



**Vitosha
Research**

Ministry of Economy and Energy

**BULGARIAN SMALL AND MEDIUM-SIZED ENTERPRISES
AND THEIR PARTICIPATION IN THE ABSORPTION OF THE
STRUCTURAL FUNDS OF THE EUROPEAN UNION**

Analytical Report

JULY – AUGUST 2006

TABLE OF CONTENTS

I. INTRODUCTION.....	3
1.1. RATIONALE OF THE RESEARCH PROJECT.....	3
1.2. OBJECTIVES AND TASKS.....	4
1.3. DESCRIPTION OF PROJECT ACTIVITIES AND TARGET GROUPS.....	5
II. CHARACTERISTICS AND MAIN PRINCIPLES OF THE POLICY FOR SMES.....	7
2.1. GENERAL CHARACTERISTICS OF SMEs IN BULGARIA.....	7
2.2. CHARACTERISTICS OF THE POLICY FOR PROMOTION OF ENTREPRENEURSHIP AND SMEs DEVELOPMENT IN BULGARIA.....	12
2.3. MAIN PRINCIPLES AND INSTRUMENTS OF THE EU POLICIES FOR SUPPORT OF SMEs AND IMPROVEMENT OF THEIR COMPETITIVENESS.....	16
III. ASSESSMENT OF THE CURRENT STATE, THE NEEDS AND THE PROBLEMS OF SMES.....	18
3.1. REQUIREMENTS TO THE BUSINESS, STEMMING FROM THE MEMBERSHIP OF BULGARIA IN THE EU.....	18
3.2. SME COMPETITIVENESS.....	27
3.3. INNOVATION ACTIVITY AND INNOVATIVE CAPACITY OF BULGARIAN SMEs.....	37
3.4. LEVEL OF USE OF INFORMATION AND COMMUNICATION TECHNOLOGIES IN SME OPERATIONS AND MANAGEMENT	49
3.5. ACCESS TO FINANCING OF SME.....	53
3.6. CURRENT STATE OF THE CONSULTANCY NETWORK AND SERVICES.....	61
3.7. BUSINESS STRATEGIES AND MANAGEMENT PROGRAMMES OF SMEs	69
IV. SMES ABSORPTION CAPACITY FOR PARTICIPATION IN EUROPEAN FUNDS.....	72
4.1. PARTICIPATION OF SMEs IN THE EUROPEAN PRE-ACCESSION FUNDS	72
4.2. LEVEL OF AWARENESS OF SMEs REGARDING THE OPPORTUNITIES OFFERED BY THE EU STRUCTURAL FUNDS. SOURCES OF INFORMATION AND KNOWLEDGE ON THE RULES AND REQUIREMENTS OF THE STRUCTURAL FUNDS.....	77
4.3. WILLINGNESS FOR PARTICIPATION IN THE EU STRUCTURAL FUNDS AND ABSORPTION CAPACITY OF BULGARIAN SMEs.....	82
V. CONCLUSIONS AND RECOMMENDATIONS.....	91

I. INTRODUCTION

1.1. Rationale of the research project

After Bulgaria joins the EU in 2007 the country will receive access to the Structural Funds (SF) and the Cohesion Fund of the European Union (EU), which are the main instruments for reducing the economic and social disparities within the Union. The effective management of these proceeds entails good knowledge of the EU Funds' requirements and thorough preparation at national, regional and local levels both by the public and private sectors, including the small and medium-sized enterprises (SMEs).

In 2000 in Lisbon, the European Commission and the EU Member States agreed upon the ambitious goal that by 2010 the European Union would have to become the most dynamic knowledge-based economy in the world¹. The instruments and mechanisms to achieve this goal have been outlined in the Lisbon Strategy of the EU. In 2005, an interim review on the progress of the Lisbon Strategy was done, based on which it was concluded that the Union was falling behind in some of its basic parameters, and that the gap between the EU and the leading innovative world economies of the United States and Japan was broadening.

In order to address this slowdown and taking into consideration the EU enlargement to 25 Member States in 2004 and the expected accession of Bulgaria and Romania in 2007, on 2nd February 2005 the European Commission proposed and the European Council approved 'A New Start for the Lisbon Strategy'². Within the framework of this initiative, the EU decided to reform its main rules of financial support under the Structural and Cohesion funds during the new programming period 2007 – 2013. In July 2005, after the analysis of the 'Third Report on Economic and Social Cohesion', the European Commission proposed new *Strategic guidelines of the EU cohesion policy in support of growth and jobs*³. To face the challenge of the extensive regional disparities within the EU-27, the new Cohesion Policy is based on:

- placing the focus on economic growth, employment and innovation;
- reducing the financial instruments from 6 to 3 and the objectives of the targeted intervention from 9 to 3;
- improvement of the cohesion policy management to five consecutive steps:
 - Community Strategic Guidelines which are developed by the European Commission;
 - National strategic reference framework, which represents the strategic programming of the cohesion policy at the respective national level;
 - Operational programmes (OP) which determine the specific actions and measures under a particular priority and financial instrument;
 - Programme management and project selection, where specific decisions shall be taken on the financing of particular actions under the OPs;
 - Strategic review and annual update.

¹ An Agenda of Economic and Social Renewal for Europe, Doc/00/7, Brussels, 28 February 2000

² Working together for growth and jobs: A new start for the Lisbon Strategy, COM (2005) 24

³ Cohesion policy in support of growth and jobs: Community strategic guidelines, 2007 – 2013, COM (2005) 0299

The small and medium-sized enterprises (SMEs) are the main bearer and beneficiary of the social and economic cohesion, which makes them a major part of the EU cohesion policy. During the previous programming period 2000 – 2006, 11% of the financial resources under the EU Structural and Cohesion Funds have been allocated to SMEs. The new policy in support of growth and jobs emphasises even stronger the participation of SMEs in the EU programmes, as well as the complementarities between the measures of the Structural Funds and the Cohesion Fund, the Competitiveness and Innovation Programme (CIP) and the EU framework programmes for research, technology development and demonstration. The SME Charter of the EU has been updated in November 2005 to include the principle ‘Think Small First’, which recognizes the major importance of SMEs for the innovation uptake, the growth and the employment in the EU. Indicative in that respect is the fact that the total number of SMEs in the EU (~ 23 million) represents approximately 99% of the overall business activity within the Union.

In the last 15 years Bulgaria has recorded sound progress in strengthening its market economy. According to the 2004 *Report on the status and development of SMEs in Bulgaria*, the SMEs constitute 99% of all enterprises in the country and account for 79% of the employment⁴. According to the draft versions of the Bulgarian National Strategic Reference Framework, the National Development Plan, the National Strategic Rural Development Plan, the National Plan for Development of Fisheries and Aquacultures, and the six operational programmes, the SMEs shall play a significant role in achieving the strategic objectives of Bulgaria for higher growth and better human capital during the period 2007 – 2013.

The OP “Competitiveness”, which encompasses the main areas of activity of the European Regional Development Fund in the field of innovation and competitiveness in Bulgaria, is the main instrument for the effective and adequate participation of SMEs in the absorption of the EU Structural funds. The good knowledge of the opportunities and challenges, faced by the SMEs in Bulgaria, including the work with the EU funds, is a prerequisite for improving the programming and the effectiveness of the impact of the Structural funds in the country.

1.2. Objectives and tasks

The overall project objective is to produce an analytical report on the status and development of SMEs in the country, which shall be used to improve and fine-tune the OP “*Development of the Competitiveness of the Bulgarian Economy*” by taking into account to the utmost degree the specific problems of the Bulgarian small and medium-sized enterprises. The specific project objectives are:

- ✓ Studying the condition, the needs and the issues faced by SMEs in terms of their readiness to introduce the European standards; innovativeness of enterprises; competitiveness of SMEs and their competitive advantages; the role of the consultancy business and its response to the market needs; access of SMEs to additional funding sources, etc.
- ✓ Identifying the capacity of SMEs to participate in the absorption of funds under OP “*Development of the Competitiveness of the Bulgarian Economy*”.

The project objectives have been further diversified in the following tasks:

⁴ “Annual report on the condition and development of SMEs in Bulgaria, 2004”, Ministry of Economy and Energy

- Identifying the level of awareness and the readiness to accept the requirements towards the business, resulting from the membership of Bulgaria in the EU;
- Assessment of the current level of competitiveness of SMEs in Bulgaria in regard to their access to the internal and external markets, prices and quality of manufactured goods and services, state of production technologies and funds allocated for technological re-engineering, as well as funds for patents and intellectual property;
- Assessment and identification of the innovation potential of SMEs by identifying the share of enterprises oriented to innovative industries and the share of own financial resources allocated to research and development activities;
- Analysis of the main issues associated with the access to financial resources by assessing the options for financing SMEs by various banking and non-banking resources, size of the approved loans and leasing schemes, as well as by identifying the major barriers before obtaining additional financing from banks;
- Assessment of the current state of the consultancy network and the advisory services provided in terms of accessibility, quality and diversity of services, as well as the use of external consultancy services;
- Identifying the orientation and the status of the business strategies and the management programmes of SMEs;
- Identifying the level of awareness and use of various information sources about the EU Structural Funds in regard to the opportunities they provide to SMEs;
- Analysis of SMEs' readiness to participate in the absorption of European funding in terms of knowledge of the rules and procedures for participation in calls for proposals and tenders, their capacity to generate project ideas and the opportunities to secure project co-financing.

1.3. Description of project activities and target groups

A combination of quantitative and qualitative methods has been used during the project implementation, with the aim to summarise and analyse the opinions and ratings of the various target groups. The main activities performed were:

- A quantitative questionnaire-based survey has been carried out at national level, with a focus on the problems of SMEs in Bulgaria. The survey was carried out among managers, directors and owners of SMEs. It generated diversified and reliable information on the opinions and assessments among this group in regard to their readiness, the problems faced and the real changes associated with the accession of Bulgaria to the EU.
- Information has been gathered as well through qualitative methods (discussions in focus groups, in-depth interviews) from representatives of institutions and organisations playing key role in the processes of information dissemination, servicing and analysis of the activities associated with the absorption of the Structural and the Cohesion Funds of the European Union, such as managers and owners of SMEs, national representative organisations of employers, bank and non-bank financial institutions, consultancy and public research organisations.
- Other methods used were the desk research and analysis of secondary data from available information sources such as policy documents of the European Union and

the Bulgarian government in the areas of small and medium-sized enterprises promotion and pre-accession programmes, laws and statutory acts in force, available statistical information, data from other surveys and studies on similar topics.

The combination of quantitative and qualitative methods provided information on the various opinions and stand-points of the target groups that have been surveyed. More specifically, the following target groups have been encompassed by the survey:

In the quantitative survey:

- Small and medium-sized enterprises according to the definition provided in the Small and Medium-sized Enterprises Act (SMEA). The surveyed sample comprises non-financial enterprises, the core activity of which has been specified within the scope of the industrial sectors with initials from C to K in the ‘National Classification of Economic Activities’ (NCEA-2003) distributed in groups according to the number of employees;

In the qualitative survey:

- Small and medium-sized enterprises according to the definition provided in the Small and Medium-sized Enterprises Act (SMEA);
- National representative organisations of employers which have been designated by decisions of the Council of Ministers according to the ‘Regulation on stipulating the order for establishing the presence of the criteria of representativeness of trade unions and of employer organisations’;
- Banking sector and non-banking financial institutions (equity funds, micro credit schemes, venture capital funds, international and national programmes and projects for support of SMEs);
- Consultancy organisations (companies and non-governmental organisations) and their networks with national and regional representation (for example, the networks of BARDA (Bulgarian Association of Regional Development Agencies), JOBS, the Bulgarian Chamber of Commerce and Industry, etc.)
- Public research organisations (the Bulgarian Academy of Science, universities, etc.)

Survey results are presented in several modules:

First: Requirements towards the business, resulting from the Bulgarian membership in the EU, in regard to the level of knowledge of the overall EU policy in relation to SMEs (internal market, Lisbon Strategy, innovation and research, Structural Funds, etc.), awareness on EU requirements towards the businesses, degree of fulfilment of the European requirements and readiness for introducing the obligatory requirements, the opportunities to secure the resources necessary to fulfil the requirements and main challenges before the readiness for participation in the Common European market.

Second. Assessment of the current condition of SMEs’ competitiveness in terms of access to internal and external markets, prices and quality of products and/or services, state of production technologies and funds allocated for technological upgrade and for improving the quality of the available human capital. This module includes data on the export activity of SMEs, the presence of monopolies in the supply-side, demand-side and/or business activity, the participation in national and international production networks (clusterisation), the implementation of quality, environmental protection and energy efficiency standards.

Third. Assessment of the innovation potential of SMEs: the share of innovative

enterprises and of enterprises oriented towards innovative industries; the share of own financial resources for research and development activities and/or innovation; the assessment of new products sold on the market within a certain time period, etc.; patents and intellectual property of SMEs; level of use of information and communication technologies in the operation and management of SMEs.

Fourth. Assessment of SMEs' access to financial resources. Analysis of the opportunities for financing SMEs from various banking and non-banking sources; size and type of loans obtained and leasing schemes used; the problems faced when applying for additional financing from banks – interest rates, collaterals, documentation, fees, redemption, etc.; use of non-banking financial sources.

Fifth. Level of awareness and current status of the consultancy network and the advisory services in terms of accessibility, quality and diversity of the services provided, the contracting of external organisations as consultants, most frequently demanded and used services, etc.

Sixth. Assessment of SMEs' capacity to participate in the absorption of the European funds: the experience gained in the absorption of funds under the pre-accession programmes, the level of awareness on the EU Structural and the Cohesion funds and knowledge of their rules for participation, the readiness of SMEs to participate in the absorption of the European funds (the capacity to generate project ideas, to develop projects, to secure co-financing).

II. CHARACTERISTICS AND MAIN PRINCIPLES OF THE POLICY FOR SMES

2.1. General characteristics of SMEs in Bulgaria

Sources of statistical data on SMEs in Bulgaria are the annual surveys of enterprises carried out according to the EU Council Regulation No. 58/97 of 20 December 1996. The National Classification of Economic Activities (NCEA) has been applied since the beginning of 1997 and is structured on the grounds of the statistical classification of the economic branches in the EU.

The Classification⁵, which is based on the new SME definition proposed by the European Commission on 1 January 2005, applies mainly three independent criteria to the group of SMEs: **number of employees, annual turnover and annual balance sheet** (value of the assets).

TABLE 1. CLASSIFICATION OF SMEs IN THE EU

Criteria	Size of the enterprises		
	Middle sized	Small	Micro
Number of employees	up to 250	up to 50	up to 10
Annual turnover	up to 50 millions Euro	up to 10 millions Euro	up to 2 millions Euro
Annual balance sheet	up to 43 millions Euro	up to 10 millions Euro	up to 2 millions Euro

Source: L 124/36 EN Official Journal of the European Union 20.5.2003.

⁵ See Official Journal of the European Union, L 124/36 EN of 20 May 2003

Recently this definition has been introduced in Bulgaria as well, with respect to the forthcoming membership of Bulgaria in the EU, and it differs from the EU wording only in the BGN-expression of the values.

TABLE 2. CLASSIFICATION OF SMEs IN BULGARIA

Criteria	Size of the enterprises		
	Middle sized	Small	Micro
Number of employees	up to 250	up to 50	up to 10
Annual turnover	up to 97 500 000 BGN	up to 19 500 000 BGN	up to 3 900 000 BGN
Annual balance sheet	up to 84 000 000 BGN	up to 19 500 000 BGN	up to 3 900 000 BGN

Source: Amendment Act of the Small and Medium-sized Enterprises Act (promulgated in SG, No. 84 of 1999), promulgated in SG, No.59 of 21 July 2006

It is important to note that the number of employees is the binding provision for classifying an enterprise as a SME, and one of the two other criteria (annual turnover and value of the assets) can be determined by the enterprise independently. The introduction of the EU definition in Bulgaria, where the SMEs are times smaller in terms of the value of assets and turnover, shall have different and ambiguous consequences. The opportunity to choose the criteria (under the new definition) provides to the SMEs, operating in various economic areas, the benefits of more fair and impartial treatment. The higher thresholds imply in practice more companies that can benefit from the programmes and the EU support in the form of financing from various funds, access to services provided by business incubators, consultancy, etc.

The uniform SME definition, applied in all EU acts and programmes, is integrated in the national programmes of the Member States and is observed as well by the European Investment Fund and the European Investment Bank, which are the main lending institutions for the sector.

The analysis of the SME structure in the Bulgarian economy is based on aggregated data from the annual balance sheets and the income statements of 217,470 private and public non-financial SMEs⁶ which represent 90,3 % of the total number of non-financial enterprises. For the purposes of the present survey, the characteristics of the public enterprises, i.e. enterprises with more than 50 % state or municipal property, shall not be analysed in detail. The number of private enterprises is 216,489 (99.2 %) while the public enterprises are 981. **The number of large non-financial enterprises (more than 250 employees) is relatively small as they are only 666.** In the sector of private SMEs, the enterprises with less than 10 employees (micro-enterprises) prevail and number 195,780 out of the total of 216,489 private small and medium-sized non-financial enterprises, which makes 90.43%. The small enterprises (10 to 49 persons employed) are 17,388 and the medium-sized enterprises (50 to 249 employees) are 3,321, thus representing respectively 8.03 % and 1.53 % of all SMEs.

According to the 2004 “Annual report on the condition and development of SMEs in Bulgaria”, the SMEs in Bulgaria constitute 99 % of all enterprises in the country, generate 79% of the employment, account for 75% of the turnover and 61% of the added value of private enterprises⁷.

⁶ See “Annual report on the condition and development of SMEs in Bulgaria, 2004”, Sofia, Ministry of Economy and Energy, p. 20-21

The breakdown of enterprises' indicators by groups by size, and by industrial and regional sectors is of varying informative value. For example, more than 55% of all SMEs operate in the 'Wholesale and retail trade and repair of motor vehicles, personal and household goods', over 12% are engaged in the 'Processing industry', about 10 % is the share of SMEs in 'Hotels and restaurants' as well as in 'Real estate operations and business services', over 7% of SMEs operate in 'Transport, warehousing and communications', about 4% are in the 'Construction' business and less than 0.1% deal in the 'Extracting industries' and in the 'Production and distribution of electricity, gas and water supply'.

TABLE 3. SHARE OF SMEs IN THE ECONOMIC SECTOR IN PROPORTION TO THE RESPECTIVE INDICATOR FOR THE TOTAL OF SMEs, 2003, IN PERCENTAGE

	Enterprises	Employees	Tangible Fixed Assets (TFA)	Turnover	Production	Value added	Investments in TFA	Relatively Production of SMEs=100
Mining and quarrying	0.1	0.5	1.1	0.4	0.7	C	0.6	C
Manufacturing	12.4	34	33.1	21.5	42.2	33.0	26.0	97
Electricity, gas and water supply	0.1	0.2	1.5	0.7	0.4	0.9	1.7	453
Construction	4.3	7.9	6.0	5.8	12.0	8.9	7.1	113
Trade, repairing activities	55.2	35.2	27.0	60.1	22.0	33.4	32.1	95
Hotels and restaurants	9.8	7.9	11.6	1.9	3.0	4.8	9.5	61
Transport, warehousing and communications	7.5	6.0	7.8	5.2	10.6	C	10.6	C
Operations with real properties and business services	10.7	8.4	11.8	4.4	8.9	10.3	12.3	123

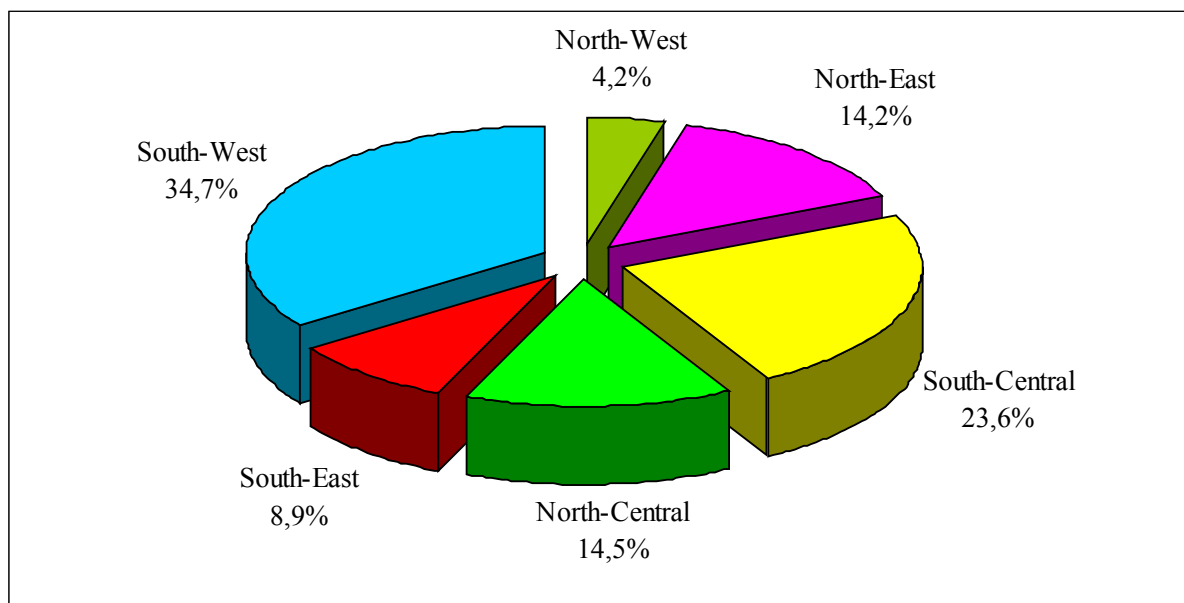
Source: "Annual report on the condition and development of SMEs in Bulgaria, 2004", Ministry of Economy and Energy

In regional aspect, the predominant class of enterprises (according to the number of employees) in a given planning region is the group with the highest contribution to the employment in the sector. The SMEs dominate as a whole in each of the planning regions with shares in the overall employment in the regions between 77.7% in the North Central Region and 81% in the North-East Region. Micro-enterprises are the prevailing component in each of the planning regions. The highest share of persons employed by micro-enterprises in the total number of persons employed in a given region is observed in the South-East Region (37.2 %), while the lowest but still predominant share is reported in the South-West region (28 %). The share of persons employed by small enterprises varies slightly between 22.6 % of the total number of employed - in the North Central Region, to 24.6 % - in the North-East Region. Medium-sized enterprises generate between 20.5 % of employment - in the South-

⁷ "Annual report on the condition and development of SMEs in Bulgaria, 2004", Ministry of Economy and Energy, p. 16

East Region, and 25.6 % - in the South-West Region. The figures indicate that micro-enterprises, irrespective of their location, generate the highest employment. However, their contribution in the value added is the lowest, i.e. the employment in the micro-enterprises has the lowest productivity when compared to the larger enterprises.

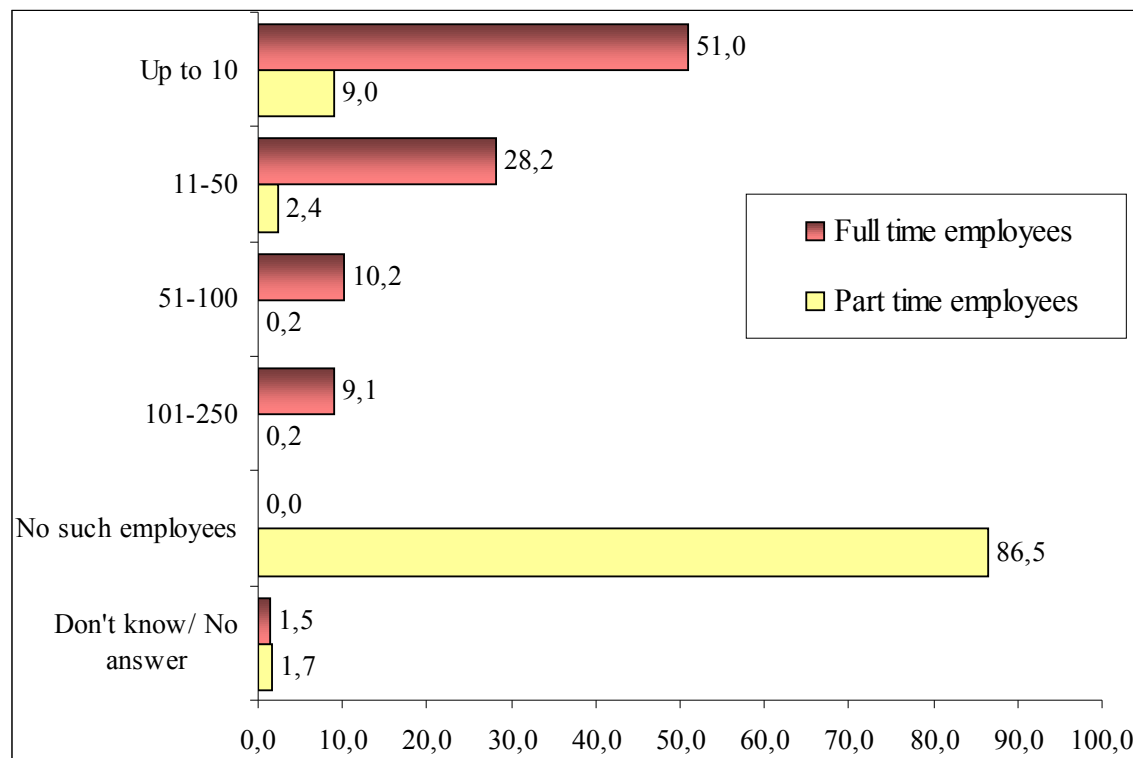
FIGURE 1. SHARE OF PERSONS EMPLOYED BY SMEs, BY PLANNING REGIONS, 2003



Source: “Annual report on the condition and development of SMEs in Bulgaria, 2004”, Ministry of Economy and Energy, p.55

The breakdown of companies in the present survey by the number of employees corresponds to the enterprise distribution data from the ‘Annual report on the condition and development of SMEs in Bulgaria, 2004’ indicating that micro-enterprises are 56.2%, the small enterprises are 24.3% and the medium-sized companies account for 18%.

FIGURE 2. BREAKDOWN OF SMEs INCLUDED IN THE QUANTITATIVE SURVEY ACCORDING TO THE NUMBER OF EMPLOYEES



Base N = 1011

According to the data on annual turnover, 62.6% of the companies that have presented the relevant information (72.1 % of the sample) generate annually up to 3 million BGN turnover, which ranks them in the number of micro-enterprises.

The data for Bulgaria in the recent years indicate that SMEs register an outpacing growth rate in productivity and generated added value when compared to the indicators for the economy as a whole. The real input of SMEs in the national gross domestic product has raised to 34 % in 2003 and in the gross value added it is respectively 43 %. The productivity growth rate for all SME groups is 5.9 %, which is higher than the productivity growth rate for the economy as a whole (4.7 %). The SMEs' fixed tangible assets (FTA) represent 56.6 % of the FTA of all companies in 2003. The share of SMEs in the overall turnover of 36 billion BGN, generated by all companies in Bulgaria in 2003, has reached 75.2%.

A number of international surveys report that SMEs as a whole are not appropriately represented in the global trade, although the internationalisation of their activities is continuously growing. The trends of the Bulgarian SMEs are similar with those of their European peers. According to OECD assessments, the SMEs account for 25 to 30% of the world export. The narrow domestic market forces the companies to access foreign markets at the very stage of their establishment while they still have limited volume of internal resources and almost no experience. The data for the BGN equivalence of the foreign currency income from export in the turnover of enterprises issuing balance sheets (i.e., 30 % of the micro-enterprises, 90 % of the small and 100 % of the medium-sized) come in support of that statement. For example, the income from export of the medium-sized enterprises with export activities represent 20 % of their total turnover, for the small enterprises the share is 7,8 %, while for the micro-enterprises it reaches 5.8%. The implementation of the European

definition for SMEs and the ongoing restructuring processes in the large enterprises create conditions to further increase their role in the foreign trade of the country.

The export-oriented SMEs are of prime importance for the future development of the economy. The SMEs that trade only through export form just 38 % of all exporters while the net importers account for a little bit over 70 % of the importers. The main barrier to the export orientation of SMEs is the lack of product certification and adjustment of their products to the quality requirements in Europe. The predominant part of SMEs trade both through export and import. Despite the fact that the contribution of SMEs in the export of the country is the highest, the export volumes realised by SMEs are almost twice smaller compared to the import volumes.

2.2. Characteristics of the policy for promotion of entrepreneurship and SMEs development in Bulgaria

The economic policy of the Bulgarian government is presented in the ‘National Plan for Economic Development, 2000 – 2006’ and aims at achieving sustainable low-inflation economic growth. It is a prerequisite to the increase of the income levels and to the improvement of the living standards from the perspective of the further integration in the European economic and social area. The industrial policy of the government is subordinated to the foremost goal of the economic policy and its main objectives are the completion of the privatisation and restructuring processes, the improvement of competitiveness and the development of SMEs.

According to the vision spelled out in the draft of the National Strategic Reference Framework (NSRF)⁸, towards 2013 Bulgaria has to become a country with considerably better quality of life, based on sustainable socio-economic development in the process of full integration in the European Union. To achieve this vision, it is necessary to implement the following strategic medium-term goals: the achievement and maintenance of high economic growth through a dynamic knowledge-based economy in accordance with the principles of sustainable development; the improvement of the quality of human capital and the achievement of employment, income and social integration levels, which provide for improved quality of life.

The targeted vision and strategic goals can be achieved through the following strategic priorities:

1. Enhancing the competitiveness of the Bulgarian economy;
2. Development of the human resources and improvement of the social infrastructure;
3. Improvement and development of the basic infrastructure;
4. Sustainable and balanced regional development;
5. Modernisation of the state administration and improvement of its services.

The ultimate goal of the activities foreseen in the NSRF strategy is the **improvement of the competitiveness of the Bulgarian enterprises** on the international markets by fostering the export orientation of their production. Since Bulgaria is a country with a small open economy, the increasing of export revenues is critical for maintaining sustainable economic growth.

Entrepreneurship is one of the main engines behind economic growth, competitiveness and innovation. A number of policy measures of the Council of Ministers of the Republic of Bulgaria have been elaborated to promote entrepreneurship and the development of small and

⁸ Draft of the National Strategic Reference Framework of the Republic of Bulgaria, for the programming period 2007 – 2013, Ministry of Finance, Sofia, 2006, p.33

medium-sized enterprises in line with the EU policies: ‘National Strategy for promoting the development of small and medium-sized enterprises for the period 2000 – 2006’ and Work Programme for its implementation; Decision for participation of the Republic of Bulgaria in the Multiannual programme (2001 – 2005) of the European Commission for Enterprise and Entrepreneurship Development; Innovation Strategy of the Republic of Bulgaria, etc. The Ministry of Economy and Energy launched the implementation of an array of programmes to support the small and medium-sized businesses in the period 2005 – 2007, which are realised with funds from the national budget, the National PHARE programme and other donors’ programmes.

1. The programme “Implementation of Quality Management Systems” aims to secure financial support for the efficient introduction and implementation of quality control systems in about 180 small and medium-sized enterprises, which have been selected on a competitive basis;

2. The programme “Establishment of operative and sustainable infrastructure on quality issues” is developing a strategy for improvement of the policy on quality. Both legislative measures and administration restructuring are envisaged aiming to ensure conformity with the applied European practices and standards.

3. The programme “Support and development of small and medium-sized enterprises and entrepreneurship” encompasses several projects aiming to increase the competitiveness of the companies, to simplify the legislative and administrative environment for business activity, to improve the access of small and medium-sized enterprises to information and services; to improve the entrepreneurial culture, to introduce the cluster model.

3.1. The project “Support for Increasing the Competitiveness of the Bulgarian enterprises” is focused on increasing the competitiveness of Bulgarian enterprises through bringing them in line with the requirements and standards of the European Union.

3.2. The project “Improving the entrepreneurial culture” or “How to build a successful business in Europe?” is aiming to raise the awareness on the European Union policies for small and medium-sized companies, on the outcomes of the negotiation process, on the opportunities and difficulties that the entrepreneurs shall face upon the accession of the country in the EU.

3.3. The project ‘Introduction of a cluster approach and the establishment of a cluster model’ aims at improving the competitiveness of the Bulgarian enterprises through the implementation of the cluster approach in the economy.

3.4. The programmes ‘Export stimulation’ and ‘Promotion of the export potential’ focus on the organised participation of small and medium-sized companies in specific international events, business forums in the country and abroad, specialised training for foreign-trade companies, support to the trade policy of Bulgarian companies on the foreign markets.

4. The programme “Supporting the establishment of small and medium-sized enterprises” encompasses two projects intended to support the entrepreneurs in starting a new business and to provide entrepreneurial training.

5. The programme “Promoting the introduction of energy-saving and environmental friendly technologies” provides, with the financial support of the PHARE programme, for the development of a national strategy and an action plan to establish the legal and economic framework to support the production sector in the process of harmonisation with the environmental legislation.

6. The project “Support to the Implementation of the National Innovation Strategy”

7. The project “Development of cluster initiatives – phase 2”

The main objective of the policies, programmes and projects is to prepare the Bulgarian enterprises to face the challenges stemming from the EU accession by promoting and cultivating entrepreneurial spirit for the development of efficient and competitive small and medium-sized businesses. The expected results in that respect are related to:

- Promoting the need for cultivating entrepreneurial spirit;
- Strengthening the links between the educational institutions and the business;
- Decrease of unemployment among young people graduating the secondary schools
- Application of working practices for successful business activity
- Development of a set of measures to raise the level of education, training and cultivation of entrepreneurial spirit;
- Development of operating framework for cultivation of entrepreneurial spirit, for education and training in entrepreneurship and/or for promoting entrepreneurship;

During the last years a number of initiatives and activities have been performed within the national policy framework for promotion of entrepreneurship and SMEs:

1. The simplification of the legislative and administrative environment is one of the key priorities of the Bulgarian government. Decision No 392/07.06.2002 of the Council of Ministers for repeal or simplification of 192 regulatory regimes is in the course of implementation. The recommendations related to 144 regimes have already been observed which represents 75% of all recommendations. The ‘Law on reducing the administrative regulation and the administrative control of business activity’ provides for the application of the tacit consent principle in the process of issuing registration certificates or permits for certain activities or transactions by the administration.

2. The implementation of the project ‘Establishment of competitive new companies’ (Project 100) started in March 2004. The project is executed by the Ministry of Economy with the support of the United Nations Development Programme (UNDP) as a component under the project ‘Job Opportunities through Business Support (JOBS)’. The project objective is the creation of a sustainable and competitive private sector by providing comprehensive and targeted support at the start-up stage and in the process of development of micro and small enterprises in Bulgaria in both production and services.

