



SUPPORTING “GENERATION START-UP”: OPPORTUNITIES FOR MONTENEGRO

This case note presents our research findings and analysis on the start-up enterprise landscape in Montenegro. This research was designed to identify current good practice among financial services providers and international organizations serving start-ups; understand the future potential role of microfinance vis-a-vis start-ups; and propose concrete and practical steps to bring about more support for start-ups. This project is being implemented within the four-year Framework Partnership Agreement of MFC and the European Commission within the EaSI Programme.

THE BIG PICTURE

Montenegro has the smallest population, and the highest income per capita, in the Western Balkan region, with an economy dominated by the tourism and metal industries. Trade with CEFTA economies (Central European Free Trade Agreement) and EU markets represent the vast majority of international trade in Montenegro. It adopted the Euro as its sole legal tender in 2002 after pegging formally to the Deutschmark in 1999. Tourism, which accounts for roughly 20% of Montenegro’s GDP, brings in three times as many visitors as Montenegro’s total population every year. In addition to tourism, energy and agriculture are considered two distinct pillars of the economy.

Montenegro has been an EU membership candidate since 2010. Accession negotiations began in June 2012, with negotiating the initial chapters of the *acquis*¹. In June 2015, the sixth meeting of the Accession Conference with Montenegro took place and two more chapters of the *acquis* were opened for negotiation (Chapter 9: Financial services and Chapter 21: Trans-European networks). It has opened 20 out of 35

chapters for negotiations so far and 2 have already been provisionally closed.

In the first year of its independence, in December 2006, Montenegro joined NATO’s Partnership for Peace program and joined the Membership Action Plan in December 2009. On 2 December 2015, Montenegro was invited to start accession negotiations to join NATO.

THE START-UP LANDSCAPE

At the end of 2013, there were 21,880 SMEs in Montenegro, accounting for 99.8% of all enterprises and generating 64.5% of the economy’s total value added. Since 2010, the number of SMEs in operation has increased by more than 20%. More than half (55%) of SMEs operate in the wholesale and retail sector, followed by construction (16%) and manufacturing (13%).

These statistics exclude the agricultural sector, however, as farmers are not counted. According to the 2010 agricultural census, there were 48,824 “family agricultural holdings” (i.e. family farms). Although no breakdown by size categories is provided, it can be assumed that all of these family holdings would meet the definition of a small enterprise.

¹ The *acquis* is the body of common rights and obligations that is binding on all the EU member states.

The development of SMEs in Montenegro contributes to the increase in gross domestic product, creation of new jobs, reduction of unemployment, substitution of imports and higher export competitiveness of the domestic economy. SMEs are a source of innovation, and play a significant role in uniform regional development, as well as in the process of European integration.

Data on the number of new enterprises created each year or the number of enterprises 0-2 years old are not available, yet there are statistics of the World Bank from 2014 showing that the new enterprise creation rate (number of limited liability companies created during the year per 1,000 adults) is quite high in Montenegro: 6.8 new companies per 1,000 adults (compared to the global average of 4.0).

THE SURROUNDING ECOSYSTEM

National Strategy for SME Development

The National Strategy for the Development of Small and Medium Enterprises (2011–2015) has expired and the new one will be drafted for the period of 2018–2021 in line with the government's new priorities. The main goals of the previous strategy were to further improve the business environment, develop financial support, strengthen SME competitiveness, and promote women's entrepreneurship and business start-ups. The next strategy is said to continue along the same lines.

Strategy implementation was managed by the Directorate for SME Development within the Ministry of Economy (DDSME) which designed and implemented policies in support of small enterprises.

Start-ups were addressed in the strategic objective 3 'Strengthening SME competitiveness and promoting entrepreneurship' and strategic objective 4 'Support for beginners in business (start-ups)'.

A separate strategy for women entrepreneurship exists, but is inactive because of a lack of funding for implementation.

Entrepreneurship education

Following coordinated efforts by the Ministry of Economy, Ministry of Education and other policy

partners, strategies for Lifelong Entrepreneurial Learning for 2008-2013 and 2015-2019 were adopted. The Directorate for SME Development acts as a co-coordinator for the national partnership, and plays a leadership role in strategy implementation.

