Role of the State in Financial Sector Development and Achieving Pro-Poor Growth: Evidence from Bosnia and Herzegovina

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Abstract: *This paper provides theoretical background and empirical research on state's role in financial sector development, focusing on state's role in achieving pro-poor economic growth through its activities in development of the financial sector. To this end, in the theoretical part of the paper, it is explained that pro-poor growth depends on the strong private sector, while at the same time private sector development is dependent on the degree of financial sector development. The empirical part of the paper discusses the role of the state in financial sector development and its contribution to economic growth and poverty reduction in Bosnia and Herzegovina (BH), arguing that this growth needs to be pro-poor oriented as BH is the poorest country in Europe. In order to assess the state's role in financial sector development and its implication to pro-poor growth in BH, surveys among small and medium enterprises (SMEs) and government representatives were conducted. The research shows significant disagreement between the two surveyed groups about the efforts currently being implemented by BH government in supporting the private sector through financial sector development. It is concluded that government needs to work more closely with the private sector as well as with the financial sector so as to better identify the private sector needs and then create policies and take actions necessary for the private sector to develop, which would consequently lead to poverty reduction.*

Keywords: *state, financial sector, pro-poor growth, Bosnia and Herzegovina (BH)*

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Introduction

The year 2015 was set as the target year by the United Nations (UN) to implement the Millennium Development Goals (MDGs), with halving absolute poverty set as the first most important goal. Unfortunately, evidence shows that in many developing countries, mostly in Sub-Saharan Africa and Oceania, this goal would not to be met (UN, 2015). In order to reduce poverty, governments need to take necessary actions to assure what in academic literature is referred as the pro-poor economic growth.

Broadly, pro-poor economic growth can be defined as one that enables the poor to actively participate in and significantly benefit from economic activity. Promoting pro-poor growth requires a strategy that is deliberately biased in favor of the poor so that the poor benefit proportionally more than the rich (Kawani 2000:3).

Pro-poor economic growth can be achieved through private sector development (e.g. promotion of entrepreneurship) as the generator of work places. Government role in private sector development is of crucial importance, since the government is responsible for policies and regulations promoting positive environment for private sector development. One of the aspects of promoting pro-poor growth through private sector development is by means of support and development of the national financial system (creating adequate financial market structure and stable financial institutions, as well as assuring adequate prudential supervision). Financial system development requires government support to provide stable and favorable environment for different types of financial institutions to develop, and furthermore, to provide incentives for financial institutions to create financial products/services tailored to the needs of private enterprises and of poor people to be able to self-employ.

The main goals of this paper are twofold. The first goal is to investigate the role of the state in financial sector development with the main focus to establish the link between government efforts to achieve sustainable pro-poor growth and its efforts to develop the financial system which will be in the function of pro-poor growth.

The second goal is to analyze the current state of government intervention in the financial sector oriented to poverty reduction in Bosnia and Herzegovina (BH). Also, the paper is to provide guidelines and recommendations for the improvement of government policies regulating financial sector and for greater involvement of the state in providing financial support to private sector development.

BH is a rather dysfunctional country with a relatively high poverty rate. According to UNICEF's poverty measure AROPE (*At-Risk-of-Poverty and Social Exclusion*), BH has the greatest risk of poverty and social exclusion among European countries. AROPA for BH is 58.6% (of population), and it fairly deviates from the EU-27 AROPE that totals to 24.2% as well as from the new member countries whose AROPE totals to 30.6%. This evidence shows that BH needs the shift in current economic policies.

The first part of the paper provides the theoretical background on the financial sector impact on poverty reduction. It focuses on establishing the link between state's role in financial sector development and state's role in contributing to poverty reduction by creating policies (among other policies) that ensure the development of the financial sector. In the second part of the paper a review on the existing literature and previous research on the subject is presented. In the third part of the paper empirical research results on the state's role in financial sector development in BH are presented.

Using discriminant analysis, it was found that a huge gap exists between government perceptions of their influence on financial sector development and perceptions of private sector participants on the government role in financial sector development.

