NEAR EAST UNIVERSITY

MAN 400

GRADUATION PROJECT

# FINANCE OF THE SMEs IN THE EU AND THE CASE OF TRNC

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## 1. INTRODUCTION

Small and medium sized enterprises play an important role in the development of a country's economy. A healthy SME environment is assurance of good economic development. Researches show that many new enterprises close soon after they start operation. The main problem that face the SMEs is financial crises. The following study will look into the alternative financing possibilities for the SMEs, the financing of the SMEs in the EU, the support of the SMEs in EU, Turkey and TRNC, and the possible impact of the entry of the TRNC into EU.

It shouldn't be forgotten that the big enterprises were small enterprises at the beginning. Firms start small and get bigger. The ultimate aim of any commercial organization is to get bigger. Getting bigger needs finance. The process of growing is very challenging and the management needs to tackle many problems. However there is almost no organization that does not envisage growth and prosperity(OECD, 1997).

The SMEs are even more important in the TRNC since almost all the enterprises can be identified as SMEs. And the SMEs of the TRNC faces much more challenges than the SMEs in the other parts of the world. First of all the TRNC SMEs are working under high inflation, high interest rate and minimum support. Therefore the possible membership to the EU will mean operating in much different environment. Therefore it is interesting to learn the impact of the monetary union and use of Euro on the TRNC economy.

The importance of SME sector was also recognized in TRNC and a number of organizations were established in order to develop and suggest policies for the improvement of the sector. These institutions have been mainly operating in order to deal with the financial disadvantages of SME's because of their size and the current problems of banking sector after 2001 financial crisis. It will be shown that these problems repel small firms from taking bank credit, which is the most common source of finance. As small firms are seen an employment generating institutions, this dampens their plant improvement and consequently slows down the growth of the nation, in macro sense. The bids to prevent this problem are found to be insufficient since the government designates solely one government owned bank, Vakıf Bank, which makes credit taking extremely difficult because of formal procedures and high interest rates. If this monopolistic power were removed, the private banks would supply greater amount of credit to entrepreneurs together with lower rates.

## 1.1 Concept Of SMEs In EU

The term small business generally refers to an enterprise which, mostly operates with labour intensive production and lower level of capital. They have the advantage of easy decision-making and source shifting, so as low management costs. The firm owner is usually the manager of the firm. There is not any strict classification for small firm since it differs from country to country in accordance to the lack of homogeneity of size and economic structure between country economies. Another reason is that these firms are supported by different purposes in each country and the definition will determine who will benefit from SME support schemes. (Palas and Oguzkurt, 1997) Therefore, the definitions used by different institutions are inconsistent. Even in the same country, they may change from sector to sector.

| Number of Employees | Annual Turnover | Definition |
|---|---|---|
| Less than 10 | - | Micro enterprise |
| Less than 50 | Less than 7 million€ | Small enterprises |
| Less than 250 | Less than 40 million€ | Medium enterprise |

Since the definition for SME comes from the classification, we can observe the criteria used in two components;( Hamilton R.T. and Fox M.A. 1998)

i- Quantitative criteria:

These criteria are measurable and statistically meaningful magnitudes for the firms which are mainly comparing the number of workers, profits and fixed assets, machinery park, amount of investment per worker and physical technology level. Generally, the most common source of classification is the number of employers.

ii- Qualitative criteria:

These can be summarized as shares of effort and capital used in production, satisfying required conditions to provide credits, use of machine equipment and marketing power of the firm. Although these firms reflect the qualitative characteristics more evidently, in practice it is easier to classify them by quantitative criteria in order to make more explanatory definition.

iii- The European Union definition:

Since it is necessary to use a common definition to describe SME, it is examined by the number of people engaged, amount of turnover and balance sheet aggregation. In accordance with this, having at most 250 employers, turnover level below ECU 40 million or annual balance sheet not exceeding ECU 27 million are small and medium sized whereas the small enterprise is defined as having maximum 50 workers, and ECU 7 million turnover or balance sheet aggregation below ECU 5 million (Palas, 1997).

## 3. EU FINANCE SCHEME FOR THE SMES

### 3.1 Bank and SME Participation

EU commissioner for business conducted a roundtable meeting with bank representatives to discuss the finances of the SMEs in 1993. Representatives of the SME organizations were also present at this meeting and the sole purpose of the meeting was to find ways to increase bank-SME collaboration. The conclusion of the meeting was presented to the commission and also the participating organizations. As well advises to the EU Investment Bank and the Investment Fund the report also demanded further research into effective financing of the SMEs.( COM(94) 435 final of 28 October 1994)

Now SMEs typically rely on bank loans for the financing of their investment activities, as access to capital markets and venture capital is still very limited.