Box 1: Doing Business in Montenegro

Globally, Montenegro comes 58th in the ranking of 190 economies on the ease of starting a business with a distance to frontier (DTF) score of 90.

Montenegro eliminated several procedures for business start-up by introducing a single registration form for submission to the tax administration, a "one-stop shop".

Starting a business requires 6 procedures and takes 10 days. The cost of opening a business is 1.5% of income per capita. Companies can be partially registered online: a registration request can be submitted through the e-government portal, but payments need to be done in person.

The Central Registry of the Commercial Court was introduced in 2011. Company registration is available in eight regional tax administration units. Montenegro has introduced Tax Identification Numbers, which act as a single identification number when dealing with all the standard public administration functions.

Although the tax on profits is low (9%), the tax burden comes from VAT (23%) and from income tax of employees. The law requires that at least one person is employed in each business, and pays taxes and social contributions. Additionally, taxes can be imposed by local municipalities. However, tax incentives can also be introduced by local municipalities to attract businesses, such as a grace period and salary tax relief. For instance, in the north there are business zones with tax incentives for business development and investors for the first 2 years of operations.

Information on how to register a company is available on the website of the Chamber of Economy www.privrednakomora.me/en/how-register-company.

The European Training Foundation (ETF) is recognized within Montenegro as a leader in entrepreneurship education. In 2015, Montenegro began full-scale implementation of entrepreneurship as a cross-curricular competence in primary and secondary schools, including special training for teachers and school principals in every school. Entrepreneurial education is also present at university level but only on economic faculties, not on technical faculties.

Montenegro stands out in the region in the area of exchange of good practice on entrepreneurial learning. It has embedded the “Training Firms” initiative as an obligatory element of formal education practice, and there are consistent efforts to link peer exchange, networking and capacity building measures like teacher training. Montenegro was active in the South East European Centre for Entrepreneurial Learning (SEECLE) regional good practice initiatives and contributed to piloting the key competence approach.

Perception of entrepreneurship

Montenegro has not participated in research on entrepreneurship within Global Entrepreneurship Monitor project since 2010, therefore there is no recent data on the entrepreneurial attitudes and perceptions of the population. Common opinion in Montenegro holds that people prefer low-paid state jobs over better-paid jobs in private sector, or running their own business. Especially among young people, governmental jobs are seen as a stable career path. For that reason, most people start a business out of necessity. Although young people are slightly more entrepreneurial, they are still exposed to the mind-set of older generations, raised in pre-transition times, when almost everybody had a job in a state-run institution or company, and the private sector (and its entrepreneurial spirit) was unheard of. Education is key to changing the attitudes.

Access to finance

Despite Montenegro’s small population, there are a high number of institutions providing financial services to SMEs. However, these institutions are more geared towards the provision of credit products to well-established enterprises.

Banks

All 14 banks are engaged in lending to the SME sector – given the small size of the corporate sector, they have little choice but to work with SMEs. However, banks typically only serve businesses that have been operating for at least 1 year. Only a few banks, such as Erste Bank, CKB or Hipotekarna Bank provide loans to newly-registered businesses, albeit with very high collateral requirements.

Investment and Development Fund of Montenegro (IDF)

IDF is a state institution, established in 2009, that mainly supports SMEs, although it also finances projects relating to infrastructure and environmental protection. Its special target groups are young people, women in business, graduates of higher education and individual agricultural producers. The female entrepreneurship program is implemented in conjunction with the UNDP.

The interest rates for the IDF programs range from 0% to 4%, and fees are 0–1.5%. The maturity of loans is up to 12 years, grace period up to 4 years and maximum amount up to 50,000 EUR. Entrepreneurs need to contribute at least 25% of the project budget to access an IDF loan, although they can do so up to one year after disbursement.

The problem is with guarantees: loans below 10,000 EUR can be guaranteed by a third person, but larger loans require a mortgage guarantee.

In 2016, the total number of loans disbursed to SMEs reached 202, including 21 loans to youth businesses, 10 loans to start-ups, 13 loans to college students and 38 loans to female businesses.

