

Serbian Small and Medium-sized Enterprises in Times of Crisis

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Abstract: Over the previous decade SMEs have become an important agent in the Serbian economy. Although they have made encouraging development achievements, due to a belated transition process, SMEs in Serbia are well behind other transition economies and the EU, especially with respect to efficiency. During the global economic crisis, small and medium-sized enterprises have suffered as much as other companies have. In 2010, micro and small enterprises started to recover by moving their activities to less risky businesses while medium-sized enterprises fell in number and saw declining employment as they were less adaptive to new, tougher circumstances. This affected the intensity of the recovery of the entire SME sector. It is also important to note that in 2010 and 2011 for the first time in the transition period the number of shops closed was larger than the number of shops established. After the initial signs of economic recovery were registered in mid-2010, since the second half of 2011 there has been widespread fear of the so-called W effect, e.g. the recurrence of recession (induced by the recession in the EU). The SMEs are critically important for economic recovery. In the future, the SME support policy should be focused on: a) the enhancement of competitiveness, and b) innovation development. Only with more efficient small and medium-sized enterprises will the Serbian economy have better prospects in the global market.

Keywords: recession; support policy; innovation; competitiveness

Introduction

Over the past ten years, Serbia has undertaken a number of market reforms, owing to which small and medium-sized enterprises have become a significant economic factor. Their share in total GDP, overall employment, and import and export has

increased considerably. This is a result of improved economic environment, as well as a more advanced legal and institutional framework for doing business. In addition, the government introduced measures to support the development of the SME sector.

These achievements look impressive if we cast our mind to the 1990s and the level of SME development we had back then. Still, Serbian small and medium-sized enterprises are well behind other transition economies and, particularly, the EU member states. The SMEs' share in total GDP, employment, export, and import is similar to that of other countries in the region. However, should we compare different economic ratios per employee, we will conclude that Serbian SME are less efficient and, consequently, less competitive on the global market.

In the last decade SME support measures have been mainly of the quantitative kind – the underlying objective was to achieve a rising number of newly opened companies each year and, ultimately, to have a critical mass of SMEs. An ever larger number of companies helps boost employment and absorbs a surplus of workers who have been made redundant in companies during restructuring. Since 2005 overall employment has been rising steadily.

The global economic crisis started to adversely affect the Serbian economy from the end of 2008. All the companies suffered, and small and medium-sized ones were no exception whatsoever. During the time of crisis, the number of newly opened companies decreased, while the number of closed ones rose in the meantime. In 2010, micro and small companies started to recover, while medium companies still faced problems. They are less adaptable by their nature and to a great extent impact on overall intensity of SME recovery. Shops faced the most difficult problems, and their net demographic effect was negative in 2010 and 2011. From mid-2010 onward there had been signs of humble economic recovery, but it seems that from the third quarter of 2011 recession is back.

For a steady recovery and self-sustained economic development SMEs are of critical importance. Having in mind their low competitiveness abroad, in the future the SME support policy should be focused on: a) competitive strengthening, and b) innovation development. Some early steps in this direction have been made but it requires a long-term approach and the engagement of considerable human and financial resources in order to achieve success.

The aim of the paper is threefold: a) to shed light on problems that SMEs face in times of crisis, b) to assess the competitive level of Serbian SMEs, and c) to take stock of innovative strength and potentials and deliver reasonable policy advice.

1 SMEs are Pivotal Economic Agents but They Suffer

In the period 2000-2010 Serbia underwent transition and a number of market-oriented reforms were realized. Now, one could say that the first stage of transition is over. The legal framework for doing business is mainly in line with the EU requirements as the daunting task of legal harmonization is near to its end. The institutional infrastructure has been developed on the basis of the EU's White Book. The economy is well restructured (transformed) and so is GDP formation. On the company level, the majority of social-owned companies have been privatized and restructured. However, public (state-owned) companies are only at the beginning of their restructuring process, as few of them have been privatized or, at least, have embarked on restructuring.

Rapid GDP growth in the transition period, and a more stable and favorable business environment than before made room for small and medium-sized enterprises and entrepreneurship (SMEE) to develop. Proactive policies designed to help SMEs grow at a pace faster than the average helped create favorable business conditions. Policies conducive to the development of SMEs and entrepreneurship arose from several lines of activity, namely: 1) *Institutions* in charge of SME and entrepreneurship support have been created on the republic, regional, and local levels; 2) the *Legal environment* (laws and other regulations), through harmonization with the EU legal framework, has become more business-friendly than before; 3) the Government introduced a number of *tax, customs, and investment incentives* for SMEs in particular; 4) Government and non-governmental institutions introduced *financial incentives* for SMEs and entrepreneurs, while considerable support came from international financial institutions. As a result, an increasing number of small and medium-sized enterprises and shops were established year in, year out. Total employment started to increase in 2005. SMEs absorbed a number of unemployed people who had to leave their companies as a consequence of restructuring. One can argue that the first phase of SME development in Serbia is over. In this period the goal was a quantitative one - to establish a sufficient number of SMEs within economy, and it was fulfilled.

Shining achievements resulted from an altered and a more favorable business environment and support policy measures that stimulate rapid SME growth. SMEs have become an important economic agent. In 2008, the year before the global economic crisis broke out, SMEs accounted for 59.1% of total GDP and 67.2% of total employment. At the same time, SMEs accounted for 66.6% of total turnover, 59.1% of total value added in the non-financial sector, and 58.7% of overall profit [1].

The first signs of the global economic crisis emerged in mid-2007 as the US real estate market collapsed. The peak was in September 2008 when one of the oldest investment banks, Lehman Brothers, went bankrupt. Banks stopped lending money to each other and a formidable liquidity problem occurred. The crisis

became global as banks in every corner of the world were involved in speculations with US securities based on (dubious) mortgage credit lines. The crisis produced its first negative effect on the Serbian economy in May 2007 when international players withdrew from the Belgrade Stock Exchange, which made prices of different securities drop by 30% on average, just like in other financial markets in the region.

