BARRIERS FOR ACCESS TO FINANCE FOR MSMEs IN NORTH MACEDONIA

STOCK OF EXISTING DATA AND KNOWLEDGE

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Author: Macedonia2025

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CONTENTS

List of abbreviations

BIS - Bank for International Settlements

EESE – Enabling Environment for Sustainable Enterprises

EIB – European Investment Bank

EU – European Commission

FSAP - Financial Sector Assessment Program

FX - Foreign exchange

IFRS - International Financial Reporting Standards

ILO - International Labour Organization

IMF – International Monetary Fund

MSMEs - Micro, small and medium-sized enterprises

NBRNM – National Bank of Republic of North Macedonia

NFC – Non-financial corporations

NPL – Non-performing loans

RCC - Regional Cooperation Council

SEE – South Eastern Europe

SMEs - Small and medium-sized enterprises

SSO – State Statistical Office

WB – Western Balkan

WBT – Western Balkans and Turkey

EXECUTIVE SUMMARY

The objective of the present assignment, commissioned by the International Labour Organization (ILO), is to: i) explore the main reasons why access to finance remains a key challenge for companies in North Macedonia, especially for micro, small and medium enterprises (MSMEs), and ii) identify potential actions and measures required to improve the access to finance. This policy paper will be discussed within the Economic and Social Council of North Macedonia, which will consequently provide its recommendations for policy actions to the Government. The problem of barriers for access to finance is of equal concern to businesses and policymakers. Limited access to finance can constrain operations and growth of companies and therefore can be viewed as an impediment to economic growth (ECB, 2017). This is especially true for emerging countries with underdeveloped financial markets, as is the case for North Macedonia.

The study finds that the financial system in North Macedonia is sound, but still underdeveloped. It is dominated by banks, which have high share in total assets of the financial sector, as well as in the financial intermediation. Credit to private sector (50 per cent of GDP) is still low in international comparison, especially in relation to developed EU countries.

According to the analysis, access to finance is one of the biggest obstacles for businesses, but not a major one. MSMEs face larger barriers in accessing the needed finances relative to large firms. Macedonian firms are more likely to use banks' loans for financing of the working capital and investments, compared with firms in the European and Central Asia (ECA) regions, as well as the global average.

From the company perspective, the main impediments for access to finance are: i) the cost of financing (high interest rates); ii) high collateral requirements; iii) long and complex administrative procedures; iv) high risk aversion of banks; v) lack of useful and developed alternative financing sources such as equity financing, business angels and venture capital. In the view of banks, the main obstacles for access to finance from the perspective of Macedonian banks are: i) weak financial literacy of MSMEs; weak corporate reporting (also low use of external audits) and business planning skills and knowledge of companies; unwillingness of companies to disclose and share business information; perceived lack of profitability and inadequate credit history, as well as low awareness of companies for the alternative instruments and options for external financing such as venture capital, business angels, etc.

These findings point to the need for action on both sides to mitigate the identified barriers for access to finance. For MSMEs, there is a need for improving financial literacy, corporate reporting and business planning, as well as raising the awareness and knowledge of various financing instruments. Interventions on the banks' side should involve improvement of their skills (the skills of the staff) for assessment of MSMEs, further streamlining of the loan applications, and approval and seeking options for further reduction of interest rates (and/or fees). The government, as the main regulator but also provider of some services (mainly through the Development Bank), certainly has a role to play in the overall efforts of improving the access to finance. From the legislative perspective, the government (in cooperation with the Central Bank) may undertake the following activities: create a specific legal framework for factoring; ease the legal requirements and the procedures for establishment and operation of financial institutions offering alternative financial instruments; and, some interventions in the framework for insolvency and creditor rights. Efforts should also be invested into improving the access to the registers for securities over movable assets and further improvement of the major structural vulnerabilities of the banks. Finally, the government

should consider reviewing the existing credit guarantee scheme of the Development Bank to ease pressure on MSMEs to provide collateral.

The findings of the report also show that some structural indicators and institutions, such as corruption, rule of law, etc. may also be seen as barriers for access to finance. As the country fights corruption, strengthens the rule of law, and reduces informalities, the access to finance and total lending will increase.

1. INTRODUCTION

The International Labour Organization (ILO) supported the two leading employers' organizations of North Macedonia (the Organization of Employers of Macedonia, OEM, and the Business Confederation of Macedonia, BCM) through an assessment of the business environment of the country in 2013[1]. Report was produced which provided an analysis of member enterprises' perceptions of the most important hurdles of the business environment in the country. The exercise provided entry points for evidence-based advocacy of the Employers and led to several successful reforms. In 2019, an updated analysis of the critical constraints of the business environment was conducted.[2] This analysis showed to what extent the environment has improved since 2013 and what the remaining challenges are. Based on consultations with the representatives from employers' organizations, trade unions, and government, it has been agreed to select the most burning, remaining challenges and to prepare an in-depth analysis of what needs to be done to contribute to a thriving business enabling environment. One of these priority topics that so far has not seen significant improvements, is access to finance.

In this regard, the objective of the present assignment is to identify the main reasons why access to finance remains a key challenge for companies in North Macedonia, especially for micro, small and medium enterprises (MSMEs). Furthermore, the assignment should explore the options and potential actions and measures required to increase access to finance in North Macedonia. The output of this assignment is a policy paper for the Economic and Social Council with suggested actions to be discussed in the Council and to be presented to the Government.

Limited access to finance can constrain operations and growth of companies and therefore can be also viewed as an impediment to economic growth (ECB, 2017). This is especially true for emerging countries with underdeveloped financial markets, as is the case of North Macedonia. Hence, the problem of barriers for access to finance should be of equal concern to businesses and policymakers. The positive relationship between finance and growth for emerging countries is well documented in the empirical literature (Barajas et al., 2013), although there also seem to be a threshold above which the financial depth does not impact growth (Arcand et al., 2015). In this regard, improvements in the access to finance can have positive implications for a country growth.

The methodology of the analysis should combine several methods: i) summary of the existing literature on the topic, ii) field research (interviews, survey and focus groups) with the main stakeholders on supply and demand side, and iii) validation workshop and presentation to the Economic and Social Council. However, due to the new situation caused by the COVID-19 pandemic, the project team was not able to conduct the field research and to organize a

1 https://www.ilo.org/budapest/what-we-do/publications/WCMS_723390/lang--en/index.htm

2 https://www.ilo.org/budapest/what-we-do/publications/WCMS_723390/lang--en/index.htm

validation workshop. Hence, this report explores and presents findings of the literature review (i.e. desk research). However, the report will be distributed to the Employers Organizations and to the other members of the Economic and Social Council for consideration.

This report provides a summary of the existing knowledge, literature and official data on the barriers of access to finance, and is meant to provide the general context for the field work, as well as for the policy recommendations. The report starts with an examination of the corporate sector in North Macedonia, firms' characteristics, contribution of the MSMEs to the value added and employment, and their performance relative to the large companies and to their peers from the EU countries and the Western Balkans. Section 3 then investigates the size and depth of the financial system and financial intermediation in North Macedonia. It provides an analysis of the credit activity, assets of the financial institutions, main financial stability indicators, as well as some comparisons with the developed countries. It also identifies some structural weakness of the financial system and of corporations which may hinder the deepening of the financial intermediation. Section 4 examines the available information and studies on the access to and affordability of financing to companies in North Macedonia, based on available international reports and studies.

2. CHARACTERISTICS OF THE MACEDONIAN CORPORATE SECTOR

In 2018, Macedonian corporate sector composed of 72,315 companies as reported by the State Statistical Office (SSO). When analyzing the corporate sector in North Macedonia, one should have in mind that the analysis is limited by several obstacles. One of them is the quality and non-availability of annual financial reports (especially of small and micro entities). In particular, the small and micro entities do not have a legal obligation for preparation of audited financial reports and they mainly outsource their accounting activities to licensed accountants. They are not obliged to follow the international financial reporting standards (IFRS). Preparation of financial reports for taxation purposes or the need of fulfilment of certain legal requirements is the primary motivation of their financial reporting. Therefore, reliability of the data extracted from their financial statements is an additional reason for caution within the analysis. Out of these 72,315 companies, only 53,669 submitted financial reports in the Central registry which represents around 75 per cent of all the companies. The analysis below is based exactly on those companies.

Given the common finding in the literature that firms' size might be an important factor of their capital structure, below we examine the structure of the Macedonian corporate sector by the relative importance of the size of the firms. Annex 1 examines the national definition of MSMEs in comparative perspective with the EU definition.

With more than two thirds of total value added and three quarters of employment, the share of MSMEs in the economy of Macedonia is well above the respective EU averages of 57 per cent and 66 per cent, respectively (Table 1). Over the period 2008-2016, MSMEs' value added increased by 28 per cent and employment rose by 24 per cent, implying a slight rise in labor productivity.[3] In 2018, MSMEs in North Macedonia employed 285,682 workers, compared to 93,055 employees of the large companies. They created a value added which is approximately twice the value added of the large companies.

3 https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/sba-fs-2018_nmk.pdf

Table 1: Characteristics of the corporate sector by firms' size, 2018

Size	Number of entreprises			Number of persons employed			Value added		
	North Macedonia		EU	North Macedonia		EU	North Macedonia		EU
	Number	Share	Share	Number	Share	Share	Number	Share	Share
Micro	34275	63.9%	93%	123310	33%	29%	879	22%	20%
Small	18142	33.8%	5.9%	85669	23%	20%	929	23%	18%
Medium	773	1.4%	1.0%	76703	20%	17%	824	21%	18%
MSMEs	53190	99.1%	99.8%	285682	75%	66%	2632	66%	57%
Large	479	0.9%	0.2%	93055	25%	34%	1370	34%	43%
Total	53669	100%	100%	378737	100%	100%	4002	100%	100%

Source: Central Bank of Republic of North Macedonia (NBRNM) and Eurostat[4]

In the Western Balkans, MSMEs make up 99 per cent of all firms, generate around 65 per cent of total value added and account for 73 per cent of total business sector employment[5], which is similar to the country data for North Macedonia. Acknowledging these crucial contributions of MSMEs to their economies, governments across the region have set up dedicated agencies and have developed strategies to foster MSMEs' competitiveness. However, more remains to be done to tackle the challenges facing MSMEs and entrepreneurs in the region, ranging from access to finance to participation in international trade. In light of the future economic integration in the European Union (EU), the Western Balkan countries need to address those challenges to be able to cope with the competitive pressure within the Union.

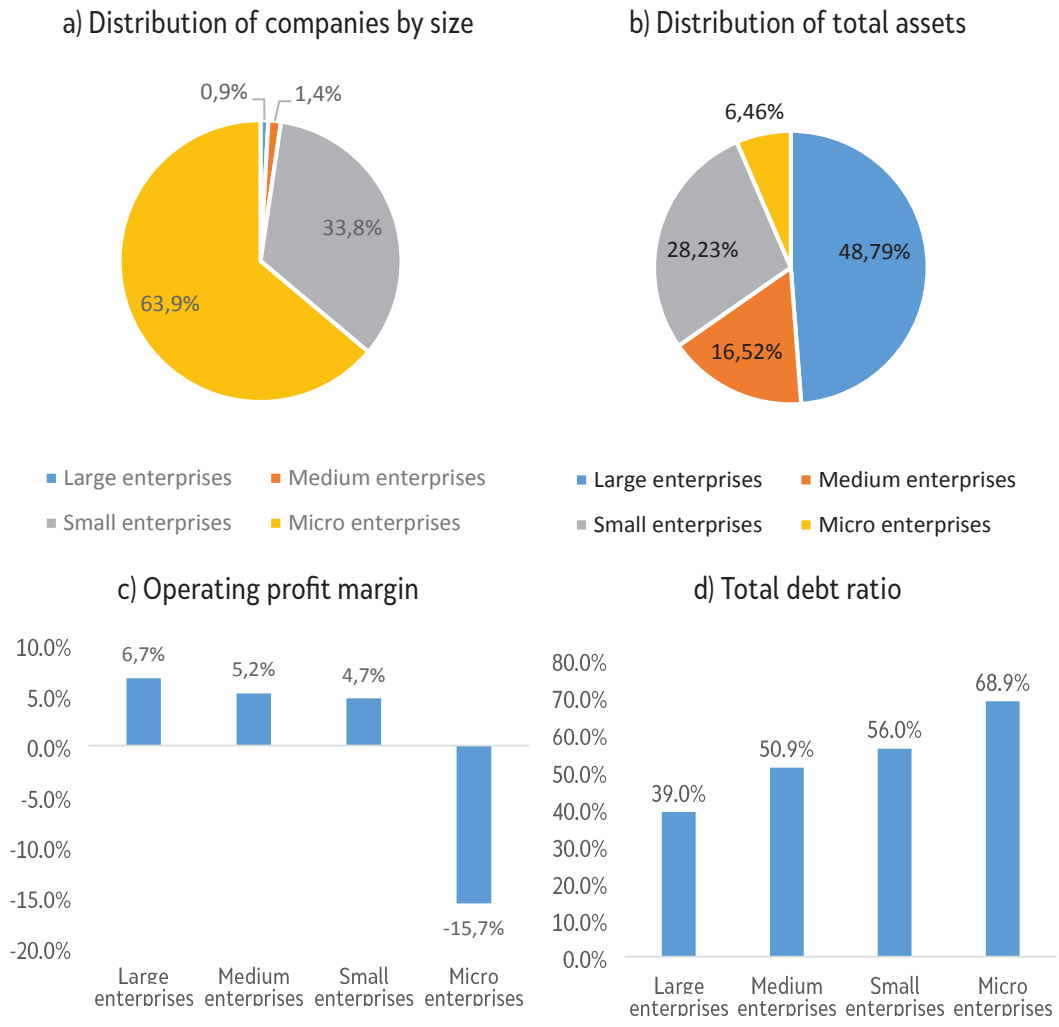
As presented in Figure 1a, MSMEs comprised about 99 per cent of the total number of registered non-financial corporations[6] in Macedonia at the end of 2018. However, they participate with about half (51 per cent) in the total assets (Figure 1b). The economic and financial performance of micro and small companies is inferior to that of the medium and large firms as shown in Figure 1c and Figure 1d. They experience lower operating profit margins and have higher debt ratios.

