# DEVELOPMENT POLICY AND INVESTMENT PROJECTS ASSESSMENT IN THE SECTOR OF SME IN SERBIA

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***Abstract***

*The problems of rational investing, in other words efficient planning and realization of investment projects, are among key problems in development of every enterprise. For successful realization of business plans, enterprise should make use of its internal strengths and available resources from surroundings, and turn them into its competitive advantage. Small and medium enterprises in Serbia are facing low liquidity and a lack of their own funds for investing into long-term and development projects. Therefore, investment projects are conducted with a high participation of loaned funds, mainly credits, with high interest rates and short terms for paying back.*

*The sector of small enterprises makes numerous mistakes when creating financial plans. Enterprises don't understand basic parameters of revenues, especially which leverage points manage revenues, and revenues, themselves, are set on a too optimistic level. The time necessary to create revenues is also underestimated. In projections, many significant cost items are underestimated, and some costs are overlooked, which, inevitably, leads to liquidity problems. Needed cash funds are not acquired quickly, so the consequence is a negative cash flow, with all negative consequences in the later life of an enterprise.*

*Such situation dictates necessity of additional caution when assessing investment projects' profitability because investment failures cause large negative consequences, both for an enterprise and a wider area or branch in which it functions. For the assessment of its investment projects small enterprises must use dynamic methods which take time value of money into consideration and which contribute to a better control of cash flows and liquidity of an enterprise.*

***Key Words:*** *business plans, development policy, investment projects' assessment.*

***Classification JEL:*** *L21, D78,H79.*

## 1. Introduction

Business plan should help enterprise in supplying with necessary capital and it should alleviate managing enterprise's growth and development. Problem with small enterprises and entrepreneurs, when it comes to making and realization of development plans, represent: lack of capital, shortage of skilled workers, inferior position in relation to suppliers and similar. For successful realization of business plans, enterprise should make use of its internal strengths and available resources from surroundings, and turn them into its competitive advantage. Some of the threats that small enterprises could face are: new competitors with new technologies, economic crisis and recession, inflation, interest rates' increase, regulatory limitations, changes of demographic structure of population and similar.

Requirement for development of every enterprise is a correct choice and efficient realization of investments. Investing appears to be the final act of the entire development process, by which planned development objectives are being fulfilled. Enterprise development policy defines objectives of development and, in general, ways and measures for their accomplishment, while investment policy determines concrete programmes by whose realization development objectives are being accomplished. Enterprise investment policy must be harmonized with enterprise's basic objectives, completely consistent with development policy and objectives when making decisions on most favourable investment solutions. The most significant factors that have an impact on investment policy are market, science and technology development, financial and personnel capabilities of an enterprise, institutional conditions and others.

Small and medium enterprises are characterized by high flexibility, fast accepting of innovations and new technological solutions, so therefore, they could be a carrier of economic development in future. For completion of that role in Serbia, it is necessary to significantly improve entire economic environment, especially in part which would enhance realization of development and investment undertakings.

Due to a lack of their own financial funds for financing investment projects, enterprises need external funds sources with, as long as possible, terms for paying off and suitable grace period, with interest rate that won't be higher than the rate of return on invested assets, steady exchange rate and other. On the other hand, due to unstable economic conditions, enterprises must pay great attention to choosing and assessing of investment projects profitability.

## 2. The Role Of Planning In Enterprises Development Policy

Business plan usually implies a document which precisely states a way for accomplishing defined objectives. Business plan, on one hand, sums up business opportunities, and on the other, defines and articulates ways through which management team will make use of identified opportunities [1]. Business plan arises as a result of structured process of business idea evaluation, which answers three fundamental questions: where is enterprise now, where does it go and how will it get there?

Business plan has two basic purposes: [2]

- to help enterprise in supplying with necessary capital, and
- To alleviate management of enterprise's growth and development.