Furthermore, the world economic crisis has caused severe problems in the financial sector of the Serbian economy and non-financial companies as of the last quarter of 2008. Foreign direct investments shrunk and capital outflow started, foreign demand decreased considerably, household savings deposits in banks (FX deposits mainly) decreased by 1 billion euros in just a few months¹, credit conditions worsened dramatically², and liquidity problems were exacerbated as it became extremely difficult to collect claims, especially from the Government and public companies.

One has to bear in mind that the global economic crisis did not really cause economic problems in Serbia but rather aggravated the existing situation. To be more precise, over the last decade a neo-liberal concept was prevalent, producing negative effects for overall development. Rapid economic growth (a 5.4% GDP growth on average in 2001-2008)³ rested mainly on expansive public and personal consumption⁴. A high share of public consumption in GDP⁵ was a signal that public services (ranging from government to pension services) had not been restructured. Restructuring in public companies did not start at all. Macroeconomic policies were poorly coordinated: the fiscal policy was expansionary but the monetary policy had to be very restrictive so that macroeconomic stability could be safeguarded. Therefore the GDP increase was below the optimal (lower than potentially feasible). All in all, development before the crisis was in fact unsustainable in the medium-term and the external crisis only exacerbated domestic economic problems.

When the world economic crisis hit the Serbian economy, the government and the central bank were reluctant to react and, consequently, belated with their response. Measures they introduced were too weak to prevent recession. Generally speaking, Serbian banks were in a better shape than banks throughout the region when the

¹ Data released by the National Bank of Serbia (NBS)

² Because of an increase in country risk (to 2% p.a.) and an increase in the key policy rate of the National Bank of Serbia (interest rate on governmental bonds of up to 17.5% p.a.).

³ Statistical Office of the RS.

⁴ Free formation of wages resulted in their high increase of over 10% per year in real terms. *Source*: Ministry of Finance of the RS.

⁵ During the period 2001-2008 the share of public consumption in GDP was 45-50% and an increase in indirect tax duties was 9.8% p.a. *Source*: Ministry of Finance of the RS.

crisis struck⁶. At first, the National Bank of Serbia introduced measures to improve liquidity (it lowered the compulsory reserves obligation). In order to prevent the outflow of FX deposits from banks, the amount guaranteed by the state (insured)⁷ was raised from 3 thousand euros to 50 thousand euros per deposit. An agreement between the NBS and foreign banks operating on the Serbian market⁸ was brokered (the so-called Wiener agreement). By agreement, banks accepted an obligation to stabilize the level of credit to their clients, whether companies or citizens and not put it down. Unlike other central banks, which put down the interest rate to a level close to zero in order to avert recession, the NBS raised the key policy rate instead so as to prevent inflation expectations (and that to 17.5% p.a.).

The government introduced (weak) encouraging measures in an attempt to prevent recession. Tax duties on savings deposits were temporarily abolished in order to preserve domestic savings. Tax duties linked with securities transfer were also abolished with the view to sustaining the volume of transfers on the Belgrade Stock Exchange. In order to curb recession, the government extended support for different credit lines by subsidizing interest for: 1) *Companies with liquidity problems* (0.8 billion €); 2) *Investment companies* (0.17 billion €), and 3) *Citizens* - for consumption and mortgage credits (0.2 billion €)⁹.

The government and NBS measures mainly pursued the right direction, but they were weak and undertaken with delay. It was clear that the impact of the global economic crisis was stronger than anticipated. The government acknowledged that recovery was impossible without the IMF's support. A stand-by arrangement with the IMF covered the period March 2009-April 2011 and it involved the financial support of 4 billion dollars; its aim was to strengthen the FX reserves of the NBS and to prevent deterioration in the FX ratio of domestic currency. USD 2.1 billion of this support was withdrawn. At the same time the arrangement underscored the need to continue market reforms and public service reforms, as well as to cut down on public spending and secure macroeconomic stability in the medium term.

The national economy suffered a lot in 2009. GDP dropped by 2.8%, industrial production by 13%, trade by 12%, and traffic volume by 15%. The export volume decreased by 26% because of a weaker foreign demand, while the import volume dropped even more, by 35%¹⁰. SMEs and entrepreneurs were not immune and their development slowdown was immense. There were a lot of detrimental factors but the most influential seemed to be the following: 1) *Fewer opportunities* for

⁶ They were overcapitalized (capital adequacy was 28%), partially due to the higher capital adequacy ratio requirement in Serbia (12%). *Source*: NBS

⁷ According to the law Foreign Currency (FX) deposits in Serbia are secured within the Deposit Insurance Agency of the Republic of Serbia.

⁸ Approximately 75% of total bank assets in Serbia belong to foreign banks. *Source*: NBS

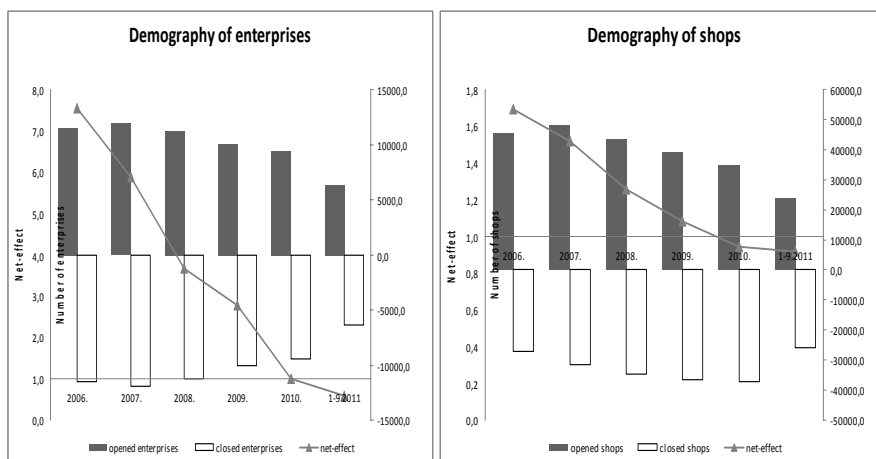
⁹ *Source*: NBS

¹⁰ Data released by the Republic Statistical Office

entrepreneurs than before on the domestic and foreign markets, as usually happens during the downturn of the economic cycle; 2) *Stronger fear* on the part of entrepreneurs who wanted to start a business or develop it because the conditions were unstable and domestic and foreign demand was weak; 3) *Unfavorable financial conditions*, a lower credit volume available, and more demanding crediting requirements; 4) *Falling demand* on the domestic and external markets, both on the part of companies and citizens; 5) *Rising competition* among entrepreneurs as well as between SMEs and large companies as all economic entities strove to survive, and 6) *Lower liquidity* and more difficult debt collection.