4 The data cover the 'non-financial business economy', which includes industry, construction, trade, and services (NACE REV. 2 Sections B to J, L, M and N), but not enterprises in agriculture, forestry and fisheries and the largely nonmarket service sectors such as education and health.

5 SME Policy Index: Western Balkans and Turkey 2019.

6 The non-financial corporations (or corporate sector) does not include legal entities that have registered predominant activity in the following activities: "financial activities and insurance activities", "public administration and defense, compulsory social insurance" , "education" , "health and social care activities" and "art, entertainment and recreation".

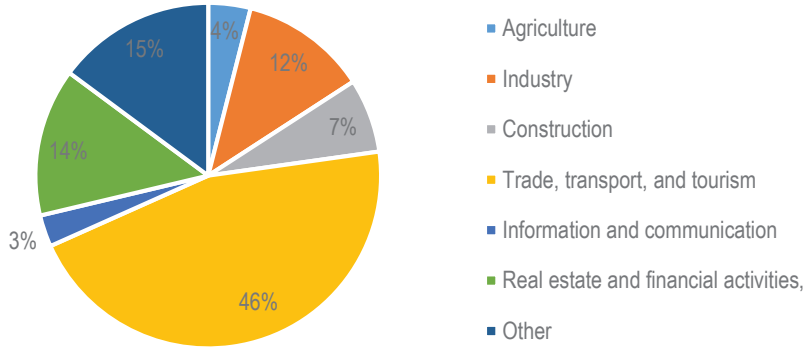
Figure 1: Decomposition of the corporate sector based on the size of the companies



Source: SSO and National Bank of Republic of North Macedonia (NBRNM)

As Figure 2 shows, most of the MSMEs (46 per cent) are operating in the Trade, transport and tourism, followed by 14 per cent which work in Real estate and financial services. 12 per cent of the MSMEs are operating in the industry sector. The distribution of MSMEs by industry is similar to the overall structure of the economy by sector, with small differences. For instance, while 56 per cent of all companies in North Macedonia operate in the sector of Trade, transport and tourism, that is the case for 46 per cent of MSMEs. Similarly, Industry is slightly less common among MSMEs than among general population of companies.

Figure 2: Distribution of MSMEs in North Macedonia by sector



Source: NBRNM

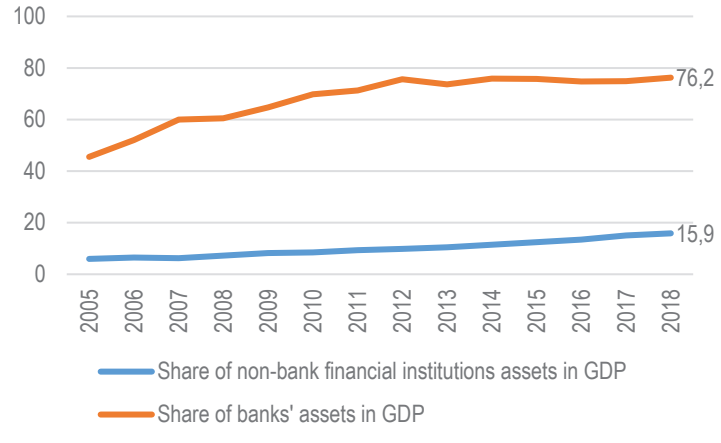
Overall, the structural analysis of the Macedonian corporate sector shows that micro, small and medium-sized enterprises (MSMEs) play an essential role and are very important for the economy. In North Macedonia, more than 99 per cent of all companies are MSMEs, which provide 75 per cent of total employment in the country. The structure of the MSMEs in North Macedonia is similar to the countries in the European Union in terms of distribution by size, but not in terms of the employment and value added.

3. FINANCIAL SECTOR AND FINANCIAL INTERMEDIATION

This section examines the size and depth of the financial system and the financial intermediation in North Macedonia, as well as the financial stability. The soundness of the financial system and the deepness of the financial intermediation are important ingredients of the overall access to finance.

Total assets of banks in 2018 were 76.2 per cent of GDP (Figure 3). Commercial banks comprise 82.8 per cent of the total assets of the financial system in 2018. The share of banks' assets in the total financial system was increasing until 2012, and stagnates afterwards. The stagnation is related to the growing importance of non-bank institutions, such as mandatory pension funds, non-life and life insurance companies, as well as the share of investment funds.

Figure 3: Banks and non-banks' assets share in GDP in North Macedonia (in per cent)

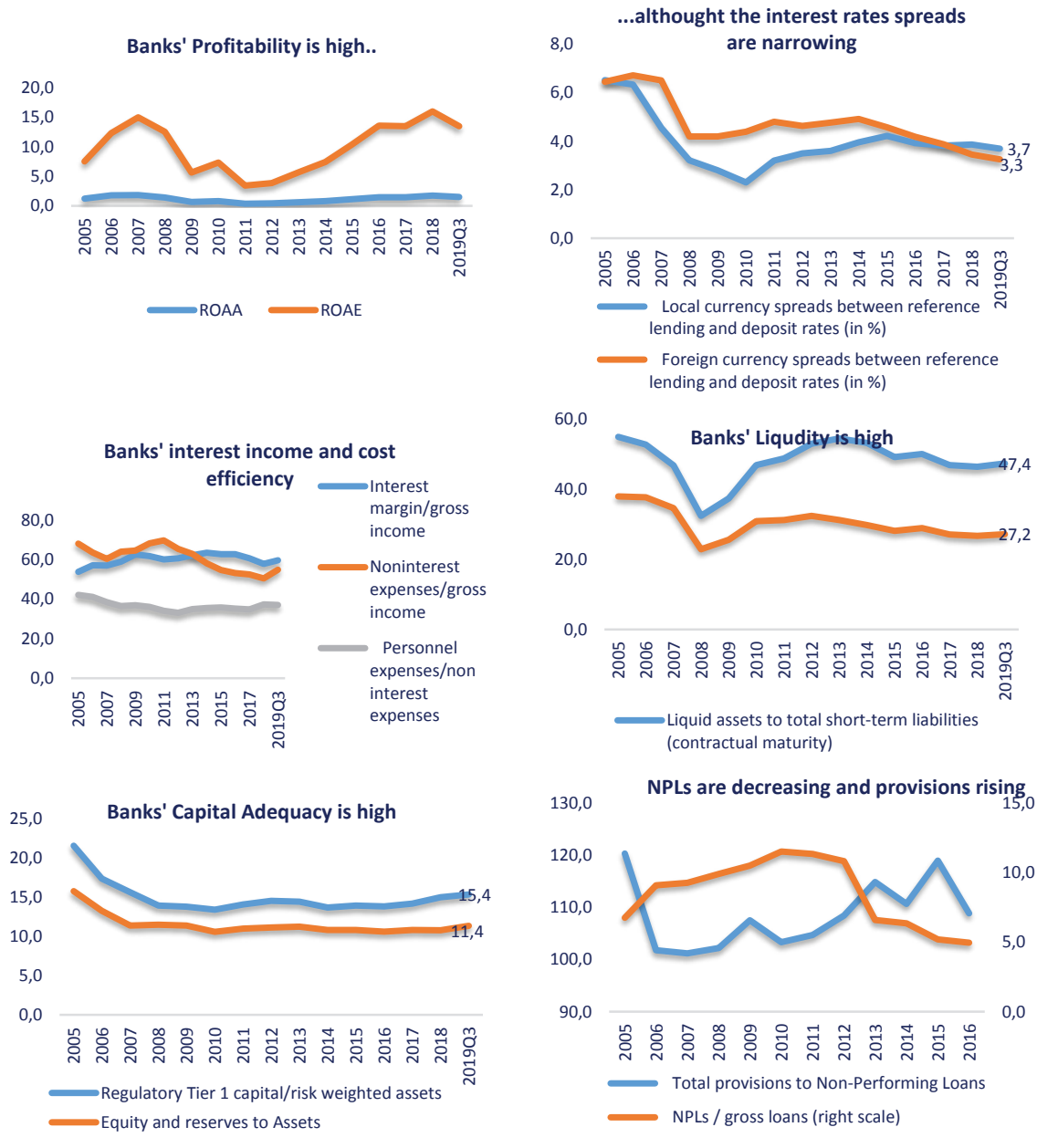


Source: NBRNM

Saving houses, leasing companies and financial companies that could be additional source of finance to MSMEs are of very small size, jointly accounting for 1.5 per cent of total assets (NBRNM, 2018). Detailed breakdown of the total assets by financial institution are presented in Annex 2.

Financial stability indicators provide good assessment of the Macedonian banking industry. The capital adequacy is well above the regulatory requirement, non-performing loans (NPLs) levels are declining in the last few years and there are high provisions to NPLs. Capital standards follow the Basel III accord. More than a quarter of total assets are liquid and cover almost half of short-term liabilities. Bank profitability has been improving since 2012 benefiting from higher net interest income, mainly as a result of lower interest expenses, and improved cost efficiency (see Figure 4). Interest rates spreads are narrowing which is partly a result of increased competition within the sector (even though the number of banks has declined in recent years due to some mergers).

Figure 4: Financial Stability Indicators



Source: Financial Stability Indicators, NBRNM

The total number of commercial banks in Q3 2019 was 15, most of them with foreign capital (Table 2).[7] However, most of the banking activities (around 2/3) are concentrated in the group of large banks that are prevalent in assets, equity, deposits and loans, as well as in total performance indicators. The large banks hold 79 per cent of the deposits of the nonfinancial corporations (NFC) and 74 per cent of the NFC credit. ECB (2017) shows that the 5-banks concentration ratio in North Macedonia is slightly below 75 per cent, and is higher than in the EU11 countries and the euro area.[8]

Table 2 Indicators by banks' size, Q3-2019

Bank size	Share of foreign equity in total equity	Total assets	Equity and reserves	Total deposits of nonfinancial entities	Gross loans to nonfinancial entities	Financial result
Large banks	80.4%	74.6%	76.0%	78.9%	74.0%	96.6%
Medium-sized banks	68.7%	21.9%	21.0%	17.8%	22.6%	1.4%
Small-sized banks	57.2%	3.4%	3.0%	3.3%	3.4%	2.0%
Banking system	74.6%	100%	100%	100%	100%	100%

Source: National Bank of Republic of North Macedonia (NBRNM)

This section shows that the financial system in North Macedonia is sound, though it is still underdeveloped. It is dominated by banks, which have high share in total assets of the financial sector, as well as in the financial intermediation.

