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## **SMALL AND MEDIUM SIZED ENTERPRISES DEVELOPMENT IN BULGARIA: PROBLEMS AND PERSPECTIVES**

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### **INTRODUCTION**

This paper sets out to analyse the current situation in Bulgaria in regards to Small and Medium-Sized Enterprises (SMEs) and more precisely, the main barriers and opportunities for their development. This work is a continuation of a paper under the title “*SMALL AND MEDIUM-SIZED ENTERPRISES DEVELOPMENT IN THE PERIOD OF TRANSITION TO MARKET ORIENTED ECONOMY*” (Dr. Miroslav Mateev). The present paper is divided into five parts: part one is on the political and economic environment for SMEs in Bulgaria, part two deals with the current state of small business in Bulgaria, part three stresses on some problems faced by SMEs and mainly on the business support services and the financial resources, the fourth part is focused on the opportunities for SMEs development in Bulgaria, some general remarks and conclusions are given in part five.

### **1. CHANGING POLITICAL AND ECONOMIC ENVIRONMENT FOR SMEs IN BULGARIA**

Dramatic changes have been the main characteristic of both political and economic life in Bulgaria over the past 12 months. The socialist government was forced to resign after the remarkable social unrest in January 1997. A Caretaker Cabinet has been appointed until April when new elections took place. In May 1997, there already was a new Union of Democratic Forces government with full majority in the Parliament. There has been a clear statement for a membership in NATO. The new Government has also introduced its policy towards EU membership, which had as a consequence the need for designing a pre-accession strategy for political and economic development. Administrative reform, approximation of EU legislation and privatisation were pointed out as the most urgent among the activities to be undertaken in the coming months. The end of 1997 has been rich in events aiming at promoting the new government policy and attracts the attention of foreign financial institutions and potential big investors. Such business events with

significant foreign participation were the **Investment Forum** in October 1997; The **Round Table** on Investment Climate in Bulgaria organised by *The Economist*, the **Invest in Bulgaria** forum, etc.

All these new orientations of the present government show the will and attempts made to overcome the political isolation in which Bulgaria has been during the office of the previous government.

The structural economic reform has been broadly analysed during the last year. Downsizing of a large number of loss-making enterprises and banks, closure or liquidation of others and the need for strengthening the social safety net in order to be able to assist displaced workers, inflation and hyperinflation in the first half of the year, privatisation of state properties and introduction of currency board are some of the most remarkable changes during 1997. Hence, the economic destabilization and the decline of business activities in Bulgaria have seriously influenced the SMEs development. The Government policy has not been supportive to the sector and in some cases even being hostile towards the small business. Macroeconomic deficiencies have affected the private sector in general, but their negative impact on the SME is complex due to the SME incapability for access to information and capital. Bulgarian private sector still has a number of weaknesses: 60% of the company sell on the local market and 25 % operate on the national market\*, the access to new technology and know-how is difficult; insufficient administrative and accounting skills, very insignificant internationalisation of the business.

Slow privatisation has led to decline in foreign investment in SMEs and creation of unfavorable investment climate. Inconsistent Government policy on taxation caused tax chaos rather than establishing tax culture and discipline. Inadequate tax policy has forced the SME to work in “shadow economy” and entrepreneurs are pressed by different groupings and corrupted institutions. All these have resulted in suppressed entrepreneurship and decline in foreign investments.

Before May 1997 there has been a lack of clearly defined economic priorities. The new Government however has prepared a programme called **Programme 2001** that contains indicators for a pre-accession oriented strategy with an emphasis on sectors such as transport, agriculture, SME, tourism and environment as well as privatisation and tax reform.

At present, there is a political will for economic reform. However, the practical implementation especially of privatisation and administrative reform is slow and rather complex. The pace of reform had a negative impact on the SME sector and it is still going to survive in turmoil. All these factors combined with the lack of networking and cooperation with international institutions, limited access to information on projects and the unstable banking system are the key limitations to obtaining financial resources for SME activities. Despite the formal recognition of the SME as a factor for economic and social development this sector has either been underestimated or deliberately not paid attention on.