During a creation of a business plan, the three perspectives must be considered: [3] entrepreneur's perspective (entrepreneur best understands the concept and idea on which the business undertaking is based, processes and technology of functioning, so therefore he is the most capable of explaining the core of business undertaking), market perspective (when creating a business plan, enterprise's business must be seen by the eyes of buyers - customers) and investors' perspective (investors expect business plan to give real and persuasive projections of financial elements, such as revenue, expenses, cash flow, financial result and similar).

Analysis and assessment of development capabilities of an enterprise consist of analysis of past development and analysis of future development of an enterprise. This analysis comprises market, technical-technological, organizational and financial aspects. Analysis of future development enables connection between results from the past and planned investments which are a subject of business plan. Future market share depends on entrance and exit barriers, level of horizontal and vertical integration and the level of globalization [4].

In accordance with development stages of an enterprise, business planning can be divided into three segments. Strategic planning, as a basic activity of strategic undertakings, is primary and has a task to ensure goals which are set, in other words, it has to justify the purpose of enterprise's existence. Strategic planning is followed by tactical planning which refers to start of enterprise's functioning and ways how to execute strategic plans in practise, and operative planning which is engaged in problems related to carrying out planned activities.

Enterprise should build its competitive advantages on the basis of its own key capabilities to serve clients better than competitors on the market. Key capabilities can be high quality, innovations, business organization, team work, flexibility, after-sale service, responsibility and other. Small enterprises, as, usually, new competitors on the market, can gain competitive advantage only if they are able to offer customers a better product at the same price as competition, or offer a product of the same quality at a lower price.

In accordance with [5], business connections of SME represent the basis for carrying out of regional policy in all high developed countries. Developing countries have a weak system of such connections, which is one of the causes of insufficient competitiveness of enterprises from these countries and significant regional disproportions, which, on the other hand, lead to hampering overall development, unused resources and unfavorable migration flows. According to [6], local development of agencies, their entrepreneurial or leading behavior could significantly contribute to local/regional development in unpredictable economic surroundings. According to [7], small and medium enterprises were not able to use "soft budget limitations" that were enabled to big enterprises by banking sector, so they were affected by the crisis to a larger extent. Today, the most important risk is market risk, after that financial and personal risk. Because of business environment's deterioration, the performance of small and medium enterprises dropped for, at least, 15% [8].

Fundamental principle of every good business strategy is to establish synergy. Synergy is a phenomenon when two or more elements of a whole, by performing together, realize bigger effects in comparison to those they would have if they performed individually [9]. Strategic plan of a small enterprise [10] has to be short, simple, up-to-date, future oriented, positive and optimistic, in accordance with business culture and ethics and has to include all employees in order to everyone recognize their place and role.

Mistakes in strategic planning can be very expensive, especially in small enterprises which, in its initial phases of development, have very scarce fund sources. That enforces enterprises to, besides its own potential, explore external surroundings: strengths and weaknesses of competition, potential buyers and restrictions in markets functioning and similar. There are adequate tools for that, where SWOT analysis is among the most important ones. This analysis' task is to estimate strengths and weaknesses of an enterprise, as well as opportunities and threats in surroundings.

The most common weaknesses of small enterprises are lack of capital, shortage of qualified workers, inferior position in relation to suppliers and similar. Properly identified strengths and weaknesses enable enterprise to understand better its capabilities. For a successful realization of business plans, enterprise should make use of existing strengths and disposable resources from surroundings and turn them into its competitive advantage. On the other hand, threats for small enterprises represent new competitors with new technologies, economic crisis and recession, inflation, interest rates' increase, regulatory restrictions, changes of population's demographic structure and similar.

One of the most important parts of a business plan is financial plan. Final decision on profitability of a certain business undertaking (investment) is made on the basis of quantitative indicators from financial plan. On the other hand, banks and other external users of business plan make their decision whether or not, and how to support business undertaking and that decision is also based on indicators of financial performance of an enterprise. Data in financial plan are shown in quantitative form which contributes to better comprehensibility and bigger comparability, and by that to drawing conclusions [11].