4. ACCESS TO AND AFFORDABILITY OF FINANCE

4.1 Macroeconomic and banking sector indicators

ECB (2017) argues that higher levels of GDP per capita and greater financial depth (measured by credit to private sector) significantly contribute to reducing financial constraints. In an environment of relatively low GDP per capita level in North Macedonia (which is 38 per cent of the average EU-27 level in 2019) and low financial intermediation, companies (and individuals) may face large impediments in accessing finance.

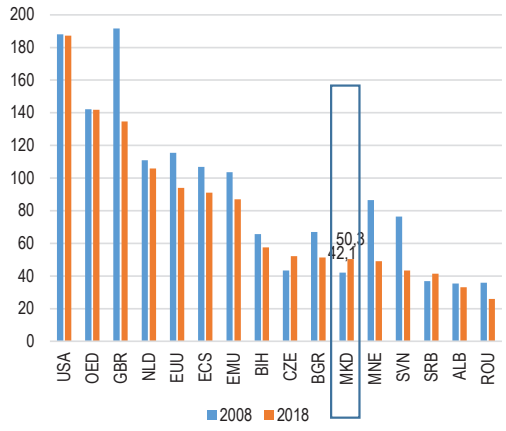
Domestic credit to private sector, as proxy indicator of the depth of the financial system, in North Macedonia was 50.4 per cent of GDP in 2018. It is well below the developed countries' levels, but comparable with the Western Balkan countries. The banks are dominant in the overall credit activity, with total credit to private sector of 48.8 per cent of GDP (Figure 5). Only small share of credit is provided by other financial institutions - saving houses, leasing companies and other financial companies.

7 Plus one public institution, the Development Bank of North Macedonia. In the time of preparation of this report, one of the small banks Eurostandard bank went into bankruptcy.

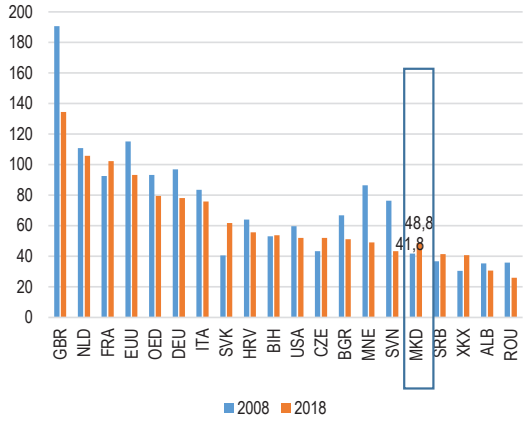
8 Unweighted average of the share of assets of the five largest banks as a per centage of total assets in 2016.

Figure 5: Domestic credits by financial sector and by banks

a) Domestic credit to private sector by financial sector (per cent of GDP)



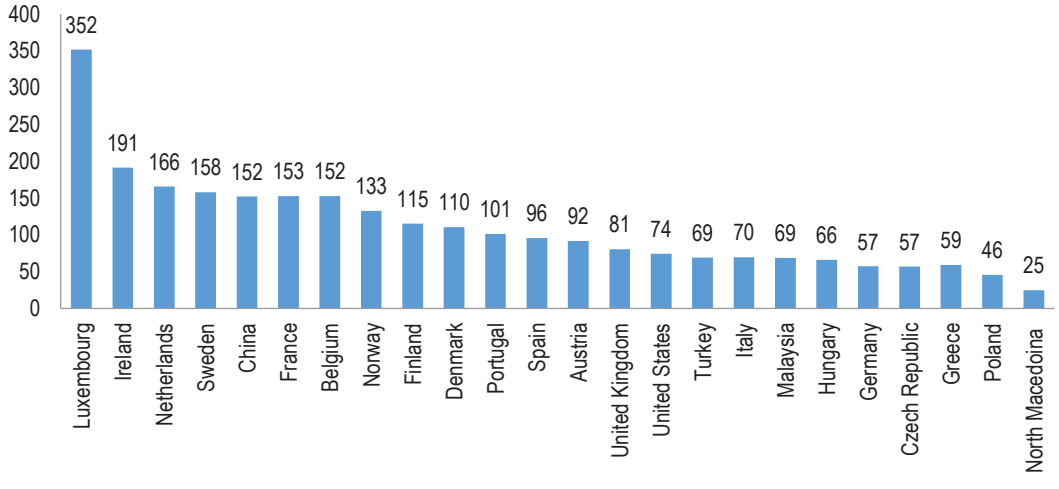
b) Domestic credit to private sector by banks (per cent of GDP)



Source: World Bank, World Development Indicators

Moreover, in some European countries, credit is higher than the GDP, and in Central European countries credit to firms are twice higher than in Macedonia (Figure 6). This comparison shows clearly that there is a large room for increasing the supply (availability) of finance for MSMEs in North Macedonia.

Figure 6: Credit to NFC by banks as a share of GDP (2019)



Source: Bank for International Settlements (BIS)

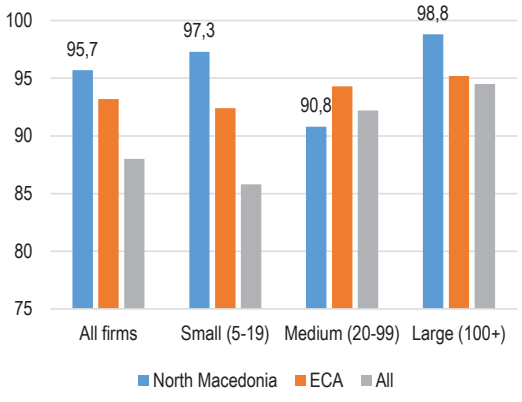
The latest data (end of 2019) show that the share of banks' credit to NFC is 23.9 per cent of GDP and for the first time it is lower than the share of banks' credit to households (24.7 per cent of GDP). This is clear indication that the banks are more in favor of lending to households, which are considered as diversified and less risky sector. The NBRNM Financial Stability Report (2018) shows that 35.5 per cent of firms in Macedonia use banks' loans for financing purposes. According to the total credit exposure by sector of activity, the banks are mostly exposed to Wholesale and retail trade sector, Manufacturing and Construction. Furthermore, 29 per cent of total credits to NFCs are short-term credits, 62 per cent are long term credits, while 7.5 per cent are Non-performing loans.

About 38 per cent of banks' credit to NFCs are in foreign currency (herein with FX clause). This is seen as one of the risks to banks by Financial Sector Assessment Program (FSAP) that was performed by IMF and World Bank in 2018 (IMF, 2019 January). FSAP finds high structural vulnerabilities for banks, mainly in a form of: i) indirect credit risks due to large FX exposures to potentially unhedged borrowers, ii) high dependence on adjustable and variable-rate loans, as well as iii) high corporate portfolio concentrations. However, these findings also impose vulnerabilities to NFC. The high stock of FX loans and high share of adjustable and variable-rate loans, in an adverse scenario of depreciation pressures and interest rates hikes could potentially impair the NFC balance sheets. Still, the NBRNM is committed to foreign exchange stability and the current environment is in favor of low interest rates. Moreover, de-euroization is one of the objectives of the NBRNM strategy (NBRNM, 2018a).

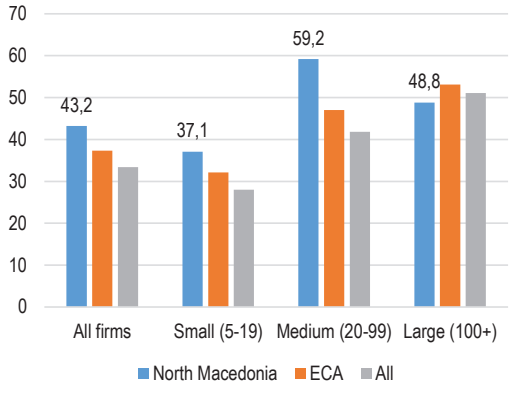
Macedonian companies have relatively good access/penetration to banks, measured by opened checking and savings accounts than the ECA region and the world average (Figure 7a). The per cent of companies with banks' accounts is 95.7, whereas small and large companies are more likely to have a bank account than the medium-sized companies. That indicates that opening a banking account in North Macedonia is not an obstacle for the firms. One of the reasons is the current regulation[9] that drives companies to open checking accounts, because they can perform payments only through commercial banks. Regarding the savings, companies can open an account both with the banks and with the saving houses.

Figure 7: Per cent of firms having accounts with the banks and using loans from the banks

a) Per cent of firms with a checking or savings account



b) Per cent of firms with a bank loan/line of credit



Source: Enterprise Survey 2019, World Bank

According to the Enterprise Survey of the Word Bank[10], around 43 per cent of Macedonian companies have a loan/credit line from banks (Figure 7b). Medium-sized firms are more likely to have borrowed from banks (59.2 per cent), relative to the small firms, of which 37 per cent have loans from the banks. These are higher per centages than the ECA region and the world average. More than half (56.4 per cent) of Macedonian companies reported that they do not need a loan, similar to the situation in the ECA region. Higher per cent (around 59 per cent) of small and large companies responded that they do not need loans which was also the case for 50 per cent of medium-sized companies. It is in line with the findings of the EESE report of 2013, which shows that firms' growth to a large extend is based on firms' self-financing. Two out of five firms acknowledged that they do not have debt, and nearly three out of five firms prefer equity reserves (retained profits), own or family/friends' equity (Organization

9 Law of Payment operations: https://www.nbrm.mk/content/Law_on_payment_operations_OVofRM_7_19-rt.pdf

10 https://www.enterprisesurveys.org/en/data/exploreeconomies/2019/north-macedonia#finance

of Employers of Macedonia and Business Confederation of Macedonia, 2013). The Business Opinion Survey of the Regional Cooperation Council shows that loan applications are much more common for exporters (33 per cent) than non-exporters (17 per cent), and for large companies (51 per cent) compared to micro (21 per cent).

Another important source of comparable information on the overall business environment including the financing is the Business Opinion Survey, performed by the Regional Cooperation Council (RCC). According to the 2019 report, in South-Eastern Europe (SEE), the banking sector remains the key external financing partner for businesses. However, although in recent years banks are increasing their lending, corporate financing is stagnating while household financing increases. The Survey shows similar finding/data as the NBRNM Financial Stability Report (NBRNM, 2018b). 36% of companies in North Macedonia reported that they had used loans in the past five years, and only 27 per cent have applied for a loan in the previous year. Business Opinion Survey shows that there is large difference in the use of bank financing by firm size: while 70 per cent of larger companies used a bank loan, that was the case for 30 per cent of micro-enterprises. On the other hand, micro companies rely more frequently on family and friends (18 per cent compared to 6 per cent of large companies). These same findings are confirmed by the ECB study (2017) showing that size of the company is the most important predictor of access to finance. The study provides aggregate data for the Western Balkan countries and finds that in this group of countries, small firms have 36 per cent higher likelihood of being financially constrained relative to large companies. For medium-sized companies, the probability to be financially constrained is 26 per cent higher than for large companies.

This section shows that the depth of the financial intermediation in North Macedonia is well below the developed countries' levels, though comparable with the Western Balkan countries. The banks are dominant in the overall credit activity. Medium and large companies are more likely to borrow from banks than small and micro ones, as are exporters. Non-bank financial institutions play a minor role in providing external financing to companies. Some of the structural vulnerabilities of the banking sector include indirect credit risks due to large FX exposures to potentially unhedged borrowers and high share of adjustable and variable-rate loans.

4.2 Access to finance as obstacle for Macedonian companies: comparative perspective

This section intends to "quantify" the challenge of access to finance of Macedonian companies in a relative perspective, i.e. compared to: i) other main obstacles to Macedonian companies and ii) the importance of this obstacle in the neighboring countries and the EU countries. It is mainly based on available international studies, providing comparative perspective.

