FYROM

Assessment of financing needs of SMEs in the Western Balkans countries

August 2016

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Country report: FYROM

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Business & Finance Consulting

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List of Acronyms

BEEPS	Business Environment and Enterprise Performance Survey
BFC	Business & Finance Consulting
BkUF	Balkan Unlimited Foundation
CAGR	Compound Annual Growth Rate (geometric mean)
CAR	Capital Adequacy Ratio
CDF	Crimson Development Fund
CEB	Council of Europe Development Bank
CEED	Center for Entrepreneurship and Executive Development
CIIP	Competitive Industries and Innovation Support Program
CPI	Consumer Price Index
DEG	Deutsche Investitions- und Entwicklungsgesellschaft
DPL	Development Policy Loan
EBRD	European Bank for Reconstruction and Development
EFSE	European Fund For Southeast Europe
EIB	European Investment Bank
EMKICE	Euro-Macedonian Knowledge Innovation Center
EU	European Union
EUR	Euro currency
FDI	Foreign Direct Investment
FI	Financial Institution
FITD	Fund for Innovation and Technology Development
GDP	Gross Domestic Product
GGF	Green for Growth Fund
GoM	Government of Macedonia
GVA	Gross Value Added
HDI	Human Development Index
ICT	Information and Communication Technology
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
IT	Information technology
KfW	German Development Bank
LGF	Loan Guarantee Fund
MBAN	Macedonian Business Angels Network
MBDP	Macedonian Bank for Development Promotion
MEDF	Macedonian Enterprise Development Foundation
MFI	Micro-finance Institution
MKD	Macedonian Denar
MoF	Ministry of Finance

MSE	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprises
NACE	Statistical classification of economic activities in the European Community
NATO	North Atlantic Treaty Organization (North Atlantic Alliance)
NBFI	Non-bank Financial Institution
NBRM	National Bank of the Republic of Macedonia
NDFI	Non-depository Financing Institution
NGO	Non-governmental Organization
NPL	Non-performing Loan
OECD	Organization for Economic Co-operation and Development
PPP	Purchasing Power Parity
SBA	Small Business Act
SEAF	Small Enterprise Assistance Funds
SIDA	Swedish International Development Cooperation Agency
SME	Small and Medium Enterprises
SOB	State-owned Bank
SSO	State Statistical Office
TA	Technical Assistance
TIDZ	Technological Industrial Development Zones
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USD	United States Dollars
YES	Youth Employability Skills
VAT	Value Added Tax

End of period exchange rates used in this report

	2015	2014	2013	2012	2011	2010
EUR/MKD	61.5947	61.4814	61.5113	61.5000	61.5050	61.5050
USD/MKD	56.3744	50.5604	44.6284	46.6510	47.5346	46.3140

Source: NBRM

About this report

This report is one of a series of reports produced by Business & Finance Consulting GmbH (BFC) for European Investment Bank (EIB) as part of the project "Assessment of financing needs of SMEs in Western Balkans countries." The series of reports includes individual reports on Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Montenegro, and Serbia as well as a synthesis report which considers the results of all six reports. The purpose of the project is to assess the financing needs of SMEs in the Western Balkans and identify market failures that prevent SME access to finance.

The project was carried out from October 2015 to April 2016 by a team of three experts from BFC. Onsite visits were conducted for each country in order to meet with representatives from financial institutions, development institutions, government organizations, and other relevant experts who can provide insights into the SME sector.

The visit to Macedonia took place from November 26 to December 4, 2015, during which time meetings were held with representatives from 27 organizations (including local financial institutions, international development institutions, government organizations, and SMEs).

The authors take full responsibility for the contents of this report. The opinions expressed do not necessarily reflect the view of the European Investment Bank.

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1 Executive summary

Seven years after the onset of the global financial crisis, economic growth remains below the potential of Macedonia, with high unemployment being a continuing problem. The GoM intends to continue stimulating economic growth by increasing public spending and keeping taxes low even though the fiscal deficit is at its historical high and the tax environment is among the most favourable in the region. Trade is the largest activity and is one of the main drivers of economic growth. Macedonia tends to run a big trade deficit that is largely financed through private transfers. Despite substantial foreign trade deficits, the inflation rate has consistently been low and turned negative in recent years. The country has been successful in attracting some high-profile FDIs, but backward linkages to spur the development of the SME sector are lagging. Further economic reform and development are hindered by a certain level of fatigue in the EU integration process and political instability since early 2015.

SMEs in Macedonia play an important role in terms of employment, turnover, and value added. Trade still dominates and drives the SME sector but other sectors have potential to grow —agriculture, tourism, and IT sectors having the largest potential. The country has significantly improved the environment for doing business. In particular, Macedonia is #2 in the world on the ease of starting a business. The percentage of SMEs introducing innovations is relatively high, but in-house innovation remains weak. Implementation of specific innovation support measures has been sparse and slow. GoM has launched several programmes to support innovation and the supporting environment for SME innovation is gradually improving.

Loans will continue to account for the largest part of the demand, which is expected to be driven by the small enterprises from outside Skopje, especially in agriculture and tourism. Demand for non-loan products remains generally low due to reduced awareness of their availability and/or benefits. However, the potential demand for risk capital is high, especially among the start-ups in the IT sector, which are mostly unbankable.

The degree of financial intermediation in Macedonia is relatively low, with total assets of the entire financial sector being below 90% of GDP. More than 98% of SME financing consists of bank loans. There is one state-run loan guarantee scheme, but its impact is minimal. The non-bank financial sector is very small and faces challenges including regulatory constraints and high competition from banks. Private equity and venture capital has been present for some time, but the investment portfolio is low.

As a result of a generally abundant supply of SME credit, access to which is only restricted by insufficient collateral and perceived inability of the borrowers to repay the loan, the funding gap for loans in Macedonia is rather small. As lending is mostly collateral-based, the gap is higher in rural areas, with agriculture remaining largely underserved.

With a low loan-to-deposits ratio and high liquidity, banks, in general, have a reduced need for additional borrowings. Funding is not a priority for non-bank financial institutions either. Additional funding would be mostly needed to help raise awareness among SMEs of benefits and principles of non-loan products such as leasing, factoring, and equity or quasi-equity investment. Thus, the major opportunity for IFIs consists in a well-designed technical assistance component to be included in a funding package.

2 Macroeconomic environment[1]

Key findings:

- *Seven years after the onset of the crisis, economic growth remains below the potential of Macedonia, with high unemployment being a continuing problem*
- *Trade is the largest activity and one of the main drivers of economic growth*
- *Macedonia tends to run a big trade deficit that is largely financed through private transfers*
- *Despite substantial foreign trade deficits, the inflation rate has consistently been low and turned negative in recent years*
- *While the country has been successful in attracting some high-profile FDIs, backward linkages to spur the development of the SME sector are lagging*
- *Even though the fiscal deficit is at its historical high and the tax environment is among the most favourable in the region, the GoM intends to continue stimulating economic growth by increasing public spending and keeping taxes low*
- *A certain level of fatigue in the EU integration process and political instability since early 2015 hinder economic reform and development*

2.1 Economic development and growth

Seven years after the onset of the crisis, economic growth remains below the potential in Macedonia. The country enjoyed robust economic growth of 4.7% from 2003 to 2008. After the economic crisis of 2008–2010 however, the country has not been as successful in re-starting its economic growth. The growth rates are still behind expectations and lower than those of the region's most dynamic countries. 2012 was especially unsuccessful, resulting in a contraction of 0.5%. The GDP growth rate in 2015 is estimated at 3.7%, up from 3.5% in 2014 and 2.9% in 2013. In the medium term, Macedonia's growth is expected to accelerate, driven by FDI-related manufacturing exports, public investment, and a gradual recovery in domestic demand.

Unemployment is a continuing problem in Macedonia. Ever since the 1990s, Macedonia has suffered from high rates of unemployment. In 2005, the official unemployment rate reached its maximum of 37.3%. The rate has been decreasing since (28.0% in 2014 and an estimated 26.1% in 2015), but still remains high. Registered SMEs accounted for 75.6% of all non-agricultural and non-financial labour. It is widely thought, however, that the unemployment is actually lower and the contribution of SMEs is higher due to the importance of the informal economy. Unemployment is, more or less, the same among men and women but is particularly acute among youth and some ethnic minorities. The youth unemployment rate has been above 50% over the last decade and stood at 53.9% in 2015, one of the highest rates in the world. The high percentage of young people unemployed in Macedonia is primarily related to a significant supply-demand mismatch (the labour market is flooded with university graduates, which are much less demanded compared to skilled workers). Regional unemployment rates vary significantly, but the disparities have narrowed. The north-east region traditionally has the highest unemployment, although it is gradually decreasing (from 64.8% in 2009 to 44% in 2014).

Gains from growth have not been widely shared. The boom years of the early 2000s brought steady increases in incomes. The rapid growth, however, brought uneven benefits resulting in increased income inequality. Despite a relatively high Human Development Index of 0.747[2], the inequality-adjusted HDI of 0.622 is the lowest among the Western Balkans countries, and the Gini Index of 43.6 is the highest in the region. The country's GDP per capita is a third of the EU average of members that have joined since 2004 and 15% of the EU average as a whole. Although the official poverty rate has dropped from 27.0%

[1] Key macroeconomic indicators for the country are presented in Annex 1.

[2] According to the UNDP's *2015 Human Development Report*, Macedonia is among the countries with a high development level, as are all other countries in the Western Balkans.

in 2010 to 22.1% in 2014, the population at risk of poverty is estimated at around 30% and is not expected to change significantly. The buoyant construction sector, which is dominated by SMEs, is expected to contribute to urban poverty reduction by increased employment of the less skilled and less well-off.

2.2 The structure of the economy

Trade is the largest activity in Macedonia. Trade accounts for more than 15% of GVA, of which about 85–90% is contributed by SMEs. Trade is still one of the main drivers of economic growth in Macedonia, in general, and SME development, in particular.

Construction and real estate activities represent two other significant economic sectors. Accounted for 7.3% and 13.6% of GVA in 2014, respectively, construction and real estate activities are well represented by SMEs. The value added by real estate activities has been steadily growing at an average annual rate of 3.5% over the last five years. Construction has grown faster (at 7.5% per year, on average), but its development has not been as gradual. After an impressive growth of 33.8% in 2013, the sector contracted by 6.0% the following year. In 2015, construction rebounded and it is estimated that the value added will hit a record high[3].

Other large economic sectors include manufacturing and agriculture, both of which are well represented by SMEs. In 2014, manufacturing and agriculture accounted for 12.3% and 11.6% of GVA, respectively. The contributions of both sectors increased in 2014 compared to 2013. In 2015, agriculture did not perform worse in absolute terms, but its contribution to GVA slightly decreased. The agricultural sector, which employs about 20% of the workforce, is constrained by several factors, including a large share of state-owned land which needs to be better managed to unleash its productive and export potential.

Macedonia's privatization process is almost complete and private capital is dominant in the market. The GoM is trying to sell four remaining loss-making companies through international tenders. To finalize the privatization of remaining loss-making and bankrupted state companies, the GoM offered large discounts and did not impose employment and investment requirements. There are about 15 state-owned enterprises operating in several sectors including energy, banking, water supply, utilities, and public transportation. The government has not announced plans to sell shares in any of them.

Although privatised, former state-owned enterprises are slow to restructure and affect the country's overall competitiveness. According to IMF, most state enterprises were sold to insiders rather than to strategic investors with capital and know-how. Due to the resulting stakeholder structure in those enterprises, corporate governance and enterprise restructuring remained a challenge, and state support often continued despite their substandard performance. As one of the interviewees mentioned, there is a big difference between a *private* company and a *privatised* company.

The informal sector is significant and remains the biggest problem for SMEs. The informal market is estimated to be at least 20% and as much as 45% of GDP. The vast majority of informal sector activities provides goods and services whose production and distribution are perfectly legal. However, although there have been some improvements in dealing with unregistered firms, competitor practices in the informal sector remained the biggest problem for Macedonian firms, according to the latest EBRD's *Business Environment and Enterprise Performance Survey* (BEEPS V). The percentage of firms that reported competing against firms in the informal sector decreased from 74% in BEEPS IV to 56% in BEEPS V but well exceeded the south-eastern Europe average.

[3] In 2015, it is estimated that the contribution of the construction sector and real estate activities have increased to 8.1% and 14.0% of GVA, respectively.

2.3 Inflation and asset prices

The exchange rate is stable. The official exchange rate is freely determined by the market. The NBRM operates in the foreign exchange market with the strategy to maintain a stable exchange rate by pegging MKD to EUR, thereby maintaining low inflation. The MKD lost just 1.6% against the EUR since 2000. Parallel foreign exchange markets do not exist in Macedonia.

Macedonia currently experiences deflationary pressures. Despite the growth and substantial foreign trade deficits, the inflation rate has consistently been relatively low, with the exception of 2008 when the inflation rate went over 8%, mainly driven by increased prices on food and beverages. From 2011 to 2013, the worsening economic climate and events in Europe, especially in south-eastern Europe, significantly affected Macedonia, and the inflation rate was between 2.8% and 3.9%. As food and oil prices plummeted over the last couple of years[4], the CPI declined by 0.3% in both 2014 and 2015.

The real estate market has been in a continuous decline since the financial crisis. Both primary and secondary real estate markets experience decreased demand, resulting in fewer transactions. Real estate developers, in search for clients, engaged in a price competition. According to SSO, the average price of residential dwellings in Macedonia has been continuously declining from the peak of MKD 55,556 (or EUR 900) per sq. m in 2008 to MKD 46,085 (or EUR 750) in 2015. A similar trend can be observed in the commercial sector as well. Reduced prices have a negative effect on the SMEs' access to finance as they directly affect the value of collateral for loans. On the positive side, reduced prices for commercial real estate encourage small retailers and food service operators to purchase new shopping areas and open new restaurants and cafés.