In view of the above-mentioned trends in the banking sector, the relatively higher risk and the difficulty in carrying out a proper credit risk assessment of smaller companies, access to finance is likely to become even more difficult for smaller companies in the future.

The recent strong development of venture capital in Europe will play a key role in enhancing access to finance by SMEs, particularly in certain economic sectors. It provides money to companies that otherwise could not develop at all their business (start-ups, high tech, etc.) and it has an even more important leverage effect on bank debt (no loan is bankable if not underpinned by adequate own funds).

However, bank debt will remain by far the main or only source of external financing for the large majority of SMEs in Europe. For one company that may attract equity investors, there might be one thousand that would not even think of seeking the support of venture capitalists (for a variety of reasons: weak profitability, family business, no wish to expand, fear of external interference, etc.)

The EIF manages various guarantee programmes on behalf of the European Commission (EC).

Such guarantees are provided to financial institutions free of charge within the framework of the following two EC programmes:

### 3.2 SME Guarantee Facility

The SME Guarantee Facility was implemented in 1998 as part of the European Union's Growth and Employment Initiative, a larger programme of financial assistance to SMEs. In December 2001, the EIF signed a new agreement with the European Commission in the framework of the Multi-Annual Programme for Enterprises 2001-2005 (MAP). Such agreement extends the coverage of the facility to other products and countries.

Currently, institutions from the Member States of the European Union, the Acceding and Accession Countries (includes Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia, Turkey) and the EFTA countries (Norway, Iceland, Liechtenstein) are eligible to participate in the SME Guarantee Facility (Isbank, 2003).

The SME Guarantee Facility consists of 4 special windows(Berger,2002):

- Loan Guarantees (former SME Guarantee Facility)
- Micro-credit Guarantees
- Equity Guarantees
- ICT Loan Guarantees

**Loan Guarantees**

The Loan Guarantee Facility is the continuation of the SME Guarantee Facility. Its objective is to reduce the particular difficulty SMEs face in having access to financing because of the relatively higher risk they represent and the insufficient security.

Accordingly, the Facility aims to encourage intermediaries to provide:

- higher volumes of guarantees for their existing guarantee products
- access to financing to a larger population of small companies for a wider variety of investments
- guarantees for riskier loans

**Micro-credit Guarantees**

The Micro-credit Guarantee supports enterprises with up to 10 employees. Its objective is to reduce the particular difficulty especially entrepreneurs starting their business face in having access to financing because of the relatively higher risk they represent and the insufficient security.

Accordingly, the Facility aims to encourage financial institutions:

- To become more involved in this area by offering loans of a smaller amount

- To provide access to financing to a larger population of small companies for a wider variety of investments
- To provide guarantees for riskier loans

**Equity Guarantees**

The Equity Guarantee supports own funds investments in small and medium sized companies with growth potential. Its objective is to reduce the particular difficulty such enterprises face because of their weak financial structure.

The EIF will not provide direct guarantees to venture capital funds.

Accordingly, the Facility aims to encourage intermediaries:

- To provide higher volumes of guarantees for their existing guarantee products
- To implement such product

## 4. FINANCIAL INSTRUMENTS OF THE EU

### 4.1 Investment financing

Economic and Financial Affairs DG provides analysis of the financial environment affecting investment in the Member States and accession countries, with the aim to define best practice and to formulate relevant policy proposals. The Community has two specialised financial institutions in this field, namely the European Investment Bank (EIB) and the European Investment Fund (EIF).The Commission is also a provider of investment finance out of the Community budget, channelled through the EIB and the EIF and through specialised programmes such as those targeted to SMEs and Trans-European Networks (TENs).

- Coordination and relations with the EIB
- Coordination and relations with the EIF
- Funding programmes for SMEs
- Funding for TENs

#### 4.1.1 Coordination and relations with the EIB

The EIB is an institution of the Union owned by its Member States. Its task is to contribute, through the financing of investments, to the integration, balanced development and economic and social cohesion of the Community. To this end, it raises on the markets substantial volumes of funds which it directs on the most favourable terms towards financing capital projects through long-term loans according with the objectives of the Union. Although the bulk of projects is located within the Union, the EIB has also significant operations outside the Union, implementing the financial components of agreements concluded under European association and development cooperation policies, mostly covered by a Community guarantee.Economic and Financial Affairs DG is responsible for the exercise of the rights and obligations of the Commission under the Treaty in respect of the EIB. The Director-general of Economic and Financial Affairs DG is member of the Board of Directors of the EIB, representing the Commission.

