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Impact of FDI on Development of S&M Enterpreneurship in Croatia

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Abstract: FDI (foreign direct investment) is an important factor for promoting economic activity, access to the new technologies, a source of new investment in existing or in creating new production capacities. This paper attempts to determine the magnitude of FDI directed towards SMI (small and medium enterpreneurship) in Croatia and verify if the same represented a significant stimulant for the development and establishment of new enterprises.

JEL Classification: F21

Key words: foreign direct investment, small economy, Croatian economy, EU

Introduction

Economies face many problems in the process of transition, especially non-competitiveness of products, which, due to trade liberalisation (abolition of customs and other non-customs restrictions), bring foreign competition to the domestic market. Consequently, unable to respond to challenges of foreign prices, the domestic production diminishes. It further has its implications on the unemployment, growth, social dimensions, etc. Non-competitiveness of economy is the result of placing products on less demanding markets, and the lack of investment in technological modernisation during a long period.

With the lack of own finances for refreshing the production, creation of a new product, investment in the image and products attributes, the countries see the solution in foreign direct investment. The introduction of foreign direct investment (FDI) is the consequence of liberalisation of capital and financial flows, imposed by World Trade Organisation.

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After receiving the foreign direct investment, a country-receiver often does not sufficiently take care of the direction of flow of investment. This did happen in Croatia. It attracted a sufficient amount of foreign direct investment, but the majority of the capital was invested into acquisition of shareholders packages in attractive enterprises through privatisation (brown-field investment). Investment into new production and launching of new products, which could have become the bearers of competitive advantages of Croatian economy, were left out (green-field investment).

In market economies, small companies constitute the base for economic growth and development, as well as an engine of employment and new production initiatives. Croatian economy faces the problem of development and stimulation of small and medium size enterpreneurship that should execute the above mentioned role, and bring the country closer to the European Union standards.

The aim of this paper is to relate and analyse the FDI and SME, and to show as to what extent foreign direct investment contributed to the development of small economy in Croatia, and which measures should have been taken to increase investment in this sector.

The Characteristics and Trends of Global FDI Flows

International relations among countries are reflected in trade and also in the financial flows making FDI an important feature of financial globalisation. FDI influences the balance of payments in the first place, especially in developing countries, where it is often used as an instrument used to neutralise big trade deficits or to improve the overall balance of payments position.

The flow of FDI, like other financial investment, is the consequence of liberalisation of capital account. This process has followed only after long-term trade liberalisation process of the last 45 years (from the signing GATT). A prerequisite for eliminating barriers to free capital flows was definitely was the reduction and elimination of custom and non-custom barriers for goods and services. Then only this process had a positive and significant result manifested in the Uruguay round that opened the door for liberalising international capital flows.

FDI is defined as a category of international investment that reflects the objective of a resident in one economy (the direct investor) obtaining a lasting interest in an enterprise resident in another economy (the direct investment enterprise) (IMF, 1993). The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise, and a significant degree of influence by the investor on the management of the enterprise.

A direct investment relationship is established when the direct investor has acquired 10 percent or more of the ordinary shares or voting power of an enterprise abroad. This 10% does not imply control of the enterprise, but the statistics say that a large proportion (over 90% in inflows) of FDI flows are in big shares than 10% in ownership and that involves majority-owned subsidiaries and branches.

FDI has three components: equity capital reinvested earnings and intra-company loans. Equity capital is the foreign investor's purchase of shares of an enterprise in a country other than its own. Reinvested earnings comprise the direct investor's share of earnings not distributed as dividends by affiliates, or earnings not remitted to the direct investor. Intra-company loans or intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises (UNCTAD, 2003).

The interest of foreign investors is the existence of long-term relations with the direct investment enterprise and a significant degree of influence on the management of the enterprise. It is usually that FDI comprises not only the initial transaction establishing FDI relationship between the investors and enterprise but also subsequent capital transaction between them and among affiliated enterprises resident in different economies. Increases in FDI can take the form of injections of additional equity capital, the reinvestment of earnings not distributed as dividends by subsidiaries and affiliated enterprises and earnings of branches not distributed (Patterson, 2004).

