

## CHAPTER 15. THE ROLE OF DEVELOPMENT ENTREPRENEURSHIP AND SMALL AND MEDIUM ENTERPRISES IN MANAGING STRUCTURAL CHANGES<sup>1</sup>

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### **Abstract:**

*Small and medium-sized enterprises, under the direction of entrepreneurs, are considered to be the driving force of economic growth and development. Entrepreneurship is associated with job creation, innovation, welfare distribution, poverty reduction and an increase in economic performances of a country. In the last decade, there has been an increasing recognition of the role of entrepreneurs in economic development of Serbia. The main objective of the chapter is to analyse development of entrepreneurship and its contribution to economic development of Serbia over the 2006-2010 period of time by using the methodology initially developed by Venesaar and Loomets (2006), and adjusted to the objectives of this study and to the available data. The methodology assesses the development of entrepreneurship through SMEE sector development and new firm formation activity over the observed period. The measured firm formation rate indicated relatively strong but insufficient intensity of entrepreneurial activity. The empirical analysis shows a relatively stable activity in firm formation over time in terms of the average annual number of registrations per 1,000 active inhabitants and more significant variations in terms of the ratio of new firm registrations to the registered stock of businesses at the end of the year. The data also show a positive and significant relationship between firm formation rate and employment generation as an important indicator of economic development.*

**Key words:** *entrepreneurship, small enterprises, medium-sized enterprises, economic development, firm formation activity, employment*

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## INTRODUCTION

During the 1960s and the beginning of 1970s, owing to the effects of the economy of scale, large enterprises were expected to take advantage of the entire technological progress, lower the costs and satisfy the more demanding needs of customers. However, rising problems in organization and management of large enterprises in the mid-1970s and 1980s put in question the previous beliefs about the perfections of strong and large national and multinational corporations (Beraha 2011, p.316). As a result of that, a shift in economic activity from large towards smaller business entities occurred. Ever since then, there has been a continuous growth in the share of entrepreneurs and small and medium-sized enterprises in the total number of enterprises in the vast majority of economies throughout the world. Recognizing that small and medium-sized enterprises and entrepreneurs (SMEE) provide the great potential for employment creation, Gross Domestic Product (GDP) growth, more balanced income generation and the creation of wealth, policy makers have focused on adopting new approaches and new ways to foster SMEE development.

Entrepreneurship is considered to be the driving force of economic growth and development. There is an extensive literature linking entrepreneurship to economic development. It is generally perceived that small and medium-sized companies, under the direction of entrepreneurs, are major contributors to job creation and economic growth (Mamede and Davidsson 2003, p.1). As a source of innovation and flexibility, they contribute to growth of productivity and economic competitiveness. Entrepreneurs and small and medium-sized enterprises play an important role in creating employment opportunities, thus reducing unemployment as one of the most burning issues of the present day world. By seeking opportunities and taking risks, they create new and advanced products and services, new techniques in sales and distribution and explore new undiscovered markets. SMEEs are a stable source of GDP growth and they contribute to more equal distribution of income and wealth, which consequently leads to poverty reduction and more balanced regional development.

The evidence suggests a positive correlation between the level of industrialization and the level of entrepreneurial activity in a country. Entrepreneurs play a key role in the process of structural change which is a precondition of a successful economic development. They contribute to the productive reallocation of resources and are a source of innovation. As a process, rather than a static phenomenon, entrepreneurship is a way a person behaves in certain phases of his life or career and it is commonly related to risk taking, opportunity seeking and innovativeness. As it was described long ago by Joseph Schumpeter, entrepreneurs are innovators they bring new ideas, processes and knowledge, introduce new technologies and

products to existing markets and create new markets. Entrepreneurship is associated with job creation, innovation, welfare distribution, poverty reduction and an increase in economic performances of a country.

In the last decade, there has been an increasing recognition of the role of entrepreneurs in economic development of Serbia. Since the early 2000s, a rising share of SMEEs in the Serbian main macroeconomic indicators has been reported. SMEEs are assumed to be the single most important factor in bringing the Serbian economy closer to the developed market economies. SMEEs have become a significant factor in the restructuring process and on the Serbia's road to the EU.

Entrepreneurship and firm creation are often described as the keys to economic growth (Schumpeter 1942). It is assumed that there is a correlation between the intensity of entrepreneurial activity and economic growth and development of a country. New firm formation rate can be used as an indicator of the dynamics of entrepreneurial activity. The variation in the number of new firms is typically explained by the nature of a country's institutions (tax code, bankruptcy law), sources of financing, as well as more qualitative factors such as cultural precepts about business failure and attitudes toward risk-taking (Stangler and Kedrosky 2010, p.2). Since SMEEs are the main source of new job creation, firm formation rate is related with the change in the number of employees. Both the growth of jobs and businesses are indicators of economic growth and development.

