“Reforming the Business Environment - from assessing problems to measuring results”

Engaging the Private Sector
in Business Environment Reforms
- Experience from Southeast Europe -

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EXECUTIVE SUMMARY

Regulatory transparency has been improving in Southeast Europe due partially to the increasing participation of the private sector in the process of creating new laws and regulations. Donor funded development projects have contributed significantly to this.¹

One of the most important lessons learned in the implementation of reforms in the developing world is that public consultation with various private sector stakeholders is one of the prerequisites for successful reforms of the business environment. There are a number of different mechanisms to bring private sector interests into the policy process. Some of them have proven to be more successful and some have not worked well in the region of Southeast Europe. The experience shows that broad initiatives such as the creation of permanent forums between business and governments have not had a long life. However, when there is a very specific business environment reform such as the introduction of legislation that targets and can greatly affect a very specific industry, it is much easier to obtain private sector participation in the process. This is in stark contrast to the broad coalition, broad issue groups that tend to collapse under free rider and incentive problems.

The general conclusion would be that a combination of different public consultation tools throughout the regulatory processes would have the greatest impact. As IFC/SEED leasing and factoring project experience indicates, informal consultations and circulation for comment of draft legislation have been ideal when there is a limited number of key players from the specific industry. These ideally take the form of round tables and small group presentations at the early stage of a business enabling environment intervention. Large public debates designed to allow input from the general public should be left for the final stage of a business enabling environment intervention.

¹Private sector development projects such as Serbia Enterprise Development Program (SEDP) and IFC/SEED project work will be presented in the paper.
The paper’s main objective will be to present a few case studies outlining both successful and less successful examples of the participation of the private sector in the reform process. More importantly, the paper will also present and assess various approaches to project assessment, design and implementation, which significantly contribute to the inclusion of the private sector in the process of creating new regulations.

The paper will also try to provide an analysis of the impact of the presented business enabling environment (BEE) projects. This will be the most challenging task. Many would agree that it is very difficult to measure the impact of BEE interventions, especially short-term. In the specific projects related to introduction of new financial instruments in the market place (The BEE component of these project would be introduction of specific legislation) it is easier to measure the impact since there are concrete figures presenting the volume of financing before and after the intervention. However, in some “classical” BEE projects, such as the reform of inspection procedures or the introduction of certain pieces of legislation, it is not an easy task.
Introduction

Southeast Europe Enterprise Development (SEED), was a donor-sponsored facility managed by IFC with a five year mandate (2000-2005) to develop small and medium enterprises in the region of Southeast Europe (Serbia and Montenegro, Albania, Bosnia and Herzegovina and FYR Macedonia). Together with other donors, IFC/SEED has played an active role in improving the business environment for private sector development. This paper will lay out lessons learned in Southeast Europe with some attention to how these lessons could be applied elsewhere in the world. This paper will mostly rely on IFC/SEED’s project work and experiences in the area of the business enabling environment (BEE) in the region. The main focus will be on case studies from Serbia and Montenegro, but as a regional facility IFC/SEED implemented the same projects and applied the same project methodology elsewhere in the region.

The main paper’s focus will be on the conference topic “The practice of reforms” with special emphasis on the issue “Engaging the private sector in business environment reforms and promotion of private-public dialogue.” However the paper will also briefly address other conference themes such as business environment assessment and project design, since good diagnostic tools and project design are necessary prerequisites for a successful BEE intervention.

The paper will also examine studies on the potential of leasing and factoring development in the region of Southeast Europe. By identifying major legislative gaps and barriers for development of these financial instruments, these studies provided necessary input for legislative changes. The studies proved that the lack of an adequate legal framework was the main reason preventing banks and other financial institutions from being more flexible in their lending practices and introducing so-called alternative financial instruments such as leasing and factoring. Therefore market surveys with direct feedback from the private sector, at least as per SEED’s experience, are very important diagnostic tools in and of themselves, in addition to serving as the first phase of any BEE intervention.
Within the above topic the paper’s main focus will be on public consultation of various stakeholders in the regulatory reform process with special emphases on the participation of the private sector. Using a few case studies from the region of Southeast Europe, the paper will introduce IFC/SEED’s methodology, and discuss how this methodology significantly contributed to the inclusion of the private sector in the public reform process.

Definitions

There is no unique and widely accepted definition of the business enabling environment. Even within the IFC there are many approaches to what is a BEE. In the lively on-line discussion on the IFC ‘s BEE Net\(^2\) in the spring of 2005 there were many different, often contradictory views on what encompasses a BEE project. These opinions ranged from the belief that only interventions leading directly to changes of laws and regulations were a BEE project, to the opinion that even this type of project when referring to one aspect of a larger program like access to finance, cannot qualify as a BEE project. Furthermore, when discussing BEE tools one discussant argued that surveys should not be considered BEE projects, but rather a study on the potential for factoring in a particular country would, at best, be project preparation not a “real” BEE project.