Table 1.: Allocation of Global FDI Inflows in the Period 1970-2002 (in billions of US dollars)

	1970	1980	1990	2000	2003
Total	13.0	55.0	208.6	1489.8	559.6
Developed countries	9.5	46.5	171.1	1241.5	366.6
Developing countries	3.6	8.4	36.9	248.3	172.0
CEEC % of GDP	0.0	0.0	6.4	27.6	21.0
World	-	6.6	9.3	19.3	22.9
Developed countries	-	4.9	8.2	16.6	20.7
Developing countries	-	12.4	14.7	29.3	31.4
CEEC	-	-	1.3	19.2	23.7

Source: UNCTAD, 2003, FDI Inflows by Host Region and Economy, 1970-2003, Available from: [http://www.unctad.org/sections/dite_dir/docs/wir_inflows_en.xls]

Table 1 shows the inflows of FDI on the global level from 1970 until 2002. The total inflows of FDI increased during this period, but significantly rises in period from 1990 until 2000. After that the total FDI flows decreased and recovery is projected for 2004. The inflows of FDI risen from 13 billions US$ in 1970 to 1.5 trillions US$ in 2000, and after that it slowdown to 560 billion US$ in 2003.

From the period 1990-97 FDI grew by an average of 13% a year as a results of integration of international capital markets. The biggest increase of FDI inflows was in period 1998-2000 when the average rate of FDI growth was 50% a year. Large cross-border mergers and acquisitions drove it. In 2000, FDI reached a record 1.5$ trillion. Later, the FDI inflows declined as a results of the interplay of factors operating at the macro, micro and institutional level. Most of the decline came from a sharp drop in cross-border merger and acquisition among the industrial countries, a pause in privatisation and a loss of confidence in the wake or corporate scandals and the demise of some large corporations. Macroeconomic factors such as slower economic growth (recession in some countries), decline in stock market activity of the previous few years, financial crises in many countries around the world did have an impact on the FDI flows. Note that inflows of FDI to the developing countries grew by an average of 23 percent a year during 1990-2000. It is estimated that the Triad (EU, Japan and the US) holds around 80% for the world's outward stock and 50 to 60% for the world's inward stocks.

Interests of direct investment enterprise involves the establishment of manufacturing facilities, bank premises, warehouses, and other permanent or long-term organisations abroad, but it may also involve the operation of mobile equipment and expenditure on exploration for natural resources, the creation of a new establishment abroad, joint ventures, or the acquisition of an existing enterprise abroad.

FDI is also locationally determined. Basically, the FDI flows towards countries that have lower wages and abundant natural resources. However, there is an important agglomeration effect as well. In this case, the economies of scale become the driving force of FDI. Except these, an important determinant is the extent of administrative barriers and the institutional framework.

The question is as to what are the benefits of FDI inflows? Almost in all cases, for the host country FDI inflows represent the possibilities of obtaining so badly needed capital for improvement of existing production capacities or for the start of new production lines. But this is not a path danger free. However, the risks from FDI inflows depend upon the kinds of inflows.

FDI in Croatia

What can a transition country expect from the entry of foreign investors in its territory? Each foreign investment brings certain advantages to the country. But it also involves some dangers. While on one hand, at least in theory, most frequently emphasised, gains from the FDI are initiation of new productions, opening of new jobs (unemployment reduction), transfer of knowledge and technologies into the host country. Some indirect benefits such as increased fiscal revenues, improved management techniques, and improvement of quality of work force – resulting from the green-field investment, are also mentioned. On the other hand, to mention a few dangers, if the FDI went in direction of purchase of shareholder packages, the country might witness higher social costs because of labour shredding due to rationalisation of production process.

Table 2.: Foreign Direct Investment in the Transition Countries in the Period 1990 to 2002 (in millions of US$)

Countries	1990-95	1996-01	2002	Cumulative 1990-2002	FDI per capita
BUL	337.2	3,784.3	479.0	4,600.5	555.6
CZ	4,085.3	23,397.0	9,305.0	36,787.3	3,575.1
EST	660.4	2,231.4	285.0	3,176.9	2,175.9
HUN	11,234.1	12,987.0	858.0	25,079.1	2,480.6
LAT	468.6	2,180.7	396.0	3,045.2	1,243.0
LIT	134.1	2,743.4	732.0	3,609.4	975.5
PL	8,307.0	38,096.0	4,000.0	50,403.0	1,303.4
ROM	971.0	6,744.0	1,106.0	8,821.0	391.9
RUS	2,755.0	18,700.0	2,421.0	23,876.0	162.9
SK	704.8	5,156.0	4,012.0	9,872.8	1,831.7
SLO	492.0	1,470.0	1,865.0	3,827.0	1,932.8
CRO	359.6	6,180.1	1,015.2	7,554.9	1,678.9