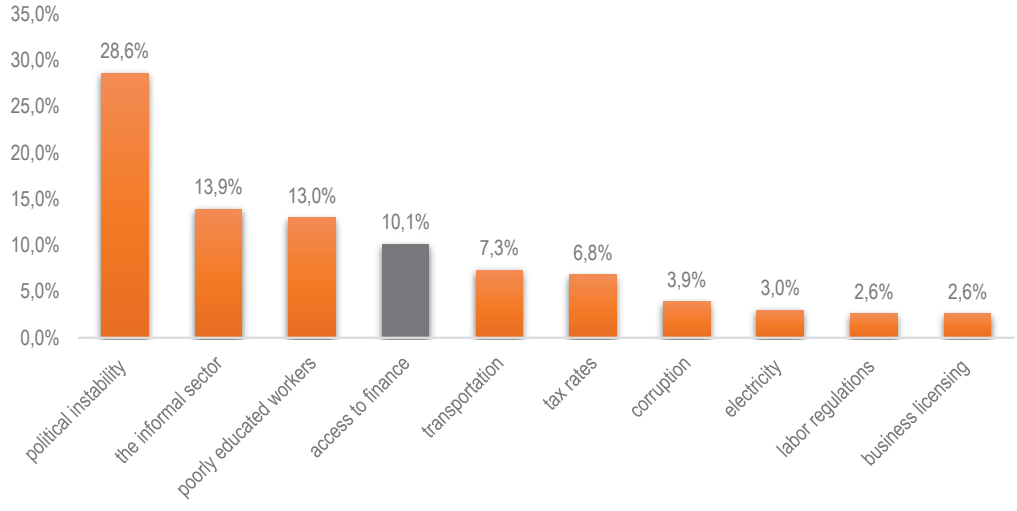
The Enterprise Survey of the World Bank for 2019[11] is a solid foundation for understanding the experience and views of the companies on the access to finance, as well as the main drivers of demand for loans. It also provides a breakdown of information and data by size of enterprises, hence recognizing the views of small and medium-sized firms[12]. Overall, the survey reveals that access to finance is the fourth biggest obstacle for companies in North Macedonia. From the interviewed 360 companies, 10 per cent have stated that the inadequate access to finance harms their business. Political instability, the informal sector, and poorly educated workers are perceived as larger impediments for businesses relative to

11 https://www.enterprisesurveys.org/en/data/exploreeconomies/2019/north-macedonia#finance

12 Enterprise Survey uses a non-standard typology of firms by size, where firms employing 5-19 have identified as small companies, those employing 20-99 are medium, and companies with more than 100 employees are considered large.

the access to finance (Figure 8). Similarly, the Small Business Act (SBA) by the OECD (2019)[13] also shows that the access to finance of Macedonian MSMEs is in line with the EU average.

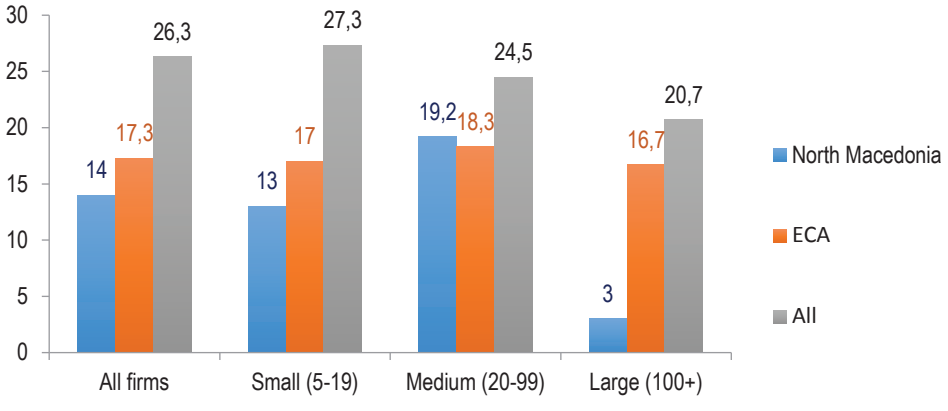
Figure 8: Ranking of the main obstacles for firms in North Macedonia, 2019 (per cent of firms)



Source: Enterprise Survey, World Bank, data available at https://www.enterprisesurveys.org/en/data

Moreover, 14 per cent of the interviewed companies in North Macedonia in the Enterprise Survey identified access to finance as a primary (top) constraint for their businesses. However, there is a significant difference by size of companies. Access to finance is the main obstacle for 19.2 per cent of medium-sized companies and for 13 per cent of small-sized companies. To some extent, this is similar to firms' responses in the Europe and Central Asia (ECA) region, but far less than the world average (Figure 9). On the other hand, only 3 per cent of large companies in North Macedonia stated that access to finance is a significant constraint, much lower than the ECA region and world average. While access to finance may not seem a main constraint for businesses, these findings indicate that the small and medium size firms in North Macedonia have more prominent constraints for access to finance than the large firms.

Figure 9: Per cent of firms identifying access to finance as a major constraint



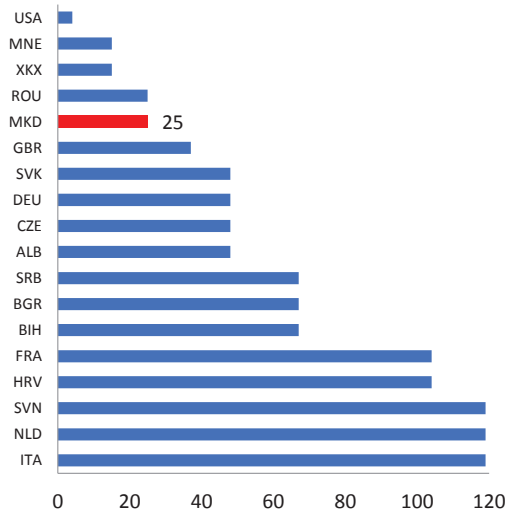
Source: Enterprise Survey, World Bank

13 We use the reference OECD (2019), as an abbreviation. Otherwise, four international institutions are authors of the report/study: OECD, European Training Foundation, European Union and European Bank for Reconstruction and Development.

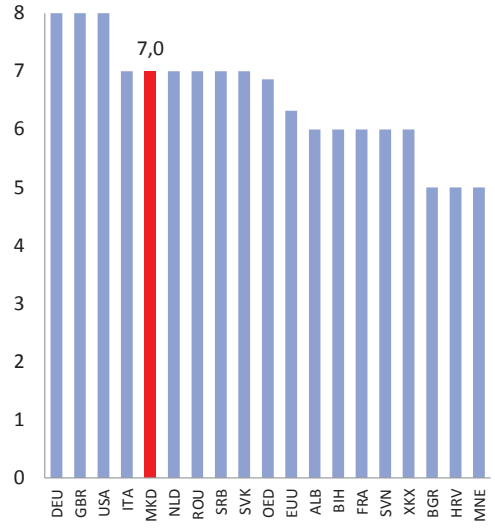
According to Doing Business ranking of the World Bank (May 2020), North Macedonia is ranked on the 25th place in the world for ease of Getting credit out of 190 economies. The country is doing comparatively well, within the peer countries from the Western Balkan region, but also world-wide (Figure 10).

Figure 10: Doing Business performance of North Macedonia for category Getting credit

a) Country ranking



b) Credit information index



Source: Doing Business, World Bank, available at: https://www.doingbusiness.org/content/dam/doingBusiness/country/n/north-macedonia/MKD.pdf

The Enterprise survey of the World Bank also provides information about drivers of firms' demand for loans. Macedonian firms are more likely to use banks' loans for financing the working capital and investments than the firms in the ECA region and world average (Table 3). Relatively high per cent (38.6 per cent) of Macedonian firms use bank loans to finance their working capital, which is the case for 49 per cent of the medium-sized firms and 34.3 per cent of the small firms. Also, a higher proportion of their working capital is financed by banks (13.9 per cent) relative to ECA and the world. That makes the significant difference between North Macedonia and ECA countries (and the world): Macedonian companies rely more on banks' finance as a source of working capital, and less on supplier/consumer credits (only 3 per cent). On the contrary, firms from ECA mainly rely on supplier/consumer credits to finance working capital (25.4 per cent of firms).

Another significant difference is the higher share of companies (35.4 per cent) that use banks to finance investments, relative to the ECA region and the world (25.7 per cent, in ECA and 26.5 per cent of all countries). In North Macedonia, medium-sized companies are most likely to use bank loans to finance their investments (41.8 per cent), followed by 32.7 per cent of small firms. However, companies fund a higher proportion of investments internally, 82.1 per cent relative to 74.8 per cent in the ECA region and world average (71.4 per cent).

Table 3: Use of bank loans, 2019

	North Macedonia	Europe & Central Asia	All Countries
Per cent of firms using banks to finance investments	35.4	25.7	26.5
Small (5-19)	32.7	23.8	23.6
Medium (20-99)	41.8	26.9	29
Large 100+	27.2	31.9	33.2
The proportion of investment funded internally (in per cent)	82.1	74.8	71.4
Small (5-19)	81.8	75.9	73.3
Medium (20-99)	82.3	73.1	69.1
Large 100+	82.5	72.7	69.8
The proportion of investment financed by banks (in per cent)	13.9	13.4	14.9
Small (5-19)	13.2	12.4	12.9
Medium (20-99)	15.3	14.2	16.5
Large 100+	12.6	16.4	18.9
Per cent of firms using banks to finance working capital	38.6	31.5	30.2
Small (5-19)	34.3	28	26
Medium (20-99)	49	37.6	37.3
Large 100+	48.3	45.4	43.7
Per cent of firms using supplier/ customer credit to finance working capital	3.0	25.4	29.9
Small (5-19)	1.2	24.5	28.4
Medium (20-99)	7.7	27.7	32.5
Large 100+	5.2	26.6	33.1
The proportion of working capital financed by banks (in per cent)	13.9	10.5	11.8
Small (5-19)	12.7	9.2	10.1
Medium (20-99)	17.4	12.8	14.6
Large 100+	13.7	15.4	17

Source: Enterprise Survey, World Bank

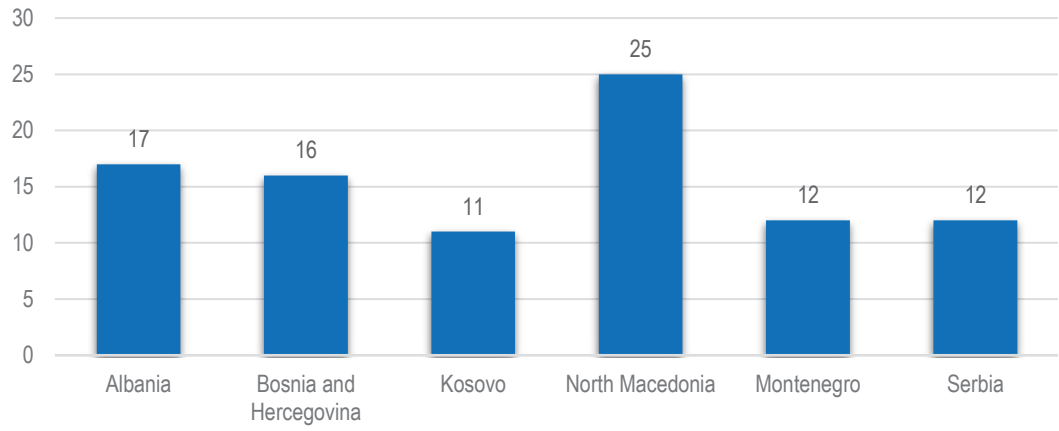
4.3 Impediments for Access to Finance for MSMEs

This section investigates the obstacles to access to finance for Macedonian MSMEs, based on the available data and reports from national and international institutions and organizations. Barriers are classified into several categories, following the literature and findings of previous studies.

Administrative burden: long and complex procedures

Several studies show that length and complexity of the loan application procedure is an important impediment for access to finance in North Macedonia. The Business Opinion Survey of the RCC, for instance, provides information about the firms' constraints when applying for banks' loans. It shows that the administrative burden is a problem for firms in North Macedonia. It took on average 15 days for the credit to be approved in the countries of SEE in 2018, while in North Macedonia, firms reported that the loan procedure lasts on average 25 days. North Macedonia is the worst performer among the SEE counties, while the most efficient loan procedures take place in Kosovo (11 days), Montenegro (12 days), and Serbia (12 days) (Figure 11).