The main objective of the current chapter is to analyse development of entrepreneurship and its contribution to economic development of Serbia over the 2006-2010 period of time. The methodology used in this chapter was initially developed by Venesaar and Loomets (2006), and adjusted to the objectives of this study and to the available data. The methodology assesses the development of entrepreneurship through SMEE sector development and new firm formation activity over the 2006-2010 period of time, as a reliable indicator of the intensity of entrepreneurial activity.

The chapter is structured as follows. Section 2 describes the data and methodology of analysis. Section 3 analyses the level of development of the SMEE sector. Section 4 presents the results of the empirical analysis of the new firm formation rate. Section 5 concludes.

## **DATA AND METHODOLOGY**

The level of development of the SMEE sector and its contribution to economic development of Serbia is analysed through a set of indicators i.e. share in the

number of enterprises, employment generation, export activity, turnover generation, creation of GDP and Gross Value Added (GVA). The analysis is based on the data contained in the Report on small and medium-sized enterprises and entrepreneurship for the years 2006, 2007, 2008, 2009 and 2010, prepared by The Ministry of Economy and Regional Development of the Republic of Serbia along with The National Agency for Regional Development. The reports are based on the database of The Ministry of Finance, The Statistical Office of the Republic of Serbia and The Serbian Business Registers Agency.

The data used for the purpose of calculating the business formation rate, also come from the above mentioned reports. Data on births, deaths, and survival of SMEs in the period 2006-2010, data on SME density and basic data on enterprise births and deaths are provided by The Serbian Business Registers Agency. According to the data of the Business Registers Agency all newly-founded and deleted enterprises are SMEEs.

The new firm formations rates are calculated in two ways. Firstly, the firm formation rate is defined as the average annual number of registrations per 1,000 active citizens (B1). Population from 15 to 64 years of age is considered as active population. This indicator is used to measure the activity of population in establishing new enterprises and shops. Secondly, the firm formation rate is calculated as the ratio of new firm registrations to the registered stock of businesses at the end of the year (B2). This is an important indicator of progress in the development of entrepreneurship for it shows the intensity of enterprise/shop births. In order to explain the variations from the firm formation rates over observed period of time, additional indicators were used i.e. the ratio between the number of enterprises births and deaths and the SMEE survival rates.

### **THE SMEE SECTOR DEVELOPMENT**

A set of indicators is used in order to get an overall picture of the level of development of the SMEE sector in Serbia over 2007-2010 period of time (due to availability of consistent data in some cases from 2006). The share of SMEEs in the main macroeconomic indicators i.e. number of enterprises, number of employees, exports, turnover, GDP, Gross Value Added (GVA), as well as the structure of the sector by size class are often used to evaluate the development level and contribution of SMEEs to economic development of a country. In order to indicate where Serbia stands as to the level of development of the SMEE sector in comparison with EU-27 and selected neighbouring countries, a comparative analysis is provided.

The SMEEs play a key role in economic growth and development of Serbia and tend to dominate the country's economy. The SME's share in total number of enterprises, as well as their role in economic growth and development is growing year after year (Erić, Beraha and Đuričin 2011, p.60). According to the Report on SMEE 2010, the SMEE sector on average accounted for 99.8% of the total number of registered enterprises (which amounted to 319,044), 45.4% of total employment, 44.5% of total exports and around 33% of total GDP and for 66.4% of employment, 65.3% of turnover and 55.9% of GVA of the non-financial sector of the economy<sup>4</sup>.

The trend of an increasing number of SMEEs continued throughout the observed period of time. In comparison with 2007, the number of enterprises and entrepreneurs increased by 22,454 in 2010. Due to the effects of the world financial crisis and worsening of general conditions for doing business, a decrease in the number of employees in 2009 and 2010 comparing to 2007 and 2008 occurred. The negative effects of the crisis additionally emphasized the problems of SMEEs, which mostly referred to a lack of financial resources, followed by a lack of human resources, liquidity problems, administrative and legal burdens. (Beraha, Baranenko and Jaško 2011, p.333) Despite declining trend, the SMEE sector continued to generate a significant portion of GVA.

