

## The Potential of Small and Medium Enterprises in Belarus

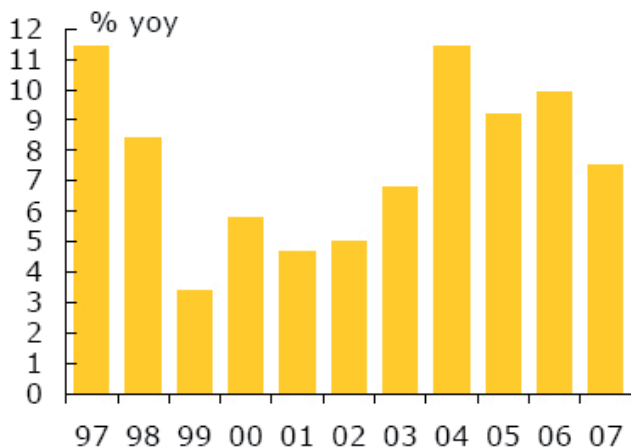
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The private sector in Belarus produces only 25% of national GDP despite employing 47% of all employees in the domestic economy. The potential for the development of the private sector in Belarus in terms of productivity and share of GDP is great. Small and medium-sized enterprises (SMEs) can become a leading force in achieving that potential. Yet according to a recent joint-study undertaken by researchers from CASE - Center for Social and Economic Research and the IPM Research Center in Belarus, SME owners in Belarus do not take out any loans and do not perceive a lack of credit as a substantial obstacle to their development. Why not? Is this because of the practice left over from Soviet times of financing one's own business with cash? Or is it due to a limited amount of credit available in the Belarusian financial market?

### THE PRIVATE SECTOR IN BELARUS

Belarus has shared a border with the European Union since 2004, and has been drawing increasing attention from European policy-makers and private business owners. Belarus has reported a high annual GDP growth since 1996 (see figure 1), but there is a huge concern regarding the sustainability of this growth in terms of the share of private businesses in GDP.

Figure 1. GDP growth in Belarus from 1997 - 2007\*

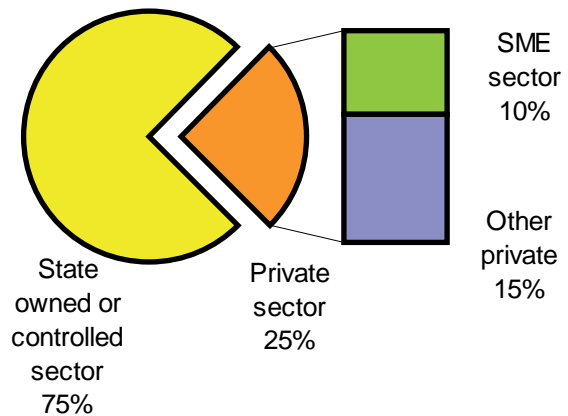


Source: IPM Research Center

\* estimated for 2007

The majority of Belarusian GDP is produced by state-owned or state-controlled enterprises (75%, see figure 2). The private sector makes up only about 25% of GDP and this amount has remained stable from 2002-2006.

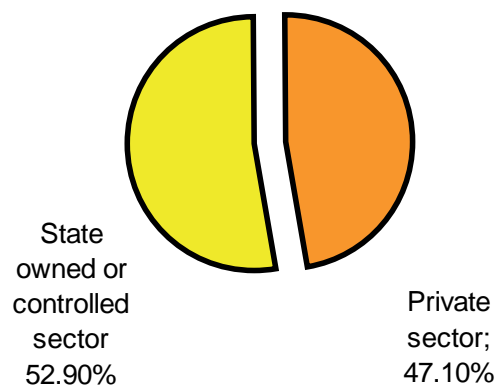
Figure 2. Share of Private sector and SME in Belarusian GDP in 2006



Source: Ministry of Statistics of Belarus

At the same time private businesses employ nearly half of the working population (47%, see figure 3) which indicates that the productivity of the Belarusian private sector is very low.