Theoretical Background on State's Role in Poverty Reduction through Financial Sector Development

Economic growth, which is in the function of poverty reduction, requires macroeconomic stability, efficient investment in human and physical capital including infrastructure, regulation of enterprises and well-functioning financial sector (financial institutions as well as financial markets). Private sector, dominated by small and medium enterprises, is perceived as the most important key for assuring economic growth and job creation. In that respect, government efforts should be directed to enforce policies and create positive environment for promoting private sector development which, in the end, will deliver pro-poor economic growth.
Moreover, an important precondition for strong private sector development and its ability to deliver pro-poor growth is the existence of a sound financial system. According to the UK government's Department for International Development, the

financial system contributes to factors needed for private sector to deliver pro-poor growth by the following activities (DFID, 2004:4-5):

- Mobilizing savings for productive investment, and by facilitating capital inflows and remittances from abroad. The financial sector has a crucial role to play in stimulating investment in both physical and human capital, and hence increasing productivity;

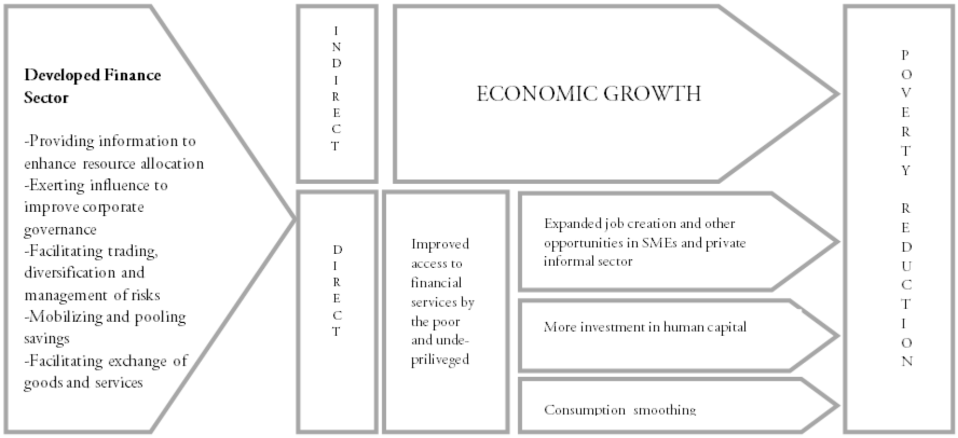
- Reducing transactions costs, facilitating inward investment, and making capital available for investment in better technologies. The financial sector can promote technological progress, thus increasing productivity, and improving resource use;

- Enabling the poor to draw down accumulated savings and / or borrow to invest in income-enhancing assets (including human assets e.g. through health and education) and start micro-enterprises, wider access to financial services generates employment, increases incomes and reduces poverty;

- Enabling the poor to save in a secure place, the provision of bank accounts (or other savings facilities) and insurance allows the poor to establish a buffer against shocks, thus reducing vulnerability and minimizing the need for other coping strategies such as asset sales that may damage long-term income prospects.

Developed financial sector contributes to poverty reduction in two different ways: directly and indirectly (see Figure 1).

Figure 1: Financial Sector Development and Poverty Reduction



Source: Zhuang J. et al., 2009:10

Directly, financial sector contributes to poverty reduction through improving the access to financial service for poor and underprivileged people. Government may enforce policies which promote and create opportunities for self-employment and SMEs development. Furthermore, government can invest in better education and human capital development. Through better allocation of fiscal revenues for social spending, government can contribute to consumption smoothening among different population groups. Indirectly, the financial sector contributes to poverty reduction through boosting economic growth.

In most developing countries, the major challenge of financial systems development is to provide access to formal financial sources (products and services) to the poor. Poor people are usually deprived of accessing commercial bank loans and financial services since poor people are observed as risky clients. For that reason, poor people mostly rely on the informal or semi-formal financial institutions which, in general, offer much more expensive financial products/services. Empirical evidence (Beck, Demirgüç-Kunt, and Martinez-Peria, 2007) confirms that the most important direct channel through which financial sector development impacts on poverty reduction is better access to financial services.

Furthermore, it is important to emphasize that state's role in financial system development is extremely important. Through regulation and supervision, the state creates secure and stable environment for financial institutions and markets to develop.

To assure poverty reduction, governments need to implement policies which would lead to the increase in economic growth rates. But, efficiency of economic growth in poverty reduction depends on the capacity of the poor to participate in the growth (WB, 2005). Poor people can participate in achieving the economic growth only if they are given an active role in job creation. This is confirmed by the World Bank study titled "*Pro-Poor Growth in the 1990s: Lessons and Insights from 14 Countries*", where it is emphasized that policymakers who seek to reduce poverty should implement policies that enable their countries to achieve a higher rate of growth. But growth is more effective in reducing poverty in some countries than in others, depending on the capacity of poor people to participate in and benefit from growth.[1]

As emphasized, development of the private sector as the new job creator is of key importance. The biggest responsibility for private sector development is on the government, because they need to create stimulative environment for development of the existing and the opening of new enterprises. There is persuasive evidence from all over the world confirming that rising levels of competition have been unambiguously associated with increased economic growth, productivity, investment and increased average living standards (OECD, 2006:41).