Source: Croatian National Bank, Available from: [http://www.hnb.hr]

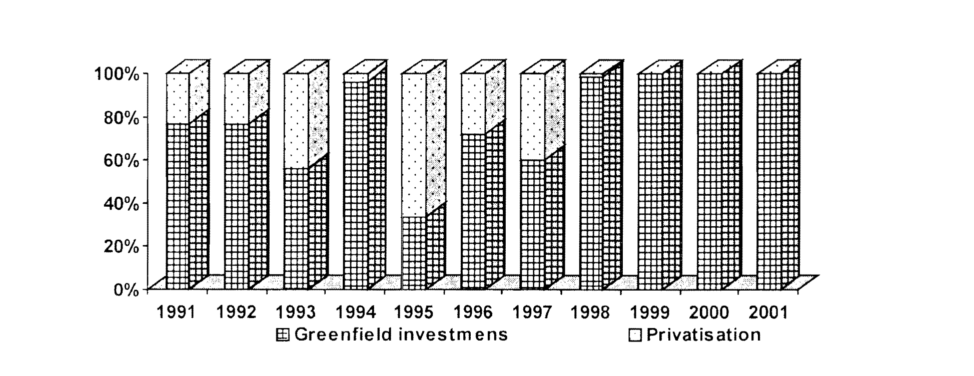
Table 2 illustrates the total mass of attracted foreign investment in the countries of Central and Eastern Europe. It is especially significant to note the volume of received finances per capita. Croatia was in the group of countries that received between 1,500 and 2,000 US$ per capita, thus it was ranked in the middle. Significantly more capital than Croatia attracted the Czech Republic, Estonia and Hungary, and less than Croatia attracted the least developed countries in the region. When observing the entire period of transition, it is obvious that Croatia received very little foreign investment at the early phase, but the investment increased after the war, i.e. they appeared parallel with the process of restructuring and privatisation of the economy. Political insecurity, the fragmentation of markets and hesitant market reforms hindered economic development and kept away foreign investors during the beginning of 1990s.

The motivations of investors differ between countries, and over time. In most CEE countries, the opening of formerly closed markets first attracted FDI. Domestic market-oriented FDI was initially mainly in the form of the acquisition of privatised firms or of joint ventures with local firms. Later on, export-oriented efficiency-seeking investment appeared in some countries. Export-oriented greenfield investment is almost exclusively confined to countries close to the EU: Hungary, Poland, Czech Republic, Slovakia, and more recently also along Romania's western border. These are the areas that provide the best transport facilities and lowest transaction costs for companies, while investors enjoy relatively low labour costs. A new wave of domestic market-oriented investment recently appeared in services and public utilities. Another recent development is the increase of FDI in domestically privatised firms mostly in the Czech Republic, Romania and Bulgaria. Companies sold to domestic investors lacked the resources for further development and searched for foreign partners.

Figures 1 and 2 illustrate the structure of foreign direct investment in Hungary, which attracted the most FDI per capita, and Croatia. It is interesting to note that the level of green-field investment was much higher in Hungary, where, after 1998, almost 100 % of foreign investment were green-field. The share of investment directed towards privatisation of Hungarian companies was high only in 1995.

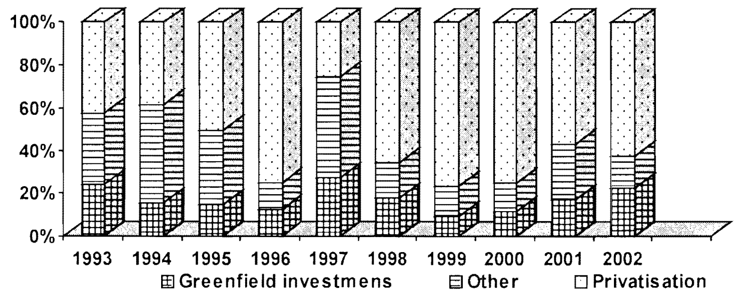
Croatia did not have the same classification. The foreign investment were divided to three categories: green-field investment, privatisation and take-over (relates to investment into existing domestic companies) and 'other' (new companies created with the combination of foreign and domestic capital). This means that the part of other also entered the green-field investment (where through such investment the foreigners have got the ownership share higher than 10%), but it is very hard to determine the share without concrete data. Yet, even when the entire category other is added to the green-field investment, we get the share of minimum 23.1 (in 1999) to the maximum of 73.84% (in 1997). Even a negative tendency of reduction can be noted in this share compared to the beginning of observed period.