Figure 11: **Time required for a loan to be approved, SEE countries, 2018**



Source: Business Opinion Survey, 2019, RCC. Available at: https://www.rcc.int/seeds/results/3/balkan-business-barometer

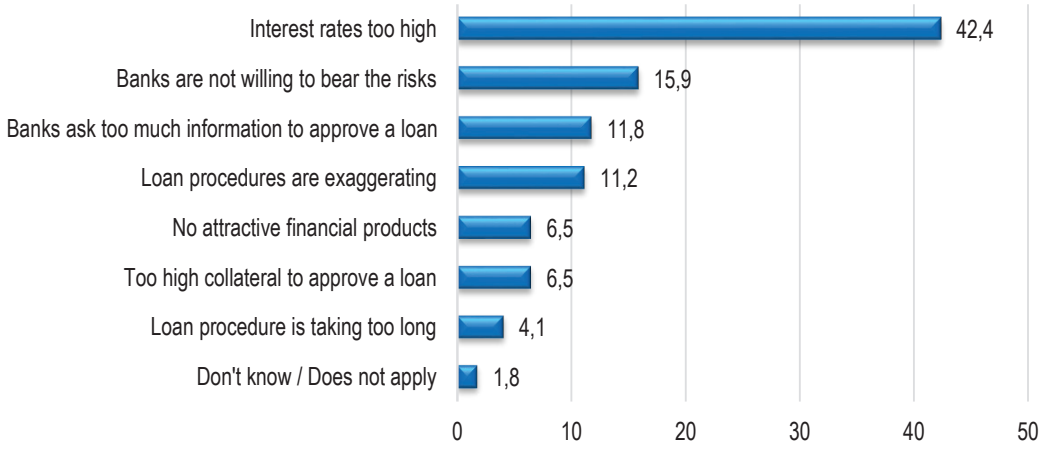
In a similar vein, OCED (2019) also argues that MSMEs in North Macedonia are constrained in their access to finance by complex and long loan application procedures. The long time needed for the loan to be approved could be an indicator of weaker banks' effectiveness in the credit process or extensive and complicated procedures.

Long and complicated loan approval procedures act as a barrier for firms to access banks' financing, and at the same time, facilitate informal financing (from family and friends). These findings are also present in the 2013 EESE report[14]. Macedonian companies have reported that some of the main obstacles for access to finance are that the banks are asking too much information to approve a loan (12 per cent), loan procedures are exaggerating (11.8 per cent), and loan procedure is too long (4.1 per cent). These barriers could be having relatively higher importance nowadays compared to 2013, having in mind that the main obstacle reported by companies in 2013 – the interest rates - are far lower today than in 2013 (Figure 12). Similarly, ECB (2017) shows that 16.4% of companies in North Macedonia which did not apply for a loan stated that the main reason for not applying for a loan is the complex application process (after high interest rates).

14 . In a lack of more recent data, we use the information from the 2013 EESE report on the main obstacles of access to finance, as reported by companies.

However, even though the prevailing view of the companies is that banks require too much information and procedures are slow, it may also indicate that firms are not willing to share business information. Probably it could be one of the reasons for strong companies' preference for equity financing and financing from family and friends. Moreover, according to IMF (2019), the quality of the corporate reporting remains weak which impairs the assessment of firms' financial conditions, which may also constrain the access to finance.

Figure 12: Obstacles to debt financing (in per cent)



Source: EESE, 2013.

Interest rates

Section III showed that interest rates spread in North Macedonia are narrowing since 2005, which is partly a result of increased competition within the sector. Still, many international studies and comparisons show that interest rates in North Macedonia are relatively high or perceived as high by companies (Figure 15). While EESE results are a bit outdated, more recent study by ECB (2017) shows that for almost 75 per cent of firms in Western Balkan region, high interest rates are a major credit constraint. In particular, in North Macedonia, 58.2 per cent of companies that did not apply for a loan reported that the main obstacle for applying were unfavorable interest rates (ECB, 2017).

The interest rate spread[15] can be used as an indicator of the efficiency of the banks in reallocation of finance. It is also a measure of the cost of the external financing for companies and can affect the (willingness for) access to finance. Table 4 shows interest rates developments in the last ten years. From the data we can draw several conclusions. During the world financial crisis (2008-2009) and the European sovereign debt crisis (2012-2015), the interest rates spreads were increasing. Starting from 2016, interest rates are declining in all of the analyzed countries. Slovenia is the best performer among observed countries, followed by Serbia. This indicator shows that there is still room for reduction of interest rates spread in North Macedonia (which can also be viewed as a cost of external financing).

15 The difference between the interest rate charged by banks on loans to private sector customers and the interest rate paid by commercial or similar banks for demand, time, or savings deposits

Table 4: Interest rates spreads in selected economies

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
North Macedonia	3.8	3.0	2.4	3.0	3.4	4.0	4.1	4.6	4.5	4.4	4.1
Slovenia	1.4	1.4	2.3	2.6	1.7	1.7	2.8	2.9	2.7	2.3	2.2
Bulgaria	6.4	5.2	7.1	7.3	6.6	6.6	6.6	6.8	6.2	5.4	4.9
Serbia	na	na	5.8	5.2	5.0	5.1	5.2	4.9	4.1	3.7	3.5

Source: World development indicators for North Macedonia and Bulgaria, and National central banks for Slovenia and Serbia.

Collateral

Collateral requirements may also act as a constraint in access to finance. Several available comparative studies find that high collateral requirements in North Macedonia are acting as a barrier for access to finance (EIB, 2016; ECB, 2017; IMF, 2019). In the Enterprise survey, Macedonian firms reported that about 76 per cent of loans require collateral. This proportion increases with the firm's size (and probably the size of the required loan): it stands at 72 per cent for small firms, 83 per cent for medium ones, and 87 per cent for large firms. The collateral needed for a loan is around 172 per cent of the loan size, both for the small and medium-sized firms. These collateral requirements are comparable to those in the ECA region and the world (see Table 5). However, collateral is much higher for large firms (241 of the loan) far above the ECA region and the world average. As argued in section IV.3, high collateral requirements may be related to the weak rule of low and corruption, hence negatively affecting the available financing for companies.

Table 5: Collateral requirements and the companies needs for bank loans, 2019

	North Macedonia	Europe & Central Asia	All Countries
The proportion of loans requiring collateral (in per cent)	76.4	74.3	77.8
Small (5-19)	71.8	70.5	76.5
Medium (20-99)	82.8	78.3	80.4
Large 100+	87.4	80.8	79.8
Value of collateral needed for a loan (per cent of the loan amount)	174.5	178.2	200.1
Small (5-19)	171.3	182.3	209.8
Medium (20-99)	172.3	175.1	192.8
Large 100+	241.6	167	181.8

Source: Enterprise Survey, World Bank

Company characteristics

Company characteristics (micro level) can also play an important role in the accessibility and affordability of external financing. The comparative study of ECB (2017) for the Western Balkan region shows that certain characteristics of a company can either ease or make it harder for firms to access finance. As argued in section IV.2, company size is the most important indicator on micro level in the Western Balkan region which affects access to finance. Small and medium sized companies face higher likelihood of being constrained in the access to finance relative to large firms. The second most important factor according to the ECB study is the geographical location of the company. In general, companies operating in the capital city (which is also the financial center) access external financing more easily. This is explained by the higher concentration of banks and branch offices in the capital city, higher competition of banks in the capital, but also relationship banking which allows companies with good credit record to access finance more easily. Additional important company characteristics with positive impact on the access to finance are: age of the company (established companies face less constraints in access to finance); companies that undertake external, independent audit; firms which already have an outstanding loan (signaling an insider-outsider phenomenon); and companies expecting operational growth or expansion in the forthcoming period (ECB, 2017).

External audit may be more important in Western Balkan region given the relatively high informality and off-the-book operations. From banks' perspective, risk assessment of companies is difficult due to insufficient and sometimes unreliable information provided by companies, as well as the informality (EIB, 2016). Banks reveal other barriers which prevent them from growing their MSMEs support, such as low and uncertain earning capacity of MSMEs, small loan amounts which result in large transaction costs, and lack of feasible business projects (EIB, 2016).

Rejection

Available data show relatively low rejection rate of companies applying for a loan in North Macedonia. Enterprise Survey shows that 8 per cent of the firms in North Macedonia in 2019 have been rejected when applying for loans, which is a smaller share of firms than the ECA region and world average. The Survey shows that the rejection probability is higher for small firms (12 per cent) and then declines with the firm size, coming close to 0 for large firms. The latter may be related to the substantial collateral that large companies need to provide to get a loan. ECB (2017) finds that only 4.5 per cent of companies' applications for loans were rejected in North Macedonia, which is lower than in the peer countries of Western Balkans.

Businesses in North Macedonia stated that the main reasons for rejection of the credit application are the lack of acceptable collateral, perceived lack of profitability of the firm, and inadequate credit history of the firm (Table 6). These findings imply that the banks are more willing to borrow to firms if there is acceptable collateral due to the firms' weak profitability and inadequate credit history. Similarly, in the 2013 EESE study (Enabling Environment for Sustainable Business), the majority of respondents (54.1 per cent) considered that the positive credit history of companies improves their chances of accessing loans (Organization of Employers of Macedonia and Business Confederation of Macedonia, 2013). This is also in line with the findings of the ECB (2017) presented above.

Table 6: Reasons for a rejected loan application, 2018 and 2019 (per cent of firms)

You said that your company's loan application was rejected, what was the main reason for this?						
	Perceived lack of profitability of the firm	Lack of acceptable collateral	Inadequate credit history of the firm	The incompleteness of the loan application	Other	DK/ Refuse to answer
Balkan Barometer 2019						
SEE	25	40	0	10	18	8
Albania	20	57	0	22	0	0
Bosnia and Herzegovina	0	62	0	19	19	0
Kosovo*	0	0	0	0	50	50
North Macedonia	49	51	0	0	0	0
Montenegro	0	100	0	0	0	0
Serbia	61	0	0	0	39	0
Balkan Barometer 2018						
SEE	38	34	15	6	0	7
Albania	33	33	33	0	0	0
Bosnia and Herzegovina	25	25	25	0	0	25
Kosovo*	75	0	0	25	0	0
North Macedonia	25	50	25	0	0	0
Montenegro	0	0	0	100	0	0
Serbia	50	50	0	0	0	0

Source: Business Opinion Survey, 2019, RCC

Credit information and legal rights

Doing Business provides an assessment of the legal environment for access to finance through the: i) strength of credit reporting systems, as well as the ii) effectiveness of collateral and bankruptcy laws. The depth of credit information index that measures the coverage, scope, and accessibility of credit information available through credit reporting service providers in North Macedonia is 7 (on a scale of 0-8). The country has both public and private registries. The coverage of firms and individuals by public credit registry is 42 per cent of the adult

population, while the coverage by the private credit bureau is 100 per cent of the adult population. This full coverage has been achieved over recent years by starting to collect information from retailers and utility companies. In 2018, the credit bureau also introduced credit scoring, and anyone subject to credit referencing can access their credit information (OECD, 2019).

The country is also doing relatively good in the legal rights index as a measure of the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders. The index in North Macedonia is 9 (from the scale of 0-12). Also, there are registers for pledges over immovable and movable assets. A cadastre operated by the Real Estate Cadastre Agency is available online and is accessible to the public. While there is a register for pledges over movable assets (the Central Registry of the Republic of North Macedonia), it is not accessible online and interested parties need to apply to the register to receive the needed documentation (OECD, 2019). According to the findings of the Doing Business legal rights index for North Macedonia and the OECD (2019), there are two main domains where the country can make a progress regarding the collateral, that are: 1) the non-existence of a notice-based collateral registry in which all functional equivalents can be registered and 2) lack of a modern collateral registry in which all registrations, amendments, cancellations and searches can be performed online by a third party.

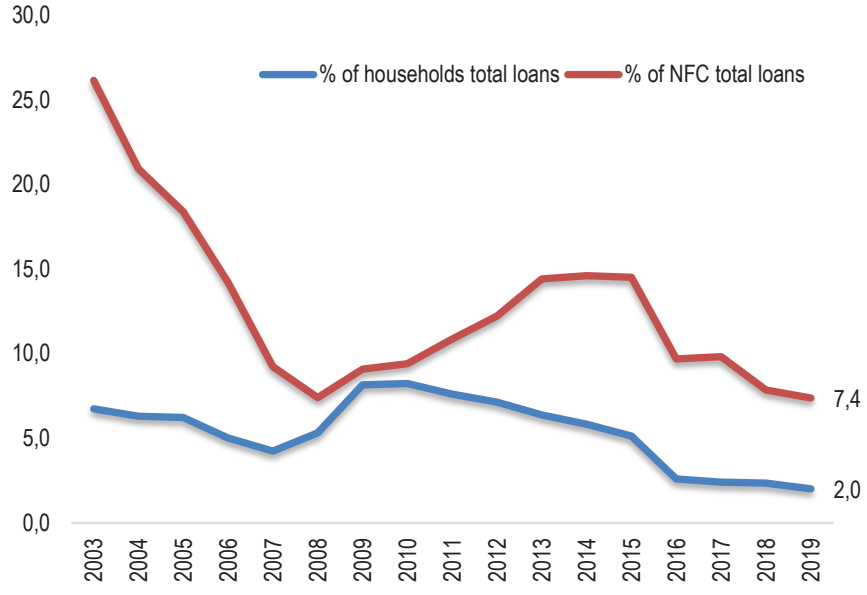
In addition, IMF (2019) argues that there is a room for improvements in the framework for insolvency and creditor rights, combined with support for business planning, could ease firms' access to banking finance. More broadly, IMF states that International Financial Reporting Standards (IFRS) for corporates should be upgraded to enable better credit risk reviews and market transparency. Also, an enhancement of the out-of-court restructuring framework by introducing standstill agreements and appropriate guidelines should be undertaken (IMF, 2019).