Therefore, based on the modern regulatory regimes for development of the private sector which include competition policy regimes, economic growth model based on the pro-poor principles is desirable in BH. The existing model of economic growth in BH is not pro-poor oriented, because the *Strategy for poverty reduction in BH* adopted in 2004 is not fully implemented.

Literature Review

Literature review shows that early researches aimed to understand the relation between financial system and social welfare, while more recent studies (last decade) are more oriented to find the link between financial sector development and poverty reduction/alleviation.

[1] We argue that the private sector, if properly supported by the government (especially in terms of development of entrepreneurship culture), is in the function of building the capacity of the poor people to participate in the country's economic growth.

Vast theoretical and empirical academic literature exists on the subject of financial sector impact on the social welfare. The majority of the papers in the 1990s debated mainly on the relation between financial system development and economic growth in general (Bencivenga & Smith, 1991; King & Levine, 1993; Levine, 1997) and on industrial growth in particular (Rajan & Zingales, 1998). Levine (2004) argues that countries with better functioning banking sector and financial markets grow faster.

Bencivenga and Smith (1991) found positive relation between financial intermediation development and increase in real growth rates. Furthermore, they conclude that regulation policies (such as reserve requirements and interest rate caps) might have an impact on economic growth and need to be considered by developing countries. King and Levin (1993) formulated and empirically proved the model showing that better (more developed) financial systems stimulate economic growth by accelerating productivity rates. It is shown that more developed systems make more efficient selection for financing entrepreneurial activities and, therefore stimulating faster economic growth. Fields (2001) argues that through better access to finance poor people have better opportunities to participate in economic activities. Most recent empirical studies shows the existence of a significant positive effect of financial system development on poverty reduction, where countries with more developed financial systems are more likely to have lower poverty rates. (e.g. Akhter et *al.* 2010; Ho S. and Odhiambo, N. M , 2011; Azra. D *et al.* 2012; Uddin, G. S. *et al.* 2012).

Honohan (2004) shows that correlation between financial development and sustainable economic growth needs to be drawn by more comprehensive statistics than merely banging sector depth. Furthermore, Quartey (2005) investigated the relation between savings mobilization and poverty reduction showing the existence of correlation between the two variables, but emphasizing the role of the government and its policy in stimulating domestic savings.

It was also observed that institutional quality and adequate regulation of financial institutions play a crucial role in positive relationship between financial system development and poverty reduction (Dhrifi, 2013a.)

Moreover, Dhrifi concludes that government must cooperate closer with the financial market and the banks acting as the regulator for formalizing models for the poorest access to formal and informal finance. Such actions of policy intervention should normally facilitate institutions providing financial services to the poor. In addition, it should foster cultures of households to invest in profitable projects. Political solutions must be tailored to the problems of the financial sector. (Dhrifi, 2013b:477).

Having in mind the importance of government involvement in financial sector development aiming to achieve pro-poor economic growth, further research focuses mainly on the government role in BH in reducing poverty through financial sector development.

Contribution of Financial Sector Development to Poverty Reduction in BH

Overview of the Institutional Framework in BH Supporting the Private Sector and SMEs

The general climate in the society should lead individuals to consider the option of starting their own business as attractive, and acknowledge that SMEs contribute substantially to employment growth and economic prosperity (EC 2008:3). In that respect, institutional infrastructure is necessary to support SMEs in proving growth and economic prosperity.

When it comes to creating stimulative environment for private sector development in general, government's role is of the utmost importance. Nevertheless, institutions forming infrastructure for private sector development are not just governments, but also non-government, private and non-profit organizations. There is no unique institutional infrastructure for private sector development and it differs from country to country. Support provided by government institutions is usually related to providing consulting and professional services, presenting good practices, etc. The majority of countries have developed different types of institutions such as government agencies, ministries, associations, chambers, and financial institutions. These institutions operate on different levels, from local, regional, state to international level.