Figure 1.: The FDI in Hungary from 1991 to 2001 in %



Source: Hungarian National Bank, internal data.

Figure 2.: The FDI in Croatia from 1993 to 2002 in %



Source: Croatian National Bank, internal data.

European countries are the main foreign investors in Croatia. The 9 mentioned countries (Table 3) represent over 90% of the total FDI inflows in Croatia. In this list of countries only Slovenia and Hungary belong to the group of (now former) transition countries that in the last decade faced similar problems of economic restructuring like the one Croatia faces today. Now, both the countries are major investors in Croatian economy.

Table 3.: The FDI Inflows in Croatia by Investors and by Sectors During the Period 1993 to Q2/2004

Countries	Share in %	Sectors	%
Austria	25.7	Telecommunications	21.0
Germany	20.7	Other monetary intermediation	19.6
United States	14.7	Manufacture of pharmaceutical preparations	11.3
Hungary	6.0	Manufacture of refined petroleum products	7.9
Luxembourg	5.9	Manufacture of cement	3.3
Italy	5.7	Hotels and motels, with restaurant	3.1
Netherlands	5.6	Other retail sale in non-specialised stores	3.0
Slovenia	3.7	Extraction of crude petroleum and natural gas	2.8
United Kingdom	2.1	Manufacture of beer	2.1
EBRD	1.7	Business and management consultancy activities	1.1
Other countries	8.3	Others	24.9
Total	100.0	Total	100.0

Source: Croatian National Bank, Available from:[http://www.hnb.hr]

Table 3 shows the distribution of foreign investment by sectors in Croatia. Telecommunications, pharmaceuticals and monetary intermediaries take a high place whilst the shares of other branches of production were small. Taking into the account that over 90% of banks are in foreign ownership, it is clear that foreign investment in the other half of 1990s were directed towards privatisation of Croatian financial sector.

It is interesting to compare the FDI structure with Hungary, where, cumulatively viewed (Hungarian National Bank, 2003), distribution was: manufacturing (36%); real estate, business activities (16%); finance (12%); trade, repair (12%), energy, water supply (9%); transport, telecom, storage, post (8%); construction (1%) and other (6%). Significant are two differences: investment in manufacturing (much larger in Hungary), and investment in telecommunications (much larger in Croatia). This justifies data shown in the Table 3, which are the result of bigger FDI share in privatisation in Croatia than investment directed to additional production.

Attracting of foreign investment requires peace and stability of the country where the finances are directed. Additional measures of economic policy, which serve the purpose to attract foreign investment, are usually fiscal, financial and other stimulation. Croatia passed the Law on Stimulation of Foreign Investment (The Official Gazette of the Republic of Croatia, 2000). It regulates certain benefits for foreign investors e.g. support to employment and re-training of employees, differential exemption of profit tax depending on the volume of investment and number of employees; cession of the land and the real estate; and similar. Profit tax rate in Croatia is 20%, which makes it very attractive since the rate in the majority of developed countries is much higher.

Article 1 of this Law facilitates stimulation to both, domestic and foreign investors. Article 5 of the same Law gives the advantage to stimulating measures of domestically owned companies. This implies discrimination towards foreign companies, which are forced to merge with the domestic companies if they want to use the advantages. The measures forecasted for investment stimulation are:

- renting, providing rights to build, selling or being allowed to use immovable properties,
- assistance in the opening of new vacancies,
- assistance with professional courses or retraining,
- tax exemptions (whole or just in part) and tariff benefits or exemptions.