Outside of IFC there is a wider understandings of what the business environment involves. The Swedish International Development Agency (SIDA) has grouped the factors that influence development of the private sector into three levels of economic activity: macro, meso, and micro. Under this definition, business environments in which enterprises operate are effected by macro and meso factors whereas micro level factors affect firms directly. The macro level factors, which are the most important for the business environment, include three spheres of influence and each of these three spheres combines to effect the market in which the private sector operates. These spheres are:

1. the social and cultural context
2. the political systems

\(^2\) Network of IFC staff involved in design and implementation of business environment reform projects IFC- wide
3. the economic systems and policies

According to the World Bank, market institutions which make up the business environment are those that are instrumental in creating the rules, enforcement mechanisms and organizations within which markets operate. In this context the business environment contains a wide range of policies, laws and regulations that generally provide the ‘rules of the game’ for private sector activities. The social, economic and political spheres, each of which are interrelated and physically represented in the range of institutions, influence these rules. The combined affect of these influences, rules and institutions is expressed through the performance of markets.

For the purpose of this paper we will understand BEE work as “Project work designed to improve institutional legal and regulatory conditions under which businesses operate, including changes to government policies, laws, regulatory frameworks and administrative practices by public sector entities.”

Promotion of private – public dialogue

Private-public dialogue has a crucial role to play in the success of regulatory reforms in developing countries. However, the success of public consultation, the active seeking of feedback and comments from all the relevant stakeholders on regulations before adoption, very much depends on the way consultations are designed. Public consultations for new laws and regulations should be adjusted to the specific cultural and institutional context of the country.

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5 Enabling small Enterprise Development through a better business environment Technical Document-White
7 Improving the regulatory and administrative environment for private sector development in Serbia (2002) Scott Jacobs
OECD countries use several approaches of public consultations:

- Informal consultations between regulators and interest groups.
- Circulation of regulatory proposals for public comment – the weak point is deciding who will be included.
- Public notice and comment – publication of draft regulations for public comments. This approach fulfils the transparency requirement, however many countries found the participation very low.
- Public hearings of regulatory proposals.
- Advisory bodies – there are many types of advisory bodies councils, committees, commissions. They usually have a specific mandate or task within the regulatory process and they include members from outside the government.

The concept of open discussion about draft laws and regulations has not been widely accepted in Serbia. The first attempts to include the private sector and other relevant stakeholders in the process of legal and regulatory reform started with the new democratic regime in Serbia in 2001 and with the beginning of donor technical assistance projects. For the first time there were public discussions in the form of roundtables and presentations of important draft business laws. The private sector was given the opportunity to provide feedback and comments before laws were passed on to the Parliament for adoption.

The Bankruptcy Law, Law on Secured Transactions, Law on Financial Leasing and the draft Law on Factoring were the subject of dynamic public debate in Serbia. These were considered to be progressive laws which foreign investors would approve of. The general consensus among those supporting legal reform projects is that representatives of the banking sector and multinational enterprises are the most responsive and proactive in providing feedback on draft regulations among private sector are. Small and medium size enterprises are still a reluctant to add their voice in the process of public consultation. Another problem for engaging small and medium size enterprises in the process, at least in the region of Southeast Europe, is a difficulty identifying their real representatives – leaders who will present their views and will act on their behalf in communication with

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8 Improving the regulatory and administrative environment for private sector development in Serbia (2002), Scott Jacobs
9 ibid
Government officials. There are very few business associations in the region and those are the only points where SME representatives can legitimately give the voice of the bulk of the private sector in the process of reforms.

One of the first attempts to enhance private-public dialogue in Serbia and to start wider public consultation with the private sector was the establishment of the SME Advisory Board. It was established by the decree of the Serbian Ministry of Economy. The task of the Board was to provide assistance to the Ministry in improving the environment for small and medium size enterprises and entrepreneurs. This would include creating better policies to stimulate the development of entrepreneurship and SMEs.

The Board was to issue appropriate conclusions, opinions and recommendations to the Minister. The members of the board were appointed for a period of 4 years. The board was composed of representatives from small and medium enterprises and entrepreneurial establishments. A weakness of the initiative was that the Board was established at the ministry level and other ministries were not obliged to accept its recommendations. Unfortunately, it was considered to be ‘outsider’ rather than a part of an open decision making process. This initiative was not successful also due to the following reasons:

- lack of political will from the related Ministry to hear the Advisory Board’s recommendations;
- that the Ministry of Economy was largely using the Advisory Board just to show the wider public that there was communication with the private sector, but at the same time did not really implement the Board’s decisions;
- business associations are still underdeveloped so it was difficult to identify the most relevant SME representatives and delegate them to the Board.

Another donor-funded initiative to create a permanent forum between business and government was the National Competitiveness Council (NCC) initiated by the USAID funded Serbia Enterprise Development Project (SEDP). A combination of elements

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10 Decree of the establishment of the SME Advisory Board, Ministry of Economy of Serbia article 2
11 ibid
12 Serbia Enterprise Development Program (SEDP), 3 years long USAID funded project in Serbia worth $11.8 million
came together to undermine success in the NCC. There was a basic lack of agreement on purpose and strategy, so other than a nebulous concept of “competitiveness” there was little to rally around. There was no consensus in the public and private sectors about their respective roles. The membership had no real tradition of working effectively in such groups. In fact, under the past system there was more of a history of being part of rather ineffective groups. Finally, whereas there were considerable costs in terms of time and resources to participate, once the photo opportunities were over, there were few tangible benefits. Executives went back to running their companies, and the government folded.