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\* Mateev, M. *Small and Medium-Sized Enterprises in the Period of Transition to Market-Oriented Economy. The Case of Bulgaria, Volume 1*, NOVA Science Publishers, Inc., USA, 1998

## 2. CURRENT STATE OF SMALL AND MEDIUM BUSINESS IN BULGARIA

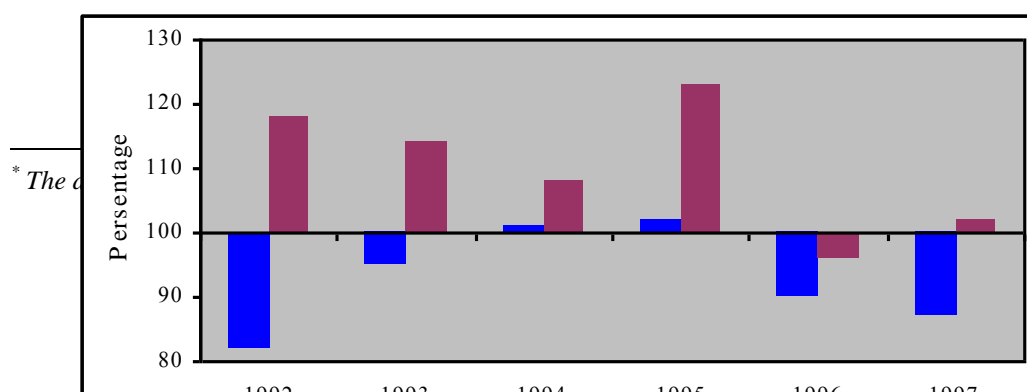
Small and medium business is closely related with private sector development and plays an important role for the transition towards a market economy. Private sector became stronger for the eight years of its existence and it now contributes with approximately 50% to the gross national product (GNP) of the country. Despite the uncertain economic environment during these years, entrepreneurship not only survived, but there are already sectors where it is predominant.

In spite of the fact that the importance of small and medium enterprises as a factor for economic development is widely recognised, there is still no agreed definition of SME. Usually, two criteria are mostly used and namely *number of employees* and *turnover of the company*. The National Strategy for development of small and medium business accepts the definition according to which small enterprise is one with up to 50 employees and middle size enterprise has from 51 to 100 employees. In the State Bank for Investments and Development Bill there is another definition of SME based on asset criterion: small enterprise is one with assets totaling 5 000 minimum work wages and medium enterprise – from 5 000 to 10 000 minimum work wages.

The growing importance of SME for the economy could be illustrated by such statistical data as relative share in Gross Value Added (GVA), number of companies registered, employment generated by private business, SME by sector and others. As an example, during the first quarter of 1998 59,9% of GVA of the economy is generated by the private sector, which is 2.7 points more as compared with the same period of 1997 (see Figure 1\*).

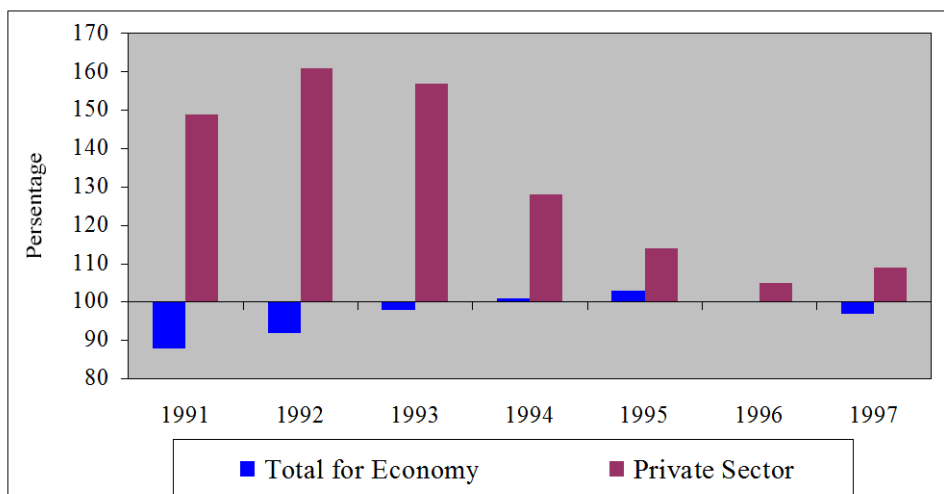
From 1990 onward, the number of firms registered goes up quickly. The first two years after the collapse of the centrally planned economy showed higher growth of private companies. For the period 1990-1991, their number has doubled. This was due to the fast increase of the number of registered firms immediately after the beginning of economic reforms in Bulgaria – 95% of the companies were mainly small companies. After this period, the growth of registered firms gradually decreased. More than 80% of this decrease is due to the decrease of the number of sole traders. These are basically micro companies with main activity – retail trade. There is significant variances in the number of registered firms across various regions - the largest numbers are for Sofia and Plovdiv (the second biggest city), respectively 23% and 16% of the total for the country, the lowest being Montana with 6%. The northwestern part of Bulgaria has the lowest business activity (based on registered firms per capita).