*Table 1: Indicators of development of the SMEE sector*

	SMEE				Share in %			
	2007	2008	2009	2010	2007	2008	2009	2010
No. of enterprises	296,086	303,449	314,827	318,540	99.8	99.8	99.8	99.8
No. of employees	906,669	940,159	872,540	814,585	65.5	67.2	66.7	66.4
Turnover (RSD m)	4,106,838	4,662,624	4,380,545	4,677,933	67.6	66.6	67.8	65.3
GVA (RSD m)	719,659	837,990	819,206	817,417	58.3	59.1	57.4	55.9

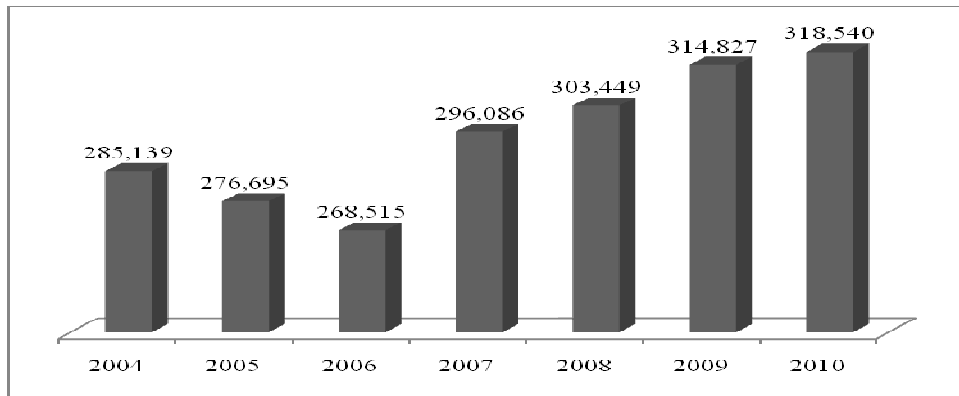
*Source: Report on SMEE 2007, 2008, 2009, 2010*

The changes in the total stock of registered enterprises and entrepreneurs in the period 2004-2010 are presented in the chart 1. In 2010, there were 89,860 registered enterprises and 228,680 entrepreneurs. Comparing to the previous year,

<sup>4</sup> According to the methodology of the Statistical Office of the Republic of Serbia, resident institutional units that form the national economy are grouped under five institutional sectors: non-financial, financial, the state, households, and non-profit institutional units that provide services for households (NPIH). The non-financial sector encompasses profit units where through production of goods and services profit is generated but which are not part of the financial sector and NPI units that provide market goods and services at economic process.

the total number of business entities in 2010 increased by 3,688 due to an increase in the number of SMEEs – the number of entrepreneurs increased by 2,439, and the number of micro enterprises increased by 1,746, while the number of small, medium and large enterprises decreased by 497. The largest increase in the total number of SMEEs occurred in 2007 comparing to 2006, as a result of the overall economic growth. An increase of 2.5% in the total number of business enterprises in 2008 in comparison to 2007 can be ascribed to an enhanced regulation in the field of company registration, bankruptcy and execution procedures.

*Figure 1: Number of business entities in the SMEE sector, 2004-2010*



*Source: Report on SMEE 2010*

The transition process, the implemented institutional and regulatory reforms i.e. formal abolition of all restrictions related to registration and operation of companies, new regulation concerning bankruptcy procedure and execution procedure, led to improved business environment and increased entrepreneurial activity and in Serbia. However, the dynamic development of the SMEE sector was interrupted by the outbreak of the world financial crisis. The sector's development before the crisis, though, didn't mean that it was truly being stronger since it was mainly a result of the growth in the number of micro enterprises and entrepreneurial shops with little economic power and low competitive strength on the market. The environment for doing business in Serbia, particularly in times of crisis, is not stimulating and suitable enough for the dynamic development of SMEEs.

The structure of the SMEE sector by size class is dominated by micro enterprises. In 2010, micro enterprises accounted for 96.3% of the total number of business entities in the SMEE sector.<sup>5</sup> While the number of small and medium-sized enterprises was

<sup>5</sup> The total number of entrepreneurs in 2010 was 228,680. A number of entrepreneurs report their final balances. They can be diversified as micro, small, and medium-sized by the number

decreasing during the observed period, the number of micro enterprises was constantly rising. Comparing to 2009 the number of medium-sized enterprises, which are expected to have a key role in promoting economic growth and development decreased by 8.6%. The average yearly 2.39% increase in the total number of SMEEs in the period 2008-2010 is due to the increase in the number of micro enterprises.