3. In order to promote the entrepreneurial spirit and to support the start up of own business, the Agency of Small and Medium-sized Enterprises (ASME) has developed and initiated jointly with the United States Agency for International Development (USAID) a project for the preparation of regional business reference books. The publications shall contain systematised information and professional advice on how to start up a business, on various national and regional programmes and projects in progress intended to support SMEs, emphasising on vocational training schools, universities and labour offices with the aim to encourage the entrepreneurial spirit and skills among young people.

4. The main objective of the project for global education in manufacturing GEM-EUROPE is to support the establishment of a new educational scheme for professionals for the industry by developing a new curriculum for a master’s degree, which shall cover both manufacturing technology and business knowledge and skills. The training modules are presented in three versions: Web-based training, distance learning and traditional education.

The Bulgarian government strives to ensure favourable legislative and administrative environment for providing on-line services to the business. The legislative framework is based on the adopted ‘e-Government’ Development Strategy’ (Council of Ministers’ decree No 866 from 28 December 2002), the Law on Electronic Document and Electronic Signature (State Gazette No 34 of 6 April 2001), the Law on Protection of Personal Data (State Gazette

No 1 of 4 January 2002). According to the ‘e-Government’ Development Strategy” the Tax Administration should provide four groups of online services.

The following can be listed among the good practices in the policy formulation in that area: the Review of regulatory regimes in 2002 (Council of Ministers’ decision No 392 from 7 June 2002), the Law on reducing the administrative regulation and the administrative control of business activity (in force since December 2003), the Law on electronic document and electronic signature (in force since October 2001), the Law amending the Law on foods (State Gazette, No. 55 of 2006), the Law amending the Law on SMEs (State Gazette, No. 59 of 2006), the Law on promotion of investments (in force since August 2004) and the reform initiated in 2003 in the tax and social-security administration that has led to the establishment of the National Revenue Agency.

The entrepreneurship training is an essential element of the policy for promoting the development of SMEs. The ‘European charter of small enterprises’ spells out that ‘General knowledge on business and entrepreneurship shall be taught at all educational levels at schools. The introduction of thematic business modules shall be a major element of the educational programmes in secondary schools, colleges and universities.’ In Bulgaria, the policy in the field of entrepreneurship education and building of entrepreneurial spirit is outlined in the ‘Human resources development strategy’ as well as in the measures and activities stipulated in the ‘National plan for employment’. The Law on vocational education and training of 1999 (as last amended in 2006), together with the Law on employment promotion and the Labour Code, are the main statutory acts establishing the legislative framework for joint actions in the field of vocational education and training and the labour market. This framework provides for the primary and on-going education as well as for re-qualification to meet the requirements of the labour market. The general framework of vocational education of the scholars in the system of public education institutions is outlined in the ‘Law on educational degrees, general educational minimum and educational plan’ adopted in 1999 (as last amended in 2004). The state educational requirement stipulates the terms and order for completion of a level of schooling and joining the next one as well as the characteristics of the general educational minimum and the syllabus for the various types of schools including for the vocational training schools.

Some of the concrete initiatives in the area of entrepreneurship education and training are: gaining economic knowledge and skills to develop entrepreneurship, the preparation and implementation of the ‘National educational strategy for integrating information and communication technologies in school education’.

Some conclusions on the status of the process on entrepreneurship education and training can be drawn on the basis of a survey accomplished by Vitosha Research⁹ in August-October 2005. As a whole, businesses assess positively vocational education, but the training and the knowledge gained by the students do not correspond to the business needs. The business requirements for the degree of qualification do not refer to the theoretical knowledge but to the practical skills mastered by the graduates. This conclusion applies to the whole system of secondary education. The bridging of that gap can be sought in three main lines: introduction of economic subjects in the educational curricula at all levels of secondary education; active co-operation between the business and the secondary education institutions; reorganisation of the educational process and its orientation towards the requirements of the labour market.

⁹ Project ‘Survey and analysis of the state of the process of cultivation, education and training of entrepreneurship in the secondary vocational schools in Bulgaria and Set of measures to improve the level of education, training and cultivation of entrepreneurial spirit. Analytical report on Phase I’, October 2005, Vitosha Research

2.3. Main principles and instruments of the EU policies for support of SMEs and improvement of their competitiveness

The EU actively supports successful entrepreneurship and aims to create public conditions and business environment for SMEs that shall enable them to meet the challenges of today's knowledge-based economy and to fully employ their potential. Today across the EU it is a generally recognised fact that SMEs play an important role in the employment, raising the competitiveness and the economic development. All EU member states take due measures to employ the potential of the small business by a series of initiatives. Under the conditions of rapidly changing economic environment, the coordination and coherence of these initiatives is a primary objective of the European Commission as well as subject to special policy applied not only to the Member States but to the transition economies as well.

Back in 1989, the Council of Ministers of the EU voted a resolution, which emphasised the importance of the measures in support of the small businesses, both on national and on European levels. A new Directorate General to deal mainly with the SMEs' issues of the EU policy (DG XXIII)¹⁰ has been established. At the moment, a number of structures exist under the framework of DG Enterprise which support the development of SMEs: the Special Envoy for SMEs who attends to the integration of the SMEs' interests in the EU policies and initiatives; the networks of Euro-info Centres and of the Innovation Relay Centres, which supply information to SMEs and provide them with opportunities for technology transfer and other services, etc.

The 'Integrated programme of the EU for SMEs and the craft sector' from 1994 is the first attempt to create a general framework for support of the small and medium-sized businesses. A new 'Integrated programme 1996' has been approved at the European Council meeting in Madrid in 1995. It did not replace the activities, initiated by the separate countries or at EU level, and covered three types of measures¹¹:

1. Measures to promote the mutual consultations between the member states and the joint coordination, if necessary, of the measures to the benefit of SMEs;
2. Measures for SMEs developed under other common policies;
3. Measures for SMEs, developed under the special EU policy for SMEs (Multiannual programme for SMEs)

Based on the fact that more than 99% of the 19 million enterprises in the EU are small and medium-sized, generating 66% of employment in the Union and performing 55% of the commodity exchange, the European Council adopted in June 2000 the 'European Charter for Small Enterprises'¹². It draws the attention of the European Commission and the EU member states to the initiation of activities for promotion and support of small enterprises in ten key areas:

1. Education and training in entrepreneurship;
2. Faster and cheaper business start up;
3. Better legislative environment and assessment of its impact on SMEs;

¹⁰ The Directorate-General XXIII (Enterprise Policy, Distributive Trades, Tourism and Co-operatives) <http://www.eu.int/comm/enterprise.htm>.

¹¹ See: 'Integrated Programme for Small and Medium-sized enterprises (SMEs) and the craft sector', Communication from the Commission, Brussels, 10.07.96, COM(96) 329 final; Main provisions of the policy and the integrated programme of the European Union for SMEs and the craft sector, Publication of the Commission of the EU, the Bulgarian Industrial Association, the PHARE programme, Project BG94-09.

¹² http://europa.eu.int/comm/enterprise/enterprise_policy/charter/index.htm

4. Improving the skills of entrepreneurs and creation of conditions for long-term and consistent education and advising;
5. Improving the access to electronic communication with the administration;
6. Increasing the benefits of the single market ;
7. Taxation and financial matters ;
8. Strengthening the technological capacity of small enterprises;
9. Implementation of successful e-business models;
10. Better representation of the small enterprises' interests at national level and at EU level.

To stimulate the progress in the field of entrepreneurship promotion, the European Commission has published a Green paper ‘Entrepreneurship in Europe’¹³. Its objective is to involve as many as possible public stakeholders in the formulation of the future agenda of the EU entrepreneurship policy. Based on an impressive volume of surveys, data, analyses and political experience, the Green paper raised ten questions related to two fundamental problems: “How to create more entrepreneurs?” and “How to provide for the growth of more companies?” As a result of the discussions, initiated by the Green paper, the European Council mandated the European Commission to develop an Entrepreneurship Action Plan.

An important instrument of the EU for promotion of entrepreneurship and SMEs is the Multiannual Programme of the European Union for Enterprise and Entrepreneurship Development for the period 2001 – 2005. This is the core programme of Directorate General ‘Enterprise’ of the European Commission, which has entered in force on 1 January 2001, and covers the following main areas: promoting entrepreneurship as a specific attitude of the individual; encouraging the creation of business environment that shall contribute to increasing the growth and competitiveness of the businesses in the globalised knowledge-based economy; providing better access for the businesses to the EU services, programmes and networks and improving their co-ordination; enhancing the financial environment of SMEs.

The framework programmes for research, technology development and demonstration encourage the participation of businesses in research and innovation projects. The launch of the Sixth Framework Programme¹⁴ has been announced on 12 November 2002. Its main goals are: increasing the share of investments (public and private) to 3 % of the gross domestic product; development of the human potential; promotion of innovation and research activities. The Sixth Framework Programme places special emphasis on the involvement of SMEs as they play a key role in raising the European competitiveness and job creation. In the new programming period 2007 – 2013, the European Commission will run a special Programme for Competitiveness and Innovation that shall focus on the creation of pro-innovative environment for the SMEs.

In 2005, the EU introduced ‘Think small first’ as its basic principle. That rule expresses the understanding that the requirements pertaining to SMEs can be observed as well by the large companies while the opposite is not always possible. It is well known that SMEs have rather more limited capacities than the large enterprises. That places them in a more difficult position and decreases their competitiveness when the overall environment (legislative, administrative, taxation) is not favourable enough for entrepreneurship development. In 2005, in response to the New Start of the Lisbon Strategy, the European Commission published a Communication on a new integrated approach for the EU policy on

¹³ Green Paper “Entrepreneurship in Europe”, European Commission, COM (2003) 27 final, 21.01.2003.

¹⁴ The 6th Framework Programme EC programme: OJ L 232, 29.08.2002, pp. 1-33, <http://www.cordis.lu/fp6/find-doc.htm>

SMEs, which shall be guiding the activities of the Member States in the following years¹⁵. According to the Communication, the main areas of action of the EU policy on SMEs shall be:

- Promoting entrepreneurship and human skills;
- Improving SMEs' access to markets;
- Cutting the red tape, faced by SMEs;
- Improving SMEs' growth potential;
- Strengthening the dialogue and consultation with SME representatives

III. ASSESSMENT OF THE CURRENT STATE, THE NEEDS AND THE PROBLEMS OF SMES

3.1. Requirements to the business, Stemming from the membership of Bulgaria in the EU

In order to be competitive to the European companies, the Bulgarian ones should meet a series of requirements related to the quality and safety of goods, introduction of new technologies, environment protection, safety at work, investment in efficient marketing strategies, etc. The technical specifications refer not only to the respective product and its components, but also to the certification requirements (especially, in relation to foodstuffs), packaging and its compatibility with the product, the methods of analysis and testing, marking and labelling, etc. When Bulgaria joins the EU, the European requirements shall become mandatory for each industry, both for the export goods and the goods for the domestic market, which shall become part of the internal European market. The adherence to the specifications and requirements should be effected even before the actual accession of the country to the European Union.

According to the survey outcomes, 27% of SMEs on the average are not familiar with the requirements of the CE-marking, environmental protection, quality management, the internal organisation of production, working conditions and occupational safety. The requirements of the occupational safety conditions are best known (31.7%) while the enterprises are least aware of the requirements of the CE-marking.

TABLE 4. LEVEL OF AWARENESS ON THE REQUIREMENTS WHICH COMPANIES SHOULD OBSERVE AFTER THE ACCESSION OF BULGARIA TO THE EU

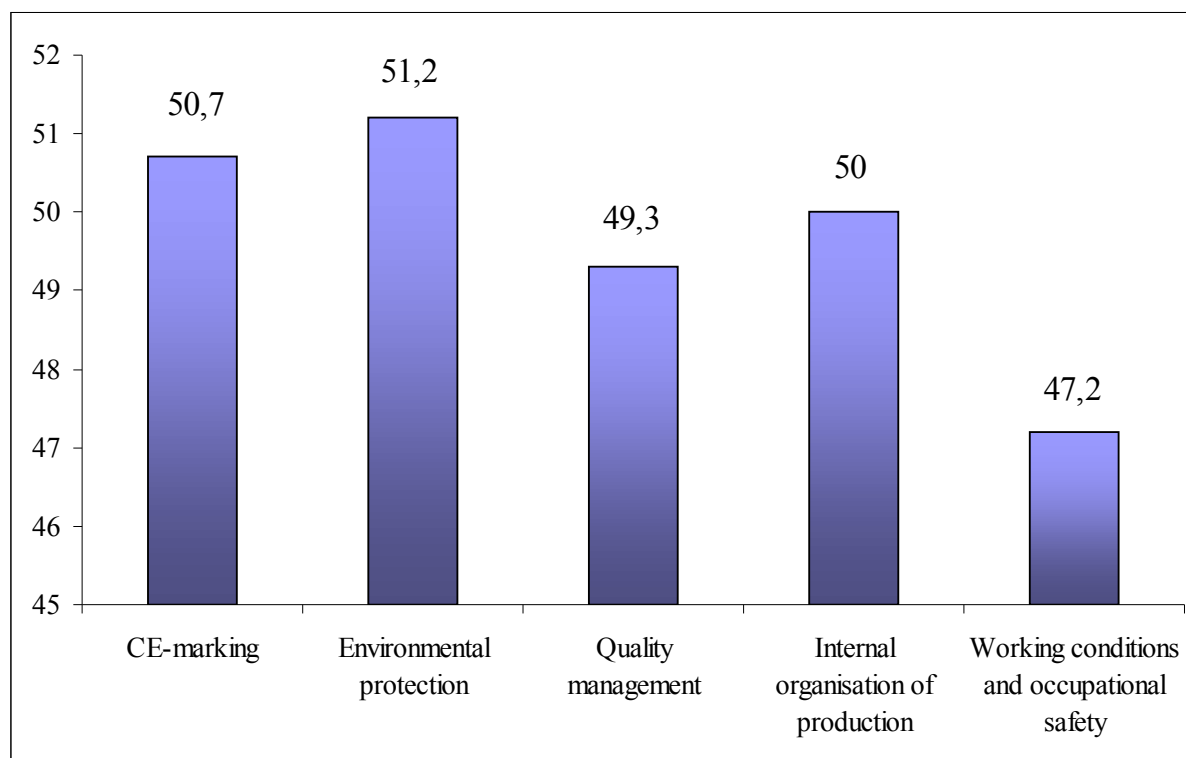
	Informed	Rather informed	Rather not informed	Not informed	Does not refer to the company	DK/NA
CE-marking	14.6	17.1	15.4	14.3	34.9	3.6
Environmental protection	19.6	29.1	16.5	11.8	18.8	4.3
Quality management	21.9	29.0	17.1	10.1	18.5	3.5
Internal organisation of production	19.8	25.0	17.9	10.2	23.7	3.4
Working conditions and occupational safety	31.7	34.9	12.8	9.2	8.3	3.2

Base N=1011

¹⁵ Commission Communication "Implementing the Community Lisbon Programme - Modern SME Policy for Growth and Employment" (COM (2005)551 final of 10.11.2005)

One out of two companies is not aware of the deadlines for introducing particular requirements, which is a clear indication that they are not likely to be observed.

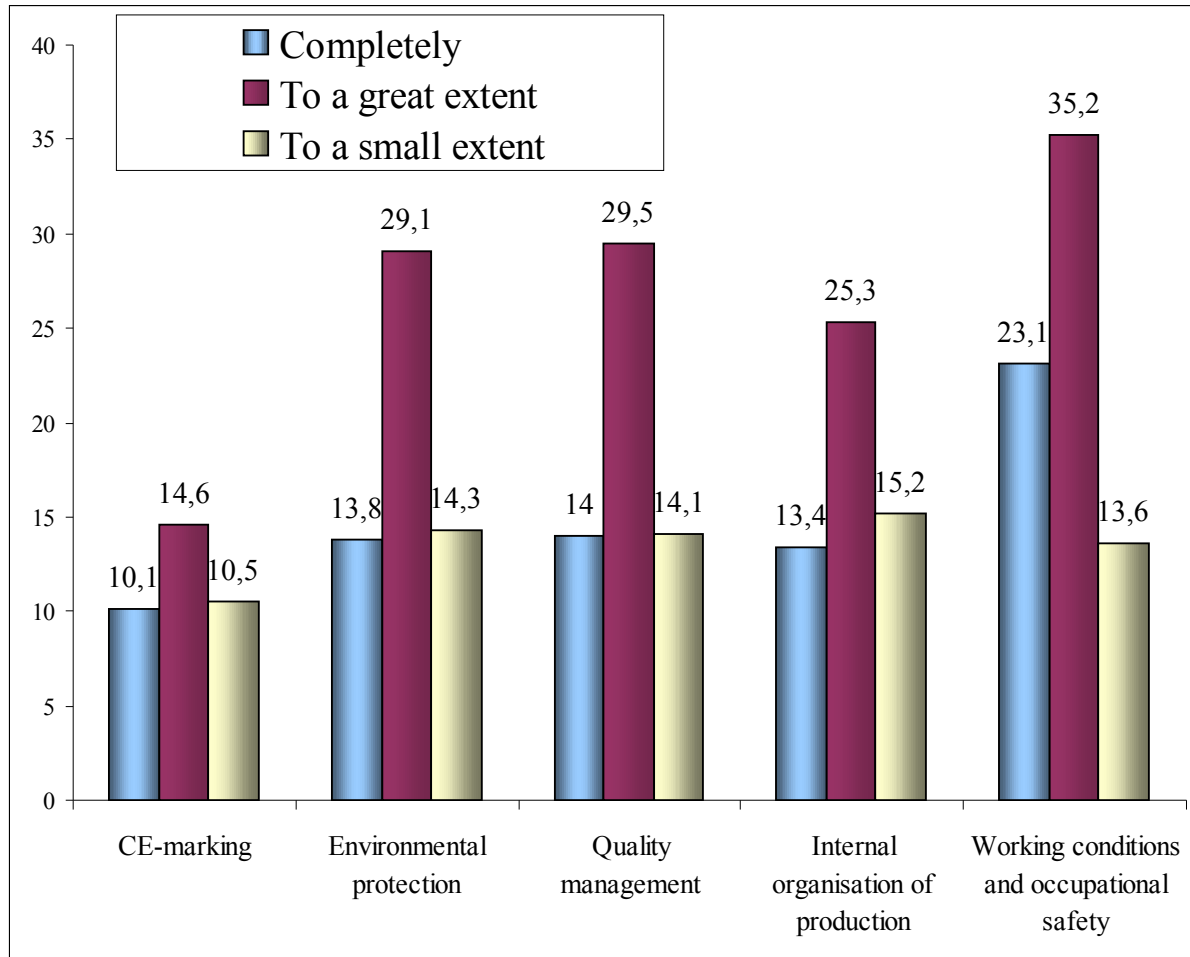
FIGURE 3. PERCENTAGE OF SMEs WHICH ARE NOT AWARE OF THE DEADLINES FOR INTRODUCING THE EU REQUIREMENTS



Base N=1011

Figure 4 presents the level to which the surveyed companies meet the European requirements of the CE-marking, environmental protection, quality management, internal organisation of production, working conditions and occupational safety. According to the self-assessment of the respondents, 10 to 23 % of the surveyed companies cover in full the European requirements in the various fields. The results indicate the relatively low readiness of the Bulgarian SMEs to fulfil the EU requirements in these directions.

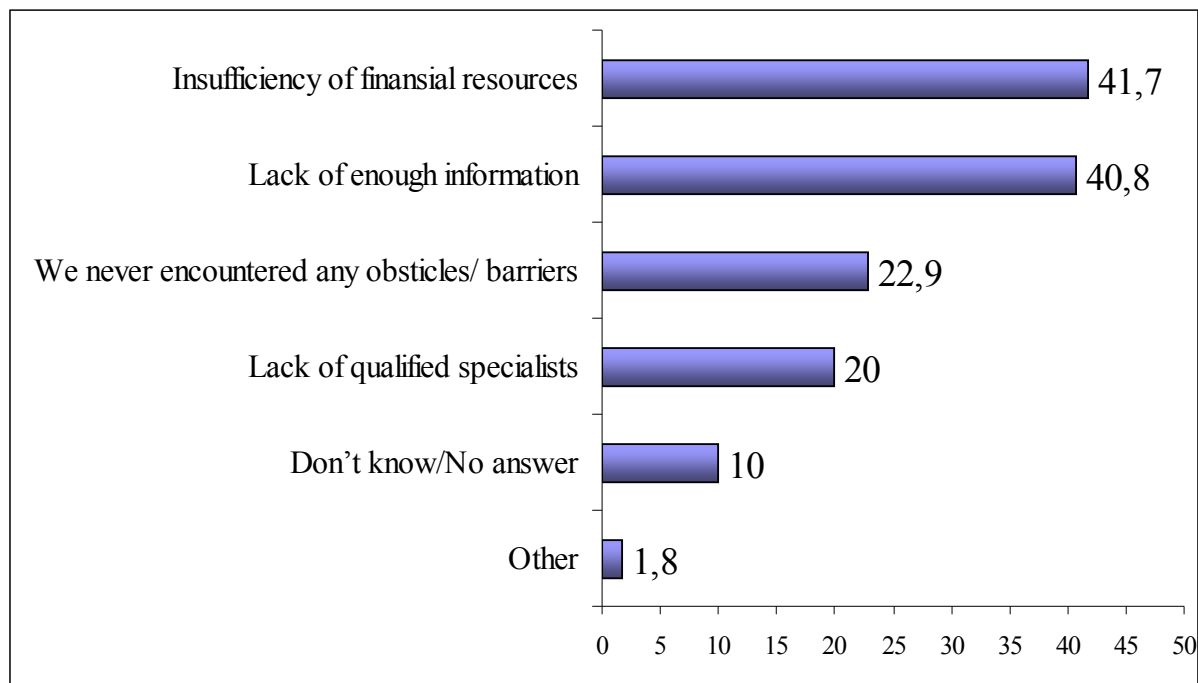
FIGURE 4. LEVEL OF FULFILMENT OF THE EUROPEAN REQUIREMENTS



Base N=1011

The survey reveals that the SMEs, which have not observed the European requirements, have faced various constraints, among them the shortage of financial resources, insufficient information, lack of qualified staff, etc. One out of five companies has not confronted any difficulties.

FIGURE 5. MAIN BARRIERS TO FULFILMENT OF THE EUROPEAN REQUIREMENTS BY THE BULGARIAN SMEs



Base N=1011

The detailed technical specification and description of the testing methods in the directives, as well as the practice to adopt a framework directive for each sector, together with its accompanying directives for the separate groups of products, cause a series of problems and result in delay in their adoption. Thus, with the EU directive for a New Approach to technical harmonisation and standardisation of 1985 a transition was made towards a more general formulation of the main requirements for the safety of goods, laid down in the 'New Approach' directives. The detailed technical specifications for the products, as per the 'New Approach' directives, are prescribed in the European harmonized standards. The objective is the complete harmonisation of national standards. An important step towards the achievement of this goal is the decision to transpose the European standards into national standards in all EU member states with no amendments, whereas the national standards inconsistent with the European ones are to be repealed. So far, 12 of the 'New Approach' directives have been transposed in the Bulgarian legislation: appliances burning gaseous fuels, construction products, machinery, recreational craft, safety of toys, lifts, simple pressure vessels, explosives for civil uses, low-voltage electrical equipment, equipment and protective systems intended for use in potentially explosive atmospheres, personal protective equipment. These directives do not provide particular technical specifications since the latter are described in the European harmonized standards.

Before marketing a given product, an assessment of its conformity to the requirements of the European standards is done. Eight basic modules for conformity assessment are applied, which have also specified variants: internal control of production, type-examination, conformity to type, production quality assurance, product quality assurance, product verification, unit verification, full quality assurance. The procedures for mutual recognition of conformity shall enter in force with the accession of the country to the EU or are applied before the accession by virtue of concluded agreements.

An indication that the product has undergone conformity assessment is the CE conformity marking. It is marked on the product or its packaging by the manufacturer or by the importer. The CE-marking indicates that the product conforms to the essential requirements of the respective directive and it has passed the necessary conformity assessment procedures. According to the results of the quantitative survey, 14.6 % of the companies are fully acquainted with the requirements for the CE-marking, 15.5 % of them know the deadlines and 10.1 % already qualify to the European requirements. Totally unaware of the requirements are 14.3 % of SMEs, 50.7 % of them are not familiar with the deadlines and 4.9 % are not prepared at all to cover the requirements.

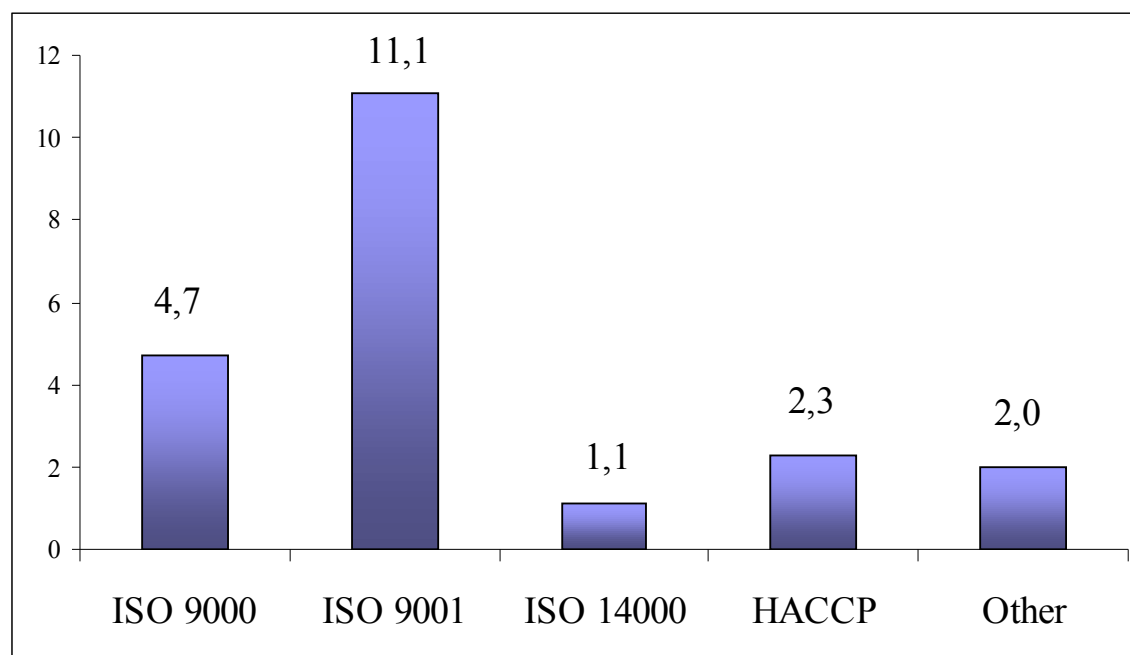
The requirements of the European legislation to foodstuffs are exceptionally strict, great attention being paid to the requirements applicable to the safety and hygiene of foods. They are stipulated in a number of directives.

- **Directive 91/493/EEC**, laying down the veterinary and sanitary requirements for the production and the marketing of fishery products, has been transposed in the Bulgarian legislation by Regulation No. 10 (State Gazette, No. 42 of 2002)

- **Directive 93/43/EEC** (transposed in the Bulgarian legislation by Regulation No. 7 / State Gazette, No. 40 of 2002) stipulates the general rules of hygiene for foodstuffs and the procedures of verifying the compliance with these rules, considers all measures necessary to ensure the safety and usefulness of foodstuffs at all stages of their production and refers to the preparation, processing, manufacturing, packaging, storing, transportation, distribution, handling and sales of the goods.

Subject to that directive, the foodstuffs manufacturers are obliged to apply the principles of the method HACCP (Hazard Analysis and Critical Control Points), through the implementation of which the safety and quality of foodstuffs is ensured. According to the conducted study, the share of the Bulgarian companies with ISO certificates is small and only 2.3 % of the sampled SMEs have HACCP.

FIGURE 6. CERTIFICATES POSSESSED BY BULGARIAN SMEs (IN PERCENTAGE)



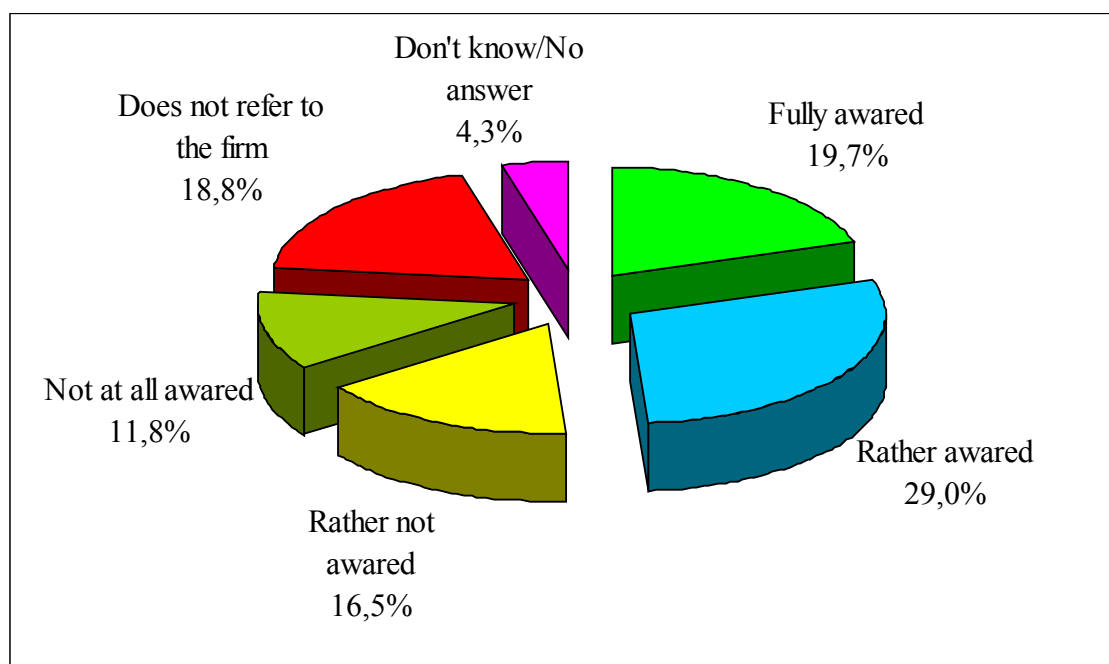
Base N=1011

Several regulations have been adopted with respect to the food safety laying down the requirements for labelling, food additives, packaging materials, hygiene, radiation, etc. The activities of the institutions entrusted with the fulfilment of these requirements are subdivided into technical regulation, standardisation, accreditation, certification and control of the market. The institutions working in that area are the Bulgarian Institute for Standardisation, the Executive Agency for Certification and Testing at the Ministry of Economy and Energy, the State Agency for Metrology and Technical Surveillance, the National Veterinary Service, a network of independent laboratories, certification bodies and control offices. Consumer protection organisations are also engaged in the control activities. However, the European Commission has recommended strengthening the co-ordination between all institutions involved in the overall metrological, veterinary and hygiene and epidemiologic control.

The EU requirements to the manufacturing processes with respect to environmental protection are also very strict. The Bulgarian entrepreneurs should be prepared to undertake the costs of fulfilling those requirements. The companies which have invested in ecologically clean production shall be more competitive on the European market. When conforming to the EU requirements for environmental protection, the products are distinguished by their eco-labelling. The eco-label or eco-mark of the EU is awarded to products and services with minimised impact on environment. The eco-labels are a modern marketing instrument of various products and services. It is expected that their implementation and efficiency shall grow significantly in the next years.

According to data from the survey, 19.8 % of the surveyed are fully acquainted with the environmental protection requirements and 29.1 % of them are informed to some extent, i.e. every second company has some information about the requirements it should observe after the accession of Bulgaria to the EU with respect to environmental protection. Almost one fifth of the surveyed (18.7 %) consider that these requirements do not apply to them.

FIGURE 7. LEVEL OF AWARENESS OF SMEs ON THE ENVIRONMENTAL REQUIREMENTS



Base N=1011

In 2003 the Law on waste management has been adopted, subject to which the manufacturers should assume a series of obligations. In order to reduce the burden on

entrepreneurs, Bulgaria has foreseen transitional periods in some areas, for example for the utilisation of packaging waste – up to 2007, for recycling of plastic packaging – up to 2009, as well as in the sectors of air quality, water management, industrial pollution control. The legislation on occupational safety has been harmonized with the European legislation.

With the accession of Bulgaria to the EU, the labour market shall gradually open as well. The Bulgarian workers shall benefit from the possibility to be employed in any country of the EU Member States, and the Bulgarian entrepreneurs shall be in a position to attract foreign staff in their teams. The mobility of workers shall influence positively the development of the Bulgarian business. It shall present broader opportunities both to employers and to work seekers. The free movement of workers imposes also the application of the harmonized EU standards for working conditions, duration of working time, protection of the interests of employees, etc.

The elaboration of a long-term strategy for raising the level of occupational safety in the Bulgarian enterprises shall be a key factor for improving their efficiency and competitiveness. The companies should plan additional resources for equipment renewal, to ensure health and safety at work, safety signs, medical care and services, training on health and safety at work, etc.

The Law on health and safety at work came in force in our country in 1998, but with a 6-year grace period, which expired on 1 January 2004. During this period, the companies had to bring their activity in line with the law, to invest in the improvement of working conditions, in equipment replacement, in medical service, in education on health and safety at work. The survey indicates that 31.7% of small and medium-sized companies know in detail the requirements for health and safety at work, and 34.9% are partly acquainted with them, which is a relatively good indicator for the level of awareness about this group of requirements.

The relationships ‘employer – employee’ are strictly regulated in the EU. In Bulgaria, a number of amendments of the Labour Code have been adopted in terms of matching the EU requirements in that area with regard to the flexibility in filling in vacant full-time and part-time jobs and positions, specifying the information that shall be contained in the labour agreement, fixing the maximum duration of the working week at 48 hours and the minimum duration of the weekly rest at 24 hours, etc.

The accession of Bulgaria to the EU single market imposes some changes in the relationships of the Bulgarian companies with their trade partners from the EU and from third countries. As of the date of accession to the EU, Bulgaria shall start to apply the Common commercial policy of the EU. This means: adoption of the Community Customs Tariff; implementation of the Generalised system of preferences; application of the EU preferential agreements with third countries. Bulgarian entrepreneurs shall have free access to the single market of the EU and to the markets of third countries with which EU has concluded trade and customs union agreements, i.e. the Mediterranean states.