In context of creating adequate institutional infrastructure for supporting the private sector, especially for supporting SMEs, the European Union (EU) has made significant improvements. By adopting "Small Business Act" for Europe, the European Commission has laid a set of principles for implementation of policies both at the EU and Member State level in order to improve the legal and administrative environment throughout the EU for SMEs. These principles are the following (EC, 2008:4):

- Create an environment in which entrepreneurs and family businesses can thrive and entrepreneurship is rewarded,
- Ensure that honest entrepreneurs who have faced bankruptcy quickly get a second chance,
- Design rules according to the "Think Small First" principle,
- Make public administrations responsive to SMEs' needs,
- Adapt public policy tools to SMEs' needs: facilitate SMEs participation in public procurement and better use State Aid possibilities for SMEs,
- Facilitate SMEs access to finance and develop the legal and business environment supportive to timely payments in commercial transactions,
- Help SMEs to benefit more from the opportunities offered by the Single Market,
- Promote the upgrading of skills in SMEs and all forms of innovation,
- Enable SMEs to turn environmental challenges into opportunities, and
- Encourage and support SMEs to benefit from the growth of markets.

By turning these principles into practice, many different institutions supporting SMEs have been established across the EU with coordinating efforts to provide better institutional framework for SMEs. By adopting *EU Acquis Communautaire*, BH has accepted these principles to create adequate institutional setting for SMEs development.

Currently, there are several institutions that provide institutional support for SMEs in BH. This infrastructure is rather complicated due to the elaborate olitical and legal system in the country. BH operates on the state level with two entities: Federation of BH (FBH) and Republic of Srpska (RS), and Brcko District. FBH is further divided into ten cantons, each operating as a state within the state. The overview of BH government institutions and governmental financial institutions supporting SMEs is given in Table 1.

On the state level, development of SMEs is coordinated by the *Ministry of foreign trade and economic relations*. Within this Ministry the *Sector for Economic Development and Entrepreneurship* is responsible for SMEs development and is in charge of the following basic activities: normative-legal, study-analytical, technical-operational, information-documentary, and administratively-technical. These activities include different areas such as: macroeconomic analysis and economic growth forecast of BH; collaboration with international institutions and organizations; collaboration with domestic and foreign scientific and research institutions; preparation of treaties, agreements, and other acts for projects and programs of economic restoration and development; projects and programs of bilateral and multilateral donations and credits for economic restoration and development; coordination of international economic assistance to BH except the part regarding the European Union assistance; preparation of bilateral and multilateral agreements and other acts regarding economic restoration and development of BH; development of entrepreneurship, support to the development of SMEs; SMEs promotion.[2] Nevertheless, the fund for financial support for SMEs on the state level does not exist. Financial government support for SMEs is under the jurisdiction of the entities.

On the level of FBH, SMEs are supported by the *Ministry of Development, Entrepreneurship and Crafts and Development* and the *Development Bank of FBH*. Furthermore, each of the ten cantons has cantonal ministry which deals with SMEs. In RS, SMEs development is supported by the three following institutions: the *Ministry of Industry, Energy and Mining of RS,* the *Agency for SMEs* and the *Development Bank of RS*.

Table 1: The overview of BH government institutions supporting the private sector and SMEs

Level of government	Government institution	Government financial institution
State level	*Ministry of foreign trade and economic relations of BH*	*Does not exists*
Entity level Federation of BH	*Ministry of development, entrepreneurship and crafts*	*Development Bank of FBH*
Entity level Republic of Srpska	*Ministry of industry, energy and mining of RS* *Agency for SMEs*	*Development bank of RS*
Cantonal level	*Designated ministry for SMEs*	*Development bank of RS.*
Brcko District	*Government of Brcko District –*	*Development Grant Fund of Brcko District*

[2] www.mveteo.gov.ba

Besides the government institutions, there is a wide network of non-government institutions providing support to SMEs development in BH, such as REDAH - *Regional Development Agency for Herzegovina*, REZ – *Regional Development Agency for Central BH region*, NERDA - *Regional Development Agency for North-East BH*, SERDA – *Sarajevo Regional Development Agency*, etc.