*Table 2: The structure of the SMEE sector by size class*

Size of enterprise	2008		2009		2010	
	No.	%	No.	%	No.	%
Micro	290,359	95.7	302,484	96.1	306,669	96.3
Small	10,415	3.4	9,873	3.1	9,614	3.0
Medium	2,675	0.9	2,470	0.8	2,257	0.7
Total SMEE	303,449	100	314,827	100	318,540	100

*Source: Report on SMEE 2007, 2008, 2009, 2010*

The SMEE sector is the single most important generator of new jobs. In 2010, the SMEEs accounted for 45.4% of total employment and 66.4% (814,585 employees) of employment of the non-financial sector of the Serbian economy. Micro enterprises have the key role in creating employment opportunities through an increase in their number. In the period 2004-2008, the overall employment increased by 1.7% (23,799 employees) and the number of job positions in the SMEE sector rose by 24.0% (187,419 employees). In 2008, the largest increase in the number of employees was registered with micro enterprises (12,123).

The structure of employment in the non-financial sector in EU-27 and Serbia clearly shows that in both economies micro enterprises generate the highest share in total employment. Serbia lags behind EU-27 concerning the contribution of the SMEE sector to total employment of the non-financial sector. While in EU-27 the share of small enterprises is greater than the share of medium ones, in Serbia it is inverse.

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of employees, but for these entrepreneurs no indicators are available (gross value added and turnover) nor are data on exports, imports, and investments. Therefore, entrepreneurs as a group, are attached to micro enterprises.

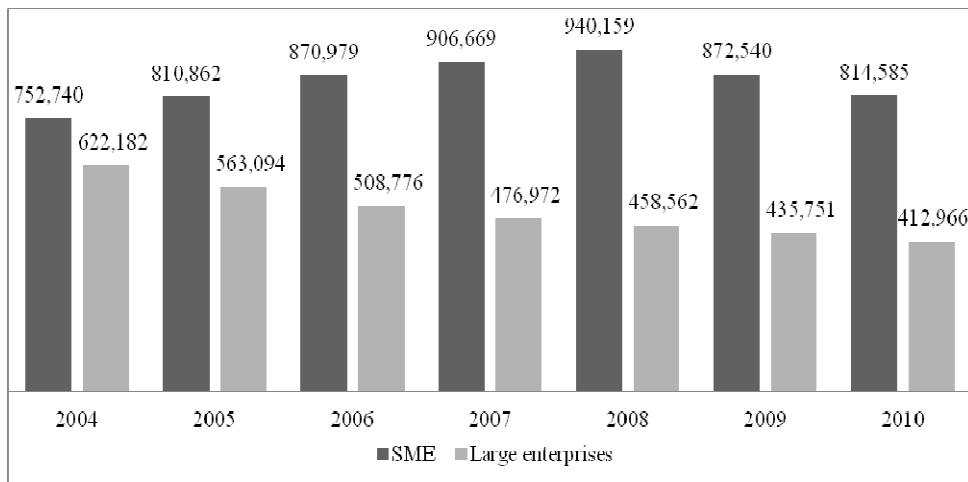
Table 3: Structure of employment in the non-financial sector, EU-27 and Serbia, 2010  
-in %-

	Micro	Small	Medium	SME	Large
EU-27	29.8	20.4	16.8	67	33
Serbia	33	15	19	45.4	33.6

Source: Eurostat/National Statistics Offices of Member States/Cambridge Econometrics/Ecorys and Report on SMEE 2010

It was assumed that the dynamic rise in the number of job positions in the SMEE sector will be enough to compensate the overall reduction in employment due to the privatization and restructuring of large public and social enterprises. Until the outbreak of the world financial crisis, the dynamic development of the SMEE sector contributed significantly to employment generation. However, the rise in employment in the SMEE sector failed to compensate the loss of job positions, which led to an increase in the total unemployment in the country. (Beraha 2011, p.323) High unemployment is considered to be one of the biggest problems in the Serbian economy, particularly since the positive trend of continuous increase in employment in the SMEE sector which lasted from 2004 until 2008 was interrupted by the crisis.

Figure 2: Employment trends in Serbia in the period 2004-2010



Source: Report on SMEE 2010

Due to worsened business and economic conditions, the overall employment, as well as employment in all organization types, except in micro enterprises excluding entrepreneurs, declined in 2010. Comparing to 2009, employment in the non-financial sector of the Serbian economy fell by 6.2% (80,740 employees).



Employment in the SMEE sector decreased by 6.6% (57,665 employees) and in the large enterprises by 5.2% (22,785 employees). The 0.1% rise was reported only in micro enterprises, while the largest fall occurred in entrepreneurial shops (10.5%) and medium-sized enterprises (9.4%).