With its accession to the EU Bulgaria becomes part of the so called Customs Union of the Community. Under the Customs Union no customs duties are collected in the commodity exchange between member states and a Common Customs Tariff is applied in the trade with countries outside the EU. Bulgaria has fully liberalized the trade with industrial goods with the EU and, since 1 June 2003, the new agreements with the European Union on the trade with agricultural goods are in force. Bulgaria imports in the EU, at zero customs duties, unlimited quantities of meat and foodstuffs, prepared from sheep and goat meat and milk; dried eggs; honey; fresh mushrooms; provisionally preserved mushrooms; peppers; vegetable mixtures; dried mushrooms; almonds; fresh blackthorns, raspberries, black currants and blueberries; chilled strawberries, raspberries, blackberries and black currants; plum moos; roast peanuts and other kernels. No customs duties are collected, under the system of quotas, for the import

in the EU of cereals – wheat, maize, oats, barley; fresh, chilled and preserved fruits and vegetables; sunflower oil; tobaccos; yoghurt, cheese and curds. Subject to the EU requirements, the customs duties for import of fruits and vegetables are determined on the principle of entry price. Thus, the price levelling achieved on the market provides the consumers to choose based on the quality of the products.

To facilitate the business activity, the EU applies a **single payment scheme and measures to combat financial fraud and abuse**. With the accession of Bulgaria to the EU, the Bulgarian entrepreneurs should abide to the EU uniform rules for internal and cross-border transfers and payments; issue and use of debit and credit cards; trade with securities. The availability of a common payment system and single currency for commercial payments contribute to the more efficient business activity and provide higher protection against currency risk. With their inclusion in the EU free capital market, the Bulgarian companies shall have greater possibilities to invest in more business projects within the EU. The opening of the market shall also increase the opportunities for foreign investments in the Bulgarian enterprises.

Most of the managers and owners of SMEs surveyed via the qualitative methods (discussions in focus groups) share that they are not acquainted with the European requirements pertinent to their field of business activity; others have obtained information from colleagues from the new Member States. They consider the requirements of the Bulgarian institutions towards companies as excessively high, but despite all they strive to observe them (hygiene and epidemiologic control, restaurant business, construction). SMEs underline as a point of discord that the institutions use the anticipated membership of our country in the EU as a pretext to lay high requirements to companies. Through other channels (personal contacts with EU companies, relatives residing in EU member states), the enterprises learn that such requirements are not mandatory in Europe (for example, for the hotel and restaurant businesses). In the opinion of the SMEs' owners and managers included in the qualitative survey, although they lack specific information, they are prepared to qualify to the EU requirements because even now they meet the high Bulgarian standards. An example revealed is the construction industry where *'the standards mandated in Bulgaria are in many aspects higher than the European'* (owner of a medium-sized enterprise). Some SMEs employ experts on a contractual basis (for example, in the manufacturing industries), who keep track of the introduction of new requirements and inform the company management about them. And yet, the micro-enterprise owners express the highest degree of fear that they would not cope with the introduction of the European requirements in their businesses whereas the fears crop up mainly from the low awareness.

The representatives of employers' organisations also consider that companies are not well acquainted with the integral European Union business-oriented policy. However, the same is true for the new enterprises in the member states. Through various types of consultations with the business it becomes possible for the companies, on the one hand, to get acquainted with the European policy and, on the other hand, to directly participate in its formulation. Both employers and the consultancy businesses consider the trend of companies' growing activity towards acquainting with EU requirements and rules applicable to SMEs. More and more managers turn to consultancy agencies either to get information on new EU requirements or to get help for preparing respective plans for development of future companies' activities. The consultancy agencies report an ongoing increase in the number of companies that have obtained ISO certificates or certificates for other standards. The focus of companies on their day-to-day survival, the lack of knowledge of foreign languages and the company size (the majority are small and micro-enterprises) are considered the major reasons for their low awareness. "External" reasons for the weak readiness of SMEs to respond to the

European requirements are considered to be the following: the companies have not been duly and timely informed and the information has not been made available in a tangible and comprehensive manner.

Box 1. REQUIREMENTS TO THE BUSINESS RESULTING FROM THE EU MEMBERSHIP OF BULGARIA – OPINIONS OF PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“Yes, the purely Bulgarian requirements, but the EU is used only as a pretext, so we are already sick with the EU” (manager of a medium-sized company)*
- *“I don’t know such a thing. I shall change, as I already said, but this is my own decision, not that I need to bear in mind some EU.” (manager of a small company)*
- *“The bigger problem is that there are firms and firms’ managers, who think that these requirements have nothing to do with them. They shall either stoop and the requirements shall pass above or say ‘Why should I dwell 2 years ahead, if I don’t know where the salaries shall come from within 2 months’, etc. It is very probable to face problems with the survival of these companies and a temporary increase in unemployment may happen, but then such companies are more or less working in the grey sector of economy” (employers’ organization)*
- *“They (the businessmen) go dumbfounded at seeing such a thing, this information, or even fully plastered...they simply don’t know where to start from and how to start.” (consultancy agency)*
- *“In that respect the business, according to me, is not at all ready, it has no real idea what might happen, especially the small and medium-sized enterprises. I have been recently at a meeting of enterprises from the meat-processing industry. They simply could not believe at all that they shall be closed on 1st January 2007 if they have not accepted the ISO system. They think: ‘Ah, no, this cannot happen, they shall simply vault over us. They shall change the framework. It is not possible the whole of Bulgaria to meet these requirements.’ Simply put, the general thinking is that they shall again pass dry between the raindrops, but this surely shall not happen.” (consultancy agency)*

The representatives of employer organisations consider that the main challenges before the SMEs’ readiness to participate in the common European market are the different scale of thinking, of work, of organisation, the strong competitive pressure on companies, the additional investments needed to implement the European requirements, which impose a completely different mode of investment and business planning of the companies’ activities. This calls for a new type of entrepreneurial behaviour, including the application of the principles of corporate social responsibility. Another challenge is the attraction of qualified work force and especially of young highly-qualified specialists. The strong business impulse for survival, of small and micro-enterprises in particular, to safeguard the opportunity to make for the living of the family, is the main driver *‘everybody to be ready to use one’s best endeavours’ (employers organisation)*.

The level to which SMEs respond at present to the European requirements towards the business is assessed as low by all participants in the qualitative survey. These requirements have been met to the best by companies, which have participated or have had access to European programmes, from the agricultural and food, drinks and tobacco industries.

With respect to the capacities of companies to secure the necessary funding to cover the EU requirements, the representatives of employers’ organisations share the opinion that *‘every company, even if not prepared as a whole, shall find internal mechanisms to reveal such capacities’*.

Box 2. REQUIREMENTS TO THE BUSINESS RESULTING FROM THE EU MEMBERSHIP OF BULGARIA – OPINIONS OF PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“It is most important that firms continuously, during the last year, make efforts, they themselves display activity to get acquainted with the requirements of the European Union, with its rules, which is very important, but this is only the first stage” (employers’ organization)*
- *“There are lots of people who go around, show interest and they certainly shall not wait 1 January to fulfil the requirements, which they know that should be fulfilled by them” (consultancy agency)*
- *“After 1st January the business shall realise by its own that there are things which can and which cannot go on in the same way and the ”natural selection” shall be very serious and very strong and shall throw overboard those who are not prepared.” (consultancy agency)*

3.2. SME Competitiveness

It was the opinion of those covered by the qualitative survey that there already exist SMEs and products in Bulgaria that are competitive to the companies and goods in the European markets. It was recognized that an increasing number of Bulgarian companies offer and maintain constant quality of their products. Overall, however, the representatives of the banks and the employers’ organizations deem limited the capability of SMEs to withstand, with their end products, the competitive pressure from the European producers. Most SMEs are thus expected to encounter difficulties in keeping their positions in the Bulgarian market and/or launching their product in European/world markets. In this respect, what they still rely on is the competitive advantage provided by the low cost of labour in this country. This advantage is expected to remain in effect even after our accession but not for long. One banking specialist noted the limited capability of Bulgarian business to take on activities based on economy of scale in view of the essentially limited scale of the operations of Bulgarian business and of SMEs in particular.

“And the only thing that holds up Bulgaria, both in the apparel industry and the manufacture of various components, is the fact that if a company needs, say ten units, it had better order them in Bulgaria. But if it needs ten thousand units it is sure to buy them from China because it would get a lower price and higher quality.” (Banker)

Nevertheless, noted as strengths of SMEs as opposed to their European competitors were the adaptability and flexibility of Bulgarian companies and the enterprising nature of Bulgarians.

Box 3. SME COMPETITIVENESS – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“It is wrong to say all products in a given sector are competitive or this or that sector has excellent prospects while another one doesn’t. There are good and bad products in each sector. And this division that is going on at the Ministry of the Economy, where they’re trying to distinguish certain sectors or industries, or even groups of products, could affect negatively the Competitiveness Operational Programme and the acquisition of funds under this program.” (employers’ organization)*

Box 3. SME COMPETITIVENESS – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY (CONTINUED)

- *“Regarding clusterisation, there has been a certain delay. It is still not a common practice for companies to join together. And that’s one of the possibilities for small companies to withstand the pressure from the competition and enhance their own competitiveness.” (employers’ organization)*
- *“But then we do have some advantages- the smaller ones are more flexible, they’re faster, with fewer resources but higher speed and at higher speed, as we say here, it is not the big fish that eats the small one, but the fastest one. So that’s our chance. But if we are to do it we need to be very well informed because the fast fish needs information in order to make the most of its advantage – speed – and thus outdo the bigger ones.” (consultancy organization)*
- *“They just come here for the cheap labour. And my biggest concern is that after the accession they will continue to relocate their production to Bulgaria. My impression is that they intend to come, at least this particular company I work with, and they would come for the sole reason of cheap labour: high quality, cheap labour, and the big profit go to them.” (owner of medium-sized company)*
- *“Let me immediately cite in example apparel. There are clothes-making companies working on commission that will very soon cease to be competitive in the market and there are companies manufacturing under their own brands, developing client networks – those are the companies with a future.” (employers’ organization)*
- *“They can already smell the heavy competition and they are motivated and will do it. I don’t know how but they will, they have the ambition. And as for the small ones, here the division is particularly ruthless, the dividing line between small and medium is really deep – whether the small ones are doomed I can’t say but what I do know is that the medium ones have a chance to resist the pressure from the competition by various means, honest means. I have no idea about the small ones, though.” (consultancy organization)*

In the present analysis the level of competitiveness of Bulgarian small and medium-sized business is viewed as determined by four basic components:

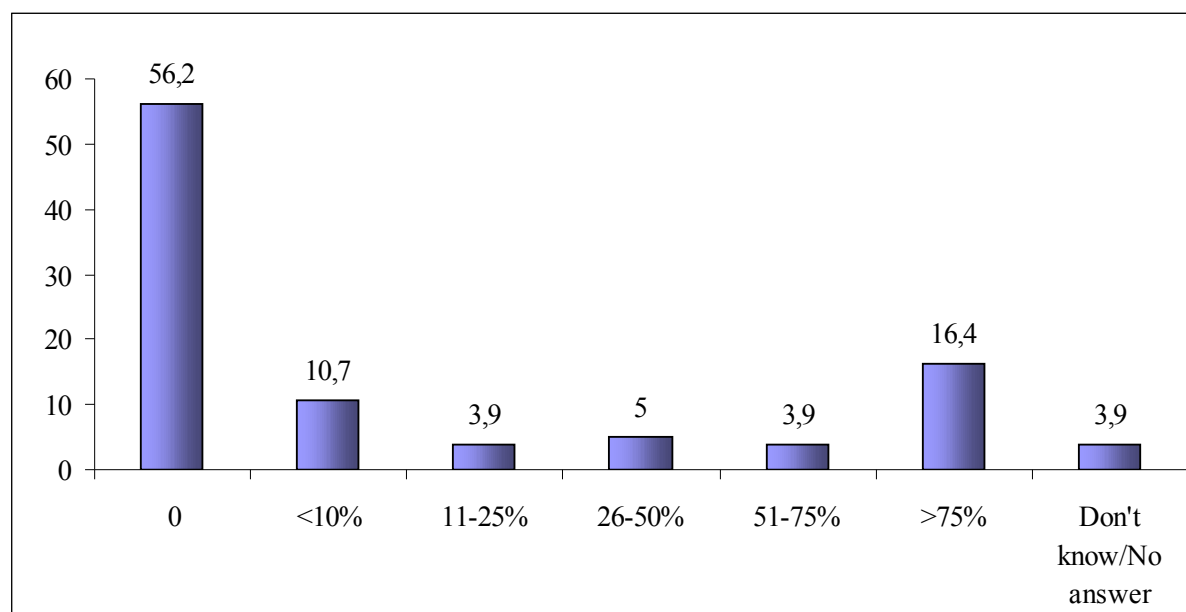
- a. Export activity and degree of exposure of SMEs to external competitive pressure;
- b. State of production technologies;
- c. Available human capital;
- d. SME readiness to meet the European product standards.

3.2.1. Export activity and degree of exposure of SMEs to external competitive pressure

The quantitative survey of Bulgarian small business shows that it is still largely a passive observer of developments in the international markets. Its participation in international market competition remains limited. Barely 17.5% of those who fell within the representative sample have sold some part of their output abroad in the past year, with fewer than 7% of all respondents having a marked export orientation (i.e., exports account for more than half of their annual turnover). The reason for the strongly pronounced local profile of Bulgarian SMEs is above all the large share of trade, services, and construction. About two-thirds of Bulgarian SMEs operate in these typically domestic spheres.

If we consider only manufacturing the export potential of small business appears more promising. The relative share of exporters in this sector is about 40%, with more than half having a share of exports exceeding 50%.

FIGURE 8. DISTRIBUTION OF COMPANIES IN MANUFACTURING INDUSTRY BY SHARE OF EXPORTS IN THEIR TURNOVER (%)



Base N = 281

The quantitative survey shows a clearly pronounced differentiation among export companies: to about 27% of them exports make up an insignificant, rather incidental, share, while more than 40% export in excess of 75% of their output. Most of the companies producing predominantly (more than 50%) for foreign markets, however, were established more than 11 years ago, many even before 1990. Thus, for instance, 53.4% of the companies exporting between 50 and 75% of their output have been in the business for more than 11 years. Among those exporting more than 75% of their output, the respective proportion is 56.4%. There are very few successful exporters among the relatively younger companies in the market (established in the past 5 years).

TABLE 5. SHARE OF EXPORTS IN THE ANNUAL TURNOVER OF SMEs BY NUMBER OF ACTIVE YEARS IN THEIR CURRENT BUSINESS (%)

Export share in the turnover 2005	Total number active years in current business			
	1-5	6-10	11-16	> 16
Up to 10%	15.4	34.6	23.1	25.0
Between 11 and 25%	12.0	32.0	32.0	24.0
Between 26 and 50%	20.0	33.3	33.3	13.3
Between 51 and 75%	6.7	40.0	26.7	26.7
Over 75%	10.9	30.9	38.2	18.2
Don't have export activities	23.3	31.6	31.0	13.0

Base N = 1011

A good indicator of the prospects of new exporters regarding **foreign market** penetration is the participation in fairs and exhibitions. In excess of 85% of the companies

have not taken part in such events in the past three years, i.e. only one out of seven companies has some kind of experience with this type of promotion of its products in foreign markets.

As regards the Bulgarian market, external competitive pressure is weakly pronounced. To nearly 90% of the respondents the chief competition comes from Bulgarian companies. Barely 6.8% cited imported products, and 4.6%, foreign companies, as their chief competitors. A relatively small number are exposed to competitive pressure from national monopolies (1.7%) or oligopoly structures (11.9%). For two-thirds of the respondents, the main competitors are the numerous local companies and the chief threat in the market is not so much external competition but the unfair competition in the domestic market. About two-thirds of the respondents defined it as a significant or big threat, making it the top threat to small and medium-sized business. Unfair competition refers to all of the injustices that Bulgarian companies are confronted with in the market. These typically involve inequitable application of the law or corruption-related preferential treatment of some at the expense of others by the respective authorities.

There is an immediate connection between the insufficient external competition and the unfair competition in the Bulgarian market. On the one hand, it is precisely the unfair competition and the ambiguous rules of the game that drive away foreign investors. Owing to their stricter accounting standards, internal reporting systems and adherence to the European standards, foreign companies stand smaller chances against Bulgarian ones unless the rules of the game are clear-cut and equal for all. Naturally, this does not apply to all foreign investors. Some are offshore companies of Bulgarian citizens with little or no experience in the European markets. Others have turned to Bulgaria precisely to make excessive profits from the cheap labour and the weaknesses in the enforcement of environmental and labour regulations. In this sense, there is reason to claim that the genuine foreign competitors of the domestic companies in the Bulgarian market are still few in number. There are few sectors (the milk-processing industry, for example) where a foreign investor directly competes with domestic producers. In most others, (e.g. the brewing industry), Bulgarian small business takes on sub supplies, wholesale or retail and does not compete directly with the big foreign producers. In the sewing industry, on the other hand, a large number of the foreign companies work on commission, i.e. they do not compete with the local companies in the Bulgarian market. In sum, the competition between foreign and Bulgarian business in the domestic market still takes place on two separate tracks.

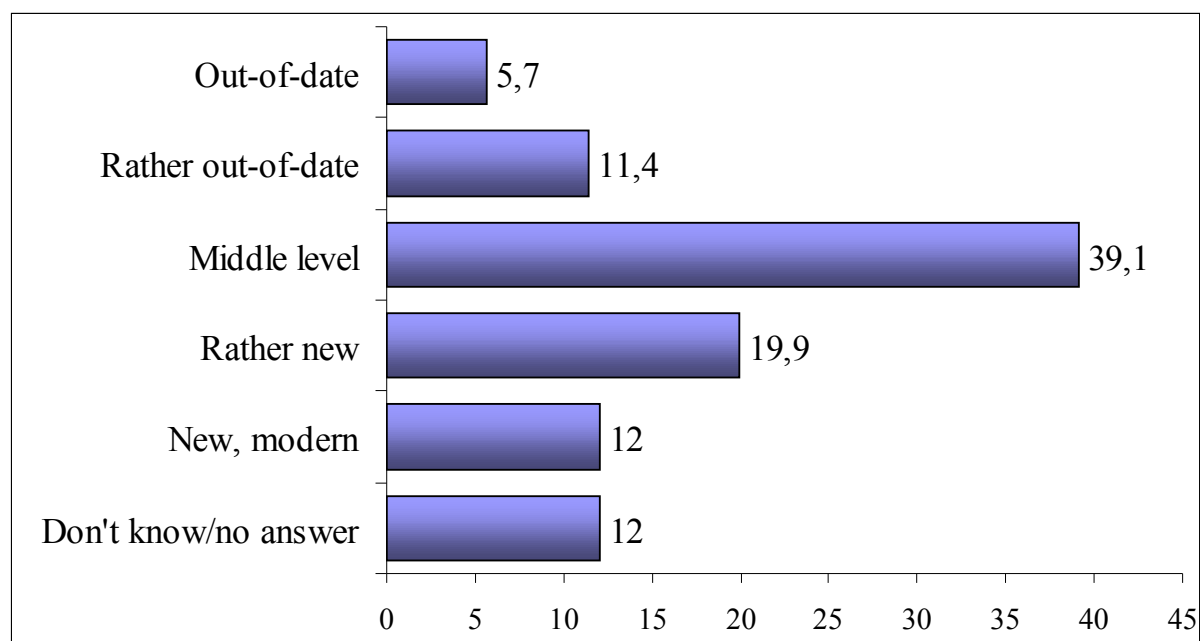
The relatively limited exposure of small business to external competitive pressure is one of the explanations for the registered high optimism regarding its prospects in the common European market. About 41% of those interviewed expect their business to grow after the accession and 28%, to keep their positions.

3.2.2. State of production Technologies and Funds Allocated for Technological Renovation

Bulgarian companies allocate an insufficient portion of their revenues to investment in new technologies. To half of the respondents this share was below 10%. Respectively, innovations have relatively little weight among the strengths of Bulgarian SMEs. Only 18.5% of the managers believe their competitive advantage comes from technological innovation. To 60% of small businesses competition is essentially price-related.

One in three companies reportedly works with modern equipment. A small share (17%) of them defines it as rather outdated and outdated. At the same time, the information about the years of make shows that nearly half of the production companies (45%) work with equipment more than ten years old and close to three-fourths (72.8%) have equipment that is more than 5 years old.

FIGURE 9. SELF-EVALUATION OF THE COMPANY'S TECHNOLOGICAL EQUIPMENT (% OF THE RESPONDENTS)



Base N = 1011

The data suggest the conclusion that the main problems with the innovation of Bulgarian small business are found on the demand side. The qualitative survey (in-depth interviews), however, shows that the managers are inclined to see the problems on the supply side. There still persist some attitudes inherited from the years of planned economy when the research departments used to develop technologies and introduced them into production under the plans for scientific-and-technological development. Even today, small business to a great extent tends to regard innovations as a process external to the company – something created at government-funded institutes for the use of business. Hence the tendency to blame *science* or *the state* for the lack of innovation or links between science and business. Business still does not seem to realize its own part of responsibility in the innovation process nor the fact that relations between science and business need to be based on market principles. Indeed, the state does have the responsibility for an adequate policy to encourage innovations but ultimately, they are not a public good but the result of company investments. The investments of the public sector in innovations have a longer-term, indirect impact and mainly concern human capital and the scientific infrastructure.

The average annual share (in total company revenues) of the funds allocated by the surveyed SMEs for technological renovation in the past three years amounts to 18.04%. More than one-third of the companies from the sample found it difficult to estimate this share. More than one-fourth of the SMEs reinvested 1 to 10% of their profits in long-term fixed assets in 2005, and barely one in 15 companies reinvested more than 75% of its profit for the past year in long-term fixed assets.

TABLE 6. IN 2005, WHAT PART OF THE PROFIT WAS REINVESTED IN LONG-TERM FIXED ASSETS?

0%	13,6
1-10%	25,9
11-25%	15,1
26-50%	11,7
51-75%	4,5
Over 75%	6,7
The enterprise didn't have profit	6,5
Don't know/No answer	15,9
<i>Total:</i>	<i>100,0</i>

Base N = 1011

All of the groups covered by the qualitative surveys were of the opinion that the state of production technologies of Bulgarian SMEs is not good enough and significantly lags behind the European standards. The technological superiority of Western companies is equally due to the better, more accessible and comprehensive information they have on new materials and technologies. The equipment is deemed expensive by the entrepreneurs and in order to purchase new one, the company either has to spend a significant portion of its funds or take out credit.

Box 4. STATE OF PRODUCTION TECHNOLOGIES – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“Regarding technologies and the technological equipment of companies, we very much lag behind. The smaller companies have neither the possibility nor the resources. That should be the goal – they should be able to apply under projects, obtain funding and improve their facilities. They simply don't have such funds at their disposal. The companies realize this, they're aware of this problem.” (consultancy organization)*
- *“Overall, about 10% of the equipment is new. You know how difficult it is to set aside funds for new equipment. There are many cases of various banks extending credits but the conditions are drastically inadequate.” (employers' organization)*
- *“Small and medium business, in my personal opinion, can hardly develop modern, up-to-date technologies without the support of financial and crediting institutions – banks, various financial-and-crediting cooperatives, brokerage houses even, and so on. I would say this is very important for them if they are to make any progress. And I have a specific proposal in that respect – to design special credit products.” (consultancy organization)*
- *“The market is highly dynamic and we have a lot of catching up to do. I think the funds allocated are insufficient because the profit margins are quite small. So people usually look for financially more accessible models such as buying used equipment, Bulgarian adaptations of Western technologies.” (employers' organization)*
- *“Besides, the policy – including the fiscal one – is not particularly encouraging for investments. That's why you can see the manager of some small or medium company buying himself a jeep rather than a tractor because of the policy and the fact that it would not be recognized as an investment.” (consultancy organization)*

3.2.3. State and Quality of the Available Human Capital

One of the most critical problems of SME competitiveness in the long term concerns human resources. The common European market is expected to open up greater opportunities for the qualified Bulgarians and to deepen the shortage of skilled labour in the SME sector. Even in this respect they are disadvantaged compared to the large companies. Owing to the limited size of the staff they cannot rely on specialization and high efficiency. One qualified specialist usually takes on several functions with relatively low remuneration. Owing to financial constraints and high staff turnover, spending on training is not comparable to that in the big companies.

In 22.1% of the SMEs surveyed there is not a single full-time worker or employee with higher education or postgraduate degree. In another one-fourth of the enterprises included in the sample 1 to 10% of the staff have higher education, and in 9.2% of the SMEs, the respective share is more than 80%. In more than two-thirds of the companies surveyed, there is no full-time staff with education lower than secondary. In 16.6% of the SMEs, there are workers or employees who in the past three years have completed professional training courses and in 5.8% of the SMEs surveyed there are employees who have received special training for applying under international and national programmes and/or project management.

TABLE 7. APPROXIMATE SHARE OF FULL-TIME WORKERS AND EMPLOYEES OF THE COMPANIES BY EDUCATION

Share	Higher education	Secondary education	Lower than secondary education	Completed courses for professional education and/or qualification advancement through the last three years
None	22,1	8,9	67,8	79,0
1-10%	24,6	2,6	14,3	8,8
11-20%	14,9	4,4	5,3	3,4
21-30%	8,7	4,3	3,0	1,7
31-40%	3,4	3,3	1,8	0,5
41-50%	8,0	11,5	2,1	0,7
51-60%	1,8	6,9	0,7	0,1
61-70%	2,3	9,1	0,9	0,4
71-80%	3,1	12,8	0,5	0,2
Over 81%	9,2	35,1	0,8	0,9
Don't know/No answer	2,0	1,3	2,9	4,4
<i>Total:</i>	<i>100,0</i>	<i>100,0</i>	<i>100,0</i>	<i>100,0</i>

Base N = 1011

The problem of shortage of qualified workers in the sector of small and medium business is mainly a problem of the education system and the underdeveloped labour market. A large number of the managers in Bulgaria note a serious discrepancy between the product

of the higher education establishments and the needs of business. According to the reputed international competitiveness rating World Competitiveness Yearbook 2006, Bulgaria is in the last decil (56th out of 61 participants in the ranking) by shortage of qualified financial managers. Another problem to small business is posed by labour market regulations. Small companies find it even more difficult to cope with their human resource problems on account of the existing restrictions on part-time labour contracts and hourly wages, on redundancy protection measures, etc.

In addition to education and the labour market deficiencies, the problem with the human capital deficit is equally closely related to company management. It is ultimately responsible for forming the specialist needed through professional and in-company training. Managers usually ascribe an employee's inability to cope with his/her tasks to inadequate qualification without considering their own responsibilities in adapting the specialist's skills to the needs of the company or the other conditions necessary for their professional fulfilment. Revealingly enough, according to the above-mentioned ranking, Bulgaria trails behind the other countries in terms of HR management. By criteria such as training and motivation of the staff, Bulgaria is found at the bottom of the ranking – 55th and 54th, respectively, out of 61 countries.

An important factor for motivation is the presence of a strategic vision for the future of the company shared by the workers and employees. Bulgarian SME rarely have a formal long-term company strategy or vision for development. To SMEs planning is all too often reduced to some document for obtaining a credit rather than an instrument of business development and market success. The staff members are simply supposed to do what they are told and concentrate on their immediate tasks without knowing where the company is headed in the mid- and long-term, or how their own tasks fit into its strategy and goals. This is a common flaw of company management in Bulgaria but applies to a greater extent to small and medium-sized business.

Regarding the quality of the labour force in Bulgaria, the persons surveyed by qualitative methods did not share a clear-cut opinion – both negative and positive evaluations were made. What all of the groups surveyed agreed on was the foremost importance of human resources and the fact that it should be the top concern of SMEs and all other institutions. According to the representatives of employers' organizations, the highly qualified specialists, the graduates from specialized schools and universities are on a European level but they are very few. The opinions shared suggested that the workers are mostly low skilled and that the quality of education has dropped considerably. It was noted that there was a shortage of labour in some occupations – fitters and welders, for example. Companies from other regions outside Sofia have reported to the Chamber of Commerce & Industry that they are already faced with the problem of labour shortage. All too often, the good specialists begin their career at SMEs to move on to big companies because the latter can afford to pay higher salaries. Small business does not have too high ambitions regarding the staff. These companies hire people without previous experience who obtain access to training and information and take advantage of this to get better paid jobs in bigger companies: *“In this connection, there is high turnover because this market for specialists gets more competitive every day and if there are good specialists at the small companies at all it's because there are other mechanisms of retaining them”* (representative of employers' organization and businessman). According to the surveyed consultants, few businesses are interested in raising the qualification and education level and most companies actually show lack of concern on this matter.

SME owners themselves believe there are highly competitive specialists in Bulgaria who are on par and sometimes even better than Western ones, as acknowledged even by their

European partners. The companies realize the need for staff training in management and foreign languages. In addition to the acquired education and qualification level, what matters to SME owners is to hire hard-working, committed and enterprising people – “*they should be smiling, polite, not make elementary mistakes*” (owner of small trading company).

Box 5. STATE AND QUALITY OF THE AVAILABLE HUMAN CAPITAL - OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- “*I think the level is far too low, at least compared to how I would like things to be in medium business. As for small business, it’s hard to say. Perhaps they don’t have too high ambitions.*” (consultancy organization)
- “*On the whole, Bulgarians are curious and eager to learn and the average qualification level in Bulgaria, in my personal opinion, is in no way inferior to that in the member countries. It is very important for the qualified workforce to possess foreign language skills, as well.*” (employers’ organization)
- “*The employers, i.e. the managers, need to realize that they have to train people for the application process because project writing is a highly specific type of activity and not everyone can do it.*” (employers’ organization)
- “*But things are still very centralized and when the entrepreneurs have to absent themselves to take part in trainings or seminars they would rather send other employees who tend to establish different types of contacts and all too often, contrary to expectations, the entrepreneurs are left without staff. They actually start some business of their own. Colleagues of ours have complained that they have lost employees whom they had trained for several years.*” (employers’ organization)
- “*It is not possible for small and medium enterprises to retain highly qualified managerial staff, particularly financial managers. Someone who is a good general or financial manager would never stay in a medium or small business.*” (consultancy organization)

The surveyed representatives of employers’ organizations recommended making more efforts to involve the staff in various forms of training and qualification, to improve their foreign language skills and organize special training events devoted to specific topics and areas of activity. It was further suggested to try and train employees not only in business- and industry-specific skills but also in project development and project management in general. There were also recommendations concerning more unpopular measures to retain qualified young specialists such as additional financial and fiscal incentives and introduction of special benefit packages.

Box 6. STATE AND QUALITY OF THE AVAILABLE HUMAN CAPITAL - OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- “*Education should in any case be closely related to the labour market. As it is, a multitude of young people are graduating only to go straight to the employment offices. And I’m forced to take a student and train him properly in order to hire him to work for me. So what are we paying taxes for – if we have to do the training ourselves, and ensure our own security, and do everything ourselves. Since statehood is missing why would I possibly need a state at all?*” (employers’ organization)

Box 6. STATE AND QUALITY OF THE AVAILABLE HUMAN CAPITAL - OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY (CONTINUED)

- *“The young generation are graduating from the higher education establishments where nobody knows exactly what they study or how they enrol – they manage to get in somehow but then that’s also how they graduate. And I think that’s going to be a big problem over the next 5-10 years. Though of course, even though they formally hold degrees, they, too, will be forced to learn. And hopefully, because they are young and because they have no other choice, they will actually learn. Because the European market will open up as well. They will go there to work and nobody will hire them because they don’t know how to do anything, perhaps just a foreign language but that’s not enough.” (consultancy organization)*
- *“Education used to be free of charge for decades and people have grown accustomed to having free education. I think the problem is not so much that they don’t want to study but rather, that they don’t want to pay to study.” (consultancy organization)*

3.2.4. Level of Conformity to European Requirements and Internationally Established Standards¹⁶

For the purposes of the present analysis, European business-related standards may provisionally be divided into three groups. The first one concerns consumer protection and product safety. The second one is related to environmental protection. And the third one concerns work safety conditions. All three are ultimately concerned with the health and quality of life of EU citizens. This justifies the extra expenditures these requirements entail for business companies.

In terms of SME competitiveness, this raises at least three issues:

- a. Are Bulgarian SMEs ready to take on these additional expenditures in implementation of the European directives, i.e. are they familiar with them and ready to implement them?
- b. How will they affect their competitiveness?
- c. Are the control authorities ready to implement them in a way as to guarantee equal standing of the companies and effective protection of the consumers, the environment, and work safety?

Although two-thirds of the respondents claimed they know the European requirements, few are ready to comply with them. **Most companies are not ready to meet EU requirements regarding quality, consumer protection, environmental protection and work safety.** A considerable proportion – one-third to one-half – is not even acquainted well enough with these requirements and those who are do not know what the deadlines are.

In the analysis of competitiveness, the more important issue is to what extent this relatively weak readiness can be penalized by the market, i.e. to what extent it is the outcome of non-market and short-sighted company management. As shown above, a relatively small number of Bulgarian SMEs work for external markets and still fewer, for the European one. Consequently, very few of them are forced into compliance with European standards by market competition. This applies mainly to companies depending on exports. They seem to be

¹⁶ European standards concerning product quality and safety and work conditions have been considered in greater detail in paragraph 1 of the present chapter. At this point, the analysis focuses on SME readiness to implement these requirements and the implications for their competitiveness.

prepared or are about to get adequately prepared for the requirements of the European single market. The overwhelming majority of SMEs, however, operate largely in the Bulgarian market. Although it would formally become a part of the common European market after the accession, its actual integration in terms of the European rules depends on the capacity of the respective authorities to enforce them. From their practical market experience a great many of the small business owners know that the law in Bulgaria – that is the particular inspector. From this point of view, it makes sense to them not to rush but to wait and see exactly what the authorities will expect of them and how much it would cost to have them close their eyes. In terms of the market, company competitiveness, and the existing financial constraints, to a great many medium and small businesses it would not be rational to invest in the introduction of European standards before they are made to do so by the **clients** or the **control authorities**.

As for **consumer demand**, it still has a weak impact in terms of the adoption of European standards. Bulgarian consumers are still more sensitive to the price of the product than to its quality. The low purchasing power of most consumers in this country limits their choice and moderates the pressure on the demand side for compliance with European requirements. This tends to apply in the highest degree to environmental standards, but also to product standards. Similarly, in the labour market, the low incomes and still considerable unemployment lower the pressure on the supply side regarding work conditions.

Regarding the **control authorities**, some small business owners probably count on coping by irregular means. That is why, in the absence of powerful market incentives for compliance, the observance of European requirements will chiefly depend on the administrative capacity and professional integrity of the various inspecting bodies. Whether conformity to European standards will prove a competitive advantage or, on the contrary, lead to loss of competitiveness, will depend on how they enforce the law.