2.4 Balance of payments

The current account deficit has steadily declined since 2009. After peaking at 6.8% of GDP in 2009, the current account deficit has been declining gradually in terms of GDP to 0.8% in 2014. Export growth was driven by FDI-related exports, especially in the automobile industry and electrical machinery. At the same time, these FDI-related exports have contributed only around a 6% growth in net exports as the import content of FDI-related exports remains high[5]. Lower oil prices have also reduced pressures on the current account. Energy imports (increasing in volume, but at lower prices) reduced the current account deficit by around 0.4% in 2014. In 2015, the current account deficit is estimated at 1.4% of GDP.

Macedonia tends to run a big trade deficit that is largely financed through private transfers. Although the trade deficit in terms of GDP has declined in recent years to 20.7% in 2014 (and an estimated 19.0% in 2015) and the export-to-import ratio has risen from its record low of 53.4% in 2009 to 67.8% in 2014 (and an estimated 70.1% in 2015), Macedonia remains highly dependent on imported goods which are financed by remittances. This reliance on private transfers exposes the country to external risks that could be mitigated by increasing FDI, enhancing backward linkages between foreign firms and domestic suppliers, reducing energy imports, and strengthening competitiveness. The policy of pegging MKD to EUR, however, made the needed adjustment to the competitiveness challenge more difficult.

The global economic crisis and the euro zone debt crisis caused a significant slowdown in foreign direct investment (FDI). FDI slumped from 4.5% of GDP in 2011 to only 1.7% of GDP in 2012, mainly due to the outflow of profits of foreign-owned companies and intercompany loans. However, in 2013, FDI surged to 2.8% of GDP as the global economy recovered. Recent events in the neighbouring EU countries have resulted in a slightly decreased FDI in 2014 (2.3% of GDP) and even less in 2015 (estimated at 1.9% of GDP). The latest FDI was primarily new foreign investment in free trade zones but also additional investment by existing foreign investors. The largest FDI in recent years has been in the automotive parts

[4] Food prices have fallen by 40% from their peak in the summer of 2012, according to *The Economist*'s commodity-price index. Agriculture is an energy-intensive sector, and, since 2014, the plunging oil price has reduced input costs.

[5] For example, iron and steel are the second most important exported goods, but about 40% of the exported value is imported.

industry. Activities in free trade zones accounted for most of the increase of the country's foreign trade, both on the export and the import side.

While the country has been successful in attracting some high-profile FDIs, backward linkages to spur development of the SME sector are lagging. FDI projects (especially in the automotive industry, mining, and textiles and apparel) offer good opportunities for increasing backward linkages with local companies. These, however, are currently limited, thus restraining employment gains, net export growth, know-how sharing, and other FDI benefits. Investments go primarily to large enterprises and SMEs are not benefiting much.

Macedonia could improve its competitiveness and take better advantage of the economic benefits of FDI. Most export volume is produced by large enterprises and is still too concentrated in commodities (metals and minerals) where value added is low and prices are volatile. However, most exporting firms, by number, are small enterprises with fewer than 10 employees and have difficulty competing in export markets because of inefficiencies and high costs related to customs, logistics, and trade infrastructure. In addition, according to the World Bank, medium and large firms do not invest sufficiently in quality or innovation.

2.5 The fiscal and political situation

Macedonia's public debt, though low by regional standards, has increased in recent years. Between 2008 and 2014, Macedonia's public debt almost doubled, increasing from 23.1% of GDP in 2008 to 46.0% of GDP in 2014. This increase in public debt was driven by sustained fiscal deficits at the central government level and investments by the state-owned enterprises. The GoM put forward an ambitious policy program in 2014 that, if fully implemented, would steeply increase Macedonia's public debt over the medium term. In 2015, it is estimated that Macedonia's public debt increased to 46.5% of GDP.

The fiscal deficit reached a historical high in 2014. Data for 2014 suggest that the fiscal deficit reached 4.2% of GDP. This compares to an original budget deficit target of 3.5% and a revised budget deficit target of 3.7%[6]. Spending pressures related to the parliamentary and presidential elections in 2014 pushed the budget deficit above the target. Expenditures grew due to increases in pensions, public wages, subsidies, and capital investments. At the same time, revenues of 28.0% of GDP are among the lowest in the region. An eventual fiscal consolidation policy may target a growth in budget revenues by increasing tax rates, which may also hit SMEs. So far, however, the GoM intends to stimulate economic growth by increasing public spending and keeping taxes low.

Businesses in Macedonia have benefitted from a very favourable tax environment. The corporate profit tax rate is one of the lowest in Europe at 10%. In addition, since 2009, profit tax is not payable on undistributed profits (i.e. the retained profit is not taxable)[7]. Foreign investors are eligible for profit tax exemptions for profits generated during the first three years of operation as follows: in proportion to the amount of foreign investment; all profits reinvested in the company; profits invested in environmental protection; and profits invested in "underdeveloped" regions of the country. Companies with at least 20% foreign capital are exempt from customs duties for the first three years after their registration. In-

[6] The GoM also missed its fiscal targets in 2012 and 2013. According to the preliminary estimates, the target of 3.5% of GDP has been met in 2015.

[7] However, a corporate tax payer is still taxable on certain expenses as well as on understated revenues due to available tax credits and tax reliefs. In this case, profit tax is payable on a monthly basis regardless of whether the corporate tax payer incurs a profit or a loss. A number of interviewed SMEs stated that it would be more advantageous with a higher corporate income tax rate but without being taxed on certain expenses as estimates of the tax authorities are reportedly oftentimes exaggerated.

vestors in free trade zones[8] can further benefit from tax holidays for up to 10 years for profit tax and personal income tax for employees, VAT, and customs duties exemptions and other incentives.

There is fatigue in the EU integration process. The process of accession to EU membership – arguably the main catalyst of reforms – remains a distant prospect for Macedonia. Macedonia has been a candidate for accession to the EU since 2005 but has not yet entered into accession negotiations. Among current obstacles to full membership is the ongoing dispute with Greece over the country's name[9], which is also the reason why it is officially addressed by the EU with the provisional appellation "Former Yugoslav Republic of Macedonia" rather than its constitutional name, "Republic of Macedonia". Another problem is that there are strained relations between Macedonia and Bulgaria. Accession to the EU has been defined as the highest strategic priority for the country's government, but the expected accession is currently described as a "medium to long term" prospect.

Further economic development is hindered by the lack of political stability since early 2015. The prime minister of Macedonia resigned in mid–January 2016, clearing the way for elections as the country tries to recover from a wiretapping scandal that paralyzed the country. In February 2015, the opposition party revealed that it had copies of more than 670,000 secretly recorded conversations. It was expected that the prime minister and several other top officials would face criminal charges in connection with the wiretaps which secretly recorded senior officials discussing plans to rig elections, control judges, punish opponents, arrange suspicious business deals and cover up killings. In July 2015, an agreement called for the appointment of a special prosecutor to investigate the wiretaps and for elections to be held in April 2016 (postponed to June 2016).

[8] These are known as Technological Industrial Development Zones (TIDZs), the establishment, development and monitoring of which is carried out by the Directorate for TIDZs. There are four major TIDZs (two in Skopje, one in Tetovo and one in Stip) and seven smaller ones (Prilep, Gevgelija, Kicevo, Strumica, Rankovce, Struga and Radovis).

[9] Macedonia has also applied for NATO membership. The country's NATO entry was blocked by Greece in 2008 over the naming dispute. NATO nations agreed that Macedonia would receive an invitation upon resolution of the dispute with Greece. Greece may also block Macedonia's accession to the EU over the same dispute.

3 Demand analysis

Key findings:

- *SMEs in Macedonia play an important role in terms of employment, turnover, and value added*
- *Trade still dominates and drives the SME sector, but other sectors have potential to grow — agriculture, tourism, and IT sectors have the largest potential*
- *The country has significantly improved the environment for doing business. Macedonia is #2 in the world on the ease of starting a business*
- *The percentage of SMEs introducing innovations is relatively high, but in-house innovation remains weak. Implementation of specific innovation support measures has been sparse and slow. The GoM has launched several programmes to support innovation and the supporting environment for SME innovation is gradually improving*
- *The total demand for SME loans is estimated at EUR 1.3 billion, and loans will continue to account for the largest part of the demand. The demand is expected to be driven by small enterprises from outside Skopje, especially in agriculture and tourism*
- *Demand for non-loan products remains generally low due to reduced awareness of their availability and/or benefits*

3.1 Size and growth of the segment

3.1.1 Size and definition of the sector

The legal identification of SMEs in Macedonia is regulated by law, based on the number of employees and annual turnover or total assets. If questions arise as to an enterprise being micro or small, the commercial entity is classified as small. Similarly, an enterprise is classified as medium if questions arise as to it being small or medium.

Table 1. Definition of micro, small, and medium enterprises in Macedonia

	Number of employees	Annual turnover	Average total assets
Micro	< 10	< EUR 50,000	n/a
Small	< 50	< EUR 2,000,000	< EUR 2,000,000
Medium	< 250	< EUR 10,000,000	< EUR 11,000,000

Source: Company Law of May 2004 (amended)

The State Statistical Office (SSO) mainly reports on the basis of number of employees. According to SSO, there were 70,659 active business entities[10] in 2014, out of which 64,187, or 90.8%, were enterprises with up to 9 employees. The share of registered individual entrepreneurs is rather small, about 15% of total business entities. Enterprises with 10–49 and 50–249 employees had a share of 7.0% and 1.8%, respectively. SMEs accounted for 99.7% of total number of enterprises in 2014.

Table 2. Breakdown of active business entities by number of employees

No. of employees		2014	2013	2012	2011	2010
0[†]	(micro)	3,972	4,415	7,158	6,674	10,756
1–9	(micro)	60,215	60,599	61,053	60,620	59,276
10–19	(small)	3,092	2,989	2,937	2,754	2,483
20–49	(small)	1,869	1,787	1,795	1,698	1,568
50–249	(medium)	1,305	1,291	1,280	1,187	1,211
SMEs		**70,453**	**71,081**	**74,223**	**72,933**	**75,294**

[10] Business entities are all legal and natural persons (including independent performers of activities, craftsmen, individual farmers, and sole proprietors) that are properly registered.

No. of employees		2014	2013	2012	2011	2010
250+	(large)	206	209	201	185	203
TOTAL		**70,659**	**71,290**	**74,424**	**73,118**	**75,497**

Note: †Including those with unknown number of employees
Source: SSO, Business Register

3.1.2 Importance of the sector

SMEs account for three quarters of employment. In 2014, the SME sector accounted for 75.6% of total employment[11] (micro – 33.3%, small – 22.5%, medium – 19.7%), which is higher than the 67% average in EU countries. Employment, in general, has been increasing at an average annual rate of 2.2% since 2010. Since growth was mainly driven by large enterprises (4.7%), the share of SMEs in total employment has been decreasing.

SMEs contribute about two thirds to total turnover and value added. In 2014, SMEs' contribution to total turnover and value added was 67.7% (micro – 25.1%, small – 24.3%, medium – 18.3%) and 65.5% (micro – 23.2%, small – 22.7%, medium – 19.6%), respectively. As with employment, despite their ever growing turnover, SMEs' share in total turnover has been decreasing over the last few years due to faster growth in the turnover generated by large enterprises. In contrast, SME's contribution to value added has not changed much and remains above the 58% average of EU countries. High growth in value added of small and medium enterprises has been offset by micro-enterprises.

3.1.3 Other estimates

SSO also provides a breakdown of active business entities based on a broader definition which takes into account annual turnover and total assets. According to this classification, 2014 had 49,539 (70.1%) micro-enterprises, 19,937 (28.2%) small businesses, 724 (1.0%) medium-sized enterprises, and 459 (0.7%) large companies. Performance indicators, however, are only reported based on number of employees.

Statistics on enterprises are reported in two different annual reports. The total number of enterprises, their distribution across economic sectors, and their sizes are reported in the Business Register while the performance indicators (such as employment, turnover, value added, etc.) are reported in the Structural Business Statistics. The two documents have major methodological discrepancies. The Structural Business Statistics are reported in line with EU guidelines and cover the 'non-financial business economy' which includes industry, construction, trade, and services (NACE Rev. 2 sections B to J, L, M and N) but not enterprises in agriculture, forestry, fisheries, and largely non-market service sectors like education and health.

3.1.4 Accuracy of estimate

The importance of SMEs is lower if using the legal definition. The number of SMEs in Macedonia, and their contribution to employment and value added, as reported by SSO based on the headcount only, is overestimated. According to the broader legal definition, there are less SMEs and their contribution is lower as well.

The importance of SMEs is higher if using the EU definition. The Macedonian legal definition of SMEs has lower thresholds than the EU definition (i.e. firms that employ less than 250 people and have an annual turnover of no more than EUR 50 million or a total balance sheet that does not exceed EUR 40 million). According to EuroStat, the SME share of business population in Macedonia was 99.8% of registered entities (including micro – 90.9%, small – 7.6%, and medium – 1.3%) in 2013. Their contribution to employment and value added was 76.6% and 66.6%, respectively, both above EU averages.

[11] Employment, turnover, and value added are reported for SMEs, which do not include agriculture, finance, and non-market service sectors such as education and health.