According to the foresaid Law an investor is an entity that invests at least 4 million HKN. If investors invest from 4 to 10 million HKN, there is a possibility of receiving an additional financial grant when employing new workers as well as the tariff exemption when importing equipment. Investors with investment of 10 million HKN and greater are entitled to partial tax exemptions, which rise with the size of their investment (The Official Gazette of the Republic of Croatia, 2000, p.2944).

It is interesting to compare the situation of Croatia with that of Hungary as it did successfully attract the FDIs in S&M entrepreneurship. It is well known that the inflow of foreign capital contributed immensely to the development of Hungarian economy. Hungary ranked at 6.1 points only behind Ireland with 6.2 points in bringing-in new technologies through FDI (World Economic Forum, 2003).

Investment in Hungary are also stimulated through certain relieves (Csosz, 2001, 17). Hungary provides the 50% reduction on taxes for 5 years, if at least 3.9 million EUR is invested into production and the annual growth of sales is minimum 5% of the value of the investment (effect up to and including 2002). If the amount invested is more than 39 million EUR, and at least 500 new jobs are created in 2 years, 100% tax exemptions are granted for 10 years. For the same preference, it is enough to invest 11.7 million EUR and create 100 new jobs in the least developed regions. This tax allowance will be in effect up to and including 2011.

To this should be added a low rate of profit tax in Hungary (18%) (The Hungarian Investment and Trade Development Agency, 2003), which is much higher in the EU and other transition countries (for instance Slovakia 25%; Poland 27%; Austria 34%; Italy 38.25%, etc.) However, Hungary managed to attract big foreign investment during the transition period and become one of the most successful transition countries. Hungary brought The New Investment Promotion Package in January 2003 with the purpose of keeping the existing foreign companies and stimulating them to invest into Hungarian economy, increase the attractiveness of less developed regions, include more Hungarian R&D and innovative capabilities, create clusters. Thus, high levels of the FDI do not mean halting of their stimulation. Instead the new forms of attraction should be developed since they would contribute to the association of Hungary to the EU (May 2004). This would simplify formalities, create bigger trust, simplify the conversion (if Hungary joins the EMU in 2008), and increase competitiveness of Hungary in labour-intensive products.

Development of the SME in Croatia

Transition process brought changes in the ownership structure in its early phase. Big state companies were privatised and received the most attention in the after war period. Small and medium sized enterprises, which received more official attention only after the year 2000, did appear on large scale around the same time. Numerous stimulation programmes, aiming to help development of this segment of economic life, started to develop. The proof that the SME sector was neglected during the process of transition in Croatia lay in the fact that the Law on Small-scale Industry

Development and Stimulation (Official Gazette of the Republic of Croatia, 2002) was brought about only in 2002. It stated the following as goals: increase in employment; increase in export and adjustment to the world market, increase in efficiency, quality and competitiveness of small economy, research-development and utilisation of modern technologies and innovations, stimulation of environment friendly activities. Evidently this was quite late since Croatia entered the transition process at the beginning of 1990s like other transition countries. In spite of that, this sector is an important part of Croatian economy.

Table 4.: The Share of SME in the Number of Companies and in the Number of Employees in the Republic of Croatia (2000/2001 average)

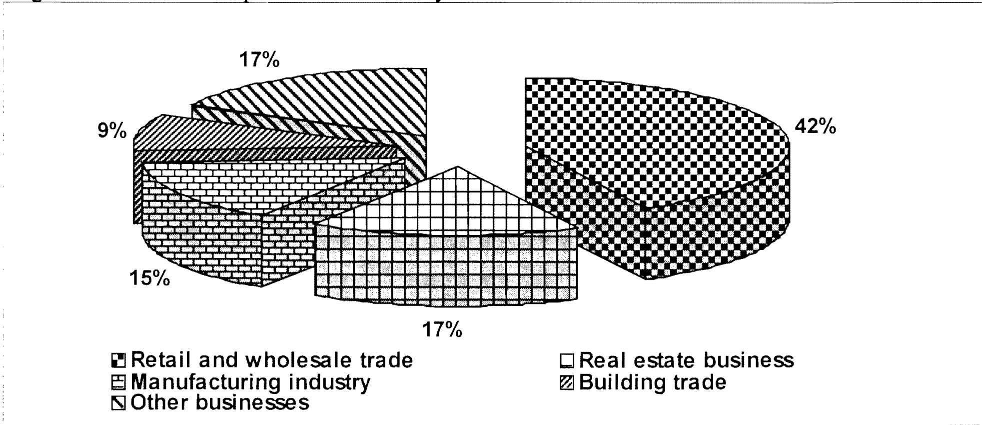
Companies	Number of companies	%	Number of employees	%
Micro	49 540	86.6	113 305	15.4
Small	5 735	10.0	114 355	15.6
Medium	1 516	2.7	166 649	22.7
Large	411	0.7	349 452	46.3
Total	57 202	100.0	743 761	100.0

Source: Croatian Chamber of Economy - database.