In 2010, the total employment in the non-financial sector of the Serbian economy amounted to 1,227,551. The SMEE sector employed 66.4% (814,585) of the non-financial sector's total employment. Within the SMEE sector, micro enterprises employed almost ½, while small and medium-sized enterprises employed 52.8% of the sector's total number of employees (small employed 23.9% and medium-sized employed 28.8%).

In Serbia, the SMEEs generate around 2/3 of the non-financial sector's total turnover and approximately two times more than large enterprises do. The contribution of the SMEE sector to total turnover remained fairly stable throughout the observed period of time. However, a mildly decrease in the SMEE's share occurred in 2009 as a result of the crisis. Comparing to 2009, in 2010 the SMEE's share in total turnover of the non-financial sector rose by 0.3% due to the slight increase in the volume of economic activity.

In 2010, the SMEE sector generated 65.3% of total turnover of the non-financial sector. Despite declining tendency, micro enterprises again made the greatest contribution to the level of turnover generated by the SMEEs (58.9% in 2004, 40.1% in 2010). Small enterprises accounted for 29.9% and medium-sized enterprises for 30% of total sector's turnover.

*Table 4: Rates of increase/decrease in the SMEE sector turnover, in nominal and real terms, 2004-2009*

Size of enterprise	2005/2004		2006/2005		2007/2006		2008/2007		2009/2008	
	n	r	n	r	n	r	n	r	n	r
Micro	1.4	-12.9	25.9	11.7	0.1	-6.3	4.1	-6.1	-5.0	-13.7
Small	24.0	6.5	37.9	22.4	29.2	21.0	14.8	3.5	-11.8	-19.9
Medium	25.5	7.8	28.7	14.2	31.5	23.1	29.5	16.7	-1.6	-10.6
Total SMEE	11.0	-4.7	29.5	14.9	14.4	7.2	13.5	2.4	-6.0	-14.7

*Source: Report on SMEE 2009*

Turnover per employee within the SMEE sector is below the level recorded in large enterprises and in the Serbian economy as a whole. Small enterprises generated the highest turnover per employee (24% above the average of the non-financial sector).

Business activity of the SMEE sector rose in real terms by 7.4% comparing to 2009 (18.3% in large enterprises).

*Table 5: Turnover per employee by size of business entities*

*-in billion RSD-*

Size of enterprise	2007	2008	2009	2010
Micro	4.3	4.4	4.5	4.9
Small	6.0	6.5	6.1	7.2
Medium	3.7	4.7	5.0	6.0
SMEE	4.5	5.0	5.0	5.7

*Source: Report on SMEE 2008, 2009, 2010*

Even though, around 50% of total exports of the Serbian economy is generated (45.5% in 2008, 50.5% in 2009, 46.4% in 2010) through the SMEE sector's foreign trade activity, the level of internalization of the SMEE sector is not satisfactory. Characterized by low competitiveness on foreign markets, the SMEEs share the same destiny like all other Serbian companies. Viewed by size, the largest number of exporters and importers were among micro enterprises including entrepreneurs, but the greatest value of exports and imports was generated by small and medium-sized enterprises. During the entire period under survey, the SMEEs generated foreign trade deficit and the coverage of exports by imports was below the average of economy and large systems (in 2008 36.5%, versus 48.2% and 66.1%, respectively, in 2010 49.9%, versus 58.5% and 68.6%, respectively).

GDP is the most frequently used indicator of market activity and a measure of the country's economic well-being. In 2008, Serbia reached only 80% of GDP it created in 1990. In 2008 comparing to 2000, GDP rose in real terms by 52%. However, the level of GDP was still not sufficient to boost employment and economic growth. In 2008, SMEEs accounted for 35% of GDP of the Republic, and in 2010 for around 33%. By looking at the GVA, as an indicator of development of overall business activity and development of market economy, the SMEE sector made the greatest contribution to the level of GVA that was generated by the non-financial sector of the economy (59.1% in 2008, 55.9% in 2010), whereby the greatest value was generated by micro enterprises (39.9% in 2008, 39.4% in 2010). According to GVA, the SMEE sector in Serbia is equal to that of EU average. However, productivity and efficiency of operations are mainly determined by large enterprises. In 2010, large enterprises accounted for only 0.2% of the total number of enterprises but generated 44.1% of total GVA of the non-financial sector.

In the observed period of time, GVA per enterprise and GVA per employee in large enterprises were far above the average formed by the SMEEs and the non-financial

sector. Within the SMEE sector, in 2008 in comparison with the previous year, GVA per enterprise rose by 2.4% and GVA per employee by 1.3% owing to the rise of these indicators in medium-sized enterprises. In 2010 relative to 2009, GVA of the SMEE sector declined by 2.5% in real terms while GVA per employee increased by 5.7% due to 6.6% fall in the sector's employment.