- The Statute of the EIB requires every loan proposal to be submitted for a Commission opinion before being presented to the Board. In this context, the Commission reviews the proposals' compliance with Community acquis and policy.
- Economic and Financial Affairs DG is responsible for the preparation of the legislation for Community guarantees to cover the lending risk of EIB's operations in third countries.

**4.1.2 Coordination and relations with the EIF**

The EIF is the specialized financial institution of the European Union for the support of the creation, growth and development of Small and Medium-sized Enterprises (SMEs). It intervenes through venture capital and guarantee instruments.The EIF does not finance directly SMEs, but always acts through financial intermediaries. The EIF may conduct its activities in the 15 Member States of the European Union and in the Accession Countries.The EIF is a tripartite structure between the European Investment Bank (EIB), the majority shareholder, the European Commission and several banks and financial institutions.Economic and Financial Affairs DG is responsible for the exercise of the rights and obligations of the Commission as a major shareholder of the EIF (30%). The Commission holds two seats at the Board of Directors of the EIF. The EIF funds its activities from the following resources:

- EIB funds. Mandated by the EIB, the EIF manages and implements the risk-capital facilities of the Bank (European Technology Facilities 1&2 and Risk Capital Mandate).
- Community financial instruments. Mandated by the Commission, the EIF manages and implements risk-capital (ETF Start-up) and guarantee instruments (SME Guarantee Facility; Growth and Environment Facility).
- Own funds. Guarantee operations are focused towards Credit Enhancement, Credit Insurance and Structured SME Finance. Equity operations are complementary to the other facilities.

### 4.1.3 Trans-european Networks (TENs)

- Economic and Financial Affairs DG works on developing financial structures to facilitate the implementation of trans-european networks.
- Grants.
- Loans. The EIB is a major source of loan finance for TENs projects.
- Equity - the TEN Risk-capital Facility. Appropriate provisions to the TENs Financial Regulation allow for a part of the TENs budgetary resources to be applied as risk-capital contributions. The EIB is managing the TENs Risk Capital Facility on behalf of the Commission.

### 4.1.4 Funding programmes for SMEs

The Economic and Financial Affairs DG is involved in the following funding programmes for SMEs:

- ETF Start-up Facility
- SME Finance Facility
- SME Guarantee Facility
- Growth and environment scheme

The Economic and Financial Affairs DG does not provide direct financial support to individual businesses or entrepreneurs. The programmes mentioned are usually implemented via networks of financial intermediaries or specialised funds, to which those interested should refer directly if they wish to apply.

The EIB offers financing in support of projects, depending on eligibility and project category:

1. Loans for SMEs through an Intermediary (Global Loans)
2. Direct Loans (also known as Individual Loans)
3. Structured Finance Facility (SFF)
4. Venture Capital

### 4.2. Global Loans

These are credit lines made available to banks or financial institutions, which onlend the proceeds for small or medium-scale investment projects meeting the Bank's criteria. To complement EIB financing, the intermediary also advances funds in support of the projects concerned.

Local authorities or firms with fewer than 500 employees and having fixed assets of up to EUR 75 million can benefit of global loans.

The types of projects are new capital investment projects worth up to EUR 25 million, undertaken by SMEs or, in the case of small infrastructure projects, by local authorities. The amount is a maximum of EUR 12.5 million and up to 50% of the investment costs.

### 4.3. Individual Loans

Promoters in both the public and private sectors, including banks can borrow these loans. The amount has to be agreed directly with the EIB if capital investment project exceeds EUR 25 million and up to 50% of the investment costs.

### 4.4. Structured Finance Facility

In order to match the types of funding to the requirements of projects with a high-risk profile and to pursue its equity financing and guarantee operations in favour of large-scale infrastructure schemes, the EIB has established a Structured Finance Facility (SFF). Total reserves of 750 million have been set aside under this heading over the next three years for the purpose of generating operations amounting to between 1.5 and 2.5 billion, providing a broad mix of financial products:

- senior loans and guarantees incorporating pre-completion and early operational risk;
- subordinated loans and guarantees ranking ahead of shareholder subordinated debt;
- mezzanine finance, including high-yield debt for industrial companies in transition from SME scale or in the course of restructuring;
- project-related derivatives.

The aim of the SFF is to provide value added for priority projects by complementing the commercial banks and capital markets. These operations will be undertaken primarily in the countries of the European Union, but also in non-member countries.