3.1.5 Growth rate

The total number of active SMEs has been declining at an average rate of –1.6% since 2010. The decline is primarily due to a continuous reduction in the number of micro-enterprises with no or an unknown number of employees which cease their activities or are reclassified when the number of employees becomes known. As a result, the number of all other enterprises has grown over the period. The share of SMEs in the total number of enterprises has been rather stable, standing at 99.7%, as the number of large enterprises has not changed significantly.

3.2 Characteristics of SMEs

3.2.1 Economic activity

More than 24,600 enterprises, or 35.0% of all SMEs, carry out their activities in the field of trade. Almost 95% of SMEs involved in trade are micro-enterprises. This economic sector generates a high turnover (more than half among all non-agricultural, non-financial, and non-public SMEs) but accounts for less than a third of value added. Trade is also the largest employer, accounting for about a third of total SME employment.

The second largest group of SMEs are more than 7,600 manufacturers, of which 80.4% are enterprises with up to 9 employees. They generate 17.1% of turnover and account for 22.3% of value added. Manufacturing is the second largest employer. In this group, medium-sized enterprises dominate in terms of employment, turnover, and value added.

Agri-business (including both agricultural production and agri-processing) is a very important economic sector. Almost 435,500 people, out of a population of 2 million, make whole or part of their income from agricultural activities. Other important activities are construction, transportation and storage, accommodation and food services, professional activities, scientific and technical activities, and administrative and support services. SMEs in these sectors account for a significant employment share (up to 98.6% of the sector) and generate most of the sector's turnover and value added.

Table 3. Breakdown of SMEs by economic sector, 2014

Economic sector	Number of enterprises	Number of employees	Value added
Agriculture, hunting and forestry	4.0%	excluded	excluded
Mining and quarrying	0.2%	0.6%	0.9%
Manufacturing	10.8%	27.4%	22.3%
Electricity, gas, and water	0.6%	2.1%	2.6%
Construction	6.2%	8.7%	11.3%
Trade	35.0%	31.2%	31.3%
Transportation and storage	8.4%	8.9%	10.4%
Accommodation and food services	6.4%	7.4%	3.4%
Information and communications	2.1%	2.8%	4.8%
Other services	26.3%	10.8%	13.0%

Source: SSO, Business Register (count) and Structural Business Statistics (employment and value added).

3.2.2 Regional distribution

Concentration of SMEs is high in and around the capital city. Traditionally, most SMEs (about 38%) are located in the Skopje region. The share of the other seven regions varies from 5.9% to 7.7%, with the western regions accounting for more SMEs than eastern regions.

3.3 Performance

3.3.1 Performance by economic activity

The overall contribution of SMEs to total turnover has slightly declined since 2010 due to decreased contribution of manufacturing and, to some extent, trade. SME manufacturers reached their maximum turnover in 2011, but their business contracted by about 20% in the following three years. In contrast, large manufacturers showed a better performance mainly due to new FDI. Similarly, despite an ever growing turnover of SME retailers and wholesalers between 2010 and 2014, large companies grew faster. Nevertheless, trade still accounted for 35.1% of total turnover and for 51.9% of SME turnover.

Table 4. Contribution of SMEs to total turnover by economic sector

Economic sector	2014	2013	2012	2011	2010
Mining and quarrying	0.3%	0.3%	0.4%	0.4%	0.4%
Manufacturing	11.5%	12.0%	11.7%	15.3%	14.0%
Electricity, gas, and water	2.9%	3.1%	3.5%	3.0%	2.9%
Construction	5.3%	6.0%	5.5%	5.3%	4.6%
Trade	35.1%	35.4%	35.4%	35.6%	36.1%
Transportation and storage	5.5%	5.2%	5.2%	5.1%	5.4%
Accom. and food services	1.4%	1.3%	1.2%	1.1%	1.2%
ICT	1.7%	1.7%	1.6%	1.6%	1.8%
Real estate activities	0.4%	0.5%	0.4%	0.4%	0.4%
Professional activities	2.3%	2.3%	2.1%	2.1%	2.5%
Administrative service	1.1%	1.1%	1.0%	1.0%	1.1%
Repair of household goods	0.1%	0.1%	0.1%	0.1%	0.1%
SME TOTAL	**67.7%**	**69.1%**	**68.2%**	**71.0%**	**70.5%**
Large	32.3%	30.9%	31.8%	29.0%	29.5%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: SSO, Structural Business Statistics

Although from a smaller base, tourism-related services have shown very strong growth in recent years. The accommodation and food services sector has grown at an average rate of 9.3% per year due mainly to an increase in the number of foreign tourists. This is partially due to government grants for rural tourist accommodation and also a consequence of reduced tax rates for overnight stays in rural areas. Efforts are made to support further growth in tourism, including alternative forms of tourism (hiking, biking, paragliding and fishing).

SMEs in the administrative activities sector also achieved good growth rates in employment, turnover, and value added, driven by three sub-sectors: employment activities (which profited from increased demand for temporary workers in the public and private sectors); travel agency and related activities (which received financial subsidies for each foreign tourist); and office administrative and business support services (which benefited from FDIs, such as for the establishment of new call centres).

The IT and software sector is one of the fastest growing industries in Macedonia. According to the Agency for Foreign Investments and Export Promotion, the sector has grown at about 47% per year in the last five years. Hardware is the largest (nearly 62%) and most dynamic (yearly growth of 84.7%) segment of the Macedonian IT market. IT services are the second largest segment, comprising 25.6% of total IT expenditure, whereas packaged software is third, comprising 13% of the total market with an 8.2% yearly growth rate. The overall growth is spurred by large spending by the GoM, telecommunications companies, and financial sector. In addition, the export promotion strategy provides technical and financial support to export-oriented IT companies.

3.3.2 Performance by size

Generally, the performance of enterprises by size is mixed. Over the period of 2010–2014, large enterprises performed better than SMEs in terms of employment and turnover. Among SMEs, growth was driven by small companies followed by medium sized enterprises. The number of employees in small companies grew by an annual rate of 2.7%, more than in micro and medium-sized enterprises but well below the growth of 4.7% in large companies. Similarly, enterprises of all sizes have shown an increase in their annual turnover since 2010, but SMEs performed worse than the large enterprises (4.3% annual growth compared to 7.8%, respectively). Growth in SME turnover was driven by small (10–49 employees) and medium-sized enterprises (50–249 employees), with their growth rates of 5.4% and 4.4%, respectively. In contrast, turnover of micro-enterprises (0–9 employees) grew at only 3.4% per year. As a result, the contribution of micro-enterprises in total turnover has dropped over the last five years. In terms of value added, however, only small enterprises showed an increase over the last five years (1.1%). Value added by enterprises of all other sizes, including the large ones, dropped, with the worst performance shown by the medium-sized enterprises (–3.9%).

Table 5. Contribution of SMEs to total turnover by size

Size	2014	2013	2012	2011	2010
Micro	25.1%	26.0%	26.4%	25.6%	27.1%
Small	24.3%	24.3%	24.0%	24.2%	24.3%
Medium	18.3%	18.8%	17.8%	21.2%	19.1%
SME TOTAL	**67.7%**	**69.1%**	**68.2%**	**71.0%**	**70.5%**
Large	32.3%	30.9%	31.8%	29.0%	29.5%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: SSO, Structural Business Statistics

3.4 Institutional and regulatory issues

Macedonia ranked 12 out of 189 countries in the World Bank *Doing Business 2016*. Macedonia climbed two positions by improving the protection of minority shareholders and maintaining high ranks for starting a business, dealing with construction permits, and paying taxes. At the same time, inefficient law enforcement, weak transparency of the regulatory system, and a generally low level of entrepreneurship are among the main constraints of the SME development in Macedonia.

3.4.1 Starting a business

Macedonia is currently the second-best country in the world on the ease of starting a business. After several improvements in previous years, Macedonia first made online registration free of charge and then, in 2015, introduced compulsory online registration carried out by certified agents. Starting a business now requires just one procedure, takes one day, and costs only MKD 250 (or EUR 4).

3.4.2 Getting electricity

Electricity issues are the third most important obstacle for Macedonian firms, according to BEEPS V. Analysis by the IMF points to the inefficiency of electricity use, limited options for electricity supply and ageing generation facilities as the main challenges for the country's electricity sector. The share of revenue lost due to power cuts has decreased from 11.8% in BEEPS IV to 7.5% in BEEPS V but is still very high compared with the BEEPS V average and is the second highest in south-eastern Europe, topped only by Kosovo.

3.4.3 Paying taxes

Macedonia is currently the seventh-best country in the world on the paying taxes. After having reduced the corporate income tax rate in 2008, Macedonia took several more steps to make paying taxes easier and less costly for companies. Social security payments were clarified and employers' social security contribution rates were reduced in 2009. The next year, tax costs for businesses were further lowered by requiring that corporate income tax be paid only on distributed profits. In recent years, companies have been encouraged to use electronic filing and payment systems for corporate income and value added taxes.

3.4.4 Entrepreneurship and support programs

The level of entrepreneurship among SMEs is generally considered to be low. The legacy of state ownership is still present. Many Macedonians (especially older ones) prefer a stable job, working for somebody else (e.g. the government, banks, large enterprises) rather than owning an enterprise and would think about business opportunities only if unsuccessful in finding employment. The young generation is reluctant to start a business due to various reasons, including reduced self-confidence and a fear of failure, which comes from the lack of entrepreneurial knowledge. Several initiatives promoting entrepreneurship included distribution of educational materials among schools, organisation of workshops and seminars for teachers, startup competitions for pupils, and exchanges of experiences between schools. In 2014, the Strategy for Entrepreneurial Learning 2014–2020 was launched, envisaging updated curriculums. Other measures encouraging self-employment have been adopted and are aimed at supporting youth entrepreneurship; they provide some of the funds needed for training of the unemployed up to the age of 29. Female entrepreneurship has been strengthened through targeted initiatives. Mentorships by experienced entrepreneurs have also been provided through workshops where awards were given to the best business plans.

3.4.5 Trading across borders

Worldwide, Macedonia ranks relatively high when it comes to making trade. In 2008, the time for to export and import was reduced by rationalizing the customs fee schedule and permit structure, improving the risk-based inspection system, simplifying customs procedures and reducing the number of documents required. Currently, Macedonia performs much better than their region in terms of time and cost for border and documentary compliance.

3.4.6 Environmental issues

Efforts have been made to integrate green growth into the national policy framework, but green growth in the SME sector remains constrained. The development of eco-products and services is one of the priorities under the Strategy for Industrial Policy (2009–2020). However, the SME Strategy does not contain any provisions on eco-efficiency, suggesting that environmental protection and SME development are still perceived as disconnected policy areas. The GoM provides information on environmental issues and tools through the relevant ministries and chambers of commerce, and programmes have been adopted which co-finance eco- and energy-efficiency equipment for SMEs. According to OECD, however, green growth in the SME sector remains constrained by a lack of expertise on environmental issues. Companies remain largely unaware of environmental management systems and standards, and the GoM has not yet put in place measures to encourage their adoption.

3.4.7 Enforcing laws

Law enforcement remains a problem. In its determination to become an EU member, Macedonia has harmonized most of its legislation with the EU. Implementation remains weak, however, and there are even examples of laws contradicting one another. Market players complain that laws change very fast[12] and they are enforced unevenly or not at all. Bureaucracy and lack of communication and capacity within the GoM also frustrate the business. The judicial system is slow and believed to be corrupt. Corruption, in general, is widespread and largely goes unpunished.

[12] For example, the Company Law has been changed and updated 16 times since 2004 and an updated version of the law is nowhere to be publicly found.

Transparency of the regulatory system is weak. According to the Transparency International *Global Corruption Barometer 2013*, corruption is a large concern in the public sector as more than half of the surveyed respondents considered Parliament, police, public officials, and, particularly, the judiciary and political parties as being very corrupt. In 2014, the GoM created the Inspections Council, an independent body responsible directly to the GoM. The Inspections Council's goal is to harmonize procedures for inspection surveillance between 14 inspectorates which originally functioned under various ministries and to regulate and control the functioning of the inspectorates as a whole as well as regulating and controlling individual inspectors. There are allegations, however, that the GoM uses inspections punitively against political opponents and critics.

3.4.8 Labour market

The labour law has long prohibited sufficient flexibility in the labour market. Labour market reforms, including recent amendments to the Law on Labour Relations, have injected some benefits to employers. In general, failure to tackle the legacy of self-management and social ownership has contributed to labour market rigidity and *de facto* protection for insiders. These problems have, in turn, been compounded by a reliance on remittances, which tends to raise the wage at which people are willing to work above what productivity levels can sustain.

3.5 Innovation

The percentage of SMEs introducing innovations is relatively high. According to the European Commission *2015 SBA Fact Sheet*, almost 40% of SMEs introduced product, process, marketing, or organisational innovations in Macedonia. At the same time, in-house innovation remains weak. Despite the relatively high percentage of SMEs introducing innovations (which is above the EU average), sales of new-to-market and new-to-firm innovations account for only 10% of total turnover, which is below the EU average. The percentage of SMEs selling or purchasing online has slightly increased but remained well below the EU average. Turnover from e-commerce was rather low.

The strategy for innovations and law has been adopted, but implementation has been slow. In 2011, Macedonia built the foundation for innovation by conducting a comprehensive evaluation of its national innovation system and drafting an innovation strategy and action plan under the OECD Regional Competitiveness Initiative. Implementation of specific innovation support measures, however, has been sparse and slow. A special fund for innovation and technology development (FITD) was established in 2013 and became fully operational in 2015.

The GoM has launched a new fund to financially support innovation and technology development. FITD aims to improve access to finance for innovation and technology development and to promote and enhance the innovation activities of SMEs. There are four instruments that are available under the FITD:

1. Co-financing grants for innovative start-ups and spin-offs;
2. Co-financing grants and conditional loans for commercialization of innovations;
3. Co-financing grants for technology transfer;
4. Technical assistance through business-technology accelerators.