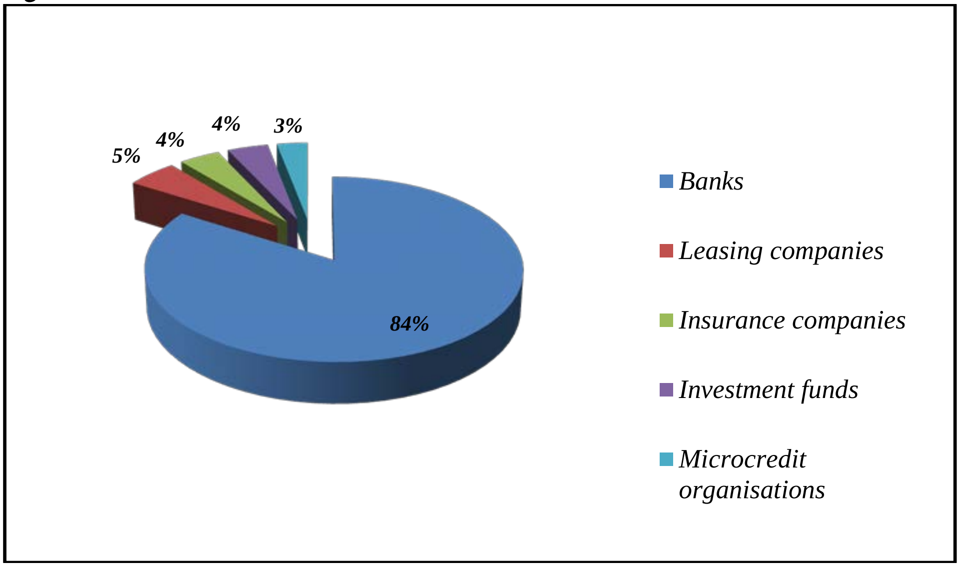
This existing legal infrastructure in BH, with different laws adopted on different government levels (state, entities, and cantons) and problems in the implementation of the Strategy for SMEs development, is rather complicated and does not provide proper conditions for enterprises to operate. Laws adopted on different government levels are not harmonized. Furthermore, there is no single state register of SMEs. Other infrastructural problems are related to complicated public administration, high costs of maintaining public administration, redundancy in functions of different institutions on all government levels with unclear responsibilities, etc. The number of registered enterprises in BH is reduced year by year, and conditions for the operation of the existing enterprises are worsened.

Overall, it can be concluded that the current infrastructure supporting SMEs in BH is not in favor of achieving sustainable growth in the country. The Strategy of SMEs development is not being implemented properly and Strategy for poverty reduction is nothing more than cold facts on paper, as government is doing nothing to enforce and achieve strategy objectives. These strategies are not producing pro-poor growth.

Overview of the BH Financial Sector

The BH financial system is bank centric, where the dominant role is played by the commercial banks. The non-bank financial sector is relatively underdeveloped with the following financial institutions operating within the sector: microcredit organizations, leasing companies, investment funds and insurance companies. As Figure 2 shows, commercial banks account for 84% of the total financial asset within the BH financial system, while the remaining financial institutions account for 5% or less of the total assets.

Figure 2: Structure of financial institutions of the BH financial sector in 2013



Source: CBBH (2014)

Stability and security of the overall banking sector is adequate, according to the data provided by the Banking Agencies of Federation of BH and of Republic of Srpska. In 2012, capital adequacy rate of the banking sector, as the most important measure of banking sector performances, was 16.4%, which is substantially above the regulatory minimum of 12%. Regardless of the financial crisis, the financial system of BH remains strong in terms of its ability to provide financial support to non-financial sector (companies and households).

On the other hand, statistical data shows that credit activity of banks was decreased during 2012, where 51.6 % of total credits (approx. BAM 16 billion) was granted to non-financial companies (public and private), 42.6% to households and 5.2% to the government. In the same period, microcredit financial institutions in Federation BH granted only 2% of the total credits (BAM 400 million) to companies and 98% to households.

According to the Annual Report for 2012 of the Central Bank of BH, there were 28 licensed banks in BH, with 18 of them operating in FBH and 10 in RS. There were 19 microcredit financial institutions (13 in FBH and 6 in RS), with 15 of them organized as microcredit foundation and 4 as microcredit organizations.[3] Leasing companies are less developed financial institutions with only 9 being licensed for providing leasing contracts (7 in FBH and 2 in RS).

Furthermore, capital markets in BH are not used to their full potential. Organized capital markets exist within two securities exchanges (Sarajevo Stock Exchange and Banja Luka Stock Exchange), but the annual turnover at these exchanges is rather symbolic. The structure of the securities exchanges turnover shows the lack of foreign investors and dominance of government debt securities. Private companies do not use securities exchanges to raise capital funds through stock or bonds issuing or initial public offerings.

Research Methodology and Sample

For the purposes of assessing government involvement and policies impact on strengthening the financial sector oriented to poverty reduction and pro-poor growth, we conducted the research among SMEs and government bodies. The aim of the research was to better understand the perceptions of SMEs as the most important creators of work places, as well as of the perceptions of government agencies representatives about the level of government involvement in financial sector development.

