Chapter 7. Access to finance for SMEs (Dimension 6) in the Western Balkans and Turkey

This chapter assesses the policies in the Western Balkans and Turkey that support SMEs' access to external sources of finance. It starts by providing an overview of the assessment framework and progress since the last assessment in 2016. It then analyses the five sub-dimensions of Dimension 6: 1) the legal and regulatory framework, which looks at the legal and regulatory environment for creditor rights, collateralisation options, credit information systems, banking regulation and capital markets; 2) bank financing, focusing on the provision of bank loans and government support schemes to facilitate access to credit; 3) non-bank financing, which considers the legal framework and availability of alternative financing instruments such as microcredit, leasing and factoring; 4) the venture capital ecosystem, examining the financing environment for start-ups and young firms; and 5) financial literacy, focusing on efforts to broaden financial management skills among the business community and the wider population. Each sub-dimension concludes with key recommendations for helping to resolve specific challenges in facilitating SMEs' access to finance.

Key findings

- **Legal and regulatory frameworks are in place in all economies of the Western Balkans and Turkey (WBT),** facilitating access to finance for SMEs. The coverage of credit information systems has expanded in most economies, enabling more enterprises to build the credit history they need.
- **Bank lending continues to be the dominant source of finance.** As banking systems recover lending has resumed and, in some economies, commercial banks are increasingly focusing on SME lending.
- **Systemic issues remain across all WBT economies,** as loan conditions are typically less favourable for SMEs, reflecting perceived risks by lenders about their ability to repay. Public sector interventions are still common, often in the form of subsidised lending, although governments are slowly shifting towards more commercially aligned solutions such as credit guarantees.
- **Non-bank finance instruments have gained momentum as governments increasingly recognise the need to diversify sources of finance.** The activities of microfinance institutions have increased in some economies, and across the region efforts are underway to strengthen legal frameworks to support leasing and factoring. Although these steps are welcome, further efforts will be needed to support uptake of these types of finance.
- **Venture capital is still in its infancy across the Western Balkan region**, although some pioneer venture capital fund investments took place in the Republic of North Macedonia and Serbia during the reporting period. Venture capital is active in Turkey boosted by strong government support.
- **Levels of financial literacy remain low**. Both public and private sector efforts to increase financial know-how among businesses and the wider population more generally remain scattered and uncoordinated, and all the WBT economies lack a clear strategic approach to tackling shortcomings in this area.

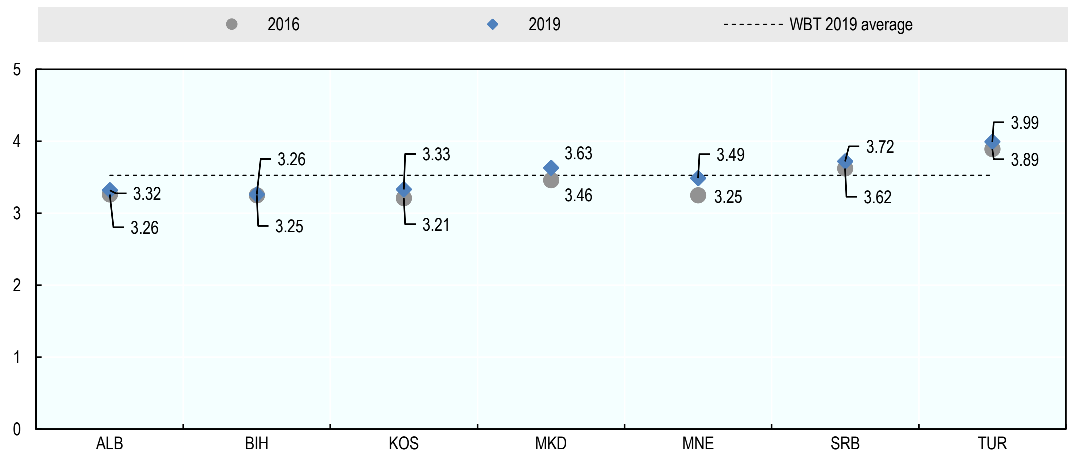
Comparison with the 2016 assessment scores

All the WBT economies have made progress in this dimension, but the speed of improvement has slowed since previous assessments. On average, the region scores 3.53, compared to 3.41 in the 2016 assessment (OECD, 2016[1]). The WBT economies perform best in the area of legal and regulatory frameworks, followed by non-bank finance. In contrast, the region continues to underperform in supporting financial literacy.

Overall, Turkey remains the strongest performer in this dimension, followed by Serbia and North Macedonia. Albania, Bosnia and Herzegovina[1] and Kosovo[*] all perform similarly, with the average score ranging between 3.26 and 3.33. Figure 7.1 summarises the region's performance and improvements since the last assessment.

[*] This designation is without prejudice to positions on status, and is in line with United Nations Security Council Resolution 1244/99 and the Advisory Opinion of the International Court of Justice on Kosovo's declaration of independence.

Figure 7.1. Overall scores for Dimension 6 (2016 and 2019)



Note: Scores for 2019 are not directly comparable to the 2016 scores due to a methodological change increasing the focus on implementation. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Policy Framework and Assessment Process chapter and Annex A for information on the assessment methodology.

Implementation of the SME Policy Index 2016 recommendations

Implementation of the policy recommendations outlined in the 2016 SME Policy Index has been mixed, with economies making good progress in some areas while lagging behind in others (Table 7.1).

Table 7.1. Implementation of the SME Policy Index 2016 recommendations for Dimension 6

Overall 2016 recommendations	SME Policy Index 2019	
	Main developments during the assessment period	Regional progress status
Tackle current issues in the banking sector	- Levels of non-performing loans (NPLs) have fallen in most of the Western Balkans region, albeit from high levels. NPL ratios in Turkey remain stable. - Growth recovery and structural reforms, such as stricter write-off policies and better NPL resolution procedures, have helped NPL resolution in the region. - Credit growth has revived and banks have ample liquidity, although SME lending remains subdued either due to risk perceptions on the supply side or low demand.	Moderate
Broaden the availability of credit information	- The coverage of public and private credit information registries has improved in most economies, with progress particularly evident in Albania, Montenegro and North Macedonia. - Credit information could be further enriched with data from utility providers, which would allow smaller companies and start-ups without loans to build a credit history.	Advanced
Promote policies that make funding more accessible for SMEs	- Some economies, notably Serbia and Kosovo, have made progress in preparing or launching credit guarantee schemes with international donor support, which may reduce fiscal burdens if well designed. – The budget for the Credit Guarantee Fund in Turkey has increased.	Limited

Develop non-bank finance instruments	- The availability of microfinance has increased in most economies, except Turkey and Serbia, where this type of finance remains limited due to restrictive legal frameworks. - Leasing and factoring have gained momentum in the Western Balkan region – albeit from low levels – amid increasing efforts to embed these types of finance into dedicated legal frameworks. In Turkey, both instruments remain a viable finance option for SMEs. - New legal frameworks for leasing and factoring have been passed in Montenegro and Bosnia and Herzegovina (Federation of Bosnia and Herzegovina). - Factoring reforms in Kosovo and North Macedonia are ongoing. - Venture capital remains underdeveloped in the Western Balkans, but a number of pioneer investments under the donor-supported Enterprise Innovation Fund send an important signal to international investors.	Moderate

Introduction

Access to finance is an important factor for companies, allowing them to expand their operations, modernise equipment or move into new undertakings, thereby increasing their competitiveness and helping them grow. However, ease of access to finance is typically correlated with firm size, meaning that the smaller the company, the more difficult it is to tap into external financing options. This can be for many reasons, including higher rates of informality among smaller firms, a higher perceived risk profile, fewer collateral options, and lower accounting and financial management capacity.