The indicator employment illustrates the SME importance in the creation of new work places. While the employment in the public sector decreased twice between 1990 and 1996 and continues to fall of in 1997, in the private sector it has increased five times.



**Figure 1. GVA index for the period 1992-1997  
(based on the previous year = 100)**

From 1994 to 1996, the biggest number of people employed in the private sector compensates for the employment decline in the public sector\* (see figure 2). In 1995, the employed by the private sector increased with 165.7 thousands, while at the same time the employment in the public sector decreased with 125.1 thousands. In 1996, the employed by the private sector are with 4.4% more as compared with 1995. The number of people working in the private sector in 1997 is over 1.2 million, which represents 42% of the total number of employed people.



**Figure 2. Employment index for the period 1991 - 1997  
(based on the previous year = 100)**

According to the last data provided by the National Agency for SMEs (ASME), out of 29 734 statistically active enterprises in the industrial sector 91,6% are with personnel less than 50 people, 2.77% are in the range 50 –100 people and 5.63% have more than 100 employees\*. For the agricultural sector - out of 5 035 statistically active enterprises

\* The same source of data

\* Petrounova, Ir. *Small and Medium Enterprises - Important Factor of the Growth, Report for World*

86.14% have up to 50 people employed, 8.96% from 51 to 100 people employed and 4.9% - more than 101 people. For trade and commerce sector the figures are: 99.35% (up to 50), 0.37% (51-100 people), and 0.28% (over 101 people). In the industrial sector, 97.9% of the firms that employ up to 50, 55.4% of the firms that have between 51-100 employees, and 40.2% of the firms that have more than 101 employees are privately owned. In agriculture and trade sectors the figures are respectively: 95.1%, 83.1%, 68.4%, and 99.4%, 45.3%, 45.1%

Approximately 77% of the SME in Bulgaria are family enterprises with up to 10 employees. In the Central and Eastern European countries (CEECs) this figure is 66% and in the European Union (EU) member states – 50%. Put of all registered SME in Bulgaria 21% are with up to 50 employees, while in the other CEECs – 32% and in EU countries – 49%. Only 2% of the Bulgarian SME are with more than 50 people. Based on this specific feature, one can point out that the majority of private companies in Bulgaria are microcompanies.

Most private companies are registered in sectors with low capital utilisation, while in the industry and construction the number of newly registered private companies is still lower as compared with the other CEECs. The same distribution by sectors is given in Table 1.

Significant number of entrepreneurs has started their business in trade and services that is typical for transition when the initial investments are returned rather quickly. Around 95 % of trade (retail and wholesale) in the country is in private hands. In the industry, businessmen are interested in small scale and flexible production, since the large scale productions require not only serious investments, but also new technologies and know-how, which is accessible for the big companies. Third important sector for SME is transport (domestic and international).

**Table 1. Small and medium enterprises by sectors (by March 1998 )**

ENTERPRISES	INDUSTRY	CONSTRUCTION	AGRICULTURE	TRADE	TRANSPORT
SMALL (1-50 employees)	27 235	10 281	4 307	96 583	12 074
MEDIUM (51-100 employees)	824	273	451	360	75

Despite the rapid development of private sector illustrated by the above data, the economic and legal framework is still not a stimulating the establishment and growth of SME. On one side, SME potential as accelerator of economic growth and their role in the creation of new work places is not used to full extend. On the other side, there are several macro- and microeconomic factors, hampering the development of small

business. Relevant institutional environment is also lacking. All these factors created various barriers to the private business development in Bulgaria.

### **3. BARRIERS TO SMALL AND MEDIUM BUSINESS DEVELOPMENT IN BULGARIA**

Different studies and research works\* have focused on the problems, faced by SME over the last years. The main difficulties could be grouped around two main categories and namely business support structure (legal and administrative environment, consultancy services, regional business centres, business associations, etc) and financial support. Below are some main generalisations about the barriers to SME development in Bulgaria:

#### 3.1 Business support infrastructure

3.1.1 Legal environment – there is a lack of favourable legislative environment for the SME development; legislation at national, regional and local level is not satisfactory; often change of legislation; lack of preferential conditions for attracting foreign investments; need for internationalisation of SME activities in order to access EU and World trade markets.