The first step in creating a financial part of a plan represents determination of structure and dynamics of long-term investments. Those are investments that are expected to produce effects in a longer period of time, and they comprise investments in fixed assets (immaterial assets, immovable assets, plant, equipment and biological means) and lasting working assets. This property can be financed from internal and external (lent) sources. Bigger participation of internal (own) sources enables higher elasticity and independence in running a business policy of an enterprise, and it reduces costs of financing (interest rates), which are extremely high in Serbia (because of unwarrantably high interest rates).

Creation of financial part of a business plan is followed by a creation of planned financial statements-planned balance sheet, income statement and cash flow statement. It is especially important to notice the differences and their causes between planned income statement (which shows revenues and expenses) and cash flow statement (which shows inflows and outflows of money from business, investment and funding activities). Significant attention should be paid to tax aspects of a business plan (value added tax, tax on profit, tax on property, nontax expenditures) which can significantly affect final result of a business undertaking.

The final decision on (UN) profitability of a business undertaking-investment is made on the basis of financial plan. This decision is based on efficiency indicators which are divided into static (do not take time value of money into consideration) and dynamic, which take time value of money into consideration. One of important parts of a business plan is perceiving uncertainty (riskiness) of a project in terms of unexpected circumstances. Methods that are mostly used for analysis in conditions of uncertainty are break-even method (static) and sensitivity analysis method (dynamic).

## 3. Development And Investment Policy Of Enterprises

Development policy is more complex than enterprise growth, which is usually expressed through an increase of realized production. Besides this segment, development also includes improvement of production technique, technology and organization; upgrade of work methods in other areas of functioning; betterment of entire enterprise's organization; development of certain departments and opening of new ones; products' development and improvement of product programmes; working conditions amendment and similar. The essence of enterprise's development is in ensuring adaptation in a continual course of enterprise's functioning and constant changes of surrounding, with which an enterprise is in a tight interdependence.

Correct choice and efficient realization of investments is a condition for every enterprise's development. Investments represent a part of global development problem as a permanent process, by which an enterprise insures its future existence and its efficient functioning in perspective. Investing comes as a final act of entire development process, by which planned development objectives are being realized, and by that, entire development, too. After necessary exploratory activities, defining development objectives and development policy, as well as creation of an appropriate development plan, investing is necessary to ensure realization that is accomplishment of planned development objectives.

From quoted, it is obvious that development - development policy, and investments - investment policy, are closely connected. It is a whole group of problems, which does not allow isolated and separate exploration and realization. Development is not possible without investments, because they are basic means for its accomplishment, and investments, without correctly defined development and good development policy, are in most cases failures that lead into functioning with loss, and not towards desired development objectives.

Development policy should be based on four key elements: [12]

- restrictive fiscal policy - surplus in budget,
- slack monetary policy - low interest rates,

- ensuring favourable investment climate, and
- Liberalization of market which leads to improvement of products and services quality and reduction of their prices.

Development policy is general and it refers to policy of development in a longer period of time, while investment policy is more concrete and more operational, and refers to a shorter period of time. Development policy defines development objectives and in general, ways and measures for their accomplishment. Investment policy determines concrete programmes by whose realization development objectives are being accomplished. Basic principles, on which investment policy is based, are:

- harmonization with basic objectives of an enterprise,
- total consistency with development policy of an enterprise,
- exploration as basis for running investment policy,
- objectivity when making decisions on most favourable investment solutions,
- Harmonization with living standard increase policy [13].

Factors that determine investment policy defining are mostly those factors that have an influence on defining of development policy and realization of every enterprise's development. The most significant factors are: market, science and technology, financial and personnel capabilities of an enterprise, institutional conditions, organizational capabilities of an enterprise and other.

Ensuring favourable investment climate is a very complex part of development economic policy which implies: good legislative frame, efficient and uncorrupted administration of justice, minimal number of bureaucratic barriers for investments, good physical infrastructure, qualified and qualitative work force, etc.