Figure 3. Employment in the Private Sector in Belarus in 2006



Source: Ministry of Statistics of Belarus

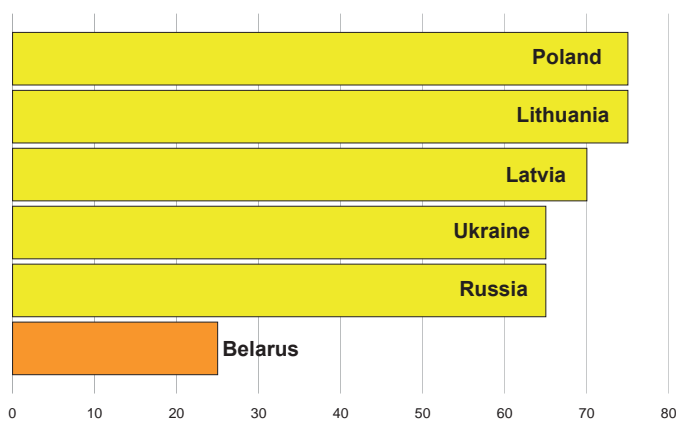
1 Source: EBRD

In this situation, GDP growth cannot be sustainable as it is created by state-originated investments which are directly dependent on the political situation in the country.

The reason for the low productivity of the private sector in Belarus is the high operational cost of opening and running a private business. Economists from CASE and IPM Research Center studied the development barriers facing private small and medium businesses by surveying 253 SMEs registered in Belarus<sup>2</sup>. 99% of private enterprise managers think that costs of both entering and operating in the market are high. The main barriers that were highlighted by the managers of private businesses were high taxes, numerous investigations and fines, accounting costs, costs of getting licenses and permits, direct price regulations and costs of state registration.

In comparison with its neighbors (Russia, Poland, Ukraine, Latvia and Lithuania), the size of the private sector in Belarus is very small (see figure 4).

**Figure 4. Private sector in Belarus compared to neighboring countries (as a % of GDP), 2006**



Source: EBRD

In most countries, SMEs are the main source of development of the private sector. In Belarus at the moment the situation is quite different. The SME sector alone produces no more than 10% of national GDP. In light of this, what are the chances for the SME sector to develop in Belarus? On one hand, with such a low productivity rate in the private sector, the outlook seems rather limited. On the other hand, the possibilities for growth as a result of greater productivity in the private sector seem to be enormous, and Belarus is certainly not reaching its full potential.

## SOURCES OF DEVELOPMENT FOR BELARUSIAN SMEs

<sup>2</sup> The survey was conducted in November 2006 by CASE and IPM. 253 SMEs were interviewed (the sample is representative). The results of the research 'Problems of Development and Small and Medium Business in Belarus' can be found at <http://research.by/rus/surveys/f9953d723aa828f2.html>.

- In most parts of the world, there are two major sources of funds for developing a small enterprise: loans from either a bank or credit union. Both can be used for circulating assets as well as investments. In Belarus, only 25% of SMEs use loans according to the CASE-IPM study. Considering the high growth rates of the Belarusian economy (9.9% growth in 2006), the low percentage of SMEs taking out loans appears disappointing. This is troubling when considering the country's latest spate of problems, from low oil prices to Russia's volatile attitude.

- In Belarus, bank micro-loans are the most widespread form of borrowing, while loans provided by credit unions occupy a very small share in the total volume of loans. This situation differentiates Belarus from its neighbors such as Russia, Ukraine, Poland, Lithuania and Latvia. In the other countries in the region, credit unions dominate: they provide up to 40% of the total volume of micro-credits, while their share in micro-loan organizations is 96%.

- Based on this, it is clear that state policies which aim to assist the development of the SME sector should be based on the provision of broader access to credit. In the coming years, this lack of access to credit will become the major obstacle to SME development. The executive authorities of Belarus possess considerable capacities to speed up the micro-loan sector development in the country and, consequently, SME development as a whole.

## UNDERSTANDING WHY BELARUSIAN SMEs DO NOT USE LOANS

- In order to understand why SMEs in Belarus do not borrow, we should take a few facts into consideration. First, the majority of Belarusian SMEs do not perceive lack of credit as a problem. The managers of the surveyed enterprises listed many other obstacles to their prosperity before lack of credit, including taxation, inspections and fines, complicated accounting and paperwork, price and wage regulation, and ease of obtaining licenses and permits.

- Second, companies spend a lot of time and money on paying taxes, fines and other accounting-related costs. A fraction of these expenditures could certainly be redirected for investment into fixed assets. It could also be used to increase the volume of circulating assets. We estimate that for every reduction of the cost burden of 10 USD for each company (in terms of taxes, fines, accounting and paperwork costs, changes in prices and wages, licenses and permits) a gain of approximately 2 million USD could be obtained.