Access to credit was made more difficult by the financial crisis in 2008/09 in many countries, including those of the European Union (EU). Since then, conditions have eased somewhat. For example, according to EU data (EC, 2017[2]), fewer small and medium-sized enterprises (SMEs) in EU Member States now consider access to finance to be the single most important obstacle they face, although this is still perceived to be the case by 1 in 11 (down from 1 in 6 in 2009). SMEs tend to be particularly exposed to downturns in the supply of finance due to their higher risk profile and more limited collateral options; EU survey data show that access to finance is a disproportionate hindrance for younger and fast-growing SMEs (EC, 2017[2]).

Governments can play an important role in improving access to credit by creating a legal environment that provides flexible collateral options and transparent and reliable legal recourse in cases of default, and by establishing schemes to support SME access to finance. The Small Business Act for Europe recognises that governments "should facilitate SMEs' access to finance, in particular to risk capital, microcredit and mezzanine finance and develop a legal and business environment supportive to timely payment in commercial transactions" (EC, 2008[3]).

Policy support can come in several forms. An efficient legal framework that supports the enforcement of creditor rights helps to increase financing opportunities from banks. A well-functioning cadastre and a system to register security interests over movable assets increases SMEs' collateral opportunities while minimising risks for lenders. Comprehensive, reliable and easily accessible credit information systems reduce the asymmetry of information between creditors and borrowers. When it comes to bank financing, credit guarantee schemes can stimulate SME lending by addressing banks' concerns over the risks presented by SMEs. Alternative sources of finance – such as microfinance, leasing and factoring – may also be actively supported through dedicated legal frameworks and supervisory mechanisms, and by raising awareness among SMEs of the range of financing options available to them. Finally, supporting SMEs' financial literacy through formalised programmes helps them develop their business planning and financial management skills, making them more attractive clients to financial service providers.

A crucial aspect to consider when implementing support schemes of this kind is their additionality: they should aim to support the private sector provision of financial services without crowding it out. Otherwise, market distortions risk making businesses dependent on continued public budget support rather than leveraging private funding, affecting the sustainability of support schemes. In addition, any support programme should be systemically monitored against performance indicators and evaluated to make sure that it reaches those most in need of support and adjusted as needed.

Assessment framework

Structure

Access to finance for SMEs is assessed through the following five sub-dimensions:

- **Sub-dimension 6.1: Legal and regulatory framework** focuses on the legislation facilitating access to finance, including protection of creditor rights, facilitating the use of collateral and credit information, and banking and stock market regulations.
- **Sub-dimension 6.2: Bank financing**, including the lending practices of local banking markets and the availability of credit guarantees.
- **Sub-dimension 6.3: Non-bank financing**, reviewing the legal framework and use of microfinance, leasing and factoring.
- **Sub-dimension 6.4: Venture capital ecosystem**, assessing the legal framework enabling venture capital and the existence of business angel networks.
- **Sub-dimension 6.5: Financial literacy**, analysing government efforts to promote financial know-how among the business community and wider population.

Figure 7.2 illustrates how the sub-dimensions and their constituent indicators make up the assessment framework for this dimension. For more information on the methodology see the Policy Framework and Assessment Process chapter and Annex A.

The assessment framework puts particular emphasis on the legal and regulatory framework for facilitating access to finance for SMEs. However, it should be noted that access to finance is the result of a complex interaction of a variety of determinants linked to areas such as the general macroeconomic environment, the health of local financial markets and the overall creditworthiness of enterprises. These cannot be all captured by the assessment framework, which focuses on a set of specific themes and indicators which are deemed to be disproportionally important for SMEs compared to larger firms.

Key methodological changes to the assessment framework

Small adjustments have been made to the framework since the 2016 assessment to allow for a more in-depth analysis of the quality of the regulations (Table 7.2).

Table 7.2. Key changes in the composition of Dimension 6

Sub-dimensions	Key changes since 2016 assessment
Sub-dimension 6.3: Non-bank financing	Removal of references to savings and loan associations as they were only operating in Albania, and are typically already captured under microfinance or bank finance. In some cases, this has led to substantial changes in the scoring.
General	Introduction of a more detailed analysis of the quality of leasing and factoring legal frameworks and higher weights given for their penetration data.

Figure 7.2. Assessment framework for Dimension 6: Access to finance for SMEs

Access to finance for SMEs

Outcome indicators
Bank loans to SMEs
Interest rate for new business loans for SMEs
Government loan guarantees
Total annual volume of microfinance loans
Total annual leasing volume
Total annual factoring volume
Venture capital investments, total volume
Adult population that hold a bank account
Government direct loans

Sub-dimension 6.1: Legal and regulatory framework

Thematic block 1: Creditor rights	**Thematic block 2:** Register	**Thematic block 3:** Credit information bureau
Thematic block 4: Banking regulations	**Thematic block 5:** Stock market	

Sub-dimension 6.2: Bank financing

Thematic block 1: Banking lending practices and conditions	**Thematic block 2:** Credit guarantee schemes

Sub-dimension 6.3: Non-bank financing

Thematic block 1: Microfinance institutions	**Thematic block 2:** Leasing	**Thematic block 3:** Factoring

Sub-dimension 6.4: Venture capital ecosystem

Thematic block 1: Legal framework	**Thematic block 2:** Design and implementation of government activities	**Thematic block 3:** Monitoring and evaluation

Sub-dimension 6.5: Financial literacy

Thematic block 1: Planning, design and implementation	**Thematic block 2:** Monitoring and evaluation

Quantitative indicators
World Bank *Doing Business* – Strength of legal rights index
Credit information coverage (% of population)
Quality of legal framework for capital markets
Market capitalisation (% of GDP)
Share of credit-constrained firms
Severity of access to finance as an obstacle to doing business
Total leasing volume (% of GDP)
Total factoring volume (% of GDP)
World Bank *Doing Business* – Strength of minority investor protection index

Note: The outcome indicators serve to demonstrate the extent to which the policies implemented by the government bring about the intended results, and they have not been taken into consideration in the scoring. By contrast, quantitative indicators, as a proxy for the implementation of the polices, affect the overall scores.

Other sources of information

Data from the World Bank *Doing Business* report were used to supplement the assessment of the legal framework for secured transactions (World Bank, 2018[4]). These include indicators such as the coverage of credit information systems and recovery rates in cases of insolvency to compare countries and changes over time. Data from the *Business Environment and Enterprise Performance Survey* (BEEPS) V (EBRD, 2014[5]) are used to provide information on the extent of credit constraints. Reports – mainly by national or international associations on the use of certain instruments such as factoring, leasing or capital markets – were also used to provide context for the relevant sections. The World Bank's *Global Financial Development* database (World Bank, 2018[6]) provided credit data for the WBT and comparator economies and the European Business Angel Network provided data on venture capital (VC) investments (EBAN, 2017[7]).

Overall, the data available for this chapter were relatively limited, particularly data disaggregated by firm size and on non-bank financing instruments. It was therefore not always possible to use the same reporting year, but in all cases the latest available data were used.

Analysis

Performance in access to finance for SMEs

Outcome indicators play a key role in examining the effects of policies, and they provide crucial information for policy makers to judge the effectiveness of existing policies and the need for new ones. Put differently, they help policy makers track whether policies are achieving the desired outcome. The outcome indicators chosen for this dimension (see Figure 7.2) are designed to assess the Western Balkan economies and Turkey's performance in creating the conditions that facilitate SMEs to access the finance they need. This analysis section starts by drawing on these indicators to analyse the health of the financial sector in the WBT.