Broad coalitions such as the NCC and the SME Advisory Board have strong public goods aspects to them and nearly always require government support to work. Government also responds to incentives, however, and must feel that its constituency will view such an initiative positively. In the case of the both above-presented initiatives there was insufficient focus and insufficient public recognition. One lesson for such projects is that the initiators may benefit from a strong initial public information campaign to generate adequate public sector incentives for participation.

However, there have been a few more successful attempts at soliciting the participation of the private sector in the business reform process. Below, we are going to examine a few case studies: introduction of leasing and factoring legislation in the region of Southeast Europe as a part of IFC/SEED’s broader Access to Finance program, and the IBRD project on reform of the business registration system. The paper will also briefly mention two BEE initiatives implemented by SEDP in Serbia where participation of the private sector contributed to project success: the Serbian Labor Law Revisions and the introduction of competition legislation.

The next few sections will focus on IFC/SEED’s methodology in facilitating dialogue between the governments and the private sector in the process of legal reform, with a special emphasis on the participation of the private sector in reforming the business environment. Various diagnostic tools will also be addressed here that can be used first to identify and then to include major private sector stakeholders in the process of creating different pieces of legislation.
BEE Components of IFC/SEED’s Access to Finance Program

Lack of financial instruments available to SMEs has been identified as a major problem for private sector development in transitional economies. “Whether due to supply or demand constrains, on average one in five SMEs in Europe considers access to finance as a barrier to growth”\(^{13}\). In Southeast Europe, for decades financial markets were isolated and lacked the support of international financial institutions. Most SMEs still use their own capital as a main source of financing. Entrepreneurs and small enterprises in most cases cannot qualify for bank loans due to the banks’ high collateral requirements. In most cases, to secure a loan banks ask as collateral real estate or other tangible assets two or three times the value of the loan itself.

In the region of Southeast Europe where classic forms of SME financing (loans) are not sufficient due to an undeveloped financial sector and high transaction costs of lending, the development of leasing and factoring industry programs were seen as potential alternative methods of financing that would partly compensate. In accordance with its strategic objective to improve access to finance in the region of Southeast Europe, SEED has been working on development of financial leasing and factoring in Serbia and Montenegro, Albania, Bosnia and Herzegovina, and the former Yugoslav Republic of Macedonia. The programs, utilizing similar methodologies, have consisted of two phases: (i) legislation development and, (ii) market development, in the respective countries.

In the legislation development phase, SEED partners with the governments of the respective country to introduce relevant leasing or factoring legislation. Firstly, an assessment of all laws related to these financial instruments is undertaken, in conjunction with Government authorities, in order to determine whether separate legislation is required or if only amendments of various pieces of legislation would be sufficient. Depending on the particular requirement, new laws are drafted or amendments proposed, after significant consultation with the relevant public and private stakeholders.

\(^{13}\) Analyses of use of factoring (2002), Greater London Enterprise Ltd, p.1
In the market development phase, SEED focuses on capacity building activities. These are mostly technical assistance and training activities, focusing on local key stakeholders such as commercial banks and other financial institutions as potential lessors or factors, local business service providers, and SMEs. Intensive promotion of these financial instruments targeting all relevant parties is part of market development.

**IFC/SEED Factoring Development Project - Case study Serbia**

*Project background*

The objective of the project was to improve access to finance for working capital to SMEs in the region. The tactic was to approach and partner with strategic factoring companies that were interested in entering the SEE market, assist government institutions and central banks in creating a factoring friendly environment, enhance the local capacities of regulators, financial institutions, companies, and local consultants, and increase public awareness of the benefits of factoring.

The IFC has had extensive experience in investing in the factoring industry. To date the IFC has invested $3.1 million in seven factoring companies. On average, the IFC has taken a 20% equity stake in these firms. The IFC/SEED factoring development project is one of the pioneer technical assistance projects within the IFC.

Factoring is one of the alternative financial instruments that operates outside of the traditional banking sector. The collection of receivables is one of the largest problems that SMEs face in the region. Introducing factoring companies or factoring activities within commercial banks or other financial institutions would help accelerate cash circulation, speeding the rate at which it is re-injected into the economy. Factoring is also important for export-oriented companies as it helps export promotion and so increases foreign currency liquidity. Export factoring has also proven to be very successful in promoting international trade. It enhances access to new markets and relieves the exporter of the financial burden of the export transaction. In particular the exporter can concentrate on his real business, the selling and marketing of his products rather than the collection of the receivables due from overseas buyers.
Factoring has become a major source of financing in developing world: “only in Eastern Europe factoring grew by 434 percent in aggregate between 1998 and 2003”14.

