;
- To enhance the role of business incubators, their activities and possibilities, and so forth.

Generally, Macedonia needs to pay more attention to further development of SMEs in terms of access to finance, particularly by accomplishment of the rule of law. Hence, a more liquid market for financial instruments will be established resulting in new financial products and more diversified financial structure for SMEs.

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