### 4.5. Venture Capital

Since 1997, the EIB has been deploying throughout the European Union a venture capital facility designed to strengthen the equity base of high-technology SMEs and those with strong growth potential.

Operations under this heading encompass financing for:

- venture capital funds
- security packages for such funds
- conditional and subordinated loans.

They are set up in close co-operation with the banking and financial communities in the Member States.

On 7 December 2000, the European Investment Bank (EIB) and the European Investment Fund (EIF) signed a Master Agreement strengthening the relations between the two institutions in general and streamlining the type of operations offered by each institution (EIB Group).

An important point of this agreement concerns the transfer of the management of all existing EIB risk capital investments to the EIF. The EIF will be the only point of contact for all venture capital and SME portfolio guarantee transactions within the EIB group.

### 4.6 DG Enterprise Grants

A grant is a direct financial contribution from the European Commission to support a specific action or project of a non-commercial nature, to cover eligible costs directly incurred by the beneficiaries. A grant can only be given to non-profit making beneficiaries (universities, firms, interest groups, NGOs).

Each year the Enterprise Directorate-General publishes a General publicity presenting the objectives of its annual work programme and the grant programme linked to it. It includes a list of planned actions and a list of ad-hoc grants (for actions that can only be carried out by specific beneficiaries).

In a second step, the planned actions are the object of specific calls for proposals. The submission of proposals is only possible upon their publication. All the necessary information to introduce an application is provided in the specific calls for proposals.

The European Community has the task to promote equality between women and men and shall aim in all its activities to eliminate gender inequalities (articles 2 and 3 of the EC Treaty). In this context, women are particularly encouraged to either submit proposals or to be involved in their submission.

### 4.7 The European Regional Development Fund

ERDF resources are mainly used to cofinance:

- productive investment leading to the creation or maintenance of jobs;
- infrastructure;

- local development initiatives and the business activities of small and medium-sized enterprises.

In practice, all development areas are covered: transport, communication technologies, energy, the environment, research and innovation, social infrastructure, training, urban redevelopment and the conversion of industrial sites, rural development, the fishing industry, tourism and culture.

Whether you are an ordinary citizen, the director of a company, a member of a local development association or a local official, perhaps you have a project which might benefit from ERDF support? If so, you may wish to consult the summaries of the regional programmes currently being implemented.

**4.8 New Support Framework**

The Innovation & SME Programme of the European Union The "Innovation and SME Programme" within the 5th Research & Technological Development (RTD) Framework Programme of the European Union stands at the cross-roads of the Community's policies on Research, Innovation and Small and Medium-sized Enterprises (SMEs). It promotes Innovation at European level and encourages SME participation in research projects. The programme supports European businesses from all industrial sectors (including furniture and related areas) to innovate, to develop, market and integrate new technology and to manage change more effectively. The programme also aims at contributing to a more innovation friendly environment in Europe, improved conditions for the creation and development of new companies, the diffusion of new technologies, the emergence of new economic activities and at fostering the "innovation culture" in Europe.

With its focus on Innovation and SMEs, the programme aims at improving industrial competitiveness, sustainable growth, social development and job creation. It intends to demonstrate new ways of orienting innovation and growth more effectively towards employment and helps SMEs to contribute to employment and to better play their essential role in the economic fabric of Europe.

To optimise the economic impact of Community RTD, the programme lubricates the effective use of Community RTD results. In areas such as Intellectual Property Rights and Innovation Finance the programme will provide help services to 5th Framework Programme participants and carry out pilot activities. Specific emphasis will be given to help with the setting-up and development of innovative firms.

The programme serves three main functions:
1. As a "service provider", the programme offers information services and assistance to SMEs, other firms and relevant players and supports the Thematic Programmes in their approach to Innovation and SMEs.
2. As a "clearing house", the programme collects innovation data and analyses trends, initiatives and policies at Community and Member States level. It offers platforms for trans-national experience exchange and contributes to Community policy initiatives.
3. As a "test bed", the programme launches pilot actions in the areas of Innovation and SME participation and aims at the continuous improvement of Community instruments.

Why specific measures for European SMEs in the field of research and innovation?