In the Western Balkans, a region that has seen very high levels of non-performing loans (NPLs) since 2010 and subdued credit growth, access to finance for SMEs has been difficult. High collateral requirements and complex application procedures deter SMEs from accessing bank loans. Less favourable loan terms for SMEs often reflect lenders' perceptions about their ability to repay them. The picture in Turkey is slightly different. SMEs have benefitted from a rising trend in bank lending, partly fuelled by substantial government support programmes, particularly in recent years. However, access to credit in less advanced regions of Turkey and for longer tenors is still an issue and the banking sector may be vulnerable to macroeconomic developments.

With credit growth somewhat static or even negative since 2008, domestic credit to the private sector as a share of gross domestic product (GDP) has remained at similar levels across the WBT region in the past ten years with few, but notable, exceptions. On average, private credit has remained around 40-43% of GDP, apart from in Turkey and Montenegro, which have seen significant shifts of around 35 percentage points upwards and downwards, respectively (Table 7.3). This compares to private credit levels of 97% of GDP in the EU-15 and 68% in the EU-13,[2] which suggests that the level of financial intermediation is still low in most economies in the region.

There have been more positive signs more recently. NPL levels in the Western Balkans have come down since their peak in 2010-14, ranging from below 3% in Kosovo to 13.3% in Albania as of June 2018. Credit growth has picked up slightly and liquidity is ample. In some economies, such as Montenegro, banks are showing renewed interest in SME lending whereas in other markets lending remains subdued, either due to risk perceptions on the supply side or low demand. Across all WBT economies, lending to SMEs represents around 40% of total loans on average (calculations based on IMF data (2017[8]).

Table 7.3. Key banking sector indicators (2008-18)

	Private sector credit, as % of GDP			Credit constrained firms, as % of firms needing a loan		NPLs, as % of total gross loans		
	2008	2014	2016	2008	2012	2008	2014	2018
ALB	35.4	37.1	34.7	35.6	60.4	6.6	22.8	13.3
BIH	66.8	55.3	53.2	35.8	37.1	3.1	14.0	9.7
KOS	32.9	36.0	39.3	64.9	46.5	0.0	8.2	2.8
MKD	42.1	48.9	47.4	50.2	50.3	6.7	10.8	4.9
MNE	87.0	51.4	48.9	44.0	63.2	7.2	17.2	7.4
SRB	39.0	43.8	43.4	36.3	39.1	11.3	23.0	9.2
TUR	35.2	74.5	69.9	26.6	18.7	3.4	2.8	3.0

Note: NPL ratios: latest available (Q1 2018 for BIH, MNE, SRB; Q2 2018 for ALB, KOS, MKD, TUR).
Source: (World Bank, 2016[9]), *World Development Indicators 2016*, http://documents.worldbank.org/curated/en/805371467990952829/World-development-indicators-2016; (EBRD, 2014[5]), *Business Environment and Enterprise Performance Survey, BEEPS V (2011-2014)*, http://ebrd-beeps.com; respective regulatory bodies, latest available.

While non-bank financing instruments could provide an alternative for some SMEs, alternative financing sources such as leasing and factoring are underdeveloped. Penetration rates in terms of annual volumes are mostly below 1% of GDP, which is below EU levels, particularly for factoring.

Legal and regulatory framework (Sub-dimension 6.1)

The legal and regulatory framework surrounding secured transactions is important to encourage banks to lend to SMEs, especially as small firms are perceived to be more risky borrowers. It is important to have a framework that allows information asymmetries to be reduced and for security to be easily used and enforced in case of default. Credit information systems facilitate the collection and distribution of credit information on borrowers, while allowing different types of assets to be used as collateral can help increase banks' appetites to lend to SMEs. The effective realisation of collateral if a borrower is unable to pay is also an important mechanism for reducing lending risks or costs. Therefore, creditor rights, functioning systems for registering security interests, comprehensive credit information systems and adequate banking regulations are important ingredients of a legal framework that supports, rather than impedes, lending to SMEs.

This section looks at these different aspects of the legal and regulatory framework that support bank lending to SMEs. Overall, the legal and regulatory frameworks for bank lending are already relatively well set up. There has been no significant further progress since the last assessment on this sub-dimension, with the exception of the coverage of credit information systems, which has significantly improved (Table 7.4).

Table 7.4. Scores for Sub-dimension 6.1: Legal and regulatory framework

	ALB	BIH	KOS	MKD	MNE	SRB	TUR	WBT average
Creditor rights	4.44	3.85	3.55	4.76	5.00	4.27	3.56	**4.20**
Registers	4.42	4.50	4.92	4.75	4.58	4.45	4.42	**4.58**
Credit information bureaus	4.43	4.25	4.22	5.00	4.42	5.00	4.51	**4.55**
Banking regulations	3.50	3.00	3.50	3.50	3.50	4.50	5.00	**3.79**
Stock market	1.31	3.07	1.00	3.46	4.00	3.29	4.35	**2.93**
Weighted average	**3.86**	**3.87**	**3.67**	**4.46**	**4.41**	**4.38**	**4.31**	**4.14**

Note: See the Policy Framework and Assessment Process chapter and Annex A for information on the assessment methodology.

A solid legal framework for secured transactions is in place across the region

A well-designed legal framework for secured transactions can reduce lending risks and thus encourage bank lending at acceptable terms. In the WBT economies, the legal framework for secured transactions is relatively well developed in general. For example, in most economies apart from Bosnia and Herzegovina, secured creditors are paid first in cases of default or insolvency. Albania has made progress in this area since the last assessment by adopting legislative changes that give secured creditors priority when a firm liquidates. Similarly, Turkey changed its legislation in early 2018 to stipulate that secured creditors are paid before taxes (for more information, see Chapter 2 on bankruptcy and second chance for SMEs).

However, enforcement remains an issue in many jurisdictions, with lengthy procedures and sub-optimal outcomes. For example, the World Bank *Doing Business* indicator measuring the recovery rate in insolvency proceedings suggests that across WBT economies, secured creditors recover only around 38 cents on the dollar on average, compared to 71 cents in the EU (World Bank, 2018[4]).

Registers for security interests over movable assets are not yet sufficiently utilised to support the collateralisation of such asset types

Within a secured transactions framework, it is important to have reliable and accessible registers that facilitate the use of immovable and movable assets as collateral. Up-to-date, accessible systems are very important for secured lending. Together with a legal framework that allows for a straightforward repossession process, such systems can facilitate collateralised lending and bring down interest rates by increasing the chances of recovery in cases of default.

It is therefore important to have a cadastre that allows for the registration of land and real estate, including information on their value, ownership and existing pledges over the asset. Online availability and broad access (within the limits of privacy laws) are important to improve ease of use and reduce costs. All the WBT economies have cadastres in place, but in many cases they are only partly available on line (for instance in Albania, Montenegro and Serbia). These economies should improve their accessibility and ease of use.

Registers for security interests over movable assets can widen the range of assets companies can use as collateral. This is particularly important for SMEs, as they often lack access to sufficient land or real estate to use as a security. Such registers should be centralised and unified in order to avoid multiple use of the same asset. As with a cadastre, accessibility is important to lower costs and increase usage. All the economies in the region have an operational registration system for pledges over movable assets. However, accessibility is still an issue and could be improved by making registration or records available on line (for instance in Albania, North Macedonia and Serbia) in one central register, and by increasing the speed of updates so that a potential lender is always sure they have access to up-to-date status information. In Turkey, the reform of the non-possessory movables pledge regime in 2017 has made it easier to use movable assets as collateral, and this is becoming increasingly common.