Non-performing loans

The Non-performing loans (NPLs) could be one of the reasons why banks are borrowing less to firms, especially to younger and riskier firms with no credit history. As elsewhere, the NPLs of companies in North Macedonia increased substantially after the global financial crisis, whereas the level of NPLs of the households after an initial rise, afterwards followed a declining path (Figure 13). In comparative perspective, NPLs in North Macedonia are lower than in the Western Balkan region and the euro area, though slightly higher than in the New Member States (ECB, 2017). In 2016, under the regulatory requirements[16] a significant share of NPL was written-off, and in the last three years, they are declining. Following these developments, the strategy of better NPL management and support of the market for NPLs sales has been prepared along with an action plan to guide implementation. North Macedonia's banking sector has one of the highest NPL coverage ratios in the region (OECD, 2019) which is also a signal of high-risk awareness of the banks.

16 Decision on amending the Decision on credit risk management (Official Gazette of the Republic of Macedonia No. 223/15) that requires from banks by 30 June 2016 to transfer all claims that have been fully booked for more than two years to the off-balance sheet record. This requirement continues for non-performing claims that will meet the above-mentioned criteria. Despite the write-off, the banks reserve the right to collect these claims.

Figure 13: NPLs of firms and households (per cent of total)



Source: NBRNM

Structural challenges of the banking sector

Structural challenges of the banking sector (as a dominant source of external financing for companies) may impair the access to finance. The structural vulnerabilities for banks, identified by the Financial Sector Assessment Program (FSAP, IMF 2019), are equally important for the NFC balance sheets. The relatively large share of foreign currency loans (38 per cent, including loans in denars with foreign clause) of unhedged firms are seen as an indirect credit risk to banks. At the same time, it could also impair NFC balance sheets in an adverse scenario of depreciation pressures. FSAP finds high banks' dependence on adjustable and variable-rate loans and high corporate portfolio concentrations. The high share of adjustable and variable-rate loans could be challenging for firms in the interest rates hikes, though the current environment of low-interest rates is favourable for firms. The high prevailing corporate portfolio concentration is an indicator that some banks are in favour of lending to a few companies, probably the large ones, perceiving such scenario as of lower risk.

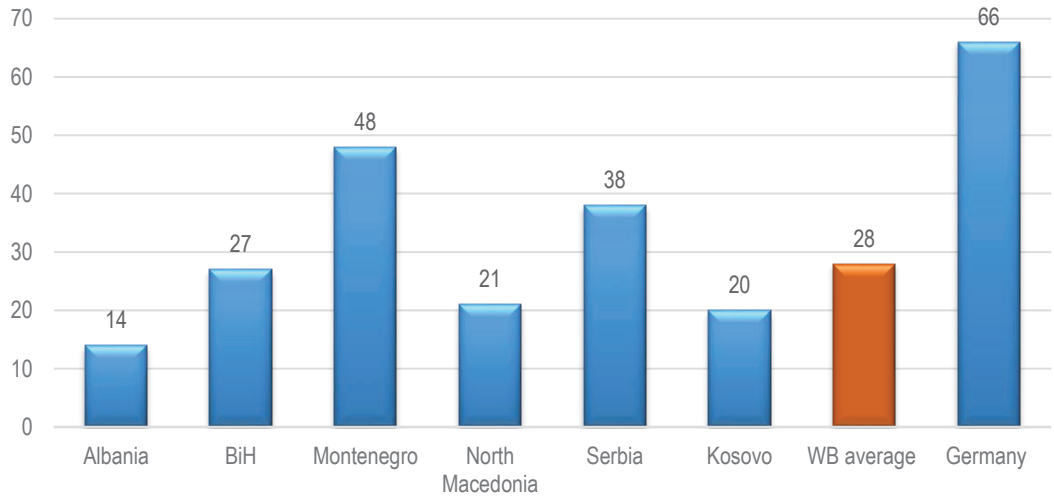
The regulation of the banks in North Macedonia is harmonized with Basel III. The capital requirements are in line with Basel III, with MSME loans having the same capital requirements as corporate loans. The banks also need to disclose foreign exchange risks to their clients when they take a loan in foreign currency or local currency with a foreign exchange clause. The capital adequacy is above the regulatory requirement. More than a quarter of total assets are liquid, covering almost half of short-term liabilities. All of this is a solid basis for higher financial support to firms.

Financial literacy

Several studies point out to the need for improving the financial literacy, corporate reporting and business planning skills of Macedonian companies and executives as a way for increasing the access to finance (IMF, 2018; OECD, 2019). In the S&P Financial Literacy Survey, MSMEs have indicated that the lack of programs to strengthen their financial literacy, together with

investment readiness, is a primary obstacle to their development[17]. The share of financially literate adults in North Macedonia the population is low – 21 per cent in 2014 compared to a regional average of 28 (GFLEC, 2015)[18]. OECD (2019) also finds very low financial literacy in North Macedonia. On a scale of 1-5, the average financial literacy is 1.79 which is much lower than the regional average of 2.19 (OECD, 2019). In the study of the European Investment Bank (EIB, 2016), banks express their dissatisfaction with the financial literacy of their potential MSMEs clients. Low financial literacy impairs the access to finance, but is also likely to reduce the uptake of alternative financing instruments (such as venture capital, business angels, etc.).

Figure 14: Adults who are financial literate in North Macedonia and Wester Balkan countries (per cent of the population), 2014



Source: World Bank (S&P's Financial Literacy Survey).

The financial regulators in North Macedonia have agreed to undertake steps to improve the population's financial literacy, but the efforts are mainly focused on school programs.

Structural and institutional indicators of the economy

Some structural and institutional indicators may also affect/create barriers for access to finance for companies. ECB (2017) uses the World Bank's Worldwide Governance Indicators to assess the potential relationship between institutions and access to finance. They show that the Western Balkan countries are doing relatively poor on these governance indicators (such as control of corruption, political stability, rule of law, etc.) compared to the New Member States and the euro area countries, which may adversely affect access to finance at macroeconomic level. For instance, corruption and weak rule of law may negatively affect the willingness of banks to lend as in such situation execution of collateral may be difficult, costly and more risky, leading to high borrowing costs to make up for the risk. Hence, improvements in the structural indicators and institutions can also bring progress in the access to finance for companies.

17 North Macedonia: Small Business Act profile, available at https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/sba-fs-2019_north-macedonia.pdf.

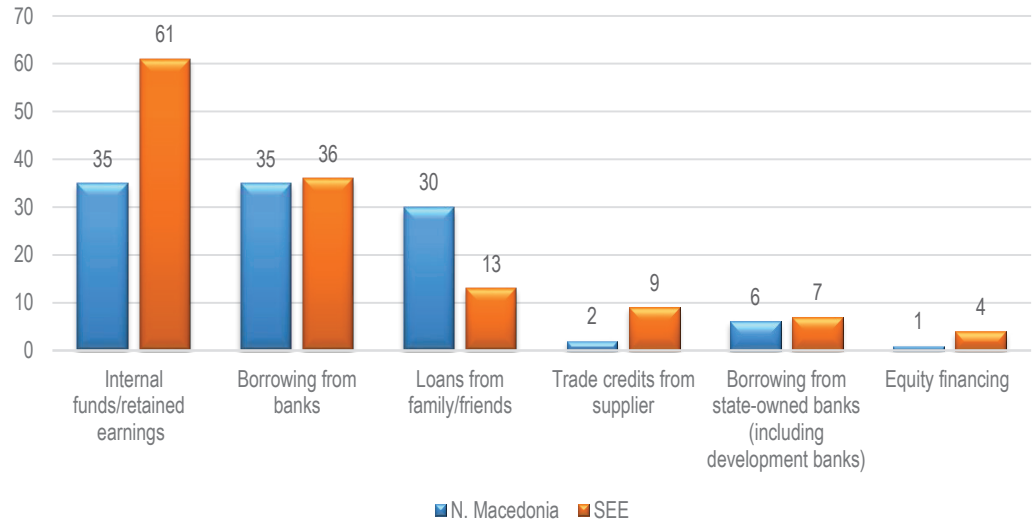
18 S&P's Financial Literacy Survey covers more than 140 countries, asking the population about four basic financial concepts. Further information can be found here: https://gflec.org/wp-content/uploads/2015/11/3313-Finlit_Report_FINAL-5.11.16.pdf?x47626

Availability of non-bank financing

As section IV.3 shows, bank loans dominate in the external financing of companies (and MSMEs) in North Macedonia. In this section, the availability and the use of other types on financing (non-bank financing) is explored as it is also part of the "access to finance" concept. Several international comparative studies show that the non-bank financing and the alternative types of external financing of companies in North Macedonia is quite low and underdeveloped.

In comparative perspective, Macedonian firms rely much more on family/friends as a source of finance (30 per cent), and less on internal resources/retained earnings (35 per cent) than the SEE firms (see Figure 15). Possible reasons for this are the weaker financial results of Macedonian companies relative to their peer firms and/or an unwillingness (attitude) of Macedonian managers and owners to disclose company information. Trade credits and equity financing (through share issues in the capital market, equity investment by institutional investors, or private placement) are only 2 per cent and 1 per cent of the total financing, respectively, and below the regional average. On the other side, borrowing from private commercial banks (35 per cent) and state-owned banks (6 per cent) is similar to the regional average (Figure 15).

Figure 15: Financing structure of firms in North Macedonia and SEE countries, 2018*

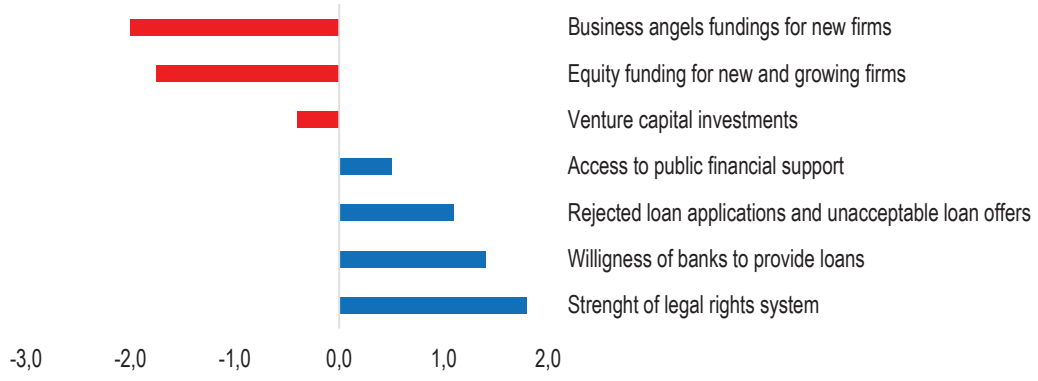


*multiple answers were allowed.

Source: Business Opinion Survey, 2019, RCC. Available at: https://www.rcc.int/seeds/results/3/balkan-business-barometer

Small Business Act (OECD, 2019) shows that there is a lack of alternative financing sources in North Macedonia, such as equity funding and business angels and venture capital. These indicators are amongst the lowest of all countries (see Figure 16). On the other hand, North Macedonia is relatively good in the measures related to the bank financing (for instance, rejections of loan applications) and in the access to public financial support.