Much can still be expected from nongovernmental organizations, as well. At first glance, there seem exist active environmental, trade-union, or consumer protection organizations but their actions are as yet hardly in position to bring into line the particular employers and producers. The state has its responsibilities in enforcing the law but the public sector has long ceased to be universally responsible for each and every instance of environmental pollution or violation of work safety and product safety standards.

The relative immaturity of market and social mechanisms, i.e. the lack of economic incentives as a driving force of implementation of European standards, assigns a more important role to administrative coercion in the short term. In turn, this increases the risk of arbitrary enforcement of the regulations and their use for corruption purposes. It is the obligation of control and regulatory authorities to protect consumers, workers, and the environment from detrimental and unethical practices on the part of business. Yet it also the responsibility of legislators and the government to protect business from administrative discretionary power in the enforcement of the law. The practical implementation of this goal is hardly an easy task but it is an indispensable condition for Bulgarian companies to be able to compete while observing, rather than circumventing, the European rules.

3.3. Innovation activity and innovative capacity of Bulgarian SMEs

Innovation is in the heart of the EU policies for achieving the objectives of the Renewed Lisbon Strategy for growth and jobs. In the beginning of 2005, the European Commission reported that EU is lagging behind in achieving the objectives of the Lisbon Strategy set in the year 2000 to transform the EU into the most dynamic knowledge-based economy in the world by 2010. At present, the economies of the main partners and competitors of the EU – the United States and Japan, enjoy substantial competitive

advantages in almost all areas of the innovation system. To address the conclusions made in 2005, the European Commission decided to revise its policy placing stronger focus on the strategic objectives of the Lisbon Strategy by concentrating the efforts on two priority areas: growth and jobs based on innovation¹⁷. Research and innovation will have the central role in the EU policies and financial instruments.

As a result, the activities focused on innovation will absorb a great share of the resources under the Cohesion and the Structural funds for the period 2007 – 2013. This is particularly true for the European Regional Development Fund (ERDF), which shall be the main source of the European support for Bulgaria in its first budget period as a Member State. In addition, EU pays special attention to the mutual complementarities of the innovation activities that will be financed under ERDF, with those that will be supported under the 7th EU Framework programmes for research, and the Framework programme on competitiveness and innovation¹⁸. The success of the integration of the country in the EU will depend on how successful Bulgaria and the Bulgarian SMEs will be in combining and complementing the funding under these instruments. No doubt that the primary instrument in this area is the Operational programme “Competitiveness of Bulgarian Economy”. The priority axis 1 of the programme “Development of a knowledge-based economy and innovation activities” is focused on promoting the development of R&D activities of enterprises with the aim to strengthen their innovation potential and to create adequate pro-innovative business infrastructure that shall foster the ‘science – business’ links. Its implementation should take into account the specifics, strengths and weaknesses of the Bulgarian innovative enterprises in order to fully achieve its objectives.

As already mentioned, the micro-enterprises with low productivity and limited capacity for absorption and management of resources are still prevailing among the Bulgarian SMEs. They have development potential and reveal outpacing growth rates of productivity and value added but in absolute values these indicators remain far below the EU average. The Bulgarian SMEs are times smaller in size than their partners and competitors in the EU in terms of fixed tangible assets, which delimit to a considerable extent their access to financing and their growth. Despite the growth registered in the past few years, the enterprises performing innovation activity remain two to three times less when compared to the average figure for EU-25. According to the data from quantitative and qualitative studies completed by Vitosha Research, a top priority for the larger part of SMEs is still their survival and they find it extremely difficult to allocate additional resources for innovation activities. The innovation activity of companies is hindered as well by the lack of long-term planning: more than half of the surveyed SMEs (57.6 %) do not prepare written business plans and, where such are drafted, the planning horizons rarely exceed 1 year (18.5 %) or up to 2 – 3 years (10.4 %). The access to financing is also seen as impeded as most of the banks believe that innovation activity is extremely risky. The links between companies and the research community are weak or broken.

¹⁷ The new EU common innovation strategy has been outlined in the Communication of the EC More Research and Innovation - Investing for Growth and Employment: A Common Approach SEC(2005) 1253

¹⁸ The Seventh Framework Programme for research, technological development and innovation and the Framework programme for competitiveness and innovation, which shall be initiated in 2007 for the first time in the EU

Box 7. INNOVATIONS IN SMEs – OPINIONS OF PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“In the construction business we are interested in these things, as construction is a very dynamic process. In the finishing works and in the building technology we use many innovations. As far as a construction company cannot have a production profile, we focus on the use of new materials. To start a production requires extensive research and there is a complex technological process. It can be afforded only by large construction companies or by a company which is focused on production only... If most of the companies have technological information on more products (on the material and on the technology) and it is accessible maybe other things can be produced in the country.” (representative of a medium-sized company)*
- *“On a national level the support to innovations is a state policy ...In general, good intensions exist, good programmes and much money. In order to go on and not turn back to the topic ‘Why we do not assume the money?’ I think that the demand for new things, the introduction of something new in production is one of the ways to draw forward the medium-sized enterprises. Or, another way is not that they themselves introduce something new, but rather find a partner and learn as his sub-contractor in order to get know-how, organisation, technical means and patents. As the small enterprises are concerned, here in particular (in innovations) the division is very sharp – between small and medium-sized there is a thick line.” (consultancy agency)*
- *“The introduction of something new such as new knowledge, new technology, new know-how, method of management, etc. is the better way to compete on the market than to cut down prices. Because that is an old story – there shall always be somebody to place a still lower price – a Chinese, for example.” (consultancy agency)*

3.3.1. Innovative companies

Innovation activity is still not typical and quite often a terra incognita to the Bulgarian SMEs, although in the last years the business in Bulgaria recognises more and more the importance of innovation and the research and development activity (R&D) for the increase of competitiveness. According to latest available official data¹⁹, the share of innovative enterprises in Bulgaria in 2004 is 11.4 % or ¼ of the quota of innovative enterprises in EU-15 in 2001. It presupposes the development of a relatively broad and comprehensive support to SMEs in Bulgaria aiming both at strengthening and growth of the existing innovative enterprises and creation of more new innovative start-ups. In this respect, the specific objectives of Priority axis 1 of OP “Competitiveness of Bulgarian Economy’ are well targeted at the current needs of the Bulgarian economy:

- Facilitating the creation of enterprises based on innovative ideas;
- Promotion of the research and development activity in micro-, small and medium-sized enterprises;
- Support for promotion of the patent activity of the country;

¹⁹ NSI, 2004, Eurostat, NewCronos, 2001.(Innovation.bg newspaper, Applied Research and Communications Fund, 2005). NSI and Eurostat use the methodology Community Innovation Survey (CIS), which covers only selected sectors of economy and enterprises with more than 10 persons employed. The study of Sociologic and Marketing Agency Vitosha Research, performed for the purposes of the present report, is representative of all SMEs, i.e. it comprises also micro-enterprises, which doesn't provide direct compatibility with the studies of NSI and Eurostat under the CIS methodology.

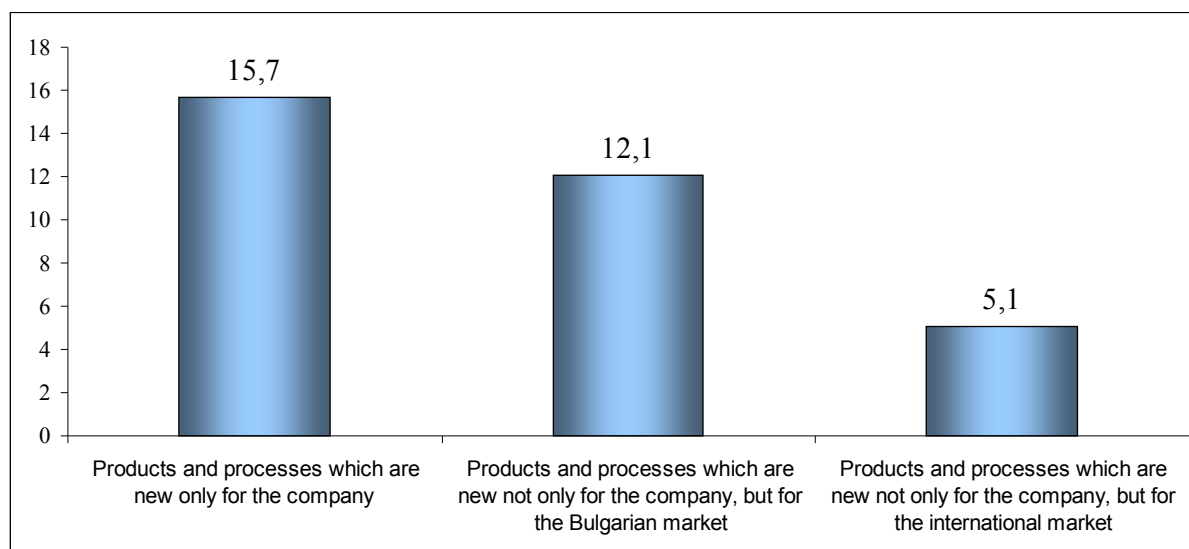
- Development of favourable pro-innovative environment for micro-, small and medium-sized enterprises

However, in the process of implementing the activities under these priorities, a number of characteristics and specific features of the Bulgarian innovative enterprises should be taken in consideration.

The Bulgarian innovative companies are focused mainly on the introduction of product innovations and much less on process or mixed types of innovations²⁰. It is natural, in view of the catching-up growth of the country compared to the EU, but the proportion shall change in the future more and more in favour of process innovations. With the ‘depreciation’ of the low labour costs as a main competitive advantage of the Bulgarian companies, they should change towards improving the efficiency of the in-company processes in order to be able to compete with their global competitors.

As expected, the majority of companies in Bulgaria introduce products and processes which are new only for them (15.7 % of all surveyed companies) or only for the Bulgarian market (12.1 %), i.e. they focus only on the renovation of the product range or on opening new market niches for products already available on the Bulgarian market. The companies that have international ambitions in the realisation of new products are 5.1% of all SMEs in Bulgaria. All three types of innovators are important for the development of the Bulgarian innovation system and for the improvement of the innovative capacity of the Bulgarian economy. But, while the first two categories need mainly favourable market environment and opportunities for technological renovation (access to technical, financial and human capital), the last one needs support for research and development infrastructure and well-functioning technology transfer structures both in the country and in international aspect. These characteristics of Bulgarian SMEs shall determine in general the common demand and the specific requirements to the types of instruments of OP „Competitiveness”, which are mostly demanded by enterprises.

FIGURE 10. COMPANIES, WHICH HAVE PLACED ON THE MARKET DURING THE PAST THREE YEARS INNOVATIVE (NEW OR SUBSTANTIALLY IMPROVED) PRODUCTS (GOODS OR SERVICES) AND/OR PRODUCTION PROCESSES, INCLUDING METHODS FOR PROVISION OF SERVICES AND MODES OF PRODUCT SUPPLY (%)

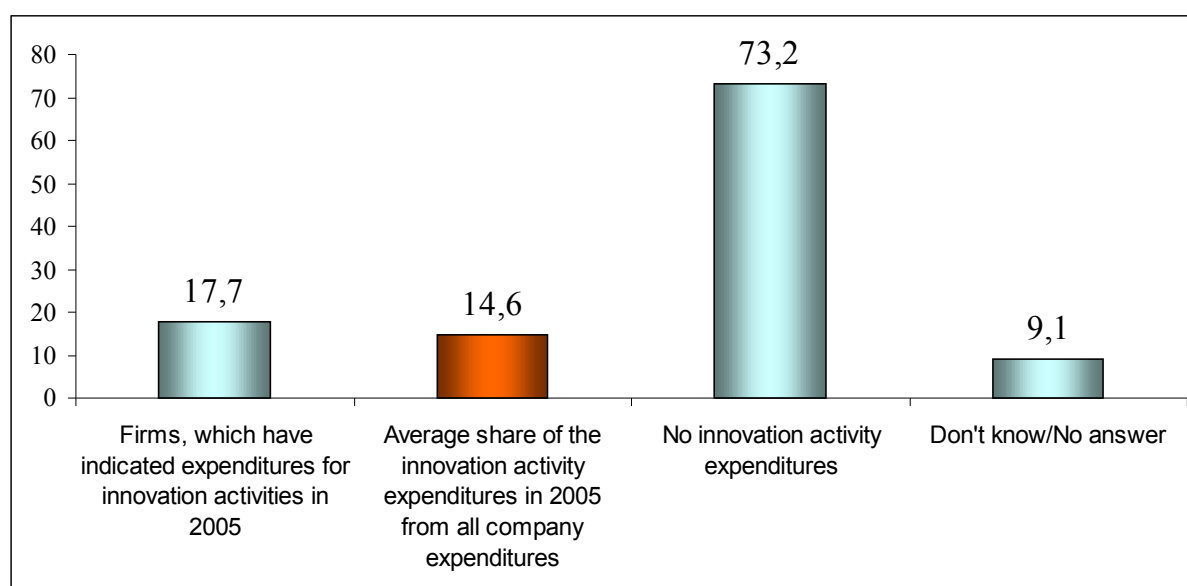


Base N = 1011

²⁰ NSI, 2004. (Innovation.bg newspaper, Applied Research and Communications Fund, 2005)

Almost 75% of the surveyed SMEs have not made any expenditure for innovation activity, and 18% have declared such expenditures. On the average, they spend on innovation activity 15 BGN out of each 100 BGN. In view of the relatively small amount of the turnover and the fixed tangible assets of Bulgarian SMEs, it can be presumed that the resources of the Bulgarian SMEs allocated to innovation activity are relatively small in absolute value. More than 72 % of the surveyed SMEs have declared annual turnover of less than 3 million BGN. Even if a non-realistic assumption is made that the average turnover of one Bulgarian SME is 3 million BGN, it shall make average annual expenditures on innovation activity of 450,000 BGN.

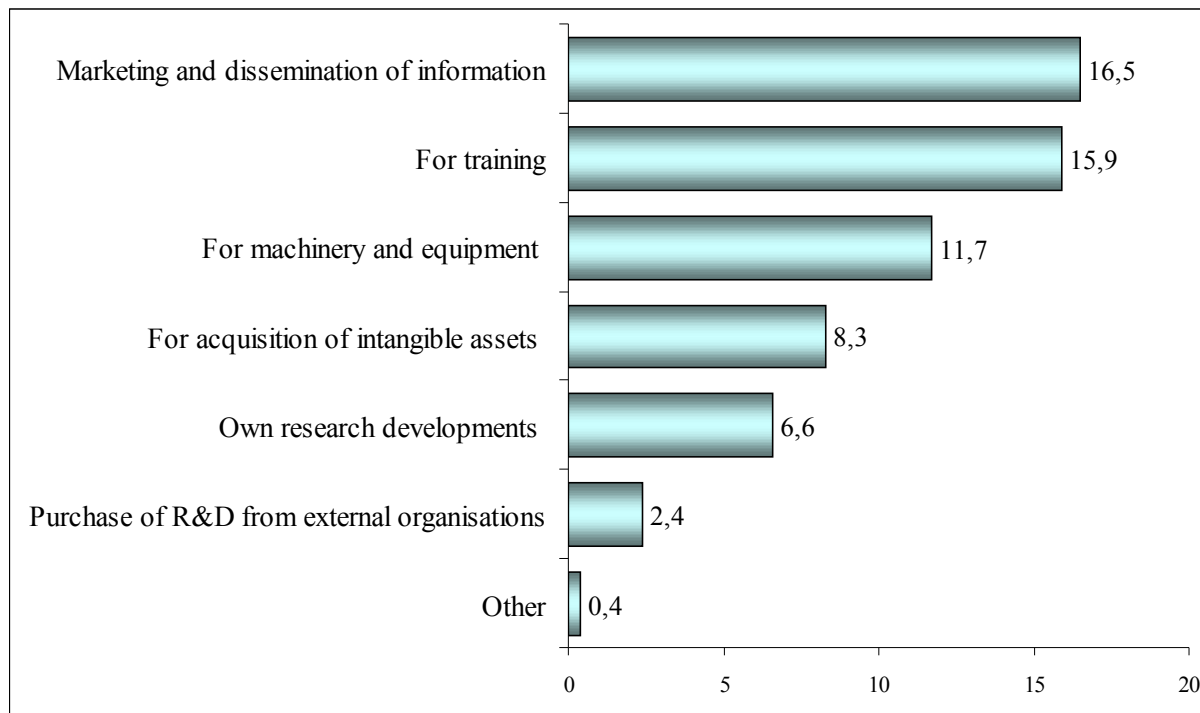
FIGURE 11. EXPENDITURES FOR IMPLEMENTING INNOVATION ACTIVITY DURING 2005



Base N = 1011

The major part of Bulgarian SMEs make innovation expenditures for marketing (16.5%), training (15.9%) and for machinery and equipment (11.7%). This corresponds also to the main challenges before the innovation activity of SMEs in the future – the availability of qualified staff and access to the end-user through well developed marketing mix and distribution channels. For the moment, relatively few SMEs in the country spend on the acquisition of intangible assets (8.3%), own research developments (6.6%) and purchase of R&D from external organisations (2.4%). This is a sign of the very early stage of development of the national innovation system, when the implementation of ready-made foreign innovations and the access to foreign innovation markets are far more important for the innovativeness of enterprises than the development of in-company and internal national capacity for creation of innovations.

FIGURE 12. PERCENTAGE OF SMEs THAT HAVE MADE EXPENDITURES FOR:



Base N = 1011

Most of the innovative companies (34.9 %) have 11 to 50 persons employed or less (32.1 %), which is predetermined by the nature of the SME sector in Bulgaria, where the small and micro-enterprises prevail. However, in the breakdown of enterprises by the number of employees, the innovative enterprises with 101 to 250 employees rank first (40.2 % of them execute innovation activity), followed by the enterprises which are less staffed. A reduction of the share of innovative enterprises is observed with the decrease in the number of employees. In the group of medium-sized enterprises (with more than 51 persons employed), the share of innovative enterprises is larger, because they are the ones that face the strongest international competition and respectively have the largest capacity, resources and potential for development and growth. It is most likely that the activities under the specific objectives of Priority axis 1 of Operational programme for promotion of R&D and the patent activity shall be directed to them. These enterprises, together with the small ones (with 11 to 50 persons employed), are expected to bear the main burden of the competitive pressure of the EU market.

TABLE 8. NUMBER OF THE FULL-TIME EMPLOYED WORKERS AND PERSONNEL (RESPONSES OF SMEs THAT HAVE, DURING THE LAST THREE YEARS, PLACED ON THE MARKET INNOVATIVE PRODUCTS (GOODS AND SERVICES) AND/OR PRODUCTION PROCESSES)

A. Percentage of innovative and non-innovative enterprises in the respective group of enterprises, by persons employed

	Non-innovative	Innovative	Total
Up to 10	86,6	13,4	100
11-50	73,7	26,3	100
51-100	68,0	32,0	100
101-250	59,8	40,2	100
<i>Don't know/No answer</i>	93,3	6,7	100

Base N = 1011

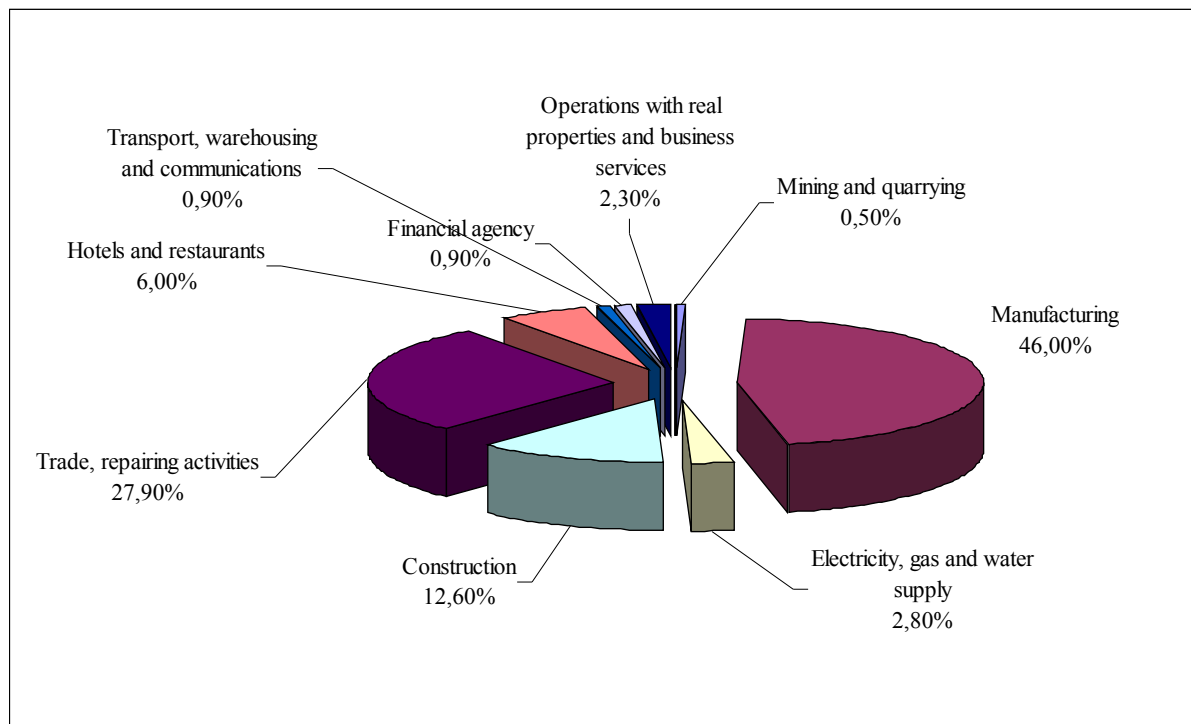
B. Breakdown of innovative enterprises by number of employees

Up to 10	32,1
11-50	34,9
51-100	15,3
101-250	17,2
<i>Don't know/No answer</i>	0,5
<i>Total</i>	100

Base N = 1011

Most Bulgarian innovative companies operate in the processing industries (46 %), ‘Trade and repair’ (27.9 %), ‘Construction’ (12.6 %) and ‘Hotels and restaurants’ (6.0 %). On the one hand, it is typical for these branches of the national economy to be most exposed to the international competitive pressure (processing industries, wholesale trade, hotels and restaurants), and on the other hand the dynamic development and the high profit rate on the national market are the enablers for the introduction of new technologic decisions in them (construction). While the innovativeness of companies in the ‘Trade and repair’ sector is concerned, it should be taken into account that their innovations can be predominantly process innovations and the support to projects, which report as innovation the trade with new commodities is not appropriate. The innovative development of the processing industries shall be the natural engine of the overall innovative development of Bulgarian economy during the forthcoming years. It has to be further supported by novelties in sectors like financial intermediation and business services, which at present concentrate a very small number of the innovative companies in Bulgaria. The development of the latter is decisive for the future innovation-based growth of economy in view of the leading position of innovations in the services sector worldwide. Globalisation caused unprecedented acceleration of productivity of the leading world economies through innovations in the software services (Internet), financial services (the international financial markets), communications and telecommunications (mobile communications and voice over Internet) and in trade (new forms of global distribution networks, etc). The involvement of Bulgarian enterprises in the process of bringing innovations to the services sector shall be an important prerequisite for enhancing the capacity for growth and integration of Bulgarian SMEs in the EU. It is most reasonable that the support to innovative business, financial and communication services to SMEs comes through initiatives under the specific objective ‘Development of favourable pro-innovative environment for micro, small and medium-sized enterprises’.

FIGURE 13. FIELD OF ACTIVITY OF SMEs WHICH HAVE, IN THE LAST THREE YEARS, PLACED ON THE MARKET INNOVATIVE (NEW OR SUBSTANTIALLY IMPROVED) PRODUCTS (GOODS OR SERVICES) AND/OR PRODUCTION PROCESSES, INCLUDING METHODS FOR PROVISION OF SERVICES AND MODES OF PRODUCT SUPPLY



Base N = 215

3.3.2. Pro-innovative infrastructure and technology market

The enhancement and the realisation of the innovation capacity of Bulgarian SMEs depend on a series of factors. Their openness to the other participants in the national innovation system and abroad and the exchange of ideas are among the main preconditions. Although the Bulgarian economy is commercially widely open, the majority of SMEs operate on the national market. A very small number of them attend specialised international exhibitions and fairs – 85.2 % of the companies declare that they have never participated in any such event outside the country. At the same time, 85.8 % of Bulgarian SMEs announce that they do not participate as well in national or in international production networks. And yet, one out of ten enterprises participates in a national network and one out of thirty enterprises – in an international network for production, which reveals the need to simultaneously strengthen the positions of those enterprises, which already participate in production networks, and encourage the inclusion of new participants.

In addition, special attention should be paid to innovation co-operation. The enterprises still implement innovation projects by employing their resources and investing their own efforts (9.5 % of SMEs in Bulgaria). The reasons for the weak development of partnership formation in the implementation of innovation projects have been thoroughly examined in a series of analyses and reports and can be summarised as follows: broken up “science – business” link, lack of stimuli for the commercialisation of the scientific results in the country, obsolete and underdeveloped infrastructure for technology transfer. The process of cluster formation (networks of interrelated industries), mainly under the initiative and with

the support of the PHARE programme, completed by the Ministry of Economy and Energy, can be indicated as a positive development in that respect. The support for and the development of clusters shall be continued also in the process of implementation of OP “Competitiveness”, when the share of the viable clusters shall be ascertained in practice, which can be integrated in the European economy.

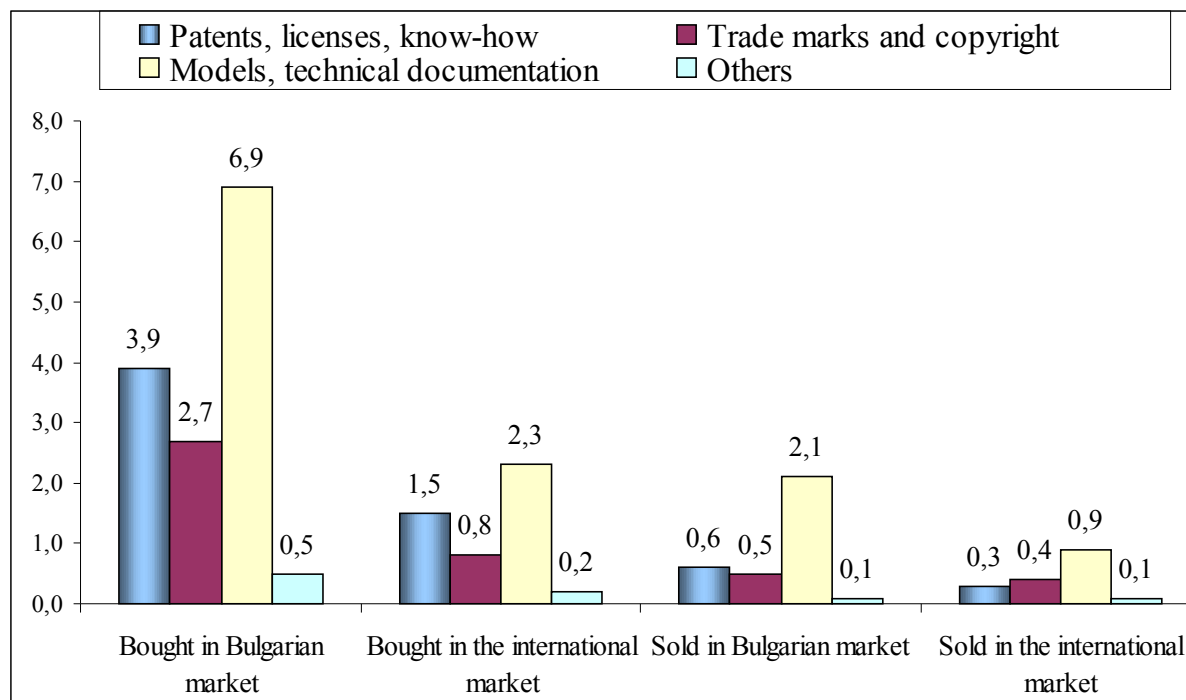
TABLE 9. HAS YOUR COMPANY, IN THE LAST THREE YEARS, DEVELOPED/INTRODUCED INNOVATION (NEW PRODUCT, SERVICE, PRODUCTION PROCESS) THROUGH ANY OF THE FOLLOWING FORMS OF COOPERATION?

	Yes	No	Don't refer to the company	Don't know/No answer
Contract with scientists, researchers, lecturers	2.9	52.1	42.1	2.9
Cooperative development in partnership with scientific and/or educational organizations	3.1	52.2	41.8	2.9
Purchasing developed service/product from scientific organization or a scientist	1.9	54.2	40.8	3.2
Invitation of scientific or/and educational organizations as sub-contractors	2.2	52.7	42.1	3.0
Own research structure	9.5	46.0	41.1	3.4
Other form of cooperation	1.6	33.6	25.4	39.4

Base N = 1011

Despite the fact, that 71 % of Bulgarian SMEs define their main technological equipment as medium-aged to modern, ¼ of them share the opinion that the main factor by which they are falling behind their competitors is the lack of modern production technologies. In regard to competitiveness the only factor announced as a weakness, is the lack of reliable markets. Despite the above said, the national and international technology markets remain unused or inaccessible to Bulgarian SMEs. Less than 4 – 7 % of SMEs have purchased patents, licenses or trade marks and technologies on the national market during the last three years, and the quota of companies that have purchased technologies on foreign markets is even smaller. The share of SMEs, which, during the same period, have sold technologies on the national and/or international technology markets, is almost insignificant. The factors to enhance the participation of SMEs on the local and foreign technology markets are numerous and complex, they are examined in OP ‘Competitiveness’. The more significant of them are: lack of awareness, know-how and financial instruments and resources on technologies; insufficient encouragement to use intellectual property protection instruments; lack of demand on the part of enterprises and inadequate supply of commercial intellectual products on the part of the Bulgarian R&D sector.

FIGURE 14. HAS YOUR COMPANY, IN THE LAST THREE YEARS, PURCHASED TECHNOLOGIES FROM THE NATIONAL AND INTERNATIONAL MARKETS?



Base N = 1011

3.3.3. Financing of innovation projects

The major problem encountered in the innovation activity of SMEs in Bulgaria is the lack of adequate financing and the high costs of the innovation projects²¹. It can be substantially alleviated or largely overcome by using the opportunities provided by the EU Structural funds and the prescribed measures in OP “Competitiveness”. Bank financing of innovation projects in Bulgaria is not accessible to SMEs because of the restrictions related to the high-risk assessment by the banks and the collateral to be secured by the companies. In practice, the market of intangible assets, which form the main part of the assets of innovative SMEs, is not developed and is largely unknown to Bulgarian banks. The share of non-banking financing, such as venture capital funds or ‘business angels’ is still very small as compared to other European countries. The venture capital funds’ resources are not directed to SMEs because of the traditionally larger volumes of their investments, for which the conditions in Bulgaria are not yet favourable. Normally, the venture capital funds intend to invest minimum 5 to 8 million EUR acquiring no more than 30 % ownership in the enterprise, which delimits the number of enterprises capable to absorb such amounts. The optimum volume of venture capital funding in the Bulgarian context might be considered an investment in the range from 300,000 to 2,000,000 EUR. There is clearly spelled out need for non-banking resources, granted under more liberal conditions and more accessible to SMEs. The subsidy granted under European programmes shall support the capitalisation of SMEs and shall optimise their risk financial leverage²².

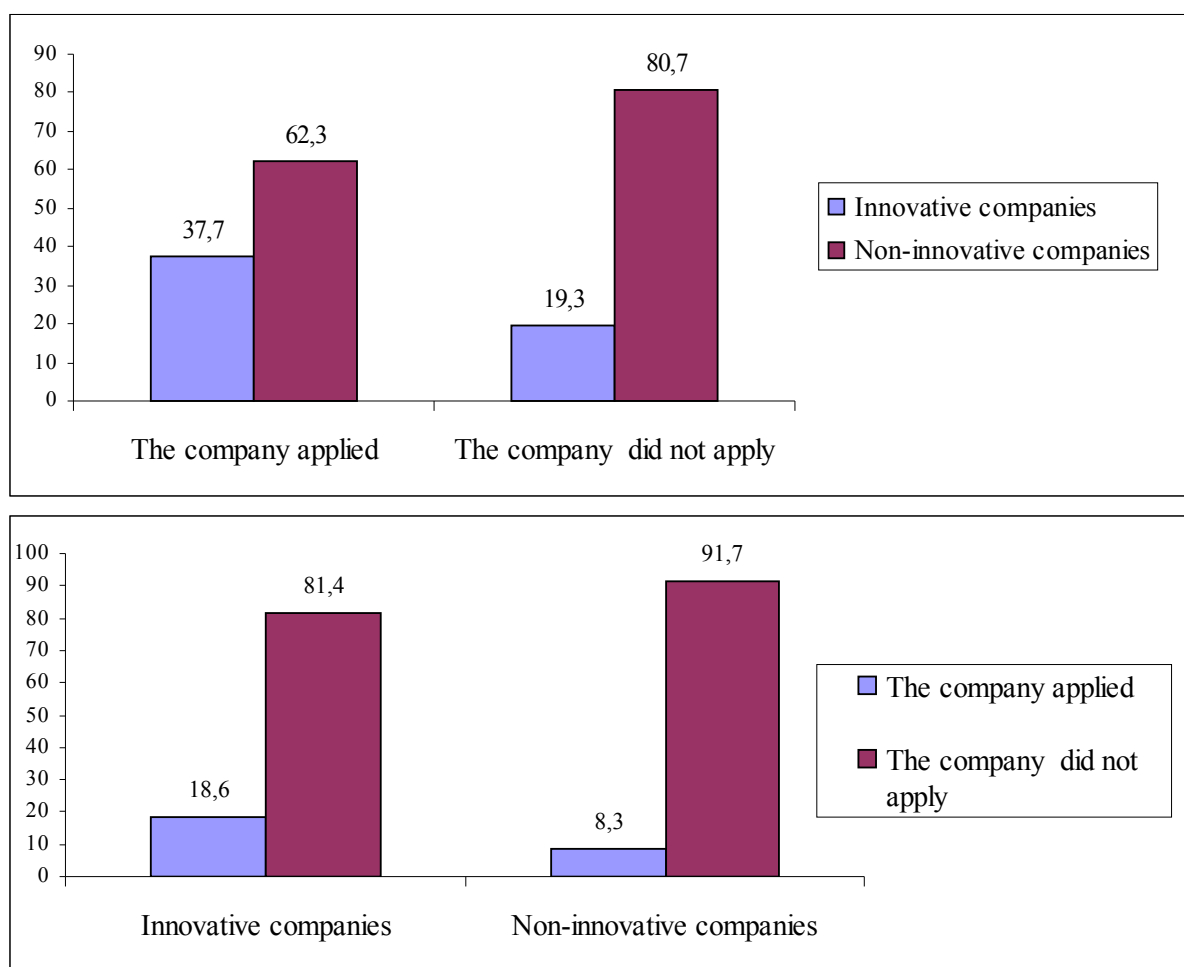
²¹ NSI, 2004 (*Innovation.bg newspaper, Applied Research and Communications Fund, 2005*)

²² Study of Vitosha Research, performed among bank officers, directly responsible for crediting of SMEs, under the method of in-depth interviewing, July 2006

3.3.4. Innovative companies: capacity to absorb EU funding and need of support under OP „Competitiveness”

Most of SMEs (81.4 %), which have performed innovation activities, have not used and/or have not applied at all for financial support under European or international funds and programmes. The quota of the applicant innovative companies, however, is far bigger than the share of applicants from the non-innovative enterprises. Some 11.2 % of the innovative companies have applied but have not been financed. From those that have received financial support the share of innovative companies which have been supported by the PHARE programme is the largest (2.3% of all companies or 35.7% of the innovative companies, supported by PHARE, compared with 64.3% supported non-innovative companies, followed by the ones that have received support under ISPA and SAPARD). Extremely worrying is the fact that none of the 1,011 surveyed companies has participated in the Sixth Framework programme for research, technological development and demonstration, where numerous Bulgarian organisations have already acquired good experience.