The coverage of credit information systems has significantly improved

Credit information systems can help reduce information asymmetries between lenders and borrowers by giving potential lenders access to the credit history of a borrower. While public registries are usually managed by the central bank which is collecting lending data mainly for supervisory purposes, private credit bureaus typically collect a broader range of information which can include data from utilities or telecommunication companies. Collecting information from a broader range of sources can be particularly helpful for first-time borrowers who have not yet established a credit history with a bank or other financial institution. All the economies in the region have either a public credit registry or a private bureau, with the coverage of the population varying (Table 7.5). In some economies, coverage has increased significantly in the past three to four years, most notably in Albania, Montenegro and North Macedonia, with the latter reaching 100% coverage in 2017. However, only credit bureaus in Bosnia and Herzegovina and North Macedonia collect data from retailers and utilities. The Serbian credit bureau is the only one in the region to recognise SMEs as a distinct group of borrowers and provide SME-specific credit reports.

Table 7.5. Credit information coverage in the WBT economies (2008-18)

	Public credit registry coverage (% of adults)			Private credit bureau coverage (% of adults)		
	2008	2014	2018	2008	2014	2018
ALB	6.8	16.7	57.4	n/a	n/a	n/a
BIH	n/a	39.7	43.7	69.2	8.1	12.9
KOS	n/a	22.8	41.3	n/a	n/a	n/a
MKD	6.5	36.4	40.7	n/a	83.7	100
MNE	26.3	26	56.6	n/a	n/a	n/a
SRB	n/a	n/a	n/a	91.9	100	100
TUR	12.7	63.6	77.72	26.3	n/a	n/a

Note: 'n/a' means institution does not exist in the economy.
Source: World Bank (2018[6]), *Global Financial Development Database*, https://www.worldbank.org/en/publication/gfdr/data/global-financial-development-database.

The banking regulatory framework has started to align with Basel III requirements

Most economies in the region have started to align their regulatory framework with Basel III.[3] All the economies except Albania and Kosovo have made progress in this area, though at differing levels. In the Western Balkans in particular, banks' capital adequacy position is relatively comfortable and does not seem to constrain lending.

While some economies have adopted the euro or have a pegged currency, foreign exchange (FX) denominated loans are still prevalent, averaging 58% in the Western Balkans (excluding Kosovo and Montenegro) and 32% in Turkey (as of December 2017). Serbia, where over 70% of loans are denominated or indexed to a foreign currency, has formulated a dinarisation strategy; but FX loan levels have not effectively come down, particularly for businesses. In Albania, over half of total loans are foreign currency loans. However, the share has significantly decreased – from nearly 70% in 2010 – supported by a national strategy to encourage local currency use. To protect consumers, all economies not using the euro require banks to disclose FX risks to prospective borrowers. This is particularly important for SME lending as small entrepreneurs tend to be less sophisticated borrowers and financial literacy remains low in many economies of the region – see also the section below on Financial literacy (Sub-dimension 6.5).

Capital markets are underdeveloped but a regional solution might be more successful

The notion of financing SMEs through capital market instruments has gained traction in recent years. If tailored to SME needs, capital markets can provide a viable alternative for some more mature companies to access (long-term) financing, either in the form of an initial public offering or corporate bonds. Attempts to adapt capital market instruments to SME needs have been made in both developed and emerging markets in recent years – albeit with mixed results (see Box 7.1). With the support of the European Bank for Reconstruction and Development (EBRD), the Belgrade Stock Exchange is currently preparing a programme aimed at increasing the awareness and demand for investment capital and the supply of securities, while in Turkey the Emerging Companies Market of Borsa Istanbul, which targets SMEs, continues to provide access to finance for companies – although its impact is somewhat below potential.

In contrast, capital markets remain underdeveloped in most economies of the Western Balkans, often due to small market sizes. As a result, they have increasingly focused on strengthening connectivity in the South East Europe region through the SEE Link in recent years, which is now fully operational.[4] Since the last assessment, the stock exchanges of Belgrade, Sarajevo and Banja Luka have joined the platform, which now links seven national stock exchanges in South East Europe. Albania and Kosovo are currently not participating in the platform, while Montenegro applied to join in 2016, although its membership is pending. Integration of the trade environment is now complete, but the consolidation of the post-trade environment remains outstanding. Deploying harmonised post-trade solutions would streamline processes for the settlement and clearing of security transactions, and provide a single access to all the central securities depositories of the SEE Link Markets. For investors, this would provide more certainty and security, and increase the liquidity of the SEE Link in the long term.

Box 7.1. Strengthening SME access to capital market finance: The Progress Market in Croatia and Slovenia

In 2015, the European Commission adopted an action plan setting out measures to establish the building blocks of an integrated capital market in the EU – the Capital Markets Union – to broaden the range of financing options for companies at all stages of the business cycle. Among other measures, the action plan envisages more access by SMEs to capital market funding.

One way to enable this type of finance for SMEs is via dedicated SME growth markets. Some European and other emerging market stock exchanges operate such markets, which typically have less restrictive listing and reporting requirements than the main markets. As an alternative source of financing, such dedicated SME markets can play a significant role in helping SMEs to finance inclusive, long-term growth.

Against this background, in 2017 the Zagreb Stock Exchange (ZSE), together with the EBRD, launched a feasibility study into establishing an SME growth market in Croatia and Slovenia, which was aimed at creating a regional SME financing platform. The feasibility study provided a proposal for the market set-up and most suitable measures to increase access to capital market financing by companies in Croatia and Slovenia, and potentially the wider Western Balkan region. Specifically, it provided the ZSE with sufficient capacity to decide on the optimal set-up of the SME market, together with a business and implementation plan as a policy-making lever with relevant stakeholders.

This new SME growth market – the Progress Market – has launched operations under the Markets in Financial Instruments Directive II of the EU (MiFID II). This regulation eases listing and reporting requirements for SME markets compared with the main markets, and is designed to strike a balance between listing requirements and providing adequate information for financial investors. A first listing took place in January 2019.

The implementation of the Progress Market for Croatia and Slovenia complements the successful establishment of the equity crowdfunding platform for SMEs and start-ups at ZSE in 2017, which transformed the ZSE into a company financing hub. The company financing hub is a model developed by the EBRD in which exchanges evolve into multi-level equity markets, covering issuers of various sizes at different development stages in segmented markets, thus enabling exchanges to offer access to capital market financing to small- and mid-cap companies throughout their different growth stages.

Sources: European Bank for Reconstruction and Development; EC (2015[10]), *Action Plan on Building a Capital Markets Union*.

The way forward for the legal and regulatory framework

- **Continue efforts to strengthen collateral registries**, in particular for movable assets. For SME lending in particular, steps should be taken to facilitate a framework in which collateral can be easily established and repossession processes are straightforward. This could encourage lending activity which is currently subdued despite good capital adequacy and liquidity.
- **Strengthen and align data collection**. Informed policy decision making and impact monitoring can only occur in an environment where policy makers have access to reliable and standardised statistics. In the context of access to finance, governments should prioritise and regulate data collection from financial institutions, including non-bank finance instruments (NBFIs), ideally disaggregated by size of enterprise and demographic factors such as gender and age. This would also help close the existing gaps in statistical data collection

standards and allow all the economies to be included in comparative performance analyses, such as the OECD Financing SMEs and Entrepreneurs Scoreboard[5].

Bank financing (Sub-dimension 6.2)

Many factors influence the availability of bank financing for SMEs. These range from the competitive environment in the banking system and the legal framework for bank lending to the financial readiness of borrowers. Governments can put in place policies to improve the "enabling environment", such as the legal framework or financial literacy, and they can also run support schemes that directly increase access to bank finance.

Support schemes can take many different forms: interest rate subsidies, caps, guarantees and other instruments. While the choice of instruments can depend on a variety of factors, it is important to align instruments as much as possible with market decision making in order to have a more sustainable and less distorting effect. For example, providing guarantees is more closely aligned with banks' commercial lending decisions than a straight interest rate cap dictated by policy makers with no consideration for risk profiles and cost of funding.