In order to collect the research data two types of questionnaires were created, one for SMEs and other for government representatives. The questionnaires were structured to collect data about government policies and actions impact on private sector development and poverty reduction focusing on the financial sector impact.[4] The questionnaires were created consulting the OECD document - *Promoting Pro-Poor*

[3] One of the main differences between microcredit foundations and microcredit institutions is related to the maximum amount of granted credit. Microcredit foundations can grant a credit in the maximum amount of BAM 10,000 (approx. EUR 5000), while microcredit organizations can grant a credit in the maximum amount of BAM 50,000 (approx. EUR 25,000 EUR).

[4] The research results, presented in this paper, are part of the broader research on government role in poverty reduction in BH which, besides its role in strengthening the financial sector, covered government role in strengthening entrepreneurial environment and the overall support to the private sector by eliminating different barriers, such as regulatory, administrative and financial.

Growth: Private Sector Development and the European Commission document - *The European Platform against Poverty and Social Exclusion: A European framework for social and territorial cohesion*. The questionnaire for SMEs included thirteen questions, while the one for government bodies included eighteen questions.

The sample of the surveyed SMEs was created based on the partial data on the number and types of SMEs from the Indirect Taxation Office of BH and the Agency for Statistics of BH, since the state level database of SMEs operating in BH does not exist. Having in mind that the sample would be rather large to collect the data, it was decided to include 250 SMEs in the sample. The size and structure of the sample is shown in Table 2. The response rate among SMEs was 50%.

Table 2: Size and structure of the sample of the surveyed SMEs

Group	Number of employees	Type of SME	Stratums		Sample	
			Number of enterprises	%	Number of enterprises	Number of enterprises in the sample
1	0 – 10	Micro Enterprises	31,102	78.58	196.45	197
2	10 – 50	Small Enterprises	6,539	16.52	41.3	41
3	50 – 250	Mid-sized Enterprises	1,938	4.90	12.25	12
∑			39,579	100.00	250.00	250

Source: Authors' research

The survey of government institutions included the following institutions and agencies: Federal Ministry of Development, Entrepreneurship and Crafts, FBH Development Planning Institute, Agency for Development of Small and Midsized Enterprises of Republic of Srpska, Government of Brcko District – Development Grant Fund of Brcko District, Federal Ministry of Energy, Mining and Industry, Ministry of Foreign Trade and Economic Relation of BH, and ten cantonal ministries of entrepreneurship. The response rate among government institutions was 81%.

The data was collected in the period from May to November 2014, by e-mail, phone and direct contact.

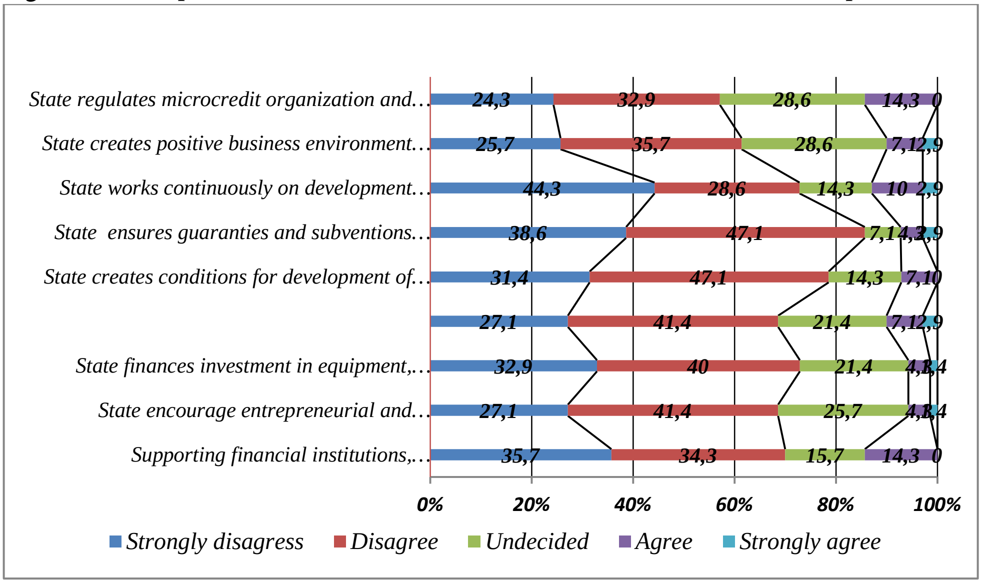
Research Results and Discussion

As it was indicated in the previous part of the paper, economic pro-poor growth implies orientation to poverty reduction through different government measures, including financial sector development. Financial sector development contributes to pro-poor growth by creating a network of different types of financial institutions as well as a variety of financial products/services for the private sector and supporting entrepreneurial development, which contributes to poverty reduction by increasing employment and self-employment.