*Table 6: Comparative analysis of the level of SMEE development in selected EU countries and Serbia, 2010*

	EU	BG	CZ	HU	PL	RO	SI	SRB	
	2008							2009	2010
Number of enterprises, in 000	20,727	303,4	899,0	532,0	1563,0	440,0	102,0	314,8	318,5
Number of employees, in 000	90,006	940,2	2,505	1,767	5,880	2,663	424,0	872,5	814,6
Turnover, in BN EUR	14,284	58,3	245,0	163,0	421,0	268,0	51,0	46,6	45,4
GVA, in BN EUR	3,262	10,5	49,0	25,0	81,0	37,0	11,0	8,3	7,9
Profit, in BN EUR	977	4,0	9,0	1,0	19,0	19,0	1,0	2,7	2,9
Number of SMEs on 1000 inhabitant	41.6	41.4	86.6	53.0	41.0	20.4	50.7	43.0	43.5
Number of employees per enterprise	4.3	3.1	2.8	3.3	3.8	6.0	4.2	2.8	2.6
Turnover per employee, in 000 EUR	158,7	62,0	97,8	92,2	71,6	101,8	120,3	53,7	55,7
GVA per employee, in 000 EUR	40,3	11,1	19,6	14,1	13,8	14,1	25,9	9,5	9,7
Profit per employee, in 000 EUR	10,9	4,2	3,6	0,6	3,2	7,2	2,4	3,1	3,5
Profitability rate	27.0	38.1	19.0	2.0	23.0	52.0	9.0	32.8	36.1
Percentage of SMEs in non-financial sector									
Number of enterprises	99.8	99.7	99.8	99.8	99.8	99.6	99.7	99.8	99.8
Number of employees	67.4	74.1	67.6	71.1	68.9	63.6	67.0	66.7	66.4
Turnover	57.7	65.1	58.8	58.8	59.2	58.7	63.2	67.8	65.3
SVA	57.7	54.1	54.8	51.9	51.7	42.2	59.8	57.4	55.9
Profit	49.4	45.4	31.5	-	33.6	34.8	29.1	54.1	51.6

*Source: Report on SMEE 2010*

A comparative analysis of the SMEE sector development in Serbia and in EU countries gives better picture on the overall performance of SMEs. Serbia is at the EU level according to the share in the number of enterprises and employment, as well as to the generated turnover and GVA. However, these indicators do not mean that the SMEE sector in Serbia is at the same development level like in EU-27 countries, but rather shows the impact of SMEs on the overall economic

movements. The SMEE sector lags behind the average of EU and most of observed surrounding countries according to the turnover per employee, GVA per employee and profit per employee, as well as according to investments per employee and investments per enterprise.

### **THE MEASUREMENT OF ENTREPRENEURIAL ACTIVITY BY FIRM FORMATION RATE**

The new firm formation rate (B1) is calculated as the average annual number of registrations per 1,000 active inhabitants. Inhabitants between 15 and 64 years of age are considered as active. It is found that the average annual number of newly established SMEEs in the observed period of time is 10.7. In the period 2007-2010, a decline in the number of founded enterprises was reported. By looking at the variation from B1 in each year, it is observed that the annual number of newly established SMEEs changed relatively little from year to year despite significant worsening of economic circumstances and conditions for doing business as a result of the outbreak of the world financial crisis. The new firm formation rate (B1) changed but not much in response to larger changes in the ratio of new firm registrations to registered stock of businesses at the end of each year (B2). Variations from B1 ranged between 0.8 in 2006 and -1.7 in 2010. In 2006, 11.5 new SMEEs were founded per 1,000 active inhabitants, while in 2010 there were 10. It is interesting to notice that due to the crisis employment changed more.

The number of people who decide to establish new enterprises depends on a number of factors i.e. recession, availability of capital, tax changes, and unemployment. In times of crises less people are willing to take risk and leave their existing job positions. Furthermore, start up financing is more expensive and less available. However, it is reasonable to expect that higher unemployment will encourage more people to try out as entrepreneurs. Those people often reach for financial assistance programs provided by governmental agencies. By examining the new firm formation rate (B1) over time, it can be concluded that the average number of new registrations does not vary much from year to year. A relatively constant rate of entrepreneurship activity in Serbia is mostly the result of needs to reduce negative effects of transition and world financial crisis, primarily high unemployment. However, considering the extremely high unemployment in the country, the firm formation indicates the insufficient development of the SMEE sector.