The development of Serbian SMEE slowed down measurably after the period 2004-2008, the time when the sector became an important factor in market reforms and revitalization [1]. As a consequence of the economic crisis and worsened business environment, since 2008 the number of opened companies and shops has been in decline and the number of economic entities that terminate their operations has been on the rise.

Table 1
Business Demography



Source: Serbian Business Registers Agency, Republic Development Bureau

In the course of 2009, 10,014 new enterprises and 39,365 new shops were established (11% and 9.2%, respectively, less than the year before), while 3,597 companies and 36,441 shops were closed (17.2% and 5.4% more than the year before). In 2010 the net effect of the so-called business demography worsened further. The tendency of a decreasing number of newly established companies, on one hand, and an increasing number of closed ones, on the other, gathered momentum. As a result of further deterioration of business conditions, in 2012, 9,469 companies were established (5.4% less than the year before) and 9,340 were closed (as much as 169.7% more than in 2009). At the same time 35,036 new shops were established (11% less than the year before) and 37,168 were closed

(2% more than the year before). The net effect relating to companies (the number of established vs. the number of closed) worsened year in, year out and in 2010 it stood at 1:1 (1:2.8 in 2009). The *net effect for shops was even worse - at 1:0.9, which means that for the first time there were more shops closed in Serbia than ones opened. One of the most influential reasons for closing the shops, in addition to worsening business conditions, was the development of market chains in Serbia.*

In the period January-September 2011, 6,359 new SME were established (14.7% less than in the same period in 2010) and 10,738 enterprises were closed (101.9% more). At the same time 23,833 new shops were set up (13.3% less than in the first nine months of 2010) and 25,919 were closed (3.9% less). The ratio between the number of opened and the number of closed companies (net effect) equalled 0.6:1 and it was much less favorable than in the same period of 2010 (1.4:1). The net effect regarding the opening of new shops was 0.9:1, approximately similar to the level of the previous year of 1:1. Undoubtedly, data still suggest that conditions for doing business are difficult, especially for the start-ups. Such a state of affairs can partially be attributed to a slow reaction of entrepreneurs to the deterioration in business climate. New, stronger concerns about the economic recovery reveal there is not much room for optimism.

The economic crisis led to a setback in development and a drop in competitiveness of the SME sector. Major business indicators are less favorable than before – there is a drop in turnover, GDP, and profit. Qualitative business indicators suggest that the problem is serious. Recession effects limited entrepreneurial activities and chances of entrepreneurs and small economic subjects to transform economic downturn into recovery and growth. A decline in domestic and foreign demand and investments, higher risk and investments costs, as well as the fear of failure led to a decrease in the number of new entrepreneurs and, consequently, less job creation. The GEM research [2] into different aspects of entrepreneurial activities in 2009 highlighted negative effects of the crisis on the entrepreneurial climate in Serbia. The number of start-ups and new enterprises had been in decline, thus posing significant limitations to job creation opportunities. By comparing tendencies in selected countries in the period prior to the crisis with the period 2008-2009, one can conclude that more than a half of entrepreneurs within the region believe it is more difficult to start doing business now. *They also believe that it is easier to achieve growth of a business in place than to start a new one.* Their expectations as regards employment rise are very modest and so is their penetration of foreign markets.

There were some signs of economic recovery worldwide around mid-2009 but economic experts were afraid of the so-called W effect.¹¹ Economic recovery in Serbia started in mid-2010. Industrial output in 2010 was 3% higher than in 2009.

¹¹ The so-called W effect means that the economic situation is still fragile and that after growth the return of recession is possible.

Table 2
Rise/fall of business indicators 2009-2010

	Comp.	Micro	Small	Medium	SMEE	Large	Total
2009							
No of companies	226,241	76,243	9,873	2,470	314,827	529	315,356
No of employees	259,383	153,074	200,954	259,129	872,540	435,751	1,308,291
Turnover (RSD m)	924,491	935,282	1,229,336	1,291,436	4,380,545	2,078,312	6,458,857
GVA (RSD m)	193,688	119,187	212,145	253,088	778,108	584,771	1,362,879
Export (RSD m)	6,037	60,090	68,647	140,603	275,378	270,437	545,814
No of exporters	1,955	6,166	3,131	1,175	12,427	333	12,760
Import (RSD m)	6,450	155,321	217,929	247,447	627,147	402,030	1,029,177
No of importers	2,556	12,040	4,252	1,452	20,300	398	20,698
Investments (RSD m)	50,231	40,374	100,095	69,096	259,796	234,170	493,966
2010							
No of companies	228,680	77,989	9,614	2,257	318,540	504	319,044
No of employees	232,176	153,264	194,450	234,695	814,585	412,966	1,227,551
Turnover (RSD m)	805,140	1,074,186	1,396,636	1,401,972	4,677,933	2,482,401	7,160,334
GVA (RSD m)	185,300	136,832	234,073	261,213	817,417	645,309	1,462,726
Export (RSD m)	6,534	83,040	95,023	155,248	339,845	393,232	733,077
No of exporters	1,822	6,366	3,116	1,102	12,406	321	12,727
Import (RSD m)	6,531	163,930	247,223	262,865	680,549	573,291	1,253,840
No of importers	2,230	11,922	4,163	1,379	19,694	396	20,090

Source: Statistical Office of the RS, processed by the Republic Development Bureau

Retail trade had been increasing since July 2010. GDP rose 1% in all 2010¹³. The first projection of GDP in 2011 suggested an increase of 3%. However, from mid-2011 this projection has been corrected to a modest increase of 1%¹⁴, mainly due to an imminent new tide of recession in the EU and rising inflation in Serbia. These projections will surely send a negative signal to domestic entrepreneurs. In all likelihood one can expect only the continuation of negative tendencies in business demography.