What makes factoring attractive for developing countries? IFC/SEED used several arguments to convince the governments of SEE countries to introduce a legal framework for factoring development and to motivate commercial banks to engage in this activity. The crux of the argument was that there are several advantages that factoring has over other types of lending which are specific for developing countries. First, factoring is especially useful in countries with weak implementation of secured lending laws and insufficient bankruptcy procedures because factored receivables are not part of the balance sheet of a bankrupt SMEs. Second and most important for the region of Southeast Europe, is the fact that in a factoring relationship credit is primarily based on the quality of underlying accounts, not really on the creditworthiness of the client. This means that a client which cannot qualify for a loan can be a good client for a factoring company. Thus factoring can be especially attractive for high risk SMEs.15

However, despite the advantages of this financial instrument and its ability to provide immediate cash flow for enterprises, this financial instrument did not emerge in the countries of Southeast Europe.

There are many different understandings of factoring. However when advising the Governments in Southeast Europe on factoring legislation development IFC/SEED was relying on the Unidroit Convention on International Factoring (Ottawa, 25 May 1988) which defines factoring as: “Factoring contract is a contract concluded between one party (the supplier) and another party (the factor) pursuant to which:

- The supplier may or will assign to the factor receivables arising from contracts of sale of goods or services made between the supplier and its customers (debtors) other than those for the sale of goods bought primarily for their personal, family or household use;

15 ibid
The factor is to perform at least two of the following functions for the supplier:
- Finance for the supplier by advance payments;
- Maintenance of accounts (ledging) relating to the receivables;
- Collection of receivables;
- Protection against default in payment by debtors;

Notice of assignment of receivables is to be given to the debtor.

Private sector participation in IFC/SEED factoring development project

Applying the methodology described in the previous chapter, IFC/SEED first conducted factoring market surveys in each country and organized a series of roundtables with representatives of the private and public sectors. The stakeholders’ attendance and responses showed that there was a significant demand in the market for the product and factoring looked like a more promising product than it was perceived at the beginning.

The market survey started with a questionnaire, which was sent out to all the potential providers of factoring services, mostly banks and other financial institutions. The questionnaire consisted of the following questions:

- Has the bank been engaged in factoring activities and if so in what volume?
- Does the bank enter factoring deals only with clients of the bank?
- Does the bank have a specialized factoring unit?
- Does the bank require additional collateral requirements when entering a factoring deal?
- What are the bank’s projections for factoring development in the future, etc.?

Below are the survey results for Serbia, but they were similar elsewhere in the region. The survey conducted in February 2005 showed that there was no true factoring company operating in Serbia, only one non-bank financial institution in Serbia (SMECA\textsuperscript{16}) was partially engaged in specialized factoring activity (100% international factoring). A number of banks were offering quasi-factoring services. By quasi-factoring services we

\textsuperscript{16} Serbia and Montenegro Export Credit Agency (http://www.smeca.co.yu)
mean services based on asset based credit frame other/in addition to account receivables. According to the market survey, the factoring (quasi factoring) market in Serbia had an estimated value of around Euro 50 million in 2004. Furthermore, projections were made that the future factoring volume could reach the yearly level of 400 million by 2010 provided that there is an adequate legal framework in place.

Most of the participants in the survey and later at the private sector stakeholders roundtables and meetings identified the lack of adequate legislative framework as the main constraint on the development of factoring products. As in many other developing countries, legal systems in Southeast Europe face the problem of insufficient protection of creditors’ rights as a consequence of shortcomings in bankruptcy law, particularly in its implementation. An unfavorable foreign exchange regime and long contract enforcement procedures as well as uncertainty about the legal status of potential factors have been identified as the main barriers for further development of this product. These inputs collected from the private sector were vital for the further design of the IFC/SEED technical assistance factoring project, which was aimed to advise the governments of respective countries in drafting factoring legislation.

The general consensus was reached among relevant stakeholders in all four countries about the most important legal issues to be resolved in order for factoring to function. First creditor rights should be strengthened – in some countries there is sound insolvency legislation, but its implementation is questionable. Also, the time frame required for contract enforcement can become a very serious issue. Third, there is no possibility or there is a very limited possibility to exchange credit information about clients. A credit bureau exists only in Bosnia and Herzegovina, and there is a limited credit information system put in place within the Association of Banks in Serbia. Limited in the sense that the commercial banks in Serbia which are members of the Association use the Association’s database to exchange information about credit history / credit worthiness of their clients.

There was also a debate on whether a minimum capital requirement for factoring service providers should be introduced and whether factoring businesses should be licensed and supervised by the central bank, Ministry of Finance or any other supervisory body. There was a general consensus that when a bank is directly engaged in factoring operations there should be supervision. However, many argued that an independent factoring
company, as a non-deposit taking institution, should not be subject to supervision. Stakeholders also agreed that a minimum capital requirement should be introduced in order for a company to start a factoring business, but it should be lower than the capital prescribed for establishment of a bank.

In order to work closer with potential investors in factoring region-wide, IFC/SEED signed a memorandum of cooperation with two regional factoring companies (EFG Factors from Greece17, Prvi Factor from Slovenia18) interested in expanding in Southeast Europe. According to the memorandum, IFC/SEED undertook to advise the governments of respective countries to introduce adequate legal framework for development of factoring operations, to develop specialized factoring trainings and to raise awareness of SMEs on factoring and its advantages.