SMEs Perceptions of State's Role in Financial Sector Development in BH

In general, the survey shows negative SMEs perceptions of the state's role in financial sector development and its contribution to entrepreneurial development and, therefore, to poverty reduction. Figure 3 shows the results of the level of the surveyed SMEs agreement with different aspects of government (state) support to financial sector development.

Figure 3*:* Perceptions of SMEs on the state's role in financial sector development



Source: Authors' research

As Figure 3 shows, 23% to 44% of the surveyed SMEs strongly disagree, while 28% to 41% of the surveyed SMEs disagree that the state supports financial sector development oriented towards helping SMEs and entrepreneurial firms.

The majority of the surveyed SMEs disagree that state:

- ensures guaranties and subventions for debt financing of the companies (85.7% of the surveyed SMEs),
- creates conditions for development of different types of financial products/services for micro/small/mid-sized companies (78.5% of the surveyed SMEs), and
- works continuously on development and strengthening of the financial sector (72.9% of the surveyed SMEs).

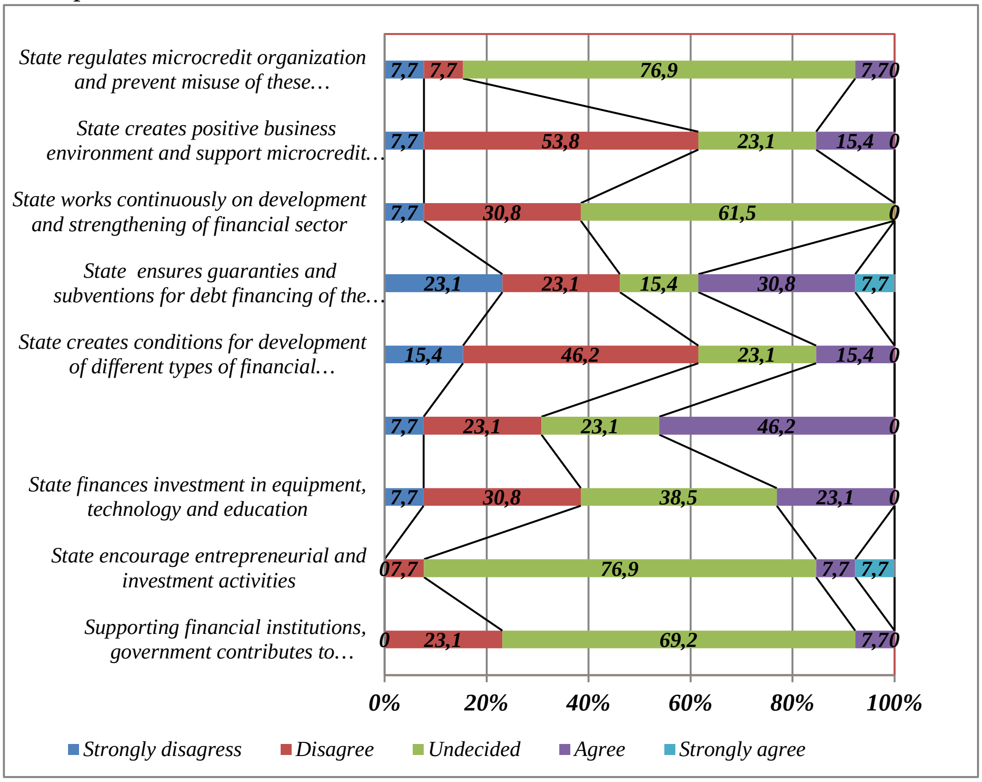
Furthermore, the research results show that most of the surveyed SMEs have either a negative or neutral attitude towards the state regulations on microcredit organizations and prevention of misuse of these organizations, state's role in creating positive business environment and support to microcredit organizations, and state's support to financial institutions.

It is interesting to observe that less than 15% of the surveyed SMEs expressed a positive attitude towards the state's role in financial sector development and its impact on entrepreneurial development.

Government Bodies Perceptions of its Role in Financial Sector Development in BH

In contrast to SMEs negative perception, the survey shows a more positive attitude among government bodies of the state's role in financial sector development. The results of the survey are shown in Figure 4.

Figure 4: Perceptions of government bodies on the state's role in financial sector development



Source: Authors' research

The majority of the surveyed government bodies are undecided (neutral) towards the statements related to state policies and to the entrepreneurial development through strengthening the financial sector. Government bodies agree that the state does not create conditions for development of a wide range of financial products/services for micro/small/medium enterprises and, moreover that it does not create positive environment and financial support for microcredit organizations.