2 The Competitiveness Level of Serbian SMEs

From mid-2010 to mid-2011 there were signs of a moderate economic recovery in Serbia in the form of GDP growth, increasing industrial production, and more voluminous trade. SMEE had an important role in setting the path to economic recovery. Over the last decade measures of support for SMEE development have

¹³ Statistical Office of the Republic of Serbia

¹⁴ The NBS projection, while the WB projection is still slightly higher (a 1.5% GDP increase)

been taken in order to create a critical mass of new small and medium-sized enterprises and shops that will form the basis for self-sustained economic growth and development in the future. This goal was successfully achieved. If we compare the scores of SMEE with the EU average, we will see their share in GDP formation, employment, and value added is at an average level. However, if we take a look at efficiency of these newly established companies and shops and compare it to the EU average, we will be able to see they lag a lot both in efficiency and with respect to different economic ratios per employee. Consequently, Serbian economy cannot be competitive on the global market, and an increasing trade deficit over the last decade proves this fact. In order to see the efficiency of SMEE improve, a set of support measures must be transformed into a qualitative one. The ultimate objective is to make companies more competitive abroad and to reduce the trade deficit as much as possible.

Via achieving dynamic transition development, the entrepreneurship sector significantly contributed to national economic growth in the previous decade. It is estimated that in 2010 the SME sector had a share of 33% in GDP formation, 43.4% in total employment, 43.9% in total investments, 44.5% in total exports, and 52.3% in total imports [3]. *The Serbian SME sector, just like other economic entities, is not competitive on foreign markets when it comes to investment activity, production expenses, and export characteristics.*

Investment activities of SMEE in Serbia diminished during the crisis. The recession caused lower values in companies' production but it did not bring down their liabilities, which resulted in rarer investment tendencies. Under changed and exacerbated business conditions (hereby we primarily refer to limited and expensive sources of financing) an underdeveloped SME sector in Serbia has not managed to lift the level of mobility, to foster development of internal potentials, and thus to prevent a fall in the level of competitiveness. The SME's share in total investment of the non-financial sector was 50.4% in 2008 while the share of investment in GVA dropped from 40% in 2007 to 27% in 2008. Investments in the non-financial sectors in 2008 with the value of 449.7 billion RSD or, on average, 1.5 million RSD per company accounted for 65.9% of total investments and they were 8.6% lower than in 2007. The SME sector accounted for 33.2% of total investments within economy and 50.4% of the non-financial sector (58.7% in 2007). Almost 43% of the value was created in medium-sized companies. By the GVA/investments ratio, the SME sector is well below the non-financial sector average (27% to 32%). The crisis hit micro businesses most and their investments in 2008 equaled only 9% of GVA (29% in 2007); only medium-sized enterprises were above the average (36%) [3].

Total investments were higher in 2009 compared to the level of investments in 2006. Investments rose by 5.5% per year on average in real terms in the period of reference. It is important to note that investments of entrepreneurs declined heavily in crisis years. Recession negatively affected medium-sized enterprises most as their investments dropped by 33% in real terms compared to the year before.

In 2009, the last year for which investment data are available, investment performance in the SME sector deteriorated further in keeping with the worsening business environment and more adverse conditions for crediting. Investments per employee and investments per company dropped to 3,400€ per employee and 8,700€ per company in line with overall drop. At the same time the ratio between investments and GVA was slightly higher than the year before (0.32 SME and 0.41 overall), probably in line with a steeper fall in GVA [4].

The comparative analysis of investments per employee and per company in neighboring countries and EU-27 suggests these indicators are markedly lower, both relating to Serbia's SME and the national economy [4]. These ratios for Serbia are similar to those of Bulgaria and Hungary but far worse in comparison to Romania, Slovenia, and the EU average.

Table 3
Investments of the non-financial sector in European countries

		Investments per employee (000 €)		Investments per company (000 €)		Investments and GVA	
		SME	Total	SME	Total	SME	Total
EU-27	2007	7.4	8.5	31.7	54.4	0.19	0.19
	2008	7.7	8.8	33.4	56.7	0.19	0.19
Bulgaria	2007	4.2	4.7	23.0	35.5	0.69	0.56
	2008	4.4	4.8	24.2	35.7	0.81	0.65
Hungary	2007	5.6	6.6	17.5	29.2	0.39	0.34
	2008	4.4	5.4	14.6	25.1	0.31	0.27
Slovenia	2007	8.3	10.0	35.0	63.8	0.32	0.34
	2008	9.4	10.8	39.3	67.1	0.36	0.36
Romania	2007	6.5	9.3	39.2	90.9	0.62	0.70
	2008	9.9	12.9	59.2	121.1	0.70	0.61
Serbia	2007	4.1	4.5	12.2	20.7	0.40	0.40
	2008	3.0	3.9	9.2	18.2	0.27	0.32
	2009	3.4	5.1	8.7	19.8	0.32	0.41

Source: Eurostat, Republic Development Bureau

The business activities of SMEs in the period prior to the crisis (2004-2008) were marked by positive tendencies in *cost competitiveness*. High growth rates were achieved with GVA (10.9%), as well as with an average value of labor costs (10.4%) and productivity (4.9%). Growth dynamics stopped in 2009 and 2010. In 2010 the total turnover of SMEs increased by 0.3% only, while GVA was 1.4% lower in real terms than the year earlier [4].