Europe is at the leading edge of scientific research in many areas. But it is much less good at converting scientific breakthroughs into commercially successful products and services. The EU has addressed this weakness through its support for high-quality multidisciplinary, transnational research projects. The Framework Programme is a five-year action plan setting out the strategic research priorities of the European Union. It offers a coherent basis for European support for science and technology as the main drivers of future industrial development and job creation. The current 5th Framework Programme (1998-2002) focuses on a limited number of specific social and economic problems where research can be expected to provide a solution. It supports transnational collaborative research projects which typically involve commercial technology suppliers both large and small, universities and research centres, and industrial or public sector end-users. It is also helping European enterprise to meet the challenges of globalisation and the new knowledge-based economy. The Framework Programme is segmented in different thematic and operative programmes, in which European furniture enterprises can participate actively in international consortia.

A variety of EU funding and support schemes are available for SMEs. Grants and loans are the main mechanisms used to provide the support. A grant is available for a specific project, whereas loans and venture capital can be used to finance any business-related activity. Unlike loans and venture capital, a grant does not have to be repaid, unless the company fails to adhere to the specific terms and conditions of the scheme. Grants can vary from 10% to 100% and from a few thousand Euros to hundreds of thousands of Euro, depending on the funding scheme. Loans are often at preferential rates and in some cases loan guarantees are provided by the European Commission.

In some cases 100% grants are supplied, but in many cases project co-financing is supported. This is where the European Commission meets a proportion of the project costs and the SME provides the remainder. For example, if an SME receives an EU grant of 50% towards a project, the SME must provide the other 50%- i.e. match the funding provided by the EC. Match funding may come from the public sector – public match funding, or the private sector- private match funding. Public match funds are sources of funding from the public sector (the Member State government) that can be used in addition to the funding received from the EU.

Whether private or public match funding there are two types which can be used- actual and in-kind. Other than depreciation charges, actual match funding within the meaning of the European Commission regulations is in the form of cash payments. In -kind contributions are made by voluntary and private sector bodies through unpaid contributions, e.g. in the form of land, long term equipment and the cost of staff time that goes into a particular project. This contribution can then be used by the project as match funding in-kind. Voluntary unpaid work by individuals can also be included as match funding in-kind.

**Research and Development**

The European Union's Framework Programme is the main mechanism for funding research and development in the EU. The Framework Programme runs in four-year cycles and the Sixth Framework Programme (FP6), which began in November 2002, will run until the end of 2006. There are a number of different methods through which SMEs will be able to access funding in FP6, across a wide range of research areas. SMEs will be encouraged to develop projects with partners from all over Europe to address specific research problems and to develop networks.

**Collective Research Projects:** These projects aim to expand the knowledge base of large groups of SMEs facing common challenges, ranging from legislative requirements to enhanced competition from companies. Research projects will be co-ordinated by industrial groupings or associations of SMEs such as trade associations.

**TACIS III:** The TACIS programme seeks to provide technical assistance to the following partner countries within the areas of government and industry: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyztan, Moldova, Mongolia, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. Support is directed at the transfer of expertise through organized formal training, co-operation or twinning between EU and partner organizations.

**4.Investments and Loans**

**Joint European Venture (JEV) Program:** This programme seeks to encourage the creation of new companies and employment through joint ventures between EU SMEs. The programme is available to SMEs, however, participants must be from two different Member States to be eligible.

**MEDA:** The aim of this programme is to further develop the Mediterranean region as a free trade area. Attempts to improve regional economies to ensure a more balanced Mediterranean economy as a whole are welcomed. The programme encompasses social services and support for the economic and financial sector. SMEs from all EU member states are eligible to take part in this programme.

**CREA:** This programme aims to improve SMEs access to seed capital in order to finance the creation of start-up companies, by supporting seed capital funds. It is the seed capital funds supported by CREA that SMEs can then apply to for start-up funding

**ETF Start-Up Scheme:** ETF Start-Up is a programme designed to support the establishment and financing of innovative SMEs in their start-up phase. The programme is managed by the European Investment Fund (EIF), on behalf of the European Commission. The scheme supports specific venture capital funds, which aim to invest in SMEs in the Biotechnology and Healthcare sectors.

**Education and Training**

**SOCRATES:** This programme was established to strengthen education across Europe by promoting the improvement in knowledge of EU languages. It also encourages innovation in teaching practices and materials. SMEs are eligible to participate in certain SOCRATES projects. These tend to be projects that promote innovation in education and the use of ICT in language training.

**Leonardo da Vinci (Second Phase):** This programme aims to enhance the aptitudes and skills of people, especially young people in initial vocational training. Funding is available for SMEs involved in vocational training to undertake projects, which develop, improve and support transnational vocational training.