Working with private sector practitioners helped IFC/SEED assess the potential size of the factoring market and determine needs and potential for future investments. This served in the later stages of the project as a powerful instrument to convince the Government that the creation of an adequate legal framework will attract new investment. The full report, including market potential and regulatory barriers, was presented to relevant policy makers and to all interested financial institutions (potential entrants into the factoring market) at a roundtable. The aim was to initiate public discussion between major stakeholders. Soon after, SEED initiated the formation of a working group to draft factoring legislation and organized a public discussion on a few of the most burning issues.

As a facilitator between the Government and the private sector, SEED was bringing commercial interests and input to the policy makers. The opportunity was given to the private sector to provide comments on the draft law. SEED then worked with the Government on redrafting the law based on the comments received. The draft Factoring Law in Serbia is planned to be introduced in the fall of 2005. Aware that without local know-how and capacity building of local participants, the factoring product will not

17 EFG Factors is a subsidiary of EFG Eurobank from Greece (http://www.eurobank.gr)

18 Prvi Faktor is a subsidiary of Ljubljanska Bank Group from Slovenia (http://www.nlb.si)
emerge in the respective markets even when adequate legislation is in place, IFC/SEED also developed and delivered a number of factoring trainings region – wide. The training title was “Introduction to Factoring” and it was aimed to build capacity of local stakeholders to engage in factoring activities. It covered the history of factoring, terminology, global presence, types and application, process flow, how a factoring business should be organized, accounting standards related to factoring, differences between banking and factoring, management of suppliers and buyers accounts, pricing, risks, credit underwriting of suppliers and buyers, marketing/selling of factoring, fraud, factoring contracts and the content of the draft Law on Factoring.

The attendees were mostly representatives of banks and other financial institutions. The number of participants was higher than expected. In Serbia the demand for trainings was so high that IFC/SEED introduced additional training days. Most of the participants attended the training because of IFC’s proven track record in investing in factoring and because of IFC/SEED’s work with the Government on the creation of factoring Legislation. Despite the closure of IFC/SEED’s factoring development project on 30 June, 2005 factoring companies and commercial banks with plans to engage in the factoring business still contact IFC/SEED as a center of information on factoring opportunities in Serbia.

The volume of factoring operations in Serbia currently exceeds EUR 7 million, 4.2 million financed by Prvi Factor for the period of 4 months and EUR 3.5 million by SMECA for the period of 6 months. These two are currently the only specialized factoring companies\(^\text{19}\) on the Serbian market. Both companies expect a much higher volume of financing later in 2005 when factoring legislation is adopted.

The participation of the private sector at the project’s early stage starting from engagement in the factoring market survey and later providing comments on factoring legislation issues, served as a vital diagnostic tool for IFC/SEED to identify the next project steps.

\(^{19}\) Serbia and Montenegro Export Credit Agency (SMECA) and Prvi Factor, subsidiary of Nova Ljubljanska Bank from Slovenia
Leasing Development Project – Case study Serbia

Project Background and achieved impact

Emerging in mid-2003, financial leasing is still a relatively new financial instrument in Serbia. The leasing business surfaced soon after the necessary legislation was put in place, and it has continued to grow since. IFC/SEED played a key role in the development of leasing in Serbia, both through its involvement in the legislation drafting phase and its ensuing market development activities.

The financial leasing law, passed in May 2003, was branded by the banking community as one of the most progressive pieces of leasing legislation in the region. The law regulates financial leasing transactions, rights and obligations of the parties to financial leasing, as well as the financial leasing registry. The repossession procedure and the tax treatment of leasing, in addition to a relatively low capital requirement has strongly encouraged new entrants into the leasing market. Moreover, there are neither licensing nor supervision requirements for leasing activities and equal treatment for both domestic and foreign-based leasing companies is guaranteed.

Favorable regulation enabled the establishment of nine leasing companies only a year after the financial leasing law was adopted. Most of the companies set up are foreign banks’ subsidiaries. Early market entry proved to be a good strategy. Four companies that launched their operations immediately after the enactment of the law are now dominating the market, while the other five (that commenced their operations in 2004) currently hold a negligible market share. The situation on the market is shown in the following graph:
All of the nine leasing companies have recently established an Association of Leasing Companies in Serbia (ALCS) to further promote financial leasing.

In view of the relatively small market size (with a population of eight million\(^20\) and a GDP per capita of a little over US$ 2,500), it is the general consensus that the Serbian leasing market grew very rapidly. In the first full year of leasing activities, the volume of financing exceeded € 150 million, with nearly 7,500 leasing deals. Given that a leasing deal averages € 20,000, it is evident that SMEs constitute the main beneficiaries. With leasing in place, it seems they have finally been granted an affordable and simple access to finance that cuts through issues of lacking collateral and conservative lending practices. Mid-term projections show that the market may grow at an annual pace of nearly 30% to reach the amount of € 450-500 M of new deals in 2008 (shown in the table bellow).