In 2010 small and micro companies adapted to worsened business conditions as they shifted to less risky activities. As a result, they recovered moderately and improved their competitiveness. At the same time medium-sized companies faced real problems in 2010 as they could not adapt so easily.

In the entire period of 2006-2010 the average value of labor costs of SMEs increased in real terms, although during the previous two years it had risen moderately (by 0.1% and 0.4%, respectively). It is important to note that the SME's share in total employment is higher than the share in total GVA. In other words, employees in micro and small companies create lower GVA in comparison with employees in medium and large companies [4].

Although in 2010, a modest recovery took place and the average value of labor costs decreased, wages in SMEs still account for almost 2/3 of GVA and there is not much room for companies to improve and modernize their business processes, especially under crisis circumstances.

Table 4
Increase in GVA and productivity (% , real terms)

	GVA				Employment				Productivity			
	2007	2008	2009	2010	2007	2008	2009	2010	2007	2008	2009	2010
Non-financial sector	11.4	2.8	-11.3	0.8	0.3	1.1	-6.5	-6.2	11.1	1.7	-5.2	7.4
Large	7.8	0.7	-7.0	3.6	-6.3	-3.9	-5.0	-5.2	14.9	4.8	-2.2	9.3
SMEE	14.1	4.2	-14.3	-1.4	4.1	3.7	-7.2	-6.6	9.7	0.5	-7.7	5.7
Manufacturing industry	8.1	1.5	-16.9	-2.0	-3.4	-1.9	-11.6	-6.9	11.9	3.4	-6.0	5.3
Large	4.9	-1.8	-16.0	-2.5	-10.9	-9.2	-13.1	-9.0	17.8	8.2	-3.3	7.1
SMEE	11.0	4.3	-17.8	-1.6	2.8	3.4	-10.7	-5.6	8.0	0.9	-7.9	4.3

Source: Ministry of Finance, based on data from the Statistical Office of the RS and the Serbian Business Registers Agency

Serbian companies are not *export competitive* on average nor are so the SMEs. The crisis affects most companies that are active in international trade, and that is the reason why the number of exporters and importers fell. Lower domestic demand in 2009 had a much bigger effect on reduced imports (-35%) than on exports (-26% in 2009), which caused an increase in the coverage ratio to 52.8% overall and to 43.4% in the SME sector. In 2010, total export increased by 24% and import by 10%. The SME sector generated 45% of the total exports and 52% of total imports. In 2010 the export value of SMEs increased by 16% in real terms, and the value of imports by 2% [4].

Until 2008, the coverage of imports by exports had constantly been lower than 50%. However, in 2009 the coverage of imports was 53% for the first time. This was induced by the world economic crisis, decreasing domestic demand, and declining prices of primary products (the share of those products in the total Serbian exports was 55%). In 2010, the modest global economic recovery caused an increase in the volume of external trade. Total exports increased more than imports and the coverage of imports by exports improved (to 59%). In the SME sector, however, the import coverage was still below 50% [4].

Serbian exports are dominated by low technology intensive products which had the highest increase in the volume of external trade in 2010. Micro companies had a lower volume in medium–high tech products than the year before. Small companies at the same time saw a lower volume of external trade of high-tech products, by 7.6% in comparison to 2009. Medium-sized companies in 2010 saw an increased volume of external trade of these products. All in all, SMEs in 2010 registered an increase of 14% in the volume of external trade of high-tech products and a drop of 20% in medium-high tech, while there was an increase of 18% with medium-low tech products and a 5% increase in low tech products [4].

Table 5
Export competitiveness

		2007	2008	2009	2010
External trade balance RSD m	SMEE	-425,802	-477,311	-351,769	-340,704
	Large	-121,380	-166,339	-131,593	-180,059
	Total	-547,182	-643,651	-483,363	-520,764
Coverage of import by export %	SMEE	34.8	36.5	43.9	49.9
	Large	70.0	66.1	67.3	68.6
	Total	48.2	48.2	53.0	58.5
Share of export in turnover %	SMEE	5.5	5.9	6.3	7.3
	Large	14.4	13.8	13.0	15.8
	Total	8.4	8.5	8.5	10.2
Export per employee RSD thousand	SMEE	250.1	292.0	315.6	417.2
	Large	593.9	706.3	620.6	952.2
	Total	368.6	427.8	417.2	597.2
Import per employee RSD thousand	SMEE	719.8	799.7	718.8	835.5
	Large	848.4	1,069.0	922.6	1,388.2
	Total	764.1	888.0	786.7	1,021.4

Source: Ministry of Finance RS

The negative effect of the economic crisis is stronger in medium-sized and large companies with a relatively large share of exports in trade (of 10.9% and 13%, respectively) than in small and micro enterprises that are mainly oriented towards the domestic market. The value of export and import per employee in 2009 in relation to 2008 dropped at the rate of 12.5% and 20.5%, respectively. A real drop in the SME sector was significantly lower than in large enterprises (of -3.4% and -20.2%, respectively). Higher figures of the revealed comparative advantage index in 2009 were also a result of a faster decrease in imports than in exports. Even though foreign trade of high-tech product shows the fastest growth, Serbian economy still depends on the export of low technology intensive industries [4].

Regarding the *application of ICT*, Serbian SMEs are slightly behind the EU-27 average, and in the use of internet they are significantly below the average. The category of equipment and the use of equipment in business operations shows that Serbian SMEs are close to the EU average and better off in comparison to some EU members (see the table).