3.1.2 Administrative environment – the speed of national, regional and local administration is a barrier for SME; slow decision-making process or lack of enough transparency; lack of coordination among structures at different levels; lack of administrative experience and motivation leading to corruption of civil servants; need for additional qualification and training for the administrative staff, working for the national and regional structures that support SMEs.

3.1.3 Consultancy services – majority of consultancy companies are not specialised and prefer to offer wide range of services, which has an impact on their professionalism; various specialised services, widely used in EU countries, are almost unknown for the Bulgarian SMEs; prices of highly specialised consultancy services are barrier for the SMEs, companies users of consultancies services are not too demanding as regards the quality of the consultancies; SMEs are not aware of many agencies and consultancy organisations (both Bulgarian and foreign) that provide different types of SME support.

3.1.4 Marketing and promotion – communication between company and client is still mainly based on personal contacts (informal contacts or business visits); small companies are not aware of the advantages of other ways of promotion; lacking is the tradition and experience in the use of various types of marketing and advertisement; mass media are too expensive for SMEs.

3.1.5 Lack of managerial and financial skills and culture – there is no sufficient managerial experience and skills, as well as and qualification at different levels of the

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\* *Marinova, M. Research findings in Bulgaria, "Operating Finance and Credit for Business in Central and Eastern Europe" conference in Bucharest, Romania, April 24<sup>th</sup>, 1998*

company (top, middle and line managers). This lack is significant in different fields, as for example, in quality standards, price expectancy, role of marketing, fulfillment of contracts, management and business planning. There is necessity of establishment of specialised centres and educational and training programmes (distance learning included) and development of new financial and entrepreneur culture.

3.1.6 Inadequate infrastructure – bad quality of existing infrastructure: roads and communication services are hampering the SME development. Monopolies in communications, electricity, water, etc. through discriminative prices (deferent prices for household and industrial purposes), increase the SMEs production expenditures.

3.1.7 Informational problems – as far as equipment is concerned, private companies suffer from lack of computers and/or access to global information networks. Many managers are not able to use computers in their accounting, managerial and marketing activities. They also face difficulty in getting economic and market information due to unreliable statistic, underdeveloped stock exchange, limited access to registers and lack of information on Local and Central Government initiatives.

3.1.8 Unfair competition – still there is no strict control on the violation of the Law on Competition

3.1.9 Crime rate and racket (selling protection) – relatively high crime rate is a problem for business and personal security. Corruption, crime and racket require additional expenditures, which reflects the investment capital. Some companies prefer to work in “shadow” or not to expand their business in order to avoid the legal taxes. Over the last year, due to the Government efforts in the fight against crime, this problem is limited.

## 3.2 Financial barriers

3.2.1 SME access to credits is difficult due to the unwillingness and lack of experience in the banking system for such customer type servicing. Nonbank institutions and schemes for alternative financing are not developed, either. Despite the achievements in trade company and business transactions regulation, still there are problems preventing the application of all existing instruments for small business crediting.

3.2.2 Companies do not have adequate access to information on credit lines and other financial support provided by international financial institutions and intermediaries

3.2.3 There is no experience in using consultancies for getting access to financial resources or applying for credits

3.2.4 Few companies have used credits ( or have stated that have used)

3.2.5 Companies that have received loan have used it mainly for purchasing of equipment, vehicles or short-term assets and not for expanding the business

3.2.6 Majority of businessmen do not like to use loans for expanding the export activities, investment and starting new operation because of high interest rates on credits

3.2.6 Interbusiness loans and family/friends financial resources remain the main source for short-term capital.

The lack of working capital and operational finance is a very important problem in the hierarchy of business problems faced by the SMEs, because various research show that the entrepreneurs in Eastern Europe would like to create strong, long-lasting, often family companies. Unlike the problems related to markets, product design, technical capabilities, etc., financial crisis threatens with a total loose of control, hampering the SMEs in the long run. The new businessmen rely on their own internal resources, which compensates the lack of external support. However, this does not apply to the short-term capital where the impact of the external environment is very strong.