Table 4 shows that the micro companies prevailed (86.6%), and those big companies employed the majority of people (46.3%). The share of companies in the entire SME sector was 99.3%, and the share of employees was 53.7%. Comparing these data to the data of other South-Eastern and Central-Eastern Europe (Falcetti, et.al, 2003), we can conclude that the observed number of the SME on 1000 citizens in Croatia was 13.7, whilst the same indicator in more developed transition countries was even few times higher (Poland 45.6; Czech Republic 85.1; Hungary 27.4), which means that the number of small and medium enterprises in Croatia should increase significantly.

TEA index measures a number of newly established enterprises in relations to the number of adult inhabitants. Its value for Croatia was 3.6 in 2002, for Slovenia 4.6, Hungary 6.6 and Ireland 9.1. Thus, it is obvious that the present situation in Croatian enterpreneurship is not satisfactory and there is a scope to increase the number of enterprises and also to provide an additional employment in the sector of small economy.

Figure 3.: The Enterprise Structure by Sectors in Croatia in 2002



Source: Croatian Chamber of Economy, (2003a), 'Analysis of small economy business in 2002', Zagreb, p.3.

The largest number of entrepreneurs was registered in retail and wholesale trade in 2002. It is interesting that a very few entrepreneurs worked in the production of technologically more developed products (only 1051 entrepreneurs worked in the production of electrical and optical equipment and 467 entrepreneurs in the production of machines and appliances). Over 70% of entrepreneurs did business with the profit.

According to our findings the fundamental problems of the SME development in Croatia are basically:

- insufficient education of the entrepreneurs (knowledge, skills) in the area of management, marketing, finances, information technology, foreign languages etc.;
- lack of various guarantee funds (at the local level);
- lack of qualitative consultant services;
- inadequate investment in production and new technologies etc.

With the intention of solving these problems, 'Programme of Small Economy Development 2003-2006' (Government of Croatia) was brought about in 2003. It defined goals and requirements of small economy development, the bearers of programme and activities, and proposals of stimulating measures. Several institutions were also established. Just to mention, firstly, the Ministry for Crafts, Small and Medium Enterpreneurship, which was contemplated as one of the most important institutions for easier establishment, business and support to the SME sector, ceased to exist (end of 2003) and was merged into the Ministry of Economy, Labour and Enterpreneurship in accordance with the new governmental organisation.

It should be expected that all positive initiated actions, directed towards stimulation of enterpreneurship in Croatia, would not disappear through this action. Aiming to encourage the enterpreneurship development, the former Ministry initiated various development projects e.g. crediting of entrepreneurs, development of entrepreneurial centres, zones and incubators, change in legislative framework, crafts-register, stimulation to crafts and co-operations, stimulation for the introduction of new technologies and standards, info-phone, education of entrepreneurs, etc. Its goal was to activate and connect units of local self-government and entrepreneurs so they would contribute to the SME development. Secondly, Croatian Agency for Small Economy is one of the agents of Development Program for Small-Scale Industry. The role of this agency is to provide the guarantees and non-repayable financial supports, credit financing, subsidising loan interests, lease and selling of real estates in state ownership, education and counselling, co-ordination of all supporting institutions, employment support, professional training, new technologies, innovations and fairs as well as the participation of the enterpreneurship for the sake of faster development of small scale industry (Croatian Chamber of Economy, 2003b).

These institutions and programmes have to achieve three goals:

1. enhance TEA index – from 3.6 to 10.0,
2. increase productivity of small and medium-sized enterprises,
3. strengthening the export orientation of small economy (National Competitiveness Council, 2004).