Table 6
Use of computers, devices and communication system in business, 2010

	% of companies using computers		Types of devices and communication systems							
			Extranet		Intranet		Wire based LAN		Wireless LAN	
	SME	Total	SME	Total	SME	Total	SME	Total	SME	Total
EU	96	96	20	21	33	33	78	78	36	36
Bulgaria	89	90	15	15	48	48	59	59	27	27
Hungary	91	91	14	14	20	20	60	60	28	28
Romania	82	82	11	12	33	33	64	64	22	22
Slovenia	97	98	12	13	32	32	84	84	41	41
Croatia	97	97	16	16	30	30	74	74	42	42
Serbia	97	98	13	14	57	57	80	80	46	47

Source: Eurostat, the Republic Statistical Office of the RS

Serbia is at the same level as Slovenia and Croatia and better positioned than Romania, Bulgaria, Hungary, and the EU average. In the use of the Internet and types of connections to the Internet, they are well behind the EU average and most countries within the region. In comparison with the EU average and countries within the region, SMEs in Serbia use more WLAN, Wireless LAN and Intranet, while the use of extranet is well behind the EU average, Croatia, Bulgaria, and Hungary, but ahead of Romania and Slovenia. The lag in types of access to the Internet is especially marked in the case of mobile connections.

Table 7
Internet use in business

	% of companies which received orders on - line		% of companies which sent orders on - line		% of companies that use Internet for banking and financial services	
	SME	Total	SME	Total	SME	Total
EU	13	13	26	27	87	87
Bulgaria	4	4	4	4	68	69
Hungary	7	8	17	17	88	88
Romania	6	6	7	7	73	74
Slovenia	10	10	16	16	96	96
Croatia	22	22	23	23	89	89
Serbia	20	20	23	23	80	80

Source: EUROSTAT, the Statistical Office of the RS

Serbian SMEs most often use the Internet for banking and financial services, while E-business (online buying and selling) is more seldom. SMEs in Serbia use the Internet for financial services more than SMEs in Bulgaria and Romania but less than SMEs in Slovenia, Croatia, Hungary, and the EU average in general.

The data presented above clearly indicate that *the priority of the policy to support SMEE development should be competitiveness strengthening [5]*. Measures should be introduced to enhance companies' abilities to operate more successfully on the global market. This aim will be realized by meeting several targets, namely: 1) On the macroeconomic level - *economic structure development in line with the EU and compatible to the EU structure* – which means the rapid growth of activities with the value added being above the average; 2) on the microeconomic level - *improvement in the competitive abilities of companies by closing the discrepancy with the EU average in gross value added per employee*; 3) *More balanced regional development* – taking into account deep regional discrepancies in Serbia, it is necessary to support rapid socio-economic growth of underdeveloped regions.

It is also important to foster and develop linkages between educational and research institutions on the one side, and companies on the other. Programs to improve competitiveness should be focused on: 1) *Support for investment in R&D and innovation*; 2) *Support for companies' internationalization*; 3) *Drafting the strategy for productivity boost in companies*, and 4) *Support for cooperation and enforcement of linkages between companies and developing clusters*.

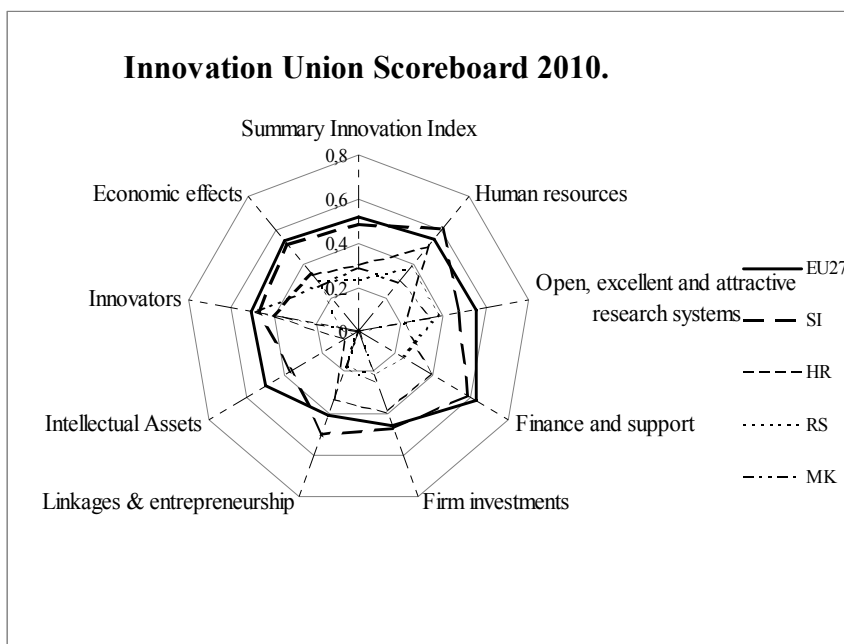
3 Innovation Level of SME

The other side of the coin of Serbia's low efficiency on the international market is the low innovation level of companies, underscoring the low level of their development and the poor application of new technologies. This is partially made clear from data on the ICT implementation within Serbian SMEE that constitute the dominant segment of the economy. It is also clear from data on the structure of foreign trade regarding the technological level of products. Should one want to account for such a low technological level, one needs to take into consideration several important factors such as: 1) *for decades the socio-economic environment has not been favourable for and conducive to innovation activity* as Serbia, being a part of the former Yugoslavia, has developed a specific market-plan mix under which companies are not profit-driven; 2) *a neo-liberal development concept prevailed during transition* and, consequently, short-term goals and market forces are seen as keys for all economic problems; 3) *in times of crisis, SMEE are faced with more limitations than large companies* in general, especially when it comes to the process of development and application of new technology.