Table 7: Firm formation rate in the period 2006-2010

Year	Total number of operating SMEEs	Number of newly established SMEEs	Number of newly established SMEEs per 1,000 active inhabitants	Variation from B1	Total employment	Change in the number of employees	B2	Variation from average +/-
2006	268,515	59,976	11.5	0.8	870,979		22.3	3.5
2007	296,086	61,432	12	1.3	906,669	35,690	20.7	1.9
2008	303,449	54,761	11	0.3	940,159	33,490	18	-0.8
2009	314,827	49,379	10	-0.7	872,54	-67,619	15.7	-3.1
2010	318,54	54,961	9	-1.7	814,585	-57,955	17.3	-1.5

Source: Report on SMEE 2006, 2007, 2008, 2009 and 2010, Statistical Office of the Republic of Serbia, authors' calculations

Greater variations are noticed in the ratio of new firm registrations to the registered stock of businesses at the end of each year (B2). Variations from averaged B2 ranged from +3.5 in 2006 to -1.5 in 2010 and the greatest variation of -3.1 occurred in 2009. In order to understand these changes, we must take into consideration the ratio between the number of enterprises births and deaths in each year in the observed period of time. In 2010, a decreasing tendency in the number of established SMEEs and an increasing tendency in the number of closed SMEES were accelerated. Comparing to 2009, the number of opened enterprises decreased by 6.2% and the number of closed enterprises increased by 159.7%. At the same time, the number of newly opened shops decreased by 11% and the number of closed ones increased by 2%. Besides the effects of the world financial crisis, such a negative tendency is also a result of the implementation of the Law on Bankruptcy i.e. the application of a provision of law that presumes automatic deletion from the register of economic entities due to insolvency in the period longer than three years.

Table 8: Number of newly established and closed SMEEs

	Number of enterprises		Number of shops		Net outcome	
	established	closed	established	closed	enterprises	shops
2006	11,536	1,528	45,693	27,010	7.5	1.7
2007	11,902	2,027	47,951	31,619	5.9	1.5
2008	11,248	3,068	43,375	34,572	3.7	1.3
2009	10,014	3,597	39,365	36,441	2.8	1.1
2010	9,470	9,389	36,337	37,162	1	0.9

Source: Report on SMEE 2010 based on the data of the Ministry of Finance and the Statistical Office of the Republic of Serbia

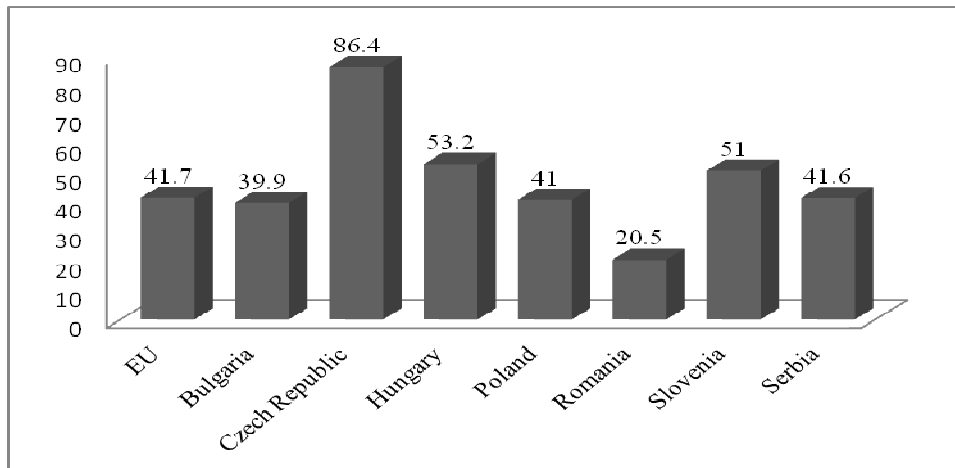
The net effect presented in the above table, which refers to the ratio between the number of enterprise births and deaths, is worsening year after year. In 2007 there were 6 business enterprise births per one business death, while in 2010 there was only 1 business birth. The net effect of shops is declining but less steep than that of enterprises. A declining tendency in the number of newly-founded enterprises/shops as a percentage of the overall number of active enterprises/shops, along with increasing rates of enterprise/shop deaths (the number of deleted enterprises/shops as a percentage of the total number of active enterprises/shops) point out to the lower overall birth rates and higher overall death rates of business entities in Serbia.