According to the European Charter for Small Enterprises the Croatian policy has to take actions in ten key areas that includes: education and training, cheaper and faster start-up, better legislation and regulations, availability of skills, improving on-line access, taxation, technology development etc. (EC, 2003)

Importance of foreign direct investment in the development of small economy lies in production modernisation of production and introduction of new technologies. Therefore, it is worth to observe the distribution of mass of foreign direct investment in Croatia.

The FDI in the SME

From the FDI structure in Croatia it is not visible how much of the volume of foreign investment is directed to the SME sector. Therefore, we would try to precisely analyse of such investment.

We approached and analysed the data provided by the numerous institutions such as the Ministry of Economy, Labour and Enterpreneurship, Croatian Chamber of

Economy, Croatian Bank for Reconstruction and Development, InvestCroatia, HAMAG (Croatian guaranty agency), Fund for Regional Development and Employment, Ministry of Crafts, Small and Medium Enterpreneurship, Croatian Privatisation Fund and Croatian National Bank. Since conflicting data exists, we tried to synthesise foreign direct investment in companies by the amount of authorised capital. The classification was performed by taking into account the capital amount (authorised capital + reserves) of companies in Croatia in the period 1993 to 2002 for the reason that there is no evidence of foreign investment by criteria of classifying entrepreneurs defined in the Accountancy Law (Official Gazette of the Republic of Croatia, 1992).

Table 5.: The Structure of FDI in Croatia by Amount of Domestic Companies' Capital with Received Direct Investment at the End of 2002

Amount of capital (000 EUR)	Foreign direct investment (mil US$)
Up to 100	199.44
From 100 to 300	10.87
From 301 to 500	11.59
From 501 to 1000	86.94
From 1001 to 1500	38.61
From 1501 to 2000	39.23
From 2001	4,786.19
Total	5,172.87

Source: Croatian National Bank, internal data.

Table 5 shows that 92.5% of foreign direct investment in Croatia was directed towards big companies due to mentioned privatisation that was attractive to foreigners. We assume that the majority of small and medium enterprises had the capital up to 100,000 EUR. They attracted only 199.44 million EUR, which is 3.9% in the total investment. Companies with authorised capital of 100,001 to 2,000,000 EUR attracted in total 187.24 million EUR or 3.62%. Consequently, it is clear that foreign investment were insufficiently directed towards the sector of small and medium enterpreneurship. This is partially the result of the lack of active policy for stimulating development in this sector since the Law brought about in 2002 (Official Gazette of the Republic of Croatia, 2002). However, the analysis shows that Croatia attracted a significant mass of capital through the FDI (viewed per capita) but it did not provide impulse to development of the SME sector. This mass was mostly made of brown-field investment in Croatia. Namely, the SME in Croatia, developed in the recent years was primarily due to a wide spectrum of stimulating measures developed by the Ministry of Crafts, Small and Medium Enterpreneurship (now Ministry of

Economy, Labour and Enterpreneurship), HBOR (Croatian Bank of Reconstruction and Development), HGK (Croatian Chamber of Economy), HAMAG (Croatian Guaranty Agency).

Conclusion

Foreign direct investment, if brings in new technology, knowledge and innovations, can significantly contribute to development of a country. Shining example for that is the Republic of Ireland, which from net FDI receiver suddenly became an investor country. Ireland is today among the fastest growing EU economies. Its development is based on attracting foreign capital and the entry of multinationals.

Since the Croatian economy is fighting high unemployment rate, problems of restructuring in large domestic companies, insufficient competitiveness, deficit in trade balance, stagnating export (and rapidly growing import), unfavourable structure of export products, the intention here was to show and analyse the volume and significance of foreign investment in a small economy with the objective of making it the key engine of growth and development of the country in 21st century.

The analysis by volume of invested capital shows that majority of capital is invested in large Croatian companies. The small and medium enterpreneurship has received only around 4% of the total FDI. For that reason, we can conclude that foreign investment, so far, did not play a significant role in providing stimulation to development of small and medium enterpreneurship. This is further proved by the fact over 40% of the SME are registered in retail and wholesale trade, whilst manufacturing industry and building trade had only 24% of small and medium enterprises.

To accelerate SME development and increase the technological edge, it is necessary to stimulate their development through various measures such as simpler and easier access to finances, special work force, providing education-cum-training, ensuring qualitative, fast and accurate information etc.

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