This section measures SMEs' access to bank financing. It looks first at the availability of bank financing more generally and then discusses support schemes that could facilitate lending to SMEs.

While in the aftermath of the 2008 crisis many governments put support schemes in place providing interest rate subsidies, credit guarantee schemes remain largely absent from the support landscape, particularly in the Western Balkans. Where they do exist, they tend to be rather small in scale and ineffective. However, steps have been taken in recent years to set up new schemes, the success of which will need to be assessed once they are more established. Turkey has a functioning credit guarantee fund which has been used as a major policy tool by the government in recent years to stimulate lending. The advanced nature of the credit guarantee fund is also reflected in Turkey's high score in this sub-dimension (Table 7.6).

Table 7.6. Scores for Sub-dimension 6.2: Bank financing

	ALB	BIH	KOS	MKD	MNE	SRB	TUR	WBT average
Banking lending practices and conditions	2.48	2.74	3.08	3.37	2.07	3.12	3.61	**2.92**
Credit guarantee schemes	2.48	2.17	3.00	1.67	1.00	2.33	3.44	**2.30**
Weighted average	**2.48**	**2.51**	**3.05**	**2.69**	**1.64**	**2.80**	**3.55**	**2.67**

Note: See the Policy Framework and Assessment Process chapter and Annex A for information on the assessment methodology.

Bank lending is slowly recovering, but intermediation levels remain below potential

As described above, there are signs of recovery in the Western Balkans' financial markets. However, many economies are still struggling with the aftermath of the global economic and financial crisis, reflected in high NPLs and a limited willingness to lend to

SMEs despite high levels of liquidity. In contrast, Turkey has experienced solid credit growth over the past few years, partly fuelled by extensive government support schemes. Despite this, Turkey's banking sector remains vulnerable to macroeconomic developments. Overall across the region, SMEs in Turkey are the least constrained in accessing finance.

SME support schemes are available, but are often too small or cumbersome to make a difference

Most of the economies have specific nationally funded development banks or SME agencies with financing programmes in place. These typically extend credit lines at more favourable terms, or provide interest rate subsidies through special SME lending programmes with commercial lenders. The only exceptions to this are Albania and Kosovo. In Albania, these programmes are mainly donor financed or co-financed, while Kosovo has no such subsidised schemes.

Credit guarantee schemes (CGSs) can be an effective tool for supporting SME lending and alleviating the financing constraints they face. They can provide important security for lenders in light of existing information asymmetries and the perceived risk of lending to small businesses. In addition, credit guarantees tend to be better aligned with commercial lending practices than measures such as interest rate subsidies. If well designed and monitored (Box 7.2), they are also less onerous on public budgets.

Many WBT governments have either established a guarantee fund, or plan to do so in the near future. This is a significant change from the last assessment when such initiatives were rare across the region. However, the extent of these schemes differs greatly across economies. In Turkey, the Credit Guarantee Fund (KGF) introduced a portfolio product in 2017 and the government has greatly increased the funding available to it, leading to guarantees being issued to the amount of around TRY 200 billion (Turkish lira; around 6.5% of GDP). The KGF is also the only scheme in the region that has some element of private ownership, as a number of banks are shareholders. CGSs in the Western Balkans are more modest in size – many could be more effective if they were scaled up. In addition, they are mainly set up and run by governments and donors with little or no private sector involvement. This may contribute to the low uptake and limited feedback loop between the guarantee scheme and the commercial banks which are supposed to use it. Some steps have been taken by Western Balkan economies to set up new schemes or invigorate old ones. In Kosovo, for instance, a new Credit Guarantee Fund was established in 2016/17 to provide portfolio guarantees to local banks with the intention of supporting SME lending. Serbia has also taken the first steps towards establishing a guarantee facility with the help of EU funding, and Montenegro is planning to set up a CGS within its Investment and Development Fund in 2019.

The way forward for bank financing

- **Continue efforts to support banking sector recovery**. Particular focus should be placed on further reducing NPL levels and providing a legal and regulatory environment that encourages sustainable credit growth.
- **Work on establishing and strengthening credit guarantee schemes.** Where the first steps have been taken, governments should continue with the establishment of CGSs; where schemes exist, but are ineffective, they should consider comprehensive reforms. The design of these schemes should be

mindful of questions of sustainability, scale and private sector participation in order to ensure that they are meaningful and result in appropriate uptake. See Box 7.2 for more information on best practices.

Box 7.2. Good practice design features of credit guarantee schemes

Credit guarantee schemes can help alleviate financing constraints for SMEs by allowing banks to absorb more risk and thus encourage more lending to the SME segment. However, if poorly designed or implemented they only add limited value and can prove to be costly.

CGSs provide guarantees on loans by covering a share of the default risk of the loan. In case of default, the lender recovers the value of the guarantee. Schemes can be designed in many different ways. They can have differing coverage ratios, risk-sharing arrangements and pricing structures; they can cover individual loans or loan portfolios; and may have private sector participation. While the ultimate design of any scheme depends on the circumstances of its inception and specific objectives, there are certain aspects that policy makers should take into account when setting up or reforming a CGS.

The risk sharing and coverage structure is one key component. For example, a high coverage ratio (i.e. the guarantor bears most or all of the losses in case of default) or imbalanced risk-sharing arrangement can increase moral hazard and may encourage borrowers to default prematurely, or relieve banks of their responsibility to assess loan risk adequately at origination. An interesting example of how to establish the guarantee rate and reduce moral hazard is the Fondo de Garantía para Pequeños Empresarios (FOGAPE) in Chile, where the coverage ratio is determined through an auction.

Pricing should adequately reflect the risk taken by the guarantor in order not to overly subsidise private market participants. While this should keep losses to a minimum, credit guarantee schemes should not try to maximise profits as this would defeat the scheme’s purpose of providing affordable financing to SMEs. Therefore, the structure should reflect policy priorities in balancing loan incrementality and cost recovery.

Providing guarantees for individual loans gives more control to the guarantee scheme as it can evaluate each loan application. However, it may be cumbersome for implementing commercial banks that have to fill in documentation for each loan and wait for a decision by the CGS. This can significantly lengthen the application and decision-making process by the commercial bank and make the loan more costly. Portfolio guarantees may be easier to implement but can be more difficult to design in ways that minimise moral hazard.

While many guarantee schemes are originated and funded by the public sector, **private sector participation** should be considered and even encouraged. Having commercial banks participate in the scheme’s capitalisation can not only provide additional financing, but also creates an important feedback loop between commercial banks and the CGS to ensure that the products offered are tailored to market needs, thus increasing their effectiveness.

Finally, some schemes provide **additional services** to end-borrowers beyond the guarantee alone. These include technical assistance – which can also be provided through referral to other state agencies – advisory services or training. For example, the Korean guarantee agency for technology finance, KOTEC (Korea Technology Finance

Corporation), provides services beyond guarantees, such as technology appraisal, which have had a positive effect on the recipients' performance.

Sources: Williams, Kijek and Cole (2004[11]), *Evaluation of the Canada Small Business Financing Program: Final Report*, http://publications.gc.ca/collections/Collection/Iu188-79-2004E.pdf; Vienna Initiative (2014[12]) *Credit Guarantee Schemes for SME Lending in Central, Eastern and South-Eastern Europe*, http://vienna-initiative.com/wp-content/uploads/2014/11/2014_credit_guarantee_schemes_report_en.pdf; OECD (2009[13]), *Facilitating Access to Finance*, www.oecd.org/global-relations/45324327.pdf.