Enterprises in Serbia do not have enough internal (own) funds for financing investments, so that problem is mostly solved by taking credits from commercial banks. From data in Table 1 we can see that participation of enterprises' credits is about 44% of total credits, which is insufficient when taking into consideration entire economic situation and needs for higher investments in economy. Due to enterprises' problems with credit repayments, commercial banks are directing large part of their financial means into other sectors (population has high participation of 34%).

Table no.1 Sectors' structure of credits on June 30, 2014
(In millions of dinars)

| Sector | Amount | Participation in % |
|---|---|---|
| Finances and insurance sector | 123.119 | 7,44 |
| Public sector | 37.337 | 2,26 |
| Public enterprises | 85.457 | 5,17 |
| Population | 561.112 | 33,90 |
| Enterprises | 729.973 | 44,11 |
| Foreigners and foreign banks | 32.324 | 1,95 |
| Other sectors | 85.586 | 5,17 |
| Total (credits) | 1.654.908 | 100 |

**Source**: National Bank of Serbia, 2014.

In Serbia, throughout the whole transition period, interest rates on enterprises' credits are on inexplicably high level, which is one of the key reasons for negative results of enterprises' functioning. Serbia is one of the worst ranked countries when considering interest rates' height, and the term structure, measured by the relation between long-term and short-term credits, is also unfavourable. It is characteristic that, according to the National Bank of Serbia data on June 30, 2014, no less than 70,6% of credits have arranged protection in foreign means of payment (primarily in Euros), and only 29,4% are in dinars.

This credit structure carries a danger of high financial costs, due to interest rates' height, as well as negative exchange rate differentials. Interest rates on domestic banking market did not react on reduction of interest rates in developed world, and react completely inelastic on reduction of the National Bank's referent interest rate. Due to high financing costs, investment and development plans are put aside, which will have negative consequences on long-term economic development.

According to data in Table 2 on June 30, 2014, approved loans for working assets have participation of 43,4% in the structure of total credits, while investment credits' participation is less (32,85%), which is an indicator of enterprises' postponing investment and development plans for better times, when uncertainty in functioning and costs of usage of external funds are lowered. According to the National Bank data, investment credits on June 30, 2014 are smaller, when compared to its level from end of 2012, for 9, 17%. Tax policy of the government has also contributed to these trends, primarily through cancellation of tax reliefs for investments into fixed assets, through law on corporate profit tax.

Also, government regulation reduced incentives which pulled some sectors into losses. Typical example is civil engineering (especially high-rise construction), which experienced a big downturn after subventions for interest rates for first-flat buyers were cancelled.

Table no.2 Structure of banks' claims from enterprises (by purposes), 2009-2014
(In millions of dinars, end of period)

| **Year** | **Credits** | | | |
|---|---|---|---|---|
| | Working assets | Investment | Other | Total |
| | 1 | 2 | 3 | 4 (1+2+3) |
| 2009 | 242.963 | 175.896 | 265.374 | 684.233 |
| 2010 | 347.256 | 254.988 | 277.960 | 880.204 |
| 2011 | 362.449 | 288.065 | 297.353 | 947.867 |
| 2012 | 465.396 | 333.699 | 250.940 | 1.050.035 |
| 2013 | 418.897 | 313.519 | 242.083 | 955.909 |
| 2014 | 400.715 | 303.111 | 218.943 | 922.769 |

**Source:** The National Bank of Serbia, 2014.

According to estimated data of Statistics Office of the Republic of Serbia, GDP in 2014 will have a drop of 2,0% in comparison to previous year, measured in constant prices. Industrial production downfall is expected to be around 6, 8%, and the value of work done in civil engineering records a drop of 4, 1%. Increase of physical volume was noticed in following sectors: agriculture (1, 5%), transportation and storage (24, 7%) and telecommunications (1, 6%). These economic movements have caused a fall of real incomes of 0, 3% in 2014, alongside with annual inflation of 1, 8%.