Employment Bureau

The employment bureau has a program supporting new business creation through grants of 5,000–10,000 EUR. The amount is sufficient for businesses in small production or services.

Non-financial services

The government provides pre-start-up and start-up training programmes through dedicated institutional structures such as the Directorate for SME Development, Employment Bureau and business incubators.

Directorate for SME Development (DDSME)

Created in 2001, DDSME provides non-financial support to start-ups in cooperation with Investment and Development Fund (IDF), although the funding for the current programming period has been much reduced compared to the previous period due to shifting governmental priorities.

A 5-day training is provided to people who want to register a company, or run a company younger than 1 year. They receive information on how to start, write a business plan, do marketing and trade. DDSME helps them write a business plan and apply to IDF for a preferential loan. Since 2015, 15 companies have been supported with training, most of them in services but also in production (out of 75 applications).

DDSME also has a mentoring program in partnership with JICA for entrepreneurs who received financing from IDF.

Additionally, DDSME, being part of Enterprise Europe Network, provides information about EU funds available to Montenegrin SMEs.

Business incubators

DDSME has opened 2 incubators (Podgorica, Bar) offering institutional support for start-ups. In 2011, there were 23 tenants in two incubators. The local municipality in Podgorica has an agreement with a local accounting organization, such that a start-up businesses registered there may access free accounting services for one year.

Innovation and Entrepreneurship Center - Tehnopolis

Tehnopolis, in Niksic, was founded in 2014 by the Ministry of Science. It is engaged in promotion and development of entrepreneurship, founding new and developing existing companies on a local and regional level, promoting and developing scientific research results.

The aim is to strengthen business operations, as well as participate in realization of different development projects ranging from educational platforms to cross-border cooperation to improve business environment.

Tehnopolis provides the following services for its tenants:

Infrastructure support

- Office space
- Access to resources such as an electro-mechanical and a bio-chemical laboratory, data center, convention center, meeting room, lounge bar, additional common areas

Consulting support

- Consulting services for new and existing entrepreneurs, including business planning and development, organization and marketing
- Help in identifying and understanding grant funding opportunities to national, regional and European funds

Training support

- Training on professional development, practical business skills, information technology, IT applications, desktop management and computer operating systems

Incubation support

- Support in developing business ideas and creating new jobs by providing the environment for business development, approaching mentors and investors, as well as providing support in marketing activities
- Networking with institutions, scientific research communities, and other businesses in Montenegro and the Balkans
- Networking with enterprises and connecting with incubators and Science and Technology Parks in the region

In 2016, Tehnopolis had 14 tenants and conducted training and programs for 950 participants.

Employment Bureau

The Employment Bureau of Montenegro (EBM) provides support to the SME sector through consulting services and training, directed especially towards potential entrepreneurs. Unemployed people who are considering self-employment can participate in seminars to learn how to register a business, do basic accounting, and develop a business plan.

NEEDS OF ENTREPRENEURS

The needs of entrepreneurs in the IT sector are vastly unmet, as there are no accelerators, IT incubators, business angels or equity investors in Montenegro. As a result, tech start-ups register in other countries (Bulgaria, Germany, Ireland) where investors are present and use the business support facilities there. The needs of the IT start-ups are different from those in the traditional sector; they need equity investors willing to share higher levels of risk. IT start-ups are not eligible for loans, as they usually do not have business plans, or their business plans evolve quickly in line with the development of the idea. Equity investors mitigate high risk by investing in 100 start-ups, of which 2–3 will be very successful and compensate for the losses of the others. Apart from access to risk capital, IT start-ups need support from mentors but also from peer entrepreneurs. In the IT sector, the exchange of ideas, brainstorming and discussion, as well as sharing contacts is crucial to the success.

In case of businesses in the traditional sectors (trade, services, manufacturing), entrepreneurs chiefly lack knowledge on how to run a business and manage the financial side of the operations. Additionally, people lack understanding of the market (understanding competition, differentiating from competitors, recognizing real market needs, adjusting products/services to needs of market). Access to market is difficult, so proper assessment of the market opportunities is key to the success of the start-up.