Non-bank financing (Sub-dimension 6.3)

Diversifying access to finance for SMEs has gained momentum across the world and has become a policy priority for many emerging economies as a way of complementing conventional bank finance. According to the *G20/OECD High-level Principles for SME Finance* (G20/OECD, 2015[14]), economies need to develop more comprehensive options for SME financing to support sustainable economic growth and boost the resilience of the financial sector, and particularly to target enterprises more likely to be under-served by the banking sector.

Microfinance can help support the financial inclusion of smaller enterprises and borrowers that are typically not covered by larger commercial banks. If tied into the credit information system, it can also help build a credit history and make borrowers more creditworthy in the long run. Typically, microfinance institutions are established with the support of governments or the donor community, but may become self-sustaining in the long term.

Other non-bank financial instruments such as asset-based leasing or factoring tools can provide access to finance for SMEs even when they struggle to meet banks' collateral or credit history requirements. Leasing can help SMEs modernise equipment and implement expansion plans in the absence of a bank loan or financial resources of their own. Under a leasing contract, dedicated leasing companies purchase a piece of equipment or technology for example, and allow the lessee to use this asset for a fee without requesting further guarantees, such as additional collateral. Factoring is a financial instrument based on the sale of accounts receivable from a firm with a good credit performance. Factoring can alleviate liquidity constraints for SMEs and enable them to have off balance-sheet access to working capital, which is priced against the credit risk of the enterprise's customers rather than that of the company itself.

Both types of financial instruments require a supporting legal framework, either incorporated into the general legal framework or supported through dedicated factoring and leasing laws. Factoring in particular often includes complex contracting procedures and requires more sophisticated legislation. Law makers and regulators can encourage the development of leasing and factoring by maximising the stability and legitimacy of the industry, ensuring that market players are well established and increasing the legal certainty of transactions.

This section looks at the existence and scope of a legal and regulatory framework that supports leasing, factoring and microfinance activities, as well as statistics on the use of these types of financial services.

Overall, the region has made some progress in developing non-bank financial instruments. In particular, the economies have strengthened their legal frameworks for enabling leasing and factoring. Market penetration of alternative finance has gradually increased but remains significantly below potential. Table 7.7 summarises the economies' performance in this sub-dimension, revealing that most economies' performance is relatively similar.

Table 7.7. Scores for Sub-dimension 6.3: Non-bank financing

	ALB	BIH	KOS	MKD	MNE	SRB	TUR	WBT average
Microfinance institutions	4.83	4.33	4.67	2.17	4.67	2.00	2.33	**3.57**
Leasing	2.46	2.75	2.54	3.17	2.33	3.30	3.33	**2.84**
Factoring	2.63	1.75	1.50	1.50	3.00	3.25	3.50	**2.45**
Weighted average	**3.31**	**2.94**	**2.90**	**2.28**	**3.33**	**2.85**	**3.06**	**2.95**

Note: See the Policy Framework and Assessment Process chapter and Annex A for information on the assessment methodology.

Microfinance is a viable source of finance for SMEs in some economies, but volumes remain low

Microfinance is available on a small scale in most of the assessed economies, and volumes have increased in recent years, although a significant share is absorbed by private households. Microfinance institutions (MFIs) account for the vast majority of the NBFI loan portfolio in Albania, where the statistics also include the activities of saving and loan associations. Microfinance is also available in Bosnia and Herzegovina and North Macedonia. Microfinance lending is also available in Montenegro at self-sustainable levels, where it has gained momentum in recent years and almost returned to pre-crisis levels. Volumes reached over EUR 60 000 at the end of 2017, almost doubling from a low in 2013.

In contrast, levels of financing through MFIs remain low in Serbia and Turkey, primarily due to legal environments that are not conducive to their operation. In Turkey, micro and smaller businesses are mainly served by commercial banks, thus leaving relatively little room for dedicated MFIs. Some non-government organisations (NGOs) provide microloans to specific segments of the population, such as women on low incomes. Given the limited scope of this type of activity, there has not been a focus on developing a specific legal framework for microfinance in recent years. In Serbia, the government's SME Development Strategy and Action Plan 2015-2020 envisages establishing a legal framework for non-bank, non-deposit credit institutions, but has made no progress in introducing legislation conducive to microfinance.

Leasing and factoring are gaining momentum as legal frameworks are strengthened, but market penetration is below potential

Leasing and factoring operations are available in all economies in the Western Balkans and Turkey, but are underused. Overall, leasing volumes remain below potential, in particular in the Western Balkans (at less than 1% of GDP), compared to 1.3% of GDP in Turkey, where leasing and factoring are more developed. This compares to 1.7% of GDP on average in EU countries, with Estonia having one of the highest leasing penetration rates (at 4.3% of GDP), showing that this type of activity can also be significant in smaller economies. Factoring penetration also remains insignificant in the Western Balkans, at 1.6% of GDP, compared to 4.5% of GDP in Turkey and an average of 7.6% in EU countries (World Bank, 2016[9]). Yet due to the low level of financial intermediation in many economies, the potential for these instruments may be even higher than for many EU members.

Despite more recent positive trends, the continuing low uptake of leasing and factoring suggests in particular demand-side limitations such as low levels of awareness among smaller businesses of the opportunities they present. For instance, leasing is only a genuine alternative financing option for smaller enterprises in Turkey, due to a strong SME focus in the portfolio of leasing companies. In addition, the Turkish leasing sector is also strong in equipment and technology leasing, not just vehicle financing (the most common use of leasing in much of Central and Eastern Europe, including the Western Balkans).

Across most WBT economies, leasing and factoring are governed by a legal framework, with some governments having implemented or currently undergoing reforms to further strengthen legislation in recent years. This will increase certainty for the market and reduce transaction risk.

With support from the EBRD, Montenegro took an important step in the reform of its legislative framework in October 2017 with the adoption of a new law on financial leasing, factoring, purchase of claims, and microcredit and credit guarantee (Box 7.3). As a result, its legal and regulatory framework has been significantly improved and is now aligned with international best practices. In Bosnia and Herzegovina, the Federation of Bosnia and Herzegovina also adopted a new law on factoring in 2016, and legislative reforms for factoring are currently underway in both Kosovo and North Macedonia. Serbia undertook an exercise in 2016 to identify areas of its legal framework requiring reform for factoring, with EBRD support. Few concrete actions have been implemented to date, however.

Box 7.3. Factoring and leasing legislative reform in Montenegro

In 2017, Montenegro introduced its first factoring legislation and reformed its leasing legislation in order to boost the financial industry and provide the market, in particular SMEs, with access to working capital and asset financing. The reform also supported Montenegro's efforts to align its financial sector regulation with the relevant EU *acquis*.

The aim of the new legislation was to reduce funding and cash flow shortages for SMEs, which are often required to provide trade credit to larger buyers and hold accounts receivable on their balance sheet. Similarly, the reform of leasing regulations aimed at boosting the use of leasing services and creating more legal certainty, as well as providing easily accessible asset financing. The main components of the reform included better regulation of leasing companies and amendments of ambiguous provisions in the existing legislation, which had previously resulted in slow enforcement and uncertainties surrounding rights and obligations in leasing transactions. In line with EU directives, for the first time the new factoring and leasing frameworks also introduced the passporting concept into Montenegrin legislation.

The legislative reform, supported by the EBRD, was undertaken in close co-ordination with financial services providers, consumers, regulators and foreign experts in financial services. Co-ordination was achieved through consultations at every stage of the process and by giving stakeholders the opportunity to comment on concept papers and propose alternative solutions that were later transposed into legislation. The involvement of all stakeholders from the beginning, and the close collaboration throughout the process, were key to the success and functionality of the reform.

Considering the level of development of the Montenegrin financial industry and recognising the importance of expanding it, the government authorities adopted a so-called light-touch approach. This meant finding a careful balance between enough regulation to introduce certainty while not placing unnecessary burdens on both service providers and consumers.