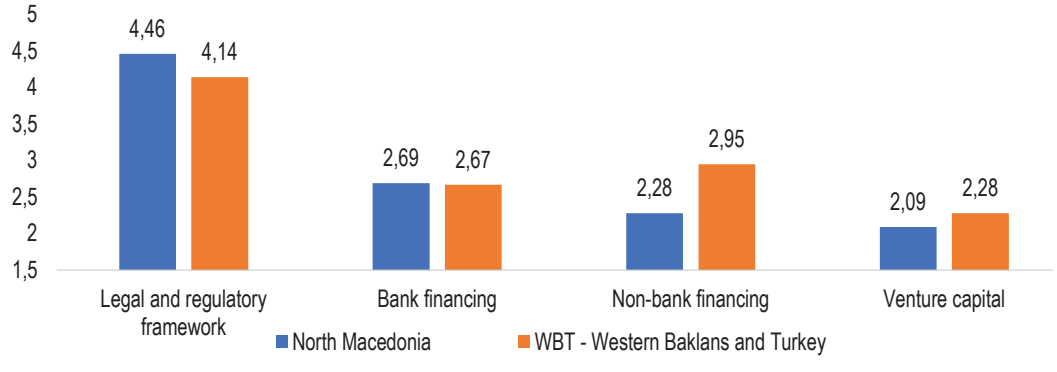
Figure 16: Similarity of the access to finance for MSMEs in North Macedonia with the EU, 2019 (variation form EU measured in standard deviation)



Source: OECD, 2019

Same conclusions can be drawn when comparing North Macedonia with the Western Balkan region (see Figure 17). North Macedonia has a better legal and regulatory framework, while underperforms in terms of the access to non-bank financing and venture capital. Bank financing is at the region average.

Figure 17: Comparative perspective of access to finance for MSMEs in North Macedonia and Western Balkans and Turkey, 2019 (scale 1-5)



Source: OECD, SBA 2019

There are several sources of public financial support for MSMEs in North Macedonia. These include the support from: the Development Bank of North Macedonia, Ministry of Economy (i.e. Agency for Support of Entrepreneurship), and the Fund for Innovation and Technology Development. The MSMEs' financing after the global financial crises is largely supported by the Development Bank of North Macedonia. The Development Bank is a state-owned bank established by the government with an aim to support the development of the Macedonian economy through providing financing to MSMEs and export-oriented companies. Five lines of loans were provided by the European Investment Bank (EIB) to the Development Bank and distributed through the commercial banks (totalling EUR 450 million). The last loan agreement has been signed at the end of 2018, for the amount of EUR 100 million, and it is still in implementation.[19] The Development Bank also offers a credit guarantee scheme. The scheme was created in 2005 with a capital of EUR 4.2 million. In the past, there were two private providers of guarantees but they ceased that activity due to low demand (EIB, 2016). However, the take up is very low, with only one active credit line in the country (OECD,

19 The government has also distributed additional financial resources in 2020, as part of the anti-crises package related to the Pandemic. In total, EUR 12.6 million were provided by the state.

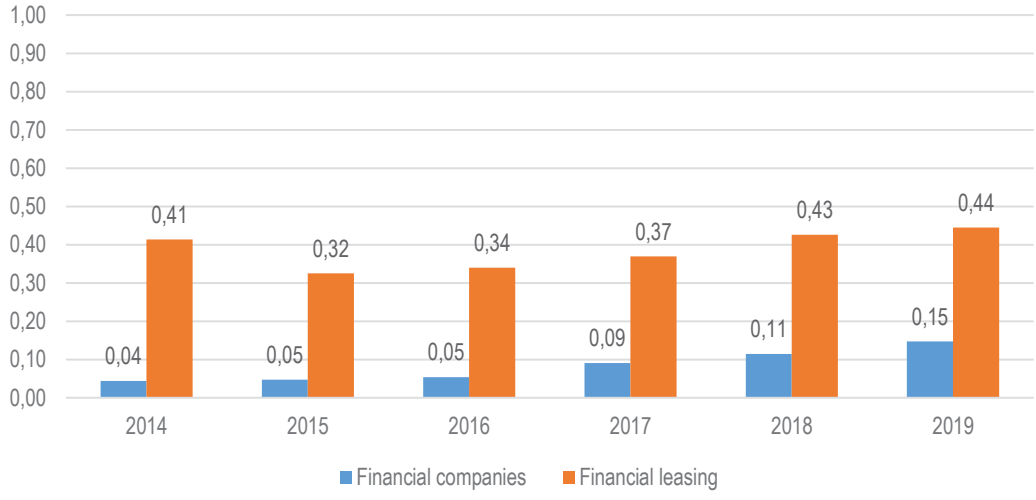
2019). The Fund for Innovation and Technology Development aims at improving the access to finance for innovation and technology development and promotion of innovation, in general. It provides funds mainly to start-ups (younger than 6 years).

Furthermore, the Ministry of Economy of North Macedonia prepares annual programs for Competitiveness, Innovations and Entrepreneurship, financed from the Central Budget. The ultimate aim of this program is improving the competitiveness and innovation capacities of the companies that are a target for this measure. Large portion of the dedicated actions and financing of these programs are directed towards MSMEs. The 2020 Program (Official Gazette No. 277/2019) is intended to support several measures that will boost the competitiveness and innovation of MSMEs, with a total financial allocation of approximately EUR 564,000 (EUR 671,000 in 2019). The foreseen activities include subsidises for operational costs, investments in working capital, improving value and supply chains of the companies, support of women entrepreneurship, etc.

Non-bank financing is exceptionally low. It is both a supply and demand side issue. While the inadequate regulatory framework and high bank competition limit the supply, the demand is for non-loan products remains generally subdued due to low awareness of their availability and/or benefits (EIB, 2016). In 2018, the loans to firms by saving houses, leasing companies, and financial companies comprised 1.1 per cent of GDP (FSR, 2018). Before the global financial crisis, the leasing sector was growing (reaching 3.1 per cent in total financial assets in 2008), but has seen a retrograde trend since then (dropped to 0.8 per cent in 2018). In the latest period, there are some signs of recovery. The largest volume of outstanding leasing contracts is for NFC (79 per cent), but almost all are for vehicle financing, and only one leasing company provides equipment leasing. In 2019, financial leasing was only 0.44 per cent of GDP (Figure 18).

Although the financial companies' growth is relatively strong in recent years, loans to firms provided by such companies are only 0.15 per cent of GDP in 2019 (Figure 18). There are 22 financial companies within the country, including the microfinance institutions that provide small-scale loans of up to EUR 10,000. These institutions also provide training alongside the finance and are widely used by the smallest companies and the informal sector. Saving houses' loans to NFC was only 0.3 per cent of GDP in 2018.

Figure 18: Loans to NFC from leasing and financial companies (per cent of GDP)



Source: NBRNM

Factoring can increase the working capital of MSMEs and improve their cash-flow, hence assisting them to expand their operation, expand their markets, and increase their competitiveness. Factoring is offered by most commercial banks in North Macedonia, as well as by dedicated factoring companies. The Development Bank also offers factoring services (both domestic and export factoring) (OECD, 2019). However, the take up is very low, partly related to the absence of an adequate legal framework and partly due to the lack of awareness of the factoring and its benefits (also related to low financial literacy). There is no special law in North Macedonia on factoring and there are no specific provisions in the contract law on factoring. Only the Law on Financial Institutions provides a definition of factoring contract, though the provisions are general and narrow (referring only to some types of factoring) (EBRD, 2018). The EBRD supported a project to improve the factoring legal framework which ended in 2019. Recently, a new USAID's Factoring Project commenced with financing of $700,000 as a three-year activity with an aim to support the growth of MSMEs by increasing their use of factoring. This project will also focus on the regulatory framework. In summary, further efforts will be needed to promote factoring (as part of the overall financial literacy) as well as to put in place a new legal framework.

Private equity and venture capital have been available in the country for some time, but the investment portfolio is low (EIB, 2016). Venture capital in North Macedonia is in early stages, even below the average for the Western Balkan region (Figure 16). The development of the sector is part of the Innovation Strategy 2012-2020, but the progress has been slow. Overall, investors' appetite remains low, and equity investments in the economy remains limited (OECD, 2019). According to the European Business Angels Network, there are three local business angel networks in North Macedonia, but investments are negligible both in number and size.

Table 7 presents comparative data on the experience and frequency (or availability) of business angels or informal financing as reported by entrepreneurs in the Global Entrepreneurship Monitor (2019). As a note, according to the European Business Angels Network, there are also three local business angel networks in North Macedonia but investments are negligible both in number and size.[20] The availability of informal financing (from family, friends and fools, or the so-called 3Fs) may reduce the need for formal external financing including bank loans, in case such financing is more convenient (say, no bureaucracy, no documentation needed, shorter "approval" process, etc.) and/or cheaper. Data shows that there is almost equal presence or availability of business angels in the comparator countries except in Latvia, where it is much more widespread in relative terms. However, on the other side, there are large differences in terms of the average amount of money provided or borrowed from the business angels. These amounts are much higher in Greece, Slovenia and Latvia, moderate in North Macedonia and very small in Croatia. Still, the availability is quite small as to limit the need for formal financing for companies.

20 http://www.eban.org/

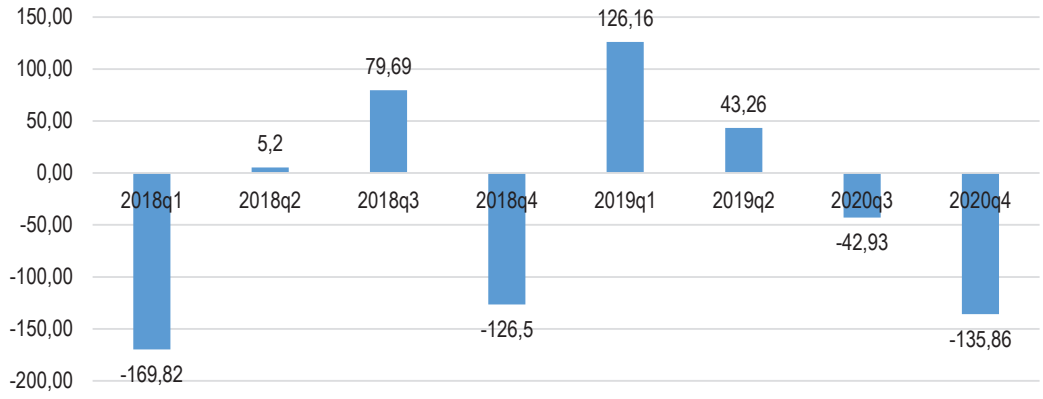
Table 7. Existence of 'Business Angels' in Macedonia, Croatia, Greece, Latvia and Slovenia, 2019

Business angels	MK	CRO	GRE	LV	SI
Have you, in the past three years, personally provided funds for a new business started by someone else, excluding any purchases of stocks or mutual funds? (as per cent of 18-64 population who provided funds for new business in past 3 years exc. stocks & funds)	5.4 per cent	5.4 per cent	5.3 per cent	6.9 per cent	5.4 per cent
Approximately how much, in total, have you personally provided to these business start-ups in the past three years, without counting any investments in publicly traded stocks or mutual funds (average in USD)	8,214 USD	512 USD	25,657 USD	16,246 USD	23,566 USD

Source: Non-published data, in-house analysis of the raw data of GEM 2019.

Another alternative way of financing companies' operations is through debt instruments from related companies (mother companies). Even though accurate data for this are not exactly available, one proxy are the debt instruments presented in the Balance of payments (BoP) in the category – Foreign direct investments (debt instruments). Based on the BOP manual of the International Monetary Fund (IMF), a credit that is received from the mother company is considered as foreign direct investment (increase of obligations). Figure 19 shows the recent developments, and we can see that, foreign companies in North Macedonia quite often use credits from mother companies as a source of external financing (negative sign is an inflow). Indeed, in the White Book of the Council of foreign investors in North Macedonia[21], they argue that the financial institutions in North Macedonia are not yet developed (referring to banks and insurance) and are not cost competitive compared to the financial system in their host countries which is probably the reason why they turn to financing from mother companies. This is mainly true for large companies, located in the technological industrial development zones.