The allocated funds are EUR 8 million over the next three year. SMEs benefit from this measure not only by getting direct, public financial support, but also by using it to attract other investors.

IT is one of the most innovative sectors in the country. The first call of FITD for co-financing grants for innovative startups and spin-offs (held in spring 2015) resulted in 78 applications, with 34 passing the pre-selection stage and 16 being selected for funding. Seven of the selected projects are in the IT sector with the other projects being in electronics (3), education (1), the food industry (1), the video games industry (1) and production of machines (3). FITD contributed a total of EUR 450,000. The second call closed in October 2015, but the results are not yet published.

The supporting environment for SME innovation is gradually improving. Aside from the GoM, there are a number of organizations that actively support innovative startups and existing SMEs. Balkan Unlimited Foundation was established in 2011 with the goal of supporting innovative ICT startups. The foundation has two main activities: an innovation forum program (Balkan Venture Forum[13]) and an acceleration program (SuperFounders). LAUNCHub is a Bulgaria-based accelerator that supports startups from the region, including Macedonia. In addition, CEED Macedonia has a number of programs through which it builds a pipeline of 'investment ready' companies by preparing entrepreneurs for outside capital, improving their financial management skills, and guiding them to the appropriate providers. MEDF helps build the capacities of chambers of commerce, promotes the development of entrepreneurship outside Skopje, and encourages alternative tourism as a new economic opportunity. Crimson Development Fund runs a USAID-financed Innovation Financing Vehicle of USD 300,000 designed to support business innovation and startups.

Box 1. Example of innovative SME – Evrokontakti DOOEL Prilep

Evrokontakti from Prilep deals with the purchase, processing and sale of waste (plastic, paper and metal). The company was established in 2003 by Mr. Vasko Gelev. The business started on 200 m^2 with a simple paper press and scales. Gradually, Mr. Gelev expanded his business by adding new plastic processing machinery and offering waste pick-up services. Since transportation of waste turned out to be a very successful value-adding service, Mr. Gelev invested in expanding his transportation fleet. Today, Evrokontakti operates on two acres of land and has 17 transport units (vehicles and trailers) and provides employment to 13 people. Future plans are to build a new plastic processing facility and integrate waste collection, processing, and sales into one system.

3.6 Demand for finance

3.6.1 Estimate of demand

Total demand for SME loans is estimated at EUR 1.3 billion, which is about 15% of GDP and 30% of total loans of the financial system. This figure was derived using the loan volume breakdowns collected from SME lenders, data from the SSO and Business Register, and World Bank estimates of firms not needing a loan. The calculation is shown in the table below.

Table 6. Calculation of demand for loans from SMEs

Step in Calculation	Value	Source
A. Number of SMEs	70,453	SSO, Business Register
B. Average loan size demanded (EUR)	45,052.3	BFC calculations
C. % of enterprises needing a loan	40.1%	World Bank Enterprise Surveys[14]
D. Total demand (EUR million)	**1,272.8**	**= A * B * C**

The demand estimate is only intended to give a general idea of the level of demand. The methodology of the calculation is simplistic and based on a number of assumptions. Since there is no available survey data on the loan size demanded from SMEs, the average loan size disbursed was used as a proxy for loan size demanded. The average loan size disbursed was calculated by dividing the estimated SME loan portfolio (see section 5.6) by the estimated number of borrowers. The number of borrowers was estimated based on the total number of SMEs in Macedonia and the percentage of firms with a bank loan/credit line as reported by the World Bank Enterprise Survey. Each data source uses a different definition of

[13] Balkan Venture Forum is the largest venture capital, private equity and investment forum in the region that showcases innovative companies to active investors and promotes innovation, entrepreneurship, investment readiness and access to finance in the Balkans

[14] The World Bank surveys report the % of enterprises not needing a loan, from which the percent of enterprises needing a loan is inferred as 100% minus the % not needing a loan.

SMEs, which reduces the accuracy of the estimate. There are no reliable data that could be used to estimate the demand for non-loan products such as equity, leases and letters of credit.

3.6.2 Demand by type of SME

Demand is uneven across economic sectors. The size of each economic sector directly affects the demand for finance. Furthermore, the demand for each economic sector will grow or decrease depending on the expected development of the sector. Trade is expected to continue driving the SME sector and, hence, the overall SME demand for finance. In addition, there are several sectors that the GoM has identified as key sectors for development and actively supports. The Agency for Foreign Investments and Export Promotion encourages investment in four sectors that are believed to have the greatest growth potential and impact on Macedonian economic development, including agriculture, the automotive industry, the textile industry and the IT sector. At the same time, the Agency for Promotion and Support of Tourism has the mandate to stimulate an increase in tourism.

Small enterprises will drive the demand for SME finance. In terms of size, small enterprises will most probably lead demand. Micro-enterprises do not perform well, and their number and contribution to turnover and value added have been declining. At the same time, demand from medium-sized companies is expected to be stable. In contrast, small enterprises perform better, and the number of small enterprises is expected to increase due to successful micro-enterprises moving up the classification ladder.

Demand from outside Skopje will increase. If the efforts of the GoM prove successful and the identified key sectors start growing faster, the demand for financing will grow accordingly. While some industries are concentrated in Skopje (i.e. automotive and IT sectors), other sectors are outside the capital, with agriculture mostly in the south-east, textile in the north-east, and tourism in the south-west.

3.6.3 Demand by instrument

Loans will continue to account for the largest part of demand as the banking system is the most developed and loan products are the most familiar. Currently, demand for working capital loans is increasing at the expense of investment loans. On the one hand, the prevailing uncertainty about the future reduces businesses' willingness to invest in the long term. On the other hand, payment discipline is worsening, and the general tendency in the country is to delay payments for abnormally long periods of time — up to a year and more. The tone is, unfortunately, set by the GoM which is late with payments on public works. The term for a working capital loan can thus go up to five years.

Demand for trade finance will grow further. As a small, land-locked country, Macedonian economic growth depends on trade with other countries. Real and sustainable growth is believed to be driven by SMEs that manage to do business outside Macedonia. Trade finance is thus expected to become more important, and the demand for it will most probably grow.

Demand for leases is low, and loans are preferred over leases. Loans are more attractive for a number of reasons: SMEs are less familiar with leasing; loans may be even cheaper than leasing; and getting a loan may be easier. Other disadvantages include a double property transfer tax, VAT treatment, and rigid leasing contracts. In addition, Macedonians seem to prefer owning rather than renting.

Demand for equity is also low even when external financing is much needed. Equity financing is largely unknown in Macedonia. The limited knowledge about risk capital (as opposed to traditional bank lending) makes many smaller entrepreneurs feel uncomfortable with this instrument. Without properly understanding the risk and profit sharing principle, SMEs are generally reluctant to consider equity financing since it involves giving up some ownership (and/or control) to a stranger investor. The notable exception to this is the IT sector, where many potential entrepreneurs with innovative ideas are looking for risk capital to start a business.

4 Supply analysis

Key findings:

- *The degree of financial intermediation in Macedonia is relatively low, with total assets of the entire financial sector below 90% of GDP*
- *The total supply of SME financing is estimated at EUR 1.5 billion*
- *More than 98% of SME financing consists of bank loans*
- *There is one state-run loan guarantee scheme, but its impact is minimal*
- *The non-bank financial sector is very small and faces challenges including regulatory constraints and high competition from banks*
- *Private equity and venture capital has been present for some time, but the investment portfolio is low*

4.1 Number and type of intermediaries

Macedonia's financial system consists of depository financial institutions (banks and saving houses) and non-depository financial institutions. Each category is discussed separately below.

4.1.1 Banks

Financial resources are almost entirely managed through the banking system. In 2014, the 15 Macedonian commercial banks accounted for 86.8% of total financial sector assets. However, the banks' share of total assets has been slowly declining since 2010, when it was 89.2%. The total assets of the banking system have been growing at an average annual rate[15] of 8.2% over the last five years, faster than the country's GDP. As a result, the intermediation rate (measured as total assets to GDP) went up, from 69.8% in 2010 to 76.1% in 2014, but is still low, even by regional standards.

Table 7. Number of institutions, total assets, and gross portfolio of the banking sector

	2014	2013	2012	2011	2010
Number of banks	15	16	16	17	18
Total assets (EUR million)	6,510.6	6,007.1	5,738.0	5,384.5	4,963.7
Gross loans (EUR million)	4,122.1	3,746.3	3,521.3	3,290.9	3,033.0

Source: NBRM

The number of banks has decreased since 2010 due to three mergers. Bulgarian Central Cooperative Bank, which entered Macedonia by acquiring and renaming Sileks Bank in 2008, took over Stater Banka in 2011. Similarly, Turkish state-owned Halkbank purchased Izvozna i Kreditna Banka in 2011 and, through its Macedonian subsidiary, took over Ziraat Bank one year later. The latest consolidation took place in 2014 when Postenska Banka was absorbed by Eurostandard Bank.

Concentration in the banking system is high but decreasing. The largest three banks (Komercijalna Banka, Stopanska Banka, and NLB Tutunska Banka) accounted for 60.4% of total assets in 2014, whereas the top five banks (adding Ohridska Banka and Halk Bank) accounted for 74.8%. The last merger between two small banks and the general faster growth of smaller banks has reduced, to some extent, the size difference between banks, but it still remains high. According to the NBRM, the profitability of small banks is both insufficient and unstable to support their sustainability in the long term, and, most probably, some of them are very likely to face the need to change their business model or operating strategy.

The Macedonian Bank for Development Promotion has a specific nature of operations. This is the only state-owned bank[16] that was established by the GoM to provide support to and stimulate development

[15] Calculated as compounded annual growth rate (CAGR) on amounts expressed in EUR.
[16] The state had a 33.3% stake in Postenska Banka, which was acquired by Eurostandard Bank in 2013.

of the Macedonian economy through provisions of financing to SMEs and export-oriented companies. The bank channels loans from various IFIs to domestic commercial banks (see more details in sections 5.1.4 and 5.5.2 below).

Foreign capital continues to dominate the capital structure. In 2014, foreign capital was present in 14 of Macedonia's banks (all but MBDP), accounting for 76.2% of total capital. Eleven banks are controlled by foreign shareholders. Greece is the largest investor (Stopanska Banka and Alpha Bank)[17]. The share of domestic investors has been decreasing due to recapitalization of the banks by their foreign shareholders.

All banks serve the SME sector, although at various degrees. While some banks have no or very small minimum loan amount requirements and directly compete with NBFIs for micro-enterprises, other banks prefer not to work with very small businesses at all. The share of SME credit in the total loan portfolio of the banking system is estimated at 35% (about EUR 1.4 billion), based on financial statements, a BFC survey, and interviews with six banks.

4.1.2 Saving houses

The impact of saving houses is very limited. In 2011, there were eight institutions, but the largest three saving houses accounted for almost 94% of total assets. Only these three institutions are still in business as saving houses[18] with the rest of them being liquidated or transformed into financial companies (see section 5.1.3 below). Overall, the sector's assets have not changed much, but the share of saving houses' assets in the entire financial sector has been steadily declining from more than 1% before the crisis to 0.6% in 2014.

Table 8. Number of institutions, total assets, and gross portfolio of saving houses

	2014	2013	2012	2011	2010
Number of saving houses	4	4	7	8	8
Total assets (EUR million)	47.1	47.1	46.0	51.4	48.6
Gross loans (EUR million)	39.3	38.8	42.8	47.3	46.5

Source: NBRM

Saving houses are allowed to lend to legal entities, but the business loan portfolio is tiny. Two saving houses extend loans to businesses. The share of business loans in the total loan portfolio, however, is only about 10%.

4.1.3 Non-depository financial institutions

Non-depository financing is growing but still plays a minor role. The sector of NDFIs in Macedonia includes insurance companies, leasing companies, pension and investment funds, fund managers, financial companies, and other intermediaries. The insurance segment accounts for more than half of NDFIs and drives the overall increase in number and growth in assets (along with the mandatory pension funds). Despite a significant increase in assets (14.2% per year in 2010–2014), NBFIs accounted for only 12.5% of the financial sector in 2014.

[17] The Greek debt crisis has not affected Macedonian subsidiaries as they, similar to other commercial banks in Macedonia, have a rather small exposure to non-residents and do not depend on parent funding (see section 5.5.3 below).

[18] These are Moznosti, MAK-BS, and FULM. Al-Kos was the last institution that ceased its operations as a saving house in the first quarter of 2015 and transformed into a financial company.

Table 9. Number of institutions and total assets of the NDFI sector

	2014	2013	2012	2011	2010
Non-depository financial institutions, including	101	93	86	75	73
Insurance companies	15	15	15	15	13
Leasing companies	8	10	10	10	10
Financial companies[1]	7	6	2	-	-
Pension funds	4	4	4	4	4
Investment funds[2]	13	10	9	8	6
Other[3]	54	48	46	38	40
TOTAL assets (EUR million)[4]	**939.7**	**803.5**	**701.2**	**651.3**	**552.5**

Note: [1] This category was added by the Law on Financial Companies of 2011.
[2] Private investment funds and private fund management companies are excluded as they do not have to report.
[3] Includes insurance brokers and agents, brokerage companies, and fund management companies.
[4] Assets of private equity fund management companies and insurance brokers and agents are not included as they do not have to disclose the value of their assets.
Source: NBRM

Foreign capital in NDFIs is high. Foreign shareholders virtually own the insurance, leasing, and investment management segments. The already small share of domestic investors is even further reduced when taking into account that some of the domestic shareholders are banks that are controlled by foreign institutions.