The Montenegrin regulators decided to combine the proposed factoring and leasing legislation with the legislation governing other financial services, such as microcredit institutions. This resulted in an all-encompassing financial industry law called the Law on Financial Leasing, Factoring, Purchase of Claims, Micro-Credit and Credit-Guaranteeing. The law now regulates both the service providers (e.g. capital requirements, licensing and corporate governance) and financial transactions (i.e. rights and obligations of transacting parties). It was adopted by parliament on 25 October 2017 and entered into force on 11 November 2017. It came into effect on 11 May 2018.

Source: European Bank for Reconstruction and Development.

The way forward for non-bank financing

- **Support the market penetration of factoring and leasing.** Amid increasing emphasis on reforms of legal frameworks for factoring and leasing, the focus should be on completing and adopting them. In addition, efforts should be made to raise awareness about these types of financial instruments to increase uptake. This could include centralised awareness-raising campaigns or posting information on dedicated portals (see section on The way forward for financial literacy).
- **Embed microfinance into a supportive legal and regulatory framework.** In those markets where microfinance is currently limited, governments should further consider including legislation conducive to microfinance activity to support SME access to finance.

Venture capital ecosystem (Sub-dimension 6.4)

Traditional debt financing is particularly ill-suited to high-growth and innovative early-stage firms, which typically lack a credit history and collateral and operate in a rapidly changing environment. For these types of enterprises more equity-based financial instruments, such as venture capital, are particularly relevant. Venture capitalists – usually business angels or specialised VC funds – invest in entrepreneurs with innovative ideas and provide them with additional business expertise and support at the pre-launch, launch or early development phases (Table 7.8). In return for the high risk of investing in early phase enterprises, VC usually envisages higher-than-average returns on investment. Business angel networks have a similar approach to VC, though the size of investment is usually much smaller and driven by high net-worth individuals or successfully established entrepreneurs.

Table 7.8. Venture capital by stage

Stages	Definition
Pre-seed/seed	Financing provided to research, assess and develop an initial concept before a business has reached the start-up phase.
Start-up/other early stage	Financing for product development and initial marketing. Companies have not sold their product commercially and are in the process of being set up.
Later stage venture	Financing for the expansion of an operating company.

Source: OECD (2015[15]), *New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Instruments*, https://doi.org/10.1787/9789264240957-en.

Although currently not part of the SME Policy Index assessment, crowdfunding is also emerging as a new type of non-bank financial instrument particularly relevant to start-up companies. Crowdfunding allows businesses to draw on a multitude of investors without having to meet excessive reporting requirements or due diligence. The downside, however, is that it usually does not offer adequate investor protection. For instance, minimum capital or anti-money laundering requirements are not sufficiently regulated, unless embedded in a dedicated legal framework.

Governments can support the development of venture capital activities by creating an adequate framework for investor protection, taxation and corporate governance, as well as by building a local environment conducive to innovation and early stage enterprises (for more information, see Chapter 10 on innovation policy for SMEs).

This section assesses the availability in the WBT region of dedicated legislation to enable venture capital investment, as well as the presence of policy measures to encourage such activities.

Venture capital and business angel investments continue to be underdeveloped throughout the Western Balkan region. In contrast, in Turkey VC is available to innovative start-ups and high-growth enterprises, giving Turkey the highest score in this sub-dimension (Table 7.9).

Table 7.9. Scores for Sub-dimension 6.4: Venture capital ecosystem

	ALB	BIH	KOS	MKD	MNE	SRB	TUR	WBT average
Legal framework	1.67	1.82	2.11	1.78	1.67	2.55	4.67	**2.32**
Design and implementation of government activities	1.57	1.34	2.29	2.82	1.54	2.86	4.91	**2.48**
Monitoring and evaluation	1.00	1.00	1.00	1.00	1.00	1.00	4.33	**1.48**
Weighted average	**1.49**	**1.44**	**1.97**	**2.09**	**1.48**	**2.38**	**4.71**	**2.22**

Note: See the Policy Framework and Assessment Process chapter and Annex A for information on the assessment methodology.

Venture capital remains in its infancy, with the focus on building an adequate environment

In Turkey, venture capital is embedded in the legal framework, and the government provides incentives for VC investment through the Turkish Investment Initiative. A recent decision to enable the Turkish Treasury to invest directly in venture capital funds is likely to further stimulate the market, which may help in light of increased macroeconomic uncertainty. The secondary market at Borsa Istanbul, which enables smaller businesses to access capital markets, also provides VC funds with a viable exit option. In addition, the government introduced new legislation in December 2017 to increase clarity on the treatment of crowdfunding activities. This new law moves the Turkish regime from a grant or reward-based system to a return-based one. Additional legislation is currently under preparation, with the support of the EBRD, to regulate equity-based crowdfunding.

None of the economies in the Western Balkans has a dedicated legal framework for VC; instead activities are de jure regulated by more general investment laws. Although some governments had carried out a review of the regulatory framework to address the needs of venture capital during the previous assessment period, no progress has been made in this area. Instead, most economies are primarily focusing on enhancing the overall enabling environment for innovation and have implemented several policies which may lead to increased VC activity in the medium term. Montenegro and Serbia are currently preparing new legislation to establish an alternative investment fund, which may eventually lead to better regulation of venture capital activity. Montenegro is also considering setting up a crowdfunding platform, but no concrete plans are yet in place.

The launch of operations in the Western Balkans of the Enterprise Innovation Fund, supported by the EU and IFIs (International Financial Institutions), is also a noteworthy development. To date, the fund has made a total of ten investments in North Macedonia and Serbia, investing more than EUR 5 million and giving an important signal for other investors looking at the region (EC, 2018[16]).

Business angels continue to be embryonic throughout the Western Balkan region, as existing networks remain largely non-operational and investments are limited. In contrast, numerous business angel networks in Turkey are an important source of finance for start-ups (Box 7.4), laying the foundation for VC investors. According to data collected by the European Trade Association for Business Angels, business angels in Turkey invested EUR 130.3 million between 2015 and 2017, compared to EUR 8.6 million in Serbia, EUR 3.3 million in North Macedonia, EUR 1.8 million in Kosovo and EUR 100 000 in Montenegro (EBAN, 2017[17]). Data for Albania and Bosnia and Herzegovina are not available.

Box 7.4. Public sector support to boost business angel activity in Turkey

Through a variety of policies, from tax incentives to passing a dedicated law, the Turkish government has been successful in significantly increasing business angel activity. Business angel investment volumes have almost quadrupled within four years (2014-17), making it the fifth largest market in Europe.

The increase is commonly attributed to a number of policies. First, Turkey was the third country in the world (after the United Kingdom and the United States) to pass a dedicated angel investor law in 2013. Second, the Turkish Treasury provides a tax incentive of 75% on qualifying investments, rising to 100% on investments in projects previously supported by specific government bodies such as the Scientific and Technological Research Council of Turkey (TÜBİTAK). However, it is worth noting that such schemes primarily target the development of the short-term market and should, in the medium term, be phased out to support more commercially sustainable solutions, such as the dedicated fund announced by TÜBİTAK, to which it has pledged USD 25 million.

As a result of the various support schemes, Turkey is now one of the largest business angel markets in Europe, with 16 angel networks and a total investment volume of EUR 52 million in 2017. While it is too early to showcase exits from this recent investment growth, Turkish start-ups and VC funds have made headlines with large-scale exits, with multiple acquisitions in 2017 and 2018 exceeding USD 100 million.

The Turkish case highlights the importance of a clear, reliable and dedicated legal framework, as well as the role of government incentive schemes in getting financing opportunities off the ground and widening the access to finance for SMEs. While early results look very promising, the Turkish example will be an interesting one to follow as it matures and transitions to more sustainable, market-driven mechanisms.