FIGURE 15. APPLICATIONS BY INNOVATIVE AND NON-INNOVATIVE COMPANIES FOR FINANCIAL SUPPORT UNDER EUROPEAN AND INTERNATIONAL FUNDS AND PROGRAMMES



Base N = 1011

The red tape and the lack of information on the programmes are the main barriers which the innovative companies face when applying for financial support under the European

funds (these barriers have been reported by respectively 36.7 % and 26.5 % of the innovative companies). Other barriers are the complex procedures of financial accounting, the additional payments for intermediaries in the application process, the securing of co-financing, the difficulties to find partners as sub-contractors, etc. These problems should be thoroughly taken in consideration in the development of the future activities under OP “Competitiveness”, as if found hampering by the innovative companies, they shall be still more embarrassing for the non-innovative enterprises.

TABLE 10. PERCENTAGE OF INNOVATIVE AND NON-INNOVATIVE SMEs IN BULGARIA, WHICH HAVE INDICATED THE FOLLOWING FACTORS AS IMPEDING THEIR APPLICATION FOR FUNDING UNDER EU PROGRAMMES

	Non-innovative companies	Innovative companies
Large expenses for applying	13,7	15,8
The programmes don't correspond to the needs of the company	11,9	14,9
Lack of information about the programmes	28,9	26,5
Difficulties with the forms for applying	13,9	16,3
Complicated and bureaucratic procedure of applying	27,0	36,7
Difficulties to find partners	12,6	16,7
Difficulties in ensuring co-financing	14,7	17,7
Problems with using foreign language	11,1	9,8
Complicated procedures in the financial reports	14,4	20,5
Additional payments for intermediaries	16,3	18,6
Absence of qualified personnel	17,0	12,6
Other	1,1	2,3
The company didn't apply for support from European/international funds and programmes	91,7	81,4

Base N = 1011

The companies that have performed innovation activities, plan to invest in the next three years mainly in the technology upgrade and renewal of production, in introducing the standards and fulfilling the requirements of the European Union and in development of new products, technologies and services. Although they declare plans to apply for support under the EU Structural funds (i.e., mainly under OP “Competitiveness”) to cover all their investment needs, for several of the innovation areas they shall rely almost entirely on EU funding. These are the following: development of new products/technologies/services, introduction of energy-saving technologies, modernisation of the management of the company, training and improving the staff qualification and use of consultancy and business services. Almost all innovative SMEs, which have plans to invest in these areas, have expressed readiness to seek support for these investments from the EU funds. This presupposes that the resources of OP “Competitiveness” shall be concentrated predominantly in these areas.

TABLE 11. INVESTMENTS PLANNED BY THE COMPANIES IN THE NEXT THREE YEARS, AND AREAS FOR POSSIBLE APPLICATION FOR SUPPORT UNDER EUROPEAN FUNDS/PROGRAMMES PROVIDED THAT ABOUT 50% OWN FINANCING IS REQUIRED (RESPONSES OF INNOVATIVE ENTERPRISES)

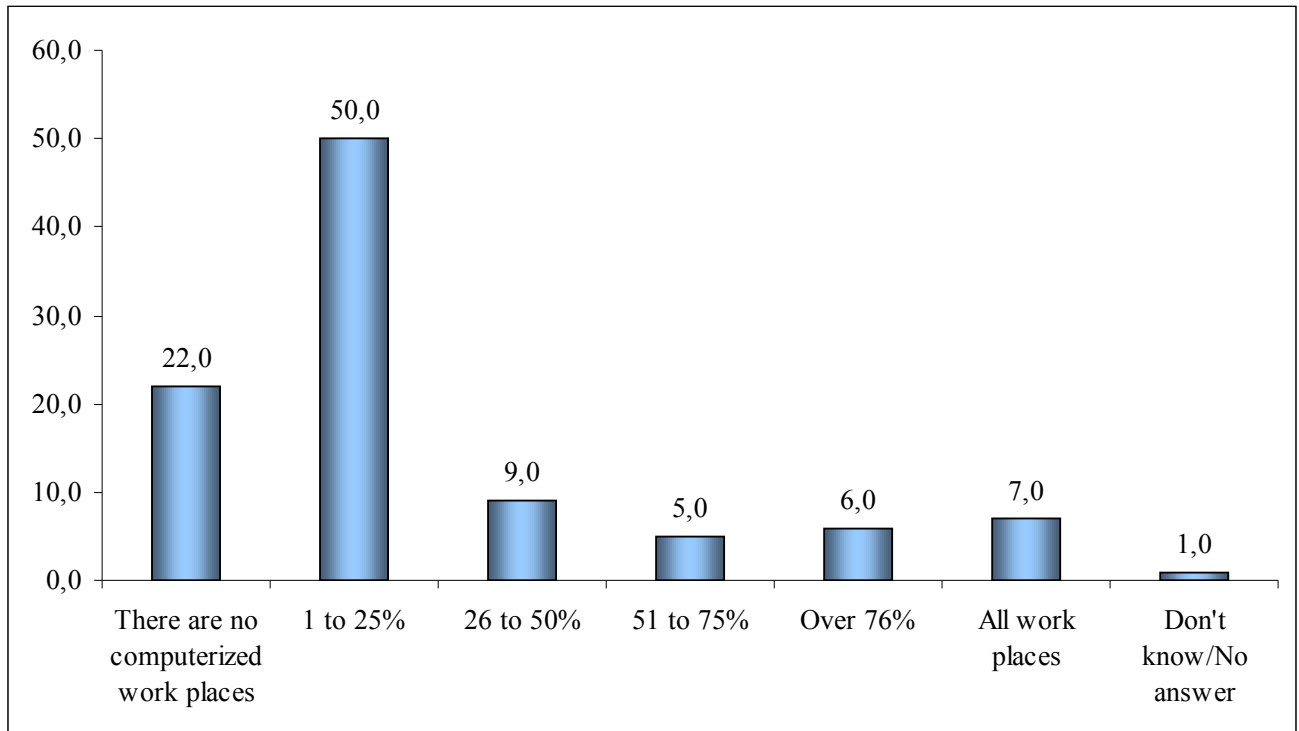
	Intention for investments	Intention for applying European funds/programmes
For technical upgrade of production facilities	73.3	58.6
For developing new products, technologies, services	31.9	30.2
For attracting foreign investments	15.5	10.3
For promoting and increasing the export of the company	11.2	8.6
For covering the European standards	44.0	32.8
For ensuring quality consultant and information services for my business	6.0	6.0
For education and training of the personnel	10.3	9.5
For modernizing the company management	19.0	17.2
For introducing energy saving technologies	28.4	26.7
For business cooperation and entry into business networks (clusters)	12.1	6.0
Other	0.9	0.9

Base N = 215

3.4. Level of Use of Information and Communication Technologies in SME Operations and Management

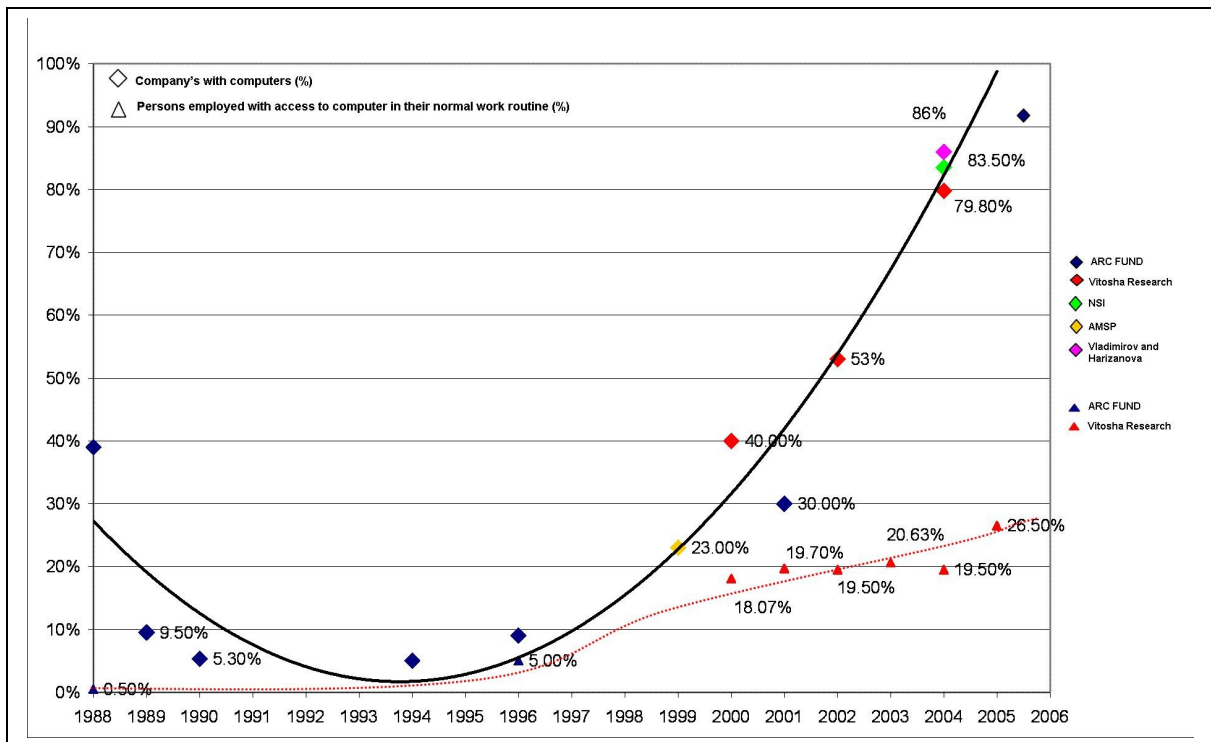
According to the data from the survey conducted by Vitosha Research, 78.3% of the Bulgarian enterprises are equipped with at least one computer. The remaining 21.7% are micro, usually family businesses, which represent a form of self-employment or operate in underdeveloped regions. Roughly half of the enterprises (50.4 %) have equipped with computers up to 25% of their workplaces and 8.7% have computerized 26 to 50% of the workplaces. The share of companies with high level of computerization is still low – 5.5% have more than 76% computerized workplaces and those in which every workplace is equipped with a computer amount to 7.4%. The process of computer penetration into Bulgarian enterprises is evolutionary, driven by administrative necessity rather than by proactive enterprise strategies for enhancing and innovating their business.

FIGURE 16. PROPORTION OF COMPUTERIZED WORKPLACES



Base N = 1011

FIGURE 17. ENTERPRISE COMPUTERIZATION

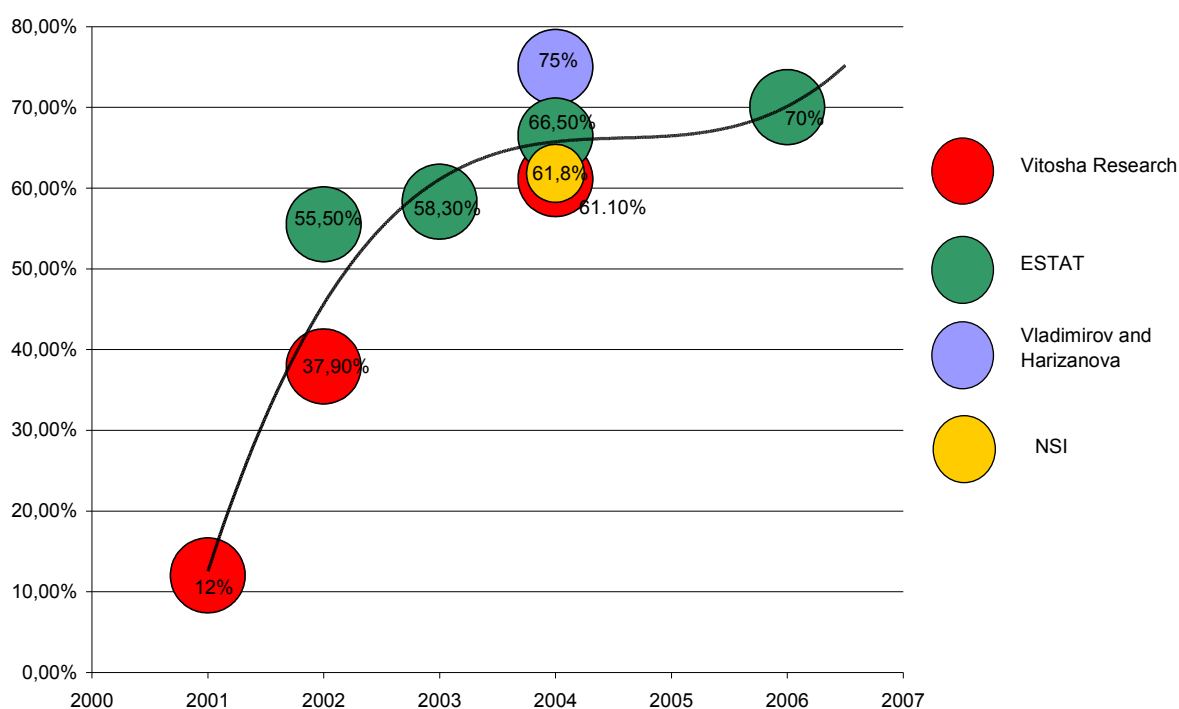


Source: Report "e-Bulgaria 2006"

Use of the Internet in Bulgarian Enterprises

About 73% of Bulgarian enterprises have an Internet connection currently. Their proportion is expected to reach a maximum of 90% in 2007. According to the Vitosha Research survey, the share of companies with their own web sites is 32.2 %. However, another survey, conducted by the Applied Research and Communications Fund, registered a share of 23.5%. The discrepancy is due to the different methodology used in defining the online presence. ARC Fund chose a different approach – instead of requesting feedback from the organizations through questionnaires, typically addressed to older and easily identifiable enterprises, a research team searched for the web sites of a sample of enterprises.

FIGURE 18. ENTERPRISES WITH INTERNET ACCESS



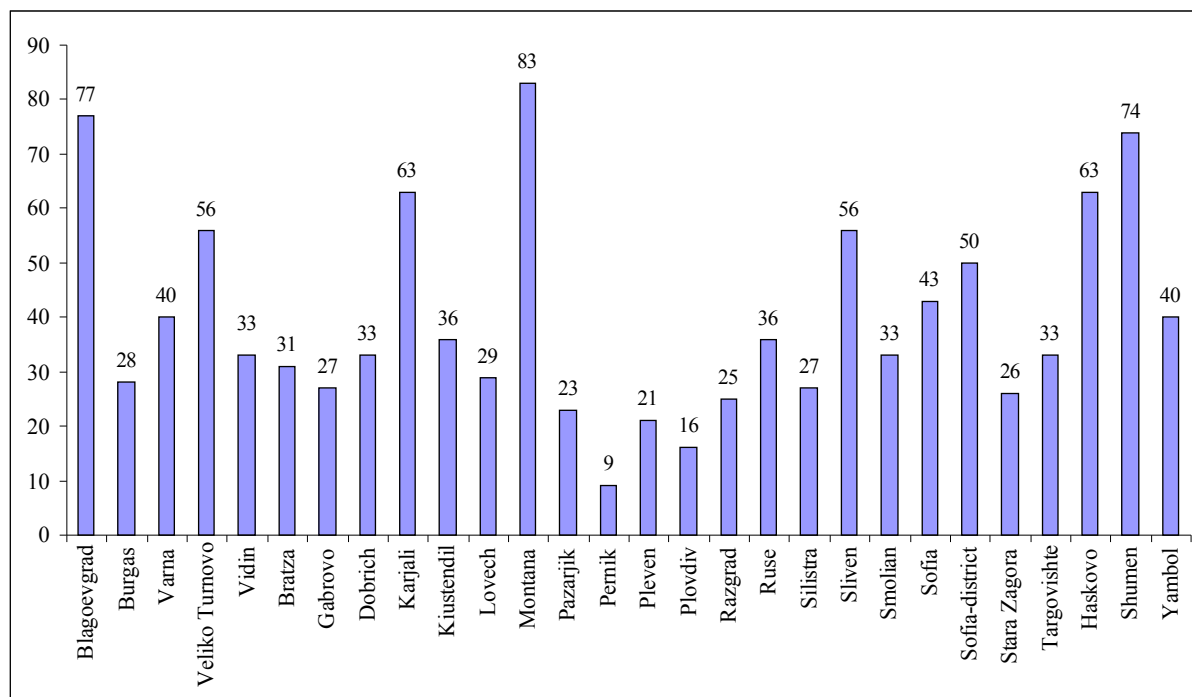
Source: Report “e-Bulgaria 2006”

The situation is similar as regards the companies with web sites allowing for e-commerce: according to the Vitosha Research survey, their share amounts to 6.9% (it is important to note that 11.2% of those surveyed did not know whether the site of the company for which they work offered such an option). On the other hand, ARC Fund data points that 11% of the companies, which have web sites, have integrated an option for e-commerce.

Computer Specialists at the Enterprises

More than half (60.5%) of the surveyed companies do not have any computer specialists but at least 63% of the companies with a staff of 101- 250 employed at least one IT specialist. Of the latter, 12 to 15% had only one computer specialist. Excluding the micro companies, 11-14% of the enterprises employ two IT specialists.

FIGURE 19. SHARE OF COMPANIES EMPLOYING AT LEAST ONE COMPUTER SPECIALIST BY DISTRICT



Base N = 1011

In terms of the share of companies employing at least one IT specialist, the leading districts are those of Montana (83%), Blagoevgrad (77%), and Shumen (73%). The respective share is smallest in the districts of Pernik (9.1%) and Plovdiv (16%).

Bulgarian enterprises are already well equipped with computers, with full workplace computerization expected to take place over the next 1-2 years. The process of building up LAN networks and connecting to the Internet is continuing at a rapid pace.

The representatives of employer organizations noted that in some regions, SMEs have no access to the Internet or the connection is of very poor quality. In turn, this was cited as a reason why SMEs fail to get properly informed on matters related to the European funds, since *“these are usually sites requiring a clean and stable connection”*.

The surveyed SME owners and managers said they had access to, and used the Internet – *“almost everyone has a computer and that’s not a problem”, “everyone is surfing the Net”, “I like to look around for information on things of interest to me”*. It is worth noting that to some of the companies, having a computer with Internet access is a matter of keeping up with some fashion trends rather than a functional necessity associated with their operation and/or management. SMEs face some problems regarding the searching for information – unawareness what to look for and where to find it, how to get the information needed using the computer, etc. Most companies have financial-and-accounting software programs; some use computers to monitor the movement/supply of goods; and in some specific sectors, companies hire specialists to work with particular software programs (apparel design, developing plans and designs, projects, etc.). Nevertheless, the participants in focus groups and in-depth interviews were positive that every serious company has and uses information and communication technologies in its operations and management.

**Box 8. USE OF INFORMATION AND COMMUNICATION TECHNOLOGIES IN SME OPERATIONS
AND MANAGEMENT – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY**

- *“In a number of cases I’ve come across business cards with just a cell phone number and nothing else. I think it’s high time to decide what kind of companies the government should and should not deal with. Personally, I would not bother with a company whose owner only has a cell phone number on his business card.” (employer organization)*
- *“SMEs are generally not too concerned with technologies and innovation. They’ve set up their business somehow and are happy to run it the way it is. We were amazed by the amount of information read – and I mean actually read, not just received - not by electronic mail but by fax. To be quite honest, I was shocked. 80% of the information is read if it arrives by fax.” (consultancy organization)*
- *“If you say these people do not read their e-mail, then what can be expected when it comes to surfing the net, looking for things of interest to them. It’s a technology. Browsing the net is a skill in itself, knowing how to browse.” (consultancy organization)*

3.5. Access To Financing of SME

The problem of the access to financing is a key one for the capacity of SME to absorb the structural funds for at least two reasons. First, the access to external finance is a critical condition for access to the structural funds and programmes, because the capacity of the majority of small and medium-sized enterprises to secure co-financing depends on it. Second, on the access to external finance depends the scale of innovation activity and the growth of the firm, which, in turn, also determine the chances for participation in grant schemes. Not many firms can afford technological upgrade solely through internal sources of financing, from the reinvested profit for example. Even if such a possibility exists, this would raise the price of the financial resource compared to their competitors, who make the same investment through bank loans. The taxation of business earnings favours debt financing over retained profit or the sale of shares.

The limited access to financing is traditionally among the most serious obstacles facing entrepreneurship in Bulgaria. In the last two to three years, the credit market in the country seems to have opened and is even showing signs of a credit boom. The banks entered into a sharper competition, interest rates have definitely fallen (although at the expense of some shifting of the credit cost to the supplementary conditions), the range of banking products has increased, services have significantly improved. The scale of the credit expansion is also evidenced by the concern of the BNB and IMF about its consequences on the trade deficit and the restrictions introduced for the cooling of the economy. These positive changes, however, remain mainly in the sphere of consumer credits and do not lead to a commensurate improvement of the access of small business to commercial loans. According to representatives of the employers’ organisations, there is nevertheless a upswing on the credit market and the role of companies’ own funds and mortgages of property is increasingly being reduced.

3.5.1. Degree, types and amount of used standard bank instruments – credits, leasing, etc.

The quantitative research among business shows that bank credits still remain a source that is expensive and difficult to access for the larger part of the Bulgarian SME. More than half of them have not used any credits at all during the last three years. A total 44% of the respondents have had access to credits during that period. Moreover, a part of them used **a consumer credit** for the needs of their business – i.e. smaller credits with considerably higher interest rates at the expense of the facilitated requirements for collateral. Some 37% of the participants in the survey used **a commercial credit** in the last three years. The amount of these credits is limited – their ceiling is on the average around 70,000 BGN.

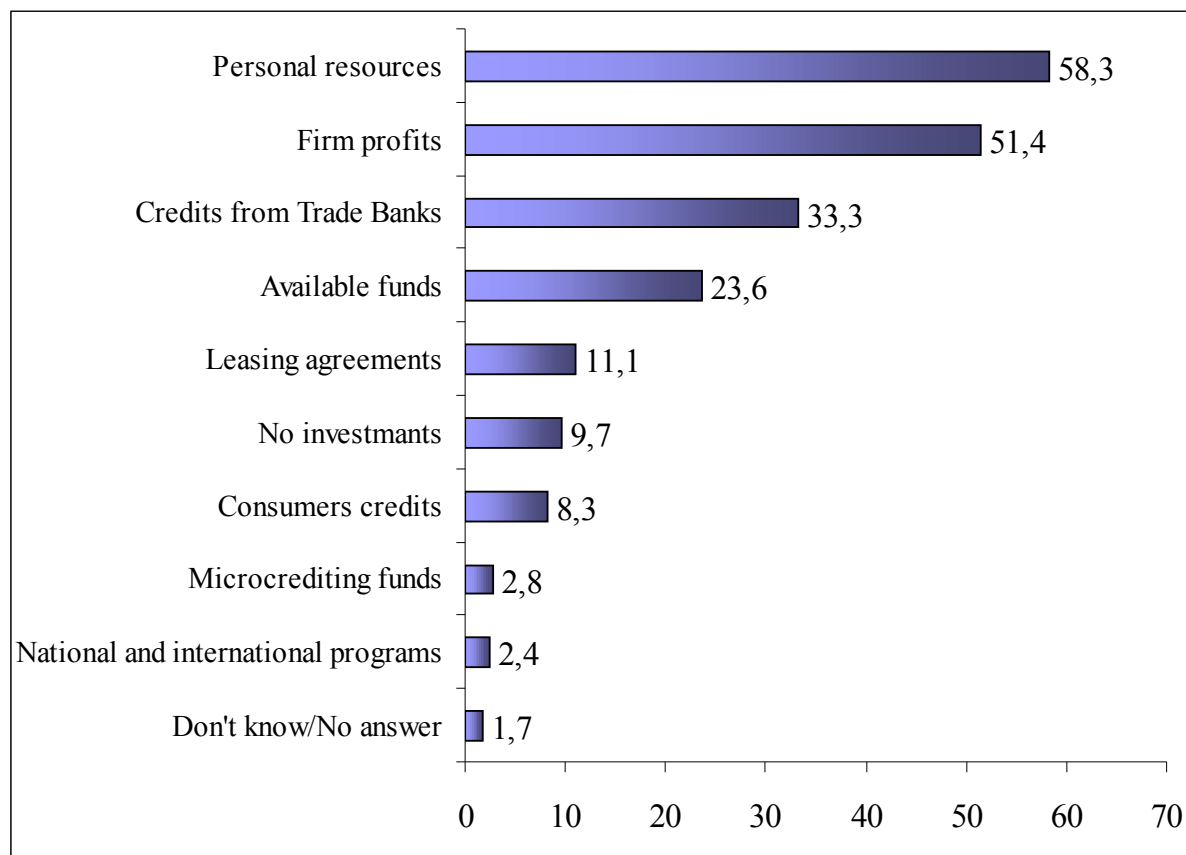
The share of **investment credits** is even smaller: some 18% of the respondents used such a credit. The maximum amount here averages 78,000 BGN. For comparison, the average ceilings of turnover credits are around 60,000 BGN, and of the “consumer” credits used by business - 47,000 BGN. If these amounts are compared to the amounts of housing and consumer credits for citizens, it becomes evident that regardless of the widely discussed credit boom, the banks are engaged mainly in micro and small-scale operations in the business sector.

Even smaller is the share of **leasing schemes** in the investment activity of the firms – one out of ten firms has used lease financing. The share of leasing among the main sources is negligible - 1.2% of the respondents cite it as a basic financial instrument. The level of maturity of the sector of financial intermediation is also evidenced by the fact that the share of those who have quoted consumer credits as the main financial source of their investments is larger than that of those who cite leasing schemes.

As a result, more than 60% of SME in Bulgaria have financed their investments in the last three years mainly with own funds. They cannot rely on external financing for new production capacities, which to repay from their future profits. In other words, the growth and investments of 60% of SME are determined by the reached production capacities and production scale, and not by the potential of the market. The access to credits is a basic condition for supply to meet market demand. In Bulgaria this condition is met only for 16.5% of SME, which have cited commercial credits as the main source of financing.

The conclusion may be drawn that the small and medium-sized business is still not relying sufficiently on the sector of financial intermediation, but uses mainly own funds. This statement is even more valid with regard to new and start-up firms. Among them, the share of internal (non-commercial) sources of financing is much larger, i.e. they are more isolated from the sector of financial intermediation than the older firms. Start-ups and new firms usually do not have a credit history, large assets, savings. Their chance lies in the special financial schemes and programmes for the encouragement of small business, but their share in financing is negligibly small. Nearly 10% of the firms created in the last three years have not made any investment so far.

FIGURE 20. SOURCES OF FINANCING FOR START-UP BUSINESS (%)



Base N=72 (firms, registered less than there years ago)

The interviewed representatives of the banking sector define the segment of SME as an attractive niche in the credit market in the country. The growth of the credits for SME in the overall growth of bank loans is considerable. For example, for 2005 in the range of 20,000 – 200,000 BGN CCB reports a rise of 174%, while the growth of its entire credit portfolio is 37%. The banks that are not specialised in services for SME, maintain special teams (divisions, sections, etc.) which study this credit market and develop products for it. These banks offer special (privileged) conditions for SME of the type of turnover credits, products with more attractive cost parameters, than those, for example, for corporate clients; programmes without required collateral; facilitated procedures are applied with a smaller number of required documents; the risk assessment is made under a special, facilitated procedure, differing from that for big corporate clients, etc. One of the surveyed banks launched the programme “Together in Europe” aimed at boosting the competitiveness of Bulgarian small and medium-sized enterprises in the process of the country’s accession to the European Union. The firms under the programme “Together in Europe” can, on the basis of the prepared project, apply for partial financing under the various EU pre-accession programmes for Bulgaria. The credits under the programme have a maximum term of seven years and a grace period of up to one year under a simplified and quicker procedure of consideration and decision-making.

A number of banks do not require the client to present a business plan for project appraisal. The views on the business plans prepared by the client are contradictory. For some banks this is *a waste of time*, others see it as a facilitation, which they provide for SME. For still others, regardless of the quality, the business plans are a *necessity, because they provide*

a possibility to see the client's viewpoint. In general, the banks agree that the quality of the presented investment projects, and business plans in particular, is not high and rather bad. Regardless of whether they do or do not require a business plan prepared by the client, the banks assume the role of consultant by advising their clients how to prepare such a plan or prepare their own business plan. The quality of the prepared business plans would improve if the firms start taking the EU requirements into consideration. With the accumulation of credit history, SME accumulate also more experience in the preparation of business plans, the quality of the presented plans increasing. The quality of the investment projects prepared by SME, with which the firms currently apply for credits, however, is assessed mainly as “tragic” or “bad” by the organisations of employers.

Box 9. CREDITING OF SMEs AND QUALITY OF THE PREPARED BUSINESS PLANS – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“We lack this clarity, for this is the most important thing – we all speak of the funds, but nobody grants this money without a perfect business plan. And a perfect business plan is made with a guarantee, a bank guarantee. This means that there must also be a bank to guarantee that you will absorb this fund and it will monitor how this fund is used. But in Bulgaria, I have to tell you that “bank – small and medium business” – the distance between the two is from here to the Moon. The bank and medium-sized businesses do not communicate at all. They only use our money passing through them, but they are not interested in how we progress, how we work.” (owner of small firm)*
- *“Here we have departments with colleagues who help firms to prepare projects, business plans. Most often investments are made on an intuitive basis, and not because all financial aspects can be presented.” (employers' organisation)*
- *“We are approached mainly for credits. Ways are sought. We even thought of occasionally assigning our representative to the credit specialists in some of the banks, in order to protect our members, because it is quite an ordeal to apply for a loan. It is almost impossible, unless you have some protection or super pledge. Our members are mainly seeking co-financing and respectively trust in financing, seen in a smaller set of documents.” (employers' organisation)*

The banks are flexible in the application of their programmes for SME. Their framework serves as orientation, and the aim is not to force the client inside it, but on the contrary, for the bank to take into consideration the expectations of the client. These credit framework conditions can change, the conditions of the loan differ – for example, from a credit ceiling of 200,000 BGN to seven million BGN. The term of the credit is also changeable, the maximum possible term being 10 years. In some cases the repayment term may also be structured up to 30 years. If the client is promising, the credit ceiling may be raised by respectively also changing the category of the client – from SME he passes into the group of big corporate clients.

3.5.2. Basic problems in the access to credits and the reasons for not using them

Among the main obstacles, which the respondents cite to their access to bank credits, are the high interest rates (54.3% of the respondents), the “hidden” costs on the credit (19%), as well as the excessive requirements for collateral (40%). Thus, for example, the collateral is mainly fixed assets: land, buildings, machinery and equipment. The share of intangible collateral is small (12%). For a considerable part of the firms, bank bureaucracy proved an

insurmountable obstacle: weighty documentation, insufficient competence and efficiency of employees, etc. This definition might possibly also include the unjustified, according to the clients, requirement of the banks with regard to business plans, accounting reports and credit dossiers, but this is nevertheless an indicator of the standard of services as perceived by the client.

TABLE 12. MAIN REASONS FOR THE FIRMS NOT USING CREDITS

	From bank institutions	From non-bank institutions
High interest rates	54.3	12.5
Excessive requirements for collateral	40.3	9.2
“Hidden” costs on the credit	19.0	6.0
Weighty documentation	19.6	5.6
Insufficient credit history of the firm (according to the Bank)	7.7	1.9
Insufficient efficiency of employees	1.2	1.0
Insufficient competence of employees	2.1	3.3
No need of credits	34.4	36.1
Other	1.7	1.2
No answer	4.8	41.3

Base N = 1011

The reasons for these still significant barriers to the access to financing reflect mainly problems on the supply side and, more specifically, good opportunities for the banks for quick and higher profits from consumer and housing credits, compared to investment credits, which leads to a disproportionate share of the former in the credit portfolios of the commercial banks. Not to be ignored, however, are also the problems on the demand side and the overall regulatory environment in which the financial sector in Bulgaria operates, and their effect on the assessment and management of the credit risk. Considerable parts of SME still do not have credit histories. Besides this, a large part of their operations are in the “grey” part of the economy, which is dominated by cash payments and concealment of incomes, while good and complete accounting reports are rare. In most cases, the presented business plans are also unable to give the banks enough input for risk assessment. At the moment, start-up firms would find it very hard to cope without the help of the banks, but they, for their part, do not tolerate the start-up business and very rarely assist start-ups. The policy of the majority of the banks is to grant credits mainly to well established firms. According to a bank specialist, *“not only the banks have to change something in their policy, but the firms too should do so, because they are still in the ‘grey’ economy and will have to try to come out of there, and in this way it will be easiest to absorb the funds. And the banks must prepare new products for easier credits for the renewal of the technologies and machines of the firms. An upturn in this market is expected by the end of the year.”*

The lack of credit history and reliable accounting information about the past and the feasibility of the future plans of the applicant hamper the banks in the assessment and management of the credit risk and cause them to over-insure themselves with higher risk premiums and securing receivables with fixed assets. The latter, however, especially in the case of production equipment, have low liquidity. This leads to the underestimation of their market value and makes the credit more expensive. Even real estate, although at first glance being more liquid than equipment, hides the risk of unsettled ownership rights, incomplete urbanization and cadastre plans, etc. All these defects in the factor markets increase the risk of

the collectibility of debts. Bank employees point out that the inefficiency of the judicial system in the enforcement of the obligations and contracts is another factor which heightens the risk premium and the cost of the credit.