\(^{20}\)Excluding Kosovo
Private sector participation in the IFC/SEED leasing development project

IFC/SEED has always advocated for public consultation as a prerequisite for successful regulatory reform. Open communication between major stakeholders helps governments to make better decisions about regulations. IFC/SEED achieved its biggest success in engaging the private sector in business environment reform in the course of its three year long leasing development project.

One of the key project considerations at the very beginning was identifying appropriate private sector stakeholders and finding the best way to motivate them to participate in the process of introducing leasing legislation.

Broadly, stakeholders are those groups or people that are either actively involved in developing leasing locally, or that will be affected by the development of leasing. Key stakeholder groups include the local Government, the banks, non-bank financial institutions, any existing or potential lessors, existing or potential lessees, small and medium sized enterprises (SME’s), equipment manufacturers, the professional services sector – lawyers and accountants.  

IFC Leasing Development Manual, September 2004
Once the stakeholders were identified, it was difficult to convince the line ministry in charge of drafting leasing legislation to hear the voice of the private sector and to create legislation that could be successfully implemented. At the very beginning of commercial law reforms in Serbia there was a tendency to apply a very academic approach in creating new legislation. Therefore it was one of the main project objectives, and at the same time one of the largest challenges, to try to change people’s way of thinking and emphasize the importance of participation of practitioners who will be implementing regulations at the very early stage of legislation creation.

Based on the above principle, the private sector has been involved in all stages of IFC/SEED’s leasing program. The participation of all relevant stakeholders has been a vital aspect contributing to program ownership by the banks and leasing companies and the outstanding success with enterprises.

From the beginning, commercial banks and other financial institutions were involved in drafting the law. Roundtables were organized incorporating the private sector, allowing them to give input and comment on the various drafts of the leasing law. These comments were reviewed and incorporated in the draft law where appropriate. The financial institutions also provided significant support to a relatively quick law adoption. In a communication to Government, the financial institutions set out the benefits of adopting the law, thereby assisting to accelerate the law adoption process, which had been stalled.

Following the adoption of the law as a part of the implementation process, significant training programs were implemented for local banks/leasing companies, SMEs and business service providers. The training was repeated 18 times in 10 cities nationwide over a period of 7 months following the adoption of the law.

In parallel with the training program, a two-stage national awareness campaign on leasing and its advantages was undertaken by IFC/SEED. Stage I consisted of a three month long nationwide education programme introducing leasing to SMEs. Presentations were made to SMEs nationwide via the local SME support structures and flyers were distributed to more than 10,000 SMEs. Stage II, undertaken following SEED’s facilitation of the creation of a leasing company association, detailed below, consisted of directly
promoting the leasing association members in the electronic and printed media and distributing flyers to 30,000 SMEs. The leasing association members’ involvement consisted of input to campaign design and full funding. Additionally, the overall campaign resulted in more than 120 minutes of broadcasting on national radio stations, more than 20 minutes of broadcasting on 4 national TV stations, more than 180 hours of broadcasting on local TV stations, 15,000 “hits” on the SEED website and 20 articles published in various newspapers and magazines.

From adoption of the financial leasing law in May 2003 over 400 million Euro has been financed through leasing deals to date. The average deal value is 20,000 Euro indicating strong SME participation. The number of leasing companies has grown from two to eleven and an association of leasing companies has been established. As a result of training, business service providers are able to provide independent consulting services on the legal, accounting and taxation aspects of leasing. A unique part of programme sustainability in Serbia has been cost recovery through collection of fees and private sector support for individual programme components.

**Association of Leasing Companies**

In order to enhance the participation of the private sector in further improvement of the business environment for leasing and also as a part of exit strategy from the leasing project in Serbia, IFC/SEED initiated the formation of a national association of leasing companies (“Association of leasing Companies in Serbia – ALCS”). One of the main objective of the Association was for its members to jointly approach the government and advocate for the improvement of a legal and tax environment for financial leasing.

As one of its first activities, the Association proposed for the Financial Leasing Law to be amended and include real estate leasing. The Association was also active in lobbying for a more favorable tax environment for leasing. A very good cooperation was established between the Association and the Registry of Leased Assets as the registration of leasing contracts in Serbia is mandatory.

At the very end of its leasing development project, IFC/SEED was successful in transferring all its leasing training materials, leasing promotional brochures and leaflets,
and the content of its leasing website to the Association. Even the intern who had been assisting on the SEED’s leasing program was appointed as administrative secretary of the Association.

In order to introduce the leasing product to the private sector IFC/SEED entered into a partnership agreement with the Association and its members and jointly a conducted a three month long leasing awareness campaign. The experiences in the Balkans showed that there is lack of knowledge about leasing and its advantages and that most of the population, including entrepreneurs, saw it only as a way to get a new vehicle. The main goal of the campaign was to present leasing as a new financial instrument which enables the private sector to finance their investments in new equipment and other fixed assets. The strong emphasis on private sector participation and ownership of the reform process was the key to the successful establishment of leasing and the successful transfer of sustainable capacities.