Figure 19: FDIs debt instruments in North Macedonia



Source: NBRNM

21 Available at: http://www.mchamber.mk/upload/White%20Book%202018%20pdf.pdf.

5. CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

The objective of the present assignment is to identify the main reasons why access to finance remains a key challenge for companies in North Macedonia, especially for micro, small and medium enterprises (MSMEs). This present report provides a summary of the existing knowledge, literature and official data on the barriers of access to finance in North Macedonia, adding a comparative perspective whenever possible with the Western Balkan region and the EU countries. The report first examined the characteristics of the MSMEs in North Macedonia. It then investigated the size and depth of the financial system and financial intermediation in North Macedonia. It provided an analysis of the credit activity, assets of the financial institutions, main financial stability indicators, as well as some comparisons with the developed countries. It also identified some structural weaknesses of the financial system and of corporations which may hinder the deepening of the financial intermediation. Section IV examined the available information and studies on the access to finance in North Macedonia from three perspectives: i) macroeconomic, structural and banking indicators, ii) the views of companies and comparative international perspective and iii) impediments to access to finance.

The analysis of the Macedonian corporate sector shows that MSMEs play an essential role and are very important for the economy, and that the structure of the MSMEs in North Macedonia is similar to the countries in the European Union. In North Macedonia, more than 99 per cent of all the companies are MSMEs, which provide 75 per cent of total employment in the country. The Government should stay committed to continuously improving the business environment for MSMEs, with focus on access to finance. The progress of this field is currently assessed through the Small business act (SBA) of the OECD (2019), and will be a point of interest during the negotiations process.

The study found that the financial system in North Macedonia is sound, though it is still underdeveloped. It is dominated by banks, which have high share in total assets of the financial sector, as well as in the financial intermediation. Slightly above third of all companies use some bank loans as a form of external financing. Credit to private sector (50 per cent of GDP) is still low in international comparison, especially in relation to the developed EU countries. The banks are dominant in the overall credit activity, with total credit to private sector of 48.8 per cent of GDP.

The study finds that access to finance is one of the bigger obstacles for businesses, but not a major one. The barriers for access to finance are greater for small and medium companies relative to the large ones. Over the last five years, around 36 per cent of Macedonian firms have borrowed from banks, while the rest largely depend on internal resources/retained earnings and family/friends as a source of finance. The borrowing from the development bank is relatively important, while trade credits and equity financing are of relatively low significance. The financing from retained earnings is exceptionally low compared with peer firms from the ECA region. Macedonian firms are more likely to use banks' loans for financing of the working capital and investments than the firms in the ECA region and the world average. A noted difference between Macedonian companies and companies in the ECA region is the large use of bank' loans for financing of the working capital and lower reliance on the supplier/consumer credits of the former.

The main obstacles for access to finance from the demand side (as identified by Macedonian banks are):

- Weak financial literacy of MSMEs
- Weak corporate reporting (also low use of external audit) and business planning skills and knowledge of MSMEs
- Unwillingness of companies to disclose and share business information
- Perceived lack of profitability and inadequate credit history
- Low awareness of the alternative instruments and options for external financing such as venture capital, business angels, etc.

From the company perspective, main impediments for access to finance are:

- High interest rates
- High collateral requirements
- Long and complex administrative procedures
- High risk aversion of banks
- Lack of useful and developed alternative financing sources such as equity financing, business angels and venture capital

5.2 Recommendations

Based on the analysis and the identified weaknesses of the access to finance, we identify the following recommendations for mitigating the barriers to access to finance:

Regulators

a) Consider reviewing the existing credit guarantee scheme of the Development Bank to ease pressure on MSMEs to provide collateral

Despite the availability of the credit guarantee scheme, the take up is very low. Credit guarantee scheme can also help companies to meet the collateral requirements and mitigate the problem of insufficient collateral. The most viable option may be to revitalize the existing credit guarantee scheme of the Development Bank, which is also one of the goals of the National Competitiveness Strategy for 2016-2020.

b) Undertake measures to support deepening of the financial intermediation and inclusion

The depth of the financial intermediation in North Macedonia is comparatively low. Increasing the depth will require actions on both the supply and demand side. Possible solutions are: i) an improvement in the framework for insolvency and creditor rights, combined with ii) support for business planning for MSMEs (we come back to this below). More broadly, the International Financial Reporting Standards for corporates should be upgraded to enable better credit risk reviews and market transparency. The establishment of a comprehensive regulatory framework for financial consumer protection would help address unfair business practices and boost confidence in using financial services.

c) Improving the access to the registers for securities over movable assets

The system should ensure online access to the register and easy accessibility. It should provide reliable and updated information as to encourage lending against such collateral. This can help to address one of the barriers for access to finance that is the collateral requirement.

d) Create a specific legal framework for factoring

Factoring can increase the working capital of MSMEs and improve their cash-flow. Although the supply of factoring is relatively good with a multitude of financial institutions offering

this product, the take up is very low. The low use of factoring is a result of absence of an adequate legal framework, as well as the lack of awareness or knowledge on this financial instrument. Several projects, including an ongoing USAID project, attempted to establish a good quality legal framework for factoring, but the process is still ongoing. Hence, this should also be in the focus of the government institutions (in partnership with the providers and potential users of factoring) for the forthcoming period. The awareness and knowledge of the factoring will be addressed by the measures suggested above (training in financial literacy and the awareness raising on available financial instruments).

e) Easing the legal requirements and the procedures for establishment and operation of financial institutions offering alternative financial instruments

The use of alternative financing instruments in North Macedonia is very low in comparative perspective, which also adds to the limited access to finance. Leasing is one such example, as well as factoring, business angels, etc. Financial institutions providing alternative financial instruments also face high competition from banks. The responsible government institutions should consider possible changes in the regulation as to reduce the legal requirements and the procedures for establishment and operation of financial institutions, using the examples of best practices of emerging countries (mainly the New EU Member States). This also includes the Fintech sector/companies which is still in infant phase.

f) Further improvement of the major structural vulnerabilities of the banks

Regulators (mainly the Ministry of Finance) should work with the National Bank of Republic of North Macedonia to improve some of the major structural weaknesses of the banks, such as: i) indirect credit risks due to large FX exposures to potentially unhedged borrowers, ii) high dependence on adjustable and variable-rate loans, as well as iii) high corporate portfolio concentrations. This should be a long-term goal, but one of the main milestones for a developed and reputable banking sector.

MSMEs

a) Advisory services to MSMEs on financial literacy, corporate reporting and business planning

National and international studies find that the financial literacy of population, in general, and of the representatives of MSMEs is very low. While there are some programs and efforts to improve the financial literacy, they mainly focus on school children and young adults. Low financial literacy impairs the access to finance (mainly bank loans) but also reduces the use of alternative financial instruments such as business angels, venture capital, etc. Greater financial literacy can also lead to a deepening of the financial intermediation. This measure may be led either by the employers' organizations (which may ensure higher take-up) or by some government institution (such as the Development Bank of North Macedonia or Agency for Support of Entrepreneurship). A training program can be developed consisting of several modules and delivered to MSMEs.

The study also finds that there is a room for improving the corporate reporting and business planning skills of Macedonian companies and executives which may also positively impact the access to finance. While these are also relevant topics and areas for improvement, it is beyond this report to suggest activities and measures for improvement. Still, corporate reporting may be incorporated in the program for financial literacy. External audit has been shown to reduce the barriers for access to finance for MSMEs. As companies are somewhat reluctant to hire external audit, the government may design some programs or subsidies to promote and support companies to undertake external audit.

b) Increase awareness of the various financing instruments

This measure is related to the financial literacy, but also has a more informative nature. Improving the information flow on available financial instruments to MSMEs may lead to higher demand and take up of non-bank financing. This can be achieved through a new or an existing centralized online platform (https:/konkurentnost.mk is an example of the later). The platform can combine i) information on the available types of financial instruments and ii) an educational component where owners/managers of MSMEs can learn more on what is the most appropriate type of instrument for their specific case or a need. This should be an employers' led initiative to ensure sustainability and utilization, though may be supported by the government institutions (such as the Ministry of Economy and Ministry of Finance) and international donors

Banks

a) Improve the skills of banks for MSME assessment

The report argued that risk assessment of companies is difficult due to insufficient and sometimes unreliable information provided by companies, as well as the high informality in the country. This increases the risk and the costs of lending for banks. Hence, there is a room for improving the skills of the bank employees for MSME assessment. The Macedonian Bank Association may be the most appropriate institution to design and deliver such training.

b) Streamline the process of loan applications and approval

The study shows that one of the main issues in the access to finance (for bank loans) is the long and complex procedure for loan application and approval. This includes also the large documentation needed (in view of the companies), and also the fact that the procedure cannot be fully completed electronically. A dialogue may be started between MSMEs representatives and representatives of Macedonian banks (or the Macedonian Bank Association) to seek options for rationalizing the loan procedure. The Ministry of Finance should also be involved in the process.

Banks may also reconsider the requirements that they pose to MSMEs in terms of past performance and future performance indicators (such as requirement of x per cent increase of sales or exports, or maintaining the same number of employees, etc. which sometimes discourage firms with good investment projects and modern, technology driven companies).

c) Seek options for further reduction of interest rates

Interest rates are ranked as a major impediment for higher demand for loans by companies in North Macedonia. Despite the continuous reduction of interest rates, the interest rate spread is still comparatively high. While interest rate policy is an internal bank affair and also subject to competition in the market, there is a room on a longer term for reduction of interest rates. In particular, if banks' efficiency is improved and/or corporate reporting and business planning of companies is enhanced, there will be a room for further reduction of interest rates.

Long term

The report found that some structural indicators and institutions (understood in a broad sense) may also be seen as barriers for access to finance. These, inter alia, include corruption and rule of law: high corruption and/or weak rule of law increase the costs for lending (and the risk) which then translates into lower willingness of banks to lend and/or higher borrowing costs. Hence, as the country likely progresses in fighting the corruption, strengthening the rule of law, reducing the informality, and similar, the access to finance and total lending will increase.

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ANNEX 1 NATIONAL DEFINITION OF SMALL AND MEDIUM-SIZED ENTERPRISES

Small and medium-sized enterprises (MSMEs) are defined in the EU recommendation 2003/361.The main factors determining whether an enterprise is an MSME are:

- *staff headcount*
- *either turnover or balance sheet total*

Table A1: Definitions of MSMEs

	Staff headcount		Turnover		Balance sheet total	
Company category	**EU**	**MK**	**EU**	**MK**	**EU**	**MK**
Medium-sized	50 < 250	50 < 250	≤ € 50 m	≤ € 10 m	≤ € 43 m	≤ € 11 m
Small	10 < 50	10 < 50	2 ≤ € 10 m	≤ € 2 m	2≤ € 10 m	≤ € 2 m
Micro	< 10	< 10	≤ € 2 m	≤0,05 m	≤ € 2 m	≤0,05 m

Source: DG Internal market, and Ministry of Economy (2018): National Strategy on SMEs (2018-2023) and Macedonian' Law on trade companies

Table A1 shows that there is a difference between the European and Macedonian definition of small and medium enterprises. While the staff headcount criteria are same, there are differences in the criteria related to the turnover and the balance sheet (the threshold amounts are higher in the European definition in all three groups of company size). Currently, a new Law for small and medium sized companies is being prepared by the Ministry of Economy, with plans to harmonize the definition with the European one.

ANNEX 2 TOTAL ASSETS BY TYPE OF FINANCIAL INSTITUTION

Table A2: Total assets, number and share in total assets and GDP of the financial institutions in North Macedonia in 2018

	Total assets (mil. denars)	Number	Per cent in total assets	Per cent of GDP
Depositary financial institutions	505,517	17	82.9	76.8
Banks	503,469	15	82.5	76.5
Saving houses	2,048	2	0.3	0.3
Non - depositary financial institutions	104,392	126	17.1	15.9
Insurance companies	21,369	16	3.5	3.2
Non-life insurance companies	14,275	11	2.3	2.2
Life insurance companies	7,094	5	1.2	1.1
Insurance brokers	1,531	35	0.3	0.2
Insurance agents	141	11	0.02	0.02
Leasing companies	4,923	7	0.8	0.7
Pension funds	65,941	4	10.8	10.0
Mandatory pension funds	64,386	2	10.6	9.8
Voluntary pension funds	1,555	2	0.3	0.2
Pension fund management companies	1,115	2	0.2	0.2
Brokerage houses	141	5	0.02	0.02
Investment funds	6,378	15	1.0	1.0
Investment funds management companies	149	5	0.02	0.02
Private equity fund management companies	n.a	n.a	n.a	n.a
Financial companies (including microfinance)	2,707	22	0.4	0.4
TOTAL	**609,912**	**143**	**100.0**	**92.7**

Source: Financial Stability Report 2018, National Bank of Republic of North Macedonia (NBRNM)