Leasing increasingly loses its small role and significance. The total assets of leasing companies have been declining over the last three years. In 2014 alone, two out of ten companies went out of business and total assets shrank to EUR 70.1 million, a 28% decrease. Compared to 2011, total assets decreased by 53.5%. Three leasing companies (S-Leasing, Euroleasing, and NLB Lizing) are related to banks (Sparkasse Bank, Eurostandard Bank, and NLB Tutunska Banka, respectively)[19]. In the leasing portfolio, enterprises have an estimated share of 70%, with SMEs accounting for a sizeable share of a small and decreasing portfolio.

The importance of other non-insurance and non-investment intermediaries is still marginal. Collectively called financial companies and defined as non-deposit taking institutions under the MoF, non-insurance and non-investment intermediaries are allowed to lend, issue guarantees, offer factoring services, issue and administrate credit cards, and rent movable and immovable property (operating leasing). The total number of financial companies has increased from 2 in 2010 to 8 in 2015. A 2013 law enabled savings houses to transform themselves into financial companies, defined as non-deposit taking institutions under the MoF. Four of them did as reporting requirements for financial companies are less burdensome than those for savings houses. Three financial companies have reported factoring as their activity, but only one (FactorTrust) is active. It should be noted that financial companies primarily target enterprises rather than individuals. In 2014, business lending accounted for 75.2% at Horizonti, the largest of the few MFIs operating in Macedonia.

4.1.4 Government programs

The GoM has a number of programs to financially support SMEs. The majority of these programs are run by the state-owned MBDP and various agencies (see section 4.5.3). In addition, the GoM established a separate institution, the Fund for Innovation and Technology Development, with the aim of improving access to finance for innovation and technology development and to promoting and enhancing innovation activities, in general. The fund provides direct financial support to SMEs (see section 3.5).

[19] NLB Lizing stopped signing new contracts in 2015 as it is shutting down based on a strategic decision made at parent bank Nova Ljubljanska Banka(Slovenia).

4.1.5 Guarantee funds

There is currently one guarantee scheme for SMEs, which is run by the MBDP (created in 2005 with a capital of EUR 4.2 million). Eleven banks have access to this scheme. In addition to the MBDP, there used to be two private providers of guarantees (the Garanti Fund, financed by SIDA, and the Macedonian Enterprise Development Foundation), but both stopped issuing guarantees due to low demand. USAID's Development Credit Authority provided loan portfolio guarantees of USD 9 million to Unibank and NLB Lizing in 2007-2014 for SME development and USD 5 million to Moznosti and Fulm in 2009-2019 for micro-enterprise development.

4.1.6 Private equity and venture capital funds

Private equity has been available in Macedonia for a good number of years. SEAF Macedonia was established in 1998 as a venture capital fund[20] with a total committed capital of USD 13 million (investors included USAID, EBRD, DEG, and IFC). The fund made 14 investments (USD 6.3 million) and had a lifetime of 10 years. Exits were mostly management buyouts and a few sales. In 2014, a follow-up fund, called SEAF Macedonia II, was launched. This time, the main investors were members of the Macedonian diaspora, which committed USD 8 million. The first investments have already been made.

Currently, several private equity and venture capital funds are available for Macedonian SMEs, but the total investment portfolio is very small. Macedonia-focused funds include the Small Investment Fund (2007; USD 600,000; three investments), the Micro Investment Fund (2012; USD 800,000; six investments), and the CEED-managed MSE Fund (USD 80,000; 2011). Equity or quasi-equity investments are also made by the Macedonian Enterprise Development Foundation (MEDF) and the Crimson Development Fund. Regional funds that cover Macedonia include the SEAF South Balkan Fund (Serbia, Montenegro, and Macedonia), the Dutch Good Growth Fund (66 emerging markets), LAUNCHub (10 countries in south-east Europe), the Alpha Adriatic Ventures (8 countries in south-east Europe), the Arco Capital Corporation (Central and south-east Europe), ARGUS Capital (central and south-east Europe), ARX Equity Partners (central and south-east Europe), Blue Sea Capital (ex-Yugoslavia), the KD Private Equity Fund (south-east Europe), and others. Regional funds, however, are not known to have invested in Macedonian SMEs[21]. SuperFounders and MEDF plan to establish a new regional venture capital fund (with a target of EUR 35 million) and a new equity fund (starting with EUR 3 million) by the end of 2016.

Equity investments are also available from angel investors, although the investment amount is currently very low. Macedonia has three full members of the European Business Angel Networks. One network of angel investors, called I2BAN, was established by CEED in 2011 and has made two investments (with co-investment by CEED), and more are in the pipeline. The other two networks are the Macedonian Business Angels Network (MBAN), which cooperates with the Euro-Macedonian Knowledge Innovation Center (EMKICE), and the SuperFounders Club Business Accelerator, which is an integral part of the Balkan Unlimited initiative to promote innovate IT startups (see section 3.5 above). SuperFounders has not directly invested in any company but has facilitated an investment of USD 0.5 million in a Macedonian startup by angel investors from Kosovo.

4.2 Type of funding instruments

4.2.1 Loans

Besides their own cash flows, SMEs secure financing primarily from bank loans. After the crisis, the business loan portfolio grew at an average rate of 6.9% per year, much slower than in the pre-crisis years

[20] Small Enterprise Assistance Funds (SEAF) is an international investment management group based in the United States that provides growth capital and business assistance to SMEs in emerging and transition markets underserved by traditional sources of capital.

[21] LAUNCHub has invested in a company that operates from Skopje, Macedonia but it is registered in Bulgaria.

when the annual growth rate was above 30%. Furthermore, the share of business loans in the total portfolio has been decreasing in recent years, from 61.4% in 2011 to 58.1% in 2014, due to faster growth in retail lending.

In general, credit is available but not always affordable. With almost 6,000 employees and 430 branches across the country, banks serve enterprises of any size. Loan maturity can go up to 10 years with a grace period of up to two years, and the repayment schedule can be tailored to future cash flows. Maximum loan amount is generally not a constraint, but borrowers are sometimes required to co-finance their investment projects (up to 50% for startups). Interest rates have been decreasing. Moreover, funds are available from numerous sources at preferential conditions. Unsecured lending, however, is rarely used. Loans have to be secured by real estate (the preferred collateral[22]), movable assets[23], bills of exchange, or loan guarantees. Over the years, increased competition has resulted in better terms and conditions for SME loans.

4.2.2 Loan guarantees

Under certain conditions loans can be extended with a loan guarantee. Under the MBDP guarantee scheme, the MBDP provides 70% of the loan amount and the participating commercial bank covers the remaining 30%. The MBDP guarantees 60% of its part, resulting in a guarantee of 42% of the total loan amount. The individual loan guarantees are provided to SMEs only and are currently free. Due to reportedly cumbersome administrative procedures and difficulties encountered in the event of a guarantee payment, both the banks and SMEs try to avoid this instrument.

4.2.3 Leases

Leasing products cannot effectively compete with loans. Passenger vehicles have the largest share in the total lease portfolio, accounting for about 75%. However, car loans provided by banks are cheaper and are driving leasing companies out of the market. Banks can compensate for reduced interest rates by applying various fees and/or selling other products which leasing companies cannot do. NLB Lizing and S-Leasing started to lease equipment but with little success as the secondary market for the demanded assets (e.g. medical equipment) is underdeveloped. In addition, leasing companies used to be more accessible than banks due to easier and faster procedures. Since 2008, however, risk assessment became very rigorous and, reportedly, even stronger than that of banks. Leasing of immovable assets is disadvantaged because of a flaw in legislation which results in the double payment of the property transfer tax.

4.2.4 Trade finance

SMEs increasingly use trade finance products and services. All major banks, and some other non-bank financial institutions, provide trade finance loans, guarantees, and letters of credit. A few banks offer factoring/forfeiting among their products and services as well. In 2014, the total off-balance sheet credit exposure of banks to the business sector stood at EUR 547.1 million, which is 16.2% more than in 2013. As of mid–2015, two surveyed banks which account for about a third of the total SME gross loan portfolio in Macedonia reported their off-balance sheet exposure to the SME sector, which included EUR 24.6 million in loan guarantees and EUR 18.1 million in letters of credit, as representing 8.3% of their combined SME gross loan portfolio. A number of banks participate in the IFC Global Trade Finance Program and EBRD Trade Facilitation Program.

[22] Furthermore, banks are generally reluctant to accept real estate outside Skopje as collateral due to questionable reliability of cadastral information and a relatively illiquid market. Similarly, property rights on agricultural land are not duly registered, thus frequently excluding agricultural land as a collateral option.
[23] Using equipment as collateral is constrained by a relatively illiquid market as well.

One institution focuses on trade finance for SMEs. The Crimson Development Fund (CDF) provides SMEs with a variety of instruments (short-term working capital, term loans, revolving credit lines, and convertible debt) which can be combined and tailored to fit the specifics of an investment opportunity. CDF uses products such as purchase order and pre-export financing and claims to be a principal provider of short-term trade finance for SMEs in Macedonia. Since 2003, CDF has made loans totalling more than USD 33 million to Macedonian SMEs. In addition to its lending operations, CDF loan officers improve the financial literacy of and provide management training to its client borrowers. The fund works with SMEs from all regions of Macedonia and all sectors of the economy, but particularly targets rural businesses, entrepreneurs and enterprises owned by women and minorities.

4.2.5 Risk capital

A number of risk capital providers are ready to invest in Macedonian SMEs. There are several Macedonia-focused funds, more than a dozen regional funds that have Macedonia among their target countries, and networks of angel investors that provide risk capital. Risk capital can come in the form of equity (common or preference) and/or quasi-equity (unsecured subordinated debt, convertible debt, or any other debt that has traits of equity). Each risk capital provider has its own set of terms and conditions, including eligibility criteria (which may be related to the target SME groups: size, sector, region; legal form; profitability; level of corporate governance; and accounting transparency), maximum participation in a single company, maximum exposures per instrument, interference with company management, investment return formula, and exit policy. SEAF Macedonia I, for example, invested in SMEs and targeted companies that employed between 5 and 100 people and had a turnover of USD 150,000 up to USD 2 million. The investments had to be in the range of USD 200,000–800,000 per client, and SEAF usually took a 20–49% ownership position. The fund had no stage or co-investment preferences. Risk capital provided by SEAF Macedonia II has significantly different characteristics. The fund invests EUR 0.5–1.5 million per client, takes 10–49% ownership, avoids startups, and prefers established businesses with growth potential.

The stock market is operational, but the securities market in Macedonia remains small. The Macedonian Stock Exchange was established in 1995 in Skopje. At the end of 2015, it had ten members, including four commercial banks, and 114 listed companies. The ability to raise financing on the stock market is very small, with the exception of February 2011 and October 2014 when Kommercijalna Banka and ArcelorMittal Skopje (a large steel product manufacturer in the Balkans) raised unusually high amounts of public capital. The turnover and number of transactions has been decreasing since the economic crisis of 2008–2010

Development of the securities market

	2015	2014	2013	2012	2011	2010
No of transactions	11,873	13,398	13,585	14,951	23,426	25,741
Turnover (EUR million), including:	43.2	141.2	52.5	91.0	221.9	95.0
shares	23.3	32.3	22.7	25.3	34.9	32.8
public offering	0.2	70.2	0.3	1.6	15.1	0.0
Capitalization (EUR million), shares only	1,669.8	1,713.9	1,669.9	1,837.7	1,935.5	1,993.0

Source: Macedonian Stock Exchange

4.3 Characteristics of funding recipients

The SME portfolio is dominated by trade. About 35% of the estimated SME portfolio is loans made to the trade sector. The rest of the loan portfolio is distributed as follows: manufacturing (about 25%), construction (10%), services other than trade (about 20%), all other activities (10%). Agriculture accounts for about 3% of the SME loan portfolio[24]. The distribution of the SME portfolio by economic activity has not changed significantly since 2010.

The SME portfolio has some regional peculiarities. Although passing through difficult times, the textile industry is still a significant business in the north-eastern and eastern regions, and the SME loan portfolios in these regions are largely in textiles. Much of the SME agri-business portfolio originates in the south-eastern region. Polog is known to be the richest region, where a cash economy dominates. Most of the SME clients from Polog are in trade, both external and internal (e.g. buying fruits and vegetables from the south-eastern region and selling the produce all over the country). The south-western region is characterised by a growing portfolio in tourism. In general, SMEs from the west account for a larger share of total supply outside Skopje as the west is more populated and richer.

SME lending is concentrated in urban areas. Although banks have a rather sophisticated branch network across the country and are well suited to on-lend funds from various development and support programs, the SME portfolio is concentrated in urban areas. Non-bank lenders tend to be more active in rural areas than banks. Nevertheless, the majority of SMEs operate in urban areas, which explains the urban nature of the SME loan portfolio. The city of Skopje alone accounts for more than 50% of the SME portfolio due to a high concentration of SMEs in the capital.

4.4 Institutional and regulatory issues

The NBRM is regarded as a strong regulator of the deposit-taking institutions. The regulatory environment is conductive to banking sector development. NBRM has taken a number of measures in recent years to stimulate business lending and economic growth in the country by reducing requirements regarding reserves, liquidity, and capital adequacy and by cutting down the policy rate (from 3.75% at year-end 2012 to 3.25% at year-end 2015) and interest rates on seven-day and overnight deposits (from 2.0% and 1.0% at year-end 2012 to 0.5% and 0.25% at year-end 2015, respectively).