The rejection of credit applications also vary according to the policy of the bank – from 10% to 70%. But this kind of statistics may exaggerate the problem of access to credit. In some cases, it includes the initial contact with the client, i.e. the initial screening, when conformity to the basic credit requirements is verified. Once this hurdle is cleared, the share of approved credits quickly increases. Cited as the main reasons for refusal are: 1) the quality of documentation, respectively the way of presentation of the business idea; 2) the providing of collateral, which is most often a real estate mortgage or tangible fixed assets; 3) many of the firms are in the “grey” economy, do not declare profits, the accounting documents are irregular; 4) inability of the firm to provide the information required by the bank – not because of missing documents, but due to low economic and financial culture; 5) poor credit history – debts / overdue payments to other banks.

Outlined as a key problem of the access of SME to a financial resource is the interaction of the bank and non-bank financing. If we were to speak of a competition between these two sources of financing, for the time being it is definitely won by the banking sector. The only financing which competes with the banks to some extent at the moment is leasing. The reasons for the lack of sufficient risk capital funds, directed at SME, are mainly objective. The problem of these funds is that they are trying to make bigger investments, for which no favourable conditions exist in the country.

The European programmes for the financing of business, including SME, are viewed as a separate instance of non-bank financing. The banks are aware that in this case the firms are granted funds at a significantly lower price than that of the credit resource. The non-bank sources, especially the international programmes, offer more liberal conditions – for example, the financing of a basically investment project in the form of short-term financing. Undoubtedly, these funds are attractive for SME and if this source is advertised actively, the SME will turn to it. There is an objective need for such a non-bank resource. It helps to overcome a definite risk element in the work of SME. According to bank specialists, currently a significant number of SME work on the whole as banks due to the lack of sufficient own funds, i.e. with 10-15% own capital, the rest being supplemented by attracted capital and arrears to suppliers.

In working with external programmes for financing, the SME may also come across difficulties of a different kind, which ultimately make the extended resource more expensive. These difficulties can be a number of commitments as to term, outputs, targeted social impact, type of admissible expenses (requirements for EU suppliers, which may raise the cost of investment and reduce its returns), disbursement of an effectively made investment, etc. According to a bank expert, faced with them, the entrepreneurs and businessmen “*who are tied to terms, prefer bank financing, because things there are much clearer and they can make some sort of estimation - when they start working, when they stop and what results are achieved*”. But the banks are definitely aware of the opportunities they are given by the European programmes with the conditions they make for the absorption of the respective funds. For example, the requirements for co-financing or for the disbursement of an effectively made investment after its conformity to formal criteria for admissibility has been evaluated, open possibilities for bank crediting of people working under such programmes.

“Usually in the sense, which is implied in the concept of non-bank financing, in most cases it is simply impossible to be realised without bank financing. We are speaking of small and medium-sized enterprises and their participation in the process of financing by non-bank financial institutions in the aspect we are now discussing. Now, in most cases in this situation

it is impossible to realise without the mediation of the bank. So that things go in parallel.”
(Bank specialist)

The banks that have worked under the SAPARD Programme until now, for example, have garnered valuable experience in this respect. The point is, by learning lessons from the practice with the pre-accession funds (SAPARD, PHARE), to achieve a more effective absorption of the resources. An important prerequisite for this is also to set the kind of conditions for the management of the European funds, which will not allow businesses to view them as a “scam” to benefit from.

The prospect to set up a National Guarantee Fund has again revealed two traditional points of view, which conditionally may be defined as “*interventionist*” and “*liberal*”. Virtually all interviewed banks, with one exception, declared themselves in favour of the interventionist point of view, i.e. the state is obliged to create such a fund precisely for the purpose of assisting SME, whose access to credits is difficult anyhow due to the high risk they generate. For example, the strategy of the state-run Encouragement Bank for expanding its functions provides for the creation in its structure of a National Guarantee Fund, as well as of a risk capital fund.

The “liberal” point of view sees the guarantee as a kind of subsidised credit, which can only distort and disturb the competitiveness of the market. This is not an acceptable approach, because it encourages ineffectiveness, and the banks themselves are stimulated not to seek effectiveness, but access to guarantees, regardless of the competitive power of the business, which makes use of this guarantee. This is so because the subsidy is not allocated according to market principles, i.e. according to the assessment of the risk and the profitability of the investment, but due to other, including political considerations.

“Because the money in the economy is not distributed on the basis of some objective market weighed indicators, such as risk and profitability, causing the banks to invest money where they think profitability is highest and the risk lowest, they will invest where there are subsidies. ... For example, one party will push for tobacco, another – for tailors, but these are not the sectors that are promising in the long term, ... and instead of Bulgaria finding its place on the economic map of the world in which it would be good to specialise and to develop, time and resources will be wasted ... in order to finance some ineffective politically decided directions” (Banker).

In contrast to the National Guarantee Fund, the opinion of all interviewed bankers regarding the funds for micro-crediting is markedly positive, even in cases when they are based on providing guarantees by a non-bank institution. The leading criterion in this case is the social effect, which is achieved by attacking unemployment. This, a bank specialist says, is “*a good way to cope with the high unemployment. This is something different from the Guarantee Fund. For it is one thing to give a guarantee of 500,000 euro to an enterprise, which is ineffective, to buy some machines and to continue to exist, because it has a guarantee, and another thing to give 20,000 BGN at low interest to a person who is unemployed, to enable him to get back on his feet and to help himself, This is completely different.*”

What is still lacking is information about the possible tie-up of the resource from the Euro-fund with such guarantee funds for micro-financing. The banks which until now have worked on micro-credit guarantee schemes such as CCB, EIBank, etc. consider that their experience should be actively used in future too.

It may definitely be said that the banks are familiar with the conditions for working with the currently existing guarantee schemes for micro-credits. They specifically also point to some weaknesses in their organisation, which ultimately lead to making the resource more expensive. Thus, for example, mentioned as a principal weakness is the mechanical division

of the bank and non-bank part of the operation. In this way, the target strategy, investment policy, social parameters, conditions of the credit are determined without the direct participation of the bank, i.e. without taking account of the purely financial effectiveness of the product. For this reason, i.e. due to the disproportionate “swelling” of the non-bank criteria and conditions, some banks have estimated that their participation in these funds is not favourable for them.

The above considerations are indirectly supported by the structure of the credit portfolio for SME. The general impression is that investment credits predominate, their share varying from 20% to and over 50%. The main purpose of the investment credits is the investment in tangible fixed assets. Leading are the sectors of agriculture and the food industry. Attention is also paid to the fact that the division of the portfolio of investment and turnover credits is conditional, since a successful investment requires also a certain share of working capital. What is indicative in this case is that in the view of the interviewed bank specialists, either insignificant or no funds at all are allocated for consultancy services, market research, development activity, staff training and qualification and for optimisation of the company management, i.e. for investments, which would ultimately lead to an increase of the value added of the offered production.

In general, it may be concluded that SME resort to bank or non-bank credits under the pressure of events, for fear of failing in the conditions of high competition. From this point of view, no matter how unusual it may seem, with respect to the observance of the European standard it is the banks that are in a leading position, and not so much their clients. In trying to manage the credit risk, the banks are forced to evaluate the business idea from the position of the future European standards, which will have to be observed.

Box 10. GOOD PRACTICE

First Investment Bank increased the maximum amount of micro-credits for business from 30,000 to 50,000 BGN (or their equivalent in euro or US dollars). The “Turbo” credit, targeting producers, dealers and freelancers is extended under an extremely facilitated procedure and a minimum amount of documentation. The repayment term depends on the purpose of the credit. If it is for turnover capital, the period is up to two years, respectively for investment credits – up to seven years, overdrafts – one year, revolving at the end of the period. The FIB does not require the applicants to present either a business history, or a business plan. The purpose of the loan is discussed with an expert and the most suitable credit scheme is suggested.

The clients can apply not only at the offices of the bank, but also at its website. Within 24 hours after the necessary documents have been submitted FIB gives an answer to the applicant. The annual loan management fee amounts to 1.0 pct. Both the interest and the service management fee are calculated only on the remainder of the unpaid sum.

The bank offers unsecured micro-credits to the amount of up to 20,000 BGN without obligatory official proof of incomes. The Micro-crediting programme, under which the Turbo credit is offered, accepts the entire range of collateral securities. In case of proven incomes, the micro-credit applicants can also avail themselves of mortgage loans with a 0% interest for the first year and 7.5% after the second.

3.6. Current State of the Consultancy Network and Services

3.6.1. The use of consultancy services by business – present state and analysis of the needs of the enterprises for such services

The main conclusion that can be drawn on the basis of the Vitosha Research survey results is that the attitude of the firms towards consultants in Bulgaria tends to be reserved – only one-fifth of the surveyed companies used consultants during the past year. The most frequently cited reasons for this in the focus groups are the low quality of the offered services and their high price.

In general, firms prefer accounting/financial and marketing services related to their main and daily activities. The propensity to use consultants for the preparation of project proposals under the European funds and programmes is low. This attitude is portrayed by the views expressed by entrepreneurs in the focus groups that some of the events at which information is presented about application under different European programmes and funds are organised by consultants who do not provide the full information, but try to attract future clients instead. The distrust is amplified by the frequently mentioned existence of corruption, which causes firms to refrain from applying.

Regarding the object of the consultations, the expectations of the firms are linked with the providing of direct help in the preparation and current work on the implementation of the projects, and not with the presentation of information materials and the organisation of events to explain the conditions for applying. This conclusion is supported also by the opinion of interviewed bank specialists that the money allocated by the firms for consultancy assistance in studying the market, for development activity, for attracting foreign investments, for marketing, etc., are insignificant or non-existent. The information from the interviewed bank experts shows that the position of the consultancy business with regard to services for the SMEs is not strong. This is confirmed by the answers of the respondents concerning their intentions to take part in tenders under European programmes and funds, among which the firms have placed at one of the last places in terms of needs “ensuring more accessible and quality consultancy and information services” – 7.3%.

TABLE 13. INTENTION OF THE FIRMS TO APPLY FOR FINANCING FROM THE EU (%)

Projects	
For technical upgrade of production facilities	49.4
For meeting European standards	36.9
For developing new products, technologies, services	20.4
For introducing energy saving technologies	19.3
For modernizing the company management	14.0
For education and training of the personnel	9.5
For attracting foreign investments	8.1
For ensuring quality consultant and information services for my business	7.3
For business cooperation and entry into business networks (clusters)	7.3
For promoting and increasing the export of the company	4.5
Other	4.5

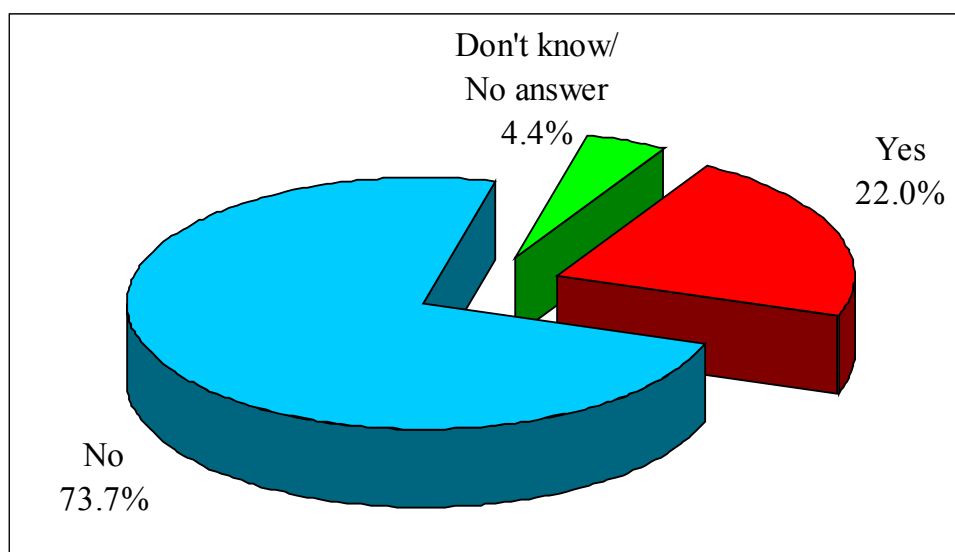
Base N = 358

One of the concerns of the SMEs commented in the focus groups was the lack of guarantees on the part of the consultancy organisations on the success of the submitted projects. These views show a lack of knowledge of the principles of tender application and to

some extent reveal the attitude of the firms to consultancy services. “Guaranteeing” the success of a project already at the application phase, i.e. the expectations of the firms for success, creates prerequisites for the development of corrupt practices. The existence of such corrupt schemes, on the other hand, impedes the normal work of the consultants, placing them in an unfriendly competitive environment.

The statements from the focus groups are confirmed by the results of the opinion survey, which show a relatively low share of SMEs using consultancy services during the last year of their activity: 22% of the surveyed have given a positive answer, with 49.5% of them being completely satisfied, and 47.3% - somewhat satisfied with the delivered services.

FIGURE 21. USAGE OF CONSULTANCY SERVICES BY THE FIRMS DURING THE LAST YEAR



Base N = 1011

As the main reason for not using consultancy services the surveyed firms cite the lack of the need for consultations – 63.2%. An almost equal number of answers cites the lack of information on consultancy services and their high price as the main reasons hampering their usage by companies – 31.5% and 30.5%, respectively. The lack of practical value of the offered consultancy services ranks fourth with 19.6%.

TABLE 14. REASONS FOR NOT USING ANY CONSULTANCY SERVICES DURING THE LAST YEAR

I don't need additional information/services	63.2
I don't have information about the services which are offered	31.0
The services are expensive	30.5
The offered information is no of practical value	19.6
I don't have enough time to use the services	14.8
There is no structure of this type in the region	13.0
I'm not satisfied with the services' quality	12.9
They don't have the information I need	12.8
Other	0.8

Base N = 745

The lack of information about the consultancy services offered and available may be explained with the answers of the SMEs about the information sources they use. The firms obtain information mainly from business partners, friends and colleagues – 68.9%, i.e. they basically rely on the recommendations of people who might have already used consultancy

services. The share of the media, advertisements and PR agencies as an information channel is almost twice lower – 33.8%. The third place as a source of information about consultancy services is occupied by fairs and exhibitions – 30.6%

TABLE 15. SOURCES OF INFORMATION ABOUT THE OFFERED CONSULTANCY SERVICES

From business partners, friends	68.9
Commercials and PR agencies	33.8
Exhibitions, fairs, specialized exhibitions	30.6
Consultant agencies	18.9
Other	7.2
No answer	0.5

Base N = 222

The results of the survey warrant the conclusion that the offer of consultancy services for the preparation of projects under the European funds and programmes does not correspond to the real needs of SMEs. This can be seen when comparing the answers of the surveyed firms to the questions of the services already used by them and the services they need (*Table 16*). Most telling are the data of the actually used and needed services by SME for “Elaborating documents for applying in tenders for projects, financed by donor organisations” and “Management and reporting of projects, financed by donor organisations in the sphere of SME”. In the first case demand exceeds almost twice the actual use (25.2% vs. 13.5%), while in the second case the difference is even more drastic – almost four times.

TABLE 16. CONSULTANCY SERVICES USED BY THE FIRMS AND THE NEED FOR CONSULTANCY SERVICES

	Consultancy services used	Need for consultancy services
Information about import-export	12.2	14.0
Marketing surveys	26.1	19.8
Finding new business opportunities and developing business plans	11.7	18.0
Looking for financial sources	23.0	30.6
Training	20.3	19.4
Making international partnerships and cooperating with suppliers and clients	12.2	16.7
Law and account services and consultations	54.1	31.5
Patents and protection intellectual property rights	7.2	8.1
Making partnerships and business cooperation in the country	13.1	15.8
Information about new technologies and opportunities for technology transfer	12.6	18.0
Organizing participation in presentations, trading fairs, publishing commercial materials	13.1	11.3
Elaborating documents for applying in tenders for projects, financed by donor organisations	13.5	25.2
Management and reporting of projects, financed by donor organisations in the sphere of SME	3.6	13.1
Other	9.0	2.3

Base N = 222

On the basis of the information from interviews with bank experts and representatives of employers’ organisations and from the focus groups with representatives of SME and

consultancy organisations, it may be concluded that the consultancy business is regarded with scepticism by SMEs in Bulgaria. Regardless of whether they do or do not require business plans prepared in advance by their potential clients, the larger part of the bank experts do not trust the plans developed by external consultants. According to the majority of the expressed opinions, the business plans prepared by consultants follow the same very well discernible pattern; there is a visible lack of interest on the part of the consultants about the fate of the business project, as long as they get their fees. For a number of reasons, including conflicts of interest, *“things are presented not the way they are, but the way they should look like in the eyes of the bank institution”*.

In general, the participants in the qualitative survey consider that the consultancy business in Bulgaria does not enjoy great trust by the SME. There are a multitude of firms claiming to be consultancy firms – both in Sofia and elsewhere in the country, but the reputation of this business is not high. Some experts including representatives of consultancy organizations express the opinion that *“...the consultancy business is a form of taking bribes. For example, if you have not been consulted by this and that firm, your project won't be approved, no matter how good it is ...”* (bank sector representative).

A bank specialist noted that *“99% of the firms do not seek consultancy services because people are embarrassed and want some trusted person to explain things to them, such as a bank employee for example. People do not trust external consultants”*.

SMEs also share the distrust of the banks in consultancy services. *“They [SME] ... simply are not aware of the effect which a well consulted project can ensure them ...I think that ...this is a lack of trust and they [the SME clients] decide to remain within their current frames, ...simply because they cannot accept that somebody else's idea, which seems a bit abstract to them will be successfully realised ...”* (Bank specialist).

Box 11. STATE OF THE CONSULTANCY NETWORK - OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“There are already many firms..., which call themselves consultants, but for me to trust them – I don't think so. It is very easy to become a consultant. They all want to absorb European funds. They all say that they have to take the money of Europe, billions, for agriculture, infrastructure, ecology. We no longer pay any attention to them (employers' organisation)*
- *“Companies say now: why should we use consultants when it's possible to do without them, but they still have not felt the fierce competition that will come tomorrow. Once they do, perhaps they will rush to the consultants. Then they will not scorn consultants, will not scream about corruption, but will be inclined to give up to 30% perhaps, only and solely to get in or only and solely to become somebody's subcontractor. The slap in the face has simply not yet come”* (NGO representative)
- *“It is very difficult to convince a small entrepreneur and to tell him something about his business. Their logic is: I have built up this firm from scratch, with my own two hands, so who are you to come and tell me how to run it”* (consultancy organisation)

Box 11. STATE OF THE CONSULTANCY NETWORK - OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY (CONTINUED)

- *“The Bulgarian says: you give me money, I don’t need brains. They really and truly believe that they do not need brains. It is not that they cannot afford it financially. For example, our survey showed that the cost of the consultancy service ranks in fourth or fifth place among the factors of importance in decision-making. Apart from this, the Bulgarian is sceptical, he does not trust consultants. He thinks that they will take away his business, steal his information, sell him out to the competition, etc. This is a way of thinking” (consultancy organisation)*
- *“The consultancy business does not correspond to the real needs of the market, at least not when compared to our partners abroad, if we compare things with the EU. I don’t know what it’s like in Sofia, but usually anyone who has graduated in some sort of general speciality, let’s say economics, says I’m a consultant and can do projects. It is much easier to say so than to actually sit down and do it. And then he justifies himself by saying that the conditions were unfavourable. For example, a small firm failed to win a project, because we did not pay in Sofia, while I cracked my head over it, while I did not sleep. This is business. We pay for these projects. Perhaps the state should intervene to the extent of setting up an authorised licensing body with high criteria and to prevent these licenses being bought.... Because we are used to them being bought and always resort to bribes” (representative of employers’ organisation and businessman)*

Some objective factors are also identified which disturb the “SME – consultant” relationship. The respondents say that there is no business information, standardized on the basis of international standards, in the country. The bad business statistics for the business activity by sectors (average operating coefficients, liquidity, assets turnover, capital turnover, leverage, etc.) force each bank to create its own data base for risk assessment. Besides this, due to the relatively high price, for the time being most SME cannot afford to make use of consultancy services. To provide a quality consultancy service requires working teams of European quality - with high education, training and experience, but the differences in the remuneration of such teams in Bulgaria and in Europe is 6-7 times in favour of the latter. Consultancy services are still not consolidated, the impression is created of a certain fragmentation of consultancy services for SMEs. Nevertheless, according to some bank experts, according to the representatives of employers’ and consultancy organisations and the owners and managers of firms, the consultants in the SME field are necessary for the firms, especially for the preparation of bigger projects. In these cases, unless consultants are hired, the firms have little chance of succeeding when applying for financing of their projects.

The bankers approve the fact that under the programmes of the European funds money will be allocated specifically for the financing of consultancy services. Part of the interviewed representatives of the banking sector express the opinion that the establishment of in-house consultancy capacity in banks – initially created to service individuals, and lately also for SMEs, is the future of the sector in Bulgaria and is yet to be developed. According to representatives of NGOs and consultancy firms, as well as of different entrepreneurs, consultancy services are necessary and in demand, and increasingly more SMEs realise the need to use such services. The main support for SME towards their preparation for accession to the EU is provided by the national network of information centres, the Bulgarian Chamber of Commerce and Industry and the regional chambers of commerce and industry, chiefly by

organising trainings, but the preparation of business in this direction is done differently and with a different pace and quality.

The representatives of the employers' organisations consider that the quality of the offered consultancy services could be improved through the introduction of *“a better form of licensing. This means that we will see the entry of quality firms or consultants, and we will really be able to trust them. Right now we are asking. And because we lack experience, not all firms have experience... exchange of information among colleagues. This is the most certain way to exchange information”*.

Box 12. STATE OF THE CONSULTANCY NETWORK – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“I have also heard of private consultants, I don't want to advertise them, but the firms are doing a good job. They are sought after and people say that they are satisfied. So that people are asking for their services.” (NGO representative)*
- *“The consultancy business already exists and it has oriented itself very well, but it needs to be fed or at least it should not be kept from working. In some cases we think that the corrupt schemes that are established, I dare say, hamper the work of the consultancy structures.” (NGO representative)*
- *“One of the ways is the differentiation of consultancy firms. You cannot be a consultant on everything. You have to know when to assume very serious responsibilities for what you are offering as a product and you have to be specialised, in a concrete field, and then I think that the struggle or at least the effectiveness of these schemes will be very accurate. In this way every self-respecting consultancy firm, I think will be able to cope with corruption.” (consultancy organisation)*
- *“The firms are beginning to realise that things are becoming more complicated, that it boils down to knowledge, and have started to turn to consultancy firms. I cannot complain over a lack of interest. But we are not used to value the work of consultants. For one thing, we do not like anybody giving us advice, let alone paying for it. In many cases I first have to convince the customer of the benefit. I am also worried by the diversity of consultancy firms, since in practice a consultancy firm does not require capital. What happens is that people who are made redundant in the state administration, start offering consultancy services. In a number of cases they are good specialists, but for two, three, five months. During that time, if they are able or establish a clientele, they begin to follow developments and keep up their qualification, but in most cases they do not succeed. The level of qualification drops. (employers' organisation)*
- *One the one hand, the firms are not prepared to pay for these services, on the other hand, there is much watering down of the market of consultancy services. Perhaps this is the place to say that the State SME Agency also offers consultancy services. And this is where things become ambiguous. In my opinion it should state clearly that it undertakes all consultancy services on such and such a question, because it should not offer certain services free of charge, and others against payment. I am not commenting the quality of what the Agency offers, but in this way the market is spoiled.” (employers' organisation)*

According to the representatives of the employers' organisations, the quality of the offered consultancy services may be improved through the activities of the sectoral umbrella organisations, which appear as a guarantor that their member-enterprises are offered quality

services. One problem, however, is the support of these organisations – attempts have been made to regulate this through the new Law on Associations, but the act has not yet been passed through Parliament.

Although increasingly more SMEs realise the need to use external consultancy services, a main obstacle for this not happening on a mass scale is the price of the services which are assessed as “*expensive and unaffordable*” by the firms. Still some companies believe that the necessary information, knowledge of the markets, the competition, the models, the organisation of business in the EU is needed, regardless of the price, because this knowledge will turn into an advantage for the firm, i.e. those who want to develop and to be the first, who want to outdo their rivals in Bulgaria, will do what is necessary to attain this advantage.

Box 13. STATE OF THE CONSULTANCY NETWORK – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *We find it difficult to distinguish quality. ... Quite a number of foreign firms have already entered Bulgaria; we think that if we turn to a certain German consultant, we will get better service. In a number of cases this was true, but ... the difference in the prices is enormous.” (employers’ organisation)*
- *“There are firms in the grey economy which couldn’t care less about consultancy services and their way of thinking differs. For them business is made by rubbing shoulders with some public servant or the mayor and through the redistribution of state funds. A firm’s owner must be well aware of the need, of what exactly he needs in order to estimate it. If he hasn’t realised exactly what he needs, he cannot assess what the benefit will be of what he needs. If he does not know what the benefit is, then he does not know how much he will pay for this service.” (employers’ organisation)*
- *“We want to know that in Slovenia, after it entered the EU, half of the SME in this sector closed down for such and such a reason. Others remained for such and such reasons. We must know what is happening in the EU with those who are closer to us. What has happened in Hungary, for example. In the dairy sector, for example, out of 6,000 enterprises only 2,000 are left. Why? Which ones? With what kind of technologies? This information is kept somewhere. I assume that it is public, because the consultants usually abuse this. Everybody has got some information from somewhere and wants to sell it. But it should be free. Until we get it we will not know what to ask for.” (representative of employers’ organisation and businessman)*

3.6.2. Tendencies for the development of consultancy services – market niches

The consultancy business in Bulgaria is a promising sector of the economy which is yet to develop its full potential. The opinion survey, the discussions in the focus groups and the in-depth interviews conducted by Vitosha Research outline the following tendencies in the development of consultancy services in this country.

- An important role of the consultancy organisations is mediation – to relay the European experience, the information about what is happening in the EU in the business realm and the respective economic sectors in a language that is understandable and accessible to SMEs.

- The free market niches in the field of consultancy services remain mainly in the field of project preparation and management under different EU programmes and funds, as well as in the preparation of business and investment plans.
- The in-depth interviews, conducted with representatives of banks, show the need for identifying and providing consultancy services, related to securing information and training of the banking sector about the opportunities they will have to secure the co-financing of initiatives/projects under European programmes and funds, linked chiefly with granting loans for the so-called “bridge financing” and the development of new financial instruments.
- The licensing of consultancy services could lead to a balance in demand and supply both with regard to quality and with regard to the quantity of services. It will heighten the trust of the firms in the advice that is offered, because it will also limit corrupt practices. It can be seen that in the spheres subject to licensing and tied to a clearly regulated legal framework – the demand and use of consultancy services is being equalised, and in some cases use even exceeds need as a percentage – these are training, legal and accounting services and consultations, patenting and the protection of intellectual property. The imbalance among the rest is obvious.

Box 14. STATE OF THE CONSULTANCY NETWORK – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *In Italy, for example, all such services are gathered under one roof in order to make them easily accessible to entrepreneurs, whereas here the associations, services and unions have to be tracked down across the whole city, they are scattered in all public buildings, in which they can be expected to be found... There is no implemented state policy to help us establish contact to these organisations and try and provide a building stock to house them, even with one office each, to have them in one place. For the time being only going from place to place and leaving a visiting card tells entrepreneurs about the existence of these organisations.” (employers’ organisation)*
- *“Concerning the private consultants – unless they are given sufficient responsibility, these corrupt schemes will continue to exist. And, in my opinion, this must happen with a law, a law on consultancy activity. ... For if such a law is passed, it will regulate and put these things in some very strict frames. And then many interests will be affected to a large extent. But this is the way.” (consultancy organisation)*

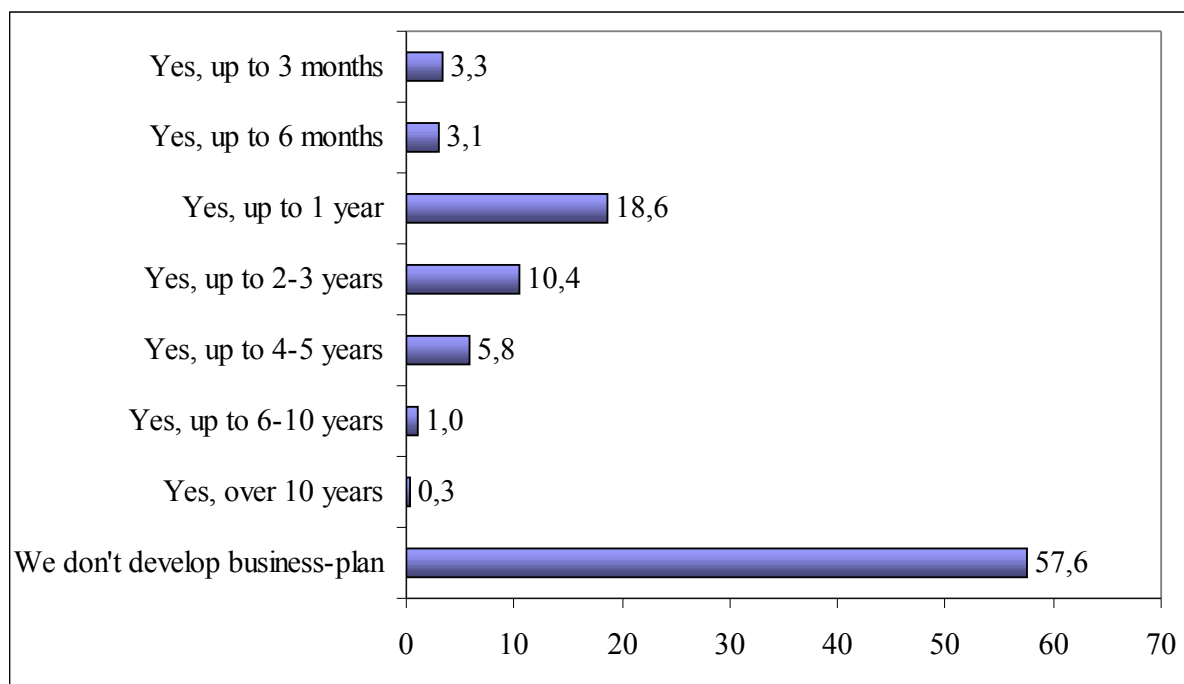
- Innovation consulting services, such as patenting and the protection intellectual property rights (7.2% of the respondents have used such services) and information about new technologies and possibilities for technology transfer (12.6% of the respondents have used such services) are also very poorly developed in Bulgaria. They represent yet another market niche that will develop in the future. The operational programme “Competitiveness” could be a catalyst of this process.

3.7. Business Strategies and Management Programmes of SMEs

The adequate preparation of SMEs for competition under the conditions of EU membership undoubtedly includes expanding the time span of planning and emphasizing strategic governance and sustainable growth, instead of the focus to date on operative management and survival only. In a situation where *strategic* is perceived in *ex-post* terms: a reflection on successful entrepreneurial behaviour, rather than *ex-ante*: a rationally developed plan for the best use of one's competitive strengths, for minimizing the threats, etc., it is necessary to focus on strategy development mechanisms and methodologies, the internal organizational structure, and partnership among the companies in developing strategies and long-term plans. In this way, the companies would be able to synchronize their business activities with those envisioned in the national development plans (with a time span of 7 years), the operational programmes (that will ensure the large portion of the financing of the growth), as well as those of their partners and stakeholders (local –through the regional innovation strategies or municipal and regional development plans; and international – through the EU framework programmes).

One of the indicators providing some idea of the strategic company management is the presence of a business plan. Nearly 60% of the companies surveyed by Vitosha Research do not have a business plan but about 10% would be willing to develop one if granted aid under some programme to engage external consultants for this purpose. Naturally, the presence of a business plan does not necessarily mean there is strategic thinking within the company – all too often, business plans are developed for external reasons – obtaining a bank credit, for instance. Nearly 60% of the company business plans have a span of one year and only 17% span more than 4 years, with a mere 2% spanning 6 to 10 years, which covers the span of the National Development Plan. Whereas up to the late 1990s the absence of long-term planning in Bulgaria was accounted for by financial instability and general economic uncertainty, in which context the winning strategy was “take the money and run”, in 2006, the lack of a vision beyond the operating year is rather a serious flaw. Nevertheless, there has been some progress compared to 2004 both in terms of elaborated business plans (increase of about 15 points) and a slight increase of the average time span (between 6 and 10 months).

FIGURE 22. COMPANY BUSINESS PLAN DEVELOPMENT (% OF COMPANIES)



Base N = 1011

About half of the companies shared that in planning the company activities they do not have a formal system but are rather guided by common sense and watch the main market trends. Such monitoring, however, is again not formalized but takes place largely through exchange of information with business partners, by following the specialized press or specialized web sites. This is largely accounted for by the specific social experience of the owners and managers who are accustomed to relying only on themselves, their own intuition and immediate circle. Furthermore, they are sceptical about the academic research and consultancy sector (a mere 3.5% of the companies hire external consultants when developing their plans). The new managerial practices and trends are still slow to make their way into Bulgarian enterprises with the most receptive sectors being human resource management and managerial information systems for medium and large enterprises.

Strategic planning is largely a prerogative of the owners and managers (24%), with only 5-6% of the companies having special departments or procedures for this activity. It is, of course, important to take into consideration the predominance of micro-enterprises in Bulgaria, which all too often are simply a form of self-employment and rather pertain to the sphere of entrepreneurship. It is not by chance that Eurostat only provides data about IT penetration in companies employing more than 10 people.

According to the results of the focus groups conducted by Vitosha Research, small and medium-sized enterprises typically plan ahead over a term of one to three years, and only in isolated cases, up to five years. The intensely dynamic environment is the chief reason why small businesses do not think along long-term lines but largely focuses on current operating problems. Even if the company develops a business plan, it can hardly be sustainable in the unstable, according to the representatives of the consultancy organizations, business environment. The frequently required changes in the activities carried out and the services offered by the small companies, which are forced to be flexible, pose an obstacle to longer-term planning of business activities. The very terminology related to business planning is

perceived as complicated and is unfamiliar to a large number of small enterprises, which further impedes the planning processes. The companies in construction, for example, develop “some kind of strategy” based on the contracts they have signed with clients. Business plans are typically developed on specific occasions – mostly in connection with credit applications, under various leasing schemes, etc.