The European Innovation Scoreboard is an instrument of the EU Commission for monitoring and comparatively analyzing the innovation performance of member and acceding countries. On the basis of their achievements, countries are categorized into four categories: Innovation Leader, Followers, Moderate Innovators, and Catching-up countries. For the first time the Republic of Serbia was included in the 2009 research [6], which is the first important step towards the screening of innovation potential of the country and of the SMEE sector. This is

rather important for the formulation of the policy and measures for stimulating innovative activities. Findings suggest companies in *Serbia belong to modest innovators while as a country in the pre-accession procedure Serbia belongs to the group of Catching-up countries.*

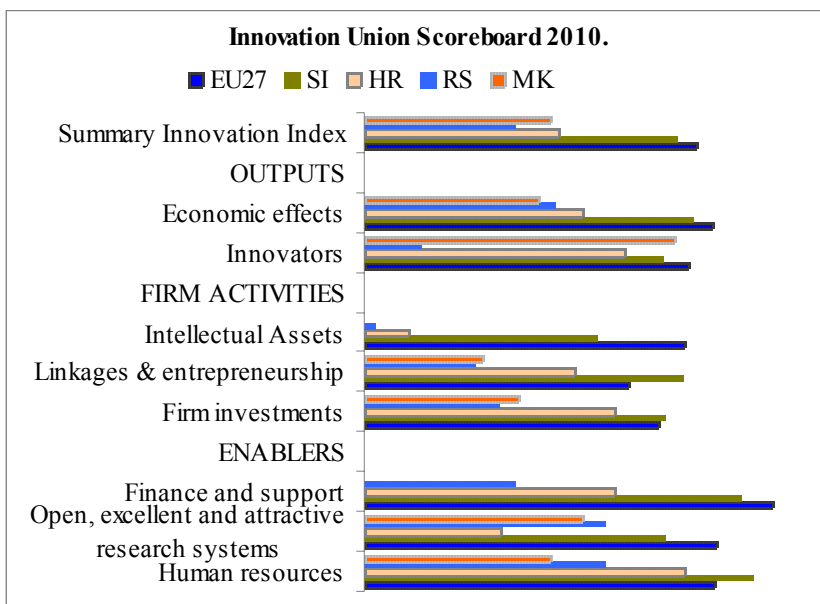
Data show Serbia is well behind the EU-27 average. The EU-27 innovation index is 47.8, while Serbia's index is at 22.7 only. However, it can be said that the potential of the economy is quite satisfactory for two factors examined - human resources and financial support. At the same time, Serbia is well below the EU-27 average regarding capacity of intellectual property and the share of companies – innovators in the total number of companies. In other words, there is a lot of room for improvement.



Source: European Innovation Scoreboard 2010

First dimension - enablers: Serbia's research system has modest potential compared to the EU average and neighboring countries (Slovenia and Croatia). Human resources also pose a limiting factor (with 19.2% of the highly educated and 85% of those with a secondary school degree in the total young population). *Second dimension – firm activities:* Serbia is investing 0.5% of GDP (public and private sources) in research (EU 2%). On the company level, 28% of all Serbian SMEs and shops can be labeled as innovative. There are 3.5% innovative SMEs with research linkages and cooperation in the total number of SMEs. *Third dimension – outputs:* the share of SMEs that regularly introduce processing/product innovations is 18.3% and 18.1% in organizational/marketing innovations in total. In comparison with the EU and matured transitory economies,

Serbia is less efficient in the application of innovations. The share of employment in knowledge-based activities is 3.9% of the total. The share of medium and high-tech product export is 27% in total and of knowledge service export is 34%. Total revenues from licenses and patents from abroad are 0.1% of Serbian GDP [6].



Source: European Innovation Scoreboard 2010

The Survey of SMEE was conducted in accordance with the Work Program of the National Agency for Regional Development for 2010 and in cooperation with the Serbian Statistical Office. The aim of the research was to analyze the real situation, problems and needs of the SME sector and the change in relation to the previous year. The Survey was carried out on a sample of 3,000 report units by means of the questionnaire comprising 65 questions¹⁵.

The Results of the Survey show that when it comes to the legal form of business SMEs most often choose the limited liability company (88% of total). The reason is that this form of company gives flexibility to managers of SMEs. Two thirds of the enterprises have been in business for more than 6 years and 43% of them for more than 11 years. There is an evident intention on the part of most entrepreneurs that their companies continue to work, on a higher (37%) or the same level of activities (50%). Only 5% of them plan to close down and 2% to transfer their business to someone else. A half of medium-sized companies have plans for further expansion while small entities shy away from expansion most (30% of sole traders and 38% of micro and small companies plan to develop their business).

¹⁵ Data from Republic Statistical Office are available internally only as the Survey results are not published yet.

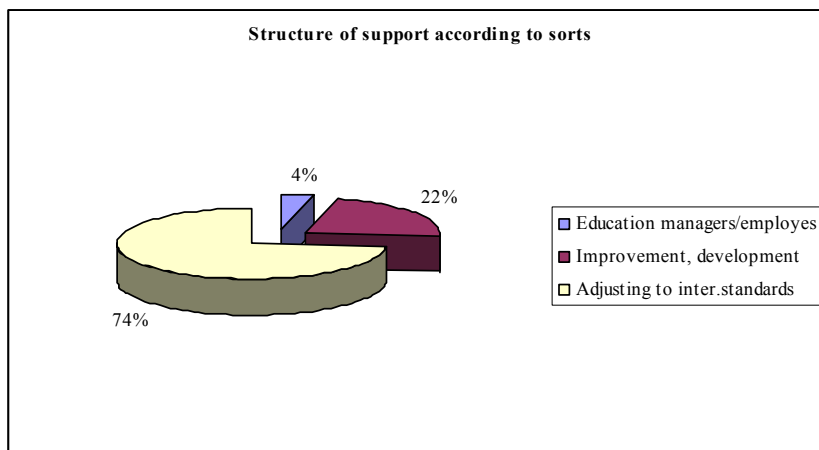
Survey results confirm the dependence of the improvement of business operation on external factors (67% of the total), such as support from the state and local government. Companies graded business problems with very high marks; the largest obstacles are related to the lack of financial sources extended under favorable conditions, and to the legal environment (graded 1.9 and 2.2 on the scale of 1-7). The surveyed SMEs are mostly equipped with medium generation equipment (5-10 years old) and only a quarter own equipment less than five years old. The need to invest in technical and technological business conditions was highlighted by 60% of companies, as they have invested over the past three years, but now their intention is to postpone investment for the future. The use of PCs is not an obstacle for making progress in business, as 83% of companies use computers (there are 6.5 computers per surveyed company). The results show that every fifth company performs innovative activities, and one out of eleven maintains innovation cooperation with other business entities or institutions. Innovative activities resulted in introduction of new products or services in 1/5 of the total number of companies. The effects of implemented innovation in 54% of cases are visible in the saving of raw materials and energy, and in 46% in the reduction of labor costs. Only 16% of companies protect some of the intellectual property types, although we notice an increasing trend here (5 percentage points more than the year before).