- Finally, when we compare the true barriers to SME development to the perception of existing barriers

- <sup>3</sup> More detailed information is provided in Pytkowska, J. and Bankowska, E. '2004 Microfinance Sector Development in Eastern Europe and Central Asia', 2004. The fact that microcredit operations are concentrated in the banking sector has been confirmed in other studies such as 'The Problems and Prospects for Microfinance Development in Belarus: Economic and Legal Aspects', UNDP in Belarus, 2005.

according to SME managers, we see a paradoxical situation. The majority of managers view taxation, inspections and fines as the most significant barriers to doing business in Belarus, as they cause a significant loss of energy and time. Managers claim that these barriers prevent them from increasing their output or volume of services or introducing innovations. In fact, it is the limited financial investment that prevents these improvements. Managers of SMEs do not point to a lack of capital as a major barrier because they do not have enough information about borrowing opportunities, including the use of microcredits to increase the volume of circulating assets. One can assume that they are largely unaware of modern methods of doing business, such as bank lending, long-term planning, out-sourcing and other business tools.

## SME POLICY IMPROVEMENT IS REQUIRED

SME development should become a priority for the government, as it can be used as a key instrument for developing the private sector. The fact that the SME sector today only produces 10% of GDP shows the great possibility for growth of Belarusian private business. Furthermore, the government of Belarus also promises to stop subsidizing state-owned enterprises as of 2008, which means that state-owned companies will become less efficient, thus producing a lower growth rate. Given the situation, a continuation of high economic growth in Belarus will only be possible with private sector growth.

Policy tools such as the establishment Regional Centers for Business Support and full-fledged cooperation with international financial organizations could spur the development of the domestic SME sector. Although local centers for business do exist in Belarus, there is a need to develop them further in terms of broader responsibilities and duties, increased number of activities, and greater financial sustainability. International experience calls for close contact between local authorities and private businesses, so regional centers should become a centralized and reliable source of information for managers and individual entrepreneurs in the area where they run their businesses. It is important that such centers initiate contact with managers. In the beginning, regional centers have to concentrate on providing a number of informational and consultancy services (in areas such as institutional conditions for conducting business, existing legislation and other related requirements) and helping to prepare and implement educational and retraining programs. Later, the centers could take on additional functions, depending on the needs of entrepreneurs and the organizational capabilities of the centers, concerning the 'internationalization' of firms, their innovativeness, and provision of financial services (loan or guarantee fund)<sup>4</sup>.

To achieve financial sustainability, regional centers should not be subordinated to local authorities (by being established as a government department). Rather, they should be separate bodies with their own budgets. Funds could be a combination of state funds, donations made by private companies and associations of entrepreneurs, as well as international financial resources. Foreign loans could be used for establishing the regional centers, backing up loans and for providing credits directly. Many international credit organizations today are willing to provide credits for Belarus. What is needed is the willingness of the executive authority to cooperate with them. In many cases these organizations provide loans at low interest rates or even charge no interest at all. The only requirement is to use funds in a rational and professional way and to manage investment and repayment risks. For instance, in Poland, when local executive authorities and international financial organizations cooperate, a small department is usually set up that manages international loans and grants.

Therefore, the development of SMEs in Belarus in the short run can be related to a) a closer cooperation between authorities and businesses, which must be initiated by the authorities and b) a redirection of enterprise expenditures from taxes, fines, accounting and paperwork costs, inefficient prices and wages, costs of licenses and permits to increasing the volume of circulating assets and purchasing new equipment. In the long run, state policies to assist the development of SMEs have to be based on the provision of a broader access to credit. Consequently, assuming that the annual inflation rate remains at less than 10%, the development of the SME sector in Belarus would be greatly enhanced.

To read more on this topic see: Naurodski, S. „The Role of Credit in the Development of Small and Medium-sized Enterprises in Belarus: Estimating the state of the Microfinance Sector”  
[http://www.case.com.pl/strona--ID-publikacje\\_eReferaty publikacja\\_id-16001214.nlang-710.html](http://www.case.com.pl/strona--ID-publikacje_eReferaty publikacja_id-16001214.nlang-710.html)

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<sup>4</sup> For more policy recommendations on regional business centers see P. Kozarzewski, M. Gorzynski, G. Badei, J. Tarasevich, E. Rakova "Local authorities and the development of small and medium enterprises: international experience and guidelines for Belarus" available at [http://www.case.com.pl/strona--ID-publikacje\\_eReferaty publikacja\\_id-16001674.nlang-710.html](http://www.case.com.pl/strona--ID-publikacje_eReferaty publikacja_id-16001674.nlang-710.html)

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