The regulatory requirements for saving houses have been tightened. In 2015, NBRM increased the capital adequacy rate for saving houses to 20% and introduced the requirement to manage currency risk and establish an internal audit function. In addition, as saving houses are not allowed to accept deposits greater than twice the amount of capital, they borrow from domestic and international sources. Saving houses now require a change to their most important constraint and are lobbying to accept higher deposits. Should the regulatory framework change, their importance to the financial system will increase. Otherwise, given the increased (and expensive) regulatory requirements, extremely strong competition from banks, restrictions on products and services, and funding constraints, the economic viability of saving houses is questionable.

The legal framework for the NDFI sector is relatively weak. Despite a rapid modernization of basic legislation of the financial sector, the legal framework for a number of financial services needs to be significantly improved. The Law on Leasing, for example, does not cover operational leasing, and there is no specific law regulating factoring and micro-finance institutions. Furthermore, adopted laws have flaws, omissions, and conflicts as they are not well-harmonized (e.g. the double payment of the property transfer tax in the case of leasing and insufficiently protected ownership rights of the leasing companies in cases of default). The interviewed NBFIs also pointed out the poor transparency in the sector and a general lack of market information.

[24] Source: NBRM and BFC bank survey.

4.5 Funding of intermediaries

4.5.1 Deposits

Traditionally, the Macedonian commercial banks' main source of funding is customer deposits. Deposits account for about 80% of total liabilities, and the loan-to-deposit ratio has stayed below 90% ever since the economic crisis. Over the last five years, total deposits grew at an average rate of 8.7% per year, keeping pace with the growth in assets and gross loans. Growth in customer deposits is driven by individuals, with their share steadily increasing compared to corporate clients. In 2014, individuals accounted for 72.0% of total customer deposits. Term deposits of individuals represent the bulk of all customer deposits. A key reason for bank deposit growth seems to be a lack of attractive alternatives.

Deposits are much less significant in the funding of saving houses. Deposits account for only one third of total liabilities. Saving houses are mostly funded by their own capital as they have a restriction on the amount of deposits they can accept (see section 5.4 above).

Deposits are guaranteed, regardless of the deposit's currency and depositor's residency. The deposit guarantee is paid in MKD and limited to EUR 30,000 per depositor per institution. Only deposits by individuals are insured. The Deposit Insurance Fund is the body which runs the deposit insurance scheme in Macedonia. Its members currently include 14 banks (all but MBPD) and all 3 savings houses.

Deposit interest rates decreased significantly after the financial crisis and are currently at a historical low. The average deposit interest rate went down from 7.1% in 2010 to 3.7% in 2014[25]. Deposits can be opened in MKD or one of a dozen foreign currencies, but deposits in MKD bear higher interest rates, the premium being 2.0–2.5 percentage points in 2014[26].

Deposits are flexible in terms of maturity. Both individuals and legal entities can open a deposit for up to 60 months. Short-term deposits are still preferred over the long-term deposits, but this preference is less pronounced compared to pre-crisis years. In 2014, short-term deposits accounted for 57.4% of all term deposits, down from 90.4% in 2007. One of the reasons for this shift in preference is the desire of the depositors to lock in a higher interest rate for a longer period of time given the general trend of decreasing rates.

4.5.2 Borrowings

Loans from IFIs represent the second most important source of funding. Banks can negotiate a loan directly with an IFI (e.g. EIB, IFC, EBRD, CEB, EFSE, GGF) or sign subsidiary loan agreements with the MBDP that manages loans to the Republic of Macedonia for implementation of various development and support projects (e.g. EIB and KfW). In general, IFI financing used to be relatively low before 2009 when EIB provided MBDP with a credit line of EUR 100 million to support SMEs and priority projects. As the amount was rather large (bigger than the combined funding of all other IFIs) and cheaper compared to other IFIs, there was a general downward pressure on interest rates in Macedonia. Since then, EIB has provided three more loans totalling EUR 250 million. Among IFIs, EIB is, by far, the largest creditor of SMEs in Macedonia.

4.5.3 Government

The GoM provides funding for a number of programs aimed at supporting various groups of beneficiaries with reduced access to finance. The majority of these programs are run by the state-owned MBDP in cooperation with various responsible agencies, including the Agency for Financial Support in Agriculture and Rural Development, the Employment Agency, the Agency for Promotion of Entrepreneurship, and

[25] Source: World Development Indicators (http://data.worldbank.org/indicator/FR.INR.DPST).

[26] In 2015, deposit interest rates fell further to 3.1% for deposits in MKD and 0.6% for deposits in foreign currency, and the spread between MKD-denominated and FX-denominated deposits narrowed to 1.5 percentage points.

the Agency for Promotion and Support of Tourism. Eligible SMEs can benefit from these programs through 12 participating commercial banks. In addition to funding through MBPD, the GoM provides funds to commercial banks through a number of agencies; the amounts, however, are not substantial.

4.5.4 Parent banks

Macedonian banks are not particularly dependent on parent funding. Nine Macedonian banks have a foreign parent (i.e. a foreign shareholder with more than 50% control), and one bank is equally owned by two foreign shareholders. The inflows into the banking system were largely in the form of equity investment rather than borrowing from parent banks and wholesale funding markets. Additional equity injections are rare, with parent funding taking mostly the form of subordinated debt. While parent funding exceeds borrowings from IFIs in some banks, it generally plays a less important role than the funding coming from IFIs. It should be noted, however, that both parent and IFI funding are significantly smaller compared to customer deposits.

A large number of banks use subordinated debt from their parents. The primary purpose of these funds is to increase tier 2 capital and comply with capital requirements set by the NBRM. In most cases, the subordinated debt is a quasi-equity instrument because of its convertibility into equity or because of no contractual maturity. The interest rates can be either fixed or variable and vary significantly among the institutions — and even within the same institution[27].

Table 10. Parent finance, as of December 31, 2014, EUR million

Bank	Parent (country) – ownership	Parent finance			
		Share capital[1]	Subordinated debt	Borrowed funds	Deposits
Alpha Bank	Alpha Bank (GR) – 100%	20.1	5.0	-	0.6
Capital Bank	Alpha Finance Holding (BG) – 98.43%	13.7	1.9	-	0.0
Central Cooperative Bank	Central Cooperative Bank (BG) – 87.35%	19.9	-	-	28.1
Eurostandard Bank	Gofi Group of Finance and Investment (CH) and Eastern Hemisphere Holding (CH) – 50% each	17.9	4.3	-	7.7
Halk Bank	Turkiye Halk Bankasi (TR) – 98.78%	51.7	-	12.5	14.9
NLB Tutunska Banka	Nova Ljubljanska Banka (SI) – 86.97%	44.3	17.7[2]	1.3	0.1
Ohridska Banka	Société Générale (FR) – 70.02%	14.7	14.3	4.7	-
ProCredit Bank	ProCredit Holding (GE) – 100%	13.0	8.5[3]	-	-
Sparkasse Bank	Steiermärkische Sparkasse (AU) – 97%	39.8	16.6	-	-
Stopanska Banka	National Bank of Greece (GR) – 94.64%	54.1	45.2	-	-

Notes: [1] *Portion of share capital, based on shareholding.*
[2] *Subordinated loan provided by NLB InterFinanz (CH).*
[3] *Includes a hybrid loan of EUR 3 million with no maturity.*
Source: *Annual Reports*

4.5.5 Local commercial sources

Some funding is available from the Macedonian Enterprise Development Foundation (MEDF). The foundation was created with the financial support of the Dutch Government but is currently entirely independent. In 2015, MEDF had about EUR 13 million in total assets, most of which were loans to five financial institutions (NLB Tutunska Banka, Halk Bank, saving house Moznosti, factoring company FactorTrust and MCF Horizonti). As funding from MEDF is very similar to credit lines from IFIs, the foundation is considering ceasing its lending intermediation and investing about EUR 3 million in SME equity.

[27] For example, in 2014, Ohridska Banka had two subordinated loans outstanding: one loan (EUR 8 million; Sep 2011 – Sep 2019) had a fixed interest rate of 13.45%, while another loan (EUR 6 million; June 2013 – June 2021) had a fixed interest rate of 3.315%.

The foundation already tried a loan guarantee scheme, but it was stopped in 2006 due to little interest and awareness on behalf of the market players on both sides, i.e. banks and SMEs.

Occasionally, non-bank financial institutions may be funded by local commercial banks. Commercial banks are not very active on the inter-bank lending market but provide some funding to non-bank financial institutions. As a share of the total bank loan portfolio, loans to other financial institutions are less than 1%. However, funding from local banks is significant for some non-bank institutions. For example, borrowings from domestic banks account for about 20% of the total funding of leasing companies. In addition, domestic banks are among the shareholders of pension and investment fund management companies (49.0% and 20.3%, respectively, in 2014), brokerage companies (7.0%) and in the leasing sector (0.8%).

4.5.6 Other sources

Some banks have subordinated debt on their balance sheets from non-parent sources. EFSE Netherlands (a subsidiary of EFSE) has provided a subordinated loan in the amount of EUR 12 million to NLB Tutunska Banka with maturity of 10 years. It is expected to convert it into capital at a later stage. ProCredit Bank used a subordinated loan from SNS Institutional Microfinance Fund II (the Netherlands) in the amount of EUR 4 million.

4.6 Supply estimate

The total supply of SME loan and lease financing in Macedonia is estimated at EUR 1.5 billion in 2014, about 35% of the total loan and lease portfolio. Banks account for more than 98% of that amount, with the balance being split among savings houses, micro-finance institutions, and leasing companies.

Table 11. Estimate of SME loan and leasing supply at 31 December 2014

	Banks	MFIs	Leasing	Total
A. % of FIs offering SME loans	100%	100%	100%	n/a
B. SME loans to total loans (survey)	34.8%	15.7%	35.0%	n/a
C. Total loans (EUR millions)	4,122.1	42.3	51.0	4,215.4
D. SME loan supply estimate (=A*B*C)	1,435.2	6.7	17.8	1,459.7

Source: BFC survey and research

The estimate may somewhat underestimate or overestimate the real supply due to a number of approximations:

- The share of SME portfolio in the banking sector is based on the average calculated from data collected (or publicly available) from six banks (accounting for 55.6% of total assets and 54.9% of total gross portfolio) and then extrapolated to the entire sector;
- The SME portfolio of savings houses is based on the breakdown of the total portfolio between business and retail lending, which can be obtained from audited financial statements, and the assumption that savings houses do not lend to large enterprises (i.e. SMEs account for the whole business loan portfolio);
- The SME portfolio of financial companies is based on the largest MFI only (accounting for 30.2% of total assets of all financial companies) and the assumption that the SME loan portfolio of all other financial companies is negligible;
- The SME leasing portfolio is based on the estimated share of legal entities of 70% of total portfolio and the assumption that SMEs account for half of it;
- The estimation does not take into account finance coming directly from development projects (e.g. Crimson Development Fund) as data was not available; the exclusion of their SME portfolios is believed to have an insignificant impact on the estimation.

The total supply of risk capital is estimated not to exceed EUR 9 million. The estimation is based on the size of venture capital funds that are known to invest in Macedonian SMEs – SEAF Macedonia II (USD 8 million), USAID-funded Small Investment Fund (USD 600,000), Micro Investment Fund (USD 800,000), and CEED MSE Fund (USD 80,000) – as well as an estimated EUR 300,000 to cover investments by angel investors and unobserved investments by regional venture capital and private equity funds.

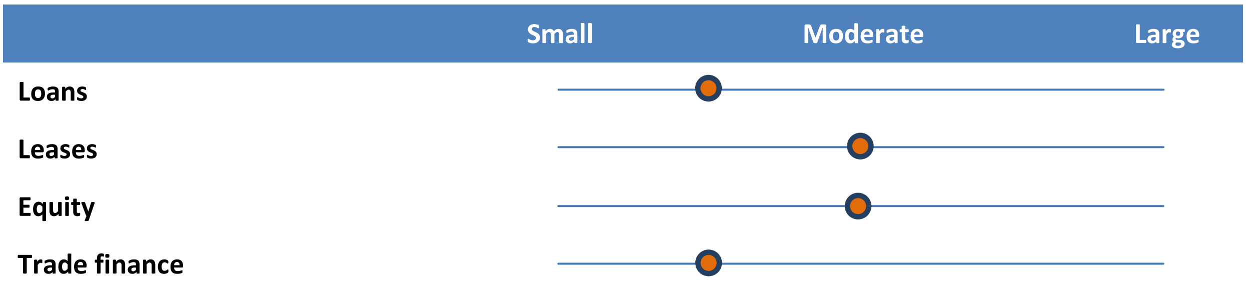
5 Gaps in private sector financing

Key findings:

- *There is a rather small funding gap for loans in Macedonia, resulting from a generally abundant supply of SME credit, access to which is mainly restricted by insufficient collateral and perceived inability of the borrowers to repay the loan*
- *As lending is mostly collateral-based, the gap is higher in rural areas, with agriculture remaining largely underserved*
- *With low loan-to-deposits ratio and high liquidity, banks, in general, have a reduced need for additional borrowings. Funding is not a priority for non-bank financial institutions either*
- *Additional funding would be most needed to help raise awareness among SMEs of benefits and principles of equity or quasi-equity investment*
- *As the potential demand for risk capital is high, especially among the start-ups in the IT sector, the gap for equity investment is judged to be moderate-to-large*
- *The major opportunity for IFIs consists in a well-designed technical assistance component to be included in the funding package*

5.1 Gaps by instrument

Summary of gaps by instrument



5.1.1 <u>Loans</u>

The funding gap for loans is small to moderate. Closing the funding gap for loans faces a number of challenges on from both the demand side and the supply side. In general, credit is available (as determined by branch coverage and product range) but not always affordable or appealing (determined by product characteristics such as interest rate, maturity, collateral requirements, etc.). Given the decreasing interest rates and generally better terms and conditions for SME loans, the main constraint that reduces affordability is the lack of sufficient collateral. However, even if a loan is offered on reasonable terms, the access to finance can be restricted if the lending institution is not convinced of the ability of the potential borrower to repay the loan. This third component (ability) seems to currently play a major role in the creation of the demand-supply gap.