### 4.9 The Multiannual Programme for Enterprise and Entrepreneurship, and in particular for Small and Medium-sized Enterprises 2001-2005

The Multiannual Programme for Enterprise and Entrepreneurship - Council Decision (2000/819/EC) of 20 December 2000 on a multiannual programme for enterprise and entrepreneurship, and in particular for small and medium-sized enterprises (SMEs) (2001-2005) - is a framework plan of activities which aim at

a. enhancing the growth and competitiveness of business in a knowledge-based internationalised economy;
b. promoting entrepreneurship;
c. simplifying and improving the administrative and regulatory framework for business so that research, innovation and business creation in particular can flourish;
d. improving the financial environment for business, especially SMEs;
e. giving business easier access to Community support services, programmes and networks and improving the coordination of these facilities.

These objectives are pursued via a series of activities that fall under one of three headings:

1. **The Euro Info Centres Network**: Euro Info Centres represent an interface between European institutions and local actors. Their task is to inform, advise and assist SMEs in all Europe-related areas while taking into account the great variety of enterprises concerned, so that, either directly or indirectly, they can make matters simpler and more efficient for SMEs.

2. **The Financial Instruments**: These are schemes, managed by the European Investment Fund, that are specifically targeted at improving the financial environment for businesses, especially SMEs, by bridging those gaps that financial markets would otherwise normally leave open:

- Start-up Scheme of the European Technology Facility (ETF). It promotes growth and employment throughout the European Union by investing in funds providing risk capital to smaller businesses.

- SME Guarantee Facility. It is designed to increase the availability of and facilitate access to debt finance for small companies with job creation potential in Europe.

- Seed Capital Action.It is a facility designed to stimulate the supply of capital for the creation of innovative new businesses with growth and job creation potential, through support (long-term recruitment of additional investment managers) for seed funds, incubators or similar organisation in which the EIF participates.

3. **Policy Development**: The Commission, in close coordination with Member States, analyses and studies how to ameliorate the overall environment that enterprises have to operate in. Within this field, particular attention is paid to the Best Procedure projects in which the Commission and national administrations actively collaborate to gain a better understanding of the various issues of concern to businesses, to identify best practices and to evaluate policy choices.

In managing the Programme, the Commission is assisted by the **Enterprise Programme Management Committee** (EPMC), which is composed of the representatives of the Member States. As EFTA/EEA and Candidate Countries participate in the activities of the programme, their representatives take part in the Committee's meetings as observers.

## 5.MEMBERSHIP OF CYPRUS TO EU AND POSSIBLE EFFECTS

The Turkish-Cypriots, as one of the two peoples of Cyprus, wish to be actively involved in the European Union (EU) process which is shaping the future of Europe. The Turkish-Cypriots fully share the European vocation and ideals as well as the objectives of the EU process.

As it had been announced by President Denktash in his 14-point Peace Initiative of January 20, 1995, the Turkish-Cypriot side is prepared to discuss the subject of EU membership of the future Federal Republic of Cyprus, within the framework foreseen in the UN "set of ideas", once an agreement is reached on a bi-communal, bi-zonal federal solution of the Cyprus question and the equal political status of the two peoples is respected.

As it stands now, the Turkish-Cypriot position is very much in keeping with the position of the United Nations Secretary General (UNSG) and the Security Council, since the Turkish-Cypriot side states that it is ready to implement the package of confidence-building measures (CBMs) and is willing to discuss matters relating to an overall settlement. The Greek-Cypriot side however, is putting forward the issue of EU membership as a precondition for future talks.

This is totally unacceptable to the Turkish-Cypriot side; nobody should expect the Turkish-Cypriot side to give support now (before the establishment of a federation) to an illegal and void unilateral application, made by the Greek-Cypriot side, which it has been vehemently opposing ever since the illegal application was made on July 3, 1990.

For the sake of this report I will assume that the political problems have vanished and the North Cyprus somehow found itself in the EU.

## 6. PRESENT ECONOMIC SITUATION IN THE TRNC

Liberal economic system has been adopted in the TRNC. Under this system the promotion of the private sector with limited government intervention. The rational use of natural resources, the encouragement of investments that generate high value added and employment preserve their priority and importance. The Gross National Product has been 651,380,055 million TL (1 039.9 US$ million) at current prices of 2000.In terms of their contribution to GNP the four most important sectors are public services, trade-tourism, transport-communication, and industry. The shares of these sectors in GDP have been 16.4%, 16.4%, 12.3% and 12.2% respectively in the year 2000. The share of agriculture was 7.9% for the some year.

GNP per capita has been 4,978 USS in 2000, which indicates that the TRNC is in the category of middle-income country group.