Different survival rates explain the variations in the ratio of new firm registrations to the registered stock of enterprises over time. The survival rate of enterprises shows how many enterprises which were founded in year  $n$  survive in year  $n+1$  i.e.  $n+2$  after which it may be expected that an enterprise adjusted to market conditions. Survival rates of new SMEES are lower in 2010 than before the crisis in 2006 and 2007. In 2006, the 2-year survival rate of new SMEEs was 72.9%, in 2007 it was 71.9% and in 2010 it was 61.7%. The 1-year survival rate was 83.8% in 2006 and 83.1% in 2007. One of the possible explanations of such a tendency refers to the limited access to financing as one of the major obstacles to the survival of SMEEs, especially in times of crisis. (Erić, Beraha and Đuričin 2011, p.73)

The changes in employee numbers during the period under research indicate the rapid reduction in employment generated by the SMEE sector. The reduction in employment is in accordance with the reduction in the number of newly established SMEEs per 1,000 active inhabitants. The reduction in the number of employees was the largest in 2009 when the lowest ratio of new firm registrations to the registered stock of enterprises was noticed. A decrease in employment is particularly expressed in 2009 and 2010, which refer to the period after the outbreak of the crisis, and it is in line with declining survival rates of new SMEEs.

If measuring entrepreneurial activity as a number of enterprises per 1,000 inhabitants, Serbia with the average of 41.6 SMEE per 1,000 inhabitants is at the EU level. The highest coefficient is reported in the Czech Republic, and the lowest in Romania. When looking at the active population between the ages 15 to 64, 63.1 SMEEs operated per 1,000 inhabitants.

Figure 3: SMEE density in selected EU countries and Serbia, 2008



Source: Report on SMEE 2010 based on DG Enterprise and Industry and the Statistical Office of the Republic of Serbia

Data show a relatively stable activity in firm formation over time in terms of the average annual number of registrations per 1,000 inhabitants and more significant variations in terms of the ratio of new firm registrations to the registered stock of businesses at the end of the year. The measurement of firm formation rate indicates a relatively strong but insufficient intensity of entrepreneurial activity. There is a high dependency of B2 indicator on the ratio between the number of enterprises births and deaths. The data also show a positive and significant relationship between firm formation rate and employment generation as an important indicator of economic development.

## CONCLUSION

The results of the research point out that development of entrepreneurship and small and medium-sized enterprises in the observed period of time was quite strong but insufficient for the needs of the Serbian economy. Development of entrepreneurship through SME development and firm formation activity had positive impact on economic development and employment generation.

The SMEE sector is an important factor of economic development of Serbia. In the period prior to the outbreak of the world financial crisis, viewed in general, positive developing tendencies prevailed. The analysis shows that SMEEs dominate the non-financial sector and the entire economy. According to the share in total number of enterprises, total employment, generated turnover and GVA of the SMEE sector,

Serbia is at the EU average, but in terms of turnover per employee, GVA per employee, profit per employee, investments per employee and investments per enterprise it significantly lags behind. However, the SMEE sector was negatively influenced by the crisis that led to reduction in the sector's beneficial impact on mitigating negative effects of transition. It is still burdened by a number of limitations that disable the sector's more dynamic development and its greater contribution to the overall economic development of the country.

The measurement of the new firm formation activity shows relatively constant activity in firm formation despite the negative effects of the world financial crisis, but rather strong impact of the ratio between the number of enterprises births and deaths. The development of entrepreneurial activity is strongly influenced by the survival rates of SMEEs which are related to economic and business circumstances. A decline in the survival rates over the 5 year period points out to the worsening conditions for doing business and lack of favourable business environment and appropriate institutional support that would enable SMEEs to overcome the negative effects of the crisis and ensure more dynamic development of entrepreneurship. The empirical analysis indicates a strong relationship between firm formation activity and employment generation.

Relatively intensive entrepreneurial activity in Serbia is typical for the low-level income transition countries with a high level of unemployment which encourages people to engage in such activities. It is assumed that the development of entrepreneurship in Serbia is driven by economic and social factors, rather than some other qualitatively different reasons. It appears that the attitude towards entrepreneurship exists within the Serb population and the number of people willing to be self-employed does not change much over time. Insufficiently developed SMEE sector is the result of the structural problems in the economy, low availability of finance, lack of adequate legal and regulatory framework for private economic activity and lack of institutional support aimed not only at business start-ups but on SMEE survival and growth as well. Significant improvement of the macroeconomic environment (legal regulations, support mechanisms of financial and non-financial support) and micro factors related to SMEE capacities, competitiveness, efficiency and innovations is necessary, as well as the policy that would support more dynamic transformation of micro enterprises into small and particularly medium-sized enterprises with potential for dynamic growth.

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