Lenders cite a number of constraints that do not allow them to grow their SME portfolios faster. Lenders argue that SMEs bear a higher risk as their earning capacity is less certain. Risk assessment of SMEs is more difficult due to insufficient and often unreliable information and leads to the need for a different approach[28]. Furthermore, smaller loan amounts translate into higher transaction costs. Most banks seem to have already dealt with all these obstacles. They normally have separate units and staff members to deal with large and SME clients, respectively. Some banks even distinguish further between micro-enterprises and SMEs. From the banks' point of view, the most important limitation is the general scarcity of feasible business projects. Banks are not satisfied with the entrepreneurial skills and financial

[28] Inability to properly assess a client's future profitability and feasibility of the project ideas are the main explanations as to why the cash-flow-based approach is generally not practiced.

literacy of their potential SME clients. As a result, many loan applications get rejected and banks end up investing in government securities instead. Financial support is necessary to facilitate SME development, but SME development is necessary to justify financial support.

SMEs see the situation from a different perspective. SMEs complain about complex and cumbersome lending procedures and excessive documentation requirements. In addition, many of them cannot provide sufficient collateral and are not very well informed about the guarantee schemes that are available to them. SMEs also find it difficult to fully understand all the costs involved with a loan and blame banks for not properly disclosing them. Most respondents, however, are of the opinion that access to finance is not the biggest constraint to SME growth in Macedonia.

5.1.2 Leasing

There is a moderate gap for leasing. Leasing accounts for not more than 1.5% of the total SME finance supply. Leasing companies suffer from inferior product offerings compared to banks. They are either acting as departments of commercial banks without a significant motivation to make leases more attractive or are driven out of the market by banks which can offer better conditions. As a result, the demand for leasing (as it is currently offered) is low. If the legal framework improves and benefits of leasing are effectively communicated to the SME market, the demand for leasing may be much higher, resulting in a moderate or even moderate-to-high gap.

5.1.3 Risk capital

The available supply of risk capital is small but exceeds the current demand. The supply of risk capital has been around in Macedonia since the late 1990s and is estimated to currently amount to about EUR 9 million, which is only 0.6% of the total SME finance supply. At the same time, a few Macedonia-focused equity investors could never use all of the committed funds due to the scarcity of suitable investments. More than a dozen regional private equity and venture capital funds which have Macedonia among their target countries are not known to have invested in any Macedonian SMEs. The limited knowledge about risk capital (as opposed to traditional bank lending) makes many smaller entrepreneurs feel uncomfortable with this instrument. Those few who consider risk capital as a financing option oftentimes do not qualify for various reasons, including not only non-compliance with the investor's eligibility criteria, but also a lack of proper understanding of the risk and profit sharing principle of an equity investment.

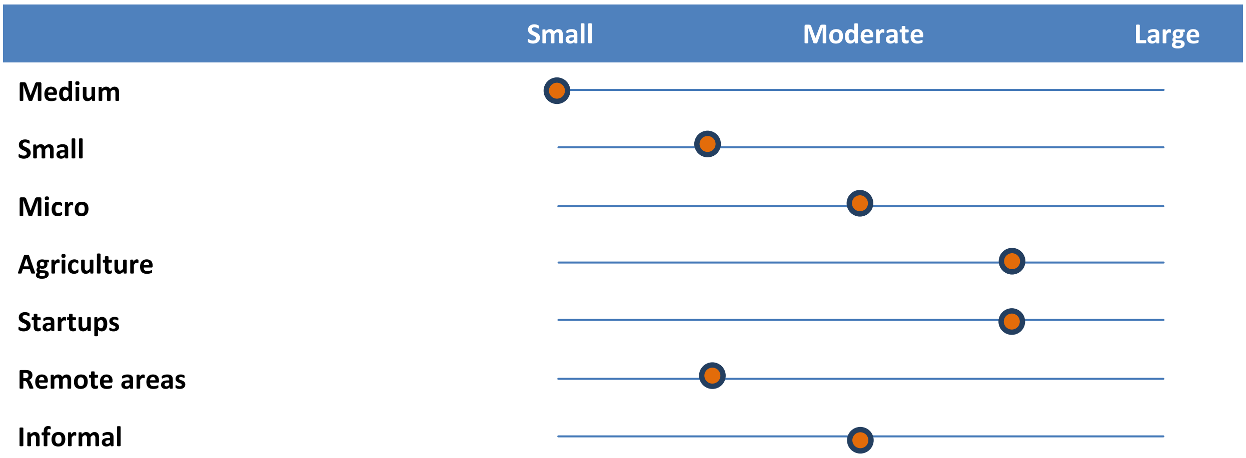
However, the demand could be spurred, especially from start-ups, and could potentially be high. Demand could be created by raising SME awareness of benefits and principles of an equity investment and SME willingness and readiness to accept an equity investor. This is already being done by several supporting organisations (e.g. the Balkan Unlimited Foundation, Center for Entrepreneurship and Executive Development, Macedonian Enterprise Development Foundation, and Crimson Development Fund) through their various educational and acceleration programs.

5.1.4 Trade finance

The funding gap for trade finance is relatively small. As a small land-locked country, Macedonian economic growth depends on trade with other countries. Real and sustainable growth is believed to be driven by SMEs that manage to do business outside Macedonia. Trade finance is, thus, expected to become more important, and the demand for it will most probably grow. At the same time, financial institutions are not very constrained and could satisfy this growing demand.

5.2 Gaps by type of SME

Summary of gaps by type of SME



5.2.1 Size

Generally, the smaller the business, the more difficult it is to access finance. Depending on size, SMEs generally have one or two of the following options: remittances, informal lenders, savings and loan associations, microfinance institutions, leasing companies, commercial banks. Funding gaps are higher for micro and very small businesses. Banks cite a huge communication gap between themselves and SMEs (with the gap growing as company size decreases), whereas non-bank institutions have a limited capacity to serve these unbankable clients.

5.2.2 Economic activity

Agriculture has been underserved by the financial sector. Agriculture, and agri-business in general, is one of the key strategic sectors in Macedonia. It has been a priority of both the GoM's policies and international projects for a long time but only now seems to have become the focus of the financial sector too. For many years and many reasons, agriculture has been underserved. Agricultural enterprises were perceived as being riskier, more expensive to monitor due to longer distances, having little collateral, and being difficult to assess. The existing supply of finance was largely limited to funds within various projects financed by IFIs. The non-bank financial sector does its best to close this gap, but it is too small to make a substantial change. Most commercial banks have only recently started to approach the agricultural sector in a different way. Considerable unmet demand exists for investments in modern agricultural technologies, storage and post-harvest facilities, and replacement of the outdated equipment.

5.2.3 Development stage

Start-ups face a moderate-to-large funding gap. On one hand, there is an abundant supply of credit in Macedonia, but enterprises in their early stage are mostly unbankable due to high risk and non-compliance with eligibility criteria. On the other hand, risk capital, which normally funds startups, is scarce. Fortunately, some banks and NDFIs do make loans to startups, and there are a few venture capital funds that do financially support new companies. In addition, the relatively new Fund for Innovation and Technology Development offers co-financing grants for innovative startups and spin-offs.

5.2.4 Regional

As lending is mostly collateral-based, the gap is higher in rural areas. There is a large segment of SMEs which lack appropriate and/or sufficient collateral and, thus, have limited access to banks. With real estate being the preferred collateral and the value of houses outside urban areas being low, entities with difficulties in finding financing are more likely to be in rural areas and classified as either micro or small enterprises. Similarly, SMEs in urban areas outside Skopje are more limited in accessing finance than those in the capital city. Since there are no parts of the country that are especially remote, the overall gap is judged to be moderate.

5.2.5 Degree of formality

It is harder to access finance for informal enterprises. The share of registered enterprises that practice tax avoidance and other means of not adhering to laws and regulations (normally through underreporting income) is high. Banks try to estimate the unreported income when assessing a loan application, but their estimates are very conservative and result in smaller loan amounts.

5.3 Gaps in funding of intermediaries

5.3.1 Banks

With a low loan-to-deposits ratio and high liquidity, banks, in general, have a reduced need for additional borrowings. If conditions are attractive enough, banks are willing to consider additional funding despite a reduced need from a low loan-to-deposit ratio and high liquidity. There are several elements that can attract a bank to additional funding: a) competitive interest rates, b) less restrictions on eligibility requirement of the end-borrowers (e.g. the type of SMEs that can borrow, their past performance, etc.), c) reasonable future performance indicators (e.g. number of employees), d) provision of a grace period, e) availability of an efficient loan guarantee facility, f) provision of the TA for banks and advisory services for SMEs.

There is a need for loan guarantee funds (LGFs) to mitigate the problem of insufficient collateral among SMEs given the rather conservative approach of the banking sector and the preference for collateral (with real estate in the capital city being the most desired). However, to be successful, LGFs need to better meet the requirements of both the supply and demand sides. In particular, the LGFs have to be faster in approval and more transparent.

5.3.2 Non-bank institutions

The NBFI lenders have a level of funding gap. Both depository and non-depository lending institutions cannot rely too much on customer deposits due to regulatory restrictions. The small size of the NBFI sector makes it less attractive for IFIs.

Funding, *per se,* is not a priority for leasing companies. Additional funding would need to have a TA component to assist companies (that really want) to improve leasing products, operations, and technical skills.

5.3.3 Risk capital providers

Funding is needed to help raise awareness of benefits and principles of an equity or quasi-equity investment. Additional funding would help the few existing organizations provide a larger set of services to a larger number of SMEs. For example, BkUF already has an acceleration program for IT startups called SuperFounders and is looking for partners to establish a regional venture capital fund. CEED needs funds to become an acceleration company with 8 planned hubs throughout Macedonia. MEDF plans to gradually exit the lending market and establish an equity fund instead.

5.4 Potential and capability of IFIs to fill gaps

5.4.1 The World Bank Group

The Competitive Industries and Innovation Support Program (CIIP) is the continuation of the World Bank's engagement in supporting Macedonia's competitiveness agenda that was recently supported through the Competitiveness Programmatic DPL series. The CIIP is a three-year, USD 1.6 million grant from the global Competitive Industries and Innovation Program Multi-Donor Trust Fund.

IFC's advisory services aim to improve the investment climate and the performance of private sector companies and to attract private sector participation in the development of infrastructure projects. Through a combination of investment and advisory services, IFC continues to partner with clients in strategic sectors crucial to the country's long-term sustainable development. Recent investment projects include USD 13.4 million long-term SME loan to Ohridska Banka. Under its Global Trade Finance Program, IFC provided a trade finance line to Stopanska Banka, NLB Tutunska Banka, Unibanka, and Ohridska Banka.

5.4.2 EBRD

In Macedonia, EBRD focuses on supporting the country's integration into regional and global markets through investments and other activities, especially intensified cooperation with key partners such as the European Union and the European Investment Bank. In addition to an SME loan to Ohridska Banka (EUR 10 million), EBRD currently invests in infrastructure and energy projects. EBRD has cumulatively invested over EUR 1.6 billion in 101 projects in Macedonia to date (with the private sector accounting for 16%) and has a current portfolio of EUR 855 million.

5.4.3 KfW

Germany began cooperating with Macedonia in 1997. Germany has made available or made concrete commitments of EUR 346 million to Macedonia in the form of grants or low-interest loans through KfW Development Bank. Since Macedonia was granted candidate status for EU membership in 2005, the bilateral development cooperation has been gradually phased out. Cooperation now focuses on meeting EU accession criteria. KfW is mainly active in the energy sector (energy efficiency and renewable energy), municipal infrastructure (water supply, sewage disposal and district heating), and sustainable economic development (promoting MSMEs, municipal credit lines).

Within the sustainable economic development focal area, cooperation aims to give small businesses access to loans and other financial services. As part of the collaboration with the MBDP, loans are made available to selected commercial banks which are then passed on to SMEs at market conditions.

5.4.4 EFSE and GGF

The European Fund for Southeast Europe provides loans to micro and small enterprises (defined as those involving loans of up to EUR 100,000) through partner lending institutions. In Macedonia, EFSE has four partner institutions (Halk Bank, NLB Tutunska Banka, ProCredit Bank, and MCF Horizonti).

The Green for Growth Fund, southeast Europe provides investments in the energy efficiency and renewable energy sectors both indirectly, through financial institutions, and directly to non-financial institutions such as renewable energy companies or projects, energy service companies, energy efficiency service and supply companies as well as companies in general. In Macedonia, GGF has two partner institutions: Halk Bank and Ohridska Banka.

5.4.5 USAID

Within the economic growth and trade area, USAID has several projects that directly support SME development and facilitate SME access to finance. Specifically, USAID focuses on:

- Improving the business environment and increasing the competitiveness of SMEs in sectors with potential for growth and job creation (Small Business Expansion Project, Micro and Small Enterprises Project, Project for Microenterprise Access to Public Procurement, Business StartUp Centre in Bitola);
- Expanding production and sales of value-added agricultural products in the fresh and processed fruits and vegetables value chains (AgBiz Program);
- Providing access to finance to companies that want to expand their operations or market opportunities (three Development Credit Authority facilities, Innovation Financing Vehicle);

- Improving the business policy and investment climate by strengthening the capacity of key economic ministries and agencies within the GoM.