The TRNC has a well-trained work force. The educational system of high standards in the TRNC aims to develop the abilities of all individuals. There are 13 technical and. vocational high schools and 8 higher education institutions. Five of these higher education institutions offer instruction in English. The working population was 89,327 in 2000, which constituted 42.7% of the total population. According to the sectoral distribution. Of the working population, public services occupied the biggest share, which was 20.2% of the total employment in 2000. The share of the other sectors in total employment in 2000 were as follows; agriculture 17.1%, construction 15.8%, business and personal services 14.6%, trade-tourism 10.8%, industry 9.7%, transport- communication 9.1% and financial institutions 2.7%. 'There isn't acute unemployment in the TRNC. The official unemployment rate has been 1.6% for the year 2000.

The rate of inflation in the TRNC is measured by the Retail Price Index, which is based on the results of Household Consumption Expenditure Survey. The last survey was conducted in the years 1998-1999 and was introduced as from January 2001. Changes in the indices show that a high rate of inflation has been prevailing in the TRNC.

The changes in Retail Price Index for the years 1998, 1999 and 2000 have been 66.5%, 55.3% and 53.2% respectively.

The economy of the TRNC has the peculiarities of an island economy with limited resources so foreign trade emerges as the major sector of the economy. The TRNC has adopted a liberal trade policy and practices no discrimination against any foreign country. She has established trade relation with more than 60 countries all over the world. The volume of foreign trade has been 475.3.million US$ of which 89.4. % constituted the total imports in the year 2000. Export earnings met only 11.9% of the total imports and the trade deficit realized as 374.5 million US$ in 2000.

The export shares of the main groups in total exports are as follows: ready-made clothing 38.3%; citrus fruit 26.6%; processed agricultural products 24.2%. The import shares of the leading groups in total are as follows: machinery and transport equipment 29.6%; manufactured goods classified mainly by materials 21.4%; food and live animals 14.3%; mineral. Fuels, lubricants and related materials 10.5%; chemicals 8.2% (SPO 2002, pp. 4-6; DPÖ 2002, pp. 3-5).

## 7.PLACE OF THE SMEs IN THE TRNC ECONOMY

The TRNC, with its small land and the small population is atypical small state economy. As the other small island economies, the country lacks the necessary resources of production. Limited resources and lack of demand due to low demand limits diversification in production. The country meets the needs by mainly importing them rather than producing. Small local markets means limited amount of production, and hence uncompetitive export capacity (Önet, 2003; 5). Similarly the TRNC business serve to the local markets and lacks competitiveness due to lack of economy of scale. All these avoids growth of the businesses in TRNC are SMEs. Another factor limiting the growth of the local businesses is the political uncertainties. The enterprise under these conditions demand high protection, and there is indeed 50-60 % protection to the local industries. The high level of production leads to high prices in many commodities. High prices have negative effects on the tourism and service sectors. Being aware of the economic realities the tourism sector has been identified as the locomotive of the TRNC economy.

Importance of the SMEs in TRNC can be realized by looking at the economic indicators such as the number of the enterprises, employment, additional value creation. (Table 2 and Table3). The table

1 shows the number of enterprises and the employment distribution as per sector.

Table 1: Enterprises And Their Share In The Employment

| | No Enterprises | % | Employment | % |
|---|---|---|---|---|
| Manufacturing | 1099 | 15 | 6647 | 25 |
| Construction | 110 | 1,4 | 1126 | 4,2 |
| Trade | 3882 | 49,7 | 10468 | 39,4 |
| Otel - Resaurant | 1402 | 18 | 4476 | 16,8 |
| Transport | 248 | 3,2 | 1117 | 4,2 |
| Finance | 58 | 0,7 | 209 | 0,8 |
| Property | 313 | 4 | 839 | 3,2 |
| Education | 56 | 0,7 | 267 | 1 |
| Health | 265 | 3,4 | 423 | 1,6 |
| Others | 374 | 4,8 | 1000 | 3,8 |
| Total | 7807 | 100 | 26572 | 100 |

Source: State Planning Organisation

According to the table 1, 49.7 % of the enterprises are in the trade sector, 18 % are hotels and holiday places, and 18 % are in the manufacturing sector. The trade enterprises contribute to the 39,4 % of the employment, the manufacturing sector at 25 % and the hotels and restaurants at 16,8. There are an average of 3,3 employees working at each of the 7807 enterprises.