Source: EBAN (2017[17]), *2017 Annual EBAN Statistics Compendium*, European Trade Association for Business Angels, www.eban.org/2017-annual-eban-statistics-compendium.

The way forward for the venture capital ecosystem

- **Continue efforts to build a business environment conducive to innovation,** including strengthening certainties for investors and highlighting clear exit routes. Adopting dedicated legal frameworks to regulate venture capital investments and supporting innovative businesses with adequate finance and support infrastructure would increase the investment readiness of companies and boost foreign direct investment. In addition, while reviewing existing legislation and assessing the need for policy measures are positive first steps, they should be linked to an action plan outlining concrete policy measures and reforms.

Financial literacy (Sub-dimension 6.5)

Financial literacy is a particularly difficult element to quantify and measure, but the importance of implementing support programmes for the wider public is now recognised as an "investment in human capital" (Lusardi and Mitchell, 2014[18]). At the same time, programmes targeting existing entrepreneurs can help start-ups and SMEs make more informed decisions and better understand their financial requirements. The overall benefits of higher financial literacy levels have been well established in academic research and range from better interest rates to more diversified investments (Lusardi and Scheresberg, 2013[19]; Abreu and Mendes, 2010[20]).

Similarly, existing programmes require diligent monitoring and evaluation to adjust and optimise their reach and impact. Examples from Indonesia, Kenya, Malaysia and Sri Lanka show that impact assessments may be carried out by professional researchers if dedicated resources within the government are limited (Atkinson, 2017[21]).

This section examines the existence of government-led financial literacy assessment and training schemes in each economy, as well as the inclusion of financial literacy in the education system. It assesses support measures not only for their impact, but also their structural monitoring and evaluation.

While the region has made progress with the introduction of additional support programmes, expanding the suite of often highly specific training implemented by government and private bodies, the focus should now be on putting formalised monitoring and evaluation schemes into practice. Scores for this policy area remain relatively low across all the economies, as summarised in Table 7.10.

Table 7.10. Scores for Sub-dimension 6.5: Financial literacy

	ALB	BIH	KOS	MKD	MNE	SRB	TUR	WBT average
Planning, design and implementation	2.26	1.38	2.89	1.98	2.33	2.78	3.45	**2.44**
Monitoring and evaluation	1.00	1.00	1.00	1.00	1.00	1.00	2.33	**1.19**
Weighted average	**2.01**	**1.31**	**2.51**	**1.79**	**2.07**	**2.42**	**3.22**	**2.19**

Note: See the Policy Framework and Assessment Process chapter and Annex A for information on the assessment methodology.

Ad-hoc financial literacy programmes exist across the region, but lack formal monitoring and evaluation

Global surveys have found a relatively low level of financial literacy in the WBT region, meaning that any policies should target both the wider population and existing entrepreneurs. On average in the assessed economies, 27% of the adult population are considered financially literate, compared to an EU average of 52% (Klapper, Lusardi and Van Oudheusden, 2015[22]). While the regional picture seems encouraging at first, with multiple governments implementing visibility campaigns, training programmes and/or online portals (such as the Serbian National Bank's Tvoj Novac educational portal[6]), efforts are generally quite ad hoc and rarely form part of a holistic framework. In Montenegro for example, training is provided by at least half a dozen different organisations, such as the Directorate for SME Development[7], the employment agency and the chamber of commerce, without any central strategy in place. As with other policy instruments, financial literacy support programmes should be based on needs assessments (in this case, a population survey), leading to an overall strategy. In the Serbian example, the National Bank has developed an official strategy, but it is not grounded in a national assessment of financial literacy.

Formal evaluation approaches are generally lacking in the WBT. Turkey appears to be the only economy in the region which conducts formal monitoring of its financial literacy initiatives under the Financial Access, Financial Education and Financial Consumer Protection Strategy and Action Plans. However, no data on their impact are available.

The way forward for financial literacy

- **Prioritise financial literacy within existing policy frameworks**. Economies should develop a centralised strategy co-ordinating a variety of financial literacy efforts targeting diverse population groups. This should range from including basic topics in secondary curricula and advanced topics in vocational educational curricula to creating portals providing all the available support schemes for potential and existing entrepreneurs. Such support programmes might also consist of training or reference material and should ideally be integrated with the other government SME financial support programmes.
- **Improve analysis of financial literacy levels.** Economies should undertake a formal assessment of current financial literacy levels (either drawing on existing international surveys or commissioning dedicated ones) and implement stringent centralised monitoring and evaluation against pre-set targets. Governments could

partner with private sector financial institutions (who would have a vested interest in expanding their potential client base) for outreach campaigns, drawing on NGOs' development experience if needed, to implement programmes targeted at particular demographics (e.g. rural SMEs, potential entrepreneurs or women entrepreneurs).

Conclusions

Overall, the relevant stakeholders in all the WBT economies have made progress in improving access to finance for SMEs.

The assessment found that acceptable legal and regulatory frameworks are in place to facilitate access to finance for SMEs, even though the effective availability of wider collateralisation options could be improved. The coverage of credit information systems has expanded, enabling more enterprises to build a credit history. Amid recovering banking systems, lending has slowly resumed and, in some economies, commercial banks are increasingly focusing on SME lending. Non-bank finance instruments have gained momentum as governments are increasingly recognising the need to diversify access to finance sources. The activities of microfinance institutions have increased in some economies, and across the region efforts are underway to strengthen legal frameworks to support leasing and factoring. Furthermore, the assessment found that venture capital remains active in Turkey amid strong government support. However, although some pioneer VC fund investments were made in North Macedonia and Serbia during the reporting period, VC remains in its infancy across the Western Balkan region.

Nevertheless, systemic issues remain across all WBT economies. In this context, public sector interventions to ease SME access to finance remain common, but, governments are slowly shifting towards more commercially aligned solutions such as credit guarantees. Steps to strengthen legal frameworks to support leasing and factoring are welcome, but their increased uptake requires support, including by raising awareness among small businesses.

Lastly, the low levels of financial literacy require both public and private sector support and a clear strategic approach to tackle shortcomings in this area. Addressing the recommendations presented in this chapter will support relevant stakeholders in the WBT region to improve access to finance for SMEs.

Notes

[1] For a description of the complex administrative set-up in Bosnia and Herzegovina and how this was handled in the scoring process, please refer to Annex B.

[2] The EU-15 comprises Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom. The EU-13 comprises Bulgaria, Croatia, Cyprus,** Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia and Slovenia.

** Note by Turkey: The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus. Until a lasting and equitable solution is found within the context of United Nations, Turkey shall preserve its position concerning the "Cyprus" issue.

Note by all the European Union Member States of the OECD and the European Union: The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

[3] Basel III is a set of measures developed by the Basel Committee on Banking Supervision in response to the 2008/09 crisis. It has beesn agreed internationally with the aim of a more resilient banking system. It underpins the regulatory and supervisory framework and strengthens banks' risk management.

[4] SEE Link website: www.see-link.net.

[5] See http://www.oecd.org/cfe/smes/financing-smes-and-entrepreneurs-23065265.htm

[6] See www.tvojnovac.nbs.rs.

[7] The Directorate for SME Development was restructured at the beginning of 2018 and renamed as the Directorate for Investments, Development of Small and Medium-Sized Enterprises and Management of EU Funds.

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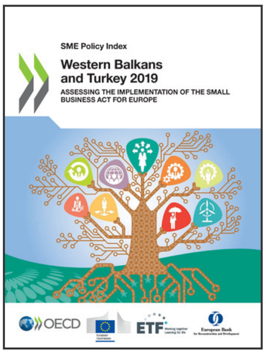

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