The Serbian Statistical Office conducted a *research into innovation activities of SMEE* for the period 2006-2008 [7] with the aim of grasping the true relation between the business policy of companies and innovative activities. Out of the entire sample of SMEs, 18% are technology innovators, 18% are other innovators that introduced organizational or marketing innovation, and 6% did not finish and implement the innovation process. When looking at the share of a type of innovation introduced by the size of SME innovators, it is clear that the highest share is that of the organizational innovation (28% of total) in small (28%) and medium-sized enterprises (29%). In total, 19% report that they were a part of a group of connected companies, and 93% of SME innovators responded that their company is a base company. Regarding the market orientation, 98% responded that they sell on the Serbian market. As for a new product or service introduced, 23% opted for a product and 28% for new services. In total, 6% of SME innovators registered their trademark, and 16% listed time advantage in relation to competitors as a significant innovation protection method.

Serbia has been implementing its '*Strategy for the Development of Competitive and Innovative Small and Medium-sized Enterprises 2008-2013*' [8] since 2008 when it was defined and adopted. The Strategy implementation envisages that measures and activities are concentrated in those companies that have the potential for fast growth and export expansion. Support priorities regarding dynamic companies and gazelles are: 1) *The legal framework reform*, with the aim of bringing laws in line with the EU's laws and minimizing administrative procedures and requirements; 2) *Innovation support*, with the aim of defining the

system of incentives for research and development, and planning innovative activities and their implementation within companies; 3) *Functional education*, the goal being to raise the overall level of knowledge of managers and employees by improving both the formal and the informal education system; 4) *Financing improvement*, with the aim of developing the institutional framework for micro financing, investment funds, and venture capital funds; 5) *Closing the institutional infrastructure* in order to further develop the institutional network that covers the entire territory; 6) *Opening to the global market*, the goal being to improve the overall competitive strength of dynamic and innovative companies on the global market.

In line with the Strategy implementation, the National Agency for Regional Development introduced non-financial and financial support measures for the SME strengthening [9]. Non-financial measures include: 1) Entrepreneurial services (legal and financial consulting and innovation and invention), 2) Training for start-ups, 3) Monitoring, 4) European network for entrepreneurship, and 5) a European network of ambassadors representing women entrepreneurs. Financial support includes: 1) A program for strengthening the competitiveness of SMEs, 2) A program for associations support, 3) Support for rapid growth of SMEs – gazelles, 4) Support for the innovation strengthening, and 5) Support for the development of innovative clusters. The Program of support for SME competitiveness is aimed at directly supporting the improvement of competitiveness by funding costs of consulting services. Several areas are picked as targets: business adjustments in line with international standards, improvement and development of new technological products, processes and services, and the education of managers and employees. Each verified project will be supported with an amount of 500-5,000€ out of the total budget of 600,000€. In the period 2008-2011 the number of supported projects reached 1,443 and the total amount of extended funds 2.98 million euros.



The programme for innovation strengthening is aimed at supporting investment of SMEs in innovation. The program is built on the cost co-financing model: development of new products, improvement of products and services, patent remuneration, new design, and the design of the marketing plan for new products. The amount envisaged as support ranges between 1,000-1,500 € per project. The total budget is 400,000 €. In the period of reference 85 projects were supported – co-financed.

The programme of innovative clusters development is aimed at helping new clusters - it envisages 2,000-20,000 euros of support per cluster, and for existing clusters 2,000-10,000 euros per cluster. New clusters will use the financial support to cover operational costs and the costs of organization. Existing clusters will use the support they receive to cover costs of drafting feasibility studies, common project realization, prototype realization, patent registration, and training.

The programme of support for gazelles is aimed at enhancing SME competitiveness so that they can grow fast and raise their employment. The support is to be extended under several conditions: minimum 3 years of doing business, an independent entity, a minimum of 8 employees, and a 30% increase in revenues over the last three years without losses. The amount earmarked for support is fixed at 1,000-8,000 euros per company.

Conclusion

During the transition period SMEE in Serbia became an important economic factor. This was a result of introduced market reforms, an improved business climate, and, above all, the pursued supportive policy. The main aim of the policy was to establish more and more SMEE each year in order to boost employment and absorb the surplus of workforce that left companies undergoing restructuring. This important goal was achieved and the share of the sector of SMEs in total GDP and employment is considerably higher than before.

Faced with the global economic crisis SMEE are suffering like others. In 2010 the number of medium-sized companies decreased most (by 8.6%), and so did employment in these companies (by 9.6%). It is important to note that medium-sized companies are seen as drivers of development of the entire SME sector. At the same time small and micro companies have recovered and refocused their activities on less risky ones, while medium-sized companies are lagging behind because they tend to adapt to new business conditions slower; in addition, they are coping with problems that have caused a slow recovery of the entire SME sector. Shops are experiencing more difficult problems than companies and over the last two years they have had negative business demography.

Recently the economic recovery in Serbia has gathered momentum, but this recovery is fragile as the risk in the EU is increasing. The role of SMEE is important for making the recovery certain and development self-sustained. Although Serbia's achievements in terms of SMEE development are encouraging,

if we compare these companies to companies from mature transition countries and EU member states, we will see they are less efficient and less competitive. This finding leads to an inevitable shift in policy incentives for SMEE development towards greater efficiency and more innovation. Some important steps in this direction have been realized, such as data collection and measurement and, in particular, strategy definition, but other measures are in the early stage of realization.

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