## 4. Management and assessment Of Investment Projects in the SME Sector

Time period between investment in present and effects that are expected in future is usually very long, and, in most cases, has the most important influence on efficiency of the entire investment process. Effects that are expected in future are uncertain, because future itself is uncertain. Investments in present times are just an assumption that the realized future effects will be bigger than investments. The longer the investment period, in other words, as we go further in future in expecting the effects-the uncertainty is higher.

Investment failures are, unfortunately, pretty common phenomenon in our economy. The biggest number of losses in our enterprises is a consequence of irrational and inefficient investments. Large number of inadequate capacities and, on that basis, big losses, as well as some other investment failures, are a constant warning that investments, often, do not bring development, but its contrast-weakening, losses and enterprises' liquidation. Because of that, the problems of rational investment, that is efficient planning and realization of adequate investment projects, are among key problems of every enterprise development.

The consequences of irrational and unsuccessful investments are huge and unpredictable. Their impact is not limited to concrete enterprise and those connected to it, but it spreads out a lot wider, often to an entire branch in which enterprise functions. Largest negative consequences of irrational investments are in unaccomplished development, and since they are not so clear and visible, people usually don't pay significant attention to them. Over time, these consequences lead to a slowdown of positive results, stagnation and losses, gradual falling behind in comparison to other competing enterprises, lagging in technological development and incapability to realize its own development in a necessary pace.

Enterprise strives to ensure its present and future survival, and continuity of present and future efficient functioning. This basic objective is further specified through two additional objectives: providing for viability of business system and ensuring consistent, desired development of business system.

Regardless of complexity of choices and, often, incapability to measure and compare investments, investment decisions are usually made on the basis of intuition and experience, and only sometimes, on the basis of exact calculations. Without neglecting the fact that, in the end, after all the calculations and measurements, choice and investment decision are made by a man, with taking into consideration immeasurable factors which are not included in calculations and which significantly influence the choice, there is a fact that exact approach is necessary, especially in complex situations in which numerous influential factors exist. Investment decisions in our enterprises are still being made on the basis of intuition and experience, and extensive studies, investment feasibility studies are made after the decision is made, in order to acquire financial means.

Certain parts of investment feasibility studies, which show expected effects and the assessment of an investment project, don't have a purpose to facilitate making of a decision, but to justify decisions that have already been made. It is certain that, among others, lack of scientific preparations of investment decisions is one of basic causes of failures and inefficient investing in our enterprises. The use of adequate methodologies for preparation and assessment of investment projects is the only right way for investment decisions' efficiency improvement and enhancement of overall efficiency of investment projects' realization.

In assessment of investment projects' profitability, static and dynamic methods (criteria) are being used. Static investment criteria are mainly used as additional or criteria for a quick evaluation of investment projects [14]. These methods are plain, from calculation's point of view, and easily understandable, because their essence is based on the effects of one representative year, alongside with neglecting of time as a factor of calculation. The main defect of these methods is that they neglect time factor.

Investments represent a specific process that cannot be assessed by the same methods as enterprise's functioning in the past, considering the fact that investments refer to future and longer time periods. Because of that, neglecting dynamics of financial means' investing and its volume by periods, as well as dynamics and structure of expected effects in future, or total investment period, de facto means unreal assessment of investment solutions [15].

Dynamic criteria take time value of money into consideration, while investment projects' costs and benefits are expressed by cash flows. These criteria begin with the fact that money has higher value at the moment of investing than in the moment of investment return; where it is not because of money's devaluation due to inflation, but because of economic logic which suggests that money invested into an investment project has to always bring a certain return. Basic dynamic criteria for investment projects' profitability assessment are net present value, profitability index and internal rate of return.

Having economic environment, in which enterprises in Serbia function, in mind, it is obvious that additional attention must be paid to the questions of choice, realization and assessment of investment projects. That refers, primarily, to the financial construction of projects because of interest rates' height, high follow-up costs of credit, currency clauses in contracts, mortgage security of credits and other. On the other hand, enterprises don't have enough internal means for financing investment projects, so they are forced to accept unfavourable conditions under which they get loaned funds.