#### **4. OPPORTUNITIES FOR SME DEVELOPMENT**

The unique challenges of modern economy: globalization, changing role of the state, developing information society, and higher quality standard requirements, put forth the task of providing SMEs with timely statistics and other empirical information regarding the development of this sector. Information is an important tool for adapting policies, stimulating the establishment of new enterprises in different industries and services, and uncovering the potential of the already existing enterprises. Reliable statistics are very important to the small business, because they allow the state and municipal administration to observe the effect of their policy and plan ahead. Only the government cannot do maintaining such database. The most efficient method is cooperation among the respective ministries, the National Institute of Statistics, the local governments, the Agency for SMEs (ASME), research centers and institutes, non-governmental organizations, etc. The government will not be directly involved in the preparation and dissemination of information and consulting services. The greater bulk of those activities will be undertaken by private institutions, non-government organizations and group initiatives that will be financially supported, as far as resources allow for it.

The main aim of the Government Strategy for facilitating entrepreneurship is creating a favorable institutional, legal, administrative and financial environment for the development of SMEs as a stable sector of our economy. The sub-goals of the Strategy are:

- promoting private ownership, open competition and entrepreneurship;
- stimulating foreign investment in the SME sector, and
- European and global market integration of SMEs.

The Strategy will support the spirit of market reforms in Bulgaria and the priorities of the State economic policy as formulated in the Government Programme 2001, which are:

- macro-economic stability;
- fixed budget constraints and a balanced budget;
- widened tax base and carefully estimated reduction of tax rates;
- liberalization of prices and trade;



- European integration;
- accelerated privatisation processes;
- decreased state influence in the economy.

The main aim suggests a *short-term implementation* of the following tasks:

- development of a National strategy for supporting SMEs and an implementation program;
- accepting a law for stimulating SME development;
- exploring opportunities for new financial instruments for SMEs and putting together projects for microcredits and insurance schemes;
- identifying potential fund resources for the ASME and for widening the network of regional centers supporting SMEs;
- creating a system of registering SMEs in ASME database;
- developing a medium-term program for the activities of ASME in the context of the National strategy;
- creating a partnership network by all active governmental, non-governmental institutions and economic units, thus achieving a synergy in SME supportive actions;
- disseminating nationally data and information related to small business, defining the strategic framework and the availability of SME services around the country; this task will be completed by an annual Report on small business, or a guide that will be prepared in cooperation with the representative SME organizations;
- a separate law for the crafts, defining the crafts and containing a list of crafts.

In *medium-term perspective /1999-2000/* the most important task is to guarantee a stable trend for intensive development of SME sector through:

- stimulating the process of European and world integration of SMEs by providing them with easy access to information about: international training and cooperation programs, international markets; and through facilitating partnerships with international companies;
- stimulating unification of SMEs in terms of branches and regions, as well as the cooperation between such unions and the respective unions in the member countries of EU and the CEE countries;
- increasing competitiveness of SMEs by: facilitating the implementation of quality control systems, adopting European standards of business culture and ethics, stimulating clean and energy-saving industries, facilitating access to modern technologies and research results;
- simplifying and improving the administrative procedures and the legal base;
- facilitating SMEs' access to specific financial instruments;
- providing opportunities for training and re-training;
- special provisions for stimulating crafts, as well as entrepreneurship among young people and women.

The Agency for SMEs is the organisation responsible for preparing and implementing the Strategy. In carrying out its activities, towards achieving the goals of the Strategy, the Agency will ensure:

- timely and reliable information of the economic state of the SME sector;

- public access to information about legislative initiatives affecting SMEs, regulating entrepreneurs' participation in discussions on draft legislation and regulatory acts changes;
- analysis of draft laws and regulations in terms of their effect on competition, and
- active interaction between entrepreneurs and governmental institutions.

In the long term aspect the task of ASME is to write a program for and coordinate the already existing and the newly constructed network of business centers and structures in the country\*, that will:

- provide information to SMEs regarding supportive programs, legislative and political initiatives;
- offer training for SMEs;
- support the quest for strategic unions in implementing training, supporting and other similar programs;
- provide the environment for discussions and information exchange (e-forum) by installing and maintaining a special server for the needs of SMEs in Bulgaria. It will serve as a catalyst for engaging in partnerships and sharing experience.

Recently, there have been various initiatives and projects aiming at promotion of SMEs development. Usually the funding comes from EU sources (PHARE, TEMPUS and other programmes), World Bank support or it is based on bilateral agreements. The EC Commission in association with the Ministry of Industry of Bulgaria has agreed to make available funds (a credit line of 6 MECU) to support the development of commercially viable and profitable SMEs which contribute to employment, economic growth and the generation of exports, by financing their investment requirements with long term loans. Bulgarian banks currently participating in the SME Line of Credit Programs are: Bulgarian Post Bank, Central Cooperative Bank, Express Bank. Unfortunately, the second tranche has been canceled because the use of funds has remained too low to justify the transfer of additional money. At the same time, SME lobby was discussing the issue of the need of credits and short-term capital for their operation. Paradoxes like this one underline the deficiencies of the SMEs support infrastructure.