Box 15. BUSINESS STRATEGIES AND MANAGEMENT PROGRAMMES OF SMEs – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“The market is very unpredictable, the general situation is puzzling and they simply have no other choice but to stay adequate to the market” (consultancy organization)*
- *“Let’s call it business planning or something of the kind. Because when you tell them that, they tend to get stressed out. A few big words, a few scary terms and they simply say, this is not for us, although things are basically not that complicated.” (consultancy organization)*
- *“As long as the legal framework in this country is not settled I cannot possibly plan ahead since I never know what law will come out next. And what commitments the country has taken on with respect to the EU. Nobody knows that. Tomorrow they might say that the staff members should or should not have a particular education, degree, or whatever. How am I supposed to start planning anything now when I have no idea what the requirements will be afterwards, after 2007.” (small company owner)*
- *“At this stage it is a little risky to plan ahead longer than one year because it is uncertain exactly what will happen after our accession... We should wait another year and see what the requirements will be.” (small company owner)*
- *“In 90% of the companies, only the managers know what the strategy is. The rest of the staff doesn’t know. A large number of them don’t even have a strategy. A vision, a strategy – such things are still strange to them.” (consultancy organization)*

Box 15. BUSINESS STRATEGIES AND MANAGEMENT PROGRAMMES OF SMES – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY (CONTINUED)

- *“They only develop a business plan for a specific purpose, one that is to be presented to the bank or in connection with some project.” (consultancy organization)*
- *“The manager may well know a lot about the strategy, about the business plan, but it’s true that the staff below don’t know. And if, God forbid, something should happen to this one person or couple of people, it’s simply the end of the business, that is, there is no continuity.”(consultancy organization)*
- *“The fact that they don’t have a written document laying out the strategy does not necessarily mean they don’t actually have one. They have some idea in their heads, but as you say, only one or a couple of people do and nobody bothers to let the others in on it. There is no documentation, people are not involved... that’s not a concern of theirs, it’s usually someone else’s problem. There is always some goal but only in the minds of a few managers.”(consultancy organization)*
- *“Our managers should realize that if their company is to be successful their employees should be aware of the goals, accept and embrace them as their own in order to work on them. And not just be given an order and be expected to carry it out without knowing why and what they’re doing and what this is actually supposed to accomplish. It may be a long and complex process but it has to start somewhere.” (consultancy organization)*

IV. SMES ABSORPTION CAPACITY FOR PARTICIPATION IN EUROPEAN FUNDS

The conducted quantitative and qualitative researches among SMEs in Bulgaria cover a wide range of questions about:

- Participation of SMEs in European programmes and the absorption of resources from European funds;
- Factors hampering the participation of SMEs in the European programmes;
- Level of awareness and information sources for SMEs on European funds;
- Willingness of SMEs to participate in the European Structural Funds during the new programming period through the Operational Programme “Development of the Competitiveness of the Bulgarian Economy 2007-2013” (OP “Competitiveness”);
- Needs of SMEs for financial support, which outline the future directions of financial support from the structural funds through OP “Competitiveness”.

4.1. Participation of SMEs in the European Pre-Accession Funds

The results of the survey show that:

- Only 1.4% of the surveyed firms have received financial support under the PHARE Programme; 1.6% of the surveyed firms have received financing from the SAPARD Programme; 0.7% have received financial support from ISPA.
- A total 5.2% of the participants in the survey state that they have applied for, but have not received financing under any European pre-accession programme. **A total 89.5%**

of the surveyed firms have never applied for financial assistance from European and international funds and programmes.

- Not a single one of the surveyed participants answered with “yes” the question: “Has the firm received financial support from: 4th, 5th, 6th European Union Framework Programme for Research and Technological Development”.

TABLE 17. RECEIVED FINANCIAL SUPPORT BY SMEs UNDER EU PROGRAMMES AND FUNDS

Received financial support from PHARE	1.4
Received financial support from SAPARD	1.6
Received financial support from ISPA	0.7
Received financial support from IV, V, VI Framework Programmes for Research and Technological Development	0.0
Received financial support from Others	0.7
The company has applied for, but has not received financing under any European programme	5.2
The company has not applied for financial support from European/International funds and programmes	89.5
Don't know/No answer	1.9

Base N = 1011

The results of the survey show very low activity of the firms in their participation in tenders under European programmes. This might be explained by the fact that most of the participants in the survey are micro and small enterprises (51% of the surveyed have a staff of up to 10 workers/employees and 28.2% have a staff of between 11 and 50 workers/employees), which have short planning horizons (57.6% of the surveyed do not prepare business plans in writing, and 18.6% prepare business plans with a time frame of up to one year). Such planning time-spans cannot be coordinated with the time frame of the preparation and implementation of projects. There is little knowledge of the European programmes and the opportunities they offer, due to insufficient in-house capacity for participation in tenders (staff speaking foreign languages, computer and Internet literacy, as well as skills for the development and management of projects). Another reason might be that only recently under the PHARE programme the government provided measures directly targeting SMEs.

Not a single one of the respondents has taken part in tenders under European Union Framework Programmes for Research and Technological Development²³ (Fourth, Fifth, Sixth Framework Programmes). This, on the one hand, shows the weak interest of the firms in participating in research and innovation projects, through which to solve certain problems of their production and, on the other hand, the virtually severed or very weak link with the research institutes and universities. This is also an indicator of the low level of willingness for real cooperation of the firms with foreign partners in scientific research and technological development projects, as international consortia of partners are formed for participation in the framework programmes. The probable reasons for the low activity of the firms are again the insufficient in-house capacity, the lack of understanding of the opportunities which these programmes offer, as well as the fact that most firms market their production on the domestic market (78.9% of the surveyed firms), due to which they feel no need for collaboration with

²³ According to data of the Ministry of Education and Science, only 52 SMEs have taken part in projects of the Sixth Framework Programme (2002-2006), of which obviously none was included in the sample of the survey, as they represent an insignificant share of all SMEs.

European partners. Another big outstanding obstacle is the unresolved problem of VAT obligation for firms, participating in the Sixth Framework Programme for Research and Technological Development. The activities on projects, financed under the *Sixth Framework Programme of the European Community (2002 - 2006)* are exempt of VAT in accordance with:

- The memorandum between the Republic of Bulgaria and the European Union on Bulgaria's affiliation to the Sixth Framework Programme for Research, Technological Development and Demonstration Activities contributing to building European Research Space and Innovations (2002 - 2006), and the Sixth Euratom Framework Programme for Nuclear Research and Training Activities also contribution to creating European Research Space (2002 - 2006) and the annexes to it.
- The directives of the European Parliament and Council of the rules for participation of subjects, research centres and universities and for the distribution of research results for implementation of the Sixth EU Framework Programme (2002 - 2006), and
- Decision No. 1/2002 of the EU-Bulgaria Association Council adopting the general terms and conditions for the participation of the Republic of Bulgaria in Community programmes.

With a view to a VAT refund under these contracts, the Bulgarian organisations can submit a *Request for the confirmation of justification for use of the regime under Article 92 of the Value Added Tax Act* and in accordance with Article 83 (2) of the *Implementing Regulation for the Value Added Tax Act* (chapter “Exemption from tax by virtue of international treaties, agreements, conventions and the like”). Despite these international and national acts regulating VAT exemptions of Bulgarian companies participating in the 6-th Framework Programme, the decision on exemption is left entirely in the hands of the tax collectors (currently Regional Directorates of the National Revenue Agency) and the subjective interpretation of the respective civil servants due to the absence of explicit mention of the Framework Programmes in the text of the Value Added Tax Act and its implementing regulation.

These conclusions are also confirmed by the discussions in all focus groups, which revealed low interest of Bulgarian firms in the European funds and programmes, as well as the focusing of the management team on the solution of daily problems. The discussions also focused on the planning horizon – among micro and small enterprises medium-term and long-term (strategic) planning of activities is virtually non-existent.

The factors which hamper the firms in receiving and using resources from the European funds and programmes may be grouped in several main groups. The firms which have not applied for such financial support have also cited factors with the presumption that they would hamper them in the application process should they decide to go forward with it:

- Complex and bureaucratic application procedures (cited by over two-thirds of the applicant firms); difficulties with application and other forms; large expenses related to the application;
- As a factor which hampers/would hamper them in applying under European funds and programmes, the firms cite also the lack of information about the programmes (respectively 38.7% and 27.2%);
- The additional payment to intermediaries in the application procedure is also seen as a significant obstacle by 38.7% of the applicant firms;
- Cited as an obstacle for successful participation is the absence of qualified personnel in the firm, as well as difficulties in the use of foreign languages;

- Securing co-financing and the complicated procedures of financial accounting are also quoted by the firms, which have applied for financial support from European/international programmes, as impeding their work with the European funds (respectively 30.2% and 36.8%).

TABLE 18. FACTORS HAMPERING ENTERPRISES IN THEIR PARTICIPATION IN EUROPEAN FUNDS AND PROGRAMMES (SHARE OF “YES” ANSWERS)

Factors	All firms in the sample	Applied for financial support	Not applied for financial support
Large expenses for applying	14.1	26.4	12.7
The programmes don't correspond to the needs of the company	12.6	12.3	12.6
Lack of information about the programmes	28.4	38.7	27.2
Difficulties with the forms for applying	14.4	30.2	12.6
Complicated and bureaucratic procedure of applying	29.1	67.0	24.6
Difficulties to find partners	13.5	25.5	12.0
Difficulties in ensuring co-financing	15.3	30.2	13.6
Problems with using foreign language	10.8	15.1	10.3
Complicated procedures in the financial reports	15.7	36.8	13.3
Additional payments for intermediaries	16.8	38.7	14.3
Absence of qualified personnel	16.0	18.9	15.7
Other	1.4	6.6	0.8
The company didn't apply for support from European – international funds and programmes	89.5		100.0

Base N = 1011 (All firms); Base N = 106 (Applied for financial support); Base N = 905 (Not applied for financial support)

Among the most cited *external factors*, hampering firms in receiving and using resources from European funds are the complicated and bureaucratic procedures (29.1%) and the lack of sufficient information about the European programmes (28.4%). In-house factors such as the lack of trained staff and the poor knowledge of foreign languages are cited as an obstacle by almost twice fewer firms. The focus groups revealed that the firms lack a clear understanding of what a project is, they lack skills for the management of projects, and the rules of financial accounting under the European programmes also hamper and even scare the firms.

Within the framework of the focus groups, the lack of sufficient information was outlined as an important factor, hampering firms in applying under European programmes and funds. It was noted that if information is available, it is too general and does not allow the firms to prepare their application documents on their own. In this connection the role of consultants was also discussed. The firms tend to seek general business consultancy, such as accounting/financing and marketing services, related to their daily and core activity, rather than consultation on how to prepare proposals for applying under European funds and programmes.

Another reason for the weak participation of the firms is the necessary co-financing, which in most cases reaches up to 50% of the cost of the project. In general, micro and small

enterprises do not have available free cash resource, they are forced to block turnover capital, and the financial instruments for co-financing by the banks, suitable for SMEs (for example, bridge financing) are greatly limited.

The main conclusion that may be drawn is that in 2006 **the firms do not envisage the European programmes and funds open for Bulgarian participation as an important source of financing of investment projects, new technologies, establishment of in-house capacity and innovation projects.**

According to all surveyed groups in the qualitative research conducted by Vitosha Research, the problems for the participation of SMEs in the absorption of pre-accession funds include difficulties with the project documentation – “*extremely detailed forms*”, failure to understand and impossibility to meet the requirements of the programmes, poor language training (language barrier). The long time frame, including the time from the first draft of the project, the filling out of the forms, the sending of documents, their consideration and possible return of capital, which can take two and more years, is also regarded as a serious problem by the representatives of employers’ organisations.

A positive fact is that increasingly more SMEs (mainly those oriented towards export) boast specialists with sufficient knowledge, including language skills, and are able to cope with the “challenge” of filling out the required project documentation properly and in English.

Part of the owners and managers of SMEs included in the qualitative survey voice their fear of corruption in the institutions, responsible for the approval of the projects and the allocation of the funds. Corruption is perceived as a chief obstacle for applying for and receiving project funds; according to the SMEs, this fear is also an important reason why “*they do not bother to prepare a project*”. Corrupt practices are most often disguised in the form of “consultations” which “guarantee” the success of the project proposal already at its preparatory stage.

A significant problem facing small firms in applying for EU financing, is also the lack of trust in the institutions, “*which we have to overcome*”. The process of interaction with the institutions tends to be perceived by the SMEs, included in the qualitative survey, as a struggle, competition, rivalry, rather than as partnership and a mutual process of providing support and assistance.

According to the opinion of surveyed SMEs and experts best prepared for the procedures of applying for EU financing are the firms from the sectors of tourism and agriculture, as well as in the field of infrastructure.

Box 16. PARTICIPATION OF SMEs IN EUROPEAN PRE-ACCESSION FUNDS – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- “Regardless of their enthusiasm to use European money, the firms tend to be a bit scared, perhaps because of the documentation they have to provide, the procedures they have to follow” (employers’ organisation)
- “Yes, being better informed would help. But everybody keeps harping on transparency and I don’t know what. There are no tenders that are regular. I want to have a real tender.” (representative of employers’ organisation and businessman)
- “I was talking to a colleague who took part in such a project, to which he devoted a lot of time, but due to minor bureaucratic obstacles his project was not approved. The problem, in his view, is that small and medium-sized firms are scrutinised in too much detail, that the danger of their making a mistake in these projects is much greater. There is also the doubt that there is no full transparency in the approval of projects” (employers’ organisation)

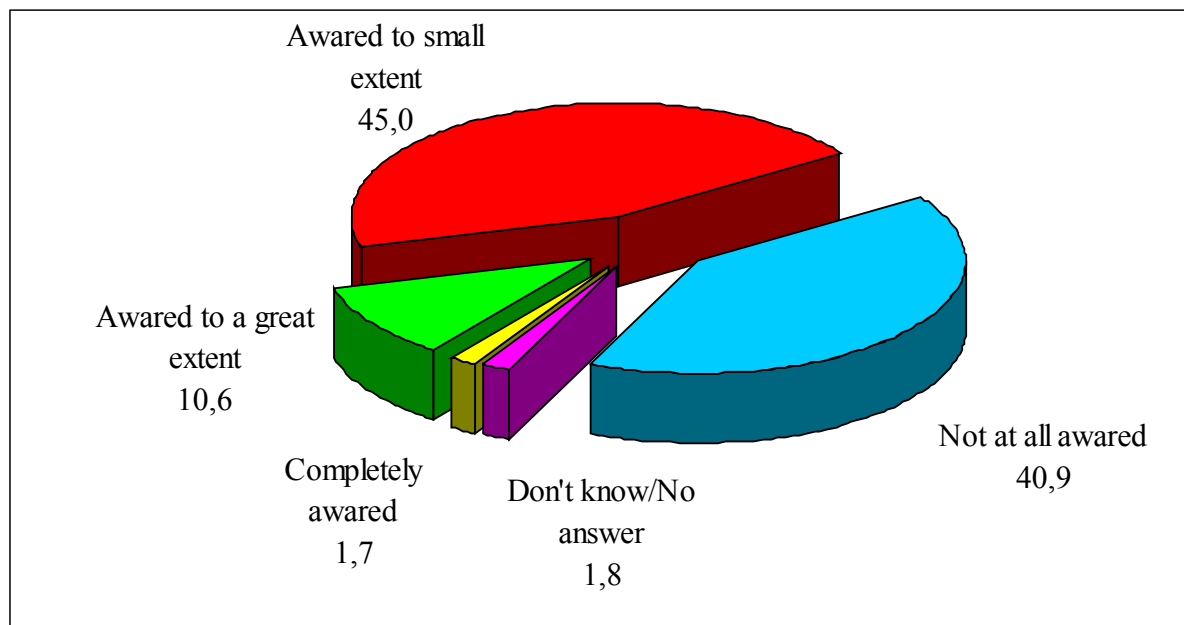
Box 16. PARTICIPATION OF SMEs IN EUROPEAN PRE-ACCESSION FUNDS – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY (CONTINUED)

- *“In the beginning the entrepreneurs take on much documentary processing, many things which it is not clear if they will be approved, it is not clear whether it will be possible to realise them... That’s why, as soon as they start preparing for application they give up” (employers’ organisation)*
- *“I am applying and taking part under these programmes. And I’m losing a lot. So I’m telling you, go and take part in one of the programmes in Bourgas municipality. The programmes are drained by Sofia, perhaps only one-tenth of the financing comes here. There is not a single programme that is not managed from Sofia. ... What we get here are leftovers and we always have to work as subcontractors. This is terrible. Can a normal business take part in a programme? There is no information. We have to push, to elbow our way to some programme before finally being able to apply, we fill out 20 pages, provide all the documents, and in the end it turns out that it has been won by somebody who knows such and such a person ... Let Sofia take the one lev, but let us have the other 9, rather than to take it all. Show me just one big programme that has not been won by Sofia” (representative of employers’ organisation and businessman)*

4.2. Level of Awareness of SMEs Regarding the Opportunities Offered by the EU Structural Funds. Sources of Information and Knowledge on the Rules and Requirements of the Structural Funds

Bulgarian SMEs are inadequately informed about the opportunities for work with the EU Structural Funds - 45% of the surveyed firms declare that they are scarcely acquainted with the possibilities for work with EU Structural Funds, and 40.9% of them say that they are not at all acquainted with these possibilities. A total of 10.6% of the respondents say that they are acquainted to a significant degree, and **only 1.7% of the firms are fully acquainted with the opportunities, which will be provided by the Structural Funds.** The reasons for this low level of awareness can be due both to the inactive search for information by the firms and the fact that the starting date of the country’s membership in the European Union is regarded as a kind of watershed, as well as to the fact that the information campaign about the opportunities which the Structural Funds offer to SME fails to reach the firms themselves. The discussions within the focus groups reveal that the firms prefer to remain in a passive position and to wait for about a year after the country’s accession to the EU, in order to acquaint themselves with the opportunities and requirements of the Structural Funds. Some firms even consider that in 2006 it is risky to plan activities for more than one year.

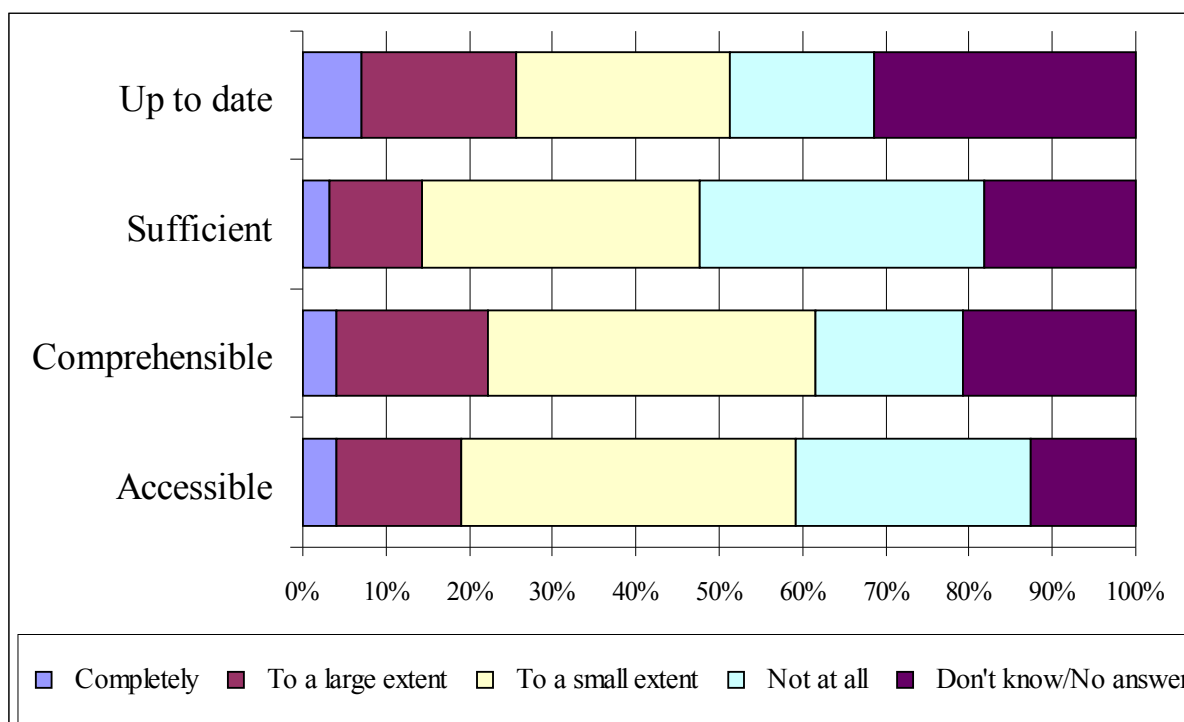
FIGURE 23. AWARENESS OF THE POSSIBILITIES FOR SUPPORT OF SMEs, WHICH WILL BE PROVIDED BY THE EU AFTER BULGARIA’S ACCESSION



Base N = 1011

The low level of awareness will probably result in a weak participation in the first tenders that will be opened after Bulgaria’s accession to the EU, due to the short periods for preparation of the project proposals. Within such short framework the firms will be unable to overcome the information deficit and to develop in-house capacity for project preparation.

FIGURE 24. THE AVAILABLE INFORMATION ABOUT THE EUROPEAN FUNDS AND PROGRAMMES IS:



Base N = 1011

Only 4% of the surveyed firms consider that the available information about the European funds and programmes is completely accessible, according to 4.1% it is completely understandable, 3.2% state that the available information is quite sufficient, and according to 7.1% the information is absolutely up-to-date.

The main information sources used by the firms may be ranked as follows: electronic media (television and radio) – 46.8%, Internet – 38.5%, business partners, friends and colleagues– 38.4%, printed materials – 34.7%. A small share is allocated to seminars and conferences, which are cited as an information source only by 5.0% of the respondents, as well as the industrial, trade and branch associations which are cited by 9.0% of the interviewees as a source of information. This may be explained with the fact, discussed in the focus groups, that a part of the events at which information is presented about how to apply under various European programmes and funds, are organised by consultants who do not provide the entire information, but try instead to lure future clients.

TABLE 19. USE OF INFORMATION SOURCES ON EUROPEAN FUNDS AND PROGRAMMES

Sources of information	Yes	No
Seminars, conferences	5.0	95.0
Press materials and magazines	34.7	65.3
Electronic media (TV, radio)	46.8	53.2
Industrial, trade-branch associations	9.0	91.0
Business partners, friends, colleagues	38.4	61.6
State institutions and departments	10.5	89.5
Universities, research organizations	0.6	99.4
Direct contacts with the European Commission	0.8	99.2
Internet	38.5	61.5
Others	4.3	95.7
<i>Don't know/No answer</i>	<i>8.4</i>	<i>91.6</i>

Base N = 1011

The representatives of employers' organisations also express the view that SMEs are still not familiar with the rules and ways of application to European Union funds and with receiving financing through the Structural Funds. This is understandable since there still is no programming documentation under these funds, no application documentation has been specified, the rules and directions for applying have been finalized yet. The employers' organisations, however, have registered growing interest among the firms in this process, notwithstanding the great attention to daily operative problems, the smaller administrative capacity and the lack of trained and competent personnel.

With regard to receiving information about the Structural and Cohesion Funds, the managers and owners of SMEs express the opinion that they would feel more at ease in establishing personal contact with experts from the respective ministries. The information about the EU funds scares the managers of small enterprises – it is available mainly from the mass media, but is assessed as “*little, insufficient and vague*”, “*ambiguous*”, not concrete. The owners of SMEs recommend local awareness campaigns - experts should acquaint SMEs with the specific requirements. For the time being, SMEs tend to be in a passive position – despite the stated desire to join projects with European financing, the owners and managers expect somebody else to get in touch with them and furnish them with information. On the one hand, the businesses complain over the lack of sufficient and clear information, but on the other, the businessmen themselves say that they do not seek information and are inactive. The

absorption of European funds tends to be perceived as a problem of the state – the state should seek SMEs to absorb the funds by providing information at local level. This inertia among part of the business circles is also noted by representatives of the employers' organisations. According to the latter it would lead to low awareness of the managers and owners of SMEs with this matter (*“or they do not know more than what is written in the papers”*).

The representatives of the employers' organisations consider that SMEs in principle have unlimited access to every kind of information from the European Union, including information about the Structural Funds. According to them, the information is accessible, sufficient, detailed and, given the desire, information can be obtained. Concerning the SMEs, however, doubts are expressed that this type of information is sufficiently clear.

According to the consultants, the information about the EU, the funds and the requirements for receiving financing from them is accessible, sufficient and clear. The representatives of the consultancy organisations also consider it necessary to launch a campaign aimed at increasing SMEs' activity in the direction of encouraging them to seek information, greater interest, heightening general knowledge and broader acquaintance with the information from and about the EU and its funds.

Box 17. LEVEL OF AWARENESS OF SMEs REGARDING THE OPPORTUNITIES OFFERED BY THE EU STRUCTURAL FUNDS; SOURCES OF INFORMATION – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“The information must not go to the big firms, but to the small municipalities, where people gather and work directly. There is absolutely no problem for a big company, it has 15 small firms and again it will get the money” (representative of medium-sized firm)*
- *“I would put the problem here in a different way – the small and medium-sized enterprises should receive information about the existing investor interest in the region and the kind of profile they are expected to show in order to choose and to decide whether they can respond to this investor interest” (consultancy organisation)*
- *“I would urge business to take the initiative to glean information, instead of just waiting for it to be presented on a plate, because for example our Euro-centre, which is functioning with the Chamber, offers all kinds of publications, which are also distributed free of charge by the European Commission. ... Not one, and I'm serious about this, not a single person has come to ask for something, yet it is described so clearly in it. Simply as a way to further your general knowledge, I don't quite know how to call it, we really need this. The sources exist, they are available, they are written in an easy language, they are in Bulgarian, the publications are nice, but not a single person has shown any interest” (consultancy organisation)*
- *“I would divide things in two. What we have here in Bulgaria and what in principle exists as information. Unfortunately, in Bulgaria a part of the civil servants think that when they go to Brussels and hear something, they become the only bearer and source of information and treat the rest of the public as completely ignorant” (employers' organisation)*
- *“The firms do not like to read. I said that there is a certain lack of information, but even what is available is not read. Most often people rely on a friend, acquaintance or civil servant they know, instead of actually reading... The Internet – we said how*

many people use the Internet. As regards the English language – the situation is obvious” (employers’ organisation)

Box 17. LEVEL OF AWARENESS OF SMEs REGARDING THE OPPORTUNITIES OFFERED BY THE EU STRUCTURAL FUNDS; SOURCES OF INFORMATION – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY (CONTINUED)

- *“The promotion and explanatory work that is carried out by the various ministries is weak. What is released from Sofia as information is not completely filtered or not completely clear. Or at any rate it is presented in a way which hampers even us as experts and specialists, and later it turns out that what we have interpreted and consider valid for business is not exactly like this. This is why we ask the respective ministries for broader promotion and explanatory work, concrete work. Concrete in the sense of defining the parameters. And in this aspect I think that things will be much better and corruption will be largely avoided if people are informed. And here I want to say that the non-governmental organisations also have place, and I accept this outstretched hand and this collaboration between the different structures – of business and of public services and of NGOs – let’s increase the economic and financial knowledge of SME. I think that there is also a place for the mass media to pursue such a promotion/explanatory activity” (representative of consultancy organisation)*

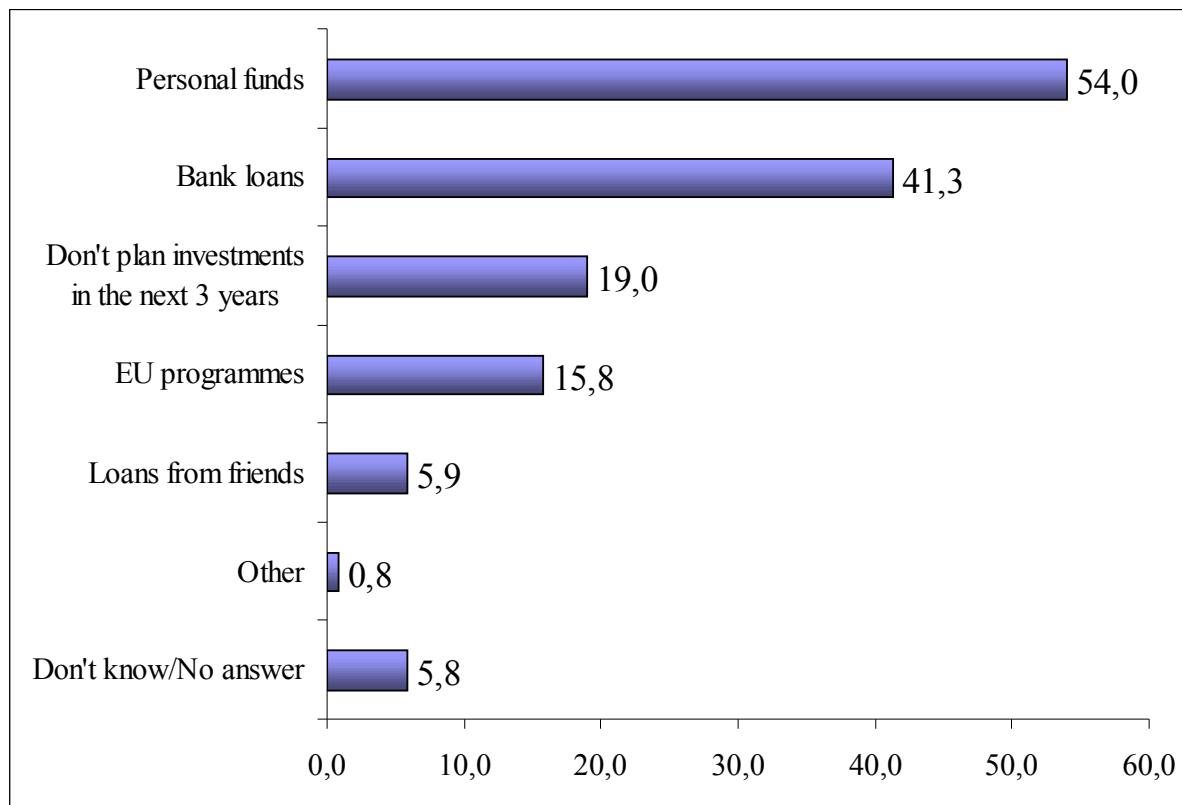
4.3. Willingness for Participation in the EU Structural Funds and Absorption Capacity of Bulgarian SMEs

4.3.1. Investment strategies of the firms

The survey results show that in the next three years, as sources for the financing of their investment projects, the firms will mainly rely on their own funds (54%) and on bank loans (41.3%), while **15.8% of the firms state that they will rely on funds from the EU programmes**. The share of the organisations which do not plan investments during the next three years is significant – 19%.

The results of the survey also reveal the still conservative attitude of the firms to external sources of financing in general, which, in turn, is a sign of low entrepreneurial and economic culture on the one hand, and on the other – an indicator of ineffective use of their own funds’ leverage. The firms consider the financing of investment projects with own funds as the better alternative in comparison with the traditional bank loans.

FIGURE 25. SOURCES WHICH THE FIRMS PLAN TO USE IN ORDER TO FINANCE THEIR INVESTMENTS OVER THE NEXT THREE YEARS



Base N = 1011

The main investment projects targeted by the firms in the next three years will be for the technological upgrade of production facilities (61.5%), for meeting the standards/requirements of the EU (50%), innovation projects for the development of new products, technologies, services (25.4%), projects for the introduction of energy-saving technologies (23.5%), as well as for the modernisation of company management (22.1%).

To the question: “Does your firm plan investments in the next three years, for which you would seek support from the European Structural Funds?” the share of firms answering “yes” increases from 15.8% to 35.4%. To realise their investment projects, the firms will seek financial support from the Structural Funds for the technological upgrade of production facilities (49.4%), for meeting the standards/requirements of the EU (36.9%), for innovation projects for the development of new products, technologies, services (20.4%), for the introduction of energy-saving technologies (19.3%) and for the modernisation of company management (14%). The comparison made with the companies’ answers on the planned investment projects warrants the conclusion that the **firms will rely on financial support from the structural funds mainly for the technological upgrade of production facilities, for meeting the standards/requirements of the European Union, for the introduction of energy-saving technologies and for innovation projects.**

TABLE 20. INVESTMENT STRATEGY OF THE FIRMS FOR THE NEXT THREE YEARS

Investment projects	Have intention for investments		Would apply for support from EU	
	No	Yes	No	Yes
For meeting European standards	50.0	50.0	63.1	36.9
For technical upgrade of production facilities	38.5	61.5	50.6	49.4
For modernizing the company management	77.9	22.1	86.0	14.0
For introducing energy saving technologies	76.5	23.5	80.7	19.3
For ensuring quality consultant and information services for my business	91.3	8.7	92.7	7.3
For attracting foreign investments	88.0	12.0	91.9	8.1
For business cooperation and entry into business networks (clusters)	90.2	9.8	92.7	7.3
For promoting and increasing the export of the company	92.5	7.5	95.5	4.5
For developing new products, technologies, services	74.6	25.4	79.6	20.4
For education and training of the personnel	84.4	15.6	90.5	9.5
Other	96.1	3.9	95.5	4.5

Base N = 358

Oddly enough, although the firms state that they will rely mainly on their own resources and bank loans, 35.4% of the respondents plan investments over the next three years for which they will seek support also from the European Structural Funds. In comparison with the participation of the firms in the PHARE, ISPA and SAPARD programmes (3.7% participation and 5.2% unsuccessful applicants) it is seen that regardless of their currently passive position, the firms have greater interest and positive expectations with regard to financing under the Structural Funds.

4.3.2. Readiness for Meeting European Standards

In connection with Bulgaria's accession to the EU and the readiness of the firms for the Single Market, **conformity with European standards** will be a necessary condition for the use of the resources from European programmes and funds, intended for the firms. It should be noted again that the Bulgarian SMEs have poor knowledge of the requirements they need to meet in relation to the country's membership in the EU: fully acquainted with the requirements of the CE marking are only 14.6% of the respondents; with the requirements for the protection of the environment – 19.6%; with quality management systems - 21.9%; internal organisation of production - 19.8%; with the requirements on labour safety - 31.7%. The need for the firms to bring their activity into conformity with European standards stems also from the currently low share of those companies which declare that they completely meet the requirements at the moment:

- CE marking – 10.1%;
- environmental protection requirements – 13.8%;
- quality management systems – 14%;
- internal production organisation – 13.4%;
- labour safety requirements – 23.1%.