Entrepreneurs, especially young people, put less emphasis on the knowledge and practical skills required for running a business. They mostly seek funding for starting their business and disregard the need to learn on how to run a business.

CURRENT MICROFINANCE INITIATIVES

Alter Modus

Alter Modus (AM) is a microfinance institution working in Montenegro since 1997. The businesses supported by AM are in the area of agriculture, husbandry, trade, services, handcraft, fishery and production. Currently, AM has about 20,000 active clients, and is the largest microfinance institution in Montenegro. In order to be eligible for a loan, it is fundamental that the business generates profit which will be used by the client for the loan repayment. The business can be a legal entity or an informal income-generating activity.

Alter Modus does not have a separate product for start-up businesses. It is difficult to assess how many start-ups are among its current clients. Some of its long-term clients run informal businesses and when they register they officially become 'start-ups', although the business has been in operations for a long time. Alter Modus rarely finances pure start-ups (young people who want to start their first business) as they are very risky and AM does not have methodology to properly assess the risk.

Nevertheless, AM would like to develop a special product for start-ups. It would need external support to develop the product (design, underwriting procedures, monitoring and training for staff on how to serve start-ups) and have access to low-cost or shared-risk funding. Alter Modus does not provide business development services, but it does recognize the fact that clients need to learn more about running a business, in order to be successful. This year, AM organized workshops for clients in various locations throughout the country that were focused on learning from clients about their practices in accounting and preparing financial statements.

Monte Credit

Monte Credit is part of AgrolInvest Holding, an affiliate of the World Vision International operating in Montenegro and Serbia. It provides loans of up to 10,000 EUR. Monte Credit's clients operate mostly in agriculture (58%), services (38%) and production (less than 1%).

Although Monte Credit does not have a separate credit product for start-ups, it serves new ventures (for

instance in agro-tourism) where people take a loan to renovate accommodation to be rented to holiday makers. Monte Credit estimates that about 30–35% of its portfolio is in start-up businesses of less than 2 years.

Currently, Monte Credit does not provide business development services, but its loan officers offer clients informal business advice throughout the lending process. Recognizing the large number of women who could potentially start a business (in traditional clothing or crafts), Monte Credit would like to start supporting more start-up businesses with dedicated credit products. In order to do so, it would need to develop staff capacity to assess risk and deliver business development services (BDS). It would also need to have access to dedicated funding for start-ups, for instance, from the Investment Development Fund, which uses EU funding for lending on preferential terms to start-ups.

NEXT STEPS

As the needs of entrepreneurs relate to both financial and non-financial aspects of running a business, our recommendations are divided accordingly. Additionally, recommendations for improving the legal environment for start-ups follow, as the current tax and para-fiscal regime is not conducive for business creation.

Non-financial services for start-ups

- Develop infrastructure to support entrepreneurship, i.e. business incubators
- Create accelerators for tech start-ups with government support
- Provide more training and mentoring for start-ups on business management
- Link the provision of financial with non-financial services, stimulate cooperation of MFIs with BDS providers
- Build the capacity of MFIs to deliver BDS
- Create an information portal on how to start a company, where to get financing, training resources, consulting services, etc.

Contact us to learn more:

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Financial services for start-ups

- Set up a fund for start-ups to provide grants of 2,000 EUR for purchasing equipment
- Support the development of MFI products for start-ups, such as grants with follow-up loans, loans with a grace period, or subsidized loans
- Improve the capacity of MFIs in serving start-ups, particularly in assessing repayment capacity
- Establish a mechanism to access EU funds under the management of Investment Development Fund
- Set up a new company to manage EU funds for subsidized loans

Regulations

- Introduce tax incentives for start-ups, - e.g. lower VAT rates
- Remove requirement of a minimum one employee per company paying taxes

This publication has received financial support from the European Union Programme for Employment and Social Innovation "EaSI" (2014-2020). For further information please consult: <http://ec.europa.eu/social/easi>. The information contained in this publication does not necessarily reflect the position or opinion of the European Commission.