Case Study: Reform of Business Registration System in Serbia

As recently as July 2003, the enterprise registration procedure in Serbia was very much bureaucratized, complex and lengthy. A long and complex procedure for enterprise formation was a big obstacle to the further development of entrepreneurship. Potential enterprise founders were faced with costs both in terms of money and time which unnecessarily postponed the start-up of their business. Apart from the costs imposed by the regulations which govern the procedure of enterprise formation, an additional burden imposed on investors was uncertainty due to the inefficiency of government institutions, non-observance of the prescribed time-limits and poor coordination among various government bodies.22

Furthermore, according to the IFC/SEED SME mapping report “The average time required to register a business was 105 days, and the average costs of registration of an enterprise were EUR 678.5. The basic problems are: poor timing between court proceedings, inefficiency of the court chambers, that the procedure is not done in one place, and lengthy decision making on the applications.”23

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22 Administrative Barriers to Investment (2003), Economics Institute, Belgrade
23 Serbia SME Map (2005) IFC/SEED Study
There were also two separate laws regulating business registration and two separate procedures of registration of business entities: Law on Private Entrepreneurs, according to which registration of private entrepreneurs was carried out by the municipalities; and the Enterprise Law, regulating registration of the companies under jurisdiction of commercial courts. Too many separate procedures and offices to visit in order to start up a business and a long start up period were identified as two out of five biggest regulatory obstacles in starting a new business. Entrepreneurs in Serbia experienced both. In order to overcome these two barriers Doing Business in 2005 gives recommendations as follows:

- Create a single access point for businesses;
- Get out of the courts and make registration an administrative procedure;
- Make registration electronic;
- Impose a “silence in consent” rule in business registration;
- Standardise paperwork.

As we will see in the next paragraph, all the above recommendations have been fully implemented in the process of reforming the business registration system in Serbia.

A comprehensive reform of the business registry system in Serbia started under the leadership of the Ministry of Economy back in 2002. The reform was supported by various donors, and was subject to World Bank conditionality. The World Bank has financed much of the development phase of the project.

The main objective of the reform was to get registration out of the commercial courts and transfer it to the Agency for Business Registers that will also include the Collateral Registry and the Leasing Registry. These changes will provide significant long-term cost-savings to the Serbian Government. In order to achieve this new legislation needed to be introduced.

The draft Law on Business Registration was developed by the inter-ministerial working group on business registration (later transferred into the Council for Regulatory Reform)

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24 Doing Business 2005
25 ibid
whose main function was to provide previous opinions on all draft laws and regulations from the aspect of their influence on the private sector).

As mentioned above, the IBRD has been broadly supporting the reform of business registration in Serbia. In support of that work, SEED identified various private sector stakeholders and supported workshops in several cities in Serbia aimed at facilitating dialogue about the necessary measures for business registration reform. The participants at the workshops were members of the inter-ministerial working group on business registration, Chambers of Commerce, commercial courts, municipalities, business associations, SMEs, business service providers, and all other stakeholders. Feedback provided by the private sector served as an important input to the creation of a very modern and progressive business registration system in Serbia.

The collection of stakeholder input was thorough and inclusive. It was argued by many that this process had been the most transparent law-drafting exercise in Serbia to date. The Working Group held three public hearings in March 2002, bringing together judges, attorneys, Chambers of Commerce, and businessmen. The Ministry circulated the drafts of the two new laws to these groups in advance of the conferences, and placed the draft law on the Ministry’s website so all interested groups had access. All stakeholders were supportive to the reform. However there were numerous issues raised such as whether it is necessary to create a single access point for registration of all business entities instead of having two different bodies, commercial courts for companies and municipalities for entrepreneurs? Also, there was debate on where the registration should be centralized. There were many options such as the Chambers of Commerce, the Insolvency Center, etc. Nearly all stakeholders agreed that nomination of an already existing body as the single access point for all business entities would be the best solution for Serbia.

Another subject of discussion was whether the registration should get out of the courts and become strictly an administrative procedure. Given that some judges had been in charge of registration during their entire careers, some of them were very reluctant due to the fear to be made redundant. Most stakeholders other than judges agreed that registration should definitely get out of the courts and be transferred to an administrative agency dealing only with business registration if this would make the process quicker and more transparent. Making the process administrative has good precedents world-wide.
Italy had the most cumbersome regulation in Europe, but in 1998 when registration was taken out of the courts the time previously needed for registration went down by three months.\textsuperscript{26}

The above-mentioned process resulted from adoption of the Law on Business Registration in May 2004 and establishment of the Agency for Business Registers as an independent administrative body. The new Agency has offices across Serbia, but works from a single centralized electronic database. It allows electronic registration and updating and ensures easy electronic accessibility to the database. A silence in consent rule has been introduced: a registration decision has to be issued within 5 days (until 1 November 2005 this term is 10 days). If not it will be deemed that registration has been accepted. Expected impact is already measurable. A unique centralized and accurate database of business entities in Serbia has been created, and the registration practices are now the same across Serbia. Furthermore, by decreasing the number of documents that have to be submitted the registration procedure itself has been simplified.

Apart from being a good business environment reform case study this project also indicates how IFC’s project development facilities such as SEED can complement and contribute to IBRD’s broader BEE projects.