The most serious obstacles faced by the firms in meeting the EU requirements are: inadequate financial resources – 42.7%; lack of sufficient information – 40.8%; lack of trained personnel – 20%. The firms, which have not come across any obstacles total 22.9%.

The owners of small firms consider that the access to the EU funds depends directly on the size of the firms – medium-sized and large firms have a greater chance than small and micro firms – this includes the availability of more resources, experience, contacts, knowledge, better positions, more opportunities for financing.

Box 18. READINESS FOR MEETING EUROPEAN STANDARDS – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“A large part of the firms, in contrast to a couple of years ago, are ready and I think that for them the accession to the European Union will be a good chance to develop their business still further, it will not be a big challenge. The sources of this information are our direct contacts with clients, firms which already two years ago came here to ask questions concerning directives and requirements. They have already introduced the requirements of the European Union, with is a positive thing” (employers’ organisation)*
- *“The training that is offered by different organisations does not teach people to fill out project applications, to take a real part in the application process. The reasons are: the Ministry of Economy has not established the procedure for work in the management body and people do not know how to fill out the documents. This is a critical issue that is being ignored. This problem has repeatedly been put to the ministry. The answer is that under the programme they have developed, these things will be clarified in November, December. Does this mean that we have to postpone our membership? They will clarify them in December and the firms will only have time until Christmas to prepare their applications. Forget this approach” (employers’ organisation)*

4.3.3. Readiness for Participation of SMEs in EU Structural Funds through OP “Competitiveness”

From the point of view of the ability to **generate project ideas, preparation and implementation of projects**, it is interesting to discuss the view of the firms with regard to which of the activities, envisaged in OP “Competitiveness”, will best correspond to their needs, as well as to which of these activities they would apply for support through this operational programme. This is seen in the following table:

TABLE 21. STRANDS FOR FINANCIAL SUPPORT FROM THE STRUCTURAL FUNDS OF THE EUROPEAN UNION THROUGH OP “COMPETITIVENESS”

	Best correspond to companies' needs		Would apply to OP	
	No	Yes	No	Yes
Support for high-tech start-ups	88.8	11.2	93.6	6.4
Support for SMEs' research and development projects	94.8	5.2	95.6	4.4
Improving SMEs' access to proinnovative infrastructure	92.7	7.3	95.2	4.8
Modernizing SMEs' management and technologies	71.5	28.5	77.0	23.0
Ensuring better consulting and informational services	80.6	19.4	88.1	11.9
Support for the introduction of energy saving technologies	77.0	23.0	83.9	16.1
Support for business cooperation	84.5	15.5	89.4	10.6
Support for the creation of guarantee funds, venture capital funds, and micro crediting funds for SMEs	74.9	25.1	84.4	15.6
Encouraging foreign direct investments	88.8	11.2	92.8	7.2
Support for promoting and increasing SMEs export	89.2	10.8	91.4	8.6
Other	95.5	4.5	99.3	0.7

Base N = 1011

Some discrepancy is registered between the needs of the firms and their intentions to seek financial support through OP “Competitiveness”. The reasons for this may be both the low level of awareness of the firms about the operational programme, as well as the need for precise coordination of the strands for support envisaged in the operational programme with the priorities of the SMEs for their future development and their investment strategies. For example, 61.5% of the firms, which plan investments during the next three years, have declared their intention to invest in technological upgrade of their production facilities, and the largest share of the respondents saying that they will apply for the modernisation of their management and technologies under OP “Competitiveness” is 23%.

The data shows a correlation between whether the firms are planning their business development and prepare written business plans on the one hand, and the inclination and willingness of SME to apply for support through OP “Competitiveness”, on the other. In general, **the majority of enterprises which would make use of financial support for most activities under this Operational Programme prepare written business plans for development** – the respective shares vary between 59% and 75%. The only exception are two of the activities under the OP – “Providing more accessible and quality consulting and information services for business” and “Creation of guarantee funds, venture capital funds and micro-crediting funds”, on which, among the firms expressing desire to apply for financial assistance, the share SMEs which do not prepare written business plans is slightly higher than the share of the SMEs that do prepare business plans.

TABLE 22. ACTIVITIES FOR WHICH THE FIRM WOULD APPLY FOR SUPPORT THROUGH OP “COMPETITIVENESS” ACCORDING TO WHETHER THE FIRM PREPARES A WRITTEN BUSINESS PLAN FOR ITS DEVELOPMENT

Activities for Which the Firm Would Apply for Support through OP “Competitiveness”		Develops a Written Business Plan	Does not Develop a Written Business Plan
		Row %	Row %
Support for high-tech start-ups	No	40.9	59.1
	Yes	64.6	35.4
Support for SMEs’ research and development projects	No	41.0	59.0
	Yes	75.0	25.0
Improving SMEs’ access to proinnovative infrastructure	No	41.3	58.7
	Yes	65.3	34.7
Modernizing SMEs’ management and technologies	No	35.7	64.3
	Yes	64.8	35.2
Ensuring better consulting and informational services	No	42.1	57.9
	Yes	45.0	55.0
Support for the introduction of energy saving technologies	No	36.9	63.1
	Yes	71.2	28.8
Support for business cooperation	No	40.3	59.7
	Yes	60.7	39.3
Support for the creation of guarantee funds, venture capital funds, and micro crediting funds for SMEs	No	41.6	58.4
	Yes	46.8	53.2
Encouraging foreign direct investments	No	41.2	58.8
	Yes	58.9	41.1
Support for promoting and increasing SMEs export	No	39.7	60.3
	Yes	71.3	28.7
Other	No	42.6	57.4
	Yes	14.3	85.7
The company would not apply for support	No	55.4	44.6
	Yes	18.9	81.1

Base N= 1011

The greatest preference and willingness of the firms for applying is seen in the strands for modernisation of management and technologies; support for the introduction of energy-saving technologies, the creation of guarantee funds, securing venture capital, micro-crediting; ensuring more accessible and quality consultancy and information services. Despite this, the share of those who would apply for financing through OP “Competitiveness” remains very low and in most cases even much below 20%. This is a sign that the capacity for generating project ideas among the firms is relatively limited, and that their preparation for the management and implementation of the projects is weak. This is also confirmed by the focus groups, which raised the problem of the lack of capacity of the firms to generate project ideas, as well as the ability to manage and implement them. The lack of sufficient information, the complicated project and account documentation, the lack of human resources in terms of number and skills, language barriers, are again stressed as the main obstacles.

The views of the representatives of the employers' organisations regarding the capacity of SMEs to generate project ideas vary. According to some, SMEs in Bulgaria have many ideas for different projects, and according to others – there are only some firms that are able to realise a complete “product” – from the idea generation, through the respective activities for its realisation, application for and receiving financing, to a successfully marketed project.

Box 19. CAPACITY OF SMEs TO GENERATE PROJECT IDEAS - OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“There are people who have received their education abroad, and I can see their different way of thinking. They think about how to expand, how to present a project which will respond to some need of the market. Whereas we tend to think of how to redistribute something. We should think of how to make the cake bigger, in order to get more of it, and not how to take away our neighbour's piece. Ideas do exist, but mostly among more educated people. Most people are unable to come up with a good idea.” (employers' organisation)*
- *“There is little willingness, it is low and the small and medium-sized enterprises seem to be lacking the capacity for participating in such projects.” (consultancy organisation)*
- *“Our interest is mutual. We are talking about the framework – we can help to right something that is wrong. For example, to one question, for we conduct very many educational seminars: “How do you communicate with each other in business?” the answer is: “Well, we do not communicate.” But since there is no communication, there is also no crystallisation of the ideas of people in the same branch. Ultimately, the project will not be only for one organisation, but for a small team. Until the branch organisations come out to the fore with what they need and jointly protect their interests, they will not be able to get these funds.” (NGO representative)*
- *“There is also another part of business which thinks, and thinks a lot. And among that part, which thinks, there are people who come up with and do something and are willing, and there are also persons who when they see a programme they know exactly what they have to do. Clearly business is not a simple concept.” (consultancy organisation)*

Participants in the focus groups have stressed as a significant obstacle for participation in projects under European programmes and funds also the reason that **SMEs cannot secure co-financing on these projects. The data show that SMEs are able to allocate for co-financing of projects an average of 32.8% as a share of own funds.** Here it is also important to note the role of the banks and their willingness to grant co-financing to projects under the European programmes. From the conducted in-depth interviews among bank experts the following conclusions can be drawn:

- Bulgarian banks are not acquainted in detail with the Lisbon strategy and do not have concrete long-term policies, in order to make use of the possibilities it offers.
- Regarding the information about the EU Structural Funds, the banks are passive as well and rely on their clients to inform themselves of the opportunities offered by the European funds.

- What prevents the banks from differentiating their credit portfolio in accordance with the new credit niches, accompanying the opening of the Structural Funds, is the lack of exhaustive and well structured information.
- Only a few banks (two of the surveyed ones) are acquainted in detail with the operational programme “Development of the Competitiveness of the Bulgarian Economy”.

Box 20. POSSIBILITIES FOR SECURING CO-FINANCING – OPINIONS OF THE PARTICIPANTS IN THE QUALITATIVE SURVEY

- *“Under PHARE, the firms in Bulgaria show much less interest to participate, because there is a percentage co-financing there. And this is a serious barrier for them” (consultancy organisation)*
- *“I think they will clearly have to resort to co-financing more and more often, because this is the trend” (consultancy organisation)*
- *“The small and medium-sized business has the willingness and desire for co-financing. In my opinion, about one third can assume this part and this does not seem to rebuff it to a large extent. But again I say, the resources, the willingness in these firms is at a very low level and that’s where the motivation comes from.. The manager has no way of seeing it unless he is committed” (consultancy organisation)*

4.3.4. Economic Sectors with the Highest Readiness for Work with the Structural Funds

According to the data from the Vitosha Research survey, Bulgarian SME will aim for financial support mainly in the following activities of OP “Competitiveness”: modernisation of their management and technologies; support for the introduction of energy-saving technologies; creation of guarantee funds, venture capital, micro-crediting of SME – respectively 23%, 16.1% and 15.6% of the firms give a positive answer to the question of their intention to apply for these activities.

The distribution of the firms intending to apply with projects for the activities envisaged in OP “Competitiveness” is shown in *Table 23*. The most active position is occupied by the organisations from manufacturing, trade and repairs, as well as construction. Their specific priority activities are:

- Support for the promotion and increase of exports.
- Support for high-tech start-ups.
- Providing more accessible and better consultancy and information services for business.
- Modernisation of management and technologies in SME.

TABLE 23. INTENTION OF THE FIRMS TO APPLY FOR FINANCING UNDER THE DIFFERENT STRANDS OF ACTIVITIES OF THE OPERATIONAL PROGRAMME

Economic Sector of the Firm	Support for high-tech start-ups	Support for SMEs' research and development projects	Improving SMEs' access to proinnovative infrastructure	Modernizing SMEs' management and technologies	Ensuring better consulting and informational services	Support to the introduction of energy-saving and renewable energy technologies
Manufacturing	44.6	36.4	26.5	42.1	25.0	40.5
Trade and repairs	29.2	13.6	26.5	20.2	45.0	19.6
Construction	16.9	22.7	24.5	20.2	13.3	18.4
Transport, warehousing and communications	3.1	2.3	0.0	3.9	2.5	3.1
Mining and quarrying	1.5	0.0	0.0	1.7	0.8	0.6
Electricity, gas and water supply	1.5	18.2	8.2	1.3	1.7	4.3
Hotels and restaurants	1.5	2.3	6.1	7.7	5.8	12.9
Real estate and business services	1.5	4.5	6.1	2.1	5.0	0.0
Financial intermediation	0.0	0.0	0.0	0.4	0.8	0.0
Other	0.0	0.0	2.0	0.4	0.0	0.6
Don't know/No answer	0.0	0.0	0.0	0.0	0.0	0.0

TABLE 23. INTENTION OF THE FIRMS TO APPLY FOR FINANCING UNDER THE DIFFERENT STRANDS OF ACTIVITIES OF THE OPERATIONAL PROGRAMME (CONTINUED)

Economic Sector of the Firm	Support for business cooperation	Creation of guarantee funds, venture capital funds, and micro crediting funds for SMEs	Encouraging foreign direct investments	Support for promoting and increasing SMEs export	Other	The company would not apply for support
Manufacturing	31.8	21.5	43.8	70.1	14.3	16.7
Trade, repairing activities	30.8	37.3	19.2	18.4	85.7	50.1
Construction	19.6	15.2	19.2	3.4	0.0	11.7
Transport, warehousing and communications	3.7	4.4	1.4	2.3	0.0	1.9
Mining and quarrying	0.9	1.9	1.4	0.0	0.0	0.8
Electricity, gas and water supply	1.9	1.3	0.0	2.3	0.0	1.7
Hotels and restaurants	7.5	13.3	11.0	2.3	0.0	10.6
Operations with real properties and business services	2.8	2.5	1.4	0.0	0.0	4.2
Financial intermediary	0.9	0.6	1.4	0.0	0.0	0.3
Other	0.0	1.3	1.4	1.1	0.0	0.8
Don't know/No answer	0.0	0.6	0.0	0.0	0.0	1.1

Base N = 1001

V. CONCLUSIONS AND RECOMMENDATIONS

Regarding SMEs awareness of the requirements for businesses, stemming from the membership of Bulgaria in the EU and the degree to which they have been met, the following conclusions may be drawn:

- One in five firms considers that EU requirements do not concern it. One in three firms is not acquainted with the European requirements in general. Every other firm does not know what the terms are for the introduction of the various requirements, while some 20% of SMEs are acquainted with these terms.
- According to the companies' own opinions a very small part of Bulgarian SMEs meet fully European requirements. Only 10% of the firms meet the requirements for CE marking and 23% the requirements for labour safety. Very few Bulgarian firms have an ISO certificate, and only 2.3% have a certification under the HACCP (Hazard Analysis and Critical Control Point) system, which guarantees food safety and quality.
- As main obstacles for meeting the EU requirements, SMEs point out to the inadequate financial resources and the lack of information. Only one out of five firms cites the lack of sufficiently trained personnel as a reason. Nearly one quarter (23%) of all SMEs have not come across any obstacles.
- Despite not meeting the EU requirements, some 70% of Bulgarian SMEs are optimistic and believe that they will withstand the competitive pressure of the Single Market. Nearly one third of the SMEs are fully acquainted with the requirements for working conditions and labour safety, while one in five firms is familiar with the other requirements. The Bulgarian SMEs, however, intend to meet the requirements, because half of the surveyed firms intend to invest funds over the next three years to meet the requirements of the European Union.

The main conclusion is that, only a few months before the country's accession to the EU, Bulgarian SMEs have a relatively low level of readiness to fulfil the requirements regarding the quality and safety of goods, the internal organisation of production, the introduction of new technologies, protection of the environment, working conditions and labour safety.

On the basis of the analysis, the conclusions and the main obstacles to the introduction of the EU requirements identified by Bulgarian SMEs, a number of recommendations may be made:

- Conduct a large-scale information campaign throughout the country about the requirements which SMEs have to observe in connection with Bulgaria's accession to the EU.
- Prepare and publish brochures with the EU requirements for business in every business sector.
- Organise specialised training at branch level, also committing non-governmental organisations, working with business.

- Tighten the control of the responsible state authorities, the aim being not to impose sanctions and fines, but to provide instructions on the spot about the quick fulfilment of EU requirements.
- Provide free-of-charge consultations for SMEs by expert teams, recommending possible restructuring of production that will help them fulfil the EU requirements with the least upsets.
- Similarly to the grant scheme “Competitiveness” of the Ministry of Economy and Energy, extend preferential loans for the introduction of EU requirements.
- Consider preferential conditions for firms which have invested in organic production and the production of organic products.
- Conduct market studies of specific promising markets and offer them free of charge to SMEs.

Regarding the competitiveness of Bulgarian SMEs, the following conclusions may be drawn:

- The quantitative survey among Bulgarian small business shows that it is still largely a passive observer of events on the international markets. Its participation in the international market competition remains limited. Only 17.5% of the participants in the representative sample have marketed some part of their production outside the country in the past year, while less than 7.0% of all respondents have a clear export portfolio (i.e. the share of exports is more than half of their annual turnover). There are very few successful exporters among the relatively newer firms on the market (created in the last five years).
- For nearly 90% of the surveyed SMEs the main competition comes from Bulgarian firms. Only 6.8% of the companies state that the main competition pressure comes from imported products, and 4.6% - from foreign companies in Bulgaria.
- For two-thirds of the respondents the main competitors are a multitude of local firms, and the main threat on the market is not so much external competition, but unfair competition on the domestic market. About two-thirds of the respondents regard unfair competition as a significant or great threat, which ranks it in first place among the threats to small and medium-sized business.
- The relatively limited exposure of small business to external competition pressure is one of the explanations for the great optimism concerning its chances in the Single Market. Some 41% of the interviewees expect their business to expand after the accession, and 28% to retain their positions.
- In general, the representatives of the banks and of employers’ organisations assess as limited the possibilities of Bulgarian SMEs to withstand the competitive pressure of the European competitors. The experts see as advantages of Bulgarian SMEs over their European competitors, their adaptability and flexibility.
- Bulgarian firms allocate an insufficient part of their revenue to investments in new technologies. For half of the respondents, this share is below 10%. One out of three firms considers that it is working with modern equipment. A small part (17%) of them characterises it as fairly old or old. At the same time, information about the years of production of their equipment shows that nearly half the production firms (45.5%) work with equipment that is more than 10 years old, and

nearly three quarters (72.8%) work with equipment that is more than five years old.

- Ensuring the necessary human resources in the sector of small and medium-sized business is connected to the deteriorated educational system and the undeveloped labour market. A big constraint for the small business is also the regulations of the labour market. The difficulties of small firms to resolve effectively their human resources problems are enhanced by the restrictions on temporary employment contracts and hourly wages, restrictions on layoffs, etc.
- From the point of view of the market and the competitiveness of the firms and taking into account the financial restrictions a large part of small and medium businesses in Bulgaria face, it might not be rational to invest in the introduction of European requirements before they are forced by clients or control bodies to do so. Given the lack of strong market incentives for the introduction of European standards, the observance of European requirements will depend mainly on the administrative capacity and the professional integrity of the different inspectorates. The relative immaturity of the market and public mechanisms, i.e. the lack of economic incentives as a motive for the introduction of the European standards, predetermines the relatively high share of administrative coercion in ensuring compliance with EU standards in the short term. This, in turn, increases the risk of arbitrary enforcement of the regulations and their use for corrupt purposes.

Regarding the current state of innovative enterprises in Bulgaria and their ability and capacity to absorb funds under EU programmes and projects, the following conclusions may be drawn:

- The Bulgarian innovative enterprises comprised 11.4% of all enterprises in 2003 or one quarter of the share of innovative enterprises in the EU-15 in 2001. Their innovative activity is seen mainly in the introduction of new products for the firm itself or for the Bulgarian market and to a much smaller extent in the development and implementation of international innovations. The innovation expenses comprise about 15% of the total expenses of Bulgarian SMEs implementing innovations and most enterprises allocate them mainly to marketing and staff training. Bulgarian innovative SMEs are mainly concentrated in manufacturing, trade, construction and tourism, although as a share of all enterprises in the respective sector their number is highest in financial services;
- The long-term development of innovative enterprises in Bulgaria is greatly limited due to the small average size of the assets of Bulgarian SMEs and the lack of suitable instruments for financing their innovative growth. The Bulgarian innovative SMEs still lack access to the local and international technological market and have not yet developed innovation cooperation, either in the country or abroad;
- Bulgarian innovative SMEs have a clearly higher capacity for participation in the different EU pre-accession programmes, such as PHARE, which makes them also more likely applicants and participants in OP “Competitiveness”. The main strands of the OP, in which they will seek the support of the programme, are for the development of new products/technologies/services, for the introduction of energy-saving technologies, the modernisation of company management, for staff training and qualification and for the use of consultation and business services.

The biggest challenges, which Bulgarian innovative SMEs expect in the application for and management of European funds are the complex and bureaucratic procedures and the lack of sufficient information about the different programmes;

- The needs of the innovative SMEs in Bulgaria, as expressed by them in the Vitosh Research survey, are well reflected and addresses in the current version of OP “Competitiveness” to a considerable extent. The envisaged goals of the programme correspond adequately to the priorities the firms have declared in their investment plans for the next three years. The main challenge will be to accurately direct funds under the operational programme to the critical points of success, which will depend greatly on the rules for the implementation of the programme.

Taking into consideration the experience in the management and absorption of pre-accession funds such as PHARE, SAPARD and ISPA, OP “Competitiveness” must seek greater effectiveness in its support for the Bulgarian innovative SMEs in the following main directions:

- Two focal points of support through OP “Competitiveness” are identified: first, establishment of a modern infrastructure for the creation and dissemination of knowledge and innovations and, second, support for the innovative firms and their contacts and cooperation inside the country and abroad. It will be particularly important to better coordinate the national efforts under OP “Competitiveness” with those at European Union level, such as, for example, support for innovative infrastructure, for the transfer of EU technologies or the participation of Bulgarian SMEs and supporting participants in the 7th Framework Programme for Research and in the newly adopted by the European Commission Competitiveness and Innovation Programme;
- Sufficient funds should be allocated for ensuring a multitude of proper channels for providing information about the available funding opportunities. Simultaneously, the Ministry of Economy and Energy should seek a passive (SMEs seek information and find it easily) and active (the Ministry of Economy and Energy promotes the operational programme and its projects) approach in its communication strategy;
- The Ministry of Economy and Energy should work in public-private partnership with non-governmental and consultancy organisations, to ensure an adequate international resource of specialists to assess the specific technological needs of the innovative Bulgarian SMEs, enabling OP “Competitiveness” to provide support for the Bulgarian enterprises with knowledge of the dynamic international technological environment;
- Preparation must be started for the development of integrated regional and sector approaches aimed at supporting the development of innovative enterprises, by seeking mainly reinforcement of the already created or emerging market competitive advantages and integration in the most profitable international production networks of Bulgarian SMEs. As a country with a still very limited national financial resource, Bulgaria must seek the natural movement of the international innovative flows and not rely on social engineering.

Regarding the use of information and communication technologies by Bulgarian SMEs, the following conclusions may be drawn:

- The share of the employed who use a computer in the work place has increased by 6% on an annual basis (for the period 2000 – 2005), but remains unevenly distributed and at relatively low levels – below 30% for 2006. Half (50.4%) of the surveyed SMEs have equipped with computers up to 25% of their work places, and 8.7% is the share of firms with 26% to 50% work places, equipped with computers. The share of firms with a high level of computerisation is still small – 5.5% have over 76% work places equipped with computers, while the share of enterprises in which all work places have a computer is 7.4%. A saturation of work places with computers is expected in the next couple of years, if only production and technologically conditioned needs of the use of computer technology at the present level of innovativeness of the economy are taken into account. The limited growth of this indicator is conditioned by the low technological intensity of some sectors of the Bulgarian economy.
- The connection of computers to local networks and the Internet continues at a rapid pace - some 73% of the Bulgarian enterprises are already online. The connection of the enterprises and computers to the Internet is also expected to reach its rational economic ceiling of around 90% in 2007.
- The share of the surveyed Bulgarian SMEs which have a website is 32.2%. By the end of 2007 or the beginning of 2008 the 50% mark is expected to be passed by enterprises with more than 10 staff. SMEs' web-sites provide not only information, but also specific additional services for their clients. In the first quarter of 2006, a total of 48% of the enterprises with their own website provided the possibility for online orders, but only between 16% and 20% of the online orders could be paid via the Internet.
- More than half (60.5%) of all surveyed SMEs lack computer specialists. Approximately two-thirds of the firms with 101-250 staff have at least one IT specialist. The capacity of the network connectivity of SMEs is not used to the full. The IT skills of the specialists in non-IT firms are mainly due to self-training rather than any company training. As a result, it turns out that the network possibilities for work, offered for example by MS Office, are virtually not used and it is easier to adopt an existing system to cooperative work, than to use its ready functional possibilities through more strictly observed rules.

The effective use of information and communication technologies by the Bulgarian SMEs can be supported in several directions:

- It is necessary to develop a **programme, securing the financing of IT components** within the framework of the projects under the Structural Funds on the existing priorities and operational programmes, which to compensate the omission of the IT problematic in the National Plan for Development. The business associations are expected to play an active role in this process. For example, the many associations in the field of tourism could recommend to their members to invest in joint IT projects for reservation activity, especially targeting small business, family and rural tourism, etc. Such IT projects, which aid the cooperation between small and medium-sized enterprises can be realised in the field of transport and forwarding, including the management of deliveries of online

orders, which continues to be a critical area for the entry in the online business of small and medium-sized enterprises.

- The introduction of **schemes for the financing of IT education and training** with a view to stimulate the turnout of more people with IT skills. If they stay to work in the country, it might be considered to provide certain incentives and easier financing of their education, or to give concessions to the firms financing such education and consequent employment.
- In the field of *e*-business, several important challenges are identified in the medium term: first, a structural change, in which the enterprises migrate from segments with lower value added to segments with a higher one; second, increase of the general technological intensity of business; third, the creation of niches of demand for high IT-intensive products and services.

The interviewed bank specialists formulate a number of conclusions and recommendations regarding the optimisation of the process of absorption of the European funds by Bulgarian SMEs:

- There is **information deficit with regard to the programmes of the European funds and the regulations under which their financing will be allocated**. The government needs to adopt a uniform information policy, including the creation of a uniform team, which to provide information services. This will help to overcome the existing practice of administrative “parcelling” of the available information.
- **Regulation of the intermediation function of the banking sector in the absorption of the European funds**. A clear state policy needs to be developed for sharing the risk in the work with projects financed under the European funds. The banks favour a clear position of the government, in which the risk of an investment project, regardless of the nature of financing, is assumed by the bank, crediting the share of the client and/or the main investment through bridge loans or in some other way. In turn, the government through its respective managing authority must assume the investment risk for each project, i.e. the risk that the project fails because the respective EU criteria have not been met.
- The government must create the legal and institutional framework in which the economic agents will be able to freely compete under observance of the contracts – something which Bulgaria has still not completely achieved. This means for the government to start fulfilling its most important obligation – to create equal playing field for all economic players, to settle lawsuits on the basis of equality before the law, and not due to other considerations, i.e. to create a truly competitive environment, effectively protecting the rights and interests of all economic players.

Regarding the access to financing of SMEs, the following conclusions may be drawn:

- The quantitative survey among Bulgarian SMEs shows that bank credits still remain an expensive and inaccessible source for the greater part of the Bulgarian SMEs. More than half of them have not used any loans at all during the last three years. A total of 44% of the respondents had access to loans during that period. Some 37% of the participants in the survey used a commercial loan in the last three years. The amount of these loans is limited – their ceiling is on the average

around 70,000 BGN (app. EUR 35,000). The share of investment loans is even lower: about 18% of the respondents have used such a credit. The share of leasing schemes in the investment activity of the firms is smaller still – one out of ten firms has used leasing financing.

- More than 60% of the SMEs in Bulgaria have financed their investments in the last three years mainly with own funds, i.e. their growth is determined by the attained scale of production, and not by the potential of the market. The small and medium-sized business still does not rely sufficiently on the financial sector in the country, but uses mainly own funds. This statement is even more valid with regard to new firms and start-ups.
- Among the main obstacles, which the respondents cite on access to bank loans, are the high interest rates (54.3% of the respondents), the “hidden” costs on the credit (19%), as well as the excessive requirements for collateral (40%).
- The surveyed bank experts consider that it would be economically ineffective to direct money from the European funds to guaranteeing bank loans. It would be more favourable to strengthen and modernise the institutional and legislative framework, including the financing of the professional training of the public administration, increasing its remuneration and other direct budget expenditures, rather than the direct subsidising of businesses.

Despite the noted improvement versus 2004 both with regard to the development of business plans and the extension of the planning horizons included in them, the Bulgarian firms still think in terms of about one year ahead, which is a serious structural obstacle for the synchronisation of their business processes with the work of the national operational programmes and Structural Funds of the EU. The still dominating strategies of the SMEs are reactive, rather than pro-active. In this connection it is recommended to develop management consulting schemes for SMEs with a view to developing management capacity in the field of strategic management and planning.

The main conclusion regarding the capacity of SMEs for participation in the absorption of resources from the European funds, is that in 2006 the firms do not see the European programmes and funds, open for Bulgarian participation, as an important source of financing of investment projects, new technologies, establishment of in-house capacity and innovation projects. Regarding the participation of the firms in the European funds and programmes, the following conclusions may be drawn:

- The Bulgarian firms’ participation in tenders under European funds and programmes is very low. The in-house capacity for participation is inadequate – few staff members who speak foreign languages, are computer literate and know how to use the Internet; poor skills for the development and management of projects; difficulties in understanding and applying the rules of financial accounting under the European programmes.
- Not a single one of the respondents has taken part in tenders under European Union Framework Programmes for Research and Technological Development²⁴ (Fourth, Fifth, Sixth Framework Programmes). The firms show little interest in participating in research and innovation projects. The link of Bulgarian SMEs to

²⁴ According to data of the Ministry of Education and Science, only 52 SME have taken part in projects of the Sixth Framework Programme (2002-2006), of which not one was included in the sample of the survey.

research institutes and universities has virtually been severed. This is an indicator of the low level of willingness for real cooperation of the firms with foreign partners in scientific research and technological development projects, as the formation of international consortia of partners is a condition for participation in the framework programmes.

- Among the external factors, hampering the firms in receiving and using the resources of the European funds, the most significant are the complicated and bureaucratic procedures, the lack of sufficient information about the European programmes, as well as the necessary co-financing of the projects. The existing corruption also keeps the firms from applying for financing under the European programmes. SMEs report corrupt practices in the form of “consultants” who “guarantee” the success of a project proposal already at its preparatory stage.
- The Bulgarian SMEs are sceptical and distrustful of the consultancy services, provided for the development and implementation of projects under the European funds and programmes. The firms tend to seek general business consultancy, such as accounting/financing and marketing services, related to their daily and core activity, rather than consultation on how to prepare proposals for applying under European funds and programmes.
- The representatives of the employers’ organisations consider it very important that not only the firms are acquainted with the rules and procedures for applying for financing under the structural funds, but also the municipal and regional bodies, as they will be the main beneficiaries of resources from these funds.

Regarding the readiness of the Bulgarian SMEs for work with the structural funds through OP “Competitiveness”, the following conclusions may be drawn:

- SMEs are poorly informed about the possibilities for work with the EU structural funds. The firms prefer to take a passive and wait-and-see position – they think that at least one year after the accession should pass before they familiarise themselves with the requirements of accession and the possibilities proceeding from it.
- Insignificant funds are allocated by the firms for consultancy services, market research, development activity, for attracting foreign investments, for marketing, staff training and qualification, and for the optimisation of company management, i.e. for investments, which would ultimately lead to an increase of the value added of the offered production.
- The low level of awareness about the opportunities which the Structural Funds will offer through OP “Competitiveness” will probably result in a weak participation in the first tenders that will be opened after Bulgaria’s accession to the EU, due to the short terms for the preparation of the project proposals. In addition, the capacity for generating project ideas among the firms is low, and they are poorly prepared to manage and implement the projects themselves.
- In the next three years, the firms will rely mainly on their own funds and bank loans as sources of financing of their investment projects. Those who intend to apply with projects for financial support from the Structural Funds will chiefly seek technological upgrade of their production facilities, meeting the standards and requirements of the European Union, introduction of energy-saving technologies

and innovation projects. Even so, the share of those who would apply for financing under OP “Competitiveness” remains below 20% of all surveyed SMEs.

- Bulgarian banks are also not acquainted with the Lisbon strategy in detail and have not developed long-term strategies to make use of the possibilities it offers. What prevents the banks from differentiating their credit portfolio in accordance with the new credit niches, accompanying the opening of the Structural Funds, is the still insufficient and well structured information about the Structural Funds and OP “Competitiveness”.
- The sectors of the Bulgarian economy stating the highest readiness to apply for financial support from the Structural Funds through OP “Competitiveness” are manufacturing; trade and repairs; construction; transport, warehousing and communication; production of electricity, heating, gas fuels and water.

In connection with the effective use of the resources under the European funds and the implementation of OP “Competitiveness”, the following conclusions can be made:

- Due to the short time left until Bulgaria’s accession as full member of the EU, it is necessary to conduct a large-scale information campaign throughout the country about the opportunities for SMEs provided under the Structural Funds through OP “Competitiveness”. The information campaign should include intermediary and employers’ organisations, as well as non-governmental organisations working with the business.
- SMEs must cooperate more actively with non-governmental organisations, which as a rule are project-oriented and have internal capacity for development and management of the implementation of projects under various European programmes. Such recommendation could be included in the elaboration of the application procedures under OP “Competitiveness”.
- Prepare and publish specialised publications, intended for business, regarding the possibilities provided by the Structural Funds through OP “Competitiveness”, as well as organise specialised training for the preparation of proposals for projects under the operational programme.
- Coordinate the efforts of the Ministry of Economy and Energy and of the Ministry of Education and Science regarding the participation of Bulgarian SMEs in OP “Competitiveness” and the 7th European Union Framework Programme for Research and Technological Development.
- Develop a national scheme for co-financing of the projects under OP “Competitiveness” and attract the banks and other potentially interested financial institutions. One of the possibilities is for a larger number of organisations to offer bridge financing. For this purpose it is suitable to carry out training and consultations for the banks, for the development of such instruments.
- In order to minimise the possibilities for corrupt schemes, the use of consultancy services by SMEs could be accounted for by a fixed percentage in the budget of the project itself. This will stimulate the inclusion of experienced, project-oriented organisations, both in the preparation of project proposals and in the actual implementation and management of the projects, and will increase the quality of the implementation of the OP “Competitiveness”.

- The municipalities should present openly to the local business and the public their plans for development, programmes, projects and investment intentions. It is advisable for the municipalities to use the capacity of SMEs, which have experience in the work on projects or which have project ideas – creating a “network of able people” for inclusion in the joint work efforts for the management and absorption of the structural funds at regional level. Municipalities and regional authorities might want to create a structure, including different highly qualified experts, to coordinate the efforts for management and implementation of projects under the Structural Funds at local level, to attract the local business with a proven capacity, and to conduct information and awareness campaigns.
- The surveyed owners and managers of SMEs state their need for a clear regulation of their relations with the public administration. They insist on the working out of regulations for the functioning of the public administration, on which basis to elaborate transparent procedures about the way in which the firms will establish contact with the state administration. Special attention is paid to the need for clear rules for the auditing of the projects and strict accreditation of the auditing bodies. The compilation of a classification of the different types of projects, which to simplify the procedures and facilitate the preparation of the required application documentation, is also suggested.