In addition, USAID works with the Ministry of Education to ensure that youth are equipped with the knowledge and skills that foster economic growth and reinforce an appreciation for diversity necessary in a multi-ethnic society. In particular, the Youth Employability Skills (YES) Network works with secondary schools, the Employment Service Agency and youth-serving NGOs to enable them to provide youth with soft skills training, work-based learning experiences and career coaching.

5.4.6 The EIB Group

EIB is one of the largest lenders to banks in Macedonia and has a number of credit lines open with the country's largest banks. These usually take the form of senior loans in relatively large amounts for general (not sector-specific) SME lending. Together with EBRD and the European Commission, EIB is also one of the founding partners of the Western Balkans Enterprise Development and Innovation Facility. This facility consists of an early-stage venture capital fund, the Enterprise Innovation Fund (ENIF), a growth-stage fund, the Enterprise Expansion Fund (ENEF, managed by EBRD), a loan guarantee facility, and a support services facility offering technical assistance directly to SMEs and other stakeholders.

A new agreement between EIF and ProCredit Bank as part of the European Commission's InnovFin program will facilitate the funding of innovative SMEs in Macedonia and other countries in the region by providing a loan portfolio guarantee. ProCredit had previously been a participating institution in the European Commission's Competitiveness and Innovation Programme (CIP), which offered loan guarantees and was managed by EIF.

EIB is also involved in financing projects not related to access to finance, such as the construction of highways and hydroelectric plants. EIB's investments in Macedonia represent 8% of its total investments in the six target countries.

5.5 Recommendations

Given the rather conservative approach of the banking sector and preference for collateral (with real estate in the capital city being preferred), there is a need for loan guarantee funds to mitigate the problem of insufficient collateral among SMEs. At the same time, the loan guarantee funds need to meet the requirements of both supply and demand sides to be successful. In particular, the loan guarantee funds have to be fast in approval and transparent. The support might come in three ways:

- increase the size of the WB EDIF Guarantee Facility;
- join the existing scheme offered by the Macedonian Bank for Development Promotion;
- establish a new guarantee fund, which would be open for all SMEs (without a special focus on exporters) and which would serve as an example of an efficiently and transparently run guarantee fund.

With low loan-to-deposits ratio and high liquidity, banks, in general, have a reduced need for additional borrowings. However, if the conditions are attractive enough, they are willing to consider funding from an IFI. In terms of improved attractiveness, it is recommended to consider the following:

- less restrictions on the past performance (e.g. a mandatory condition of recording a 5% increase in sales or exports in current year disregards the feasibility of the proposed investment project and may result in rejecting an otherwise good SME loan);
- reasonable future performance indicators (e.g. imposing the condition of at least maintaining the current number of employees over the loan term discourages investing in modern, less labour-intensive technology);
- provision of TA for banks (e.g. sales techniques, SME assessment);

- provision of advisory services for SMEs (e.g. business planning, financial literacy).

Sector-specific loans for agriculture have good potential to reduce the gap for agricultural enterprises, especially if accompanied by TA designed to improve the capability of banks to quickly and efficiently evaluate agricultural risk and cash flows, thus reducing the cost to serve these enterprises.

Funding *per se* is not a priority for the leasing sector. Leasing companies in Macedonia suffer from inferior product offering compared to banks. They are either acting as departments of commercial banks without a significant motivation to make leases more attractive or are driven out of market by banks, which can offer seemingly better conditions. It is thus recommended to include a TA component that would be necessary to assist the companies (those that really want) to improve the product, operations, and technical skills.

The success of the risk capital providers in Macedonia is highly dependent on the SMEs' understanding of the benefits and disadvantages of an equity or quasi-equity investment, and professionalism of the field staff that would inspire trust and confidence and, at the same time, be closer to the SME sector. Funding is thus needed to help raise awareness among SMEs. It is recommended to support the existing organizations that are few steps ahead in terms of creating a network of potential clients, improving their entrepreneurial skills, and establishing acceleration programs for start-ups. Additional funding would help them provide a larger set of services to a larger number of SMEs.

To improve the youth unemployment problem, interventions should focus on three key areas:

- <u>jobs</u>: ensure that enough good jobs exist for young people who seek them and improve the entrepreneurship ecosystem to promote the startup and expansion of SMEs;
- <u>skills</u>: teach young people how to identify opportunities, align their interests with market needs, and acquire relevant skills that will let them succeed in sustainable careers;
- <u>experience</u>: overcome practical barriers to initial workforce entry by young people through apprenticeship programs, school-to-work programs, services for out of school youth, and employer partnerships to ensure access to real jobs.

Annex 1: Macroeconomic indicators

Indicator	2015(e)	2014	2013	2012	2011	2010
GDP (nominal, EUR millions)	9,094	8,530	8,150	7,585	7,544	7,109
Population (thousands)	2,070.0	2,069.2	2,065.8	2,062.3	2,059.8	2,057.3
GDP (nominal) per capita (EUR)	4,393.3	4,126	3,948	3,680	3,665	3,459
GDP (PPP) per capita (current international USD)	n/a	13,142.4	12,468.4	11,874.1	11,641.2	11,670.3
Real GDP growth rate	3.7%	3.5%	2.9%	–0.5%	2.3%	3.4%
Inflation rate (CPI)	–0.3%	–0.3%	2.8%	3.3%	3.9%	1.5%
Exchange rate (EUR, end of period)	61.5947	61.4814	61.5113	61.5000	61.5050	61.5050
Change in exchange rate	0.18%	–0.05%	0.02%	–0.01%	0.00%	0.54%
Unemployment rate (official)	26.1%	28.0%	29.0%	31.0%	31.4%	32.1%
Poverty rate (national poverty line)	n/a	22.1%	24.2%	26.2%	26.8%	27.0%
Current account balance (% of GDP)	–1.4%	–0.8%	–1.6%	–3.2%	–2.5%	–2.0%
Trade balance (% of GDP)	–19.0%	–20.7%	–21.5%	–25.7%	–24.4%	–22.5%
FDI, net (% of GDP)	1.9%	2.3%	2.8%	1.7%	4.5%	2.2%
Central bank reserves (% of GDP)	24.9%	28.6%	24.5%	28.9%	27.4%	24.1%
Public debt (% of GDP)	46.5%	46.0%	40.3%	38.3%	32.0%	27.2%
Fiscal balance (% of GDP)	–3.5%	–4.2%	–3.8%	–3.8%	–2.5%	–2.4%

Sectoral distribution of Gross Value Added (% of total)

<table>
<tr><th>Sector/activity</th><th>2015(e)</th><th>2014</th><th>2013</th></tr>
<tr><td>A. Agriculture, forestry and fishing</td><td>11.2%</td><td>11.6%</td><td>11.5%</td></tr>
<tr><td>B. Mining and quarrying</td><td rowspan="4">18.0%</td><td rowspan="4">17.9%</td><td>1.6%</td></tr>
<tr><td>C. Manufacturing</td><td>11.4%</td></tr>
<tr><td>D. Electricity, gas , steam and air</td><td>3.3%</td></tr>
<tr><td>E. Water supply</td><td>1.0%</td></tr>
<tr><td>F. Construction</td><td>8.1%</td><td>7.3%</td><td>8.2%</td></tr>
<tr><td>G. Wholesale and retail trade</td><td rowspan="3">21.4%</td><td rowspan="3">21.5%</td><td>15.6%</td></tr>
<tr><td>H. Transport and storage</td><td>4.1%</td></tr>
<tr><td>I. Accommodation and food service</td><td>1.5%</td></tr>
<tr><td>J. Information and communication</td><td>3.8%</td><td>3.9%</td><td>3.7%</td></tr>
<tr><td>K. Financial and insurance activities</td><td>3.6%</td><td>3.4%</td><td>3.2%</td></tr>
<tr><td>L. Real estate activities</td><td>14.0%</td><td>13.6%</td><td>13.8%</td></tr>
<tr><td>M. Professional activities</td><td rowspan="2">3.9%</td><td rowspan="2">3.7%</td><td rowspan="2">3.7%</td></tr>
<tr><td>N. Administrative activities</td></tr>
<tr><td>O. Public administration and defence</td><td rowspan="3">13.3%</td><td rowspan="3">14.1%</td><td rowspan="3">14.7%</td></tr>
<tr><td>P. Education</td></tr>
<tr><td>Q. Health</td></tr>
<tr><td>R. Arts, entertainment, recreation</td><td rowspan="3">2.7%</td><td rowspan="3">2.9%</td><td rowspan="3">2.8%</td></tr>
<tr><td>S. Other service activities</td></tr>
<tr><td>T. Household activities</td></tr>
<tr><td>TOTAL (GROSS VALUE ADDED)</td><td>100.0%</td><td>100.0%</td><td>100.0%</td></tr>
</table>

Annex 2: Financial sector indicators

Banking sector indicators

Indicator	2015 Q2	2014	2013
Structure of the sector			
Number of banks by type:			
Large	4	4	4
Medium	8	8	8
Small	3	3	4
Total banks	15	15	16
Number of state-owned banks	1	1	2
Assets of SOBs to total bank assets	n/a	3.8%	4.0%
5-bank concentration ratio	n/a	74.8%	74.1%
Bank branches per 1,000 population	n/a	0.21	0.21
Financial indicators (EUR millions)			
Total assets	6,539.5	6,510.6	6,007.1
Total gross loans	4,256.6	4,122.1	3,746.3
Total net loans	3,726.3	3,633.8	3,301.5
Total deposits	4,711.6	4,667.7	4,215.5
Total equity	716.2	704.4	677.2
Total regulatory capital	765.2	736.9	740.4
Total net profit	33.2	51.2	37.6
Financial ratios			
Capital adequacy:			
Tier 1 CAR	n/a	13.7%	14.4%
Total CAR	16.2%	15.7%	16.8%
Equity to total assets	11.0%	10.8%	11.3%
Liquidity:			
Loans to deposits	90.3%	88.3%	88.9%
Growth rate of deposits	2.6%	10.7%	5.7%
Regulatory liquidity ratio	32.0%	33.2%	32.8%
Cash and equivalents to assets	n/a	25.5%	27.3%
Profitability:			
Return on average assets	1.0%	0.8%	0.6%
Return on average equity	9.4%	7.4%	5.7%
Net interest margin	66.5%	63.5%	62.2%
Cost-income ratio	51.9%	55.5%	60.6%
Asset quality:			
Growth rate of loan portfolio	7.2%	10.0%	6.4%
NPL ratio	11.5%	11.3%	11.5%
Others:			
Growth rate of total assets	1.6%	8.3%	4.7%
Bank assets to financial sector assets (%)	n/a	86.8%	87.6%

Annex 3: The largest lending institutions

Banks by asset size at December 31, 2014

	Bank name	Website	Assets* (EUR mln)
1	Komercijalna Banka	http://kb.com.mk	1,512.1
2	Stopanska Banka – Skopje	http://stb.com.mk	1,381.1
3	NLB Tutunska Banka	http://tb.com.mk	1,061.3
4	Ohridska Banka	http://ohridskabanka.mk	516.8
5	Halk Bank	http://halkbank.mk	423.2
6	ProCredit Bank	http://procreditbank.mk	296.4
7	Sparkasse Bank	http://sparkasse.mk	261.4
8	MBDP	http://mbdp.com.mk	245.5
9	Universal Investment Bank	http://unibank.com.mk	184.1
10	Stopanska Banka – Bitola	http://stbbt.com.mk	145.1
11	Central Cooperative Bank	http://ccbank.mk	137.0
12	Eurostandard Bank	http://eurostandard.com.mk	129.1
13	TTK Banka	http://ttk.com.mk	110.7
14	Alpha Bank	http://alphabank.com.mk	100.4
15	Capital Bank	http://capitalbank.com.mk	42.1
	TOTAL		**6,546.3**

*Note: * Based on the banks' financial statements prepared in accordance with the IFRS.*

Savings houses by asset size at December 31, 2014

	Saving house name	Website	Assets (EUR mln)
1	Moznosti	http://moznosti.com.mk	29.3
2	MAK-BS	http://makbs.com.mk	13.6
3	Fulm	http://fulm.com.mk	3.6
4	Al Kosa	n/a	0.6
	TOTAL		**47.1**

Financial companies by asset size at December 31, 2014

	Company name	Website	Assets (EUR mln)
1	MCF Horizonti	http://horizonti.org.mk	3.9
2–7	Other financial companies		9.0
	TOTAL		**12.9**

Leasing companies by asset size at December 31, 2014

	Company name	Website	Assets (EUR mln)
1	Porsche Leasing	http://porscheleasing.com.mk	n/a
2	S-Leasing	http://s-leasing.mk	n/a
3	Eurolease Auto	http://euroleaseauto.mk	n/a
4	NLB Lizing	http://nlblizing.com.mk	n/a
5	Master Leasing	http://masterleasing.mk	n/a
6–8	Other leasing companies		n/a
	TOTAL		**70.1**

Annex 4: World Bank Doing Business Indicators

Source: Doing Business 2016 (http://doingbusiness.org/reports/global-reports/doing-business-2016)

Indicator	2016 Rank	2015 Rank
Ease of doing business	12	14
Starting a business	2	2
Dealing with construction permits	10	10
Getting electricity	45	43
Registering property	50	50
Getting credit	42	36
Protecting investors	14	18
Paying taxes	7	7
Trading across borders	26	26
Enforcing contracts	26	25
Resolving insolvency	37	34

Getting credit indicators

Indicator	2016 Value	2015 Value
Strength of legal rights index (0–12)	6.0	6.0
Depth of credit information index (0–8)	7.0	7.0
Public registry coverage (% of adults)	38.0	36.4
Private bureau coverage (% of adults)	89.3	83.7

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