## **5. GENERAL REMARKS AND CONCLUSIONS**

Generally, the economic and political environment is becoming more stable with increased facility for enterprise development. However, that development remains rather uneven, particularly in respect of the financial environment. This is evidenced by the inadequate provision of financing for operating credit and working capital. Whilst the need for a strong SME sector is increasingly understood, there is a little attempt to turn rhetoric into reality. Although Government attention has turned to attempting to develop greater access to finance for SMEs, the financial instruments chosen remain largely inappropriate. Policy initiatives are predominantly aimed at long-term financing of fixed

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\* *Mateev, M. Stimulating the SMEs development in Bulgaria, Bank, Investment, Money, issue 4, 1998*

assets, however various research illustrate that the greatest need within the SMEs is for short-term financing of their working capital requirement.

Large enterprises remain the prime target for financial institutions. SMEs however remain disadvantaged due to the high interest rates charged and corresponding requirement on the part of the banks for collateral – mainly based on fixed asset values. Banks are reluctant to lend to SMEs because of the double effect of poor returns on their borrowing levels and the high risk associated with lending to SMEs. The banking community itself has a poor level of understanding of the SME sector. Banks in general are unaware of the key constraints facing SMEs whom they regard as the least attractive business clients. Lending instruments are not geared towards this sector, and complex rules and regulations often deter the SME from making applications. Banks generally feel that SMEs financial requirements should be provided by the state or other non-profit organisations, which are less risk sensitive. Thus whilst large enterprises are supported and encouraged into the mainstream business community, SMEs by and large remain on the outside, resorting to their traditional methods of corner cutting and informality for short term financing requirements.

Unlike other areas of business support, financial corner cutting can be life threatening for the enterprise in question. When that threat of failure looms, the head of the enterprise often finds a new business or subsidiary to which finances are gradually transferred and the original enterprise is left to bankrupt.

SMEs themselves suffer from a lack of understanding of the principles underpinning financial management, often failing to grasp even the need for financial management. The smaller the enterprise, the less the likelihood that they will understand the need for financial management and the poorer the understanding of the financial instruments available. In general the financial culture within the SMEs is weak and poorly developed with little understanding of the ways in which financial management could assist in the successful management of the enterprises. There is in general a lack of professionalism within the SMEs in terms of strategic planning procedures, decision making processes and business planning, and this has a detrimental impact on the image of SMEs within the banking community which is translated into an unwillingness to meet their financial requirement.

Similarly, there is a lack of professionalism within the banking sector. The privatisation of this sector has been recognised as a policy priority, but this privatisation should target increased performance and efficiency in addition to the simple task of capitalisation. A proficient, professional banking sector capable of efficient risk assessment is a critical factor within a functioning market economy. It is imperative that all the countries aspiring to membership of the EU develop such a banking sector, but the reality evidences a lack of experience and competence in risk assessment. This has particular implications for SMEs where there is a limited ability to assess risk appropriately which often translates into a general unwillingness to try to understand issues facing SMEs.

Finally, two conclusions must be drawn. They are, first, that where the infrastructure of business itself is deficient, the infrastructure of financial support should not be expected to be satisfactory. The second conclusion concerns the disparate nature of the financial support infrastructure in Bulgaria.

It is recommended that policy attention be directed to the following priority areas by public authorities and major agencies in the field:

1. Education and training in financial management for owner managers within SMEs, both to reinforce the importance of financial management as a management tool and to improve the ability of SMEs to manage their working capital and operating finance in a way to enhance the performance of their enterprise.
2. Training within the banking community to develop a greater understanding of the SME sector through the development of closer relationship leading to the generation of financing instruments more closely targeted to the needs and requirements of SMEs. Simplification of application procedures and the creation of dedicated units oriented towards the needs of SMEs.
3. Increased training and development within the banking sector to develop efficient, professional risk assessment consistent with a functioning market economy.
4. The development of a strategic approach to the provision of working capital and operating finance to SMEs to avoid ad-hoc approaches and the provision of inappropriate financial instruments leading to increasing weakness amongst the SME sector.

The final aim of these measures is the creation of stable market infrastructure for the SME activities, building a new business culture and ethics and stimulating the EU integration and globalisation of the Bulgarian small business.

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