\textbf{Labor Law Revisions and Introduction of Competition Legislation in Serbia}\textsuperscript{27}

In the fall of 2004, the Serbian Ministry of Labor put forth a set of amendments to the Labor Law that sought to largely reverse the progressive 2001 law. Many of the provisions were severe enough to be of great interest to the business community. The

\textsuperscript{26} Doing Business in 2005, A co publication of the World Bank, the International Finance Corporation and Oxford University Press

\textsuperscript{27} These two case studies were implemented by Serbia Enterprise Development Program (SEDP) – 3 years long USAID funded project in Serbia worth $ 11.8 million

* I would like to thank Mr. Andrew Vonnegut, Chief of Party of SEDP for his valuable contribution
SEDP organized a coalition of the four main business associations to defeat the new law. In this case, the activity was a partial success, both in terms of the removal of some of the worst provisions, and in terms of getting the associations to speak to the government and the press with one consistent voice.

This was a cause that was important enough for associations’ membership for them to overcome many of the coalition damaging factors that tend to prevail in Serbia. If the incentives are strong enough, many of the organizational, cultural, and political factors become less important. As shown by this example, these factors seem to operate more on the margins and can greatly affect outcome when incentives are weak. However, when incentives are strong, they become less important though never irrelevant.

The government itself had its own constituency to serve. It had previously made some compromises with union leaders that required it to pass new labor legislation. This made total defeat of the amendments nearly impossible. However, with adequate pressure from the private sector, and consequently from other members of the coalition government, the worst parts of the amendments were defeated.

Another case study of the less successful attempt to engage private sector in the business reform project is SEDP’s work on introduction of competition legislation in Serbia. As part of the EU accession process, Serbia is required to pass a set of competition laws that are aligned with EU standards. There is little flexibility in the provisions, though appeal can be made to the EU to account for particular circumstances. The draft law included two sets of provisions that were contrary to the interests of the business community and were not needed for effective competition legislation. The first had to do with a complex bureaucratic procedure that was open to rent seeking. The second had to do with a very low reporting threshold for mergers that would delay even moderately sized purchases of shares.

Though of general importance, this was not an issue that was suitable to bring lobbying power to bear on. There were few associations or members of those associations that were interested in getting involved in a law that few companies would be affected by. Similarly, the Government was loath to delay movement of a piece of legislation that they were under EU pressure to pass. There was likely nothing pernicious behind the
faulty provisions in the law. It is more likely that the drafters did not fully understand the effects or possibly care to the extent needed to change the law.

If an organization such as the National Competitiveness Council described in the previous chapters in more detail had adequate support from the public sector, dealing with these sorts of issues would fall into its purview. This is the “public good” aspect of such an organization. Otherwise, ensuring that such provisions do not make it to law requires either extremely good drafting committees, or very simple and well devised access to the policy process to lower the costs of intervention. Private interests are unlikely to expend major efforts to defeat such provisions.

CONCLUSION

This chapter draws conclusions on best practices of participation of the private sector in business environment reform in Southeast Europe. There are a number of lessons to be learned.

First, as presented above there are a number of different mechanisms to bring private sector interests into the policy process. The effectiveness of each will depend on a number of factors. The first is simply incentives. The second is a more complex mix of social cultural and political factors. Some of these include traditions of association and advocacy, past successes or failures, leadership, and real and perceived access to the policy process. Though these factors are in many ways intangible and difficult to impossible to measure, their effects need to be taken seriously when designing an initiative.

Let’s turn to the most important ones - incentives. Once these are delved into they can become more complex than they appear on the surface. It may seem obvious that business leaders would be interested in legislation that affects them. They are, but also have many competing issues that require their attention. Consequently, while you may see expressions of interest, there may be a breakdown when it comes to actually devoting time and resources to such activities vis a vis others.
It has been useful to see in the previous chapter how these factors play into several actual efforts to include the private sector into the policy process. As we saw, broad initiatives to create and maintain a permanent dialogue between business and government basically did not have a long life. These were SME Advisory Board initiative supported by the European Agency for Reconstruction and the second was the National Competitiveness Council by the USAID funded Serbia Enterprise Development Project (SEDP). Neither has lived up to its expectations.

IFC/SEED experiences have shown that most successful engagements of the private sector in businesses environment reform was mainly the participation of commercial banks and other financial institutions in the IFC/SEED access to finance projects: introduction of leasing and factoring legislation. When there is a very specific set of legislation that targets and can greatly affect a very specific industry, it is much easier to obtain private sector participation in the process. In fact, it becomes difficult to avoid it. This is in stark contrast to the broad coalition, broad issue groups that tend to collapse under free rider and incentive problems.

Also, IFC/SEED’s experiences in regulatory reform work with the governments of Southeast European countries has indicated that the effectiveness of BEE work, per se, should be looked at only as one component of a broader concept of private sector development work, involving capacity building and public-private partnerships as vital components of the implementation process. Even if we take the example of so-called “typical” BEE projects such as business registration reform and inspection, we come to the conclusion that without surveys as good diagnostic tools for business environment assessment and project design, and trainings and awareness campaigns aiming to educate broader audience on the implementation issues, BEE work cannot achieve its desired impact.
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