Table 2 Enterprises According To Their Sizes

| | 1 | 2 | 3-4 | 5-6 | 7-9 | 10-24 | 25-49 | 50-99 | 100+ | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Manufacturing | 408 | 216 | 232 | 70 | 46 | 81 | 24 | 17 | 5 | 1099 |
| Construction | 25 | 18 | 24 | 13 | 9 | 12 | 5 | 2 | 2 | 110 |
| Trade | 2131 | 1010 | 447 | 133 | 50 | 74 | 22 | 9 | 7 | 3882 |
| Hotel & Restaurant | 693 | 336 | 194 | 95 | 38 | 25 | 10 | 8 | 3 | 1402 |
| Transport | 90 | 66 | 39 | 17 | 11 | 17 | 6 | 2 | - | 248 |
| Finance | 20 | 16 | 11 | 5 | | 5 | 1 | - | - | 58 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Land | 116 | 108 | 58 | 13 | 8 | 8 | 2 | - | - | 313 |
| Education | 18 | 13 | 14 | 5 | 2 | 2 | 1 | 1 | - | 56 |
| Heath | 162 | 64 | 31 | 4 | 1 | - | - | - | - | 265 |
| Other | 221 | 74 | 48 | 12 | 4 | 10 | 4 | 1 | - | 374 |
| Total | 3884 | 1924 | 1098 | 367 | 169 | 233 | 75 | 40 | 17 | 7807 |

Source: State Planning Organisation

Table 3 : Employment With Respect To The Size

| | 1 | 2 | 3-4 | 5-6 | 7-9 | 10-24 | 25-49 | 50-99 | 100+ | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Manufacturing | 408 | 432 | 776 | 376 | 364 | 1193 | 803 | 1134 | 1161 | 6647 |
| Construction | 25 | 36 | 85 | 70 | 70 | 144 | 160 | 110 | 425 | 1126 |
| Trade | 2131 | 2020 | 1481 | 722 | 381 | 1073 | 762 | 530 | 1368 | 10468 |
| Hotel & Restaurant | 693 | 672 | 657 | 514 | 293 | 366 | 374 | 556 | 351 | 4476 |
| Transport | 90 | 132 | 133 | 93 | 80 | 215 | 229 | 145 | - | 1117 |
| Finance | 20 | 32 | 28 | 25 | - | 69 | 25 | - | - | 209 |
| Property | 116 | 216 | 198 | 69 | 59 | 125 | 56 | - | - | 839 |
| Education | 18 | 26 | 47 | 26 | 16 | 30 | 38 | 66 | - | 267 |
| Health | 162 | 134 | 99 | 20 | 8 | - | - | - | - | 423 |
| Other | 221 | 148 | 157 | 66 | 31 | 262 | 145 | 70 | - | 1000 |
| Total | 3884 | 3848 | 3672 | 1981 | 1302 | 3377 | 2592 | 2611 | 3305 | 26572 |

Source: State Planning Organisation

According table 4, out of 3,882 work places in the trading sect 97,1% employs between 1-9 employees, and only 2,9% employ over employees. Out of 1,402 hotel and restaurant business 96,7% employ less than 10 employees and only 3,3% employ more than ten employees. Out of 1099 manufacturing businesses 88,4% employ less than 10 employees and 11,6% employ more than 10 employees. Percentage of businesses that employ over 100 employees is only 0,217%. As for the employment per work place, it can be seen in the table 5 that out of 10,468 employees 64,3% work at work places with less than 10 employees, and 35,7% work at workplaces withy over 10 employees. Out of 6,647 employees working at the manufacturing businesses 35,4% work at the workplaces with less than 10 employees and 64,4% are working at workplaces with more than 10 employees. Out of 4,476 workers at the hotel and restaurant businesses 63,2% work at workplaces with less than 10 employees and 36,8% work at places with more than 10 employees. 12.4% of the total employment are at workplaces with more than 100 workers.

## 8. CONCLUSION

SMEs are the foundations of the economies both in the developed and developing countries. When evaluated on the bases of the number of employees employed at the organizations nearly all can be identified as SMEs. As well as economic and political embargoes problems arising from the structure and characteristics of the SMEs ( Finance, management, personnel, marketing, training, technology and infrastructure), and problems arising from the general economic shortcomings (High inflation, shortcoming of adequate financial incentives), the SMEs lack the necessary competition strength. The SMEs need to be supported by creating a positive investment climate and incentives to achieve strong SMEs with both e loyment power and strength to compete (productivity, high qualit production costs, and modern technology). Solution of the Cy m and membership to the EU will certainly get rid of th nd create a positive investment climate and the SMEs obtain adequate finance and incentives. This development will increase the ability of competition of the SMEs.

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