Table no.3 Enterprises' funds sources in 2012 and 2013
(In thousands of dinars)

| **Source** | **Year of observation** | |
|---|---|---|
| | **2012** | **2013** |
| Capital | 5.508.422.464 | 5.663.848.869 |
| Long-term reserves | 101.425.068 | 116.366.089 |
| Long-term liabilities | 2.168.821.719 | 2.057.108.637 |
| Short-term liabilities | 5.130.338.807 | 5.441.128.009 |
| Deferred tax liabilities | 153.438.919 | 163.786.060 |
| Total | 13.062.446.977 | 13.442.237.664 |

**Source:** Serbian Business Registers Agency (2014), Announcement of the economy results in the Republic of Serbia in 2013.

From data in Table 3, we can see that participation of capital in total sources of enterprises is only 42, 13% in 2013, while short-term liabilities' participation is no less than 40, 47%, which is a confirmation of extremely low liquidity in Serbian economy throughout the whole transition period. Vicious circle of illiquidity and losses in functioning can be stopped by new investments, based on real economic parameters and investing in, primarily, real sector (industry, agriculture, civil engineering) where new-added value is created.

The sector of small enterprises makes numerous mistakes when creating financial plans. Enterprises don't understand basic parameters of revenues, especially which leverage points manage revenues, and revenues, themselves, are set on a too optimistic level. The time necessary to create revenues is also underestimated. In projections, many significant cost items are underestimated, and some costs are overlooked, which, inevitably, leads to liquidity problems. Needed cash funds are not acquired quickly, so the consequence is a negative cash flow, and for small enterprises, positive cash flow represents success, and all the rest will later [16]. Finally, we must say that the entire observation in this paper should be seen and multi disciplinary, because it will also observe a true picture of the economy of a country, in this case the Republic of Serbia [17]. In addition the company can operate with respect to internal control mechanisms, as well as taking into account the different methods of monitoring data in accounting [18], [19], [20], [21].

The sector of small and medium enterprises and entrepreneurs is particularly affected by mentioned problems, and this sector should be the bearer of economic development in future period. Because of that, authorities in Serbia have a task to improve economic environment which will stimulate these enterprises to enter investment projects and that would result in numerous positive effects on economy development as a whole. The sector of small and medium enterprises is characterized by high flexibility, fast accepting of innovations and new technological solutions, and therefore it could be an engine of economic development in future.

## 4. Conclusion

Ensuring favourable investment climate is a very complex part of development economic policy which implies good legislative frame, efficient and uncorrupted administration of justice, minimal number of bureaucratic barriers for investments, good physical infrastructure, qualified and qualitative work force, etc. Investment policy determines concrete programmes by whose realization development objectives are being accomplished. Basic principles, on which investment policy is based, are harmonization with basic objectives of an enterprise and an overall consistency with development policy. The consequences of investment failures have an adverse effect on, not only enterprise, but a wider region or branch in which that enterprise functions.

Enterprises in Serbia do not have enough internal (own) funds for financing investments, so that problem is mostly solved by taking credits from commercial banks. According to the National Bank of Serbia data, approved loans for working assets have participation of 43,4% in the structure of total credits, while investment credits' participation is less (32,85%), which is an indicator of enterprises' postponing investment and development plans for better times, when uncertainty in functioning and costs of usage of external funds are lowered; that is also shown by the fact that investment credits on June 30, 2014 are smaller, when compared to its level from end of 2012, for 9,17%.

Tax policy of the government has also contributed to these trends, primarily through cancellation of tax reliefs for investments into fixed assets, through law on corporate profit tax. Having economic environment, in which enterprises in Serbia function, in mind, it is obvious that additional attention must be paid to the questions of choice, realization and assessment of investment projects.

That refers, primarily, to the financial construction of projects because of interest rates' height, high follow-up costs of credit, currency clauses in contracts, mortgage security of credits and other. For the assessment of its investment projects small enterprises must use dynamic methods which take time value of money into consideration and which contribute to a better control of cash flows and liquidity of an enterprise.

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