In contrast to the perceptions of the surveyed SMEs, government bodies express a positive attitude towards the state's role in creating the conditions for debt financing for start-ups and enterprise development, as well as towards the state's role in ensuring grants and subventions for debt financing of SMEs.

Using discriminant analysis existence of the significant difference among attitudes between the private and government sectors on the state's role in strengthening the financial sector was tested. In that respect, one discrimination function was determined, where the function describes 100% of the variation of the between groups variation, which is shown in Table 3.

Table 3: *Discrimination analysis for the state's role in strengthening financial sector*

F	eigenvaules λ	% of Variance	Cumulative %	Canonical Correlation r_c	Wilks' Lambda λ	Chi-squared χ^2	df	Sig.
1	0.278	100	100	0.467	0.782	18.788	9	0.027

Source: Authors' research

Squared canonical correlation (r_c), the effect size for the discriminant functions, is (0.467^2)=0.278. Wilks Lambda is rather high (Wilks λ=0.782) showing low discrimination strength of discriminant functions. Chi-squared test (χ^2) for function 1 is statistically significant (χ^2=18.788, sig.=0.027), showing that discrimination model is significant, and therefore can adequately measure group membership, but determined differences between groups are rather small.

Table 4 shows discriminant function coefficients and group centroids for the state's role in strengthening financial sector.

Table 4: *Discriminant function coefficients and group centroid for the state's role in strengthening financial sector*

	Discriminant Coefficient (DC)	Group	Centroid
State encourages entrepreneurial and investment activities	0.823	Private sector	-0.225
State ensures guaranties and subventions for debt financing of companies	0.629		
State creates conditions for debt financing of start-up/development of firms	0.624	Government	1.209
State finances investment in equipment, technology and education	0.569		

Supporting financial institutions, government contributes to entrepreneurial development	0.536		

* Difference does not exist
Source: Authors' research

Table 4 shows differences between the observed groups for chosen variables in the hierarchical order. The mayor difference in perceptions among the private and government sectors is observed in respect to the following: state's role in encouraging entrepreneurial and investment activities (DC=0.823), and state's role in ensuring guaranties and subventions for debt financing of companies (DC=0.629). On the other hand, there is no significant difference between perception among the private and government sectors on the state's role in creating positive business environment and support to microcredit organizations.

It can be observed that even though some differences in perceptions among the private and government sectors, on the multivariation level, do exists, where the private sector gives a lower grade than the government bodies for the state's involvement and contributions to financial sector development, those differences are rather insignificant.

Conclusions and Recommendations

In order to reduce poverty, governments in developing countries need to take necessary actions to assure pro-poor economic growth. Pro-poor economic growth can be achieved by greater role of the state in developing private sector and creating environment for entrepreneurship. In that respect government needs to establish economic environment which would boost private sector to create more work places for the poor. Furthermore, the state needs to engage in development of the financial sector, as financial sector development is one of the preconditions for private sector to develop. Without proper financial sector infrastructure for private sector and entrepreneurs to obtain external financial sources (more precisely, without availability of different types of external financial sources tailored to their needs), it cannot be expected that a pro-poor growth can be achieved through private sector development.

As the research shows, based on the BH experience, it is not enough to create the regulation framework of the financial system and regulation for SMEs, but it is important that regulations and government actions are in line with the expectation of the private sector.

The research shows that private sector is not satisfied with actions undertaken by the state for supporting financial sector. The analysis of SMEs perceptions reveals that SMEs have negative perceptions towards the state's role in financial sector development. The surveyed SMEs are of the opinion that the state interventions in financial sector are not contributing to entrepreneurial development in BH, regardless of the fact that BH financial sector is well developed and well regulated.

On the other hand, the analysis of perceptions of government bodies at all levels (municipal, cantonal, entity and the state level) reveals that the state is not aware of the needs of private sector, as well as of entrepreneurial sector. It is obvious that a huge lack of understanding between the state and private sector exists. In that respect, it is important that government work more closely with private sector as well as with financial sector to identify the needs of private sector and create policies and take actions necessary for private sector to develop.

In particular, when it comes to financial sector development, government bodies need to:

- rethink and better distribute guaranties and subventions for debt financing of companies,
- create conditions for development of different types of financial products/services specially tailored for the needs of SMEs,
- work continuously on development and strengthening of financial sector, hold workshops or focus groups where all interested parties (the state, financial institutions and SMEs) would be able to discuss the problems in access to financial products and services.

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